HARMONIC INC
Form 10-Q
May 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended March 30, 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)

Delaware	**77-0201147**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

4300 North First Street

San Jose, CA 95134

(408) 542-2500

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

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

The number of shares of the registrant s Common Stock, $.001 par value, outstanding on April 23, 2012 was 117,573,225.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HARMONIC INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	March 30, 2012	December 31, 2011
	(In thousands, except par value amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 81,019	$ 90,983
Short-term investments	87,440	70,854
Accounts receivable, net	111,753	109,886
Inventories	65,545	70,649
Deferred income taxes	29,897	28,032
Prepaid expenses and other current assets	18,893	21,474
Total current assets	394,547	391,878
Property and equipment, net	40,439	40,469
Goodwill	212,485	212,417
Intangibles, net	80,111	87,651
Other assets	2,473	1,751
Total assets	$ 730,055	$ 734,166
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 31,481	$ 30,537
Income taxes payable	871	2,290
Deferred revenue	35,803	33,095
Accrued liabilities	39,050	46,896
Total current liabilities	107,205	112,818
Income taxes payable, long-term	47,809	47,307
Deferred income taxes, long-term	1,259	655
Other non-current liabilities	9,660	9,070
Total liabilities	165,933	169,850
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; 117,540 and 116,257 shares issued and outstanding at March 30, 2012 and December 31, 2011, respectively	118	116
Capital in excess of par value	2,440,158	2,433,164
Accumulated deficit	(1,875,617)	(1,868,089)
Accumulated other comprehensive loss	(537)	(875)

Total stockholders equity		564,122		564,316
Total liabilities and stockholders equity	$	730,055	$	734,166

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three months ended	
	March 30, 2012	**April 1, 2011**
	(In thousands, except per share amounts)	
Product revenue	$ 110,367	$ 115,867
Service revenue	17,354	16,968
Net revenue	127,721	132,835
Product cost of revenue	66,936	64,751
Service cost of revenue	7,123	6,229
Total cost of revenue	74,059	70,980
Gross profit	53,662	61,855
Operating expenses:		
Research and development	27,829	26,149
Selling, general and administrative	32,311	33,564
Amortization of intangibles	2,179	2,229
Total operating expenses	62,319	61,942
Loss from operations	(8,657)	(87)
Interest income, net	119	92
Other income (expense), net	403	(107)
Loss before income taxes	(8,135)	(102)
Benefit from income taxes	(607)	(618)
Net income (loss)	$ (7,528)	$ 516
Net income (loss) per share:		
Basic	$ (0.06)	$ 0.00
Diluted	$ (0.06)	$ 0.00
Weighted average shares:		
Basic	117,275	113,836
Diluted	117,275	116,109

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three months ended	
	March 30, 2012	**April 1, 2011**
Net income (loss)	$ (7,528)	$ 516
Change in unrealized loss on investments, net	24	(11)
Foreign currency translation	314	454
Total comprehensive income (loss)	$ (7,190)	$ 959

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three months ended March 30, 2012	Three months ended April 1, 2011
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	$ (7,528)	$ 516
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of intangibles	7,539	7,371
Depreciation	3,798	3,403
Stock-based compensation	4,800	6,002
Net loss on disposal of fixed assets		61
Deferred income taxes	(1,262)	76
Provision for inventories	915	2,640
Allowance for doubtful accounts, returns and discounts	(684)	(510)
Other non-cash adjustments, net	(8)	121
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(1,179)	(9,767)
Inventories	4,189	(3,372)
Prepaid expenses and other assets	1,892	998
Accounts payable	936	(3,616)
Deferred revenue	2,740	4,430
Income taxes payable	(929)	(6,748)
Accrued and other liabilities	(7,255)	(9,288)
Net cash provided by (used in) operating activities	7,964	(7,683)
Cash flows from investing activities:		
Purchases of investments	(36,654)	(41,813)
Proceeds from maturities of investments	18,791	6,873
Proceeds from sales of investments	1,042	1,026
Acquisition of property and equipment	(3,715)	(4,957)
Net cash used in investing activities	(20,536)	(38,871)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	2,479	9,570
Net cash provided by financing activities	2,479	9,570
Effect of exchange rate changes on cash and cash equivalents	129	123
Net decrease in cash and cash equivalents	(9,964)	(36,861)
Cash and cash equivalents at beginning of period	90,983	96,533
Cash and cash equivalents at end of period	$ 81,019	$ 59,672

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 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 three months ended March 30, 2012.

