

HARMONIC INC
Form 10-Q
August 10, 2011

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**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 July 1, 2011**

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

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

Delaware

77-0201147

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

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

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

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

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

Yes No

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

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(Do not check if a 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 July 29, 2011 was 115,703,050.

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

	July 1, 2011	December 31, 2010
(In thousands, except par value amounts)		
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 70,370	\$ 96,533
Short-term investments	63,928	23,838
Accounts receivable, net of allowances of \$5,950 and \$5,897 at July 1, 2011 and December 31, 2010, respectively	117,861	101,652
Inventories	61,064	58,065
Deferred income taxes	39,849	39,849
Prepaid expenses and other current assets	26,399	28,614
Total current assets	379,471	348,551
Property and equipment, net	39,678	39,825
Goodwill	212,210	211,878
Intangibles, net	102,979	118,070
Other assets	2,023	2,062
Total assets	\$ 736,361	\$ 720,386
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 30,594	\$ 26,300
Income taxes payable	126	6,791
Deferred revenue	47,617	46,279
Accrued liabilities	39,486	51,283
Total current liabilities	117,823	130,653
Accrued excess facility costs, long-term	1,769	1,153
Income taxes payable, long-term	48,622	48,883
Deferred income taxes, long-term	15,635	14,849
Other non-current liabilities	6,082	4,645
Total liabilities	189,931	200,183
Commitments and contingencies (Notes 15 and 16)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000 shares authorized; no shares issued or outstanding	116	112

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Common stock, \$0.001 par value, 150,000 shares authorized; 115,670 and 112,360 shares issued and outstanding at July 1, 2011 and December 31, 2010, respectively

Capital in excess of par value	2,422,468	2,397,671
Accumulated deficit	(1,875,962)	(1,876,868)
Accumulated other comprehensive loss	(192)	(712)
Total stockholders' equity	546,430	520,203
Total liabilities and stockholders' equity	\$ 736,361	\$ 720,386

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

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HARMONIC INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except per share amounts)			
Product revenue	\$ 117,156	\$ 84,261	\$ 233,023	\$ 158,695
Service revenue	16,840	11,283	33,808	21,671
Net revenue	133,996	95,544	266,831	180,366
Product cost of revenue	65,315	46,058	130,066	87,069
Service cost of revenue	6,853	3,804	13,082	6,810
Total cost of revenue	72,168	49,862	143,148	93,879
Gross profit	61,828	45,682	123,683	86,487
Operating expenses:				
Research and development	25,662	16,977	51,811	33,943
Selling, general and administrative	32,543	24,074	66,107	44,919
Amortization of intangibles	2,230	534	4,459	1,067
Total operating expenses	60,435	41,585	122,377	79,929
Income from operations	1,393	4,097	1,306	6,558
Interest income, net	74	425	166	809
Other expense, net	(299)	(126)	(406)	(497)
Income before income taxes	1,168	4,396	1,066	6,870
Provision for (benefit from) income taxes	778	(49)	160	(2,894)
Net income	\$ 390	\$ 4,445	\$ 906	\$ 9,764
Net income per share:				
Basic	\$ 0.00	\$ 0.05	\$ 0.01	\$ 0.10
Diluted	\$ 0.00	\$ 0.05	\$ 0.01	\$ 0.10
Weighted average shares:				
Basic	114,939	96,998	114,387	96,845
Diluted	116,298	97,570	116,143	97,529

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

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

	Six months ended	
	July 1,	July 2, 2010
	2011	2010
	(In thousands)	
Cash flows from operating activities:		
Net income	\$ 906	\$ 9,764
Adjustments to reconcile net income to net cash used in operating activities:		
Amortization of intangibles	15,092	5,231
Depreciation	6,824	4,404
Stock-based compensation	11,094	6,663
Net loss on disposal of fixed assets	103	27
Deferred income taxes	76	(1,422)
Other non-cash adjustments, net	322	1,076
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable, net	(16,209)	(6,529)
Inventories	(2,994)	(7,724)
Prepaid expenses and other assets	2,783	90
Accounts payable	4,780	(1,616)
Deferred revenue	788	4,595
Income taxes payable	(6,925)	(2,211)
Accrued excess facility costs	556	(3,398)
Accrued and other liabilities	(8,056)	(3,467)
Net cash provided by operating activities	9,140	5,483
Cash flows from investing activities:		
Purchases of investments	(62,009)	(39,035)
Proceeds from maturities of investments	11,267	66,127
Proceeds from sales of investments	10,327	
Acquisition of property and equipment	(8,502)	(13,175)
Other acquisitions	(250)	
Net cash provided by (used in) investing activities	(49,167)	13,917
Cash flows from financing activities:		
Proceeds from lease financing liability		12,385
Proceeds from issuance of common stock, net	13,703	3,833
Net cash provided by financing activities	13,703	16,218
Effect of exchange rate changes on cash and cash equivalents	161	(202)
Net increase (decrease) in cash and cash equivalents	(26,163)	35,416
Cash and cash equivalents at beginning of period	96,533	152,477

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Cash and cash equivalents at end of period	\$ 70,370	\$ 187,893
Supplemental disclosures of cash flow information:		
Income tax payments, net	\$ 6,414	\$ 770

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

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HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. (Harmonic, or the Company) considers necessary for a fair 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 March 1, 2011 (2010 Form 10-K). The interim results presented herein are not necessarily indicative of the results of operations that may be expected for the full fiscal year ending December 31, 2011, or any other future period. The Company s fiscal quarters are based on 13-week periods, except for the fourth quarter which ends on December 31.

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

Use of Estimates. The preparation of the consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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

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

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

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

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

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

- eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method.

Harmonic elected to adopt this accounting guidance prospectively, beginning with the quarter ended April 1, 2011, for applicable transactions originating or materially modified after December 31, 2010. Certain of Harmonic s hardware products contain software components that function together to provide the essential functionality of the product.

Therefore, such product sales are removed from the industry-specific software revenue recognition guidance and, instead, are governed by the amended guidance described above.

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

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

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

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

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

Total revenue, as reported, and pro forma total revenue that would have been reported for the three and six months ended July 1, 2011 if the transactions entered into after December 31, 2010 had been subject to previous accounting guidance, are shown in the following table:

	Three months ended July 1, 2011		Six months ended July 1, 2011	
	As Reported	Pro Forma	As Reported	Pro Forma
	(In thousands)			
Net revenue	\$ 133,996	\$ 129,870	\$ 266,831	\$ 261,539

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

Sales of stand-alone software that are not considered essential to the functionality of the hardware continue to be subject to the industry-specific software revenue recognition guidance. The Company uses the residual method to recognize revenue for the delivered elements in stand-alone software transactions. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration, less the aggregate fair value of any undelivered elements, typically maintenance, provided that VSOE of fair value exists for all undelivered elements. VSOE of fair value is based on the price charged when the element is sold separately or substantive renewal rates for maintenance.

Solution sales for the design, manufacture, test, integration and installation of products, including equipment acquired from third parties to be integrated with Harmonic's products, that are customized to meet the customer's specifications are accounted for in accordance with applicable guidance on accounting for performance of construction/production

contracts. Accordingly, for each arrangement that the Company enters into that includes both products and services, the Company performs a detailed evaluation to determine whether the arrangement should be accounted for under guidance for construction/production contracts or, alternatively, for

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arrangements that do not involve significant production, modification or customization, under other applicable accounting guidance. The Company has a long-standing history of entering into contractual arrangements to deliver the solution sales described above and such arrangements represent a material part of the operations of the Company. At the outset of each arrangement accounted for as a single arrangement, the Company develops a detailed project plan and associated labor hour estimates for each project. The Company believes that, based on its historical experience, it has the ability to make labor cost estimates that are sufficiently dependable to justify the use of the percentage-of-completion method of accounting and, accordingly, utilizes percentage-of-completion accounting for most arrangements that are determined to be single arrangements. Under the percentage-of-completion method, revenue recognized reflects the portion of the anticipated contract revenue that has been earned, equal to the ratio of actual labor hours expended to total estimated labor hours to complete the project. For contracts that include customized services for which labor costs are not reasonably estimable, the Company uses the completed contract method of accounting. Under the completed contract method, 100% of the contract's revenue is recognized upon the completion of all services under the contract. If the estimated costs to complete a project exceed the total contract amount, indicating a loss, the entire anticipated loss is recognized.

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

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

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

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

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

In May 2011, the Financial Accounting Standards Board (FASB) issued additional guidance on fair value disclosures.

This guidance contains certain updates to the measurement guidance, as well as enhanced disclosure requirements.

The most significant change in disclosures is an expansion of the information required for Level 3 measurements, including enhanced disclosure for: (1) the valuation processes used by the reporting entity; and (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, if any. This guidance is effective for interim and annual periods beginning on or after December 15, 2011, with early adoption prohibited. The Company does not expect the adoption of these reporting requirements to have a material impact on its consolidated results of operations or financial condition.

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This guidance eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. The guidance allows two presentation alternatives; present items of net income and other comprehensive income in (1) one continuous statement, referred to as the statement of comprehensive income, or (2) in two separate, but consecutive, statements of net income and other comprehensive income. This guidance is effective as of the beginning of a fiscal year that begins after December 15, 2011. Early adoption is permitted, but full retrospective application is required under both sets of accounting standards. The Company is currently evaluating which presentation alternative it will utilize.

