

HARMONIC INC  
Form 10-Q  
November 07, 2012  
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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 September 28, 2012**
- 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)

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

**77-0201147**  
(I.R.S. Employer

Identification Number)

**4300 North First Street**

**San Jose, CA 95134**

**(408) 542-2500**

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The number of shares of the registrant's Common Stock, \$.001 par value, outstanding on October 22, 2012 was 115,780,770.

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**Table of Contents****PART I****FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****HARMONIC INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

	<b>September 28, 2012</b>	<b>December 31, 2011</b>
	(In thousands, except par value amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 103,235	\$ 90,983
Short-term investments	88,747	70,854
Accounts receivable, net	94,638	109,886
Inventories	68,269	70,649
Deferred income taxes	29,897	28,032
Prepaid expenses and other current assets	19,178	21,474
<b>Total current assets</b>	<b>403,964</b>	<b>391,878</b>
Property and equipment, net	39,121	40,469
Goodwill	212,523	212,417
Intangibles, net	65,647	87,651
Other assets	2,245	1,751
<b>Total assets</b>	<b>\$ 723,500</b>	<b>\$ 734,166</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 30,915	\$ 30,537
Income taxes payable	1,122	2,290
Deferred revenue	34,660	33,095
Accrued liabilities	39,922	46,896
<b>Total current liabilities</b>	<b>106,619</b>	<b>112,818</b>
Income taxes payable, long-term	46,972	47,307
Deferred income taxes, long-term	4,148	655
Other non-current liabilities	12,453	9,070
<b>Total liabilities</b>	<b>170,192</b>	<b>169,850</b>
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 5,000 shares authorized; no shares issued or outstanding		
Common stock, \$0.001 par value, 150,000 shares authorized; 115,732 and 116,257 shares issued and outstanding at September 28, 2012 and December 31, 2011, respectively	116	116
Capital in excess of par value	2,437,539	2,433,164
Accumulated deficit	(1,883,830)	(1,868,089)
Accumulated other comprehensive loss	(517)	(875)

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Total stockholders' equity	553,308	564,316
Total liabilities and stockholders' equity	\$ 723,500	\$ 734,166

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

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

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except per share amounts)			
Product revenue	\$ 113,769	\$ 121,954	\$ 337,691	\$ 354,977
Service revenue	22,913	16,917	59,346	50,725
Net revenue	136,682	138,871	397,037	405,702
Product cost of revenue	64,927	64,954	193,503	190,188
Service cost of revenue	11,851	9,956	32,390	27,870
Total cost of revenue	76,778	74,910	225,893	218,058
Gross profit	59,904	63,961	171,144	187,644
Operating expenses:				
Research and development	26,524	25,638	79,994	77,449
Selling, general and administrative	32,150	32,254	96,603	98,361
Amortization of intangibles	2,179	2,229	6,548	6,688
Total operating expenses	60,853	60,121	183,145	182,498
Income (loss) from operations	(949)	3,840	(12,001)	5,146
Interest income, net	128	90	363	256
Other income (expense), net	(164)	381	119	(25)
Income (loss) before income taxes	(985)	4,311	(11,519)	5,377
Provision for income taxes	7,245	765	4,222	925
Net income (loss)	\$ (8,230)	\$ 3,546	\$ (15,741)	\$ 4,452
Net income (loss) per share:				
Basic	\$ (0.07)	\$ 0.03	\$ (0.13)	\$ 0.04
Diluted	\$ (0.07)	\$ 0.03	\$ (0.13)	\$ 0.04
Weighted average shares:				
Basic	116,517	115,791	116,946	114,855
Diluted	116,517	116,208	116,946	116,005

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

**Table of Contents****HARMONIC INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(UNAUDITED)**

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands)			
Net income (loss)	\$ (8,230)	\$ 3,546	\$ (15,741)	\$ 4,452
Change in unrealized gain (loss) on investments, net	1	(10)	40	(13)
Foreign currency translation	404	(444)	318	79
Total comprehensive income (loss)	\$ (7,825)	\$ 3,092	\$ (15,383)	\$ 4,518

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

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

	Nine months ended	
	September 28, 2012	September 30, 2011
	(In thousands)	
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ (15,741)	\$ 4,452
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Amortization of intangibles	22,004	22,767
Depreciation	11,337	10,306
Stock-based compensation	14,122	16,099
Net loss (gain) on disposal of fixed assets	(57)	450
Deferred income taxes	1,627	(2,218)
Provision for inventories	2,466	2,757
Allowance for doubtful accounts, returns and discounts	216	2,646
Other non-cash adjustments, net	617	564
<b>Changes in assets and liabilities, net of effect of acquisitions:</b>		
Accounts receivable	15,036	(17,429)
Inventories	(85)	(9,914)
Prepaid expenses and other assets	1,847	7,176
Accounts payable	364	5,117
Deferred revenue	3,307	(9,610)
Income taxes payable	(1,482)	(5,927)
Accrued and other liabilities	(5,352)	(6,847)
<b>Net cash provided by operating activities</b>	<b>50,226</b>	<b>20,389</b>
<b>Cash flows from investing activities:</b>		
Purchases of investments	(94,123)	(76,164)
Proceeds from maturities of investments	44,876	15,522
Proceeds from sales of investments	30,486	18,248
Acquisition of property and equipment	(9,850)	(12,373)
Other acquisitions		(250)
<b>Net cash used in investing activities</b>	<b>(28,611)</b>	<b>(55,017)</b>
<b>Cash flows from financing activities:</b>		
Payments for repurchase of common stock	(14,388)	
Proceeds from issuance of common stock, net	4,922	13,301
<b>Net cash provided by (used in) financing activities</b>	<b>(9,466)</b>	<b>13,301</b>
Effect of exchange rate changes on cash and cash equivalents	103	29
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>12,252</b>	<b>(21,298)</b>
Cash and cash equivalents at beginning of period	90,983	96,533
<b>Cash and cash equivalents at end of period</b>	<b>\$ 103,235</b>	<b>\$ 75,235</b>



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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 (UNAUDITED)**

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

*Basis of Presentation.* The accompanying unaudited condensed consolidated financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. ( Harmonic, or the Company ) considers necessary for a fair statement of the results of operations for the interim periods covered and the consolidated financial condition of the Company at the date of the balance sheets. This Quarterly Report on Form 10-Q should be read in conjunction with the Company's audited consolidated financial statements contained in the Company's Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 29, 2012 ( 2011 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, 2012, 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 2011 Form 10-K. There have been no significant changes to these policies during the nine months ended September 28, 2012.

*Reclassifications.* From time to time the Company reclassifies certain prior period balances to conform to the current year presentation. These reclassifications have no material impact on previously reported total assets, total liabilities, stockholders' equity, results of operations or cash flows.

**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 and early adoption is prohibited. The Company adopted these reporting requirements in the first quarter of 2012. Adoption of these new reporting requirements did not have any impact on the Company because the Company does not hold any assets or liabilities for which fair value is based on Level 3 measurements.

In June 2011, the FASB issued guidance on the presentation of comprehensive income. This guidance requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance eliminates the option to present the components of comprehensive income as part of the statement of changes in shareholders equity. In December 2011, the FASB issued guidance which indefinitely defers the effective date of the requirement to disclose on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income. The guidance must be applied retrospectively, and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. The Company adopted this new guidance in the first quarter of 2012.

In September 2011, the FASB approved an accounting standard update intended to simplify how an entity tests goodwill for impairment. The amendment allows an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step annual goodwill impairment test. An entity is required to perform step one only if the entity determines, based on a qualitative assessment, that it is more likely than not that its fair value is less than its carrying amount. This update is applicable to the Company's annual goodwill impairment test performed

in the fourth quarter each year.

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In July 2012, the FASB issued Accounting Standard Update 2012-2, Intangibles - Goodwill and Other , which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived asset is impaired for determining whether it is necessary to perform the quantitative impairment test. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. Early adoption is permitted. Application of this new guidance is not expected to have any impact on the Company because it does not hold any indefinite-lived assets.

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**NOTE 3: ACQUISITIONS**

On September 15, 2010, Harmonic completed its acquisition of Omneon, Inc, at which time the holders of Omneon capital stock, including outstanding Omneon stock options and restricted stock units, were entitled to receive aggregate consideration of approximately \$194.0 million in cash and up to 17,128,176 shares of Harmonic common stock. To secure post-closing indemnification obligations of the holders of Omneon capital stock and vested and outstanding Omneon stock options and vested restricted stock units, Harmonic deposited into escrow an aggregate of approximately \$21.0 million in cash and 1,926,920 shares of Harmonic common stock that would otherwise be issued to the holders of Omneon capital stock and vested and outstanding Omneon stock options and vested restricted stock units. In the first quarter of 2012, the Company submitted an indemnification claim for reimbursement from escrow and received reimbursement of \$0.8 million, including \$0.5 million of cash and 40,372 shares of common stock valued at \$0.3 million. The return of shares was reflected as a reduction in common stock and additional paid-in-capital. The reimbursement was for previously expensed legal and tax costs incurred by the Company following the date of acquisition. The indemnification period ended on March 15, 2012, and the cash and shares remaining in escrow were distributed to the holders of Omneon capital stock.

**NOTE 4: FAIR VALUE**

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

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

The Company uses the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. During the nine months ended September 28, 2012, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.