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. The Company will apply this guidance when it performs its annual goodwill impairment test in the fourth quarter of 2012.

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 cash is included in the balance sheet as of March 30, 2012, and the return of shares is 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 three months ended March 30, 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 March 30, 2012 and December 31, 2011, based on the three-tier fair value hierarchy:

	Total	Level 1	Level 2	Level 3
		(In thousands)		
March 30, 2012				
Assets				
Money market funds	$ 37,680	$ 37,680	$	$
Certificate of deposit	1,325		1,325	
State, municipal and local government agencies bonds	47,825		47,825	
Corporate bonds	22,213		22,213	
U.S. federal government bonds	5,896	5,896		
Commercial paper	10,181		10,181	
Foreign exchange forward contracts	169		169	
Total assets measured and recorded at fair value	$ 125,289	$ 43,576	$ 81,713	$
Liabilities				
Foreign exchange forward contracts	$ 660	$	$ 660	$
Total liabilities measured and recorded at fair value	$ 660	$	$ 660	$

	Total	Level 1	Level 2	Level 3
		(In thousands)		
December 31, 2011				
Assets				
Money market funds	$ 62,131	$ 62,131	$	$
State, municipal and local government agencies bonds	38,825		38,825	
Corporate bonds	18,604		18,604	
U.S. federal government bonds	9,230	9,230		
Commercial paper	4,195		4,195	
Foreign exchange forward contracts	373		373	
Total assets measured and recorded at fair value	$ 133,358	$ 71,361	$ 61,997	$
Liabilities				
Foreign exchange forward contracts	$ 159	$	$ 159	$
Total liabilities measured and recorded at fair value	$ 159	$	$ 159	$

At March 30, 2012 and December 31, 2011, maturities of short-term investments are as follows:

	March 30, 2012	December 31, 2011
	(In thousands)	
Short-term investments:		
Less than one year	$ 69,085	$ 43,470
Due in 1 2 years	18,355	27,384
Total short-term investments	$ 87,440	$ 70,854

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The following is a summary of available-for-sale securities at March 30, 2012 and December 31, 2011:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(In thousands)		
March 30, 2012				
Certificate of deposit	$ 1,324	$ 1	$	$ 1,325
State, municipal and local government agencies bonds	47,758	67		47,825
Corporate bonds	22,208	12	(7)	22,213
U.S. federal government bonds	5,895	1		5,896
Commercial paper	10,181			10,181
Total	$ 87,366	$ 81	$ (7)	$ 87,440
December 31, 2011				
State, municipal and local government agencies bonds	$ 38,785	$ 46	$ (6)	$ 38,825
Corporate bonds	18,613	6	(15)	18,604
U.S. federal government bonds	9,226	4		9,230
Commercial paper	4,195			4,195
Total	$ 70,819	$ 56	$ (21)	$ 70,854

Impairment of Investments

Harmonic monitors its investment portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. A decline of fair value below amortized costs of debt securities is considered other-than temporary if the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of the entire amortized cost basis. At the present time, the Company does not intend to sell its investments that have unrealized losses in accumulated other comprehensive loss. In addition, the Company does not believe that it is more likely than not that it will be required to sell its investments that have unrealized losses in accumulated other comprehensive loss before the Company recovers the principal amounts invested. The Company believes that the unrealized losses are temporary and do not require an other-than-temporary impairment, based on its evaluation of available evidence as of March 30, 2012.