NOTE 3: OMNEON ACQUISITION

On September 15, 2010, Harmonic completed the acquisition of 100% of the equity interests of Omneon, Inc., a privately-held company organized under the laws of Delaware and headquartered in Sunnyvale, California. Omneon develops and supports a range of video servers, active storage systems and related software applications that media companies use to simultaneously ingest, process,

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store, manage and deliver digital media in a wide range of formats. When used for television production and on-air operations, the products are designed to provide continuous real-time record and playback capabilities, as well as file-based access to, and delivery of, digital media content. Omneon's products include Spectrum video servers, MediaGrid active storage systems, Media Application servers and other software applications that were initially designed for, and have been deployed mostly by, broadcasters that use Omneon's products for the production and transmission of television content.

The acquisition of Omneon was intended to strengthen Harmonic's competitive position in the digital media market and to broaden the Company's relationships with customers that produce and distribute digital video content, such as broadcasters, satellite operators, content owners and other media companies. The acquisition was also intended to broaden Harmonic's technology and product lines with digital storage and playout solutions that complement Harmonic's existing video processing products. In addition, the acquisition provided an assembled workforce and the implicit value of future cost savings as a result of combining entities, and is expected to provide Harmonic with future, but presently unidentified, new products and technologies. These opportunities were significant factors to the establishment of the purchase price, which exceeded the fair value of Omneon's net tangible and intangible assets acquired, resulting in goodwill of approximately \$147.5 million that was recorded in connection with this acquisition. The purchase price, net of \$40.5 million of cash acquired, was \$251.3 million, which consisted of (i) approximately \$153.3 million in cash, net of cash acquired, (ii) 14.2 million shares of Harmonic common stock with a total fair value of approximately \$95.9 million, based on the price of Harmonic common stock at the time of close, and (iii) approximately \$2.1 million, representing the fair value attributed to shares of Omneon equity awards which Harmonic assumed and for which services had already been rendered as of the close of the acquisition. The cash portion of the purchase price was paid from existing cash balances. The Company also incurred a total of \$5.9 million of transaction expenses, which were expensed as selling, general and administrative expenses in the year ended December 31, 2010.

The assets and liabilities of Omneon were recorded at fair value at the date of acquisition. The Company will continue to evaluate certain assets and liabilities as new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. Changes to the assets and liabilities recorded may result in a corresponding adjustment to goodwill, and the measurement period will not exceed one year from the acquisition date. Further, any associated restructuring activities will be expensed in future periods and not recorded through purchase accounting as previously done under prior accounting guidance. There are no contingent consideration arrangements in connection with the acquisition. The results of operations of Omneon are included in Harmonic's Consolidated Statements of Operations from September 15, 2010, the date of acquisition. The following table summarizes the allocation of the purchase price based on the fair value of the assets acquired and the liabilities assumed at the date of acquisition:

	(In thousands)
Cash acquired	\$ 40,485
Accounts receivable (Gross amount due from accounts receivable of \$17,760)	17,055
Inventory	11,010
Fixed assets	12,391
Deferred income tax assets	17,250
Other tangible assets acquired	3,294
Intangible assets:	
Existing technology	\$ 50,800
In-process technology	9,000
Patents/core technology	9,800
Customer contracts and related relationships	29,200
Trademarks and tradenames	4,000
Maintenance agreements and related relationships	5,500

Order backlog	800
	109,100
Goodwill	147,452
Total assets acquired	358,037
Accounts payable	(6,829)
Deferred revenue	(6,399)
Deferred income tax liabilities	(41,804)
Other accrued liabilities	(11,203)
Net assets acquired	291,802
Less: cash acquired	(40,485)
Net purchase price	\$ 251,317

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

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

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

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

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

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

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

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

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

Existing technology is being amortized over its estimated useful life of four years;

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

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

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

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

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

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

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

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

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

Pro Forma Financial Information

The unaudited pro forma financial information presented below for the three and six months ended July 2, 2010 summarizes the combined results of operations as if the Omneon acquisition had been completed on January 1, 2010. The unaudited pro forma financial information for the three and six months ended July 2, 2010 combines the results for Harmonic for the three and six months ended July 2, 2010 and the historical results of Omneon for the three and six months ended June 30, 2010.

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

	Three months ended July 2, 2010	Six months ended July 2, 2010
	(In thousands, except per share amounts)	
Net revenue	\$ 127,473	\$ 240,512
Net loss	(1,986)	(4,441)
Net loss per share – basic and diluted	(0.02)	(0.04)

NOTE 4: FAIR VALUE

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

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

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

Level 1 – Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.

Level 2 – Observable inputs other than Level 1 prices, such as: quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company primarily uses broker quotes for valuation of its short-term investments.

Level 3 – Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

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

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

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	Level 1	Level 2	Level 3	Total
		(In thousands)		
July 1, 2011				
Cash equivalents:				
Money market funds	\$ 27,616	\$	\$	\$ 27,616
Commercial paper		1,200		1,200
Corporate bonds		1,130		1,130
Short-term investments:				
State, municipal and local government agencies bonds		32,261		32,261
Corporate bonds		22,849		22,849
Commercial paper		4,796		4,796
U.S. federal government bonds		4,022		4,022
Total	\$ 27,616	\$ 66,258	\$	\$ 93,874
December 31, 2010				
Cash equivalents:				
Money market funds	\$ 68,395	\$	\$	\$ 68,395
Short-term investments:				
State, municipal and local government agencies bonds		11,931		11,931
Corporate bonds		11,907		11,907
Total	\$ 68,395	\$ 23,838	\$	\$ 92,233

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

	July 1, 2011	December 31, 2010
	(In thousands)	
Short-term investments:		
Less than one year	\$ 35,890	\$ 21,174
Due in 1 - 2 years	7,736	2,664
Due in 3 - 30 years (1)	20,302	
Total short-term investments	\$ 63,928	\$ 23,838

(1) Represents the final maturity of variable rate demand notes. These securities have a put right on the part of the Company which allows the Company to put the security to the issuer, generally within a month of the balance sheet date. Should the Company exercise its put option on the put date, it is entitled to receive the par value of the security plus any accrued interest.

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

Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)		

July 1, 2011

State, municipal and local government agencies bonds	\$	32,237	\$	25	\$	(1)	\$	32,261
Corporate bonds		22,851		5		(7)		22,849
Commercial paper		4,796						4,796
U.S. federal government bonds		4,017		5				4,022
Total	\$	63,901	\$	35	\$	(8)	\$	63,928

December 31, 2010

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

Impairment of Investments

Harmonic monitors its investment portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. In order to determine whether a decline in value is other-than-temporary, the Company evaluates, among other factors: the duration and extent to which the fair value has been less than the carrying value; the Company's financial condition and business outlook, including key operational and cash flow metrics, current market conditions and future trends in the industry; and the Company's relative competitive position within the industry. At the present time, the Company does not intend to sell its investments that have unrealized losses included in accumulated other comprehensive loss. In addition, the Company does

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not believe that it is more likely than not that it will be required to sell its investments that have unrealized losses included in accumulated other comprehensive loss before the Company recovers the principal amounts invested. The Company believes that the unrealized losses are temporary and do not require an other-than-temporary impairment, based on our evaluation of available evidence as of July 1, 2011.

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

NOTE 5: INVENTORIES

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

	July 1, 2011	December 31, 2010
	(In thousands)	
Inventories:		
Raw materials	\$ 12,759	\$ 10,378
Work-in-process	4,610	2,324
Finished goods	43,695	45,363
	\$ 61,064	\$ 58,065

NOTE 6: GOODWILL AND IDENTIFIED INTANGIBLES

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

	July 1, 2011			December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)					
Identifiable intangibles:						
Existing and core technology	\$ 136,210	\$ (71,146)	\$ 65,064	\$ 127,146	\$ (60,453)	\$ 66,693
In-process technology				9,000		9,000
Customer relationships/contracts	67,100	(39,132)	27,968	67,098	(36,117)	30,981
Trademarks and tradenames	11,371	(6,890)	4,481	11,361	(6,060)	5,301
Supply agreements	3,431	(3,431)		3,414	(3,414)	
Maintenance agreements and related relationships	7,100	(1,634)	5,466	7,100	(1,008)	6,092
Software license, intellectual property and assembled workforce	309	(309)		309	(306)	3
Order backlog	2,800	(2,800)		2,800	(2,800)	
Subtotal of identifiable intangibles	228,321	(125,342)	102,979	228,228	(110,158)	118,070
Goodwill	212,210		212,210	211,878		211,878
Total goodwill and other intangibles	\$ 440,531	\$ (125,342)	\$ 315,189	\$ 440,106	\$ (110,158)	\$ 329,948

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

	(In thousands)
Balance at December 31, 2010	\$ 211,878
Adjustment to deferred tax asset associated with the acquisition of Omneon	244
Foreign currency translation adjustment	88
 Balance at July 1, 2011	 \$ 212,210

For the three and six months ended July 1, 2011, the Company recorded a total of \$7.7 million and \$15.1 million of amortization expense for identified intangibles, of which \$5.5 million and \$10.6 million was included in cost of revenue, respectively. For the three and six months ended July 2, 2010, the Company recorded a total of \$2.6 million and \$5.2 million of amortization expense for identified intangibles, of which \$2.1 million and \$4.2 million was included in cost of revenue, respectively. The estimated future amortization expense of purchased intangible assets with definite lives is as follows:

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	Cost of Revenue	Operating Expenses	Total
		(In thousands)	
Years ending December 31,			
2011 (remaining 6 months)	\$ 10,869	\$ 4,449	\$ 15,318
2012	20,504	8,715	29,219
2013	19,232	8,096	27,328
2014	13,745	6,775	20,520
2015	714	5,783	6,497
2016		4,097	4,097
Total	\$ 65,064	\$ 37,915	\$ 102,979

NOTE 7: RESTRUCTURING AND EXCESS FACILITIES

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

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

As of July 1, 2011, accrued excess facilities costs totaled \$3.5 million, of which \$1.7 million was included in current accrued liabilities. During the six months ended July 1, 2011, the Company incurred cash outlays of \$1.0 million related to vacated facilities, principally for lease payments, property taxes, insurance and other maintenance fees, and received sublease income of \$1.1 million.

