HARMONIC INC
Form 10-K
March 01, 2013
**Table of Contents**

# 2012 Annual Report

Table of Contents

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the Fiscal Year Ended December 31, 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)**

**Securities registered pursuant to section 12(b) of the Act:**

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|---|
| Common Stock, par value $.001 per share | NASDAQ Global Market |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. **Yes** ¨ **No** x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. **Yes** ¨ **No** x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. **Yes** ¨ **No** x

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** | x |
| **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

Based on the closing sale price of the Common Stock on the NASDAQ Global Market on June 29, 2012, the aggregate market value of the voting Common Stock held by non-affiliates of the Registrant was approximately $422,694,000. Shares of Common Stock held by each executive officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the Registrant s Common Stock, $.001 par value, was 115,202,002 on February 7, 2013.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Proxy Statement for the Registrant s 2013 Annual Meeting of Stockholders (which will be filed with the Securities and Exchange Commission within 120 days of the end of the fiscal year ended December 31, 2012) are incorporated by reference in Part III of this Annual Report on Form 10-K.

Table of Contents

**HARMONIC INC.**

**FORM 10-K**

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| | **PART I** | |
| ITEM 1 | BUSINESS | 4 |
| ITEM 1A | RISK FACTORS | 16 |
| ITEM 1B | UNRESOLVED STAFF COMMENTS | 39 |
| ITEM 2 | PROPERTIES | 39 |
| ITEM 3 | LEGAL PROCEEDINGS | 40 |
| ITEM 4 | MINE SAFETY DISCLOSURE | 40 |
| | **PART II** | |
| ITEM 5 | MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES | 41 |
| ITEM 6 | SELECTED FINANCIAL DATA | 43 |
| ITEM 7 | MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 44 |
| ITEM 7A | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 59 |
| ITEM 8 | FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA | 60 |
| ITEM 9 | CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE | 98 |
| ITEM 9A | CONTROLS AND PROCEDURES | 98 |
| ITEM 9B | OTHER INFORMATION | 98 |
| | **PART III** | |
| ITEM 10 | DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE | 99 |
| ITEM 11 | EXECUTIVE COMPENSATION | 99 |
| ITEM 12 | SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS | 99 |
| ITEM 13 | CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE | 99 |
| ITEM 14 | PRINCIPAL ACCOUNTANT FEES AND SERVICES | 99 |
| | **PART VI** | |
| ITEM 15 | EXHIBITS AND FINANCIAL STATEMENT SCHEDULES | 100 |
| SIGNATURES | | 101 |
| EXHIBIT INDEX | | 102 |

Table of Contents

**Forward Looking Statements**

Some of the statements contained in this Annual Report on Form 10-K are forward-looking statements that involve risk and uncertainties. The statements contained in this Annual Report on Form 10-K 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, potential, or continue or the negative of these terms or other comparable terminology. These forward-looking statements include, but are not limited to, statements regarding:

- developing trends and demands in the markets we address, particularly emerging markets;
- opportunities in the markets we address;
- new and future products and services;
- capital spending of our customers in 2013;
- our strategic direction, future business plans and growth strategy;
- industry and customer consolidation;
- anticipated changes in economic conditions, particularly in certain geographies, and in financial markets;
- the expected demand for and benefits of our products and services;
- seasonality of revenue and concentration of revenue sources;
- anticipated benefits of acquisitions;
- potential future acquisitions;
- anticipated results of potential or actual litigation;
- our competitive environment;
- the impact of governmental regulation;

- the impact of uncertain economic times and markets;
- anticipated revenue and expenses, including the sources of such revenue and expenses;
- expected impacts of changes in accounting rules;
- use of cash, cash needs and ability to raise capital; and
- the condition of our cash investments.

These statements are subject to known and unknown risks, uncertainties and other factors, which may cause our actual results to differ materially from those implied by the forward-looking statements. Important factors that may cause actual results to differ from expectations include those discussed in Risk Factors beginning on page 16 in this Annual Report on Form 10-K. All forward-looking statements included in this Annual Report on Form 10-K are based on information available to us on the date thereof, and we assume no obligation to update any such forward-looking statements. The terms Harmonic, the Company, we, us, its, and our , as used in this Annual Report on Form 10-K, refer t Harmonic Inc. and its subsidiaries and its predecessors as a combined entity, except where the context requires otherwise.

Table of Contents

# PART I

## Item 1. *BUSINESS*

**OVERVIEW**

We design, manufacture and sell versatile and high performance video infrastructure products and system solutions that enable our customers to efficiently create, prepare and deliver a full range of video services to consumer devices, including televisions, personal computers, tablets and mobile phones. Our revenue is derived from selling video processing and production and playout solutions and services to traditional video service providers, content owners, broadcasters and over-the-top, or OTT, video providers and selling network edge and access solutions and services to cable providers. Our products are deployed by thousands of media companies or video service providers, a growing portion of which are located outside the United States. We derived approximately 57% of our revenue from our international customers in 2012.

**INDUSTRY OVERVIEW**

***Demand for Video Services***

The delivery of television programming and Internet-based information and communication services to consumers is converging, driven by changes in consumer lifestyles, advances in technology and by changes in the regulatory and competitive environments. Viewers of video increasingly seek a more personalized and dynamic video experience that can be delivered to a variety of devices, ranging from widescreen high-definition and 3D televisions to mobile platforms, including smart phones and tablet computers. In part driven by the growth in video consumption devices, the demand for video content, including through Pay-TV, has also increased, putting pressure on content providers to cost-effectively produce more high-quality content and make it available on as many consumer platforms as possible. Today, there are a number of developing trends that impact the broadcasting and television business and the businesses of our customers who originate and deliver video programming. These trends distinctly impact both service providers and content providers in unique ways.

***Service Provider Trends***

Service providers face increasing competition for consumers of video content and are moving quickly to provide a more personalized, on-demand video experience to consumers. Consumers want to view video content at any time, from any location and on any device. Service providers face intense pressure to satisfy these demands, and they see a number of trends, including the following, driving their business:

***On-Demand Services***

The expanding use of digital video recorders and network-based video on demand, or VOD, services is leading to changes in the way subscribers watch television programming in the home. Subscribers are increasingly utilizing time-shifting technology. Further advances in technology are accelerating these trends, with cable, satellite and telecommunications ( telcos ) operators announcing initiatives, often in conjunction with network broadcasters, to increasingly personalize subscribers video viewing experience. Those initiatives include the delivery of programming directly to broadband enabled TV sets, tablet computers and other mobile devices, in addition to conventional TV sets.

***High-Definition Television***

The increasing popularity of HDTV, 3D and home theater equipment is putting competitive pressure on broadcasters and Pay-TV providers to offer higher quality video signals for such high definition services, including initiatives to deliver video in ultra high resolution formats. At the end of 2012, leading operators in the U.S. were offering hundreds of national and local HD channels to their subscribers across the country and a similar trend is continuing to grow in international markets.

***The Internet and Other Video Distribution Methods***

As a competitive response to alternative video distribution models by Hulu and Netflix, as well as traditional broadcasters making their content available on-line, traditional service providers are expanding their offering to allow their customers to stream video to a range of personal video devices. These new platforms with either fixed or mobile broadband connections are rapidly gaining popularity and poised to become a major factor in the future of video. We believe that the delivery of video over internet protocol will continue to change traditional video viewing habits and distribution methods and also potentially alter the traditional subscription business model of the major Pay-TV service providers.

***Pay TV in Emerging Markets***

With a rapidly growing middle class across emerging markets, the Pay-TV business is poised for rapid growth over the coming decade. Consumers who are entering the middle class are now able to afford a monthly video service to gain access to their favorite sports, news and movies. Considering the early stages of economic development in many of these regions, together with the sheer scale of the population, it is conceivable that the leading video service providers in these regions will grow and could become world leaders, and, as a result, the investments they will make in their infrastructure are likely to rapidly trend upward.

***Branded Content***

In an attempt to differentiate their products in the competitive market, traditional service providers are looking to enhance their offerings by creating and delivering their own branded content. This transition to branded content is being accomplished either by organic in-house development of new content or acquisition of existing and well established content brands. The historic demarcation point between traditional service providers (distributors) and content owners (creators) will continue to become blurry over time.

***Content Provider Trends***

As the number of video consumption platforms increase and service provider competition creates more opportunities to reach consumers, content providers are facing increasing demands for more content and in many more formats. The process of producing and preparing content for multi-screen delivery means that content providers must become more efficient to keep up with demand. At the same time, content providers realize that their ownership of content rights gives them market power, with many content providers now looking at launching their own content distribution initiatives to reach consumers directly. Several important trends, including the following, are impacting content providers.

***Demand for High-Quality HD Content***

With service providers adding more HD channels and consumers viewing HD television content on ever-larger screens and home theater environments, the demand for more and higher-quality HD programming continues to escalate. From sports to news to episodic to movies, content providers face increasing pressure to deliver the highest quality HD programming across all types of platforms, driving an accelerating transition from standard definition to HD.

***Content Format Proliferation***

As service providers seek to deliver more video services to more devices and platforms, they are increasingly requiring content providers to supply content that is properly formatted for each device. With the number of devices continuing to grow, the lack of consistent video standards means that content providers must reformat and package their content in dozens of different formats so that their content is viewable across all of these different devices.

Table of Contents

***Fragmentation of Revenue Sources***

As consumers divide their viewing across a wider range of devices, the revenues associated with content correspondingly are divided across all of the different viewing outlets. While total content revenues, either from advertising or subscription fees, may remain stable or even increase, the amount of total revenue available to support any particular format or viewing platform may decrease, causing content providers to become more efficient and cost-effective in the production and packaging of their content.

***Move to File-Based Workflows***

From newsrooms to Hollywood studios, there has been a growing shift from traditional tape-based acquisition and production to a more file-based workflow, where video content is captured, compressed, stored and edited as a file residing in a storage system. The move to video file-based production streamlines the production process because content can be more readily shared across multiple production applications and various media processing tasks can be performed on stored content in a faster-than-real-time manner. These trends are driving content providers to invest in video file infrastructure that will help them produce more content, faster and more cost-effectively, with server and storage solutions that will enable them to provide content in the widest possible range of formats and at the highest possible quality.

***Content Creation in Emerging Markets***

With a rapidly growing middle class in emerging markets, media companies addressing these markets are aggressively investing in the creation of new content with the goal of creating strong brands and a growing loyal customer base. In addition, the sheer size of select emerging economies leads to regional content creation targeted towards localized subject matters and demands, also boosting the overall potential for rapid content creation growth.

***Direct Access of Consumers***

Content owners and media companies across the globe are experimenting with the notion of offering their content directly to the end consumer. Some of these efforts are in collaboration with their historic distribution partners (video service providers), such as HBO-GO, while others are in competition with those partners.

***The Market Opportunity***

Personalized video services, such as VOD, and the increasing amounts of high resolution content, as well as an expanding amount of over-the-top video services, pose challenges to both content producers and service providers. For content producers, the increase in high-quality video consumption across these new services requires high-performance, reliable video production, transcoding and playout infrastructure in order to support the increased workload. Existing tape-based operations are inadequate for keeping up with the fast-paced demands for new content, new channels and new formats for video content. File-based production storage, high-throughput media transformation and server-based playout enable content producers to meet these growing demands.

For service providers, providing access to all these new forms of content requires more sophisticated video processing capabilities and greater bandwidth to the home in order to deliver maximum choice and flexibility to the subscriber. In addition, the delivery of live television and downloadable content to broadband connected tablets and other mobile devices creates bandwidth constraints and network management challenges. The demand for more bandwidth-intensive video, voice and data content has strained existing communications networks, especially where video is received and processed, and in the last mile of the communications infrastructure, where homes connect to the local network. The upgrade and extension of existing processing capabilities and distribution networks, or the construction of completely new environments to facilitate the processing and

Table of Contents

delivery of high-speed broadband video, voice and data services, requires substantial expenditures and often the replacement of significant portions of the existing infrastructure. As a result, service providers are seeking solutions that maximize the efficiency of existing available bandwidth and cost-effectively manage and transport digital traffic within networks, while minimizing the need to construct new networks for the distribution of video, voice and data content.

***Competition and Deregulation***

Competition for traditional service providers in the cable and satellite markets has intensified as offerings from new entrants, such as telcos and OTT providers, are beginning to attract customers. This increasingly competitive environment may lead to higher capital spending by some of the market participants, particularly internationally, in an effort to deploy attractive service offerings, to capture and retain high revenue-generating subscribers, and to increase overall average revenue per user, or ARPU from the existing customer base. While global economic trends were volatile throughout 2012, particularly in Europe, this competitive dynamic appears to be continuing.

Similar competitive factors and the continued liberalization of the regulatory environment in foreign countries have led to the establishment abroad of new or expanded businesses providing video services, either in distribution of content, creation of content or both. We believe this trend is likely to increase due to growing disposable incomes and favorable macro economic trends in some foreign countries.

***Our Cable Market***

To address increasing competition, reduce loss of customers, increase ARPU and differentiate themselves, cable operators have embarked on several initiatives to improve their product offerings:

- Continued introduction of bundled digital video, voice and high speed data services.
- Expansion of VOD libraries and on-demand service offerings.
- Refresh of the user experience with upgraded home set-top box solutions.
- Launches of video delivery over IP to broadband enabled consumer devices, such as phones, tablets and TV.
- Capacity enhancement of high-speed data services, using DOCSIS 3.0.
- Expansion of network capacity to support the growing number of services, including HDTV in foreign markets.
- Collaboration with content owners on offering access to on-line content for subscribers of premium content.

To support this rapid expansion of service offerings, cable operators are investing in digital video equipment that can receive, process and distribute content from a variety of sources to a growing number of consumer devices, video storage equipment and servers to ingest, store and intelligently distribute increasing amounts of content, complemented by edge devices capable of routing, multiplexing and modulating in order to deliver signals to individual subscribers over a hybrid fiber-coaxial, or HFC, network.

***Our Satellite Market***

Over 100 satellite operators around the world have established digital television services that serve tens of millions of subscribers. These services are capable of providing tens of thousands of channels, including an increasing number of high definition channels. These linear services will likely continue to expand as operators offer premium packages targeted towards specific consumer groups, with the goal of gaining loyalty and

expanding ARPU. In parallel, satellite operators have began offering the same linear services and VOD options to their customer base via broadband connected consumer devices such as smart phones, tablets and their own set-top boxes. These services are deployed in conjunction with content delivery networks ( CDNs ) and are accessible through partnerships, acquisitions or internal investments. To support much of these new services, satellite operators are considering an upgrade to their video infrastructure in order to provide a dual gain of bandwidth efficiency and operational optimization in an increasingly complex environment.

Internationally, and specifically in emerging markets, satellite operators have continued to enjoy substantial growth in their customer base, driven mainly by rapid economic development, which has resulted in a significantly growing middle class with disposable income. As this growth continues, it is expected that these satellite operators will expand their product offerings in an effort to leverage the growing customer base and increase overall revenue.

***Our Telco Market***

Over the past several years, telcos around the world have added video services as a competitive response to cable and satellite operators and as a potential source of revenue growth. As their businesses have grown and matured, they have also expanded their offerings in an effort to successfully compete in the video arena, including premium quality HD and 3D content, larger on-demand libraries, time-shift television services, bundled packages, multi-screen offerings to smart phones and tablets and branded mobile specific services. The last of these offerings is a key advantage they enjoy today, creating a clear differentiator in any-time, anywhere service offerings, as well as a rich library option for consumers looking to view content on the move.

***Our Terrestrial Market***

In the terrestrial broadcasting market, operators in many countries in Europe, Asia Pacific, Africa and South America are now required by regulation to convert from analog to digital transmission in order to free up broadcast spectrum. The conversion to digital transmission often provides the opportunity to deliver new channels, HD services, premium content and interactive services. These broadcasters are faced with requirements of converting analog signals to digital signals prior to transmission over the air, as well as to distribute these new signals across a new terrestrial network.

***Our Broadcast and Media Markets***

Network broadcasters, programmers and content owners need to transmit live programming of news and sports to their studios, to subsequently broadcast their content, and to deliver their content to video service providers for distribution to their subscribers. These broadcasters generally produce their own news and sports highlight content, along with hundreds of channels of network programming that is played to air under strict reliability requirements. With our acquisition of Omneon in 2010, the broadcast and media market has grown to become our second largest market, representing approximately 32% of our revenue in 2012.

To successfully service consumers demands, media companies are expanding their offerings to support both a wide range of live/linear content, and to make the content available in an on-demand manner. As a result, their transition towards automated file based workflows have accelerated and, accordingly, so have their needs for media servers, video optimized storage and transformation video products. In addition, and in an effort to optimize their operations, distribution networks responsible for moving content to the service providers are being upgraded to handle larger volumes of content in more efficient formats and with greater flexibility.

***Other Markets***

We are addressing video processing and content creation opportunities with a variety of new video entrants, some of which distribute video via traditional television channels or over-the-top and many of which use both methods of distribution.

Table of Contents

***Current Industry Conditions***

Many of our customers, particularly our international customers in geographies other than Europe, appeared to have increased their capital expenditures in 2011 and 2012, compared to 2009 and 2010, and it is possible that the trends described in the previous sections above may continue to drive capital investments in 2013, particularly in emerging markets. We expect capital spending by many of our international customers to continue at 2012 levels, or increase, in 2013, and that capital spending by our U.S. customers may remain flat in 2013. Nevertheless, the global economic instability that exists today, particularly in Europe, and the potential worldwide adverse impact of that instability pose a significant risk that such expectation will not be met, as such instability may result in a tougher economic environment for our customers to access credit and to broaden their capital investments.

**PRODUCTS**

Our products generally fall into three principal categories; video production platforms and playout solutions, video processing solutions and edge and access products. We also provide technical support services and professional services to our customers worldwide. Our video production platforms consist of video-optimized storage and content management applications that provide content companies with file-based infrastructure to support video content production activities, such as editing, post-production and finishing. Our playout solutions are based on scalable video servers used by content owners and multi-channel operators for assembly and playout of one or more television channels. Our video processing solutions, which include network management software and application software products, provide broadband operators with the ability to acquire a variety of signals from different sources and in different protocols in order to deliver a variety of real-time and stored content to their subscribers. Many of our customers also use these products to organize, manage and distribute content in ways that maximize use of the available bandwidth. Our edge products enable cable operators to deliver customized broadcast or narrowcast on-demand and data services to their subscribers. Our access products, which consist mainly of optical transmission products, node platforms and return path products, allow cable operators to deliver video, data and voice services over their distribution networks.

***Video Production Platforms and Playout Solutions***

*Video servers.* The Spectrum and MediaDeck video server products are used by broadcasters, content owners and multi-channel network operators to create and play-to-air television channels. Our servers support both standard and high definition programming, as well as many different media formats, such as MPEG-2, MEPG-4, DV and AVC-Intra, using both QuickTime and MXF media wrapper formats. Typically our customers use our servers to record incoming content from either live feeds or from tapes, encoding that content in real-time into standard media files that are stored in the server s file system until the content is needed for playback as part of a scheduled playlist. Clips stored in the server are decoded in real-time and played to air according to a playout schedule in a frame-accurate, back-to-back manner to create a seamless television channel.

*Video-optimized storage.* The MediaGrid active storage system is a scale-out, network-attached storage system with a built-in media file system that has been optimized for typical read and write file operations found in media production workflows. Architected as a clustered storage system with a distributed file system, MediaGrid provides highly scalable storage capacity and access bandwidth to support demanding media production applications, such as video editing, content transformation and media library management.

*Media Applications.* Complementing our server and storage platforms, our Media Application Server or MAS, combined with a suite of integrated applications, including ProXplore, ProBrowse and ProXchange, provides a basic level of integrated media management and workflow control over content stored across our systems. For more complex media management, our underlying API, called Media Services Framework, allow both customers and other application developers to build advanced media management applications that can automate many media processing and movement tasks, collect and organize content metadata, and provide search and review functionality.

**Table of Contents**

***Video Processing Solutions***

*Broadcast encoders.* Our Electra and Ion high performance encoders compress video, audio and data channels to low bit rates, while maintaining high video quality. Our encoders are available in standard and high definition formats in both MPEG-2, and the newer MPEG-4 AVC/H.264, or MPEG-4, video compression standards, for both televisions and new multi-screen formats targeted at smart phones, tablets and broadband connected TVs. Our Electra 9000 encoder supports all of these formats on the same hardware platform. Most of these encoders are used in real-time linear video applications, but they are also employed in conjunction with our software in encoding of video content and storage for later delivery as VOD and time-shifted services.

*Contribution and distribution encoders.* Our Ellipse encoders provide broadcasters with video compression solutions for on-the-spot news gathering, live sports coverage and other remote events. These products enable our customers to deliver these feeds to their studios for further processing. Broadcasters and other operators, such as teleports, also use these encoders for delivery of their programming to their customers, typically cable, telco and satellite operators.