As of March 30, 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.

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NOTE 5: BALANCE SHEET

	March 30, 2012	December 31, 2011
	(In thousands)	
Accounts receivable		
Accounts receivable	$ 119,320	$ 118,138
Less: allowances for doubtful accounts , returns and discounts	(7,567)	(8,252)
	$ 111,753	$ 109,886
Inventories:		
Raw materials	$ 13,708	$ 14,099
Work-in-process	3,354	4,250
Finished goods	48,483	52,300
	$ 65,545	$ 70,649
Property and equipment:		
Furniture and fixtures	$ 6,681	$ 6,706
Machinery and equipment	101,379	97,916
Leasehold improvements	7,459	7,079
	115,519	111,701
Less: accumulated depreciation and amortization	(75,080)	(71,232)
	$ 40,439	$ 40,469

NOTE 6: GOODWILL AND IDENTIFIED INTANGIBLES

The following is a summary of identified intangible assets as of March 30, 2012 and December 31, 2011:

	March 30, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
			(In thousands)			
Identifiable intangibles:						
Existing and core technology	$ 136,145	$ (87,310)	$ 48,835	$ 136,145	$ (81,951)	$ 54,194
Customer relationships/contracts	67,098	(43,649)	23,449	67,098	(42,142)	24,956
Trademarks and tradenames	11,361	(8,060)	3,301	11,361	(7,700)	3,661
Supply agreements	3,414	(3,414)		3,414	(3,414)	
Maintenance agreements and related relationships	7,100	(2,574)	4,526	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)	
Total of identifiable intangibles	$ 228,227	$ (148,116)	$ 80,111	$ 228,227	$ (140,576)	$ 87,651

The changes in the carrying amount of goodwill for the three months ended March 30, 2012 are as follows:

	(In thousands)
Balance at beginning of period	$ 212,417
Foreign currency translation adjustment	68
Balance at end of period	$ 212,485

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Amortization expense for the identifiable purchased intangible assets for the three months ended March 30, 2012 and April 1, 2011 was allocated as follows:

	Three months ended	
	March 30, 2012	April 1, 2011
	(In thousands)	
Included in cost of revenue	$ 5,360	$ 5,142
Included in operating expenses	2,179	2,229
Total amortization expense	$ 7,539	$ 7,371

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

	Cost of Revenue	Operating Expenses	Total
		(In thousands)	
Years ending December 31,			
2012 (remaining 9 months)	$ 15,144	$ 6,525	$ 21,669
2013	19,232	8,096	27,328
2014	13,745	6,775	20,520
2015	714	5,783	6,497
2016		4,097	4,097
Total	$ 48,835	$ 31,276	$ 80,111

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 March 30, 2012, accrued excess facilities costs totaled $2.2 million, of which $1.7 million was included in current accrued liabilities.

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The following table summarizes the activity in the restructuring accrual during the three months ended March 30, 2012:

	Excess Facilities (In thousands)
Balance at December 31, 2011	$ 2,593
Provisions	
Cash payments	(432)
Balance at March 30, 2012	$ 2,161

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 25, 2012. As of March 30, 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 three months ended March 30, 2012. This facility, which became effective in August 2011, contains a financial covenant that requires Harmonic to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of March 30, 2012, the Company s ratio under that covenant was 3.92 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 March 30, 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 March 30, 2012) or at LIBOR for the desired borrowing period (an annualized rate of 0.24% for a one month borrowing period at March 30, 2012) plus 1.75%, or 1.99%. Borrowings are not collateralized.

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.