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The following table sets forth the fair value of the Company's financial assets and liabilities measured at fair value on a recurring basis as of September 28, 2012 and December 31, 2011, based on the three-tier fair value hierarchy:

	Total	Level 1	Level 2	Level 3
	(In thousands)			
<b>September 28, 2012</b>				
<b>Cash equivalents</b>				
Money market funds	\$ 61,481	\$ 61,481	\$	\$
<b>Short-term investments</b>				
Certificate of deposit	1,601		1,601	
State, municipal and local government agencies bonds	47,730		47,730	
Corporate bonds	27,026		27,026	
Commercial paper	10,388		10,388	
U.S. federal government bonds	2,002	2,002		
<b>Prepaids and other current assets</b>				
Foreign exchange forward contracts	142		142	
Total assets measured and recorded at fair value	\$ 150,370	\$ 63,483	\$ 86,887	\$
<b>Accrued liabilities</b>				
Foreign exchange forward contracts	\$ 496	\$	\$ 496	\$
Total liabilities measured and recorded at fair value	\$ 496	\$	\$ 496	\$
	Total	Level 1	Level 2	Level 3
	(In thousands)			
<b>December 31, 2011</b>				
<b>Cash equivalents</b>				
Money market funds	\$ 62,131	\$ 62,131	\$	\$
<b>Short-term investments</b>				
State, municipal and local government agencies bonds	38,825		38,825	
Corporate bonds	18,604		18,604	
Commercial paper	4,195		4,195	
U.S. federal government bonds	9,230	9,230		
<b>Prepaids and other current assets</b>				
Foreign exchange forward contracts	373		373	
Total assets measured and recorded at fair value	\$ 133,358	\$ 71,361	\$ 61,997	\$
<b>Accrued liabilities</b>				
Foreign exchange forward contracts	\$ 159	\$	\$ 159	\$
Total liabilities measured and recorded at fair value	\$ 159	\$	\$ 159	\$

At September 28, 2012 and December 31, 2011, maturities of short-term investments are as follows:

September 28, 2012      December 31, 2011  
(In thousands)

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<b>Short-term investments:</b>			
Less than one year	\$ 69,995	\$	43,470
Due in 1 2 years	18,752		27,384
Total short-term investments	\$ 88,747	\$	70,854

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The following is a summary of available-for-sale securities at September 28, 2012 and December 31, 2011:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
	(In thousands)			
<b>September 28, 2012</b>				
Certificate of deposit	\$ 1,601	\$	\$	\$ 1,601
State, municipal and local government agencies bonds	47,672	61	(3)	47,730
Corporate bonds	27,020	11	(5)	27,026
Commercial paper	10,387	1		10,388
U.S. federal government bonds	2,001	1		2,002
<b>Total</b>	<b>\$ 88,681</b>	<b>\$ 74</b>	<b>\$ (8)</b>	<b>\$ 88,747</b>
<b>December 31, 2011</b>				
State, municipal and local government agencies bonds	\$ 38,785	\$ 46	\$ (6)	\$ 38,825
Corporate bonds	18,613	6	(15)	18,604
Commercial paper	4,195			4,195
U.S. federal government bonds	9,226	4		9,230
<b>Total</b>	<b>\$ 70,819</b>	<b>\$ 56</b>	<b>\$ (21)</b>	<b>\$ 70,854</b>

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. A decline of fair value below amortized costs of debt securities is considered other-than temporary if the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of the entire amortized cost basis. At the present time, the Company does not intend to sell its investments that have unrealized losses in accumulated other comprehensive loss. In addition, the Company does not believe that it is more likely than not that it will be required to sell its investments that have unrealized losses in accumulated other comprehensive loss before the Company recovers the principal amounts invested. The Company believes that the unrealized losses are temporary and do not require an other-than-temporary impairment, based on its evaluation of available evidence as of September 28, 2012.

As of September 28, 2012, 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: BALANCE SHEET**

	September 28, 2012	December 31, 2011
	(In thousands)	
<b>Accounts receivable</b>		
Accounts receivable	\$ 103,150	\$ 118,138
Less: allowances for doubtful accounts, returns and discounts	(8,512)	(8,252)
	\$ 94,638	\$ 109,886

As of September 28, 2012, no customer accounted for more than 10% of net accounts receivable.





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	September 28, 2012	December 31, 2011
	(In thousands)	
<b>Inventories:</b>		
Raw materials	\$ 10,708	\$ 14,099
Work-in-process	5,182	4,250
Finished goods	52,379	52,300
	\$ 68,269	\$ 70,649
<b>Property and equipment:</b>		
Furniture and fixtures	\$ 7,548	\$ 6,706
Machinery and equipment	105,865	97,916
Leasehold improvements	7,584	7,079
	120,997	111,701
Less: accumulated depreciation and amortization	(81,876)	(71,232)
	\$ 39,121	\$ 40,469

**NOTE 6: GOODWILL AND IDENTIFIED INTANGIBLES**

The following is a summary of identified intangible assets as of September 28, 2012 and December 31, 2011:

	September 28, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)					
<b>Identifiable intangibles:</b>						
Existing and core technology	\$ 136,145	\$ (97,406)	\$ 38,739	\$ 136,145	\$ (81,951)	\$ 54,194
Customer relationships/contracts	67,098	(46,661)	20,437	67,098	(42,142)	24,956
Trademarks and tradenames	11,361	(8,790)	2,571	11,361	(7,700)	3,661
Supply agreements	3,414	(3,414)		3,414	(3,414)	
Maintenance agreements and related relationships	7,100	(3,200)	3,900	7,100	(2,260)	4,840
Software license, intellectual property and assembled workforce	309	(309)		309	(309)	
Order backlog	2,800	(2,800)		2,800	(2,800)	
<b>Total of identifiable intangibles</b>	<b>\$ 228,227</b>	<b>\$ (162,580)</b>	<b>\$ 65,647</b>	<b>\$ 228,227</b>	<b>\$ (140,576)</b>	<b>\$ 87,651</b>

Amortization expense for the identifiable purchased intangible assets for the three months and nine months ended September 28, 2012 and September 30, 2011 was allocated as follows:

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands)			
Included in cost of revenue	\$ 5,048	\$ 5,446	\$ 15,456	\$ 16,079
Included in operating expenses	2,179	2,229	6,548	6,688
<b>Total amortization expense</b>	<b>\$ 7,227</b>	<b>\$ 7,675</b>	<b>\$ 22,004</b>	<b>\$ 22,767</b>



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

	Cost of Revenue	Operating Expenses (In thousands)	Total
<b>Years ending December 31,</b>			
2012 (remaining 3 months)	\$ 5,048	\$ 2,157	\$ 7,205
2013	19,232	8,096	27,328
2014	13,745	6,775	20,520
2015	714	5,783	6,497
2016		4,097	4,097
<b>Total</b>	<b>\$ 38,739</b>	<b>\$ 26,908</b>	<b>\$ 65,647</b>

The changes in the carrying amount of goodwill for the nine months ended September 28, 2012 are as follows:

	(In thousands)
Balance at beginning of period	\$ 212,417
Foreign currency translation adjustment	106
<b>Balance at end of period</b>	<b>\$ 212,523</b>

**NOTE 7: RESTRUCTURING AND EXCESS FACILITIES**

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 September 28, 2012, accrued excess facilities costs totaled \$1.3 million, all of which was included in current accrued liabilities.

The following table summarizes the activity in the restructuring accrual during the nine months ended September 28, 2012:

	Excess Facilities (In thousands)
Balance at December 31, 2011	\$ 2,593
Provisions	
Cash payments	(1,290)
<b>Balance at September 28, 2012</b>	<b>\$ 1,303</b>

**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 and matures on August 23, 2013. As of September 28, 2012, other than standby letters of credit and guarantees (Note 13), there were no amounts outstanding under the line of credit facility, and there were no borrowings during the nine months ended September 28, 2012. This facility, which became

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effective in August 2011 and was amended in August 2012, contains a financial covenant that requires Harmonic to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of September 28, 2012, the Company's ratio under that covenant was 3.98 to 1. In the event of noncompliance by Harmonic with the covenants under the facility, including the financial covenant referenced above, Silicon Valley Bank would be entitled to exercise its remedies under the facility, including declaring all obligations immediately due and payable. At September 28, 2012, Harmonic was in compliance with the covenants under the line of credit facility. Borrowings pursuant to the line would bear interest at the bank's prime rate (3.25% at September 28, 2012) or at LIBOR for the desired borrowing period (an annualized rate of 0.21% for a one month borrowing period at September 28, 2012) plus 1.75%, or 1.96%. Borrowings are not collateralized.

**Table of Contents****NOTE 9: BENEFIT PLANS**

Harmonic grants stock options and restricted stock units ( RSUs ) pursuant to stockholder approved equity incentive plans. These equity incentive plans are described in further detail in Note 13, Benefit Plans, of Notes to Consolidated Financial Statements in the 2011 Form 10-K.

**Stock Options and RSUs**

The following table summarizes the Company's stock option and restricted stock unit activity during the nine months ended September 28, 2012:

	Stock Options Outstanding			Restricted Stock Units Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Number of Units	Weighted Average Grant Date Fair Value
	(In thousands, except per share amounts)				
Balance at December 31, 2011	7,835	9,303	\$ 7.12	3,713	\$ 7.52
Authorized	5,450				
Granted	(4,969)	1,246	5.63	2,482	5.74
Options exercised		(208)	2.83		
Shares released				(1,373)	7.51
Forfeited or cancelled	1,669	(1,298)	8.78	(490)	6.67
Balance at September 28, 2012	9,985	9,043	\$ 6.78	4,332	\$ 6.48

The following table summarizes information about stock options outstanding as of September 28, 2012:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
	(In thousands, except per share amounts and term)			
Vested and expected to vest	8,876	\$ 6.78	3.5	\$ 2,105
Exercisable	6,689	6.99	2.7	1,587

The intrinsic value of options vested and expected to vest and exercisable as of September 28, 2012 is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of September 28, 2012. The intrinsic value of options exercised during the three and nine months ended September 28, 2012 was \$0.1 million and \$0.6 million, respectively, and is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of the exercise date.

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The following table summarizes information about restricted stock units outstanding as of September 28, 2012:

	<b>Number of Shares Underlying Restricted Stock Units</b>	<b>Weighted Average Remaining Vesting Period (Years)</b>	<b>Aggregate Fair Value (1)</b>
	(In thousands, except period)		
Vested and expected to vest	4,003	1.3	\$ 18,173

- (1) Represents the fair value of the Company's common stock as of September 28, 2012, times the number of restricted stock units vested and expected to vest as of the same date.

**Table of Contents****NOTE 10: STOCK-BASED COMPENSATION**

The following table summarizes stock-based compensation costs in our Statements of Operations for the three and nine months ended September 28, 2012 and September 30, 2011:

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands)			
<b>Stock-based compensation in:</b>				
Cost of revenue	\$ 702	\$ 843	\$ 2,301	\$ 2,352
Research and development expense	1,512	1,658	4,947	5,265
Selling, general and administrative expense	2,406	2,504	6,874	8,482
<b>Total stock-based compensation in operating expense</b>	<b>3,918</b>	<b>4,162</b>	<b>11,821</b>	<b>13,747</b>
<b>Total stock-based compensation</b>	<b>\$ 4,620</b>	<b>\$ 5,005</b>	<b>\$ 14,122</b>	<b>\$ 16,099</b>

**Stock Options**

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

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Expected term (years)	4.70	4.75	4.70	4.75
Volatility	54%	53%	56%	54%
Risk-free interest rate	0.7%	1.2%	0.9%	2.0%
Expected dividends	0.0%	0.0%	0.0%	0.0%

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

*Volatility.* The Company uses its historical volatility for a period equivalent to the expected term of the options to estimate the expected volatility.