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

	Excess Facilities
	(In thousands)
Balance at December 31, 2010	\$ 2,920
Provisions	517
Sublease income	1,050
Cash payments	(1,011)
Balance at July 1, 2011	\$ 3,476

NOTE 8: CREDIT FACILITIES

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to \$10.0 million that matures on September 2, 2011. As of July 1, 2011, other than standby letters of credit and guarantees (Note 15), there were no amounts outstanding under the line of credit facility and there were no borrowings in the six months ended July 1, 2011. This facility, which was amended and restated in March 2010, contains a financial covenant with the requirement for Harmonic to maintain unrestricted cash, cash equivalents and short-term investments, net of credit extensions, of not less than \$35.0 million. If Harmonic were unable to maintain this cash,

cash equivalents and short-term investments balance, Harmonic would not be in compliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise its remedies under the facility, including declaring all obligations immediately due and payable. At July 1, 2011, Harmonic was in compliance with the covenants under this line of credit facility. Future borrowings pursuant to the line would bear interest at the bank's prime rate (4.0% at July 1, 2011). Borrowings are payable monthly and are not collateralized.

NOTE 9: FINANCING LIABILITY FOR CONSTRUCTION IN PROGRESS

The lease for the buildings at the Company's Sunnyvale, California location ended in September 2010. In December 2009, the Company entered into a lease for a building in San Jose, California, which was intended to become the Company's new headquarters. In January 2010, the Company began a build-out of this facility and during the construction incurred approximately \$18.9 million in structural leasehold improvements. Under the terms of the lease, the landlord reimbursed \$18.8 million of the construction costs.

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Because certain improvements constructed by the Company were considered structural in nature and the Company was responsible for any cost overruns, the Company was considered to be the owner of the construction project for accounting purposes under applicable accounting guidance on the effect of lessee involvement in asset construction. As a result, in December 2009 the Company capitalized the fair value of the building of \$6.9 million with a corresponding credit to financing liability. The fair value was determined as of December 31, 2009, using a combination of the revenue comparison approach and the income capitalization approach. During the year ended December 31, 2010, the liability increased by \$18.9 million due to additional structural leasehold improvements, by \$0.2 million due to land lease expense and by \$0.2 million due to capitalized interest expense.

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

NOTE 10: BENEFIT PLANS

Stock Based Incentive Plans. The Company has three active stock based incentive plans; the 1995 Stock Plan (the Stock Plan), the 2002 Director Stock Plan (the Director Plan), and the Employee Stock Purchase Plan (the ESPP). As of July 1, 2011, (a) an aggregate of 19,134,221 shares of common stock are reserved for issuance under the Stock Plan, 7,998,875 of which remained available for grant, 7,171,074 of which were subject to outstanding stock option grants and 3,964,272 of which were restricted stock units (RSUs) subject to vesting, (b) an aggregate of 619,162 shares of common stock are reserved for issuance under the Director Plan, 163,317 of which remained available for grant, 380,000 of which were subject to outstanding stock option grants and 75,845 of which were RSUs subject to vesting, and (c) an aggregate of 2,829,786 shares of common stock are reserved for issuance under the ESPP. In addition, the Company has various inactive stock based incentive plans, such as the assumed Omneon plans described below. As of July 1, 2011, an aggregate of 2,169,412 shares of common stock are reserved for issuance under the inactive plans, all of which were subject to outstanding stock option grants.

Stock Plan. Under the Stock Plan, both stock options and RSUs may be granted to employees and consultants of Harmonic. Stock options have a maximum term of seven years and generally vest 25% at one year from date of grant and an additional 1/48 per month thereafter. Stock options are granted with exercise prices equal to the fair market value of the common stock at the date of grant. Restricted stock units (RSUs) have no exercise price and generally vest over four years, with 25% vesting at one year from date of grant or the vesting commencement date chosen for the award and either an additional 1/16 per quarter or 1/8 semiannually thereafter. In May 2010, Harmonic stockholders approved amendments to the Stock Plan that (a) increased the maximum number of shares of common stock authorized for issuance by an additional 10,600,000 shares, (b) decreased the maximum term of stock options to seven years, and (c) changed the share counting provisions to provide that each award with an exercise price below 100% of the fair market value on the grant date (or no exercise price) would decrease the Stock Plan reserve 1.5 shares for every unit or share granted and any forfeitures of these awards due to their not vesting would increase the Stock Plan reserve by 1.5 shares for every unit or share forfeited. Previously, RSUs granted reduced the number of shares reserved for grant under the Stock Plan by two shares for every unit granted. In the six months ended July 1, 2011, 1,570,300 RSUs, with an aggregate grant date fair value of \$14.9 million, were granted to employees. In the six months ended July 2, 2010, 1,501,100 RSUs, with an aggregate grant date fair value of \$9.5 million, were granted to employees. Certain stock option and RSU awards provide for accelerated vesting if there is a change in control and a subsequent involuntary termination of the award holder.

Upon acquisition of Omneon in September 2010, the Company assumed substantially all unvested stock options and RSUs outstanding, as of the date of closing, under Omneon's 1998 Stock Option Plan and 2008 Equity Incentive Plan, resulting in the assumption of stock options to purchase approximately 1,522,000 shares of Harmonic common stock and the assumption of RSUs for 1,455,000 shares of Harmonic common stock. The exchange of stock-based compensation awards was treated as a modification under current accounting guidance. The calculation of the fair value of the exchanged awards immediately before and after the modification did not result in any significant incremental fair value. The fair value of Harmonic's stock options and RSUs issued to Omneon employees was

\$17.3 million, which was determined using the Black-Scholes option pricing model, of which \$2.1 million represents purchase consideration and \$15.2 million will be recorded as compensation expense over the weighted average service period of 2.5 years from the September 15, 2010 closing date.

Director Plan. In May 2002, Harmonic's stockholders approved the Director Plan. Under the Director Plan, both non-statutory stock options and RSUs may be granted to certain non-employee directors of Harmonic. In May 2010, Harmonic stockholders approved

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amendments to the Director Plan, (a) increasing the maximum number of shares of common stock authorized for issuance by an additional 400,000 shares, and (b) changing the share counting provisions to provide that each award of RSUs would decrease the Director Plan reserve 1.5 shares for every unit granted and any forfeitures of unvested RSUs would increase the Director Plan reserve by 1.5 shares for every unit forfeited. Previously, RSUs granted reduced the number of shares reserved for grant under the Director Plan by two shares for every unit granted. RSUs have no exercise price and vest either after one year from the grant date or on the vesting date chosen for such award. Stock options are granted at the fair market value of the common stock on the date of grant and have a maximum term of seven years. Initial option grants generally vest monthly over three years, and subsequent grants generally vest monthly over one year. In the six months ended July 1, 2011, 75,845 RSUs, with an aggregate grant date fair value of \$0.7 million, were granted to non-employee directors. In the six months ended July 2, 2010, 87,367 RSUs, with an aggregate grant date fair value of \$0.5 million, were granted to non-employee directors.

A summary of share-based award activity under the Stock Plan and Director Plan during the six months ended July 1, 2011 is as follows:

	Shares Available for Grant (In thousands)
Balance at December 31, 2010	10,449
Options granted	(833)
Restricted stock units granted	(2,469)
Options cancelled	384
Restricted stock units cancelled	591
Options expired	40
Balance at July 1, 2011	8,162

The following table summarizes RSU activity under the Stock Plan and Director Plan during the six months ended July 1, 2011:

	RSU s	Weighted Average Fair Value Per Share	Aggregate Fair Value⁽¹⁾
	Outstanding		
	(In thousands, except per share data)		
Balance at December 31, 2010	4,507	\$ 6.43	
Restricted stock units granted	1,646	9.50	
Restricted stock units vested	(922)	6.31	\$ 8,250
Restricted stock units cancelled	(718)	6.80	
Balance at July 1, 2011	4,513	7.51	

(1) Represents the fair value of Harmonic common stock on the date that each of the restricted stock units vested. On the grant date, the fair value for these awards was \$5.8 million.

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The following table summarizes stock option activity under the Stock Plan and Director Plan during the six months ended July 1, 2011:

	Stock Options Outstanding (In thousands, except per option data)	Average Exercise Price Per Option
Balance at December 31, 2010	11,020	\$ 6.90
Options granted	833	9.63
Options exercised	(1,714)	6.33
Options cancelled	(507)	7.55
Options expired	(384)	9.11
Balance at July 1, 2011	9,248	7.12
Options vested and exercisable at July 1, 2011	6,492	
Options vested and expected-to-vest at July 1, 2011	9,122	

The weighted-average fair value of options granted for the six months ended July 1, 2011 and July 2, 2010 was \$4.55 and \$3.09, respectively.