*Stream processing and statistical multiplexing solutions.* Our ProStream platform and other stream processing products offer our customers a variety of capabilities that enable them to manage and organize digital streams in a format best suited to their particular delivery requirements and subscriber offerings. Our multi-function ProStream 1000 addresses multiplexing, encryption, ad insertion and other advanced processing requirements of MPEG video streams and can be integrated with our DiviTrackIP statistical multiplexer, which enhances the bandwidth efficiency of our encoders by allowing bandwidth to be dynamically allocated according to the complexity of the video content. DiviTrackIP also enables operators to combine inputs from different physical locations into a single multiplex.

*Content preparation and delivery for multi-screen applications.* We offer a variety of content preparation, storage and delivery software based solutions that enable high-quality broadcast and on-demand video services on any device (TV, PC or mobile). Our ProMedia family of products provide live-based transcoding, packaging and time-shifting, file-based transcoding and workflow management solutions to facilitate content preparation in any format. Our MediaGrid active storage system provides scalable, high performance network-attached storage to store growing libraries of content. Our multi-screen solutions are used for a variety of applications, including live streaming, VOD, catch-up TV, start-over TV, network PVR through HTTP streaming and multi-bitrate adaptive HTTP streaming.

*Decoders and descramblers.* We provide our ProView integrated receivers-decoders to allow service providers to acquire content delivered via satellite, IP or terrestrial networks for distribution to their subscribers. These products are also used to decode signals backhauled from live news and sporting events in contribution applications and, more recently, are used by content owners looking to distribute their content in a controlled manner to a large base of video service providers.

*Management and control software.* Our NMX Digital Service Manager gives service providers the ability to control and visually monitor their digital video infrastructure at an aggregate level, rather than as just discrete pieces of hardware, thereby reducing their operational costs. Our NETWatch management system operates in broadband networks to capture measurement data and our software enables the broadband service operator to monitor and control the HFC transmission network from a master headend or remote locations. Our NMX Digital Service Manager and NETWatch software is designed to be integrated into larger network management systems through the use of simple network management protocol, or SNMP.

***Edge and Access Products***

*Edge products.* Our Narrowcast Services Gateway family, or NSG, is a fully integrated edge gateway that integrates routing, multiplexing, scrambling and modulation into a single package for the delivery of narrowcast services to subscribers over cable networks. An NSG is usually supplied with single Gigabit Ethernet inputs or

**Table of Contents**

multiple Gigabit Ethernet inputs, allowing the cable operator to use bandwidth efficiently by delivering IP signals from the headend to the edge of the network for subsequent modulation onto the HFC network. Originally developed for VOD applications, our most recent NSG product, the high-density, multi-function NSG 9000, may also be used in switched digital video and modular Cable Modem Termination Systems, or M-CMTS, applications, as well as large-scale VOD deployments.

*Optical transmitters and amplifiers.* Our family of optical transmitters and amplifiers operates at various optical wavelengths and serves both long-haul and local transport applications in the cable distribution network. The PWRLink series provides optical transmission primarily at a headend or hub for local distribution to optical nodes and for narrowcasting, which is the transmission of programming to a select set of subscribers. Our METROLink Dense Wave Division Multiplexing, or DWDM, system allows operators to expand the capacity of a single strand of fiber and to provide narrowcast services directly from the headend to nodes. We also offer SupraLink, a transmitter that allows deeper deployment of optical nodes in the network and minimizes the significant capital and labor expense associated with deploying additional optical fiber.

*Optical nodes and return path equipment.* Our family of PWRBlazer optical nodes supports network architectures that meet the varying demands for bandwidth delivered to a service area. By the addition of modules providing functions such as return path transmission and DWDM, our configurable nodes are easily segmented to handle increasing two-way traffic over a fiber network without major reconstruction or replacement of our customers networks. Our return path transmitters support two-way transmission capabilities by sending video, voice and data signals from the optical node back to the headend. These transmitters are available for either analog or digital transport.

***Technical Support and Professional Services***

We provide maintenance and support services to most of our customers under service level agreements that are generally renewed on an annual basis. We also provide consulting, implementation and integration services to our customers worldwide. We draw upon our expertise in broadcast television, communications networking and compression technology to design, integrate and install complete solutions for our customers, including integration with third-party products and services. We offer a broad range of services, including program management, technical design and planning, parts inventory management, building and site preparation, integration and equipment installation, end-to-end system testing and comprehensive training.

**CUSTOMERS**

We sell our products to a variety of cable, satellite and telco, and broadcast and media companies. Set forth below is a representative list of our significant end user and integrator/distributor customers, based, in part, on revenue during 2012.

| United States | International |
|---|---|
| Cablevision Systems | Alcatel Lucent |
| Centurylink | Bell Expressvu |
| Charter Communications | Capella Telecommunications |
| Comcast Cable | Huawei Technologies |
| Cox Communications | Klonex -VCS |
| DirecTV | Netorium |
| EchoStar Holding | Rogers Communications |
| TRC Integration | Sky Perfect JSAT Corp. |
| Time Warner Cable | Virgin Media |
| Turner Broadcasting | Ziggo NV |

Historically, a majority of our revenue has been derived from relatively few customers, due in part to the consolidation of the ownership of cable television and direct broadcast satellite system companies. However, in

the last few years, revenue from our ten largest customers has decreased as a percentage of revenue, due to our growing customer base, in part as a result of the acquisition of Scopus in 2009 and Omneon in 2010. Sales to our ten largest customers in 2012, 2011 and 2010 accounted for approximately 33%, 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.

During 2012, 2011 and 2010, revenue from Comcast accounted for 12%, 11% and 17% respectively, of our revenue. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows. In addition, we are involved in most quarters in one or more relatively large individual transactions, including, from time to time, projects in which we act much like a systems integrator. A decrease in the number of relatively larger individual transactions in which we are involved in any quarter could adversely affect our operating results for that quarter.

**SALES AND MARKETING**

In the U.S. we sell our products through our own direct sales force, as well as through independent distributors and integrators. Our direct sales team is organized geographically and by major customers and markets to support customer requirements. We sell to international customers through our own direct sales force, as well as through independent distributors and integrators. Our principal sales offices outside of the U.S. are located in Europe and Asia, and we have a support center in Switzerland to support our international customers. International distributors are generally responsible for importing our products and providing certain installation, technical support and other services to customers in their territory. Our direct sales force and distributors are supported by a highly trained technical staff, which includes application engineers who work closely with operators to develop technical proposals and design systems to optimize system performance and economic benefits to operators. Technical support provides a customized set of services, as required, for ongoing maintenance, support-on-demand and training for our customers and distributors, both in our facilities and on-site.

Our marketing organization develops strategies for product lines and markets and, in conjunction with our sales force, identifies the evolving technical and application needs of customers so that our product development resources can be most effectively and efficiently deployed to meet anticipated product requirements. Our marketing organization is also responsible for setting price levels, demand forecasting and general support of the sales force, particularly at major accounts. We have many programs in place to heighten industry awareness of our products, including participation in technical conferences, publication of articles in industry journals and exhibitions at trade shows.

**MANUFACTURING AND SUPPLIERS**

We use third party contract manufacturers extensively to assemble our products and a substantial majority of subassemblies and modules for our products. Our reliance on subcontractors involves several risks, and we may not be able to obtain an adequate supply of components, subassemblies, modules and turnkey systems on a timely basis. In 2003, we entered into an agreement with Plexus Services Corp. to act as our primary contract manufacturer. Plexus currently provides us with a substantial majority, by dollar amount, of the products we purchase from our contract manufacturers. This agreement has automatic annual renewals, unless prior notice is given, and has been automatically renewed until October 2013. We do not generally maintain long-term agreements with any of our contract manufacturers.

Our internal manufacturing operations consist primarily of final assembly and testing of fiber optic systems. These processes are performed by highly trained personnel, employing technologically advanced electronic equipment and proprietary test programs. The manufacturing of our products and subassemblies is a complex process, and we cannot be sure that we will not experience production problems or manufacturing delays in the

future. Because we utilize our own manufacturing facilities for the final assembly and test of our fiber optic systems, and because such manufacturing capabilities are not readily available from third parties, any interruption in our manufacturing operations could materially and adversely affect our business, operating results, financial position and cash flows.

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 are dependent on one company for certain video encoding chips that are incorporated into several of our products.

Our reliance on sole or limited suppliers, particularly foreign suppliers, involves several risks, including a potential inability to obtain an adequate supply of required components, subassemblies or modules and reduced control over pricing, quality and timely delivery of components, subassemblies or modules for a number of reasons, including as a result of the impact of natural disasters on those suppliers. In particular, certain components have in the past been in short supply and are available only from a small number of suppliers or from sole source suppliers. While we expend considerable efforts to qualify additional component sources, consolidation of suppliers in the industry and the small number of viable alternatives have limited the results of these efforts. We do not generally maintain long-term agreements with any of our suppliers.

Managing our supplier relationships is particularly difficult during time periods in which we introduce new products or in which demand for our products is increasing, especially if demand increases more quickly than we expect. An inability to obtain adequate and timely deliveries, or any other circumstance that would require us to seek alternative sources of supply, could affect our ability to ship our products on a timely basis, which could damage relationships with current and prospective customers and harm our business. We attempt to limit this risk by maintaining inventories of certain components, subassemblies and modules and through our demand order fulfillment system. As a result of this investment in inventories, we have in the past been, and in the future may be, subject to a risk of excess and obsolete inventories, which could adversely affect our business and operating results.

**INTELLECTUAL PROPERTY**

As of December 31, 2012, we held 59 issued U.S. patents and 22 issued foreign patents and had 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 cannot assure you 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 claims, or the scope of the claims, sought by us, if at all. For example, in October 2011 and June 2012, Avid Technologies, Inc. sued us for patent infringement, alleging, in the first action, that our MediaGrid product infringes two patents held by Avid and, in the second action, that our Spectrum product infringes one patent held by Avid. We cannot assure you that others will not develop technologies that are similar or superior to our technology, duplicate our technology or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or may do business in the future.

We generally enter into confidentiality or license agreements with our employees, consultants, vendors and customers as needed, and generally limit access to, and distribution of, our proprietary information. However, no assurances can be given that these actions will prevent misappropriation of our technology. In addition, if necessary, we are prepared to take legal action, in the future, 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. Any such litigation could result in substantial costs and diversion of resources, including management time, and could negatively affect our business, operating results, financial position and cash flows.

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

The markets we address are 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, as well as an increasing number of companies whose principal business is the ownership and exploitation of patents, have extensive patent portfolios. From time to time, third parties, including certain of these companies, have asserted, and may in the future assert, exclusive patent, copyright, trademark and other intellectual property rights against us or our customers. There can be no assurance that we will be able to defend against any claim that we are infringing upon their intellectual property rights, that the terms of any license offered by any person asserting such rights would be acceptable to us or our customers, or that failure to obtain a license or the costs associated with any license would not materially and adversely affect our business, operating results, financial position and cash flows.

**BACKLOG**

We schedule production of our products and solutions based upon our backlog, open contracts, informal commitments from customers and sales projections. Our backlog consists of firm purchase orders by customers for delivery within the next twelve months, as well as deferred revenue that is expected to be recognized within the succeeding twelve months. At December 31, 2012, backlog, including deferred revenue, was $132 million, compared to $125 million at December 31, 2011. The increase in backlog at December 31, 2012, from December 31, 2011, was due to an increase in orders received under which product shipments had not been made. Delivery schedules on such orders may be deferred or canceled for a number of reasons, including reductions in capital spending by our customers or changes in specific customer requirements. In addition, due to annual capital spending budget cycles at many of our customers, our backlog at December 31, 2012, or any other date, is not necessarily indicative of actual sales for any succeeding period.

**COMPETITION**

The markets for video infrastructure systems are extremely competitive and have been characterized by rapid technological change and declining average selling prices. The principal competitive factors in these markets include product performance, reliability, price, breadth of product offerings, network management capabilities, sales and distribution capabilities, technical support and service, and relationships with network operators. We believe that we compete favorably in each of these categories. Our competitors in digital video solutions include vertically integrated system suppliers, such as Motorola, Cisco Systems, Ericsson and Thomson Video Networks, and, in certain product lines, a number of smaller companies, including Envivio, RGB Networks and Elemental. In production and playout products, competitors include Harris (now The Gores Group), Grass Valley, Miranda and Avid. In edge devices and fiber optic access products, competitors include Motorola Mobility (acquired by Google in 2012), Cisco Systems, Aurora and Arris.

Consolidation in the industry has led to the acquisition of several of our historic competitor companies. For example, Scientific Atlanta, Tandberg Television, and BigBand Networks and C-Cor were acquired by Cisco Systems, Ericsson and Arris, respectively. Further, Arris recently announced that it would be acquiring Motorola Home from Google s Motorola Mobility unit. Consequently, most of our principal competitors are substantially larger and have greater financial, technical, marketing and other resources than we have. Many of these larger organizations are in a better position to withstand any significant reduction in capital spending by customers in these markets and are often more capable of engaging in price-based competition for sales of products. They often have broader product lines and market focus, and, therefore, will not be as susceptible to downturns in a

particular market. In addition, many of our competitors have been in operation longer than we have and have more long-standing and established relationships with domestic and foreign customers. Further, a few of our competitors offer long-term lease financing to customers for products competitive with ours. We may not be able to compete successfully in the future and competition may harm our business, operating results, financial position and cash flows.

If any of our competitors products or technologies were to become the industry standard, our business could be seriously harmed. In addition, companies that have historically not had a large presence in the broadband communications equipment market have expanded their market presence through mergers and acquisitions. Further, our competitors 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, which could adversely affect our revenue and result in lower gross margins.

**RESEARCH AND DEVELOPMENT**

We have historically devoted a significant amount of our resources to research and development. Research and development expenses in 2012, 2011, and 2010 were $106.2 million, $102.7 million and $77.2 million, respectively. Our internal research and development activities are conducted primarily in the United States (California, Oregon, New York and New Jersey), Israel and Hong Kong.

Our research and development program is primarily focused on developing new products and systems, and adding new features to existing products and systems. Our development strategy is to identify features, products and systems, in both software and hardware solutions, that are, or are expected to be, needed by our customers. Our current research and development efforts are focused heavily on video processing solutions, including enhanced video compression and multi-screen solutions. We also devote significant resources to production and playout and distribution solutions. Other research and development efforts are devoted to edge QAM devices for both video and data, and broadband optical products that enable the transmission of video over fiber optic networks.

Our success in designing, developing, manufacturing and selling new or enhanced products will depend on a variety of factors, including the identification of market demand for new products, product selection, timely implementation of product design and development, product performance, effective manufacturing and assembly processes and sales and marketing. Because of the complexity inherent in such research and development efforts, we cannot assure you that we will successfully develop new products, or that new products developed by us will achieve market acceptance. Our failure to successfully develop and introduce new products would materially and adversely affect our business, operating results, financial condition and cash flows.

**EMPLOYEES**

As of December 31, 2012, we employed a total of 1,148 people, including 439 in research and development, 223 in sales, 179 in service and support, 145 in operations, 57 in marketing (corporate and product), and 105 in a general and administrative capacity. There were 660 employees in the U.S. and 488 employees in foreign countries located in South America, the Middle East, Europe, Asia, and Canada. We also employ a number of temporary employees and consultants on a contract basis. None of our employees are represented by a labor union with respect to his or her employment by Harmonic. We have not experienced any work stoppages, and we consider our relations with our employees to be good. Our future success will depend, in part, upon our ability to attract and retain qualified personnel. Competition for qualified personnel in the broadband communications industry and in the geographic areas where our primary operations are located remains strong, particularly for highly qualified technical personnel, and we cannot assure you that we will be successful in retaining our key employees or that we will be able to attract the key employees or highly qualified technical personnel we may require in the future.

Table of Contents

**ABOUT HARMONIC**

Harmonic was initially incorporated in California in June 1988 and reincorporated into Delaware in May 1995.

In March 2009, we completed the acquisition of Scopus Video Networks, Ltd. The acquisition of Scopus was intended to strengthen our position in international video broadcast and contribution and distribution markets. Scopus provides complementary video processing technology, expanded research and development capability and additional sales and distribution channels, particularly in emerging markets.

In September 2010, we completed the acquisition of Omneon, Inc., a private, venture-backed company specializing in file-based infrastructure for the production, preparation and playout of video content typically deployed by broadcasters, satellite operators, content owners and other media companies. The acquisition of Omneon is complementary to our core business, expanding our customer reach into content providers and extending our product lines into video servers and video-optimized storage for content production and playout.

Our principal executive offices are located at 4300 North First Street, San Jose, California 95134. Our telephone number is (408) 542-2500. Our Internet website is http://www.harmonicinc.com. Other than the information expressly set forth in this Annual Report on Form 10-K, the information contained or referred to on our web site is not part of this report.

**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, state, local and foreign government regulation of telecommunications, television broadcasting and streaming media;
- overall demand for communication services and consumer acceptance of new video and data 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;

Table of Contents

- emphasis by operators on generating revenue from existing customers, rather than from new customers, through construction, expansion or upgrades;
- a reduction in the amount of capital available to finance projects of our customers and potential customers;
- proposed and completed business combinations and divestitures by our customers and the length of regulatory review of each;
- completion of a new system or significant expansion or upgrade to a system; and
- bankruptcies and financial restructuring of major customers.

In the past, adverse economic conditions in one or more of the geographies in which we offer our products have adversely affected our customers capital spending in those geographies and, as a result, our business. In 2008, 2009 and the first half of 2010, economic conditions in many of the geographies in which we offer our products were 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 may continue to be weak in Europe, during 2013.

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

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 experienced similar pressure during the economic slowdown in the second half of 2011 and in 2012.

Table of Contents

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 (now The Gores Group), Grass Valley, Miranda and Avid. Our principal competitors for edge and access products are Cisco Systems, Motorola Mobility (acquired by Google in 2012), 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 or payment terms, which has in the past caused, and may in the future cause, us to lose sales opportunities and the resulting revenue or to reduce our prices in response to that competition. Reductions in prices for any of our products could materially and adversely affect our operating margins and revenue. 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 revenue and decreased gross margins.

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

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

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

- are not cost effective;
- are not brought to market in a timely manner;
- are not in accordance with evolving industry standards;
- fail to meet market acceptance or customer requirements; or
- are ahead of the needs of their markets.

We are currently developing and marketing products based on established video compression standards, such as MPEG-4 AVC/H.264, which provides significantly greater compression efficiency, thereby making more bandwidth available to operators. We are also 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 introducing products that 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, the first half of 2010, the second half of 2011, and 2012. That weakness 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 have, in the past, required us to significantly increase our allowance for doubtful accounts. It is possible that adverse economic conditions may return during 2013, on a regional or global basis, and it appears that weak economic conditions that reoccurred in most countries in Europe in the second half of 2011 and in 2012, principally as a result of the European sovereign debt crisis, may continue in 2013.

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. Any further lowering of that credit rating, whether as a result of the U.S. government failing to timely increase its debt limit or to take steps to reduce its deficit, or the impact of the U.S. government forced reductions in spending due to sequestration, 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. The impact of any of these issues, which appears to have negatively affected Europe in the second half of 2011 and in 2012 and may continue to negatively affect Europe during 2013, 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. Over the last three fiscal years and particularly in 2012, 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 fiscal years ended December 31, 2012, 2011 and 2010, accounted for approximately 33%, 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 fiscal years ended December 31, 2012, 2011 and 2010, revenue from Comcast accounted for approximately 12%, 11% and 17%, respectively, of our revenue. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect, 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 fiscal years ended December 31, 2012, 2011 and 2010, represented approximately 57%, 55%, and 50% of our revenue, respectively. The percentage of our revenue attributable to international operations primarily resulted from an increase in sales in the Asia Pacific region, particularly in the second half of 2012, offset by a decrease in sales in Europe, and a decrease in sales in the U.S., primarily to the satellite market. 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

Table of Contents

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:

- growth and stability of the economy in one or more international regions;
- fluctuations in currency exchange rates;
- changes in foreign government regulations and telecommunications standards;
- import and export license requirements, tariffs, taxes and other trade barriers;
- a significant reliance on distributors, resellers and others 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, and the similar U.K. law, 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.

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 U.S. also require us to comply with a number of U.S. and international regulations. For example, our operations in countries outside the U.S. are subject to the FCPA and similar laws, which prohibit U.S. 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 U.S. 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

Table of Contents

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.

***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 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 4 G-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;

consumer interest in Ultra HDTV;

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

Table of Contents

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.

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 substantial 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.

Most of the products manufactured by our Israeli operations are outsourced to a single third party manufacturer located in Israel. Our ability to improve production efficiency with respect to those products had been limited, until 2012, 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, in 2012, 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

Table of Contents

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 revenue and other operating results. We attempt to limit this risk by maintaining safety stocks of certain components, subassemblies and modules. Increases, from time to time, 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;
- 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;

changes in the number and size of relatively large 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;

Table of Contents

- 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;
- 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 is renewed for 2014 and beyond;
- changes in our effective federal tax rate, including as a result of changes in our valuation allowance against our deferred tax assets, and changes in our effective state tax rates, including as a result of apportionment;

- changes 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.