*Risk-free interest rate.* The risk-free interest rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term.

*Expected dividends.* The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future and, therefore, used an expected dividend yield of zero in the valuation model.

The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records stock-based compensation expense only for those awards that are expected to vest. All stock-based awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. The Company's estimated forfeiture rate was 6% for both the three and nine months ended September 28, 2012. The Company's estimated forfeiture rate was 5% for both the three and nine months ended September 30, 2011.



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The weighted-average fair value of options granted for the three months ended September 28, 2012 and September 30, 2011 was \$1.89 and \$2.17 per share, respectively. The weighted-average fair value of options granted for the nine months ended September 28, 2012 and September 30, 2011 was \$2.66 and \$4.31 per share, respectively.

The fair value of all stock options vested during the three and nine months ended September 28, 2012 was \$0.8 million and \$3.8 million, respectively. The fair value of all stock options vested during the three and nine months ended September 28, 2011 was \$1.4 million and \$4.3 million, respectively.

**Table of Contents****Restricted Stock Units**

The fair value of RSUs is equal to the fair value of the Company's common stock on the date of grant.

The fair value of all restricted stock units issued during the three months ended September 28, 2012 and September 30, 2011 was \$2.6 million and \$1.9 million, respectively. The fair value of all restricted stock units issued during the nine months ended September 28, 2012 and September 30, 2011 was \$10.3 million and \$7.6 million, respectively.

**Employee Stock Purchase Plan**

The value of the stock purchase rights under the Company's Employee Stock Purchase Plan (ESPP) consists of: (1) the 15% discount on the purchase of the stock; (2) 85% of the fair value of the call option; and (3) 15% of the fair value of the put option. The call option and put option were valued using the Black-Scholes option pricing model with the following assumptions:

	Purchase Period Ending		Purchase Period Ending	
	June 30, 2012	December 31, 2012	June 30, 2011	December 31, 2011
Expected term (years)	0.5	0.5	0.5	0.5
Volatility	53%	46%	43%	46%
Risk-free interest rate	0.2%	0.2%	0.2%	0.1%
Expected dividends	0.0%	0.0%	0.0%	0.0%

*Expected term.* The expected term represents the period of time from the beginning of the offering period to the purchase date.

*Volatility.* The Company uses its historical volatility for a period equivalent to the expected term of the options to estimate the expected volatility.

*Risk-free interest rate.* The risk-free interest rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term.

*Expected dividends.* The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future and, therefore, used an expected dividend yield of zero in the valuation model.

The fair value of stock purchase rights granted under the ESPP for the purchase period ending June 30, 2012 and 2011, was \$1.51 and \$2.30, respectively. The fair value of stock purchase rights granted under the ESPP for the purchase period ending December 31, 2012 and 2011, was \$1.19 and \$2.09, respectively.

As of September 28, 2012, there was \$0.5 million of unrecognized stock-based compensation expense for stock purchase rights that will be recognized over the remaining offering period, through December 31, 2012.

**Unrecognized Stock-Based Compensation**

As of September 28, 2012, total unamortized stock-based compensation cost related to unvested stock options and restricted stock units was \$32.1 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.5 years.

**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 estimates the annual impact of certain factors, including projections of the Company's annual earnings, taxing jurisdictions in which the earnings will be generated, state and local income taxes, the Company's ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition

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to, or reduction from, the income tax provision, rather than being included in the estimated annual effective income tax rate.

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For the three months ended September 28, 2012, the Company recorded a provision for income taxes of \$7.2 million, compared to a provision of \$0.8 million for the same period a year ago, inclusive of discrete items. The increase in the provision for income taxes in the three months ended September 28, 2012, compared to the provision for income taxes in the same period in 2011, was primarily attributable to a change in forecasted income for 2012, which caused a reduction of the benefit associated with the foreign rate differential during the three months ended September 28, 2012.

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For the nine months ended September 28, 2012, the Company recorded a provision for income taxes of \$4.2 million, compared to a provision of \$0.9 million for the same period a year ago, inclusive of discrete items. The increase in the provision for income taxes in the nine months ended September 28, 2012, compared to the provision for income taxes in the same period in 2011, was primarily attributable to the expiration of U.S. Federal research and development tax credits, a change in forecasted income for 2012, which caused a reduction of the benefit associated with the foreign rate differential, and an increase in the valuation allowance on California research and development tax credits during the nine months ended September 28, 2012.

For the nine months ended September 28, 2012, 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 the net of various discrete items, the differential in foreign tax rates, non-deductible stock-based compensation expense and non-deductible amortization on foreign intangibles. The discrete items recorded in the first nine months of 2012 primarily related to the increase in the valuation allowance on California research and development tax credits, a benefit associated with the reversal of previously provided foreign income taxes due to statute of limitation expirations and accrued interest on uncertain tax positions.

For the nine months ended September 30, 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 first nine months of 2011 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.

The Company files U.S., state and foreign income tax returns in jurisdictions with varying statute of limitations periods, during which such tax returns may be audited and adjusted by the relevant tax authorities. The Company's 2007 through 2011 tax years generally remain subject to examination by federal and most state tax authorities. In significant foreign jurisdictions, the Company's 2005 through 2011 tax years generally remain subject to examination by their respective tax authorities. A subsidiary of the Company is under audit by the Israel tax authority for the years 2007 through 2010. The Company is currently under audit by the IRS for the 2007, 2008, 2009 and 2010 tax years. In addition, the statute of limitations on the Company's 2007 and 2008 U.S. corporate income tax returns has been extended to 2013.

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 \$57.7 million as of December 31, 2011, and approximately \$57.4 million as of September 28, 2012. If all of these unrecognized tax benefits were recognized, the entire amount would impact the provision for income taxes. The unrecognized tax benefits may decrease by approximately \$1.6 million in the 12 months beginning September 29, 2012, due to certain statute of limitation expirations.

The Company recognizes interest and possible penalties related to uncertain tax positions in income tax expense. During the nine months ended September 28, 2012, the Company recorded a net increase of \$0.6 million for interest and possible penalties related to uncertain tax positions, resulting in a balance at September 28, 2012 of \$5.8 million.

**NOTE 12: NET INCOME (LOSS) PER SHARE**

Basic net income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders for the period by the weighted average number of 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 (loss) per share computations because their effect was antidilutive:

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands)			
Potentially dilutive equity awards outstanding	13,608	11,555	13,382	13,412

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

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except per share amounts)			
Net income (loss) (numerator)	\$ (8,230)	\$ 3,546	\$ (15,741)	\$ 4,452
Shares calculation (denominator):				
Weighted average shares outstanding - basic	116,517	115,791	116,946	114,855
Effect of Dilutive Securities:				
Potential common stock relating to stock options, restricted stock units and ESPP		417		1,150
Weighted averages shares outstanding - diluted	116,517	116,208	116,946	116,005
Net income (loss) per share - basic	\$ (0.07)	\$ 0.03	\$ (0.13)	\$ 0.04
Net income (loss) per share - diluted	\$ (0.07)	\$ 0.03	\$ (0.13)	\$ 0.04

**NOTE 13: COMMITMENTS AND CONTINGENCIES**

*Leases.* Future minimum lease payments under noncancelable operating leases at September 28, 2012 are as follows:

	(In thousands)
<b>Years ending December 31,</b>	
2012 (remaining three months)	\$ 2,536
2013	8,138
2014	6,858
2015	6,755
2016	6,808
Thereafter	26,686
Total	\$ 57,781

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

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands)			
Balance at beginning of period	\$ 4,725	\$ 5,578	\$ 5,558	\$ 4,811
Accrual for current period warranties	1,314	1,990	4,407	6,423
Warranty costs incurred	(1,677)	(1,963)	(5,603)	(5,629)
Balance at end of period	\$ 4,362	\$ 5,605	\$ 4,362	\$ 5,605

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*Purchase Commitments with Contract Manufacturers and Other Suppliers.* The Company relies on a limited number of contract manufacturers and suppliers to provide manufacturing services for a substantial majority of its products. In addition, some components, sub-assemblies and modules are obtained from a sole supplier or limited group of suppliers. During the normal course of business, in order to reduce manufacturing lead times and ensure adequate component supply, the Company enters into agreements with certain contract manufacturers and suppliers that allow them to procure inventory based upon criteria as defined by the Company. The Company had approximately \$21.7 million of non-cancelable purchase commitments with contract manufacturers and other suppliers as of September 28, 2012.

*Standby Letters of Credit.* As of September 28, 2012, the Company's financial guarantees consisted of standby letters of credit outstanding, which were principally related to performance bonds and state requirements imposed on employers. The maximum amount of potential future payments under these arrangements was \$0.9 million.

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*Indemnification.* Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and most of its customers for specified intellectual property matters pursuant to certain contractual arrangements, subject to certain limitations. The scope of these indemnities varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorneys' fees). There have been no amounts accrued in respect of these indemnification provisions through September 28, 2012.

*Guarantees.* At September 28, 2012, Harmonic had no other guarantees outstanding.

*Legal proceedings.*

In October 2011, Avid Technology, Inc. (Avid) filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic's Omneon Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint alleging that Harmonic's Omneon Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages. At this time, the Company cannot predict the outcome of these matters. An unfavorable outcome of these matters could materially and adversely affect the Company's business, operating results, financial position and cash flows.

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 were seeking damages in the amount of 6,300,000 ILS (approximately \$1.7 million). On June 26, 2012, the action was dismissed by the Israeli Central District Court.

An unfavorable outcome on the Avid matters referenced above or any other litigation matter could require that Harmonic pay substantial damages, or, in connection with any intellectual property infringement claims, could require that the Company pay ongoing royalty payments or could prevent the Company from selling certain of its products. As a result, a settlement of, or an unfavorable outcome on, any of the Avid matters referenced above 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.