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

	Stock Options Outstanding			Stock Options Exercisable	
	Number Outstanding at July 1, 2011	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price Per Option	Number Exercisable at July 1, 2011	Weighted Average Exercise Price Per Option
Range of Exercise Prices					
\$0.19 - 5.14	1,467	5.9	\$ 2.77	866	\$ 3.12
5.18 - 5.87	1,483	3.6	5.76	1,097	5.79
5.88 - 8.12	1,036	4.8	6.65	509	6.72
8.17 - 8.17	1,895	3.7	8.17	1,523	8.17
8.20 - 8.65	1,332	2.7	8.25	1,313	8.25
8.69 - 9.69	1,398	5.0	9.39	555	9.04
9.74 - 16.73	637	1.2	10.63	629	10.63
	9,248	4.0	\$ 7.12	6,492	\$ 7.31

The weighted-average remaining contractual life for all exercisable stock options at July 1, 2011 was 3.2 years. The weighted-average remaining contractual life of all vested and expected-to-vest stock options at July 1, 2011 was 4.0 years. The weighted-average remaining contractual life of all vested and expected-to-vest RSUs at July 1, 2011

was 1.4 years.

Aggregate intrinsic value of options exercisable at July 1, 2011 was \$6.0 million. The aggregate intrinsic value of stock options vested and expected-to-vest, net of estimated forfeitures, was \$10.1 million at July 1, 2011. Aggregate intrinsic value represents the difference between our closing price on the last trading day of the fiscal period, which was \$7.46 as of July 1, 2011, and the exercise price multiplied by the number of options outstanding and exercisable. The intrinsic value of exercised stock options is calculated based on the difference between the exercise price and the market value of the common stock at the time of exercise. The aggregate intrinsic value of exercised stock options during the six months ended July 1, 2011 was \$4.9 million.

ESPP. In May 2002, Harmonic's stockholders approved the ESPP. In June 2011, Harmonic's stockholders approved an amendment to the ESPP which increased by 2.0 million shares the maximum number of shares authorized under the ESPP. The ESPP enables employees to purchase shares at 85% of the fair market value of the common stock at the beginning or end of each six month offering period, whichever is lower. Offering periods generally begin on the first trading day on or after January 1 and July 1 of each year. The ESPP is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. During the six months ended July 1, 2011 and July 2, 2010, the number of shares of stock issued under the ESPP was 945,287 and 864,800, at weighted average prices of \$5.54 and \$4.90, respectively. The weighted-average fair value of each right to purchase shares of common stock granted under the ESPP during the six months ended July 1, 2011 and July 2, 2010 was \$2.02 and \$1.91, respectively.

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

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

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands)			
Employee stock-based compensation in:				
Cost of revenue	\$ 762	\$ 527	\$ 1,509	\$ 1,006
Research and development expense	1,771	1,158	3,607	2,266
Selling, general and administrative expense	2,559	1,734	5,978	3,391
Total employee stock-based compensation in operating expense	4,330	2,892	9,585	5,657
Total employee stock-based compensation	5,092	3,419	11,094	6,663
Amount capitalized in inventory	(14)	(5)		25
Total stock-based compensation	\$ 5,078	\$ 3,414	\$ 11,094	\$ 6,688

As of July 1, 2011, total unamortized stock-based compensation cost related to unvested stock options and RSUs was \$41.1 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.6 years.

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

	Employee Stock Options			
	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
Expected life (in years)	4.75	4.75	4.75	4.75
Volatility	52%	55%	54%	56%
Risk-free interest rate	2.5%	2.2%	2.1%	2.4%
Dividend yield	0.0%	0.0%	0.0%	0.0%

	Employee Stock Purchase Plan Awards			
	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
Expected life (in years)	0.50	0.50	0.50	0.50
Volatility	43%	50%	43%	50%
Risk-free interest rate	0.3%	0.4%	0.3%	0.4%
Dividend yield	0.0%	0.0%	0.0%	0.0%

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

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

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

NOTE 11: INCOME TAXES

The income tax provision includes U.S. federal, state and local, and foreign income taxes and is based on the application of a forecasted annual income tax rate applied to the current quarter's year-to-date pre-tax income (loss). In determining the estimated annual effective income tax rate, the Company analyzes various factors, including projections of the Company's annual earnings, taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, the Company's ability to use

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tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than being included in the estimated annual effective income tax rate.

For the three months ended July 1, 2011, the Company recorded a provision for income taxes of \$0.8 million, compared to a benefit from income taxes of \$49,000 for the same period a year ago, inclusive of discrete items. For the six months ended July 1, 2011, the Company recorded a provision for income taxes of \$0.2 million, compared to a benefit from income taxes of \$2.9 million for the same period a year ago, inclusive of discrete items.

For the three and six months ended July 1, 2011, the difference between the recorded provision for income taxes and the tax provision, based on the federal statutory rate of 35%, was primarily attributable to various discrete items, the differential in foreign tax rates, non-deductible stock-based compensation expense, non-deductible amortization on foreign intangibles, and federal research and development credits. The discrete items recorded in the six months ended July 1, 2011 principally related to accrued interest on uncertain tax positions, a benefit associated with the reversal of previously provided foreign income taxes due to statute of limitation expirations, and foreign currency translation adjustments.

For the three and six months ended July 2, 2010, the difference between the recorded benefit from income taxes and the tax provision, based on the federal statutory rate of 35%, was primarily attributable to various discrete items, the differential in foreign tax rates, non-deductible stock-based compensation expense, and California research and development credits. The discrete items recorded in the six months ended July 2, 2010 principally related to a benefit associated with the reversal of previously provided foreign income taxes due to expiration of the statute of limitations, a benefit associated with the release of a portion of the valuation allowance on certain California deferred tax assets, foreign currency translation adjustments, and accrued interest on uncertain tax positions.

In compliance with applicable guidance for accounting for uncertainty in income taxes, the Company had gross unrecognized tax benefits, which include interest and penalties, of approximately \$53.4 million as of December 31, 2010, and approximately \$54.0 million as of July 1, 2011. If all of these unrecognized tax benefits were recognized, the entire amount would impact the provision for income taxes. We anticipate the unrecognized tax benefits to decrease by \$4.4 million in the next 12 months due to statute of limitation expirations.

We recognize interest and penalties related to uncertain tax positions in income tax expense. During the six months ended July 1, 2011, we recorded a net increase of \$0.5 million for interest and penalties related to uncertain tax positions, resulting in a balance at July 1, 2011 of \$5.5 million.

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

The Company's income tax returns for 2007, 2008 and 2009 are currently under examination by the U.S. Internal Revenue Service.

NOTE 12: NET INCOME PER SHARE

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

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

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
Potentially dilutive equity awards outstanding	10,671	11,755	9,103	11,715

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

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except per share amounts)			
Net income (numerator)	\$ 390	\$ 4,445	\$ 906	\$ 9,764
Shares calculation (denominator):				
Weighted average shares outstanding basic	114,939	96,998	114,387	96,845
Effect of Dilutive Securities:				
Potential common stock relating to stock options, restricted stock units and ESPP	1,359	572	1,756	684
Weighted averages shares outstanding diluted	116,298	97,570	116,143	97,529
Net income per share basic	\$ 0.00	\$ 0.05	\$ 0.01	\$ 0.10
Net income per share diluted	\$ 0.00	\$ 0.05	\$ 0.01	\$ 0.10

NOTE 13: COMPREHENSIVE INCOME

The Company's total comprehensive income was as follows:

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands)			
Net income	\$ 390	\$ 4,445	\$ 906	\$ 9,764
Change in unrealized gain (loss) on investments, net	8	(128)	(3)	(344)
Change in unrealized gain (loss) on foreign exchange contracts, net of tax		(62)		(62)
Foreign currency translation	69	(518)	523	(655)
Total comprehensive income	\$ 467	\$ 3,737	\$ 1,426	\$ 8,703

NOTE 14: SEGMENT INFORMATION

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

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

Three months ended	Six months ended
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	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
			(In thousands)	
Video processing products	\$ 51,525	\$ 49,998	\$ 115,283	\$ 88,888
Production and playout products	25,453		46,386	
Edge and access products	40,178	34,263	71,354	69,807
Service and support	16,840	11,283	33,808	21,671
	\$ 133,996	\$ 95,544	\$ 266,831	\$ 180,366

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

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	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands)			
Net revenue:				
United States	\$ 55,578	\$ 49,259	\$ 114,532	\$ 91,850
International	78,418	46,285	152,299	88,516
	\$ 133,996	\$ 95,544	\$ 266,831	\$ 180,366

	July 1, 2011	December 31, 2010
		(In thousands)
Property and equipment, net:		
United States	\$ 31,875	\$ 32,104
International	7,803	7,721
	\$ 39,678	\$ 39,825

Major Customers. For both the three and six months ended July 1, 2011, revenue from Comcast accounted for 11% of net revenue. For the three and six months ended July 2, 2010, revenue from Comcast accounted for 16% and 15% of net revenue, respectively. For the three months ended July 2, 2010, revenue from Echostar accounted for 10% of net revenue. As of July 1, 2011, Comcast accounted for 14% of net accounts receivable.

NOTE 15: GUARANTEES

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

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands)			
Balance at beginning of period	\$ 5,263	\$ 3,426	\$ 4,811	\$ 4,186
Accrual for current period warranties	2,171	1,020	4,433	1,470
Warranty costs incurred	(1,856)	(1,252)	(3,666)	(2,462)
Balance at end of period	\$ 5,578	\$ 3,194	\$ 5,578	\$ 3,194

Standby Letters of Credit. As of July 1, 2011, the Company's financial guarantees consisted of standby letters of credit outstanding, which principally related to performance bonds and state requirements imposed on employers. The maximum amount of potential future payments under these arrangements was \$0.9 million.