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

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

We are required to periodically review our deferred tax assets and determine whether, based on available evidence, a valuation allowance is necessary. Accordingly, we have performed such evaluation, from time to time, based on historical evidence, trends in profitability, expectations of future taxable income and implemented tax planning strategies. We continue to maintain a valuation allowance for certain foreign and California deferred tax assets. In the event, in the future, we determine an additional valuation allowance is necessary with respect to our U.S. state or foreign deferred tax assets, we would incur a charge equal to the amount of the valuation allowance, as a discrete item, in the period in which we made such determination 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 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 an audit, which commenced in the first quarter of 2012, by the Israel tax authority for the years 2007 through 2010. 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, operating results and cash flow 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-

Table of Contents

sharing arrangement, and certain licenses and other contractual arrangements between us and our wholly-owned domestic and foreign subsidiaries. As a result of these changes, we anticipate that our consolidated pre-tax income will be subject to foreign tax at relatively lower tax rates when compared to the U.S. federal statutory tax rate and, as a consequence, our effective income tax rate is expected to be lower than the U.S. federal statutory rate.

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

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

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the telecommunications industry have extensive patent portfolios. 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 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 Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint, alleging that Harmonic s 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, or any other intellectual property infringement action, 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

Table of Contents

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 affect 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 or currently reimburse the customer for its costs of such defense. 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 other 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 may be obligated to pay amounts to such customer(s) that, either individually or in the aggregate, could materially and adversely affect our operating results, financial condition and cash flows.

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

We generate a significant 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 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 or 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.

***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 221 employees, or approximately 19% of our worldwide workforce, as of December 31, 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 15% of those employees were called for active military duty in 2012. 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. In 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;
- 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 or disposal; and

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

Table of Contents

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 December 31, 2012, we have approximately $213 million of goodwill recorded on our balance sheet associated with prior acquisitions. In the event we determine that our goodwill is impaired, we would be required to write down all or a portion of such goodwill, which could result in a material non-cash charge to our results of operations in the period in which such write-down occurs.

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.

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

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

On February 18, 2013, we entered into an Asset Purchase Agreement with Aurora Networks pursuant to which we agreed to sell our cable access HFC business (the Business ) for $46 million in cash. Although no assurance can be given as to whether and when this transaction will close, it is presently scheduled to close on March 4, 2013, and may be terminated by either party if it does not close by March 29, 2013. In 2012, revenue from this Business was approximately $53 million, which represented approximately 10% of our revenue for the year.

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

31

The sale of the Business, if it closes, would reduce future annual potential revenue, likely in the range of $50 million to $55 million, future annual expenses, including cost of sales, likely in the range of $45 million to $50 million, and cash flow. With this reduction in revenue and cash flow, the sale could also have an adverse affect on our results of operations and financial position. A failure of the sale to close would have a material effect on our expenses in the quarter in which it is scheduled to close.

***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, which could cause a sustained interruption or loss of affected operations, and cause us to suffer significant financial losses.

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

In addition, if there is a 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, or both, 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 2010, we added 286 employees, most of whom are based in the U.S.

As of December 31, 2012, we have 488 employees in our international operations, representing approximately 43% 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 December 31, 2012, we held 59 issued U.S. patents and 22 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.

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.

Table of Contents

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

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

We incorporate certain third-party technologies, including software programs, into our products, and, as noted, intend to utilize additional third-party technologies in the future. In addition, the technologies that we license may not operate properly or as specified, and we may not be able to secure alternatives in a timely manner, either of which could harm our business. We could face delays in product releases until alternative technology can be identified, licensed or developed, and integrated into our 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.

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

On January 28, 2013, our Board of Directors approved a $75 million increase to our existing $25 million stock repurchase program. On February 19, 2013, the Board approved a further approximately $35 million increase to the program, contingent upon the closing of a sale of the Company s cable access HFC business. The Board has authorized aggregate repurchases under the program of $135 million, $22.6 million of which had been utilized for repurchases as of December 31, 2012. Under the program, we are authorized to repurchase shares of common stock in open market transactions or pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Exchange Act. The timing and actual number of shares repurchased, if any, will depend on a variety of factors, including the price and availability of our shares, trading volume and general market conditions. The program may be suspended or discontinued at any time without prior notice. Repurchases pursuant to our stock repurchase program could affect our stock price and increase its volatility. The existence of a stock repurchase program could also cause our stock price to be higher than it would be in the absence of such a program and could potentially reduce the market liquidity for our stock. Additionally, repurchases under our stock repurchase program will diminish our cash reserves, which could impact our ability to pursue possible future strategic opportunities and acquisitions and could result in lower overall returns on our cash balances. There can be no assurance that any stock repurchases will, in fact, occur, or, if they occur, that they will enhance stockholder value because the market price of our common stock may decline below the levels at which we repurchased shares of stock. Although our stock repurchase program is intended to enhance long-term stockholder value, short-term stock price fluctuations could reduce the program s effectiveness.

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

Our products are subject to U.S. export controls, and may be exported outside the U.S. only with the required level of export license or through an export license exception, in most cases because we incorporate encryption technology into our products. In addition, various countries regulate the import of certain technology and have enacted laws that could limit our ability to distribute our products, or could limit our customers ability to implement our products, in those countries. Changes in our products or changes in export and import regulations may 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 $201 million, at December 31, 2012, even as reduced through the repurchase of our common stock under the program discussed on page 34 above, 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.

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.

Table of Contents

***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.

***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

Table of Contents

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.

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.

37

Table of Contents

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

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

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

- general market and economic conditions;
- actual or anticipated variations in operating results;
- 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, including under our Employee Stock Purchase Agreement, 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 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, 2012, 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, 2012, 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 may 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 Act of 2010 that will require us to diligence, disclose, and report whether or not our products contain conflict minerals. The implementation of these new requirements could adversely affect the sourcing, availability, and pricing of the materials 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 conducting diligence procedures to determine the sources of conflict minerals that may be used or necessary to the production of our products and, if applicable, potential changes to products, processes or sources of supply as a consequence of such verification activities. It is also possible that we may face reputational harm if we determine that certain of our products contain minerals not determined to be conflict free and/or we are unable to alter our products, processes or sources of supply to avoid such materials.

**Available Information**

Harmonic makes available free of charge, on the Harmonic web site, the Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K (via link to the SEC website), and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after Harmonic files such material with, or furnishes such material to, the Securities and Exchange Commission. The address of the Harmonic web site is http://www.harmonicinc.com. Except as expressly set forth in this Form 10-K, the contents of our web site are not incorporated into, or otherwise to be regarded as part of, this report.

**Item 1B.** ***UNRESOLVED STAFF COMMENTS***

None.

**Item 2.** ***PROPERTIES***

All of our facilities are leased, including our principal operations and corporate headquarters in San Jose, California. We also have research and development centers in Oregon, New York and New Jersey, several sales offices in the U.S., sales and support centers in Europe and Asia, and research and development centers in Israel and Hong Kong. Our leases, which expire at various dates through September 2021, are for an aggregate of approximately 446,000 square feet of space. The San Jose lease has a term of ten years and is for approximately 188,000 square feet of space. The San Jose facility houses our manufacturing, research and development and

Table of Contents

corporate headquarters functions. We believe that the facilities that we currently occupy are adequate for our current needs and that suitable additional space will be available, as needed, to accommodate the presently foreseeable expansion of our operations.

Of our leased facilities, an aggregate of approximately 76,000 square feet is in the Omneon Sunnyvale office and the Scopus New Jersey office and is in excess of our space requirements. We no longer occupy these facilities and the estimated loss, net of potential estimated sublease income, for this square footage has been included in the excess facilities charges recorded in the year ended December 31, 2010. The Scopus New Jersey lease terminated in May 2011 and the Omneon Sunnyvale lease terminates in June 2013.

**Item 3.** ***LEGAL PROCEEDINGS***

In October 2011, Avid Technology, Inc. ( Avid ) filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic s Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint alleging that Harmonic s Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages.

On November 14, 2012, FastVDO served a lawsuit on Harmonic, alleging infringement of a patent allegedly essential to the H.264 standard and that Harmonic encoders, transcoders, software and servers that use H.264 infringe their patent.

At this time, the Company cannot predict the outcome of the above matters. An unfavorable outcome of these matters could materially and adversely affect the Company s business, operating results, financial position and cash flows.

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

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 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 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.

**Item 4.** ***MINE SAFETY DISCLOSURE***

Not applicable

Table of Contents

PART II

**Item 5.** ***MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES***

**Market Information of our Common Stock**

Our common stock is traded on the NASDAQ Global Market under the symbol HLIT, and has been listed on NASDAQ since our initial public offering on May 22, 1995. The following table sets forth, for the periods indicated, the high and low sales price per share of our common stock as reported on the Nasdaq Global Market:

| | 2012 Sales Price | | 2011 Sales Price | |
|---|---|---|---|---|
| **Quarter ended** | **High** | **Low** | **High** | **Low** |
| First quarter | $ 6.81 | $ 4.82 | $ 10.05 | $ 7.78 |
| Second quarter | 5.54 | 4.00 | 10.00 | 6.64 |
| Third quarter | 4.99 | 3.76 | 7.45 | 4.19 |
| Fourth quarter | 5.10 | 3.96 | 5.85 | 3.85 |

**Holders**

As of February 7, 2013, there were approximately 534 holders of record of our common stock.

**Dividend Policy**

We have never declared or paid any dividends on our capital stock. At this time, we expect to retain future earnings, if any, for use in the operation and expansion of our business and do not anticipate paying any cash dividends in the foreseeable future. Our line of credit includes covenants prohibiting the payment of cash dividends.

**Repurchases of Equity Securities by the Issuer**

On April 24, 2012, our 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.

During fiscal 2012, we repurchased and retired approximately 5.1 million shares of our common stock at an average price of $4.43 per share for an aggregate purchase price of $22.6 million. The remaining authorized amount for stock repurchases under this program was approximately $2.4 million as of December 31, 2012. On January 28, 2013, the Company s Board approved a $75 million increase in the stock repurchase program. On February 6, 2013, the Board approved a modification to the program that permits the Company to repurchase its common stock pursuant to a plan that meets the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934. The program is presently scheduled to expire in July, 2014. On February 19, 2013, the Board approved a further approximately $35 million increase to the program, contingent upon the closing of a sale of the Company s cable access HFC business. See Note 20, Subsequent Events of our Consolidated Financial Statements. The Board has authorized aggregate repurchases under the program of $135 million, $22.6 million of which had been utilized for purchases as of December 31, 2012.

Table of Contents

The following table is a summary of our stock repurchases during the quarter ended December 31, 2012 (in thousands, except per share data):

| Period | Total Number of Shares Repurchased as Part of the Program | Average Price Paid per Share | Approximate Dollar Value of Shares that May Yet be Purchased Under the Program |
|---|---|---|---|
| September 29 October 26, 2012 | | | $ 10,613 |
| October 27 November 23, 2012 | 1,050 | $ 4.24 | $ 6,163 |
| November 24 December 31, 2012 | 813 | $ 4.67 | $ 2,361 |
| | 1,863 | $ 4.43 | |

**STOCK PERFORMANCE GRAPH**

Set forth below is a line graph comparing the annual percentage change in the cumulative return to the stockholders of the Company s common stock with the cumulative return of the NASDAQ Telecommunications Index and of the Standard & Poor s (S&P) 500 Index for the period commencing December 31, 2007 and ending on December 31, 2012. The graph assumes that $100 was invested in each of the Company s common stock, the S&P 500 and the NASDAQ Telecommunications Index on December 31, 2007, and assumes the reinvestment of dividends, if any. The comparisons shown in the graph below are based upon historical data. Harmonic cautions that the stock price performance shown in the graph below is not indicative of, nor intended to forecast, the potential future performance of the Company s common stock.

| | 12/07 | 12/08 | 12/09 | 12/10 | 12/11 | 12/12 |
|---|---|---|---|---|---|---|
| Harmonic Inc. | 100.00 | 53.53 | 60.40 | 81.77 | 48.09 | 48.38 |
| S&P 500 | 100.00 | 63.00 | 79.67 | 91.67 | 93.61 | 108.59 |
| NASDAQ Telecom | 100.00 | 57.58 | 72.97 | 86.05 | 90.30 | 89.62 |

*The information contained in this Stock Performance Graph section shall not be deemed to be soliciting material , filed or incorporated by reference in previous or future filings with the SEC, or subject to the liabilities of Section 18 of the Securities Exchange Act of 1934, except to the extent that Harmonic specifically incorporates it by reference into a document filed under the Securities Act of 1933 or the Securities Exchange Act of 1934.*

Table of Contents

**Item 6. *SELECTED FINANCIAL DATA***

The data set forth below are qualified in their entirety by reference to, and should be read in conjunction with, Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and related notes included elsewhere in this Annual Report on Form 10-K. The consolidated statement of operations data for the years ended December 31, 2009 and 2008, and the consolidated balance sheet data as of December 31, 2010, 2009, and 2008, are derived from audited consolidated financial statements that are not included in this report. Historical results are not necessarily indicative of future results.

| | Year ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** | **2008** |
| | (In thousands, except per share amounts) | | | | |
| **Condensed Consolidated Statements of Operations Data** | | | | | |
| Net revenues | $ 530,464 | $ 549,332 | $ 423,344 | $ 319,566 | $ 364,963 |
| Gross profit | 236,555 | 254,514 | 195,401 | 134,360 | 177,533 |
| Income (loss) from operations | (9,307) | 11,773 | 5,142 | (12,035) | 39,305 |
| Net income (loss) | $ (10,937) | $ 8,779 | $ (4,335) | $ (24,139) | $ 63,992 |
| Net income (loss) per share basic | $ (0.09) | $ 0.08 | $ (0.04) | $ (0.25) | $ 0.68 |
| Net income (loss) per share diluted | $ (0.09) | $ 0.08 | $ (0.04) | $ (0.25) | $ 0.67 |

| | As of December 31, | | | | |
|---|---|---|---|---|---|
| | **2012** | **2011** | **2010** | **2009** | **2008** |
| | (In thousands) | | | | |
| **Condensed Consolidated Balance Sheet Data** | | | | | |
| Cash, cash equivalents and short-term investments | $ 201,176 | $ 161,837 | $ 120,371 | $ 271,070 | $ 327,163 |
| Working capital | $ 293,978 | $ 279,060 | $ 217,898 | $ 325,185 | $ 375,131 |
| Total assets | $ 717,531 | $ 734,166 | $ 720,386 | $ 572,034 | $ 564,363 |
| Long-term financing liability | $ | $ | $ | $ 6,908 | $ |
| Stockholders equity | $ 553,413 | $ 564,316 | $ 520,203 | $ 407,473 | $ 414,317 |

The following factors affect the comparability of the information reflected in the selected financial data tables provided above:

On September 15, 2010, we acquired Omneon, Inc. for a purchase price of $251.3 million, net of cash acquired. The 2010 income from operations and net loss included a charge of $5.9 million for acquisition costs related to the Omneon acquisition. See Note 3 Omneon Acquisition of the Company s Consolidated Financial Statements for additional information.

In addition, the 2010 income from operations and net loss included $3.0 million of excess facilities charges, primarily related to the closure of the Omneon Sunnyvale office, and $1.6 million for severance expenses.

On December 31, 2009, we had on our balance sheet the capitalized fair value of our San Jose headquarters building, which was under construction, of $6.9 million, with a corresponding credit to financing liability. Upon completion of the building in September 2010, and in connection with the sale-leaseback of the building, we removed from our books the carrying value of the building and the financing liability.

On March 12, 2009, we acquired Scopus Video Networks for a purchase price of $63.1 million, net of cash acquired. The 2009 loss from operations and net loss included a charge of $3.4 million for acquisition costs related to the Scopus acquisition.

Table of Contents

The 2009 loss from operations and net loss included $8.3 million of restructuring charges related to the Scopus acquisition. These charges included $6.3 million in cost of revenue, primarily related to provisions for excess and obsolete inventories of $5.8 million and $0.5 million for severance and other expenses. Charges of $2.0 million, consisting primarily of severance costs, were recorded in operating expenses related to the acquisition.

The 2008 income from operations and net income included a charge of $5.0 million for the settlement of a patent infringement claim, a restructuring charge of $1.8 million on a reduction in estimated sublease income for Sunnyvale, California and UK buildings, and an impairment charge of $0.8 million on a short-term investment. We also recognized a benefit from income taxes of $18.0 million, resulting from the use of net operating loss carryforwards and the release of the substantial majority of our income tax valuation allowance.

Income (loss) from operations for 2012, 2011, 2010, 2009 and 2008 included amortization of intangible assets of $29.2 million, $30.4 million, $17.4 million, $11.9 million and $6.1 million, respectively.

Income (loss) from operations for 2012, 2011, 2010, 2009 and 2008 included stock-based compensation expense of $18.9 million, $20.9 million, $15.5 million, $10.6 million and $7.8 million, respectively.

**Item 7.** ***MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS***

**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 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 2012, 2011 and 2010 accounted for approximately 33%, 35% and 44%, respectively, of our revenue. Revenue from our ten largest customers has decreased as a percentage of revenue, due to our growing customer base, in part, as a result of acquisitions we have made. 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 2012, 2011 and 2010, revenue from Comcast accounted for 12%, 11% and 17%, respectively, of our revenue. The loss of Comcast or any other significant customer, any material reduction in orders by Comcast or any significant customer, or our failure to qualify our new products with a significant customer could materially and adversely affect our operating results, financial condition and cash flows.

We recognized revenue of $530 million in 2012, as compared to $549 million in 2011. Our international revenue represents a growing part of our business. In 2012, international revenue represented 57% of our total revenue, as compared to 55% in 2011. In recognition of our growing international business opportunities, we have expanded our international operations and staffing to better support our expansion into international markets. We expect that international sales will continue to account for a significant portion of our net revenue for the foreseeable future and 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.

The impact of economic conditions on certain of our customers and changes in our customers deployment plans have adversely affected our business in the past. In 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. If an economic downturn were to occur in the future, customers may delay or reduce capital expenditures, which often results in lower demand for our products.

As part of our business strategy, (1) from time to time we have acquired, and continue to consider acquiring, businesses, technologies, assets and product lines that we believe complement or may expand our existing business, and (2) from time to time we consider divesting a product line that we believe may no longer complement or expand our existing business. In September 2010, we completed the acquisition of Omneon, Inc., a company specializing in file-based infrastructure for the production, preparation and playout of video content typically deployed by broadcasters, satellite operators, content owners and other media companies. Omneon s business is complementary to Harmonic s core business, and expands our customer reach into content providers and extends our product lines into video servers and video-optimized storage for content production and playout. In connection with the acquisition, our operating results for 2010 included related acquisition costs and restructuring expenses. Further, the financial results of Omneon, including the amortization of acquired intangible assets, is included in our results of operations as of the acquisition date, and has had a significant impact on our revenues, cost of revenues, and operating expenses since the date of acquisition. On February 18, 2013, we entered into an agreement to sell our cable access HFC business. See Note 20, Subsequent Events of our Consolidated Financial Statements.

**CRITICAL ACCOUNTING POLICIES, JUDGMENTS AND ESTIMATES**

The preparation of financial statements and related disclosures requires Harmonic to make judgments, assumptions and estimates that affect the reported amounts of assets and liabilities, the disclosure of contingencies and the reported amounts of revenue and expenses in the financial statements and accompanying notes. Material differences may result in the amount and timing of revenue and expenses if different judgments or different estimates were made. See Note 2 of Notes to Consolidated Financial Statements for details of Harmonic s accounting policies. Critical accounting policies, judgments and estimates that we believe have the most significant impact on Harmonic s financial statements are set forth below:

- Revenue recognition;
- Valuation of inventories;
- Impairment of goodwill or long-lived assets;

Table of Contents

- Assessment of the probability of the outcome of current litigation;
- Accounting for income taxes; and
- Stock-based compensation.

**REVENUE RECOGNITION**

Harmonic s principal sources of revenue are from the sale of hardware, software, hardware and software maintenance contracts, and the sale of end-to-end solutions, encompassing design, manufacture, test, integration and installation of products. Harmonic recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured.

We generally use contracts and customer purchase orders to determine the existence of an arrangement. Shipping documents and customer acceptance, when applicable, are used to verify delivery. We assess whether the sales price is fixed or determinable based on the payment terms associated with the transaction and whether the price is subject to refund or adjustment. We assess collectability based primarily on the creditworthiness of the customer, as determined by credit checks and analysis, as well as the customer s payment history.

Significant management judgments and estimates must be made in connection with determination of the revenue to be recognized in any accounting period. Because of the concentrated nature of our customer base, different judgments or estimates made for any one large contract or customer could result in material differences in the amount and timing of revenue recognized in any particular period.

We have multiple-element revenue arrangements that include hardware and software essential to the hardware product s functionality. For transactions originating or materially modified beginning January 1, 2011, we apply new accounting guidance on a prospective basis, which requires that we allocate revenue to all deliverables based on their relative selling prices. We determine the relative selling prices by first considering vendor-specific objective evidence of fair value ( VSOE ), if it exists; otherwise third-party evidence ( TPE ) of the selling price is used. When we are unable to establish selling price using VSOE or TPE, we use our best estimate of selling price ( BESP ) in our allocation of arrangement consideration. The objective of BESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for new or highly customized offerings. The Company s process for determining BESP involves management s judgment, and considers multiple factors that may vary over time, depending upon the unique facts and circumstances related to each deliverable. If the facts and circumstances underlying the factors considered change or should future facts and circumstances lead the Company to consider additional factors, the Company s BESP may also change.