**NOTE 14: STOCK REPURCHASE PROGRAM**

On April 24, 2012, the Board of Directors (Board) approved a stock repurchase program that provides for the repurchase of up to \$25.0 million of the Company's outstanding common stock during the term of the program, which expires 18 months from Board approval. Under the program, the Company may purchase shares of common stock through open market transactions at prices deemed appropriate by management, subject to certain pre-determined price/volume guidelines set, from time to time, by the Board. The timing and amount of repurchase transactions under this program depend on a variety of factors, including price, corporate and regulatory requirements, strategic priorities and other market conditions. The purchases are funded from available working capital. The stock repurchase program may be suspended or discontinued at any time. A summary of the stock repurchase activity under the stock repurchase program, reported based on the trade date, is as follows:

	Shares Repurchased	Weighted Average Price per Share	Amount Repurchased
	(In thousands, except per share amounts)		
Common stock repurchased	3,246	\$ 4.43	\$ 14,388

As of September 28, 2012, \$10.6 million remains available for the repurchase of shares under the stock repurchase program. The Company charges the excess of cost over par value for the repurchase of its common stock to additional paid-in capital. The common stock repurchased was immediately retired.





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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 ( Form 10-Q ), refer to Harmonic and its subsidiaries and its predecessors as a combined entity, except where the context requires otherwise.

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

developing trends and technological changes in the markets we serve;

continuation of customer concentration;

spending of our customers, particularly in Europe for the remainder of 2012 and beyond;

impact of natural disasters on our supply chain and customers;

our strategic direction, future business plans and growth strategy;

expectation of, and dependence on, international revenue, particularly from Europe;

dependence on contract manufacturers and our distribution channels;

threat of terrorism, social and political instability and tensions among countries;

industry and customer consolidation and the related effect on capital spending by our customers;

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

need to develop timely new and enhanced products;

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

concentration of revenue sources;

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anticipated benefits of recent acquisitions and potential future acquisitions;

statements regarding anticipated results of potential or actual litigation;

our competitive environment;

fluctuations in our operating results and possible fluctuations in our tax rates;

the impact of governmental regulation;

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

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

These statements are subject to known and unknown risks, uncertainties and other factors, any of which may cause our actual results to differ materially from those implied by the forward-looking statements. Important factors that may cause actual results to differ from expectations include those discussed in **Risk Factors** beginning on page 33 of this Form 10-Q. All forward-looking statements included in this Form 10-Q are based on information available to us on the date thereof, and we assume no obligation to update any such forward-looking statements.

### **Overview**

We design, manufacture and sell versatile and high performance video infrastructure products and system solutions. We enable our customers to efficiently create, prepare and deliver a full range of video services to consumer devices, including televisions, personal computers, tablets and mobile phones. Our products generally fall into three principal categories; video production platforms and playout solutions, video processing solutions and edge and access solutions. We also provide technical support services and professional services to our customers worldwide.

The principal markets we serve are cable television, direct broadcast satellite system companies, telecommunications companies, or **telcos**, broadcasters and media companies, as well as, more recently, the emerging streaming media providers, that create video

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programming or offer video-based infrastructure. 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. Sales to our ten largest customers in the three and nine months ended September 28, 2012 accounted for approximately 41% and 36% of our revenue, compared to 45% and 37%, respectively, for the same periods in 2011.

Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration. During the three and nine months ended September 28, 2012, revenue from Comcast accounted for 13% and 14%, respectively, of our revenue, compared to 12% and 11% in the same periods in 2011. 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 the three and nine months ended September 28, 2012, we recognized revenue of \$137 million and \$397 million, respectively, as compared to \$139 million and \$406 million, respectively, in the same periods in 2011. Our international sales, which had been growing at a faster pace than our domestic sales in prior periods, increased by 13% in the three months ended September 28, 2012, but decreased by 2% in the nine months ended September 28, 2012, as compared to the same periods in 2011. Domestic sales decreased by 17% and 2%, respectively in the three and nine months ended September 28, 2012, as compared to the same periods in 2011. In the three and nine months ended September 28, 2012, international sales represented 58% and 55%, respectively, of our total revenue, as compared to 51% and 55% of our total revenue in the same periods in 2011, respectively. Notwithstanding the substantially reduced market activity in Europe that we experienced in the first three quarters of 2012, as compared to the fourth quarter of 2011, we expect that international sales will continue to account for a significant portion of our net revenue for the foreseeable future, and expect that, due to sales to emerging markets in particular, our international revenue may increase as a percentage of our total net revenue from year to year.

Historically, our revenue has been dependent upon capital spending in the cable, satellite, telco and broadcast industries. More recently, we also have derived revenue from media companies, including streaming media providers. Industry consolidation has in the past constrained, and may in the future constrain, capital spending by our customers. If our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of customers in the markets on which we focus, our revenue may decline. As we attempt to further diversify our customer base in these markets, we may need to continue to build alliances with other equipment manufacturers and content providers, adapt our products for new applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the media market, which could result in higher operating costs. Implementation issues with our products or those of other vendors have caused, and may continue to cause, delays in project completion for our customers and delay our recognition of revenue.

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

Financial difficulties of certain of our customers and changes in our customers' deployment plans have adversely affected our business in the past. In 2009 and 2010, 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 the second half of 2010 and the first half of 2011, economic growth appears to have become sluggish in some geographies since the middle of 2011, and weak in other geographies, particularly in Europe, since the beginning of 2012. Further, economic growth is expected to be sluggish in some geographies, and weak in Europe, during the balance of 2012 and perhaps beyond. If an economic downturn occurs, customers in the affected geographies may delay or reduce capital expenditures, which, in turn, often results in lower demand for our products.

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**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

There have been no material changes to our critical accounting policies, judgments and estimates during the nine months ended September 28, 2012, from those disclosed in our 2011 Form 10-K other than those associated with goodwill impairment, noted below.

*Goodwill Impairment*

The Company tests for impairment of goodwill on an annual basis in the fourth quarter of its fiscal years at the Company level, which is the sole reporting unit, and at any other time at which events occur or circumstances indicate that the carrying amount of goodwill may exceed its estimated fair value. As of June 29, 2012, with a closing stock price of \$4.26 on the NASDAQ Stock Market, the Company's market capitalization was approximately \$495 million. As this market capitalization was less than the Company's carrying value of its net assets, further analysis was performed to determine if an impairment existed. When assessing goodwill for impairment, the Company used multiple valuation methodologies to determine its estimated fair value. The valuation methods used included the Company's market capitalization adjusted for a control premium and the Company's discounted cash flow analysis, which involves making significant assumptions and estimates, including expectations of the Company's future financial performance, the Company's weighted average cost of capital and the Company's interpretation of currently enacted tax laws. Based on the impairment test performed, management determined that the Company's estimated fair value exceeded the carrying value of its net assets by approximately 18%, and goodwill was not impaired, as of June 29, 2012. As of September 28, 2012, the closing stock price on the NASDAQ Stock Market was \$4.54 and the Company's market capitalization was approximately \$525 million. Based on the increase in the Company's stock price at September 28, 2012, as compared to the stock price at the end of the second quarter of 2012, together with the results of the impairment test performed as of June 29, 2012, we concluded that there was no triggering event during the third quarter of 2012 that would require further assessment of a potential impairment of our goodwill.

As noted above, assessing the fair value of goodwill includes, among other things, making key assumptions for estimating future financial performance and an appropriate control premium and discount rate. These assumptions are subject to a high degree of judgment and complexity. We make every effort to estimate future financial performance as accurately as possible with the information available at the time the estimate is developed. However, any change in the assumptions and estimates may affect the estimated fair value of goodwill and could result in an impairment charge in a future period.

In the event the market price of the Company's common stock declines substantially from its price at September 28, 2012 for an extended period of time, the Company may determine that its goodwill is impaired. If such determination is made, the Company would be required to write down all or a portion of such goodwill, which could result in a material non-cash charge to results of operations in the period in which such write-down occurs.

**RESULTS OF OPERATIONS**

**Net Revenue**

*Net Revenue by Product Line*

Harmonic's consolidated net revenue, by product line, for the three and nine months ended September 28, 2012, compared to the same periods of 2011, are presented in the table below. Also presented are the related dollar and percentage change in consolidated net revenue, by product line, in the three and nine months ended September 28, 2012, as compared to the same periods of 2011.

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	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
<b>Revenue by type:</b>				
Video processing products	\$ 49,899	\$ 57,027	\$ 161,880	\$ 172,310
Production and playout products	23,786	26,619	65,327	73,005
Edge and access products	40,084	38,308	110,484	109,662
Service and support	22,913	16,917	59,346	50,725
Net revenue	\$ 136,682	\$ 138,871	\$ 397,037	\$ 405,702
<b>Increase (Decrease):</b>				
Video processing products	\$ (7,128)		\$ (10,430)	
Production and playout products	(2,833)		(7,678)	
Edge and access products	1,776		822	
Service and support	5,996		8,621	
Total decrease	\$ (2,189)		\$ (8,665)	
<b>Percent change:</b>				
Video processing products	(12)%		(6)%	
Production and playout products	(11)		(11)	
Edge and access products	5		1	
Service and support	35		17	
Total percent change	(2)%		(2)%	

The decrease in net revenue in the three and nine months ended September 28, 2012, compared to the same periods of 2011, was primarily due to a reduction in demand for video processing products and production and playout products, primarily in the U.S. and EMEA, offset, in part, by an increase in demand for edge products and an increase in service and support revenue.

*Net Revenue by Geographic Region*

Harmonic's domestic and international net revenue in the three and nine months ended September 28, 2012, compared with the corresponding periods in 2011, are presented in the table below. Also presented are the related dollar and percentage change in domestic and international net revenue in the three and nine months ended September 28, 2012, from the corresponding periods in 2011.

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
<b>Net revenue:</b>				
United States	\$ 57,357	\$ 68,718	\$ 179,558	\$ 183,250
International	79,325	70,153	217,479	222,452
Total	\$ 136,682	\$ 138,871	\$ 397,037	\$ 405,702
<b>Increase (Decrease):</b>				
United States	\$ (11,361)		\$ (3,692)	
International	9,172		(4,973)	
Total decrease	\$ (2,189)		\$ (8,665)	
<b>Percent change:</b>				
United States	(17)%		(2)%	

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International	13	(2)
Total percent change	(2)%	(2)%

The decrease in U.S. net revenue in the three and nine months ended September 28, 2012, compared to the corresponding periods in 2011, was principally due to decreased demand for our video processing products.