Indemnification. Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and customers for specified intellectual property matters pursuant to certain contractual arrangements, subject to certain limitations. The scope of these indemnities varies but, in some instances, includes indemnification for damages and expenses

(including reasonable attorneys' fees). There have been no amounts accrued in respect of the indemnification provisions through July 1, 2011.

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

NOTE 16: LEGAL PROCEEDINGS

In March 2010, Interkey ELC Ltd, or Interkey, filed a lawsuit in Israel alleging breach of contract against Harmonic and Scopus Video Networks Ltd. (now Harmonic Video Networks Ltd. or HVN), which was acquired by Harmonic in March 2009. The plaintiffs are seeking damages in the amount of 6,300,000 ILS (approximately \$1.7 million). Although, as is the case with all litigation, no assurances can be given as to the outcome of the Interkey lawsuit, Harmonic believes Interkey's and its shareholders' claims are without merit and Harmonic and HVN intend to vigorously defend themselves against these claims. Based on the foregoing, Harmonic has not recorded a provision for this claim.

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

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

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

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

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

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

- developing trends in the broadcasting and television business;
- continuation of customer concentration;
- capital spending of our customers in the balance of 2011 and beyond;
- our strategic direction, future business plans and growth strategy;
- increases in our international revenue;
- industry and customer consolidation;
- anticipated changes in economic conditions or the financial markets, and the potential impact on our business;
- the expected demand for, and benefits of, our products and services;
- concentration of revenue sources;
- anticipated benefits of recent acquisitions;
- potential future acquisitions;
- statements regarding anticipated results of potential or actual litigation;
- our competitive environment;
- the impact of governmental regulation;
- the impact of conditions in, and changes to, economies 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.

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These statements are subject to known and unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward-looking statements. Important factors that may cause actual results to differ from expectations include those discussed in Risk Factors beginning on page 35 of this Form 10-Q. All forward-looking statements included in this Form 10-Q are based on information available to us on the date thereof, and we assume no obligation to update any such forward-looking statements.

Overview

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

Harmonic's revenue increased by 40% and 48% in the three and six months ended July 1, 2011, respectively, compared to the same periods in 2010. The increase in revenue in the three months ended July 1, 2011 was due, in part, to stronger worldwide customer demand for edge and access solutions, which grew 17% compared to the same period in 2010. The increase in revenue in the six months ended July 1, 2011 was due, in part, to stronger worldwide demand for video processing solutions primarily during the three months ended April 1, 2011, which grew 30% compared to the same period in 2010. In addition, Harmonic's revenue also increased in the three and six months ended July 1, 2011 as a result of the acquisition of Omneon in September 2010. Omneon's product revenue, which for the three and six months ended July 1, 2011 was \$25.5 million and \$46.4 million, respectively, is included in the production and playout product line under Net Revenue Consolidated below. The growth in edge and access revenue in the three months ended July 1, 2011, the growth of video processing revenue in the six months ended July 1, 2011, and the addition of Omneon product revenue in both periods also contributed to the growth in service and support activity related to the associated product solutions, resulting in services and support revenue growth of 49% and 56% in the three and six months ended July 1, 2011, respectively, when compared to the same periods in 2010.

Financial difficulties of certain of our customers and changes in our customers' deployment plans have adversely affected our business in the past. In 2008 and 2009, economic conditions in many of the countries in which we sell products were very weak, and global economic conditions and financial markets experienced a severe downturn. The downturn stemmed from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns.

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

Sales to customers outside of the U.S. in the three and six months ended July 1, 2011 represented 59% and 57% of net revenue, respectively, compared to 48% and 49%, respectively, for the same periods in 2010. A significant portion of international sales are made to distributors and system integrators, which are generally responsible for importing the products and providing installation and technical support and service to customers within their territory. We expect international sales to continue to account for a substantial portion of our net revenue for the foreseeable future, and expect that, partially as a result of the acquisitions of Scopus in 2009 and of Omneon in 2010, our international sales

may continue to increase as a percentage of net revenue from year to year.

Further, we have a number of international customers to whom sales are denominated in U.S. dollars. Sales denominated in foreign currencies were approximately 9% of net revenue in the six months ended July 1, 2011, compared to 6% for the same period in 2010. The value of the U.S. dollar fluctuates significantly against many foreign currencies, which includes the local currencies of many of our international customers. If the U.S. dollar appreciates relative to the local currencies of our customers, then the prices of our

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products correspondingly increase for such customers. Such an effect could adversely impact sales of our products to such customers and result in longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition in the affected countries. Further, if the U.S. dollar were to weaken against many major currencies, there can be no assurance that a weaker dollar would lead to growth in capital spending.

In addition, industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. Also, if our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of customers in the markets on which we focus, our revenue may decline. Historically, a majority of our revenue has been derived from relatively few customers, due in part to the consolidation of the ownership of cable television and direct broadcast satellite system companies. However, in the last two years, revenue from our ten largest customers has decreased as a percentage of revenue, due to our growing customer base, in part as a result of the acquisitions of Scopus and Omneon. Sales to our ten largest customers in the three and six months ended July 1, 2011 accounted for approximately 37% and 35% of revenue, respectively, compared to 51% and 48%, respectively, for the same periods in 2010. Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration.

In both the three and six months ended July 1, 2011, sales to Comcast accounted for 11% of net revenue, respectively, compared to 16% and 15%, respectively, for the same periods in 2010. In addition, sales to Echostar accounted for 10% of net revenue in the three months ended July 2, 2010. The loss of Comcast, or any other significant customer, any material reduction in orders by Comcast, or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, including, from time to time, projects in which we act much like a systems integrator. A decrease in the number of the relatively larger individual transactions in which we are involved in any quarter could adversely affect our operating results for that quarter.

In addition, historically, we have been dependent upon capital spending in the cable and satellite industries. We are attempting to further diversify our customer base beyond cable and satellite customers, including to the telco and broadcast and media markets. Several major telcos have rebuilt or are upgrading their networks to offer bundled video, voice and data services. In order to be successful in this market, we may need to continue to build alliances with telco equipment manufacturers, adapt our products for telco applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the telco industry. In addition, telco video deployments, including recent trials of mobile video services, are subject to delays in completion, as video processing technologies and video business models are relatively new to most telcos and many of their largest suppliers. Implementation issues with our products or those of other vendors have caused, and may continue to cause, delays in project completion for our customers and delay our recognition of revenue.

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

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

Substantially all unvested stock options and unvested restricted stock units issued by Omneon and outstanding at closing were assumed by Harmonic.

We have expanded our international operations and staffing to better support our expansion into international markets. This expansion included the implementation of an international structure that involved, among other things, an international support center in Europe, a research and development cost-sharing arrangement, and certain licenses and other contractual arrangements by and among the Company and its wholly-owned domestic and foreign subsidiaries. Our foreign subsidiaries have acquired certain license rights to use our existing intellectual property and intellectual property that will be developed or licensed in the future, including Omneon's

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existing and future intellectual property. As a result of these changes and an expanding customer base internationally, we expect that an increasing percentage of our consolidated pre-tax income will be derived from, and reinvested in, our international operations. We anticipate that this pre-tax income will be subject to foreign tax at relatively lower tax rates when compared to the United States federal statutory tax rate in future periods.

Critical Accounting Policies, Judgments and Estimates

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

Revenue recognition;

Allowances for doubtful accounts, returns and discounts;

Valuation of inventories;

Impairment of goodwill or long-lived assets;

Restructuring costs and accruals for excess facilities;

Assessment of the probability of the outcome of litigation;

Accounting for income taxes, and

Stock-based compensation.

Results of Operations

Harmonic's condensed consolidated statements of operations data for the three and six months ended July 1, 2011 and July 2, 2010, as a percentage of net revenue, is as follows:

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
Net revenue	100%	100%	100%	100%
Cost of revenue	54	52	54	52
Gross profit	46	48	46	48
Operating expenses:				
Research and development	19	18	19	19
Selling, general and administrative	24	25	25	25
Amortization of intangibles	2	1	2	
Total operating expenses	45	44	46	44

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Income from operations	1	4		4
Interest and other income, net		1		
Income before income taxes	1	5		4
Provision for (benefit from) income taxes	1			(1)
Net income	%	5%	%	5%

Net Revenue Consolidated

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Harmonic's consolidated net revenue in the three and six months ended July 1, 2011, compared with the corresponding periods in 2010, are presented in the table below. Also presented are the related dollar and percentage changes in consolidated net revenue in the three and six months ended July 1, 2011, from the corresponding periods in 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Revenue by type:				
Video processing products	\$ 51,525	\$ 49,998	\$ 115,283	\$ 88,888
Production and playout products	25,453		46,386	
Edge and access products	40,178	34,263	71,354	69,807
Service and support	16,840	11,283	33,808	21,671
Net revenue	\$ 133,996	\$ 95,544	\$ 266,831	\$ 180,366
Increase:				
Video processing products	\$ 1,527		\$ 26,395	
Production and playout products	25,453		46,386	
Edge and access products	5,915		1,547	
Service and support	5,557		12,137	
Total increase	\$ 38,452		\$ 86,465	

Percent change:

Video processing products	3%	30%
Production and playout products		
Edge and access products	17	2
Service and support	49	56
Total percent change	40%	48%

The increase in net revenue in the three months ended July 1, 2011, compared to the same period of 2010, was due, in large part, to the revenue contribution resulting from the acquisition of Omneon. Omneon's product revenue is included in the production and playout product line above. In addition, our revenue increased due to stronger worldwide demand for our edge and access solutions. The addition of Omneon product revenue and the growth in edge and access products revenue of 17% also contributed to the growth in service and support activity related to the associated products, resulting in service and support revenue growth of 49% in the second quarter of 2011, when compared to the same period in 2010.