Sales of stand-alone software that are not considered essential to the functionality of the hardware continue to be subject to the industry-specific software revenue recognition guidance. Further, the Company also applied the industry-specific software revenue recognition guidance to its multiple element arrangements for transactions originating prior to January 1, 2011. In accordance with the software revenue recognition guidance, the Company applies the residual method to recognize revenue for the delivered elements in stand-alone software transactions. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration, less the aggregate fair value of any undelivered elements, typically maintenance, provided that VSOE of fair value exists for all undelivered elements. We establish fair value by reference to the price the customer is required to pay when an item is sold separately, using contractually stated, substantive renewal rates, when applicable, or the price of recently completed stand alone sales transactions. Accordingly, the determination as to whether appropriate objective and reliable evidence of fair value exists can impact the timing of revenue recognition for an arrangement.

Solution sales for the design, manufacture, test, integration and installation of products are accounted for in accordance with applicable guidance on accounting for performance of construction/production contracts, using the percentage-of-completion method of accounting when various requirements for the use of this accounting guidance exist. Under the percentage-of-completion method, our revenue recognized reflects the portion of the anticipated contract revenue that has been earned, equal to the ratio of actual labor hours expended to total estimated labor hours to complete the project. Costs are recognized proportionally to the labor hours incurred. Management believes that, for each such project, labor hours expended in proportion to total estimated hours at completion represents the most reliable and meaningful measure for determining a project s progress toward completion. This requires us to estimate, at the outset of each project, a detailed project plan and associated labor hour estimates for that project. For contracts that include customized services for which labor costs are not reasonably estimable, the Company uses the completed contract method of accounting. Under the completed contract method, 100% of the contract s revenue and cost is recognized upon the completion of all services under the contract. If the estimated costs to complete a project exceed the total contract amount, indicating a loss, the entire anticipated loss is recognized. Our application of percentage-of-completion accounting is subject to our estimates of labor hours to complete each project. In the event that actual results differ from these estimates or we adjust these estimates in future periods, our operating results, financial position or cash flows for a particular period could be adversely affected.

Revenue on shipments to distributors, resellers and systems integrators is generally recognized on delivery. Allowances are provided for estimated returns and discounts. Such allowances are adjusted periodically to reflect actual and anticipated experience. Distributors and systems integrators purchase our products for specific capital equipment projects of the end-user and do not hold inventory. They perform functions that include importation, delivery to the end-customer, installation or integration, and post-sales service and support. Our agreements with these distributors and systems integrators have terms which are generally consistent with the standard terms and conditions for the sale of our equipment to end users and do not provide for product rotation or pricing allowances, as are typically found in agreements with stocking distributors. We have long-term relationships with most of these distributors and systems integrators and substantial experience with similar sales of similar products. We do have instances of accepting product returns from distributors and system integrators. However, such returns typically occur in instances where the system integrator has designed a product into a project for the end user, but the integrator requests permission to return the component as it does not meet the specific project s functional requirements. Such returns are made solely at the discretion of the Company, as our agreements with distributors and system integrators do not provide for return rights. We have extensive experience monitoring product returns from our distributors, and, accordingly, we have concluded that the amount of future returns can be reasonably estimated in accordance with applicable accounting guidance. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

**VALUATION OF INVENTORIES**

Harmonic states inventories at the lower of cost, using the weighted average method, or market. We write down the cost of excess or obsolete inventory to net realizable value based on future demand forecasts and historical consumption. If there were to be a sudden and significant decrease in demand for our products, or if there were a higher incidence of inventory obsolescence because of rapidly changing technology and customer requirements, we could be required to record additional charges for excess and obsolete inventory and our gross margin could be adversely affected. Inventory management is of critical importance in order to balance the need to maintain strategic inventory levels to ensure competitive lead times against the risk of inventory obsolescence because of rapidly changing technology and customer requirements. During the years ended December 31, 2012, 2011 and 2010, we recorded excess and obsolete inventory charges of $3.4 million, $3.9 million and $4.2 million, respectively.

Table of Contents

**IMPAIRMENT OF GOODWILL OR LONG-LIVED ASSETS**

The Company tests for impairment of goodwill on an annual basis in the fourth quarter of its fiscal year 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. When assessing the goodwill for impairment, the Company considers its market capitalization adjusted for a control premium and, if necessary, the Company s discounted cash flow model, which involves significant assumptions and estimates, including the Company s future financial performance, the Company s weighted average cost of capital and the Company s interpretation of currently enacted tax laws. Circumstances that could indicate impairment and require the Company to perform an impairment test include: a significant decline in the financial results of the Company s operations; the Company s market capitalization relative to net book value; unanticipated changes in competition and the Company s market share; significant changes in the Company s strategic plans; or adverse actions by regulators. 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. Identifiable intangible and other long-lived assets are also tested for impairment on the basis of undiscounted cash flows from the asset group when events or changes in circumstances indicate that their carrying amounts may not be recoverable. For example, changes in industry and market conditions or the strategic realignment of our resources could result in an impairment of identified intangibles, goodwill or long-lived assets.

Based on the annual impairment test performed as of December 31, 2012, management determined that the Company s estimated fair value exceeded the carrying value of its net assets by approximately 21% and that goodwill was not impaired.

We did not record any impairment charges related to our goodwill or long-lived assets during the years ended December 31, 2012, 2011 or 2010. However, there can be no assurance that future impairment tests will not result in a charge to earnings.

At December 31, 2012, our carrying values for goodwill and intangible assets totaled $212.5 million and $58.4 million, respectively.

**ASSESSMENT OF THE PROBABILITY OF THE OUTCOME OF CURRENT LITIGATION**

Our industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the telco industry have extensive patent portfolios. From time to time, third parties have asserted, and may assert in the future, patent, copyright, trademark and other intellectual property rights against us or our customers. We record accruals for loss contingencies when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated.

In October 2011, Avid Technology, Inc. ( Avid ) filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic s Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint alleging that Harmonic s Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages.

On November 14, 2012, FastVDO served a lawsuit on Harmonic, alleging infringement of a patent allegedly essential to the H.264 standard and that Harmonic encoders, transcoders, software and servers that use H.264 infringe their patent.

At this time, the Company cannot predict the outcome of the above matters.

Table of Contents

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

**ACCOUNTING FOR INCOME TAXES**

In preparing our financial statements, we estimate our income taxes for each of the jurisdictions in which we operate. This involves estimating our actual current tax exposures and assessing temporary differences resulting from differing treatment of items, such as reserves and accruals, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities and our future taxable income for purposes of assessing our ability to realize any future benefit from our deferred tax assets. In the event that actual results differ from these estimates or we adjust these estimates in future periods, our operating results and financial position could be materially affected.

We are subject to examination of our income tax returns by various tax authorities on a periodic basis. We regularly assess the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of our provision for income taxes. We apply the provisions of the applicable accounting guidance regarding accounting for uncertainty in income taxes, which requires application of a more-likely-than-not threshold to the recognition and derecognition of uncertain tax positions. If the recognition threshold is met, the applicable accounting guidance permits us to recognize a tax benefit measured at the largest amount of such tax benefit that, in our judgment, is more than fifty percent likely to be realized upon settlement. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the quarter of such change. Our income tax returns for 2008, 2009 and 2010 are currently under examination by the U.S. Internal Revenue Service. In addition, the statute of limitations on our 2008 U.S. corporate income tax return has been extended to 2013. A subsidiary of the Company is under an audit, which commenced in the first quarter of 2012, by the Israel tax authority for the years 2007 through 2010. 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, operating results and cash flows could be materially and adversely impacted in the period of adjustment.

We file annual income tax returns in multiple taxing jurisdictions around the world. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, we believe that our reserves for income taxes reflect the most likely outcome. We adjust these reserves, as well as the related interest and penalties, in light of changing facts and circumstances. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result. 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. Any changes in estimate, or settlement of any particular position, could have a material impact on our operating results, financial condition and cash flows.

Table of Contents

**STOCK-BASED COMPENSATION**

Harmonic measures and recognizes compensation expense for all stock-based compensation awards made to employees and directors, including stock options, restricted stock units and share purchase rights related to our Employee Stock Purchase Plan ( ESPP ), based upon the grant-date fair value of those awards. The grant date fair value of restricted stock units is based on the fair value of our common stock on the date of grant. The grant date fair value of our stock options and share purchase rights is estimated using the Black-Scholes option pricing model.

The determination of fair value of stock options and share purchase rights on the date of grant, using an option-pricing model, is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates, and expected dividends. We estimated the expected life of the awards based on an analysis of our historical experience of employee exercise and post-vesting termination behavior considered in relation to the contractual life of the options and purchase rights. The risk-free interest rate assumption is based upon observed interest rates appropriate for the expected term of the awards. We do not currently pay cash dividends on our common stock and do not anticipate doing so in the foreseeable future. Accordingly, our expected dividend yield is zero.

Stock-based compensation expense recognized in the Consolidated Statement of Operations is based on awards ultimately expected to vest and therefore has been reduced for estimated forfeitures. The stock-based compensation guidance requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience.

If factors change and we employ different assumptions to determine the fair value of our stock-based compensation awards granted in future periods, the compensation expense that we record under it may differ significantly from what we have recorded in the current period.

See Note 13 and Note 14 of our Consolidated Financial Statements for additional information.

Table of Contents

**RESULTS OF OPERATIONS**

**Net Revenue**

***Net Revenue Consolidated***

Harmonic s consolidated net revenue, by product line, for each of the three years ended December 31, 2012, 2011 and 2010, are presented in the table below. Also presented is the related dollar and percentage change in consolidated net revenue, by product line, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | (In thousands, except percentages) | | |
| **Revenues by type:** | | | |
| Video processing products | $ 219,440 | $ 236,624 | $ 202,898 |
| Production and playout products | 90,247 | 98,842 | 32,579 |
| Edge and access products | 138,653 | 141,880 | 135,306 |
| Service and support | 82,124 | 71,986 | 52,561 |
| Net revenues | $ 530,464 | $ 549,332 | $ 423,344 |
| **Increase (decrease):** | | | |
| Video processing products | $ (17,184) | $ 33,726 | $ 40,244 |
| Production and playout | (8,595) | 66,263 | 32,579 |
| Edge and access products | (3,227) | 6,574 | 17,951 |
| Service and support | 10,138 | 19,425 | 13,004 |
| Total increase (decrease) | $ (18,868) | $ 125,988 | $ 103,778 |
| **Percent change:** | | | |
| Video processing products | (7.3)% | 16.6% | 24.7% |
| Production and playout | (8.7)% | 203.4% | % |
| Edge and access products | (2.3)% | 4.9% | 15.3% |
| Service and support | 14.1% | 37.0% | 32.9% |
| Total percent change | (3.4)% | 29.8% | 32.5% |

The decrease in net revenue in 2012, compared to 2011, was primarily due to a reduction in demand for video processing and production and playout products and, to a lesser extent, edge and access products, primarily in the U.S. and Europe, offset, in part, by an increase in service and support revenue. Our revenues from Europe in 2012 were impacted significantly by the weak economic environment in Europe caused principally by the sovereign debt crisis in many European countries. Service and support revenues are derived primarily from maintenance contracts, as well as professional and integration services and training. The 14.1% increase in services revenues for 2012, compared to 2011, was primarily the result of increased maintenance revenues, driven by new maintenance contracts, and the completion of several large, multi-year projects.

The increase in net revenue in 2011, compared to 2010, was due, in large part, to the revenue contribution resulting from the acquisition of Omneon, which was completed in September 2010. Omneon s product revenue is included in the production and playout product line above. In addition, our revenue increased due to strong demand for our video processing products, particularly in international markets where Pay TV is growing rapidly. The addition of Omneon product revenue and the growth in video processing product revenue also contributed to the growth in service and support activity related to the associated products, resulting in service and support revenue growth of 37% in 2011, when compared to 2010.

Table of Contents

***Net Revenue Geographic***

Harmonic s domestic and international net revenue, for each of the three years ended December 31, 2012, 2011 and 2010, are presented in the table below. Also presented are the related dollar and percentage change in domestic and international net revenue, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | (In thousands, except percentages) | | |
| **Net revenues:** | | | |
| United States | $ 230,336 | $ 244,897 | $ 209,583 |
| International | 300,128 | 304,435 | 213,761 |
| Total | $ 530,464 | $ 549,332 | $ 423,344 |
| **Increase (decrease):** | | | |
| United States | $ (14,561) | $ 35,314 | $ 47,560 |
| International | (4,307) | 90,674 | 56,218 |
| Total increase (decrease) | $ (18,868) | $ 125,988 | $ 103,778 |
| **Percent change:** | | | |
| United States | (5.9)% | 16.8% | 29.4% |
| International | (1.4)% | 42.4% | 35.7% |
| Total percent change | (3.4)% | 29.8% | 32.5% |

The decrease in U.S. net revenue in 2012, compared to 2011, was principally due to decreased demand for our video processing products and, to a much lesser extent, our production and playout products. International net revenue in 2012 decreased, compared to 2011, primarily due to decreased demand in Europe across all product lines, offset by increased demand in Asia Pacific, largely for our production and playout products. We expect that international sales will continue to account for a significant percentage of our net revenue for the foreseeable future.

The increase in U.S. net revenue in 2011, compared to 2010, was principally due to the addition of Omneon product revenue and, to a lesser extent, increased video processing revenue and service and support revenue. International net revenue in 2011 increased, compared to 2010, primarily due to sales of Omneon production and playout products, given that a substantial majority of production and playout net revenues were international, and, to a lesser extent, increased demand from customers in emerging markets.

***Gross Profit***

Harmonic s gross profit and gross profit as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in gross profit, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | (In thousands, except percentages) | | |
| Gross profit | $ 236,555 | $ 254,514 | $ 195,401 |
| As a percentage of net revenues | 44.6% | 46.3% | 46.2% |
| Increase (decrease) | $ (17,959) | $ 59,113 | $ 61,041 |
| Percent change | (7.1)% | 30.3% | 45.4% |

Gross profit as a percentage of revenue decreased in 2012, compared to 2011. The decrease in gross margin 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 2012 and 2011, approximately $20.5 million and $21.5 million of expense related to amortization of intangibles was included in cost of revenue.

Table of Contents

Gross profit as a percentage of revenue remained relatively flat in 2011, compared to 2010. The increase in gross margin was principally due to the increase in sales of production and playout products, which typically carry a higher gross margin than our average gross margin, offset in part by higher amortization of intangibles. In 2011, $21.5 of amortization of intangibles was included in cost of sales, compared to $12.5 million in 2010. The higher amortization of intangible expense in 2011 was due to the amortization of intangibles arising from the Omneon acquisition, which was completed in September 2010.

**Research and Development**

Harmonic s research and development expense and the expense as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in research and development expense, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except percentages) | | |
| Research and development | $ 106,219 | $ 102,732 | $ 77,197 |
| As a percentage of net revenues | 20.0% | 18.7% | 18.2% |
| Increase (decrease) | $ 3,487 | $ 25,535 | $ 15,762 |
| Percent change | 3.4% | 33.1% | 25.7% |

The increase in research and development expense in 2012, compared to 2011, was primarily the result of increased employee related compensation expense of $1.1 million, and increased outside engineering services and prototype materials costs of $2.1 million, related to new product development initiatives. We expect research and development expense in 2013 to remain relatively flat, compared to 2012.

The increase in research and development expense in 2011, compared to 2010, was primarily the result of increased personnel related expense of $15.0 million, increased outside engineering services of $3.5 million, increased facilities related expenses of $3.0 million and increased stock-based compensation expense of $1.9 million. The increased personnel related expense, outside engineering services and stock-based compensation expense were primarily due to increased engineering headcount and activities resulting from the Omneon acquisition, as well as additional hiring of employees engaged in engineering activities. The increased facilities related expenses were primarily due to additional depreciation of building improvements and lab equipment costs incurred in order to consolidate the Omneon employees within our San Jose headquarters building.

**Selling, General and Administrative**

Harmonic s selling, general and administrative expense and the expense as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in selling, general and administrative expense, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except percentages) | | |
| Selling, general and administrative | $ 130,938 | $ 131,091 | $ 108,150 |
| As a percentage of net revenues | 24.7% | 23.9% | 25.5% |
| Increase (decrease) | $ (153) | $ 22,941 | $ 27,012 |
| Percent change | (0.1)% | 21.2% | 33.3% |

Selling, general and administrative expenses in 2012, compared to 2011, remained relatively flat. Increased depreciation expense of $1.1 million and increased professional fees of $0.5 million were offset by decreased third party commission expense of $0.7 million, decreased travel expense of $0.6 million and decreased bad debt

expenses of $0.2 million. The increase in depreciation expense was primarily due to additional demonstration equipment and software applications for marketing use. The decrease in third party commission expense was largely due to decreased net revenue in 2012, and the decrease in travel expense was largely due to travel cost containment efforts.

The increase in selling, general and administrative expense in 2011, compared to 2010, was primarily a result of increased compensation expense of $14.7 million, increased stock-based compensation expense of $2.6 million, increased program marketing and third party commission expense of $5.1 million, increased travel expense of $3.4 million, increased amortization of intangibles of $4.0 million, and increased consulting and professional service expense of $2.0 million. These increases were partially offset by the absence of $5.7 million of acquisition related costs incurred in 2010 in connection with the acquisition of Omneon and a decrease of $2.5 million of excess facilities charges primarily related to the closure of the Omneon Sunnyvale office in 2010. The increased compensation expense, stock-based compensation expense and travel expense in 2011 were primarily due to increased headcount resulting from the Omneon acquisition and higher commission expense resulting from increased net revenue in 2011. The increase in consulting and professional service expense was related to higher temporary headcount and additional consulting resources being used in general and administrative activities.

**Amortization of Intangibles**

Harmonic s amortization of intangibles expense charged to operating expenses and the amortization of intangibles expense as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in amortization of intangibles expense, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | (In thousands, except percentages) | | |
| Amortization of intangibles | $ 8,705 | $ 8,918 | $ 4,912 |
| As a percentage of net revenues | 1.6% | 1.6% | 1.2% |
| Increase (decrease) | $ (213) | $ 4,006 | $ 1,090 |
| Percent change | (2.4)% | 81.6% | 28.5% |

The decrease in the amortization of intangibles expense in 2012, compared to 2011, was the result of the completion of the amortization of trademarks acquired as part of a prior business acquisition. The increase in the amortization of intangibles expense in 2011, compared to 2010, was primarily due to the amortization of intangible assets obtained in connection with the acquisition of Omneon during the third quarter of 2010.

**Interest Income, Net**

Harmonic s interest income and expense, net as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in interest income, net, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | (In thousands, except percentages) | | |
| Interest income, net | $ 515 | $ 374 | $ 1,082 |
| As a percentage of net revenues | 0.1% | 0.1% | 0.3% |
| Increase (decrease) | $ 141 | $ (708) | $ (2,099) |
| Percent change | 37.7% | (65.4)% | (66.0)% |

Table of Contents

The increase in interest income, net in 2012, compared to 2011, was primarily due to higher average cash and short-term investments balances during 2012.

The decrease in interest income, net in 2011, compared to 2010, was primarily due to lower average cash and short-term investments balances during 2011, principally resulting from cash used in the Omneon acquisition in September 2010, offset by increases in cash from operations, and lower interest rates earned on the balances.

**Other Expense, Net**

Other expense, net is primarily comprised of foreign exchange gains and losses on cash, accounts receivable and intercompany balances denominated in currencies other than the U.S. dollar. To mitigate the volatility related to fluctuations in the foreign exchange rates, we may enter into various foreign currency contracts. The (gain) loss on foreign currency is driven by the fluctuations in the foreign currency exchanges rates, primarily the euro, British pound and Japanese yen.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except percentages) | | |
| Other expense, net | $ (293) | $ (514) | $ (785) |
| As a percentage of net revenues | (0.1)% | (0.1)% | (0.2)% |
| (Increase) decrease | $ 221 | $ 271 | $ 96 |
| Percent change | (43.0)% | (34.5)% | (10.9) |

**Income Taxes**

Harmonic s provision for income taxes and provision for income taxes as a percentage of net revenue, for each of the three years ended December 31, 2012, 2011, and 2010, are presented in the table below. Also presented is the related dollar and percentage change in provision for income taxes, as compared with the prior year.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except percentages) | | |
| Provision for income taxes | $ 1,852 | $ 2,854 | $ 9,774 |
| As a percentage of net revenues | 0.3% | 0.5% | 2.3% |
| Increase (decrease) | $ (1,002) | $ (6,920) | $ (4,630) |
| Percent change | (35.1)% | (70.8)% | (32.1)% |

For the year ended December 31, 2012, our effective tax rate on our pre-tax loss was -20.4%, compared to an effective tax rate on our pre-tax income for 2011 of 24.5% . The difference between the underlying effective tax rate for the year ended December 31, 2012 and the federal statutory rate of 35% is primarily attributable to lower rates on foreign earnings, offset in part by unbenefitted losses of certain foreign entities, an increase in the valuation allowance for California R&D credits, non-deductible amortization expense, and the impact of non-deductible stock-based compensation. On January 2, 2013, the Federal R&D credit was extended for two years, retroactively from January 1, 2012, through December 31, 2013. The Company has estimated the tax benefit of the R&D credit for 2012 to be approximately $2.5 million and it will be recorded in the first quarter of 2013.