International net revenue in the three months ended September 28, 2012 increased, compared to the corresponding period in 2011, primarily due to increased demand from customers in Asia Pacific, offset by a decreased demand in EMEA, particularly Europe.

International net revenue in the nine months ended September 28, 2012 decreased, compared to the corresponding period in 2011, primarily due to decreased demand in EMEA across all product lines, particularly in Europe, offset by increased demand in Asia Pacific. We expect that international sales will continue to account for a significant percentage of our net revenue for the foreseeable future.

**Table of Contents***Gross Profit*

Harmonic's gross profit and gross profit as a percentage of net revenue in the three and nine months ended September 28, 2012, as compared to the corresponding periods in 2011, are presented in the table below. Also presented are the related dollar and percentage changes in gross profit in the three and nine months ended September 28, 2012, from the corresponding periods in 2011.

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
Gross profit	\$ 59,904	\$ 63,961	\$ 171,144	\$ 187,644
As a percentage of net revenue	44%	46%	43%	46%
Decrease	\$ (4,057)		\$ (16,500)	
Percent change	(6)%		(9)%	

The decrease in gross profit in the three and nine months ended September 28, 2012, as compared to the corresponding periods in 2011, was primarily due to a change in product mix, the continuing competitive pricing environment, and, to a lesser extent, the decrease in net revenue.

In the three and nine months ended September 28, 2012, \$5.0 million and \$15.4 million of amortization of intangibles was included in cost of revenue, respectively, compared to \$5.4 million and \$16.1 million in the three and nine months ended September 28, 2011, respectively. We expect to record approximately \$5.0 million in amortization of intangibles expenses in cost of revenue in the remaining three months of 2012, primarily related to intangible assets acquired in connection with the acquisition of Omneon in 2010 and, to a lesser extent, the acquisition of Scopus in 2009.

*Research and Development*

Harmonic's research and development expense and the expense as a percentage of net revenue in the three and nine months ended September 28, 2012, as compared with the corresponding periods of 2011, are presented in the table below. Also presented are the related dollar and percentage changes in research and development expense in the three and nine months ended September 28, 2012, from the corresponding periods of 2011.

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
Research and development	\$ 26,524	\$ 25,638	\$ 79,994	\$ 77,449
As a percentage of net revenue	19%	18%	20%	19%
Increase (decrease)	\$ 886		\$ 2,545	
Percent change	3%		3%	

The increase of \$0.9 million in research and development expense in the three months ended September 28, 2012, compared to the corresponding period in 2011, was primarily the result of an increase in outside engineering services related to the development of new products.

The increase in research and development expense in the nine months ended September 28, 2012, compared to the corresponding period in 2011, was primarily the result of increased compensation expense of \$1.4 million and increased expense for development materials of \$1.0 million. The increase in compensation expense was primarily due to increased headcount and an increase in the cost of employee benefits.

*Selling, General and Administrative*

Harmonic's selling, general and administrative expense, and the expense as a percentage of net revenue in the three and nine months ended September 28, 2012, as compared with the corresponding periods of 2011, are presented in the table below. Also presented are the related dollar and percentage change in selling, general and administrative expense in the three and nine months ended September 28, 2012, from the corresponding periods of 2011.





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	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
Selling, general and administrative	\$ 32,150	\$ 32,254	\$ 96,603	\$ 98,361
As a percentage of net revenue	24%	23%	24%	24%
Decrease	\$ (104)		\$ (1,758)	
Percent change	(0)%		(2)%	

Selling, general and administrative expenses for the three months ended September 28, 2012, compared to the corresponding period of 2011, remained relatively flat.

The decrease in selling, general and administrative expense in the nine months ended September 28, 2012, compared to the corresponding periods in 2011, was primarily a result of decreased stock-based compensation expense of \$1.6 million, other compensation costs of \$0.5 million and outside commission expense of \$0.8 million, offset by increases in consulting costs of \$0.7 million and depreciation of \$0.7 million.

*Amortization of Intangibles*

Harmonic's amortization of intangible assets charged to operating expenses, and the amortization of intangible assets as a percentage of net revenue, in the three and nine months ended September 28, 2012, as compared with the corresponding periods of 2011, are presented in the table below. Also presented are the related dollar and percentage changes in amortization of intangible assets in the three and nine months ended September 28, 2012, from the corresponding periods of 2011.

	Three months ended		Nine months ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
	(In thousands, except percentages)			
Amortization of intangibles	\$ 2,179	\$ 2,229	\$ 6,548	\$ 6,688
As a percentage of net revenue	2%	2%	2%	2%
Decrease	\$ (50)		\$ (140)	
Percent change	(2)%		(2)%	

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The decrease in amortization of intangibles expense in the three and nine months ended September 28, 2012, compared to the corresponding periods in 2011, was primarily due to certain purchased intangible assets becoming fully amortized. Harmonic expects to record a total of approximately \$2.2 million in amortization of intangibles expense in operating expenses in the remaining three months of 2012, primarily resulting from the acquisition of Omneon in 2010 and, to a lesser extent, the acquisition of Scopus in 2009.

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

	<b>Cost of Revenue</b>	<b>Operating Expenses</b>	<b>Total</b>
	(In thousands)		
<b>Years ending December 31,</b>			
2012 (remaining 3 months)	\$ 5,048	\$ 2,157	\$ 7,205
2013	19,232	8,096	27,328
2014	13,745	6,775	20,520
2015	714	5,783	6,497
2016		4,097	4,097
<b>Total</b>	<b>\$ 38,739</b>	<b>\$ 26,908</b>	<b>\$ 65,647</b>

*Interest Income, Net*

The increase in interest income, net in the three and nine months ended September 28, 2012 was primarily due to a higher balance of cash, cash equivalents and short-term investments during the current periods, partially offset by a decrease in the rate of return on such assets, as compared to the 2011 periods.

*Other Income (Expense), Net*

Other income and expense is primarily comprised of the net of foreign exchange gains and losses on accounts receivable and intercompany balances denominated in currencies other than the U.S. dollar. In the nine months ended September 28, 2012, it also included a reimbursement of certain legal and tax claims previously expensed associated with the acquisition of Omneon for which the Omneon shareholders had provided indemnification.

*Income Taxes*

Harmonic's provision for income taxes, and provision for income taxes as a percentage of net revenue, in the three and nine months ended September 28, 2012, are presented in the table below. Also presented are the related dollar and percentage changes in provision for income taxes in the three and nine months ended September 28, 2012, from the corresponding periods of 2011.

	<b>Three months ended September 28, 2012</b>	<b>September 30, 2011</b>	<b>Nine months ended September 28, 2012</b>	<b>September 30, 2011</b>
	(In thousands, except percentages)			
Provision for (benefit from) income taxes	\$ 7,245	\$ 765	\$ 4,222	\$ 925
As a percentage of net revenue	5%	%	1%	%
Increase	\$ 6,480		\$ 3,297	
Percent change	847%		356%	

The increase in the provision for income taxes in the three months ended September 28, 2012, compared to the provision for income taxes in the same period in 2011, was primarily attributable to a reduction of a benefit associated with a foreign rate differential.

The increase in the provision for income taxes in the nine months ended September 28, 2012, compared to the provision for income taxes in the same period in 2011, was primarily attributable to the expiration of U.S. Federal research and development tax credits, a reduction of a benefit associated with a foreign rate differential and an increase in the valuation allowance on California research and development tax credits.



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A subsidiary of the Company is under audit by the Israel tax authority for the years 2007 through 2010. The Company's income tax returns for 2007, 2008, 2009 and 2010 are currently under examination by the U.S. Internal Revenue Service. In addition, the statute of limitations on our 2007 and 2008 U.S. corporate income tax returns has been extended to 2013.

**Liquidity and Capital Resources**

As of September 28, 2012, our cash and cash equivalents totaled \$103.2 million, and our short-term investments totaled \$88.7 million. As of September 28, 2012, a substantial majority of the Company's cash, cash equivalents and short-term investments were held in accounts in the United States. The Company believes that these funds are sufficient to meet the requirements of our U.S. operations for the next twelve months, as well as any stock repurchases under the stock repurchase program announced in April 2012.

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

We have a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to \$10.0 million and matures on August 23, 2013. As of September 28, 2012, there were no amounts outstanding under the line of credit facility and there were no borrowings during the nine months ended September 28, 2012. Future borrowings pursuant to the line would bear interest at the bank's prime rate (3.25% at September 28, 2012) or at LIBOR for the desired borrowing period (an annualized rate of 0.21% for a one month borrowing period at September 28, 2012) plus 1.75%, or 1.96%. Borrowings are not collateralized. This facility contains a financial covenant that requires us to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of September 28, 2012, the Company's ratio under that covenant was 3.98 to 1. In the event of noncompliance by us with the covenants under the facility, including the financial covenant referenced above, Silicon Valley Bank would be entitled to exercise its remedies under the facility, including declaring all obligations immediately due and payable.

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

In addition, our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including any global or continuing European economic slowdown, market uncertainty surrounding the ongoing U.S. war on terrorism, the impact of increases in oil prices 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, if at all.

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The table below sets forth selected cash flow data for the periods presented:

	Nine months ended	
	September 28, 2012	September 30, 2011
	(In thousands)	
Net cash provided by (used in):		
Operating activities	\$ 50,226	\$ 20,389
Investing activities	(28,611)	(55,017)
Financing activities	(9,466)	13,301
Effect of foreign exchange rate changes on cash	103	29
Net increase (decrease) in cash and cash equivalents	\$ 12,252	\$ (21,298)

*Operating Activities*

Net cash provided by operations in the nine months ended September 28, 2012 was \$50.2 million, resulting from a net loss of \$15.7 million, decreased by an aggregate of \$52.3 million in non-cash charges and an aggregate of \$13.6 million in net decreases in assets and liabilities. The non-cash charges included principally amortization of intangible assets, stock-based compensation, depreciation, provision for inventories and allowance for doubtful accounts, returns and discounts. The net change in assets and liabilities included: (a) an increase in inventories, which was more than offset by decreases in accounts receivable and prepaid expenses and other assets; and (b) increases in accounts payable and deferred revenue, which was offset by a decrease in income taxes payable and accrued and other liabilities.