The increase in net revenue in the six months ended July 1, 2011, compared to the same period of 2010, was due, in large part, to the revenue contribution resulting from the acquisition of Omneon. Omneon's product revenue is included in the production and playout product line above. In addition, our revenue increased due to stronger worldwide demand for our video processing solutions. The addition of Omneon product revenue and the growth in video processing products revenue of 30% also contributed to the growth in service and support activity related to the associated products, resulting in service and support revenue growth of 56% in the first six months of 2011, when compared to the same period in 2010.

Net Revenue - Geographic

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Harmonic's domestic and international net revenue in the three and six months ended July 1, 2011, compared with the corresponding periods in 2010, are presented in the table below. Also presented are the related dollar and percentage changes in domestic and international net revenue in the three and six months ended July 1, 2011, from the corresponding periods in 2010.

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	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Net revenue:				
United States	\$ 55,578	\$ 49,259	\$ 114,532	\$ 91,850
International	78,418	46,285	152,299	88,516
Total	\$ 133,996	\$ 95,544	\$ 266,831	\$ 180,366
Increase:				
United States	\$ 6,319		\$ 22,682	
International	32,133		63,783	
Total increase	\$ 38,452		\$ 86,465	

Percent change:

United States	13%	25%
International	69	72
Total percent change	40%	48%

The increase in U.S. net revenue in the three months ended July 1, 2011, compared to the corresponding period in 2010, was principally due to the addition of Omneon product revenue. The increase in U.S. net revenue in the six months ended July 1, 2011, compared to the corresponding period in 2010, was principally due to the addition of Omneon product revenue and increased video processing revenue and service and support revenue.

International net revenue in the three and six months ended July 1, 2011 increased, compared to the corresponding periods in 2010, primarily due to increased demand from customers in emerging markets and sales of Omneon production and playout products, given that a substantial majority of production and playout net revenues were international. We expect that international sales will continue to account for a significant portion of our net revenue for the foreseeable future, and expect that, with the completion of the acquisition of Omneon in particular, our international revenue may increase as a percentage of our total net revenue from year to year.

Gross Profit

Harmonic's gross profit and gross profit as a percentage of net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in gross profit in the three and six months ended July 1, 2011, from the corresponding periods in 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Gross profit	\$ 61,828	\$ 45,682	\$ 123,683	\$ 86,487
As a percentage of net revenue	46%	48%	46%	48%
Increase	\$ 16,146		\$ 37,196	
Percent change	35%		43%	

The increase in gross profit in the three and six months ended July 1, 2011, as compared to the corresponding periods in 2010, was primarily due to increased net revenue in 2011. The gross profit percentage of 46% in the three and six months ended July 1, 2011, compared to 48% in the same periods in 2010, was lower principally due to higher amortization of intangibles.

In the three and six months ended July 1, 2011, \$5.5 million and \$10.6 million, respectively, of amortization of intangibles was included in cost of sales compared to \$2.1 million and \$4.2 million, respectively, in the corresponding periods of 2010. The higher amortization of intangible expense in 2011 was due to the amortization of intangibles arising from the Omneon acquisition, which was completed in September 2010. We expect to record approximately \$10.9 million in amortization of intangibles expenses in cost of sales in the remaining six months of 2011, primarily resulting from the acquisitions of Omneon and Scopus.

Research and Development

Harmonic's research and development expense and the expense as a percentage of consolidated net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are

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the related dollar and percentage changes in research and development expense in the three and six months ended July 1, 2011, from the corresponding periods of 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Research and development	\$ 25,662	\$ 16,977	\$ 51,811	\$ 33,943
As a percentage of net revenue	19%	18%	19%	19%
Increase	\$ 8,685		\$ 17,868	
Percent change	51%		53%	

The increase in research and development expense in the three months ended July 1, 2011, compared to the corresponding period in 2010, was primarily the result of increased compensation expense of \$5.2 million, increased outside engineering services of \$1.3 million, increased facilities related expenses of \$1.2 million and increased stock-based compensation expense of \$0.6 million.

The increase in research and development expense in the six months ended July 1, 2011, compared to the corresponding period in 2010, was primarily the result of increased compensation expense of \$10.1 million, increased facilities related expenses of \$2.9 million, increased outside engineering services of \$2.8 million and increased stock-based compensation expense of \$1.3 million.

The increased compensation expense, outside engineering services and stock-based compensation expense were primarily due to increased engineering headcount and activities resulting from the Omneon acquisition, as well as additional hiring of employees engaged in engineering activities. The increased facilities related expenses were primarily due to additional depreciation of building improvements and lab equipment costs resulting from the Omneon acquisition.

Selling, General and Administrative

Harmonic's selling, general and administrative expense and the expense as a percentage of consolidated net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in selling, general and administrative expense in the three and six months ended July 1, 2011, from the corresponding periods of 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Selling, general and administrative	\$ 32,543	\$ 24,074	\$ 66,107	\$ 44,919
As a percentage of net revenue	24%	25%	25%	25%
Increase	\$ 8,469		\$ 21,188	
Percent change	35%		47%	

The increase in selling, general and administrative expense in the three months ended July 1, 2011, compared to the corresponding period in 2010, was primarily a result of increased compensation expense of \$5.1 million, increased travel expense of \$1.3 million, increased program marketing and third party commission expense of \$1.2 million, increased facilities related expense of \$1.0 million, increased stock-based compensation expense of \$0.8 million and increased consulting and professional service expense of \$0.6 million, partially offset by the absence of \$2.4 million of acquisition related costs incurred in 2010 in connection with the acquisition of Omneon.

The increase in selling, general and administrative expense in the six months ended July 1, 2011, compared to the corresponding period in 2010, was primarily a result of increased compensation expense of \$11.1 million, increased stock-based compensation expense of \$2.6 million, increased program marketing and third party commission expense

of \$2.5 million, increased travel expense of \$2.2 million, increased facilities related expense of \$2.2 million and increased consulting and professional service expense of \$1.5 million, partially offset by the absence of \$2.4 million of acquisition related costs incurred in 2010 in connection with the acquisition of Omneon.

The increased compensation expense, stock-based compensation expense, marketing and selling expense and travel expense is primarily due to increased headcount resulting from the Omneon acquisition and higher commission expense resulting from increased

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net revenue in 2011. The increase in consulting and professional service expense is related to higher temporary headcount and additional consulting resources being used in general and administrative activities. The increased facilities related expense was partially due to the additional \$0.5 million of excess facilities reserve recorded in the first quarter of 2011 related to Omneon's headquarters in Sunnyvale, California.

Amortization of Intangibles

Harmonic's amortization of intangible assets and the expense as a percentage of consolidated net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in amortization of intangible assets in the three and six months ended July 1, 2011, from the corresponding periods of 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Amortization of intangibles	\$ 2,230	\$ 534	\$ 4,459	\$ 1,067
As a percentage of net revenue	2%	1%	2%	%
Increase	\$ 1,696		\$ 3,392	
Percent change	318%		318%	

The increases in the amortization of intangibles expense in the three and six months ended July 1, 2011, compared to the corresponding periods in 2010, were primarily due to the amortization of intangible assets obtained in connection with the acquisition of Omneon during the third quarter of 2010. Harmonic expects to record a total of approximately \$4.4 million in amortization of intangibles expense in operating expenses in the remaining nine months of 2011, primarily resulting from the acquisitions of Scopus and Omneon.

Interest Income, Net

Harmonic's interest income, net, and interest income, net, as a percentage of consolidated net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in interest income, net, in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Interest income, net	\$ 74	\$ 425	\$ 166	\$ 809
As a percentage of net revenue	%	%	%	%
Decrease	\$ (351)		\$ (643)	
Percent change	(83)%		(79)%	

The decreases in interest income, net in the three and six months ended July 1, 2011, compared to the corresponding periods of 2010, were primarily due to lower cash and short-term investments portfolio balances during the periods, principally resulting from cash used in the Omneon acquisition, and lower interest rates earned on the portfolio balances.

Other Expense, Net

Harmonic's other expense, net, and other expense, net, as a percentage of consolidated net revenue in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in other expense, net, in the three and six months ended July 1, 2011, from the corresponding periods of 2010.

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	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Other expense, net	\$ 299	\$ 126	\$ 406	\$ 497
As a percentage of net revenue	%	%	%	%
Increase (Decrease)	\$ 173		\$ (91)	
Percent change	137%		(18)%	

The increase in other expense, net, in the three months ended July 1, 2011, compared to the corresponding period of 2010, was primarily due to foreign exchange losses on accounts receivable and intercompany balances denominated in currencies other than the U.S. dollar.

The decrease in other expense, net, in the six months ended July 1, 2011, compared to the corresponding period of 2010, was primarily due to lower indirect taxes, offset partially by foreign currency exchange losses on balances denominated in currencies other than the U.S. dollar.

Income Taxes

Harmonic's provision for (benefit from) income taxes, and provision for (benefit from) income taxes, as a percentage of consolidated net revenue, in the three and six months ended July 1, 2011, as compared with the corresponding periods of 2010, are presented in the table below. Also presented are the related dollar and percentage changes in income taxes in the three and six months ended July 1, 2011, from the corresponding periods of 2010.