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Stock Options and RSUs

The following table summarizes the Company s stock option and restricted stock unit activity during the three months ended March 30, 2012 (in thousands, except per share amounts):

		Stock Options Outstanding		Restricted Stock Units Outstanding	
	Shares Available for Grant	Number of Shares	Weighted Average Exercise Price	Number of Units	Weighted Average Grant Date Fair Value
Balance at December 31, 2011	7,835	9,303	$ 7.12	3,713	$ 7.52
Granted	(3,835)	899	$ 6.14	1,957	$ 6.10
Options exercised		(129)	$ 2.93		$
Shares released			$	(649)	$ 8.29
Forfeited or cancelled	815	(722)	$ 9.28	(273)	$ 6.73
Balance at March 30, 2012	4,815	9,351	$ 6.92	4,748	$ 6.77

The following table summarizes information about stock options outstanding as of March 30, 2012 (in thousands, except per share amounts and term):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Vested and expected to vest	9,185	$ 6.92	3.8	$ 3,373
Exercisable	6,817	$ 7.13	2.9	$ 2,272

The intrinsic value of options vested and expected to vest and exercisable as of March 30, 2012 is calculated based on the difference between the exercise price and the fair value of the Company s common stock as of March 30, 2012. The intrinsic value of options exercised during the three months ended March 30, 2012 was $0.4 million 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.

The following table summarizes information about restricted stock units outstanding as of March 30, 2012 (in thousands, except term):

	Number of Shares Underlying Restricted Stock Units	Weighted Average Remaining Vesting Period (Years)	Aggregate Fair Value
Vested and expected to vest	4,376	1.6	$ 23,939

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NOTE 10: STOCK-BASED COMPENSATION

The following table summarizes stock-based compensation costs in our Statements of Operations for the three months ended March 30, 2012 and April 1, 2011 (in thousands):

	Three months ended	
	March 30, 2012	April 1, 2011
	(In thousands)	
Cost of revenue	$ 794	$ 747
Research and development expense	1,724	1,836
Selling, general and administrative expense	2,282	3,419
Total employee stock-based compensation recognized in statement of operations	4,800	6,002
Amount capitalized in inventory		14
Total stock-based compensation	$ 4,800	$ 6,016

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	
	March 30, 2012	April 1, 2011
Expected term	4.70	4.75
Volatility	58%	54%
Risk-free interest rate	1.0%	2.1%
Expected dividends	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 payment 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% and 5% for the three months ended March 30, 2012 and April 1, 2011, respectively.

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The weighted-average fair value of options granted for the three months ended March 30, 2012 and April 1, 2011 was $2.94 and $4.55 per share, respectively.

The fair value of all stock options vested during the three months ended March 30, 2012 was $ 2.1 million.

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 March 30, 2012 was $ 5.4 million.

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:

	Three months ended	
	March 30, 2012	April 1, 2011
Expected term	0.5	0.5
Volatility	53%	54%
Risk-free interest rate	0.2%	0.3%
Expected dividends	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 weighted-average fair value of stock purchase rights granted under the ESPP for the three months ended March 30, 2012 and April 1, 2011 was $ 1.50 and $2.58 per share, respectively.

Unrecognized Stock-Based Compensation

As of March 30, 2012, total unamortized stock-based compensation cost related to unvested stock options and restricted stock units was $39.1 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.8 years.

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NOTE 11: INCOME TAXES

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

For the three months ended March 30, 2012, the Company recorded a benefit from income taxes of $0.6 million, compared to a benefit of $0.6 million for the same period a year ago, inclusive of discrete items.

For the three months ended March 30, 2012, the difference between the recorded benefit from income taxes and the tax provision, based on the federal statutory rate of 35%, was primarily attributable to 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 quarter of 2012 principally related to accrued interest on uncertain tax positions and foreign currency translation adjustments.

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

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 $52.5 million as of December 31, 2011, and approximately $52.6 million as of March 30, 2012. If all of these unrecognized tax benefits were recognized, the entire amount would impact the provision for income taxes. We anticipate the unrecognized tax benefits to decrease by $2.8 million in the 12 months beginning March 31, 2012, due to statute of limitation expirations, except to the extent the IRS may challenge the Company s position with respect to such benefits.