Net cash provided by operations in the nine months ended September 30, 2011 was \$20.4 million, resulting from net income of \$4.5 million, increased by an aggregate of \$53.3 million in non-cash charges and decreased by an aggregate of \$37.4 million in net change in assets and liabilities. The non-cash charges included principally amortization of intangible assets, stock-based compensation, depreciation and provision for inventories. The net change in assets and liabilities included: (a) increases in accounts receivable and inventories, which were partially offset by a decrease in prepaid expenses; and (b) decreases in deferred revenue, income taxes payable and accrued and other liabilities, which were partially offset by an increase in accounts payable.

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

*Investing Activities*

Net cash used in investing activities was \$28.6 million in the nine months ended September 28, 2012, resulting from the purchase of short-term investments of \$94.1 million and capital expenditures of \$9.9 million, partially offset by proceeds from the net sale and maturity of investments of \$75.4 million. Harmonic currently expects capital expenditures will be in the range of \$14.0 million to \$16.0 million during the year ending December 31, 2012.

Net cash used in investing activities was \$55.0 million in the nine months ended September 30, 2011, resulting from the purchase of short-term investments of \$76.2 million and capital expenditures of \$12.4 million, offset by proceeds from the net sale and maturity of investments of \$33.8 million.

*Financing Activities*

In the nine months ended September 28, 2012, net cash used in financing activities was \$9.5 million resulting from \$14.4 million of payments for the repurchase of common stock in connection with our stock repurchase program announced in April 2012, offset by \$4.9 million of net proceeds from the issuance of common stock related to our stock plans.

In the nine months ended September 28, 2011, net cash provided by financing activities of \$13.3 million was the result of net proceeds from the issuance of common stock related to our stock plans.



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**OFF-BALANCE SHEET ARRANGEMENTS**

None as of September 28, 2012.

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

As of September 28, 2012, we had approximately \$21.7 million of non-cancelable purchase order commitments. There were no other significant changes to our contractual obligations and commitments in the nine months ended September 28, 2012, from the information presented in our 2011 Form 10-K.

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

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



**Table of Contents****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 10% of net revenue in the first nine months of 2012 and 2011, respectively. 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. The table below presents the impact on the foreign exchange gain (loss) of a hypothetical 10% appreciation and a 10% depreciation of the USD against the forward exchange contracts as of September 28, 2012:

Currency - forward contracts	Position	USD Value of Net Foreign Exchange Contracts	Foreign Exchange	Foreign Exchange
			Gain (Loss) From 10% Appreciation of USD (In thousands)	Gain (Loss) From 10% Depreciation of USD
EUR	Sell EUR	\$ 6,737	\$ 674	\$ (674)
GBP	Sell GBP	3,378	338	(338)
JPY	Sell JPY	1,818	182	(182)
ILS	Buy ILS	3,227	(323)	323

**INTEREST RATE AND CREDIT 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 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 material unrealized gains and losses reported in accumulated other comprehensive income (loss). As of September 28, 2012, gross unrealized gains were nominal. If the credit market deteriorates, we may incur realized losses, which could adversely affect our financial condition and 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 September 28, 2012, our cash, cash equivalents and short-term investments balance was \$192.0 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 10% change in interest rates would have increased or decreased the fair value of our investments by approximately \$0.1 million as of September 28, 2012.

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

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

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



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**PART II**

**OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

In October 2011, Avid Technology, Inc. ( Avid ) filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic s Omneon Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint alleging that Harmonic s Omneon Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages. At this time, the Company cannot predict the outcome of these matters. An unfavorable outcome of these matters could materially and adversely affect our business, operating results, financial position and cash flows.

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 were seeking damages in the amount of 6,300,000 ILS (approximately \$1.7 million). On June 26, 2012 the action was dismissed by the Israeli Central District Court.

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 our revenue and any material decrease or delay in capital spending in any of these industries would negatively impact our operating results, financial condition and cash flows.*

Our revenue has been derived from sales to cable television operators, satellite and telco operators and broadcast and media companies, as well as, more recently, emerging streaming media providers. We expect that these markets will provide our revenue for the foreseeable future. Demand for our products will depend on the magnitude and timing of capital spending by customers in each of these markets for the purpose of creating, expanding or upgrading their systems.

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

impact of general economic conditions, actual and projected;

access to financing;

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

impact of industry consolidation;

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

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

competitive pressures, including pricing pressures; and discretionary end-user customer spending patterns.

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

weak or uncertain economic and financial conditions in domestic or international markets;

uncertainty related to development of digital video industry standards;

delays in evaluations of new services, new standards and systems architectures by many operators;

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

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

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

completion of a new system or significant expansion or upgrade to a system; and

bankruptcies and financial restructuring of major customers.

In the past, adverse economic conditions in one or more of the geographies in which we offer our products have adversely affected our customers' capital spending in those geographies and, as a result, our business. In 2008, 2009 and the first half of 2010, economic conditions in many of the geographies in which we offer our products were 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 the second half of 2010 and the first half of 2011, economic growth appears to have become sluggish in some geographies since the middle of 2011, and weak in other geographies, particularly in Europe, since the beginning of 2012. Further, economic growth is expected to be sluggish in some geographies, and weak in Europe, during the balance of 2012 and perhaps beyond.

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The severity or length of time that economic and financial market conditions may be weak or sluggish, whether certain or all of such adverse factors will persist, or whether a severe down turn may occur in the U.S., Europe or in other geographies, is unknown. During challenging or uncertain economic times, and particularly in tight credit markets, many customers may delay or reduce capital expenditures, which 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, including the Euro and other 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 foreign 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 sales prices in the past. Pressure on average sales prices was particularly severe during previous economic downturns, including in 2008 and 2009, as equipment suppliers competed aggressively for customers' reduced capital spending, and we have experienced similar pressure during the economic slowdown in 2012.

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

Many of our competitors are substantially larger, and have greater financial, technical, marketing and other resources than we have. 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 on more attractive financing terms, which has in the past caused, and may in the future cause, us to lose sales opportunities and the resulting revenue or to reduce our prices in response to that competition. Reductions in prices for any of our products could materially and adversely affect our operating margins and revenue. 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.



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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;

fail to meet market acceptance or customer requirements; or

are ahead of their markets.

We are currently developing and marketing products based on established video compression standards, such as MPEG-4 AVC/H.264, which provides significantly greater compression efficiency, thereby making more bandwidth available to operators. We are also involved in research and development efforts with respect to products utilizing new technologies, such as high efficiency video coding, or HEVC. 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 encoding or transcoding.

In order to attempt to meet fast paced, dynamic, evolving standards and customer requirements, we are intensifying our development efforts on products that will facilitate and enhance multi-screen applications, on media ( playout ) servers utilizing integrated channel playout, and on converged cable access platform ( CCAP ) products that are intended to address customers cost reduction efforts through the use of IP technology. Many of these products are intended to integrate existing and new features and functions in response to shifts in customer demands in the relevant market. The success of these significant and costly development efforts will be predicated, in substantial part, on the timing of market adoption of the new standards on which the resulting products are based. If any of the new standards are not adopted or such adoption is earlier or later than we are predicting, we risk spending research and development time and dollars on products that may never achieve market acceptance or introduction of products which miss the customer demand window and thus do not produce the revenue that a timely introduction would have likely produced.

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.

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

Adverse economic conditions in geographic markets in which we operate may harm our business. As described in the first risk factor in this section, economic conditions in some countries in which we sell products were weak in 2008, 2009, and the first half of 2010. That weakness

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was principally the result of global financial markets having experienced a severe downturn, stemming from a multitude of factors, including adverse credit conditions, slower economic activity, concerns about inflation and deflation, rapid changes in foreign exchange rates, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, adverse business conditions and liquidity concerns. Global or regional economic slowdowns have led many of our affected customers to decrease their expenditures and caused certain of our customers to reduce or delay orders for our products. Many of our international customers have been exposed to tight credit markets and depreciating currencies, further restricting their ability to build, expand or upgrade their networks. Some customers have had difficulty in servicing or retiring existing debt, and the financial constraints on certain international customers required us to significantly increase our allowance for doubtful accounts in the fourth quarter of 2008. It is possible that adverse economic conditions may return during the balance of 2012 or in 2013, on a regional or global basis, and it appears that weak economic conditions have, in fact, reoccurred in most countries in Europe, as a result of the European sovereign debt crisis.



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Beginning in the second quarter of 2011, the possible inability of some developed countries, including Greece, Italy, Ireland, Portugal and Spain, to meet their debt payment obligations has put substantial strain, both direct and indirect, on economic conditions in those countries, in Europe and in many other parts of the world, including the U.S. If one or more of the Euro-zone countries were to default on its sovereign debt, the adverse impact on European and other economies, including the U.S., could be severe. Further, the lowering of the U.S. government's credit rating in 2011 had an adverse affect on U.S. and international financial markets and any further lowering of that credit rating may have a material and adverse affect on the U.S. economy, and possibly the economies of most, if not all, of the other countries in the world. In addition, the recent lowering of the credit ratings of several of the European countries could have the same effect. The impact of any of these issues, which appears to have negatively affected Europe in the first nine months of 2012 and are likely to continue to negatively affect Europe during the balance of 2012 and perhaps beyond, could have a material adverse effect on our business, operating results, financial condition and cash flows.

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

***Our customer base is concentrated and we are regularly involved in relatively large transactions. The loss of one or more of our key customers, a failure to diversify our customer base, or 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. In the last three fiscal years and particularly in 2011, revenue from our ten largest customers decreased as a percentage of revenue, due to our growing customer base, in part as a result of the acquisitions of Scopus and Omneon. Nevertheless, sales to our ten largest customers in the nine months ended September 28, 2012, and in the fiscal years ended December 31, 2011 and 2010, accounted for approximately 36%, 35% and 44% of revenue, respectively. Although we are attempting to broaden our customer base by penetrating new markets and further expanding internationally, we expect to see continuing industry consolidation and customer concentration.

In the nine months ended September 28, 2012, and in the fiscal years ended December 31, 2011 and 2010, revenue from Comcast accounted for approximately 14%, 11% and 17%, respectively, of our revenue. The loss of Comcast or any 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, either long term or in a particular quarter, our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, 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.