For the year ended December 31, 2011, our effective tax rate on our pre-tax income was 24.5%, compared to an effective tax rate on our pre-tax income of 179.7% for 2010. The difference between the underlying effective tax rate for the year ended December 31, 2011 and the federal statutory rate of 35% is primarily attributable to lower rates on foreign earnings, a current year research credit, and a decrease in our liability for uncertain tax positions due to the expiration of the statute of limitations for certain items, offset in part by unbenefitted losses of certain foreign entities and the impact of non-deductible stock-based compensation. Further, California tax legislation, enacted in February 2009, provides for the election of a single sales

apportionment formula beginning in 2011. The Company elected the single sales apportionment method in 2011. The use of this apportionment method reduces the amount of California taxable income, which reduced our overall state rate in 2011 and 2012.

**Liquidity and Capital Resources**

As of December 31, 2012, our cash and cash equivalents totaled $96.7 million, and our short-term investments totaled $104.5 million. At that date, 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, including any stock repurchases.

In the event we need or desire to access funds from the short-term investments that we hold, it is possible that we may not be able to do so due to adverse market conditions. Our inability to sell all or some of our short-term investments at par or our cost, or 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 December 31, 2012, there were no amounts outstanding under the line of credit facility and there were no borrowings during the year ended December 31, 2012. Future borrowings pursuant to the line would bear interest at the bank s prime rate (3.25% at December 31, 2012) or at LIBOR for the desired borrowing period (an annualized rate of 0.21% for a one month borrowing period at December 31, 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 December 31, 2012, the Company s ratio under that covenant was 4.11 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 European economic slowdown, market uncertainty surrounding necessary increases in the U.S. debt limit and its future debt obligations, 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.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | | (In thousands) | |
| Net cash provided by operating activities | $ 70,813 | $ 45,177 | $ 17,566 |
| Net cash used in investing activities | (47,549) | (65,331) | (96,355) |
| Net cash (used in) provided by financing activities | (17,699) | 14,656 | 22,963 |
| Effect of exchange rate changes on cash and cash equivalents | 122 | (52) | (118) |
| Net increase (decrease) in cash and cash equivalents | $ 5,687 | $ (5,550) | $ (55,944) |

Table of Contents

*Operating Activities*

Cash provided by operations was $70.8 million in 2012, resulting from a net loss of $10.9 million, adjusted for $66.2 million in non-cash charges, and a $15.5 million increase in cash associated with the net change in operating assets and liabilities. The non-cash charges included deferred income taxes, amortization of intangible assets, stock-based compensation, depreciation, and provisions for excess and obsolete inventories and doubtful accounts. The net change in operating assets and liabilities included increases in prepaid expenses, as well as decreases in accounts payable and accrued liabilities, which were offset by decreases in accounts receivable and inventories, as well as increases in deferred revenue and income taxes payable. The decrease in accounts receivable was primarily due to improvement in our collection process, and the decrease in inventory was primarily due to improvement in our supply chain process. The decrease in accounts payable was primarily due to the timing of purchases and payments in the last quarter of 2012. The increase in income tax payable was primarily due to lower estimated tax payments made in 2012, compared to 2011.

Cash provided by operations was $45.2 million in 2011, resulting from net income of $8.8 million, adjusted for $71.5 million in non-cash charges, and $35.1 million for use of cash associated with the net change in operating assets and liabilities. The non-cash charges included deferred income taxes, amortization of intangible assets, stock-based compensation and depreciation. The net change in operating assets and liabilities included increases in accounts receivable and inventories, as well as decreases in deferred revenue, prepaid expenses, accounts payable and income taxes payable. The increase in inventory was due to higher service and production inventories to support higher revenue levels. The decrease in income taxes payable was due to estimated tax payments made in 2011. The decrease in deferred revenue was primarily due to the timing of periodic service and support billings for annual contracts and the recognition of product revenue for a large contract that had previously been deferred.

Cash provided by operating activities was $17.6 million in 2010, resulting from a net loss of $4.3 million, adjusted for $49.7 million in non-cash charges, and $27.8 million for use of cash associated with the net change in operating assets and liabilities. The non-cash charges included deferred income taxes, amortization of intangible assets, stock-based compensation and depreciation. The net change in operating assets and liabilities included increases in accounts receivable, inventories and prepaid expenses, as well as decreases in accounts payable and accrued excess facilities cost, which was partially offset by an increase in deferred revenue, income taxes payable and accrued and other liabilities. The increase in accrued and other liabilities was mostly attributable to higher incentive compensation accruals in 2010, as compared to 2009, as a result of the increase in revenue in 2010.

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, 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 $47.5 million in 2012, primarily resulting from the purchase of short-term investments of $133.8 million and capital expenditures of $12.6 million, offset by proceeds from the sale and maturity of investments of $98.8 million.

Net cash used in investing activities was $65.3 million in 2011, primarily resulting from the purchase of short-term investments of $107.5 million and capital expenditures of $17.3 million, offset by proceeds from the sale and maturity of investments of $59.7 million.

Net cash used in investing activities was $96.4 million in 2010, resulting from the purchase of Omneon in September 2010 for $153.3 million and capital expenditures of $35.6 million, primarily related to leasehold improvements to our new corporate headquarters, partially offset by proceeds from the sale and maturity of investments of $92.8 million.

Table of Contents

*Financing Activities*

Net cash used in financing activities was $17.7 million in 2012, primarily resulting from $22.6 million of payments for the repurchase of common stock in connection with our stock repurchase program announced in April 2012, offset in part by $4.8 million of net proceeds from the issuance of common stock related to our equity incentive plans.

Net cash provided by financing activities was $14.7 million in 2011, primarily resulting from $12.7 million of net proceeds from the issuance of common stock related to our equity incentive plans and $2.0 million of excess tax benefits from stock-based compensation.

Net cash provided by financing activities was $23.0 million in 2010, primarily resulting from $18.8 million in proceeds relating to lessor financing of building improvements for our new corporate headquarters and $3.9 million of net proceeds from the issuance of common stock related to our equity incentive plans.

**OFF-BALANCE SHEET ARRANGEMENTS**

None as of December 31, 2012.

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

Future payments under contractual obligations, and other commercial commitments, as of December 31, 2012, were as follows:

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| | Total Amounts Committed | 1 Year or Less | 2 -3 Years | 4 -5 Years | Over 5 Years |
| | | | (In thousands) | | |
| Operating leases (1) | $ 59,276 | $ 10,692 | $ 14,594 | $ 14,193 | $ 19,797 |
| Purchase commitments | $ 27,579 | 26,542 | 1,037 | | |
| Total contractual obligations | $ 86,855 | $ 37,234 | $ 15,631 | $ 14,193 | $ 19,797 |
| Other commercial commitments: | | | | | |
| Standby letters of credit | $ 207 | $ | $ 207 | $ | $ |
| Indemnification obligations (2) | | | | | |
| Total commercial commitments | $ 207 | $ | $ 207 | $ | $ |

1. As of December 31, 2012, $0.9 million of these future lease payments were accrued for as part of accrued excess facility costs. See Note 10 Restructuring and Excess Facilities of our Consolidated Financial Statements.
2. Harmonic indemnifies 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 and some of its other vendors, such as building contractors, pursuant to certain parameters and restrictions. The scope of these indemnities varies, but, in some instances, includes indemnification for defense costs, damages and other expenses (including reasonable attorneys fees).

Due to the uncertainty with respect to the timing of future cash flows associated with our unrecognized tax benefits at December 31, 2012, we are unable to make reasonably reliable estimates of the period of cash settlement with the respective taxing authority. Therefore, approximately $49.3 million of unrecognized tax benefits classified as Income taxes payable, long-term in the accompanying Consolidated Balance Sheet as of December 31, 2012, have been excluded from the contractual obligations table above. See Note 15 Income Taxes of our Consolidated Financial Statements for a discussion on income taxes.

Table of Contents

**NEW ACCOUNTING PRONOUNCEMENTS**

See Note 2 of the accompanying Consolidated Financial Statements for a full description of recent accounting pronouncements, including the respective expected dates of adoption and effects on results of operations and financial condition.

**Item 7A.** ***QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.***

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

**FOREIGN CURRENCY EXCHANGE RISK**

Harmonic has a number of international subsidiaries, each of whose sales are generally denominated in U.S. dollars. In addition, Harmonic has various international branch offices that provide sales support and systems integration services. Sales denominated in foreign currencies were approximately 9%, 10% and 6% of net revenue in 2012, 2011 and 2010, 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 December 31, 2012:

| **Currency - forward contracts** | **Position** | **USD Value of Net Foreign Exchange Contracts** | **Foreign Exchange Gain (Loss) From 10% Appreciation of USD** | **Foreign Exchange Gain (Loss) From 10% Depreciation of USD** |
|---|---|---|---|---|
| | | | (In thousands) | |
| EUR | Sell | $ 5,585 | $ 559 | $ (559) |
| GBP | Sell | 2,155 | 216 | (216) |
| JPY | Sell | 3,317 | 332 | (332) |
| ILS | Buy | 3,174 | (317) | 317 |

**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 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 December 31, 2012, gross unrealized gains were nominal. If the credit market deteriorates, we may incur realized losses, which could adversely affect our financial condition or results of operations. There is risk that losses could be incurred if Harmonic were to sell any of its securities prior to stated maturity. As of December 31, 2012, our cash, cash equivalents and short-term investments balance was $201.2 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 less than $0.1 million as of December 31, 2012.

**Item 8.** ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

Index to Consolidated Financial Statements


| | Page |
|---|---|
| Management s report on internal control over financial reporting | 60 |
| Report of Independent Registered Public Accounting Firm | 61 |
| Consolidated Balance Sheets | 62 |
| Consolidated Statements of Operations | 63 |
| Consolidated Statements of Comprehensive Income (Loss) | 64 |
| Consolidated Statements of Stockholders Equity | 65 |
| Consolidated Statements of Cash Flows | 66 |
| Notes to Consolidated Financial Statements | 67 |


## MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and Rule 15d-15(f) of the Exchange Act. Our internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that:

1. pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets;

2. provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that our receipts and expenditures are being made only in accordance with authorizations of our management and directors; and

3. provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

The effectiveness of any system of internal control over financial reporting, including ours, is subject to inherent limitations, including the exercise of judgment in designing, implementing, operating, and evaluating the controls and procedures, and the inability to eliminate misconduct completely. Accordingly, any system of internal control over financial reporting, including ours, no matter how well designed and operated, can only provide reasonable, not absolute, assurances. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate. Our management assessed the effectiveness of Harmonic s internal control over financial reporting as of December 31, 2012. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework. Based on our assessment using those criteria, our management has concluded that, as of December 31, 2012, Harmonic s internal control over financial reporting was effective.

Table of Contents

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of Harmonic Inc.:

In our opinion, the accompanying Consolidated Balance Sheets and the related Consolidated Statements of Operations, Consolidated Statements of Comprehensive Income (Loss), Consolidated Statements of Stockholders Equity, and Consolidated Statements of Cash Flows listed in the accompanying index present fairly, in all material respects, the financial position of Harmonic Inc. and its subsidiaries at December 31, 2012 and December 31, 2011, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2012, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company s management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management s Report on Internal Control over Financial Reporting appearing under Item 8. Our responsibility is to express opinions on these financial statements and on the Company s internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 2 to the consolidated financial statements, the Company adopted new accounting rules for revenue recognition in 2011.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PRICEWATERHOUSECOOPERS LLP
PRICEWATERHOUSECOOPERS LLP

San Jose, California

March 1, 2013

Table of Contents

**HARMONIC INC.**

**CONSOLIDATED BALANCE SHEETS**

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands, except par value amounts) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 96,670 | $ 90,983 |
| Short-term investments | 104,506 | 70,854 |
| Accounts receivable | 85,920 | 109,886 |
| Inventories | 64,270 | 70,649 |
| Deferred income taxes | 21,870 | 28,032 |
| Prepaid expenses and other current assets | 23,636 | 21,474 |
| Total current assets | 396,872 | 391,878 |
| Property and equipment, net | 38,122 | 40,469 |
| Goodwill | 212,518 | 212,417 |
| Intangibles, net | 58,447 | 87,651 |
| Other assets | 11,572 | 1,751 |
| Total assets | $ 717,531 | $ 734,166 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 25,447 | $ 30,537 |
| Income taxes payable | 1,797 | 2,290 |
| Deferred revenues | 33,235 | 33,095 |
| Accrued liabilities | 42,415 | 46,896 |
| Total current liabilities | 102,894 | 112,818 |
| Income taxes payable, long-term | 49,309 | 47,307 |
| Deferred income taxes, long-term | | 655 |
| Other non-current liabilities | 11,915 | 9,070 |
| Total liabilities | 164,118 | 169,850 |
| Commitments and contingencies (Notes 18 and 19) | | |
| Stockholders equity: | | |
| Preferred stock, $0.001 par value, 5,000 shares authorized; no shares issued or outstanding | | |
| Common stock, $0.001 par value, 150,000 shares authorized; 114,193 and 116,257 shares issued and outstanding at December 31, 2012 and 2011 | 114 | 116 |
| Capital in excess of par value | 2,432,790 | 2,433,164 |
| Accumulated deficit | (1,879,026) | (1,868,089) |
| Accumulated other comprehensive loss | (465) | (875) |
| Total stockholders equity | 553,413 | 564,316 |
| Total liabilities and stockholders equity | $ 717,531 | $ 734,166 |

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

62

Table of Contents

**HARMONIC INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except per share amounts) | | |
| Product revenues | $ 448,340 | $ 477,346 | $ 370,783 |
| Service revenues | 82,124 | 71,986 | 52,561 |
| Total net revenues | 530,464 | 549,332 | 423,344 |
| Product cost of revenues | 250,800 | 256,230 | 201,057 |
| Service cost of revenues | 43,109 | 38,588 | 26,886 |
| Total cost of revenues | 293,909 | 294,818 | 227,943 |
| Gross profit | 236,555 | 254,514 | 195,401 |
| Operating expenses: | | | |
| Research and development | 106,219 | 102,732 | 77,197 |
| Selling, general and administrative | 130,938 | 131,091 | 108,150 |
| Amortization of intangibles | 8,705 | 8,918 | 4,912 |
| Total operating expenses | 245,862 | 242,741 | 190,259 |
| Income (loss) from operations | (9,307) | 11,773 | 5,142 |
| Interest income, net | 515 | 374 | 1,082 |
| Other expense, net | (293) | (514) | (785) |
| Income (loss) before income taxes | (9,085) | 11,633 | 5,439 |
| Provision for income taxes | 1,852 | 2,854 | 9,774 |
| Net income (loss) | $ (10,937) | $ 8,779 | $ (4,335) |
| Net income (loss) per share: | | | |
| Basic | $ (0.09) | $ 0.08 | $ (0.04) |
| Diluted | $ (0.09) | $ 0.08 | $ (0.04) |
| Weighted average shares: | | | |
| Basic | 116,457 | 115,175 | 101,487 |
| Diluted | 116,457 | 116,427 | 101,487 |

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

Table of Contents

**HARMONIC INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| | | (In thousands) | |
| Net income (loss) | $ (10,937) | $ 8,779 | $ (4,335) |
| Other comprehensive income (loss), net of tax: | | | |
| Changes in cumulative translation adjustments, net of tax | 395 | (173) | (390) |
| Translation adjustments reclassified into earnings upon sale or liquidation of subsidiaries, net of tax | | | 89 |
| Foreign currency translation adjustments, net of tax | 395 | (173) | (301) |
| Changes in unrealized gain (loss) on investment arising during the period, net of tax | 15 | 10 | (140) |
| Gain (loss) on investments reclassified into earnings upon sale of investments, net of tax | | | (236) |
| Gain (loss) on investments, net of tax | 15 | 10 | (376) |
| Other comprehensive income (loss) net of tax | 410 | (163) | (677) |
| Comprehensive income (loss) | $ (10,527) | $ 8,616 | $ (5,012) |

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

Table of Contents

**HARMONIC INC.**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

| | Common Stock | | | | | |
|---|---|---|---|---|---|---|
| | **Shares** | **Amount** | **Additional Paid-in Capital** | **Accumulated Deficit** | **Accumulated Other Comprehensive Income (Loss)** | **Total Stockholders Equity** |
| | | | | (In thousands) | | |
| Balance at December 31, 2009 | 96,110 | $ 96 | $ 2,279,945 | $ (1,872,533) | $ (35) | $ 407,473 |
| Net loss | | | | (4,335) | | (4,335) |
| Unrealized loss on investments, net of tax | | | | | (376) | (376) |
| Translation adjustments | | | | | (301) | (301) |
| Stock-based compensation | | | 15,549 | | | 15,549 |
| Issuance of Common Stock for acquisition of Omneon | 14,150 | 14 | 98,049 | | | 98,063 |
| Issuance of Common Stock under option, stock award and purchase plans | 2,100 | 2 | 3,857 | | | 3,859 |
| Excess tax benefits from stock-based compensation | | | 271 | | | 271 |
| Balance at December 31, 2010 | 112,360 | 112 | 2,397,671 | (1,876,868) | (712) | 520,203 |
| Net income | | | | 8,779 | | 8,779 |
| Unrealized gain on investments, net of tax | | | | | 10 | 10 |
| Translation adjustments | | | | | (173) | (173) |
| Issuance of Common Stock under option, stock award and purchase plans | 3,897 | 4 | 12,697 | | | 12,701 |
| Stock-based compensation | | | 20,841 | | | 20,841 |
| Excess tax benefits from stock-based compensation | | | 1,955 | | | 1,955 |
| Balance at December 31, 2011 | 116,257 | 116 | 2,433,164 | (1,868,089) | (875) | 564,316 |
| Net loss | | | | (10,937) | | (10,937) |
| Unrealized gain on investments, net of tax | | | | | 15 | 15 |
| Translation adjustments | | | | | 395 | 395 |
| Issuance of Common Stock under option, stock award and purchase plans | 3,045 | 3 | 4,533 | | | 4,536 |
| Repurchase of Common Stock | (5,109) | (5) | (22,634) | | | (22,639) |
| Stock-based compensation | | | 18,926 | | | 18,926 |
| Reduction in excess tax benefits from stock-based compensation | | | (1,199) | | | (1,199) |
| Balance at December 31, 2012 | 114,193 | $ 114 | $ 2,432,790 | (1,879,026) | $ (465) | $ 553,413 |

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

Table of Contents

**HARMONIC INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands) | | |
| Cash flows from operating activities: | | | |
| Net income (loss) | $ (10,937) | $ 8,779 | $ (4,335) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Amortization of intangibles | 29,204 | 30,420 | 17,425 |
| Depreciation | 15,195 | 13,867 | 9,990 |
| Stock-based compensation | 18,926 | 20,913 | 15,539 |
| Net (gain) loss on disposal of fixed assets | (36) | 671 | 162 |
| Deferred income taxes | (4,969) | (361) | (1,461) |
| Provision for doubtful accounts and sales returns | 3,602 | 3,235 | 2,589 |
| Provision for excess and obsolete inventories | 3,377 | 3,936 | 4,153 |
| Excess tax benefits from stock-based compensation | (121) | (1,955) | (271) |
| Other non-cash adjustments, net | 1,006 | 801 | 1,529 |
| Changes in assets and liabilities, net of effect of acquisitions: | | | |
| Accounts receivable | 20,368 | (11,477) | (22,333) |
| Inventories | 3,003 | (16,588) | (16,132) |
| Prepaid expenses and other assets | (2,684) | 7,924 | (5,445) |
| Accounts payable | (5,201) | 4,750 | (3,080) |
| Deferred revenue | 1,334 | (13,470) | 5,086 |
| Income taxes payable | 1,535 | (6,843) | 11,017 |
| Accrued excess facility costs | (1,724) | (327) | (2,412) |
| Accrued and other liabilities | (1,065) | 902 | 5,545 |
| Net cash provided by operating activities | 70,813 | 45,177 | 17,566 |
| Cash flows from investing activities: | | | |
| Purchases of investments | (133,778) | (107,544) | (51,457) |
| Proceeds from maturities of investments | 57,484 | 28,733 | 80,961 |
| Proceeds from sales of investments | 41,354 | 30,999 | 63,269 |
| Acquisition of property and equipment | (12,609) | (17,269) | (35,624) |
| Acquisition of Omneon, net of cash received | | | (153,254) |
| Other acquisitions | | (250) | (250) |
| Net cash used in investing activities | (47,549) | (65,331) | (96,355) |
| Cash flows from financing activities: | | | |
| Proceeds from lease financing liability | | | 18,833 |
| Proceeds from issuance of common stock, net | 4,819 | 12,701 | 3,859 |
| Repurchase of common stock | (22,639) | | |
| Excess tax benefits from stock-based compensation | 121 | 1,955 | 271 |
| Net cash provided by (used in) financing activities | (17,699) | 14,656 | 22,963 |
| Effect of exchange rate changes on cash and cash equivalents | 122 | (52) | (118) |
| Net increase (decrease) in cash and cash equivalents | 5,687 | (5,550) | (55,944) |
| Cash and cash equivalents at beginning of period | 90,983 | 96,533 | 152,477 |

| | | | |
|---|---|---|---|
| Cash and cash equivalents at end of period | $ 96,670 | $ 90,983 | $ 96,533 |
| | | | |
| Supplemental disclosures of cash flow information: | | | |
| Income tax payments, net | $ 5,051 | $ 7,597 | $ 1,427 |
| Non-cash investing and financing activities: | | | |
| Issuance of restricted common stock for Omneon acquisition | | | 95,938 |
| Fair value of vested portion of stock options and restricted stock units assumed in connection with the Omneon acquisition | | | 2,125 |

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

**HARMONIC INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

## NOTE 1: DESCRIPTION OF BUSINESS

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

## NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

*Basis of Presentation*

The accompanying consolidated financial statements of Harmonic include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company s fiscal quarters are based on 13-week periods, except for the fourth quarter which ends on December 31.