	Three months ended		Six months ended	
	July 1, 2011	July 2, 2010	July 1, 2011	July 2, 2010
	(In thousands, except percentages)			
Provision for (benefit from) income taxes	\$ 778	\$ (49)	\$ 160	\$ (2,894)
As a percentage of net revenue	1%	%	%	(1)%
Increase	\$ 827		\$ 3,054	
Percent change	(1,688)%		(106)%	

The increase in the provision for income taxes in the three months ended July 1, 2011, compared to the same period in 2010, was primarily attributable to lower reversals of foreign taxes previously accrued as uncertain tax benefits due to an expiration of the statute of limitations.

The increase in the provision for income taxes in the six months ended July 1, 2011, compared to the same period in 2010, was primarily attributable to lower reversals of foreign taxes previously accrued as uncertain tax benefits due to an expiration of the statute of limitations, translation adjustments and accrued interest on uncertain tax positions. The increase also resulted from a reduction in the valuation allowance on the California deferred tax assets in the six months ended July 2, 2010, due to an increase in the estimated amount of income that will be apportioned to California based on anticipated changes in the geographic mix of sales and a reallocation of expenses between legal entities, that did not reoccur in the six months ended July 1, 2011.

The Company's income tax returns for 2007, 2008 and 2009 are currently under examination by the U.S. Internal Revenue Service. See Risk Factors Fluctuations in our future effective tax rates could affect our future operating results, financial condition and cash flows for additional information.

Liquidity and Capital Resources

**Six months ended
July 2, 2010**

	July 1, 2011	
	(In thousands)	
Net cash provided by operating activities	\$ 9,140	\$ 5,483
Net cash provided by (used in) investing activities	(49,167)	13,917
Net cash provided by financing activities	13,703	16,218

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As of July 1, 2011, cash, cash equivalents and short-term investments totaled \$134.3 million, compared to \$120.4 million as of December 31, 2010. Cash provided by operations in the six months ended July 1, 2011 was \$9.1 million, resulting from net income of \$0.9 million, increased by an aggregate of \$33.5 million in non-cash charges and decreased by an aggregate of \$25.3 million in net change in assets and liabilities. The non-cash charges included principally amortization of intangible assets, stock-based compensation and depreciation. The net change in assets and liabilities included: (a) increases in accounts receivable and inventories, which was partially offset by a decrease in prepaid expenses; and (b) decreases in income taxes payable and accrued and other liabilities, which was partially offset by increases in accounts payable and deferred revenue. The increase in accounts receivable is due to the non-linearity of invoicing in the six months ended July 1, 2011. The decrease in accrued and other liabilities was principally attributable to payment in 2011 of incentive compensation accruals from 2010.

Cash provided by operations in the six months ended July 2, 2010 was \$5.5 million, resulting from net income of \$9.8 million, increased by an aggregate of \$16.0 million in non-cash charges and decreased by an aggregate of \$20.3 million in net change in assets and liabilities. The non-cash charges included principally amortization of intangible assets, stock-based compensation and depreciation. The net change in assets and liabilities included: (a) increases in accounts receivable and inventories; and (b) decreases in accounts payable, income taxes payable, accrued excess facility costs and accrued and other liabilities, which was partially offset by an increase in deferred revenue. The increase in accounts receivable is due to higher shipments in the six months ended July 2, 2010. The decrease in accrued and other liabilities was principally attributable to payment in 2010 of incentive compensation accruals from 2009.

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

Net cash used in investing activities was \$49.2 million in the six months ended July 1, 2011, principally resulting from the purchase of short-term investments of \$62.0 million and capital expenditures of \$8.5 million, offset by proceeds from the sale and maturity of investments of \$21.6 million. Harmonic currently expects capital expenditures will be in the range of \$14 million to \$16 million during 2011, approximately 50% of which has been incurred in the six months ended July 1, 2011.

Net cash provided by investing activities was \$13.9 million in the six months ended July 2, 2010, resulting from proceeds from the maturity of investments of \$66.1 million, offset by the purchase of investments of \$39.0 million and capital expenditures of \$13.2 million.

Net cash provided by financing activities of \$13.7 million in the six months ended July 1, 2011 was the result of net proceeds from the issuance of common stock related to our stock plans. Net cash provided by financing activities of \$16.2 million in the six months ended July 2, 2010 was the result of proceeds received from lessor financing of building construction for our new headquarters of \$12.4 million and net proceeds from the issuance of common stock related to our stock plans of \$3.8 million.

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 some of our short-term investments at par or our cost, or any rating downgrades of issuers of these securities, could adversely affect our results of operations or financial condition. Nevertheless, we believe that our existing liquidity sources will satisfy our presently contemplated cash requirements for the next twelve months. However, if our expectations are incorrect, we may need to raise additional funds to fund our operations, to take advantage of unanticipated opportunities, or to strengthen our financial position.

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

Our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including the U.S. and global economic situation, a potential downgrade of the credit rating of the United States related to issues arising out of the recent increase in the U.S. debt ceiling, European sovereign debt concerns, and conditions in financial markets and the industries we serve. There can be no assurance that any financing will be available on terms acceptable to us, or at all.

Table of Contents**Off-Balance Sheet Arrangements**

None as of July 1, 2011.

Contractual Obligations and Commitments

There were no significant changes to our contractual obligations and commitments in the six months ended July 1, 2011, from the information presented in our 2010 Form 10-K.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Risk

Harmonic has a number of international subsidiaries, each of whose sales are generally denominated in U.S. dollars. In addition, Harmonic has various international branch offices that provide sales support and systems integration services. Sales denominated in foreign currencies were approximately 9% and 6% of net revenue in the first half of 2011 and 2010, respectively. Periodically, Harmonic enters into foreign currency forward exchange contracts (forward exchange contracts) to manage exposure related to foreign accounts receivable and reduce the effects of fluctuating exchange rates on expenses denominated in foreign currencies. Harmonic does not enter into derivative financial instruments for trading purposes. At July 1, 2011, we had a forward exchange contract to sell Euros totaling \$3.8 million. This forward exchange contract matured in July 2011. While Harmonic does not anticipate that near-term changes in exchange rates will have a material impact on Harmonic's operating results, financial position and liquidity, Harmonic cannot provide assurances that a sudden and significant change in the value of local currencies would not harm Harmonic's operating results, financial position and liquidity.

Interest Rate Risk

Exposure to market risk for changes in interest rates relates primarily to Harmonic's investment portfolio of marketable debt securities of various issuers, types and maturities and to Harmonic's borrowings, if any, under its bank line of credit facility. Harmonic has no borrowings under its bank line of credit. Harmonic does not use derivative instruments in its investment portfolio, and its investment portfolio only includes highly liquid instruments. These investments are classified as available for sale and are carried at estimated fair value, with unrealized gains and losses reported in accumulated other comprehensive income. As of July 1, 2011, gross unrealized gains were nominal. If the credit markets deteriorate, we may incur realized losses, which could adversely affect our financial condition or results of operations. There is risk that losses could be incurred if Harmonic were to sell any of its securities prior to stated maturity. As of July 1, 2011, our cash, cash equivalents and short-term investments balance was \$134.3 million. In a declining interest rate environment, as short term investments mature, reinvestment occurs at less favorable market rates. Given the short term nature of certain investments, declining interest rates would negatively impact investment income. Based on our estimates, a 100 basis point, or 1%, change in interest rates would have increased or decreased the fair value of our investments by approximately \$0.1 million as of July 1, 2011.

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

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

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procedures also is based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

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

Changes in internal controls.

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

Table of Contents**PART II****OTHER INFORMATION****ITEM 1. LEGAL PROCEEDINGS**

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

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

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

ITEM 1A. RISK FACTORS

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

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

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

access to financing;

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

the impact of industry consolidation;

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

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

evolving industry standards and network architectures;

competitive pressures, including pricing pressures;

discretionary end-user customer spending patterns; and

general economic conditions.

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

uncertainty related to development of digital video industry standards;

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

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

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

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

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

bankruptcies and financial restructuring of major customers.

The financial difficulties of certain of our customers and changes in our customers' deployment plans have adversely affected our business in the past. In 2008 and 2009, economic conditions in many of the countries in which we sell products were very weak, and global economic conditions and financial markets experienced a severe downturn. The downturn stemmed from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Although there was an increase in global economic activity in 2010 and the first six months of 2011, economic growth may be sluggish during the balance of 2011 and possibly beyond. The severity or length of time that economic and financial market conditions may be sluggish, or whether such adverse conditions may return in the U.S. and in other countries, is unknown. During challenging or uncertain economic times, and in tight credit markets, many customers may delay or reduce capital expenditures, which in turn often results in lower demand for our products. Further, we have a number of international customers to whom sales are denominated in U.S. dollars. The value of the U.S. dollar fluctuates significantly against many foreign currencies, which includes the local currencies of many of our international customers. If the U.S. dollar appreciates relative to the local currencies of our customers, then the prices of our products correspondingly increase for such customers. Such an effect could adversely impact sales of our products to such customers and result in longer sales cycles, difficulties in collection of accounts receivable, slower adoption of new technologies and increased price competition in the affected countries. Further, if the U.S. dollar were to weaken against many major currencies, there can be no assurance that a weaker dollar would lead to growth in capital spending.

In addition, industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. Further, if our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of customers in the markets on which we focus, our revenue may decline.

As a result of these capital spending issues, we may not be able to maintain or increase our revenue in the future, and our operating results, financial condition and cash flows could be materially and adversely affected.