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

***We 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 nine months ended September 28, 2012, and in the fiscal years ended December 31, 2011 and 2010, represented approximately 55%, 55% and 50% of our revenue, respectively. The percentage of our revenue attributable to international operations in the first nine months of 2012 primarily resulted from improving, but still weak, sales in Europe, offset by an increase in sales in the Asia Pacific region, particularly in the quarter ended September 28, 2012. However, although no assurances can be given with respect to international sales growth in any one or more regions, we expect that international revenue is likely to continue to represent, from year to year, a substantial, if not growing, percentage of our annual 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:

fluctuations in currency exchange rates;

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changes in foreign government regulations and telecommunications standards;

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

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

availability of credit, particularly in emerging market countries;

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

compliance with the U.S. Foreign Corrupt Practices Act, or FCPA, 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; and

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

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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 our operating results.

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

Our operations outside the 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 prohibit 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 with respect to FCPA compliance, have implemented FCPA training and compliance programs for our employees, and include in our agreements with distributors and resellers a requirement that those parties comply with the FCPA. However, we cannot provide assurances that our policies, procedures and programs will prevent violations of the FCPA or similar laws by our employees or agents, particularly in emerging market countries, and as we expand our international operations. Any such violation, even if prohibited by our policies, could result in criminal or civil sanctions against us.

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

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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, standards and devices, such as:

video compression standards, such as high efficiency video coding ( HEVC );

fiber to the premises, or FTTP, networks designed to facilitate the delivery of video services by telcos;

the greater use of protocols such as IP;

the converged cable access platform ( CCAP );

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 operating results, financial condition and cash flows could 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;

adoption of high bandwidth wireless technology, such as 3G and 4G-LTE;

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 operating results, financial condition and cash flows could be materially and adversely affected.

***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 public 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, 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.

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These risks could be heightened during a substantial economic slowdown, because our suppliers and subcontractors are more likely to experience adverse changes in their financial condition and operations during such a period. Further, these risks could materially and adversely affect our business if one of our sole sources, or a sole source of one of our suppliers or contract manufacturers, is adversely affected by a natural disaster. While we expend resources to qualify additional component sources, consolidation of suppliers and the small number of viable alternatives have limited the results of these efforts. Managing our supplier and contractor relationships is particularly difficult during time periods in which we introduce new products and during time periods in which demand for our products is increasing, especially if demand increases more quickly than we expect.

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., which manufactures our products at its facilities in Malaysia, 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 automatically renewed until October 2013.

Until recently, most of the products manufactured by our Israeli operations were outsourced to third party manufacturers located in Israel. Our ability to improve production efficiency with respect to that business had been 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 restricted the transfer outside of Israel of intellectual property developed with funding from the OCS, and also limited the manufacturing outside of Israel of products containing such intellectual property. However, recently, the Company entered into an arrangement with the OCS that permits it to transfer a significant portion of such intellectual property, and manufacture products containing such portion of intellectual property, outside of Israel.

Difficulties in managing relationships with any of our current contract manufacturers, particularly Plexus, that manufacture 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 and other operating results. 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.

Our ability to meet customer demand depends significantly on the availability of components and other materials, as well as the ability of our contract manufacturers to scale their production, and because we purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources, the risk of not meeting customer demand is increased. Our ability to meet customer requirements depends in part on our ability to obtain sufficient volumes of these materials in a timely fashion. Increases in demand on our suppliers and subcontractors from other customers may cause sporadic shortages of certain components and products. In order to be able to respond to these issues, we have increased our inventories of certain components and products, particularly for our customers that order significant dollar amounts of our products, and expedited shipments of components, subassemblies and modules when necessary, which has increased our costs and could increase our risk of holding obsolete or excessive inventory. We also employ a demand order fulfillment model which is designed to reduce the effects of increases or decreases in demand for any products. Nevertheless, we may be unable to respond to customer demand that increases more quickly than we expect. If we fail to meet customers' supply expectations, our revenue would be adversely affected and we may lose business, which could materially and adversely affect our operating results, financial condition and cash flows.

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

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

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



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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 our customers' services or products;

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

general economic and financial markets conditions, whether global or in certain geographic areas;

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

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;

the length of each customer product upgrade cycle and the volume of purchases during the cycle;

competitive market conditions, including pricing actions by our competitors;

lack of predictability in our revenue cycles;

the level and mix of our international revenue;

new product introductions by our competitors or by us;

changes in domestic and international regulatory environments affecting our business;

market acceptance of our products, particularly our new products;



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

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

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

changes in our operating and extraordinary expenses;

impairment of our goodwill and intangibles;

the impact of litigation, such as related litigation expenses and settlement costs;

write-downs of inventory and investments;

whether the research and development tax credit in place prior to 2012 is renewed;

changes in our effective federal tax rate, including as a result of changes in our valuation allowance against our deferred tax assets, and changes in our effective state tax rates, including as a result of apportionment;

changes in our mix of domestic versus international revenue;

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

the timing of our development of custom products and software.

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

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



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

*Fluctuations in our future effective tax rates, or the outcome of tax audits, could affect our future operating results, financial condition and cash flows.*

We are required to periodically review our deferred tax assets and determine whether, based on available evidence, a valuation allowance is necessary. Accordingly, we have performed such evaluation, from time to time, based on historical evidence, trends in profitability, expectations of future taxable income and implemented tax planning strategies. We continue to maintain a valuation allowance for certain foreign 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. or 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 operating results 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.

Our 2007, 2008, 2009 and 2010 U.S. corporate income tax returns are presently being audited by the Internal Revenue Service. These audits commenced in the second quarter of 2011. A subsidiary of the Company is under audit by the Israel tax authority for the years 2007 through 2010. These audits commenced in the first quarter of 2012. If, upon the conclusion of these audits, the ultimate determination of taxes owed in the U.S. or Israel 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 operating results could be materially and adversely impacted in the period of adjustment.

We 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. We completed the same non-exclusive license of Omneon intellectual property in the fourth quarter of 2010, upon the closing of the Omneon acquisition. Recently, we withdrew our request for the Advanced Pricing Agreement with the Internal Revenue Service with respect to our initial non-exclusive license of intellectual property. As noted above, our U.S. corporate tax returns for both 2008 and 2010 are presently being audited by the Internal Revenue Service. If the Internal Revenue Service, in connection with such audit or otherwise, were to disagree with our tax treatment of either of such non-exclusive licenses, we may be required to take a charge to expense related to such disagreement, which could have a material and adverse effect on our operating results in the period in which the charge is taken.

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

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

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

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

Any future intellectual property litigation, regardless of its outcome, could result in substantial expense and significant diversion of the efforts of our management and technical personnel. An adverse determination in any such proceeding could subject us to significant liabilities and temporary or permanent injunctions and require us to seek licenses from third parties or pay royalties that may be substantial. Furthermore, necessary licenses may not be available on terms satisfactory to us, or at all. An unfavorable outcome on any such litigation matter could require that we pay substantial damages, could require that we pay ongoing royalty payments, or could prohibit us from selling certain of our products. Any such outcome could have a material and adverse effect on our business, operating results, financial condition and cash flows.

In October 2011, Avid Technology, Inc. filed a complaint in the United States District Court for the District of Delaware, alleging that our Omneon Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint, alleging that Harmonic's Omneon Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages. At this time, we cannot predict the outcome of either of these matters. An unfavorable outcome of either of these matters could materially and adversely affect our business, operating results, financial position and cash flows.

Our suppliers and customers may have intellectual property claims relating to our products asserted against them. We have agreed to indemnify some of our suppliers and most of our customers for patent infringement relating to our products. The scope of this indemnity varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorney's fees) incurred by the supplier or customer in connection with such claims. If a supplier or a customer seeks to enforce a claim for indemnification against us, we could incur significant costs defending such claim, the underlying claim or both. An adverse determination in either such proceeding could subject us to significant liabilities and have a material and adverse effect on our operating results, cash flows and financial condition.

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

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 and adverse effect on our business, operating results, financial condition 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, brought 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. We cannot predict whether the claims by MPT are legitimate or actually cover any of our products, whether the claims are likely to result in a settlement or judgment against a customer defendant (although some such settlements have occurred), 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 a written 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.

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***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 percentage of our revenue through sales to distributors, value-added resellers, or VARs, and systems integrators that assist us with fulfillment or installation obligations. We expect that these sales will continue to generate a significant percentage of our revenue in the future. Further, 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. Accordingly, our future success is highly dependent upon establishing and maintaining successful relationships with a variety of channel partners.

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 any of our distributor, VAR and systems integrator customers to favor their products or, in effect, to prevent or reduce sales of our products. Any of 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 affect 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.

***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.

Recently 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.

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

Conditions in the U.S. and global economies improved from mid-2010 to mid-2011, but remain uncertain. The terrorist attacks in the U.S. in 2001, subsequent and continuing attempted and accomplished terrorist attacks in other parts of the world, and the threat of future attacks have created many economic and political uncertainties that have adversely impacted the global economy and, as a result, have adversely affected our business. The long-term effects of such attacks, the threat of future attacks, the ongoing war on terrorism, recent increased social and political instability and regime changes, particularly in the Middle East, and tensions among countries, including between Iran and Israel and the U.S., on our business and the global economy remain uncertain. Such uncertainty has increased the price of certain commodities, particularly oil, which could have an indirect material and adverse impact on the cost of manufacturing and shipping our products. Moreover, the potential for future terrorist attacks, including hacking attacks on government and commercial computer systems, increases in such social and political instability and such tensions, particularly if Israel or any other country were to attack any of Iran's nuclear development facilities, make it difficult to estimate the long-term stability and strength of the U.S. and other economies, particularly those in certain emerging market countries and certain European countries, and the impact of resulting economic conditions on our business.

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

We maintain facilities in two locations in Israel with a total of 218 employees, or approximately 19% of our worldwide workforce, as of September 28, 2012. Our employees in Israel engage in a number of activities, including research and development, the development of, and supply chain management for, one product line, and sales activities.

We are directly influenced by the political, economic and military conditions affecting Israel. Any significant conflict involving Israel could have a direct effect on our business or that of our Israeli contract manufacturers, in the form of physical damage or injury, reluctance to travel within, or to or from, Israel by our Israeli and other employees or those of our subcontractors, or the loss of Israeli employees to active military duty. Most of our employees in Israel are currently obligated to perform annual reserve duty in the Israel Defense Forces, and approximately 14% of those employees were called for active military duty in 2011. In the event that more employees are called to active duty, certain of our research and development activities may be adversely affected, including significantly delayed. In addition, the interruption or curtailment of trade between Israel and its trading partners, as a result of terrorist attacks or hostilities, conflicts between Israel and any other Middle Eastern country, or any other cause, could significantly harm our business. Current or future tensions in the Middle East could materially and adversely affect our business, operating results, financial condition and cash flows.