*Use of Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America 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 consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

*Reclassifications*

From time to time the Company reclassifies certain 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.

*Foreign Currency*

The functional currency of the Company s Israeli, Cayman and Swiss operations is the U.S. dollar. All other foreign subsidiaries use the respective local currency as the functional currency. When the local currency is the functional currency, gains and losses from translation of these foreign currency financial statements into U.S. dollars are recorded as a separate component of other comprehensive loss in stockholders equity.

For subsidiaries where the functional currency is the U.S. dollar, monetary assets and liabilities denominated in currencies other than the U.S. dollar are remeasured into U.S. dollars using exchange rates prevailing on the balance sheet date. The remeasurement gains and losses are included in other expense, net in the Company s Consolidated Statements of Operations. The Company recorded remeasurement losses of $0.7 million, $0.7 million, and $1.0 million for the years ended December 31, 2012, 2011 and 2010, respectively.

*Fair Value of Financial Instruments*

The carrying value of Harmonic s financial instruments, including cash equivalents, short-term investments, accounts receivable, accounts payable and accrued liabilities, approximate fair value due to their short maturities.

*Cash and Cash Equivalents*

Cash and cash equivalents include all cash and highly liquid investments with maturities of three months or less at the date of purchase. The carrying amount of cash and cash equivalents approximates fair value because of the short maturity of those instruments.

*Short-Term Investments*

Harmonic s short-term investments are stated at fair value and are principally comprised of U.S. federal government bonds, state, municipal and local government agencies bonds, corporate bonds, commercial paper and certificates of deposit. The Company classifies its investments as available-for-sale in accordance with applicable accounting guidance on accounting for certain investments in debt and equity securities and states its investments at fair value, with unrealized gains and losses reported in accumulated other comprehensive income (loss). The specific identification method is used to determine the cost of securities disposed of, with realized gains and losses reflected in other expense, net in the Company s Consolidated Statements of Operations. Investments are anticipated to be used for current operations and are, therefore, classified as current assets even though maturities may extend beyond one year. The Company monitors its investment portfolio for impairment on a periodic basis. In the event a decline in value is determined to be other than temporary, an impairment charge is recorded. The Company considers current market conditions, as well as the likelihood that it would need to sell its investments prior to a recovery of par value, when determining if a loss is other than temporary.

*Concentrations of Credit Risk/Major Customers/Supplier Concentration*

Financial instruments which subject Harmonic to concentrations of credit risk consist primarily of cash, cash equivalents, short-term investments and accounts receivable. Cash, cash equivalents and short-term investments are invested in short-term, highly liquid, investment-grade obligations of commercial or governmental issuers, in accordance with Harmonic s investment policy. The investment policy limits the amount of credit exposure to any one financial institution, commercial or governmental issuer. Harmonic s accounts receivable are derived from sales to cable, satellite, telco, broadcaster and other media companies. Harmonic generally does not require collateral from its customers, and performs ongoing credit evaluations of its customers and provides for expected losses. Harmonic maintains an allowance for doubtful accounts based upon the expected collectability of its accounts receivable. No customers had a balance greater than 10% of the Company s net accounts receivable balance as of December 31, 2012 and 2011. In the years ended December 31, 2012, 2011 and 2010, sales to Comcast accounted for 12%, 11% and 17%, respectively, of net revenue.

Certain of the components and subassemblies included in the Company s products are obtained from a single source or a limited group of suppliers. Although the Company seeks to reduce dependence on those sole source and limited source suppliers, the partial or complete loss of certain of these sources could have at least a temporary adverse effect on the Company s results of operations and damage customer relationships.

*Revenue Recognition*

Harmonic s principal sources of revenue are from the sale of hardware, software, hardware and software maintenance contracts, and end-to-end solutions, encompassing design, manufacture, test, integration and installation of products. Harmonic recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been provided, the sale price is fixed or determinable, and collectability is reasonably assured.

Revenue from the sale of hardware and software products is recognized when risk of loss and title have transferred. For most of the Company s product sales, these criteria are met at the time the product is shipped or delivery has occurred. Revenue from distributors and system integrators is recognized on delivery of the related products, provided all other revenue recognition criteria have been met. The Company s agreements with these distributors and system integrators have terms which are generally consistent with the standard terms and conditions for the sale of the Company s equipment to end users, and do not provide for product rotation or pricing allowances, as are typically found in agreements with stocking distributors. The Company accrues for sales returns and other allowances based on its historical experience.

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

Shipping and handling costs incurred for inventory purchases and product shipments are recorded in cost of revenue in the Company s Consolidated Statements of Operations. Costs associated with services are generally recognized as incurred.

The Company recognizes revenue from the sale of hardware products and software bundled with hardware that is essential to the functionality of the hardware in accordance with applicable revenue recognition accounting guidance. For the sale of stand-alone software products, bundled with hardware not essential to the functionality of the hardware, the Company recognizes revenue in accordance with industry specific software accounting guidance. Revenue associated with service and maintenance agreements is recognized on a straight-line basis over the period in which the services are performed, generally one year. The Company recognizes revenue associated with solution sales using the percentage of completion method. Further details of these accounting policies are described below.

*Multiple Element Arrangements.* The Company has revenue arrangements that include hardware and software essential to the hardware product s functionality. For transactions originating or materially modified, beginning January 1, 2011, the Company has applied the accounting guidance that requires the Company to allocate revenue to all deliverables based on their relative selling prices. For transactions originating prior to January 1, 2011, the Company applied software revenue recognition accounting guidance, as described in the Software section below. The Company determines the relative selling prices by first considering vendor-specific objective evidence of fair value ( VSOE ), if it exists; otherwise third-party evidence ( TPE ) of the selling price is used. If neither VSOE nor TPE exists for a deliverable, the Company uses a best estimate of the selling price ( BESP ) for that deliverable.

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

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

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

**Table of Contents**

*Software.* Sales of stand-alone software that are not considered essential to the functionality of the hardware continue to be subject to the industry-specific software revenue recognition guidance. Further, the Company also applied the industry-specific software revenue recognition guidance to its multiple element arrangements for transactions originating prior to January 1, 2011.

In accordance with the software revenue recognition guidance, the Company applies the residual method to recognize revenue for the delivered elements in stand-alone software transactions. Under the residual method, the amount of revenue allocated to delivered elements equals the total arrangement consideration, less the aggregate fair value of any undelivered elements, typically maintenance, provided that VSOE of fair value exists for all undelivered elements. VSOE of fair value is based on the price charged when the element is sold separately or, in the case of maintenance, substantive renewal rates for maintenance.

*Solution Sales.* Solution sales for the design, manufacture, test, integration and installation of products, including equipment acquired from third parties to be integrated with Harmonic s products, that are customized to meet the customer s specifications are accounted for in accordance with applicable guidance on accounting for performance of construction/production contracts. Accordingly, for each arrangement that the Company enters into that includes both products and services, the Company performs a detailed evaluation to determine whether the arrangement should be accounted for under guidance for construction/production contracts or, alternatively, for arrangements that do not involve significant production, modification or customization, under other applicable accounting guidance. The Company has a long-standing history of entering into contractual arrangements to deliver the solution sales described.

At the outset of each arrangement accounted for as a single arrangement, the Company develops a detailed project plan and associated labor hour estimates for each project. The Company believes that, based on its historical experience, it has the ability to make labor cost estimates that are sufficiently dependable to justify the use of the percentage-of-completion method of accounting and, accordingly, utilizes percentage-of-completion accounting for most arrangements that are determined to be single arrangements. Under the percentage-of-completion method, revenue recognized reflects the portion of the anticipated contract revenue that has been earned, equal to the ratio of actual labor hours expended to total estimated labor hours to complete the project. Costs are recognized proportionally to the labor hours incurred. For contracts that include customized services for which labor costs are not reasonably estimable, the Company uses the completed contract method of accounting. Under the completed contract method, 100% of the contract s revenue and cost is recognized upon the completion of all services under the contract. If the estimated costs to complete a project exceed the total contract amount, indicating a loss, the entire anticipated loss is recognized.

*Inventories*

Inventories are stated at the lower of cost, using the weighted average method, or market. Harmonic establishes provisions for excess and obsolete inventories to reduce such inventories to their estimated net realizable value after evaluation of historical sales, future demand and market conditions, expected product lifecycles and current inventory levels. Such provisions are charged to cost of revenue in the Company s Consolidated Statements of Operations.

*Capitalized Software Development Costs*

Costs related to research and development are generally charged to expense as incurred. Capitalization of material software development costs begins when a product s technological feasibility has been established. To date, the time period between achieving technological feasibility, which the Company has defined as the establishment of a working model, which typically occurs when beta testing commences, and the general availability of such software has been short, and, as such, software development costs qualifying for capitalization have been insignificant.

**Table of Contents**

The Company incurs costs associated with developing software for internal use and for which no plan exists to market the software externally. The Company capitalizes the costs as part of property and equipment and recognizes the associated depreciation over a useful life of generally three years. In the years ended December 31, 2012, 2011 and 2010, the Company capitalized $0.8 million, $1.1 million and $1.0 million, respectively, in internal use software development costs.

*Property and Equipment*

Property and equipment are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets. Estimated useful lives are five years for furniture and fixtures and up to four years for machinery and equipment. Depreciation and amortization for leasehold improvements are computed using the shorter of the remaining useful lives of the assets, up to ten years, or the lease term of the respective assets. Depreciation and amortization expense related to property and equipment for the years ended December 31, 2012, 2011 and 2010 was $15.2 million, $13.9 million and $10.0 million, respectively.

*Goodwill*

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed. The Company tests for impairment of goodwill on an annual basis in the fourth quarter of each 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 fair value. When assessing the goodwill for impairment, the Company considers its market capitalization adjusted for a control premium and, if necessary, the Company s discounted cash flow model, which involves significant assumptions and estimates, including the Company s future financial performance, the Company s weighted average cost of capital and the Company s interpretation of currently enacted tax laws. Circumstances that could indicate impairment and require the Company to perform an impairment test include: a significant decline in the financial results of the Company s operations; the Company s market capitalization relative to net book value; unanticipated changes in competition and the Company s market share; significant changes in the Company s strategic plans; or adverse actions by regulators.

There was no impairment of goodwill resulting from the Company s annual impairment testing in the fourth quarter of 2012. See Note 4, Goodwill and Identified Intangible Assets for additional information.

*Long-lived Assets*

Long-lived assets represent property and equipment and purchased intangible assets. Purchased intangible assets from business combinations and asset acquisitions include customer contracts, trademarks and tradenames, and maintenance agreements and related relationships, the amortization of which is charged to general and administrative expenses, and core technology and developed technology, the amortization of which is charged to cost of revenue. The Company evaluates the recoverability of intangible assets and other long-lived assets when indicators of impairment are present. When impairment indicators are present, the Company evaluates the recoverability of intangible assets and other long-lived assets on the basis of undiscounted cash flows from each asset group. If impairment is indicated, provisions for impairment are determined based on fair value, principally using discounted cash flows. This evaluation involves significant assumptions and estimates, including the Company s future financial performance, the Company s weighted average cost of capital and the Company s interpretation of currently enacted tax laws. Circumstances that could indicate impairment and require the Company to perform an impairment test include: a significant decline in the cash flows of such asset or asset group; unanticipated changes in competition and the Company s market share; significant changes in the Company s strategic plans; or exiting an activity resulting from a restructuring of operations. See Note 4, Goodwill and Identified Intangible Assets for additional information.

*Restructuring Costs and Accruals for Excess Facilities*

The Company applies applicable accounting guidance on accounting for costs associated with restructuring activities, including exit or disposal activities, which requires that a liability for costs associated with an exit or disposal activity be recognized and measured initially at fair value when the liability is incurred. Harmonic s restructuring activities have primarily been related to excess facilities. The Company determines the excess facilities accrual based on expected cash payments, under the applicable facility lease, reduced by any estimated sublease rental income for such facility. See Note 10, Restructuring and Excess Facilities for additional information.

*Warranty*

The Company accrues for estimated warranty costs at the time of revenue recognition and records such accrued liabilities as part of cost of revenue. Management periodically reviews its warranty liability and adjusts the accrued liability 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.

*Advertising Expenses*

The Company expenses all advertising costs as incurred. Advertising expense was $0.5 million, $0.8 million and $0.4 million for the years ended December 31, 2012, 2011 and 2010, respectively.

*Stock-based Compensation Expense*

Harmonic measures and recognizes compensation expense for all stock-based compensation awards made to employees and directors, including stock options, restricted stock units and awards related to our Employee Stock Purchase Plan ( ESPP ), based upon the grant-date fair value of those awards.

Stock-based compensation expense recognized for the years ended December 31, 2012, 2011 and 2010 was $18.9 million, $20.9 million and $15.5 million, respectively.

Applicable accounting guidance requires companies to estimate the fair value of stock-based compensation awards on the date of grant. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in the Company s Consolidated Statements of Operations.

The fair value of stock options is estimated at grant date using the Black-Scholes option pricing model. The Company s determination of fair value of stock options on the date of grant, using an option pricing model, is affected by the Company s stock price, as well as the assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the Company s expected stock price volatility over the term of the awards and projected employee stock option exercise behaviors. The fair value of each restricted stock unit grant is based on the underlying value of the Company s common stock on the date of grant.

*Accounting for Derivatives and Hedging Activities*

The Company accounts for derivative financial instruments and hedging contracts in accordance with the applicable accounting guidance, which requires that all derivatives be recognized at fair value in the balance sheet and that the corresponding gains or losses be reported either in the Consolidated Statement of Operations or as a component of comprehensive income (loss), depending on the type of hedging arrangement utilized by the Company.

*Forward Exchange Contracts Not Designated as Hedging Instruments*

Periodically, the Company enters into foreign currency forward exchange contracts ( forward exchange contracts ) to manage exposure related to monetary assets and liabilities denominated in foreign currencies. The

Company does not enter into derivative financial instruments for trading purposes. The Company does not designate these forward exchange contracts as hedging instruments, and these contracts do not qualify for hedge accounting treatment.

At December 31, 2012, the Company had a forward exchange contract to buy Israeli shekels (ILS) with a notional value of $3.2 million, and forward exchange contracts to sell euros, British pounds, and Japanese yen with notional values of $5.6 million, $2.2 million, and $3.3 million, respectively. These foreign exchange contracts mature in the first quarter of 2013. At December 31, 2011, the Company had forward exchange contracts to sell Israeli shekels (ILS) with a notional value of $4.3 million, euros with a notional value of $6.9 million and British pounds with a notional value of $5.7 million. These foreign exchange contracts matured in the first quarter of 2012.

The Company s forward exchange contracts generally have maturities of between one and three months. The fair value of these contracts has historically not been significant at the end of each reporting period. Typically, realized gains and losses on these forward exchange contracts, which arise as a result of closing out the contracts, are substantially offset by remeasurement or realized losses and gains on the underlying balances denominated in non-functional currencies. Gains and losses on forward exchange contracts and from remeasurement and realized gains and losses of the underlying asset balances, denominated in non-functional currencies, are recognized in the Consolidated Statements of Operations in other expense, net.

*Income Taxes*

In preparing the Company s financial statements, the Company estimates the income taxes for each of the jurisdictions in which the Company operates. This involves estimating the Company s actual current tax exposures and assessing temporary and permanent differences resulting from differing treatment of items, such as reserves and accruals, for tax and accounting purposes.

The Company s income tax policy is to record the estimated future tax effects of temporary differences between the tax bases of assets and liabilities and amounts reported in the Company s accompanying Consolidated Balance Sheets, as well as operating loss and tax credit carryforwards. The Company follows the guidelines set forth in the applicable accounting guidance regarding the recoverability of any tax assets recorded on the Consolidated Balance Sheet and provides any necessary allowances as required. Determining necessary allowances requires the Company to make assessments about the timing of future events, including the probability of expected future taxable income and available tax planning opportunities.

The Company is subject to examination of its income tax returns by various tax authorities on a periodic basis. The Company regularly assesses the likelihood of adverse outcomes resulting from such examinations to determine the adequacy of its provision for income taxes. The Company has applied the provisions of the accounting guidance on accounting for uncertainty in income taxes, which requires application of a more-likely-than-not threshold to the recognition and de-recognition of uncertain tax positions. If the recognition threshold is met, the applicable accounting guidance permits the Company to recognize a tax benefit measured at the largest amount of tax benefit that, in the Company s judgment, is more than 50 percent likely to be realized upon settlement. It further requires that a change in judgment related to the expected ultimate resolution of uncertain tax positions be recognized in earnings in the period of such change.

The Company files annual income tax returns in multiple taxing jurisdictions around the world. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, the Company believes that its reserves for income taxes reflect the most likely outcome. The Company adjusts these reserves and penalties, as well as the related interest, in light of changing facts and circumstances. Changes in the Company s assessment of its uncertain tax positions or settlement of any particular position could materially and adversely impact the Company s income tax rate, operating results, financial position and cash flows.

*Comprehensive Income (Loss)*

Comprehensive income (loss) includes net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes cumulative translation adjustments and unrealized gains and losses on available-for-sale securities.

*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. 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 an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity. The Company adopted this standard in the first quarter of fiscal 2012. While this guidance changes the presentation of comprehensive income, there are no changes to the components that are recognized in net income or other comprehensive income under current accounting guidance; therefore, adoption did not have an impact on the Company s consolidated financial position, results of operations or cash flows.

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. Adoption of this accounting standard update did not have an impact on the Company s financial position, results of operations or cash flows.

In December 2011, the FASB issued guidance enhancing disclosure requirements about the nature of an entity s right to offset. The new guidance requires the disclosure of the gross amounts subject to rights of set-off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The new guidance is effective for both interim and annual reporting periods beginning January 1, 2013. To the extent applicable, the application of this guidance in 2013 will result in financial statement disclosure changes only.

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. Application of this new guidance is not expected to have any impact on the Company because it does not hold any indefinite-lived assets.

**NOTE 3: OMNEON ACQUISITION**

On September 15, 2010, Harmonic completed the acquisition of 100% of the equity interests of Omneon, Inc., a private, venture-backed company organized under the laws of Delaware and headquartered in Sunnyvale, California. Omneon was engaged in the development and support of a range of video servers, active storage systems and related software applications that media companies use to simultaneously ingest, process, store,

Table of Contents

manage and deliver digital media in a wide range of formats. The acquisition of Omneon was intended to strengthen Harmonic s competitive position in the digital media market and to broaden the Company s relationships with customers who produce and distribute digital video content, such as broadcasters, content networks and other major owners of content. The acquisition was also intended to broaden Harmonic s technology and product lines with digital storage and playout solutions which complement Harmonic s existing video processing products. In addition, the acquisition provided an assembled workforce and the implicit value of future cost savings as a result of combining entities, and was expected to provide Harmonic with future, but then unidentified, new products and technologies. These opportunities were significant factors to the establishment of the purchase price, which exceeded the fair value of Omneon s net tangible and intangible assets acquired, resulting in goodwill of approximately $147.8 million that was recorded in connection with this acquisition.

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

To secure post-closing indemnification obligations of the holders of Omneon capital stock, the Company deposited into escrow an aggregate of approximately $21.0 million in cash and 1,926,920 shares of the Company s common stock that would otherwise have been issued to those holders. In the first quarter of 2012, the Company submitted an indemnification claim for reimbursement from escrow and received reimbursement of $0.8 million, representing $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.

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

Harmonic accounted for its acquisition of Omneon using the acquisition method of accounting for business combinations. Omneon s tangible and identifiable intangible assets acquired and liabilities assumed were recorded based upon their estimated fair values as of the closing date of the acquisition. The excess purchase price over the value of the net assets acquired was recorded as goodwill.