The Company recognizes interest and possible penalties related to uncertain tax positions in income tax expense. During the three months ended March 30, 2012, the Company recorded a net increase of $0.4 million for interest and possible penalties related to uncertain tax positions, resulting in a balance at March 30, 2012 of $5.6 million.

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 2008 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 US Internal Revenue Service for the 2007, 2008 and 2009 tax years. In addition, the statute of limitations on our 2007 and 2008 U.S. corporate income tax return has been extended to 2013.

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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 computations because their effect was antidilutive:

	Three months ended	
	March 30, 2012	April 1, 2011
	(In thousands)	
Potentially dilutive equity awards outstanding	10,209	7,990

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

	Three months ended	
	March 30, 2012	April 1, 2011
	(In thousands, except per share amounts)	
Net income (loss) (numerator)	$ (7,528)	$ 516
Shares calculation (denominator):		
Weighted average shares outstanding basic	117,275	113,836
Effect of Dilutive Securities:		
Potential common stock relating to stock options, restricted stock units and ESPP		2,273
Weighted averages shares outstanding diluted	117,275	116,109
Net income (loss) per share basic	$ (0.06)	$ 0.00
Net income (loss) per share diluted	$ (0.06)	$ 0.00

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NOTE 13: COMMITMENTS AND CONTINGENCIES

Leases.

Future minimum lease payments under noncancelable operating leases at March 30, 2012 are as follows:

	Total (In thousands)
2012 (remaining nine months)	$ 4,755
2013	7,922
2014	6,595
2015	6,612
2016	6,807
Thereafter	26,681
	$ 59,372

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	
	March 31, 2012	April 1, 2011
	(In thousands)	
Balance at beginning of period	$ 5,558	$ 4,811
Accrual for current period warranties	1,619	2,262
Warranty costs incurred	(2,044)	(1,810)
Balance at end of period	$ 5,133	$ 5,263

Purchase Commitments with Contract Manufacturers and 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 $24 million of non-cancelable purchase commitments as of March 30, 2012.

Standby Letters of Credit. As of March 30, 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 $1.1 million.

Indemnification. Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and most of its customers for specified intellectual property matters pursuant to certain contractual arrangements, subject to certain limitations. The scope of these indemnities varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorneys fees). There have been no amounts accrued in respect of these indemnification provisions through March 30, 2012.

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Guarantees. At March 30, 2012, Harmonic had no other guarantees outstanding.

Legal proceedings.

In October 2011, Avid Technology, Inc. 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. The complaint seeks injunctive relief and damages. At this time, the Company cannot predict the outcome of this matter. An unfavorable outcome of this matter could 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 are seeking damages in the amount of 6,300,000 ILS (approximately $1.7 million). Although, as is the case with all litigation, no assurances can be given as to the outcome of the Interkey lawsuit, we believe Interkey s and its shareholders claims are without merit and Harmonic and HVN intend to vigorously defend themselves against these claims. Based on the foregoing, as of March 30, 2012 and as of the date these financial statements were issued, we do not currently believe a loss is probable and have therefore not recorded a provision for this claim.

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

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

NOTE 14: SUBSEQUENT EVENT

In April 2012, the Board of Directors authorized a stock repurchase program that provides for the repurchase of up to $25 million of outstanding common stock during the next 18 months. Under the program, the Company could 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 will depend on market conditions and corporate and regulatory considerations. The purchases will be funded from available working capital. The stock repurchase program may be suspended or discontinued at any time.

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 Harmon its subsidiaries and its predecessors as a combined entity, except where the context requires otherwise.

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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 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 in the second quarter of 2012 and beyond;

impact of natural disasters on our supply chain;

our strategic direction, future business plans and growth strategy;

dependence on international revenue, particularly from Europe;

dependence on contract manufacturers;

industry and customer consolidation;

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;

anticipated benefits of recent acquisitions and potential future acquisitions;

statements regarding anticipated results of potential or actual litigation;

our competitive environment;

the impact of governmental regulation;