The markets in which we operate are intensely competitive.

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

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

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Many of our competitors are substantially larger, and have greater financial, technical, marketing and other resources, than us. Many of these large enterprises are in a better position to withstand any significant reduction in capital spending by customers in 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 may be capable of delivering more complete solutions than we are able to provide. To the extent large enterprises that currently do not compete directly with us choose to enter our markets by acquisition or otherwise, competition would likely intensify.

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

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

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

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

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

- are not cost effective;

- are not brought to market in a timely manner;

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

- fail to meet market acceptance or customer requirements; or

- are ahead of their market.

We are currently developing and marketing products based on established video compression standards. Encoding products based on the MPEG-2 compression standards have historically represented a significant portion of our revenue. Other standards, such as MPEG-4 AVC/H.264, that have been adopted provide significantly greater compression efficiency, thereby making more bandwidth available to operators. The availability of more bandwidth is particularly important to those operators seeking to launch, or expand, HDTV services. We have developed and launched products, including HD encoders and transcoders, based on these new standards in order to remain competitive, and are continuing to devote considerable resources to these efforts. In addition, we have launched an

encoding platform that is capable of being configured for both MPEG-2 and MPEG-4, in both standard definition and HD formats. At the same time, we need to devote development resources to the existing MPEG-2 standard that many of our customers continue to require. There can be no assurance that these efforts will be successful in the near future, or at all, or that our competitors will not take significant market share in HD encoding or transcoding.

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

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

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

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

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

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

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

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

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

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

- the timing of revenue recognition on sales arrangements;

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

- the timing of completion of our customers' projects;

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

- lack of predictability in our revenue cycles;

- the level and mix of our international revenue;

- new product introductions by our competitors or by us;

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

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

- market acceptance of our products, particularly our new products;

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

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

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

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

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

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

impairment of our goodwill and intangibles;

the outcome of litigation;

write-downs of inventory and investments;

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

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

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

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

general economic conditions.

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

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

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

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

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

six months ended July 1, 2011 and in 2010 and 2009 accounted for approximately 35%, 44% and 47% of revenue, respectively. Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration.

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In the six months ended July 1, 2011 and in 2010 and 2009, revenue from Comcast accounted for approximately 11%, 17% and 16%, respectively, of our revenue. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, including, from time to time, projects in which we act much like a systems integrator. A decrease in the number of the relatively larger individual transactions in which we are involved in any quarter could adversely affect our operating results for that quarter.

In addition, historically, we have been dependent upon capital spending in the cable and satellite industry. We are attempting to further diversify our customer base beyond cable and satellite customers, including to the telco and broadcast and media markets. Several major telcos have rebuilt or are upgrading their networks to offer bundled video, voice and data services. In order to be successful in this market, we may need to continue to build alliances with telco equipment manufacturers, adapt our products for telco applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the telco industry. In addition, telco video deployments, including recent trials of mobile video services, are subject to delays in completion, as video processing technologies and video business models are relatively new to most telcos and many of their largest suppliers. Implementation issues with our products or those of other vendors have caused, and may continue to cause, delays in project completion for our customers and delay our recognition of revenue.

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

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

Our September 2010 acquisition of Omneon, a private, venture-backed company specializing in file-based infrastructure for the production, preparation and payout of video content, involves the integration of a business that had previously operated independently. The integration of a previously independent company into the acquiring company's operations is a challenging, time-consuming and costly process. While the integration process for Omneon began in September 2010, when the Omneon acquisition was consummated, it may take additional time to complete the process fully. It is possible that the process of fully integrating Omneon could result in our inability to fully realize the expected synergies and other benefits of the acquisition, the loss of key employees, the disruption of our ongoing businesses and that of Omneon, and inconsistencies in standards, controls, procedures, and policies that adversely affect our ability to maintain relationships with customers, suppliers, and employees, and would involve many of the other risks of any acquisition described in the risk factor concerning acquisitions on page 46. In addition, the successful combination of the companies requires the dedication of significant management resources, which could divert attention from the day-to-day business of the combined company. There can be no assurance that these challenges will be met, and that we will realize the anticipated benefits from the acquisition of Omneon, on a timely basis or at all. If we are unable to realize these benefits, our goal of expanding into the markets on which Omneon focuses and our business, in general, may be adversely affected.

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

Revenue derived from customers outside of the U.S. in the six months ended July 1, 2011 and in 2010 and 2009 represented approximately 57%, 50% and 49% of our revenue, respectively. We expect that international revenue will continue to represent a similar substantial percentage of our revenue for the foreseeable future. Furthermore, most of our contract manufacturing occurs overseas. Our international operations, the international operations of our contract manufacturers and our efforts to maintain and increase revenue in international markets are subject to a number of risks, which are generally greater with respect to emerging market countries, including the impact on our business and operating results of:

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

changes in foreign government regulations and telecommunications standards;

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

fluctuations in currency exchange rates;

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

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

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

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

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

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

difficulty in staffing and managing foreign operations;

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

changes in economic policies by foreign governments;

lack of basic infrastructure, particularly in emerging market countries;

availability of credit, particularly in emerging market countries; and

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

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

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

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

Our operations outside the United States also require us to comply with a number of United States and international regulations. For example, our operations in countries outside the United States are subject to the FCPA and similar laws, which prohibits United States companies or their agents and employees from providing anything of value to a foreign official for the purposes of influencing any act or decision of these individuals, in their official capacity, to help obtain or retain business, direct business to any person or corporate entity or obtain any unfair advantage. Our activities in countries outside the United States create the inherent risk of unauthorized payments or offers of payments by one of our employees or agents, including those companies to which we outsource certain of our business operations, which could be in violation of the FCPA, even though these parties are not always subject to our control. We have internal control policies and procedures, and have implemented training and compliance programs for our employees and agents, with respect to the FCPA. However, we cannot assure you that our policies, procedures and programs will prevent violations of the FCPA or similar laws by our employees or agents, particularly in

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

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

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

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

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

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

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

- the greater use of protocols such as IP;

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

- the introduction of new consumer devices, such as advanced set-top boxes, personal video recorders (or PVRs), iPads and other tablet computers, and a variety of smartphone 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 revenue will be materially and adversely affected.

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

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

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

- the entry of telcos into the video business;

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

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

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

- increased consumer interest in 3D television and content;

- the need to develop partnerships with other companies involved in the new broadband services;

- 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 results of operations, financial condition and cash

flow could be materially and adversely affected.

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

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

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

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

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

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

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

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

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

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

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

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

We have been notified by the Internal Revenue Service that our 2007, 2008 and 2009 U.S. corporate income tax return has been selected for audit. These audits commenced in the second quarter of 2011. If, upon the conclusion of these audits, the ultimate determination of taxes owed in the U.S. is for an amount in excess of the tax provision we have recorded in the applicable period, our overall tax expense, effective tax rate and results of operations could be materially and adversely impacted in the period of adjustment.

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

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

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

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the telco industry have extensive patent portfolios. From time to time, third parties have asserted, and may assert in the future, patent, copyright, trademark and other intellectual property rights against us or our customers. Our suppliers and their customers, including us, may have similar claims asserted against them. A number

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of third parties, including companies with greater financial and other resources than us, have asserted patent rights to technologies that are important to us. Any future intellectual property litigation, regardless of its outcome, could result in substantial expense and significant diversion of the efforts of our management and technical personnel. An adverse determination in any such proceeding could subject us to significant liabilities 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 adverse effect on our business, operating results, financial position and cash flows.

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

Our suppliers and customers may have intellectual property claims relating to our products asserted against them. We have agreed to indemnify some of our suppliers and most of our customers for patent infringement relating to our products. The scope of this indemnity varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorney's fees) incurred by the supplier or customer in connection with such claims. ***We may be the subject of litigation which, if adversely determined, could harm our business and operating results.*** In addition to the litigation discussed elsewhere herein, we may be subject to claims arising in the normal course of business. The costs of defending any litigation, whether 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 adverse effect on our business, operating results, financial position and cash flows.

As an example, we have received letters from several of our customers, notifying us that the customer intends to exercise its indemnification rights in agreements between the customer and us with respect to a patent infringement claim brought against the customer that may cover products sold to the customer by Harmonic or its acquired companies. Many of these notices arise out of a spate of patent infringement claims, and related litigation, made by the Multimedia Patent Trust (MPT), an affiliate of Alcatel-Lucent, against end-users of products used in the industries we address. Any such litigation by MPT may be very expensive to defend, and there could be significant financial exposure to each of such customers if MPT is successful in such litigation or in extracting a settlement of such claims. Few of the notices we have received from a customer with respect to its indemnification rights related to the MPT litigation have demanded that we provide a defense for the customer against such claims or litigation, currently reimburse the customer for its costs of such defense, or pay any other specified sum to the customer. At this time, we cannot predict whether the claims by MPT are legitimate or actually cover any of our products, whether any of the claims may result in a settlement or judgment against a customer defendant, or whether we would have liability under our indemnification obligations for defense or settlement costs or damages paid by any customer defendant. In the event one or more of our customers makes an indemnification claim against us with respect to a specific amount of defense or settlement costs or damages it suffers as a result of such MPT claims or litigation, we could be obligated to pay amounts to such customers that would materially and adversely affect our operating results, financial condition and cash flows.

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

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

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

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

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

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

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

- unanticipated costs or delays associated with the acquisition;

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

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

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

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

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

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

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

- the potential loss of key employees of acquired businesses;

- difficulties in the assimilation of different corporate cultures and practices;

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

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

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

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

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

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

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

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

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