Table of Contents

The following table summarizes the purchase accounting and the net tangible assets acquired as of the date of acquisition (in thousands):

| | |
|---|---|
| Total purchase consideration | $ 291,802 |
| Less the fair value of net assets acquired: | |
| Net tangible asset acquired | 34,952 |
| Intangible assets acquired: | |
| Existing technology | 50,800 |
| Customer contracts | 29,200 |
| Patents and core technology | 9,800 |
| In-process technology | 9,000 |
| Maintenance agreements | 5,500 |
| Trade names / trademarks | 4,000 |
| Order backlog | 800 |
| | 109,100 |
| Goodwill | $ 147,750 |

Details of the net assets acquired are as follows:

| | |
|---|---|
| Cash and cash equivalents | $ 40,485 |
| Accounts receivable, net [a] | 17,055 |
| Inventories | 11,010 |
| Property and equipment, net | 12,093 |
| Deferred income tax assets | 18,021 |
| Other tangible assets | 3,294 |
| Accounts payable | (6,829) |
| Deferred revenue | (6,399) |
| Deferred income tax liabilities | (42,575) |
| Other accrued liabilities | (11,203) |
| | $ 34,952 |

[a] The gross contractual receivable is $17,760.

*Existing technology.* Existing technology represents products that have reached technological feasibility. Omneon s products include Spectrum and MediaDeck video servers, MediaGrid active storage systems and media management software applications, which were initially designed for, and have been deployed mostly by, broadcasters that use Omneon s products for the production and transmission of television content. The Company will amortize the existing technology intangible asset over an average estimated life of four years.

*Customer Contracts.* Customer contracts represent the value placed on Omneon s distribution channels and customer relationships. The Company will amortize the customer contract intangible asset over an average estimated life of six years.

*Patents and core technology.* Patents and core technology represent a series of processes and trade secrets that are used in Omneon s products. The Company will amortize the patents and core technology intangible asset over an average estimated life of four years.

*In-process technology.* In-process technology represents incomplete Omneon research and development projects that had not reached technological feasibility as of the closing date, including new versions and incremental improvements to its 3G MediaPort product, which was expected to be used in the Spectrum product line once completed. Acquired in-process technology is recorded at fair value as an indefinite-lived intangible

Table of Contents

asset at the acquisition date until the completion or abandonment of the associated research and development efforts. The in-process projects were completed in the first quarter of 2011. The completed technology is estimated to have a useful life of four years.

*Maintenance agreements.* Maintenance agreements relate to revenue generated by Omneon from fees that users pay when they subscribe to maintenance and support contracts. The Company will amortize the maintenance agreements intangible asset over an average estimated life of six years.

*Trade names / trademarks.* Trade names and trademarks represent the value placed on Omneon s brand and recognition in the market place. The Company will amortize the trade names/trademarks intangible asset over an average estimated life of four years.

*Backlog.* Backlog relates to firm customer orders that are scheduled for delivery subsequent to the acquisition date. The Company amortized the backlog intangible asset over its estimated life of three and one half months.

*Goodwill.* Goodwill is calculated as the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets acquired. Goodwill represents the highly skilled and valuable assembled workforce, the ability to generate new products and services as a combined company and expected synergistic benefits of the transaction. In accordance with applicable accounting standards, goodwill is not amortized, but instead will be tested for impairment at least annually or more frequently if certain indicators are present. The goodwill resulting from this acquisition is not deductible for federal tax purposes.

The results of operations of Omneon are included in Harmonic s Consolidated Statements of Operations from September 15, 2010, the date of acquisition. For the period from September 15, 2010 to December 31, 2010, Omneon products contributed revenues of $36.5 million and a net operating profit of $1.1 million.

***Pro Forma Financial Information***

The unaudited pro forma financial information presented below for the year ended December 31, 2010 summarizes the combined results of operations as if the Omneon acquisition had been completed on January 1, 2010. The unaudited pro forma financial information for the year ended December 31, 2010 combines the results for Harmonic for the year ended December 31, 2010 and the historical results of Omneon through September 15, 2010, the date of acquisition.

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

| | **Year ended December 31, 2010** (In thousands, except per share amounts) |
|---|---|
| Net revenues | $ 506,904 |
| Net loss | (17,619) |
| Net loss per share basic | (0.16) |
| Net loss per share diluted | (0.16) |

Table of Contents

**NOTE 4: GOODWILL AND IDENTIFIED INTANGIBLE ASSETS**

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

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| Identifiable intangibles: | | | | | | |
| Developed core technology | $ 136,145 | $ (102,449) | $ 33,696 | $ 136,145 | $ (81,951) | $ 54,194 |
| Customer relationships/contracts | 67,098 | (48,150) | 18,948 | 67,098 | (42,142) | 24,956 |
| Trademarks and tradenames | 11,361 | (9,145) | 2,216 | 11,361 | (7,700) | 3,661 |
| Maintenance agreements and related relationships | 7,100 | (3,513) | 3,587 | 7,100 | (2,260) | 4,840 |
| Total identifiable intangibles | $ 221,704 | $ (163,257) | $ 58,447 | $ 221,704 | $ (134,053) | $ 87,651 |

The changes in the carrying amount of goodwill for the years ended December 31, 2012 and 2011 are as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Balance at beginning of period | $ 212,417 | $ 211,878 |
| Adjustment to deferred tax liability associated with the acquisition of Omneon | | (527) |
| Adjustment to fixed assets associated with the acquisition of Omneon | | 298 |
| Adjustment to income tax payable associated with the acquisition of Omneon | | 771 |
| Foreign currency translation adjustment | 101 | (3) |
| Total changes in goodwill | $ 212,518 | $ 212,417 |

Based on the annual impairment test performed as of December 31, 2012, management determined that the Company s estimated fair value exceeded the carrying value of its net assets by approximately 21% and that goodwill was not impaired as of December 31, 2012. In addition, the Company has not recorded any impairment charges related to goodwill for any prior periods.

For the years ended December 31, 2012, 2011 and 2010, the Company recorded a total of $29.2 million, $30.4 million and $17.4 million, respectively, of amortization expense for identified intangibles of which $20.5 million, $21.5 million and $12.5 million, respectively, was included in cost of revenue. The estimated future amortization expense of purchased intangible assets with definite lives is as follows (in thousands):

| | Cost of Revenue | Operating Expenses | Total |
|---|---|---|---|
| Year ended December 31, | | | |
| 2013 | $ 19,232 | $ 8,096 | $ 27,328 |
| 2014 | 13,745 | 6,775 | 20,520 |
| 2105 | 719 | 5,783 | 6,502 |
| 2016 | | 4,097 | 4,097 |
| 2017 | | | |
| Total future amortization expense | $ 33,696 | $ 24,751 | $ 58,447 |

78

Table of Contents

**NOTE 5: SHORT-TERM INVESTMENTS**

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

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| **As of December 31, 2012** | | | | |
| Certificates of deposit | $ 1,603 | $ | $ | $ 1,603 |
| State, municipal and local government agencies bonds | 59,009 | 45 | (4) | 59,050 |
| Corporate bonds | 31,568 | 4 | (10) | 31,562 |
| Commercial paper | 10,287 | 1 | | 10,288 |
| U.S. federal government bonds | 2,003 | | | 2,003 |
| Total short-term investments | $ 104,470 | $ 50 | $ (14) | $ 104,506 |
| **As of December 31, 2011** | | | | |
| 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 |
| Total short-term investments | $ 70,819 | $ 56 | $ (21) | $ 70,854 |

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

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| Less than one year | $ 76,779 | $ 43,470 |
| Due in 1 - 2 years | 27,727 | 27,384 |
| Total short-term investments | $ 104,506 | $ 70,854 |

In the event the Company needs or desires to access funds from the short-term investments that it holds, it is possible that the Company 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 the Company s cost, it may incur a loss. Further, rating downgrades of the security issuer or the third parties insuring such investments may require the Company to adjust the carrying value of these investments through an impairment charge. The Company s inability to sell all or some of the Company s short-term investments at par or the Company s cost, or rating downgrades of issuers or insurers of these securities, could adversely affect the Company s results of operations or financial condition.

For the years ended December 31, 2012, 2011 and 2010, realized gains and realized losses from the sale of investments were not material.

***Impairment of Investments***

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

believes that the unrealized losses are temporary and do not require an other-than-temporary impairment, based on its evaluation of available evidence as of December 31, 2012.

Table of Contents

As of December 31, 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 6: FAIR VALUE MEASUREMENTS**

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

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

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

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

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company primarily uses broker quotes for valuation of its short-term investments. The forward exchange contracts are classified as Level 2 because they are valued using quoted market prices and other observable data for similar instruments in an active market.

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

The Company uses the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. During the years ended December 31, 2012 and 2011, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.

Table of Contents

The following table sets forth the fair value of the Company s financial assets and liabilities measured at fair value based on the three-tier fair value hierarchy (in thousands):

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **As of December 31, 2012** | | | | |
| **Cash equivalents** | | | | |
| Money market funds | $ 54,923 | $ | $ | $ 54,923 |
| Corporate bonds with maturity less than 90 days | | 3,614 | | 3,614 |
| U.S. federal government bonds with maturity less than 90 days | 3,005 | | | 3,005 |
| **Short-term investments** | | | | |
| Certificates of deposit | | 1,603 | | 1,603 |
| State, municipal and local government agencies bonds | | 59,050 | | 59,050 |
| Corporate bonds | | 31,562 | | 31,562 |
| Commercial paper | | 10,288 | | 10,288 |
| U.S. federal government bonds | 2,003 | | | 2,003 |
| **Prepaids and other current assets** | | | | |
| Foreign exchange forward contracts | | 344 | | 344 |
| Total assets measured and recorded at fair value | $ 59,931 | $ 106,461 | $ | $ 166,392 |
| **Accrued Liabilities** | | | | |
| Foreign exchange forward contracts | $ | $ 143 | $ | $ 143 |
| Total liabilities measured and recorded at fair value | $ | $ 143 | $ | $ 143 |

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| **As of December 31, 2011** | | | | |
| **Cash equivalents** | | | | |
| Money market funds | $ 62,131 | $ | $ | $ 62,131 |
| **Short-term investments** | | | | |
| 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 |
| **Prepaids and other current assets** | | | | |
| Foreign exchange forward contracts | | 373 | | 373 |
| Total assets measured and recorded at fair value | $ 71,361 | $ 61,997 | $ | $ 133,358 |
| **Accrued liabilities** | | | | |
| Foreign exchange forward contracts | $ | $ 159 | $ | $ 159 |
| Total liabilities measured and recorded at fair value | $ | $ 159 | $ | $ 159 |

**NOTE 7: ACCOUNTS RECEIVABLE**

Accounts receivable, net of allowances, consisted of the following (in thousands):

| | December 31, |
|---|---|

| | 2012 | 2011 |
|---|---|---|
| Accounts receivable | $ 95,515 | $ 118,138 |
| Less: allowance for doubtful accounts, returns and discounts | (9,595) | (8,252) |
| | $ 85,920 | $ 109,886 |

Table of Contents

Trade accounts receivable are recorded at invoiced amounts and do not bear interest. Harmonic generally does not require collateral and performs ongoing credit evaluations of its customers and provides for expected losses. Harmonic maintains an allowance for doubtful accounts based upon the expected collectability of its accounts receivable. The expectation of collectability is based on the Company s review of credit profiles of customers, contractual terms and conditions, current economic trends and historical payment experience.

The following is a summary of activity in allowances for doubtful accounts, returns and discounts for the three years ended December 31, 2012, 2011 and 2010 (in thousands):

| | Balance at Beginning of Period | Charges to Revenue | Charges (Credits) to Expense | Additions to (Deductions from) Reserves | Balance at End of Period |
|---|---|---|---|---|---|
| **Year ended December 31,** | | | | | |
| 2012 | $ 8,252 | $ 3,141 | $ 461 | $ (2,259) | $ 9,595 |
| 2011 | $ 5,897 | $ 2,620 | $ 615 | $ (880) | $ 8,252 |
| 2010 | $ 5,163 | $ 1,533 | $ 1,056 | $ (1,855) | $ 5,897 |

**NOTE 8: CERTAIN BALANCE SHEET COMPONENTS**

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

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| **Inventories:** | | |
| Raw materials | $ 10,731 | $ 14,099 |
| Work-in-process | 4,347 | 4,250 |
| Finished goods | 49,192 | 52,300 |
| | $ 64,270 | $ 70,649 |
| **Property and equipment:** | | |
| Furniture and fixtures | $ 7,856 | $ 6,706 |
| Machinery and equipment | 108,262 | 97,916 |
| Leasehold improvements | 7,612 | 7,079 |
| | 123,730 | 111,701 |
| Less: accumulated depreciation and amortization | (85,608) | (71,232) |
| | $ 38,122 | $ 40,469 |
| **Accrued liabilities:** | | |
| Accrued compensation | $ 10,890 | $ 10,915 |
| Accrued incentive compensation | 7,403 | 7,917 |
| Accrued warranty | 4,292 | 5,558 |
| Other | 19,830 | 22,506 |
| | $ 42,415 | $ 46,896 |

**NOTE 9: FINANCING LIABILITY FOR CONSTRUCTION IN PROGRESS**

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

of the lease, the landlord reimbursed $18.8 million of the construction costs. Because certain improvements constructed by the Company were considered structural in nature and the Company was responsible for any cost overruns, the Company was considered to be the owner of the construction project for accounting purposes under applicable accounting guidance on the effect of lessee involvement in asset construction.

Table of Contents

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

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

**NOTE 10: RESTRUCTURING AND EXCESS FACILITIES**

The Company has recorded restructuring and excess facilities charges, beginning in 2001 and throughout subsequent years, as a result of changing conditions in the use of its facilities in the United States and the United Kingdom. The initial charges that had been recorded to selling, general and administrative expense and the related liabilities have been adjusted periodically for changes in sublease income estimates.

In 2008, the Company recorded charges in selling, general and administrative expenses for excess facilities of $1.2 million based on a revised estimate of expected sublease income from a Sunnyvale building and $0.2 million based on a revised estimate of expected sublease income from two buildings in the United Kingdom. The Sunnyvale lease terminated in September 2010 and the United Kingdom lease terminated in October 2010.

In 2009, the Company recorded a total of $8.3 million of restructuring charges related to the Scopus acquisition. These charges included $6.3 million in cost of revenue, related to provisions for excess and obsolete inventories of $5.8 million and $0.5 million for severance and other expenses. Charges of $2.0 million were recorded in operating expenses related to the Scopus acquisition, consisting primarily of severance costs. Substantially all of the severance was paid during the year ended December 31, 2009.

In the fourth quarter of 2010, the Company recorded an excess facilities charge 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 as necessary, based on changes in the timing and amounts of expected sublease rental income.

The following table summarizes the activity in the restructuring accrual during the years ended December 31, 2012, 2011 and 2010 (in thousands):

| | Excess Facilities | Campus Consolidation | UK Closure | Scopus Facilities | Total |
|---|---|---|---|---|---|
| Balance at December 31, 2009 | $ 3,117 | $ 1,715 | $ 276 | $ 224 | $ 5,332 |
| Provisions (recoveries) | 3,061 | (2) | (71) | 3 | 2,991 |
| Cash payments, net of sublease income | (3,316) | (1,713) | (205) | (169) | (5,403) |
| Balance at December 31, 2010 | 2,862 | | | 58 | 2,920 |
| Provisions | 517 | | | | 517 |
| Cash payments, net of sublease income | (786) | | | (58) | (844) |
| Balance at December 31, 2011 | 2,593 | | | | 2,593 |
| Provisions | 94 | | | | 94 |
| Cash payments, net of sublease income | (1,818) | | | | (1,818) |
| Balance at December 31, 2012 | $ 869 | $ | $ | $ | $ 869 |

**NOTE 11: 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 December 31, 2012, other than standby letters of credit and guarantees (Note 18), there were no amounts outstanding under the line of credit facility, and there were no borrowings during the year ended December 31, 2012. This facility, which became effective in August 2011 and was amended in August 2012, contains a financial covenant that requires Harmonic to maintain a ratio of unrestricted cash, accounts receivable and short term investments to current liabilities (less deferred revenue) of at least 1.75 to 1.00. As of December 31, 2012, the Company s ratio under that covenant was 4.11 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 December 31, 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 December 31, 2012) or at LIBOR for the desired borrowing period (an annualized rate of 0.21% for a one month borrowing period at December 31, 2012) plus 1.75%, or 1.96%. Borrowings are not collateralized.

**NOTE 12: STOCKHOLDERS EQUITY**

*Preferred Stock*

Harmonic has 5,000,000 authorized shares of preferred stock. In July 2002, the Company classified 100,000 of these shares as Series A Participating Preferred Stock in connection with the Board s same day approval and adoption of a stockholder rights plan. This plan had a term of ten years and it expired in July 2012.

*Common Stock Issuances*

During the year ended December 31, 2010, the Company issued 14,150,122 shares of common stock as part of the consideration for the purchase of all of the outstanding shares of Omneon. The shares had a fair market value of $95.9 million at the time of issuance. To secure post-closing indemnification obligations of the holders of Omneon capital stock, the Company deposited into escrow an aggregate of approximately $21.0 million in cash and 1,926,920 shares of the Company s common stock that would otherwise have been issued to those holders. In the first quarter of 2012, the Company submitted an indemnification claim for reimbursement from escrow and received reimbursement of $0.8 million, representing $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.

*Common Stock Repurchases*

On April 24, 2012, the Company s Board of Directors (the Board ) 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 the 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 program may be suspended or discontinued at any time.

During 2012, under the program, the Company repurchased and retired approximately 5.1 million shares of common stock at an average price of $4.43 per share, for an aggregate purchase price of approximately $22.6 million, leaving approximately $2.4 million available for purchases under the program as of December 31, 2012. The Company charges the excess of cost over par value for the repurchase of its common stock to additional paid-in capital.

Table of Contents

On January 28, 2013, the Company s Board approved a $75 million increase in its stock repurchase program. On February 6, 2013, the Board approved a modification to the program that permits the Company to repurchase its common stock pursuant to a plan that meets the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934. The program is presently scheduled to expire in July, 2014. On February 19, 2013, the Board approved a further approximately $35 million increase to the program, contingent upon the closing of a sale of the Company s cable access HFC business. See Note 20 Subsequent Events . The Board has authorized aggregate repurchases under the program of $135 million, $22.6 million of which had been utilized for repurchases as of December 31, 2012.

*Accumulated Other Comprehensive Loss*

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

| | December 31, | |
|---|---|---|
| | **2012** | **2011** |
| Foreign currency translation adjustments | $ (502) | $ (897) |
| Unrealized gain on investments | 37 | 22 |
| Accumulated Other Comprehensive Loss | $ (465) | $ (875) |

**NOTE 13: EMPLOYEE BENEFIT PLANS**

**Stock Option Plans**

*1995 Stock Plan*. The 1995 Stock Plan provides for the grant of incentive stock options, non-statutory stock options and restricted stock units ( RSUs ). Incentive stock options may be granted only to employees. All other awards may be granted to employees and consultants. Under the terms of the 1995 Stock Plan, incentive stock options may be granted at prices not less than 100% of the fair value of the Company s common stock on the date of grant and non-statutory stock options may be granted at prices not less than 85% of the fair value of the Company s common stock on the date of grant. RSUs have no exercise price. Both options and RSUs vest over a period of time as determined by the Board, generally three to four years, and expire seven years from date of grant. Options granted prior to February 2006 expire ten years from the date of grant. Grants of RSUs and any non-statutory stock options issued at prices less than the fair market value on the date of grant decrease the plan reserve 1.5 shares for every unit or share granted and any forfeitures of these awards due to their not vesting would increase the plan reserve by 1.5 shares for every unit or share forfeited. As of December 31, 2012, an aggregate of 21,108,836 shares of common stock were reserved for issuance under the 1995 Stock Plan, of which 9,804,018 shares remained available for grant.

*2002 Director Plan*. The 2002 Director Plan provides for the grant of non-statutory stock options and RSUs to non-employee directors of the Company. Under the terms of the 2002 Director Plan, non-statutory stock options may be granted at prices not less than 100% of the fair value of the Company s common stock on the date of grant. RSUs have no exercise price. Both options and RSUs vest over a period of time as determined by the Board, generally three years for the initial grant and one year for subsequent grants to a non-employee director, and expire seven years from date of grant. Grants of RSUs decrease the plan reserve 1.5 shares for every unit granted and any forfeitures of these awards due to their not vesting would increase the plan reserve by 1.5 shares for every unit forfeited. As of December 31, 2012, an aggregate of 872,513 shares of common stock were reserved for issuance under the 2002 Director Plan, of which 350,912 shares remained available for grant.

*Employee Stock Purchase Plan.* The 2002 Employee Stock Purchase Plan ( ESPP ) provides for the issuance of share purchase rights to employees of the Company. The ESPP is intended to qualify as an employee stock purchase plan under Section 423 of the Internal Revenue Code. The ESPP enables employees to purchase shares at 85% of the fair market value of the Common Stock at the beginning or end of the offering period, whichever is lower. Offering periods generally begin on the first trading day on or after January 1 and

Table of Contents

July 1 of each year. Employees may participate through payroll deductions of 1% to 10% of their earnings. As of December 31, 2012, 1,230,891 shares of common stock were reserved for issuance under the ESPP. Under the ESPP, 1,598,895, 945,287 and 864,800 shares were issued during fiscal 2012, 2011 and 2010, respectively, representing $6.4 million, $5.2 million, and $4.2 million in contributions. As of December 31, 2012, a total of 8,269,109 shares had been issued under this plan.