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

As part of our business strategy, from time to time we have acquired, and we 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 possible 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 during the acquisition process;

the challenges of managing a larger and more geographically widespread operation and product portfolio after the closing of the acquisition;

difficulties in integrating acquired companies' systems, controls, policies and procedures, particularly 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;

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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;

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

the possibility that any acquisition may be viewed negatively by our customers or investors or the financial markets.

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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, cash flows 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.

As of September 28, 2012, we have approximately \$212.5 million of goodwill recorded on our balance sheet associated with prior acquisitions. In the event the market price of our common stock declines substantially from its price at October 22, 2012, \$ 4.34, for an extended period of time, we may determine that our goodwill is impaired. If such determination is made, we would be required to write down all or a portion of such goodwill, which could result in a material non-cash charge to our results of operations in the period in which such write-down occurs.

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.

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

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

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

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



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

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In addition, if there is a major earthquake or other natural disaster in any of the locations in which our significant customers are located, we face the risk that our customers may incur losses, or sustained business interruption and/or loss, which may materially impair their ability to continue their purchase of products from us. Accordingly, a major earthquake or other natural disaster in one of the geographies in which we, or our third-party manufacturers, suppliers or customers, operate could have a material and adverse effect on our business, operating results, cash flows and financial condition.

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

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

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

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

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

As of September 28, 2012, we have 473 employees in our international operations, representing approximately 41% of our worldwide workforce. Our ability to manage our business effectively in the future, including with respect to any future growth, the integration of recent and any future acquisitions, and the breadth of our international operations, will require us to train, motivate and manage our employees successfully, to attract and integrate new employees into our overall operations, to retain key employees and to continue to improve our operational, financial and management systems. There can be no assurances that we will be successful in any of those regards, and our failure to effectively manage our operations could have a material and adverse effect on our business, operating results, cash flows and financial condition.

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

At September 28, 2012, we held 59 issued U.S. patents and 20 issued foreign patents, and have a number of patent applications pending. Although we attempt to protect our intellectual property rights through patents, trademarks, copyrights, licensing arrangements, maintaining certain technology as trade secrets and other measures, we can give no assurances that any patent, trademark, copyright or other intellectual property rights owned by us will not be invalidated, circumvented or challenged, that such intellectual property rights will provide competitive advantages to us, or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. We can give no assurances that others will not develop technologies that are similar or superior to our technologies, duplicate our technologies or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or may do business in the future.

We believe that patents and patent applications are not currently significant to our business, and we do not rely on our patent portfolio to give us a competitive advantage over others in our industry. We believe that the future success of our business will depend on our ability to translate the technological expertise and innovation of our personnel into new and enhanced products. We generally enter into confidentiality or license agreements with our employees, consultants, and vendors and our customers, as needed, and generally limit access to, and distribution of, our proprietary information. Nevertheless, we cannot provide assurances that the steps taken by us will prevent misappropriation of our technology. In addition, we have taken in the past, and may take in the future, legal action to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of management time and other resources, and could materially and adversely affect our business, operating results, financial condition and cash flows.

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

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

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

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

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

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

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

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

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

We have been engaged in the design, manufacture and sale of a variety of video products and system solutions since inception, which has required, and will continue to require, significant research and development expenditures.

We believe that our existing cash and short-term investments of approximately \$192 million, at September 28, 2012, will satisfy our cash requirements for at least the next twelve months. However, we may need to raise additional funds if our expectations are incorrect, to take advantage of presently unanticipated strategic opportunities, to satisfy our other cash requirements from time to time, or to strengthen our financial position. Our ability to raise funds may be adversely affected by a number of factors, including factors beyond our control, such as weakness in the economic conditions in markets in which we sell our products and continued uncertainty in financial, capital and credit markets. There can be no assurance that equity or debt financing will be available to us on reasonable terms, if at all, when and if it is needed.



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

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

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

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

Negative conditions in the global credit and financial markets have had an adverse impact on the liquidity of certain of our investments in the past. In the event we need or desire to access funds from the short-term investments that we hold, it is possible that we may not be able to do so due to market conditions. If a buyer is found, but is unwilling to purchase the investments at par or our cost, we may incur a loss. Further, rating downgrades of the security issuer or the third parties insuring such investments may require us to adjust the carrying value of these investments through an impairment charge. Our inability to sell all or some of our short-term investments at par or our cost, or rating downgrades of issuers or insurers of these securities, could materially and adversely affect our operating results, financial condition and cash flows.

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

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

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

If demand for our products increases, the difficulty of accurately forecasting our customers' requirements and meeting these requirements will increase. Forecasting to meet customers' needs and effectively managing our supply chain is particularly difficult in connection with newer products. Our ability to meet customer demand depends significantly on the availability of components and other materials, as well as the ability of our contract manufacturers to scale their production. Furthermore, we purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources. Our ability to meet customer requirements depends in part on our ability to obtain sufficient volumes of these materials in a timely fashion. Increases in demand on our suppliers and subcontractors from other customers may cause sporadic shortages of certain components and products. In order to be able to respond to these issues, we have increased our inventories of certain components and products, particularly for our customers that order significant dollar amounts of our products, and expedited shipments of our products when necessary, which has increased our costs and could increase our risk of holding obsolete or excessive inventory. We also employ a demand order fulfillment model which is designed to reduce the effects of increases or decreases in demand for any products. Nevertheless, we may be unable to respond to customer demand that increases more quickly than we expect. If we fail to meet customers' supply expectations, our revenue would be adversely affected and we may lose business, which could materially and adversely affect our operating results, financial condition and cash flows.

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

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

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

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

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

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

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

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

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

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

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

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

These provisions, alone or together, could delay hostile takeovers, changes in control of the Company or changes in our management.

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



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

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

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

general market and economic conditions;

actual or anticipated variations in operating results;

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

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

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

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

additions or departures of key personnel; and

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

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

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

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

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

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

We have spent, and expect to continue to spend, a substantial amount of management time and costly external resources to comply with changes in laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations, the NASDAQ Stock Market rules and applicable provisions of the Dodd Frank Act of 2010. In particular, Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting and attestation of the effectiveness of our internal control over financial reporting by our independent registered public accounting firm in connection with the filing of our Report on Form 10-K for each fiscal year. We have documented and tested our internal control systems and procedures and have made improvements in order for us to comply with the requirements of Section 404. This process has required us to hire additional personnel and outside advisory services and has resulted in significant additional expenses.

While our management's assessment of our internal control over financial reporting resulted in our conclusion that, as of December 31, 2011, our internal control over financial reporting was effective, and our independent registered public accounting firm has attested that our internal control over financial reporting was effective in all material respects as of December 31, 2011, we cannot predict the outcome of our testing and that of our independent registered public accounting firm in future periods. If we conclude in future periods that our internal control over financial reporting is not effective or if our independent registered public accounting firm is unable to provide an unqualified attestation as of future year-ends, we will incur substantial additional costs in an effort to correct such problems and investors may lose confidence in our financial statements, and the price of our stock will likely decrease in the short term, until we correct such problems, and perhaps in the long term, as well.

In addition, we are subject to new requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that will require us to diligence, disclose, and report whether or not our products contain conflicts minerals. The implementation of these new requirements could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of semiconductor devices or other components used in our products. In addition, we will incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products.

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

On April 24, 2012, the Board of Directors approved a stock repurchase program that provides for the repurchase of up to \$25 million of the Company's outstanding common stock during the term of the program, which expires 18 months from Board approval. Under the program, the Company may purchase shares of common stock through open market transactions at prices deemed appropriate by management, subject to certain pre-determined price/volume guidelines set, from time to time, by the Board. The timing and amount of repurchase transactions under this program depend on a variety of factors, including price, corporate and regulatory requirements, strategic priorities and other market conditions. The purchases are funded from available working capital. The stock repurchase program may be suspended or discontinued at any time. A summary of the stock repurchase activity under the stock repurchase program, reported based on the trade date, is as follows:

	Shares Repurchased	Weighted Average Price per Share	Amount Repurchased
(In thousands, except per share amounts)			
March 30-April 27, 2012		\$	\$
April 28-May 25, 2012	950	4.36	4,146
May 26-June 29, 2012	650	4.32	2,806
June 30-July 28, 2012			
July 29-August 24, 2012	996	4.43	4,407
August 25-September 28, 2012	650	4.66	3,029
<b>Total</b>	<b>3,246</b>	<b>\$ 4.43</b>	<b>\$ 14,388</b>

As of September 28, 2012, \$10.6 million remains available for the repurchase of shares under the stock repurchase program. The Company charges the excess of cost over par value for the repurchase of its common stock to additional paid-in capital. The common stock repurchased was immediately retired.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

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**ITEM 6. EXHIBITS**

<b>Exhibit</b>	
<b>Number</b>	<b>Exhibit Index</b>
10.49	Amendment to Loan Agreement dated August 23, 2012, with Silicon Valley Bank
31.1	Section 302 Certification of Principal Executive Officer
31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Principal Executive Officer
32.2	Section 906 Certification of Principal Financial Officer
101***	<p>The following materials from Registrant's Quarterly Report on Form 10-Q for the quarter ended September 28, 2012, formatted in Extensible Business Reporting Language (XBRL) includes:</p> <p>Condensed Consolidated Balance Sheets at September 28, 2012 and December 31, 2011, (ii) Condensed Consolidated Statements of Operations for the Three and Nine months ended September 28, 2012 and September 30, 2011, (iii) Condensed Consolidated Statements of Comprehensive Income (Loss) for the Three and Nine months ended September 28, 2012 and September 30, 2011, (iv) Condensed Consolidated Statements of Cash Flows for the Nine months ended September 28, 2012 and September 30, 2011, and (v) Notes to Condensed Consolidated Financial Statements.</p>

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**SIGNATURES**

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

HARMONIC INC.

By: /s/ Carolyn V. Aver  
Carolyn V. Aver  
Chief Financial Officer  
(Principal Financial and Accounting Officer)  
Date: November 7, 2012