*Assumed Omneon Stock Options.* In connection with the Company s acquisition of Omneon, the Company assumed substantially all stock options and RSUs outstanding under Omneon s 1998 Stock Option Plan and 2008 Equity Incentive Plan. Options assumed were converted into options to purchase 1,522,000 shares of the Company s common stock. RSUs assumed were converted into RSUs for the issuance of 1,455,000 shares of the Company s common stock. The assumed options and RSUs retained all applicable terms and vesting periods. In general, the assumed options vest over a four-year period from the original date of grant and expire 10 years from the original grant date. The assumed RSUs generally vest over a four year period from the original date of grant. As of December 31, 2012, a total of 702,512 shares of common stock were reserved for issuance under the Omneon Plans.

*Other Stock Option Plans.* In addition, the Company has various inactive stock-based incentive plans. As of December 31, 2012, an aggregate of 306,882 shares of common stock are reserved for issuance under the inactive plans, representing the aggregate number of shares subject to outstanding stock options and RSUs. No further awards may be granted under any of these plans.

**Stock Options and Restricted Stock Units**

The following table summarizes the Company s stock option and restricted stock unit activity during the year ended December 31, 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 |
| Authorized | 5,463 | | | | |
| Granted | (5,145) | 1,292 | 5.60 | 2,569 | 5.70 |
| Options exercised | | (317) | 2.80 | | |
| Shares released | | | | (1,663) | 7.37 |
| Forfeited or cancelled | 2,002 | (1,378) | 8.57 | (681) | 6.50 |
| Balance at December 31, 2012 | 10,155 | 8,900 | $ 6.83 | 3,938 | $ 6.44 |

The following table summarizes information about stock options outstanding as of December 31, 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 | 8,759 | $ 6.84 | 3.2 | $ 2,473 |
| Exercisable | 6,823 | 7.03 | 2.4 | 1,879 |

The intrinsic value of options vested and expected to vest and exercisable as of December 31, 2012 is calculated based on the difference between the exercise price and the fair value of the Company s common stock as of December 31, 2012. The intrinsic value of options exercised during the years ended December 31, 2012, 2011 and 2010, was $0.8 million, $5.2 million and $1.0 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.

The following table summarizes information about restricted stock units outstanding as of December 31, 2012 (in thousands, except per share amounts and term):

| | Number of Shares Underlying Restricted Stock Units | Weighted Average Remaining Vesting Period (Years) | Aggregate Fair Value |
|---|---|---|---|
| Vested and expected to vest | 3,661 | 1.1 | $ 18,563 |

The fair value of restricted stock units vested and expected to vest as of December 31, 2012 is calculated based on the fair value of the Company s common stock as of December 31, 2012.

**401-K Plan**

Harmonic has a retirement/savings plan which qualifies as a thrift plan under Section 401(k) of the Internal Revenue Code. This plan allows participants to contribute up to the applicable Internal Revenue Code limitations under the plan. Harmonic can make discretionary contributions to the plan of 25% of the first 4% contributed by eligible participants, up to a maximum contribution per participant of $1,000 per year. Employer contributions were suspended from 2009 through 2012, but have been renewed, on the same basis, for 2013.

**NOTE 14: STOCK-BASED COMPENSATION**

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| **Employee stock-based compensation in:** | | | |
| Cost of revenue | $ 2,996 | $ 3,075 | $ 2,197 |
| Research and development expense | 6,405 | 6,926 | 5,013 |
| Selling, general and administrative expense | 9,525 | 10,912 | 8,329 |
| Total employee stock-based compensation recognized in income (loss) | 18,926 | 20,913 | 15,539 |
| Amount capitalized in inventory | | | 10 |
| Total stock-based compensation | $ 18,926 | $ 20,913 | $ 15,549 |

**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:

| | Employee Stock Options | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Expected term (in years) | 4.70 | 4.75 | 4.75 |
| Volatility | 56% | 55% | 56% |
| Risk-free interest rate | 0.9% | 1.8% | 2.4% |
| Dividend yield | 0.0% | 0.0% | 0.0% |

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,

87

**Table of Contents**

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

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

The weighted-average fair value per share of options granted for the years ended December 31, 2012, 2011 and 2010 was $2.64, $4.20 and $3.09, respectively. The fair value of all stock options vested during the years ended December 31, 2012, 2011 and 2010 was $4.7 million, $7.1 million and $6.4 million, respectively.

The total realized tax benefit attributable to stock options exercised during the years ended December 31, 2012, 2011 and 2010, in jurisdictions where this expense is deductible for tax purposes, was $0.1 million, $2.0 million and $0.3 million, respectively.

**Restricted Stock Units**

The estimated fair value of restricted stock units is based on the market price of the Company s common stock on the grant date. The fair value of all restricted stock units issued during the years ended December 31, 2012, 2011 and 2010 was $12.3 million $10.5 million and $6.9 million, respectively.

**Employee Stock Purchase Plan**

The value of the stock purchase right under the ESPP consists of (1) the 15% discount on the purchase of the stock, (2) 85% of the fair value of the call option, and (3) 15% of the fair value of the put option. The call option and put option were valued using the Black-Scholes option pricing model with the following assumptions:

| | Employee Stock Purchase Plan | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| Expected term (in years) | 0.50 | 0.50 | 0.50 |
| Volatility | 49% | 45% | 46% |
| Risk-free interest rate | 0.2% | 0.2% | 0.4% |
| Dividend yield | 0.0% | 0.0% | 0.0% |

The expected term represents the period of time from the beginning of the offering period to the purchase date. The Company uses its historical volatility for a period equivalent to the expected term of the options to estimate the expected volatility. The risk-free interest rate that the Company uses in the Black-Scholes option valuation model is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term. The Company has never declared or paid any cash dividends 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 per share of stock purchase rights granted for the years ended December 31, 2012, 2011 and 2010 was $1.33, $2.15 and $1.70, respectively.

Table of Contents

**Unrecognized Stock-Based Compensation**

As of December 31, 2012, total unamortized stock-based compensation cost related to unvested stock options and restricted stock units was $25.1 million. This amount will be recognized as expense using the straight-line attribution method over the remaining weighted-average amortization period of 2.4 years.

**NOTE 15: INCOME TAXES**

Income (loss) before income tax provision consists of the following (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| United States | $ (19,319) | $ (4,925) | $ 66,036 |
| International | 10,234 | 16,558 | (60,597) |
| Income (loss) before provision for income taxes | $ (9,085) | $ 11,633 | $ 5,439 |

The provision for income taxes consists of the following (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| **Current:** | | | |
| Federal | $ 3,994 | $ 3,184 | $ 7,940 |
| State | 433 | 755 | 1,820 |
| International | 1,193 | 1,222 | 755 |
| **Deferred:** | | | |
| Federal | (2,053) | (3,618) | 2,267 |
| State | (1,362) | (392) | (1,768) |
| International | (353) | 1,703 | (1,240) |
| Total provision for income taxes | $ 1,852 | $ 2,854 | $ 9,774 |

The differences between the provision for income taxes computed at the U.S. federal statutory rate and the Company s actual provision for income taxes are as follows (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Provision for income taxes at U.S. Federal statutory rate | $ (3,180) | $ 4,071 | $ 1,904 |
| State taxes | (604) | 1,053 | (469) |
| Differential in rates on foreign earnings | (5,181) | (9,924) | (1,842) |
| Losses for which no benefit is taken | 7,279 | 9,185 | 6,880 |
| Change in valuation allowance | (1,104) | | (450) |
| Change in liabilities for uncertain tax positions | 1,708 | (1,540) | 1,261 |
| Non-deductible stock-based compensation | 1,996 | 1,882 | 1,940 |
| Research credits | | (2,138) | (1,404) |
| Non-deductible acquisition related expenses | | | 1,289 |
| Non-deductible meals and entertainment | 232 | 237 | 165 |
| Adjustments related to tax positions taken during prior years | 619 | (255) | |
| Foreign income inclusion | 317 | | 403 |

| | | | |
|---|---|---|---|
| Adjustment related to property and equipment | | | 182 |
| Tax-exempt investment income | (248) | (71) | (180) |
| Other | 18 | 354 | 95 |
| Total provision for income taxes | $ 1,852 | $ 2,854 | $ 9,774 |

Table of Contents

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities are as follows (in thousands):

| | December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| **Deferred tax assets:** | | | |
| Reserves and accruals | $ 31,999 | $ 31,208 | $ 33,741 |
| Net operating loss carryovers | 27,522 | 24,852 | 27,431 |
| Research and development credit carryovers | 13,704 | 13,500 | 12,136 |
| Deferred stock-based compensation | 7,684 | 6,643 | 6,063 |
| Other tax credits | 2,207 | 2,764 | 2,813 |
| Total deferred tax assets | 83,116 | 78,967 | 82,184 |
| Valuation allowance | (34,347) | (28,354) | (26,557) |
| Net deferred tax assets | 48,769 | 50,613 | 55,627 |
| **Deferred tax liabilities:** | | | |
| Depreciation and amortization | (5,485) | (5,434) | (3,320) |
| Intangibles | (11,656) | (17,668) | (26,172) |
| Other | (483) | (135) | (1,066) |
| Net deferred tax liabilities | $ (17,624) | $ (23,237) | $ (30,558) |

The following table summarizes the activity related to the Company s valuation allowance (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Balance at beginning of period | $ 28,354 | $ 26,557 | $ 18,025 |
| Additions | 5,993 | 1,797 | 8,532 |
| Deductions | | | |
| Balance at end of period | $ 34,347 | $ 28,354 | $ 26,557 |

Pursuant to applicable accounting guidance on accounting for income taxes, the Company is required to periodically review the Company s deferred tax assets and determine whether, based on available evidence, a valuation allowance is necessary. The Company evaluates the need for a valuation allowance based on the weight of positive and negative evidence, including expectations of future taxable income. As of December 31, 2012, the Company had a valuation allowance of $34.3 million, which primarily relates to foreign net operating losses and a portion of its California tax credits.

As of December 31, 2012, the Company had $87.2 million of state net operating loss carryforwards available to reduce future taxable income that will begin to expire in 2014 for state tax purposes. As of December 31, 2012 the Company had foreign net operating loss carryforwards of $101.6 million that do not expire. As of December 31, 2012, the portion of state net operating loss carryforwards which relate to stock option deductions is approximately $8.8 million. The Company is tracking the portion of the Company s deferred tax assets attributable to stock option benefits in a separate memo account pursuant to applicable accounting guidance. Therefore, these amounts are not included in the Company s gross or net deferred tax assets. Pursuant to applicable accounting guidance, the stock option benefits will only be recorded to equity when they reduce cash taxes payable.

As of December 31, 2012, the Company had federal and state tax credit carryovers of approximately $1.0 million and $26.6 million available to offset future taxable income. The federal credits expire beginning in 2031, while the state credits will not expire. As of December 31, 2012, the Company had federal AMT credit carryover of approximately $2.2 million, which will not expire.

Table of Contents

Utilization of the Company s net operating loss and tax credits may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss and tax credits before utilization.

The following table summarizes the activity related to the Company s gross unrecognized tax benefits (in millions):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Balance at beginning of period | $ 52.5 | $ 48.4 | $ 47.0 |
| Increases in balances related to tax positions taken during current year | 0.6 | 6.6 | 7.8 |
| Expiration of the statute of limitations for the assessment of taxes | (0.9) | (2.1) | (5.3) |
| Decreases in balances related to tax positions taken during prior years | (0.1) | (0.4) | (1.1) |
| Balance at end of period | $ 52.1 | $ 52.5 | $ 48.4 |

The total amount of unrecognized tax benefits that would impact the effective tax rate is approximately $52.1 million at December 31, 2012. The Company accrued interest of $2.7 million related to these unrecognized tax benefits during 2012. As of December 31, 2012, the Company had recorded liabilities for potential penalties and interest of $0.3 million and $6.8 million, respectively. In 2012, the Company reversed $1.0 million of liability primarily due to the expiration of the related statutes of limitations. During the years ended December 31, 2011 and 2010, the Company accrued potential interest of $2.0 million and $1.9 million, respectively, and reversed previously recorded income tax liability of $2.5 million and $2.3 million, respectively, due to the expiration of the related statutes of limitations. The Company anticipates a decrease of $1.6 million in unrecognized tax benefits due to expiration of the related statutes of limitations within the next 12 months.

The Company anticipates the unrecognized tax benefits may increase during 2013 for items that arise in the ordinary course of business. Such amounts will be reflected as an increase in the amount of unrecognized tax benefits and an increase to the current period tax expense. These increases will be considered in the determination of the Company s annual effective tax rate. The amount of the unrecognized tax benefit classified as a long-term tax payable, if recognized, would reduce the annual income provision.

The Company files U.S., state, and foreign income tax returns in jurisdictions with varying statutes of limitations during which such tax returns may be audited and adjusted by the relevant tax authorities. The 2008 through 2012 tax years generally remain subject to examination by federal and most state tax authorities. In significant foreign jurisdictions, the 2006 through 2012 tax years generally remain subject to examination by their respective tax authorities. The Company is under audit by the US Internal Revenue Service for the 2008, 2009 and 2010 tax years. In addition, the statute of limitations on our 2008 and 2009 U.S. corporate income tax return has been extended to 2013. A subsidiary of the Company is under an audit, which commenced in the first quarter of 2012, by the Israel tax authority for the years 2007 through 2010. 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, operating results and cash flow could be materially and adversely impacted in the period of adjustment.

As of December 31, 2012, U.S. income taxes were not provided on approximately $34.6 million of cumulative undistributed earnings for certain non-U.S. subsidiaries. Determination of the amount of unrecognized deferred tax liability for temporary differences related to investments in these non-U.S. subsidiaries that are essentially permanent in duration is not practicable. The Company has not provided U.S. income taxes

and foreign withholding taxes on the undistributed earnings of foreign subsidiaries as of December 31, 2012, because the Company intends to permanently reinvest such earnings outside the U.S. If these foreign earnings were to be repatriated in the future, the related U.S. tax liability may be reduced by any foreign income taxes previously paid on these earnings.

The Company benefits from a tax ruling concluded in Switzerland. This ruling provides for a lower rate of taxation on certain classes of income and requires various thresholds of investment and employment in Switzerland. This ruling resulted in a tax savings of $1.1 million, $0.7 million and $0.9 million in 2012, 2011 and 2010, respectively, increasing diluted earnings per share by approximately $0.009, $0.006 and $0.009 in 2012, 2011 and 2010, respectively. Our agreement with Switzerland is in effect through the end of 2013 and, subject to the Company meeting investment and employment requirements within Switzerland, is renewable for an additional five years.

**NOTE 16: 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 applicable period by the weighted average number of common shares outstanding during the period. In the years ended December 31, 2012, 2011 and 2010, there were 14,136,804, 14,770,995 and 18,774,438, respectively, of potentially dilutive shares, consisting of options, restricted stock units and employee stock purchase plan awards, excluded from the net income (loss) per share computations because their effect was antidilutive.

The following table presents the calculation of basic and diluted net income per share (in thousands, except per share amounts):

| | | December 31, | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Net income (loss) (numerator) | $ (10,937) | $ 8,779 | $ (4,335) |
| Shares calculation (denominator): | | | |
| Weighted average shares outstanding basic | 116,457 | 115,175 | 101,487 |
| Effect of Dilutive Securities: | | | |
| Potential common stock relating to stock options, restricted stock units and ESPP | | 1,252 | |
| Weighted averages shares outstanding diluted | 116,457 | 116,427 | 101,487 |
| Net income (loss) per share basic | $ (0.09) | $ 0.08 | $ (0.04) |
| Net income (loss) per share diluted | $ (0.09) | $ 0.08 | $ (0.04) |

The diluted net loss per share is the same as basic net loss per share for the years ended December 31, 2012 and 2010 because potential common shares are only considered when their effect would be dilutive.

**NOTE 17: SEGMENT INFORMATION**

The Company operates its business in one reportable segment, which is the design, manufacture and sale of video infrastructure solutions, spanning content production to multi-screen video delivery. Harmonic s products enable customers to create, prepare and deliver video services over broadcast, cable, Internet, mobile, satellite and networks. Operating segments are defined as components of an enterprise that engage in business activities for which separate financial information is available and evaluated by the chief operating decision maker in deciding how to allocate resources and assessing performance. The chief operating decision maker is the Company s Chief Executive Officer.

Table of Contents

The Company s revenue by product type is summarized as follows (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Video processing products | $ 219,440 | $ 236,624 | $ 202,898 |
| Production and playout products | 90,247 | 98,842 | 32,579 |
| Edge and access products | 138,653 | 141,880 | 135,306 |
| Service and support | 82,124 | 71,986 | 52,561 |
| Total revenues | $ 530,464 | $ 549,332 | $ 423,344 |

Our revenue by geographic region, based on the location at which each sale originates, and our property and equipment, net by geographic region, is summarized as follows (in thousands):

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| **Net revenues:** | | | |
| United States | $ 230,336 | $ 244,897 | $ 209,583 |
| International | 300,128 | 304,435 | 213,761 |
| Total | $ 530,464 | $ 549,332 | $ 423,344 |

| | As of December 31, | |
|---|---|---|
| | 2012 | 2011 |
| **Property and equipment, net:** | | |
| United States | $ 30,477 | $ 32,925 |
| International | 7,645 | 7,544 |
| Total | $ 38,122 | $ 40,469 |

**NOTE 18: COMMITMENTS AND CONTINGENCIES**

*Leases*

Harmonic leases its facilities under noncancelable operating leases which expire at various dates through September 2021. In addition, Harmonic leases vehicles in several foreign countries under noncancelable operating leases, the last of which expires in 2015. Total rent expense related to these operating leases was $7.5 million, $7.5 million and $7.3 million for the years ended December 31, 2012, 2011 and 2010, respectively. Future minimum lease payments under noncancelable operating leases at December 31, 2012, are as follows (in thousands):

| | Operating Leases |
|---|---|
| **Year ending December 31,** | |
| 2013 | $ 10,692 |
| 2014 | 7,553 |
| 2015 | 7,041 |
| 2016 | 7,036 |
| 2017 | 7,157 |
| Thereafter | 19,797 |

| | | |
|---|---|---|
| Total minimum payments | $ | 59,276 |

As of December 31, 2012, $0.9 million of these future lease payments were accrued as part of accrued excess facility costs. See Note 10 Restructuring and Excess Facilities.

Table of Contents

*Warranties*

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

| | Year ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Balance at beginning of period | $ 5,558 | $ 4,811 | $ 4,186 |
| Acquired warranty obligation from Omneon acquisition | | | 949 |
| Accrual for current period warranties | 5,798 | 8,245 | 4,898 |
| Warranty costs incurred | (7,064) | (7,498) | (5,222) |
| Balance at end of period | $ 4,292 | $ 5,558 | $ 4,811 |

*Standby Letters of Credit*

As of December 31, 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 $0.2 million.

*Indemnification*

Harmonic is obligated to indemnify its officers and the members of its Board 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 the indemnification provisions through December 31, 2012.

*Guarantees*

The Company has $0.5 million of guarantees in Israel, with the majority related to rent, as of December 31, 2012.

*Royalties*

Harmonic has licensed certain technologies from various companies. It incorporates these technologies into its own products and is required to pay royalties for such use, usually based on shipment of the related products. In addition, Harmonic has obtained research and development grants under various Israeli government programs that require the payment of royalties on sales of certain products resulting from such research. During the years ended December 31, 2012, 2011 and 2010 royalty expenses were $3.0 million, $2.4 million and $3.3 million, respectively.

*Purchase Commitments with Contract Manufacturers and Vendors*

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 and services based upon criteria as defined by the Company. The Company had $27.6 million of non-cancelable purchase commitments as of December 31, 2012.

Table of Contents

**NOTE 19: LEGAL PROCEEDINGS**

In October 2011, Avid Technology, Inc. ( Avid ) filed a complaint in the United States District Court for the District of Delaware alleging that Harmonic s Media Grid product infringes two patents held by Avid. In June 2012, Avid served a subsequent complaint alleging that Harmonic s Spectrum product infringes one patent held by Avid. The complaints seek injunctive relief and damages.

On November 14, 2012, FastVDO served a lawsuit on Harmonic, alleging infringement of a patent allegedly essential to the H.264 standard and that Harmonic encoders, transcoders, software and servers that use H.264 infringe their patent.

At this time, the Company cannot predict the outcome of the above matters.

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

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 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 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 Harmonic or its 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.

Table of Contents

**NOTE 20: SUBSEQUENT EVENTS**

On February 18, 2013, the Company entered into an Asset Purchase Agreement with Aurora Networks pursuant to which the Company agreed to sell its cable access HFC business (the Business ) for $46 million in cash. Although no assurance can be given as to whether and when this transaction will close, it is presently scheduled to close on March 4, 2013, and may be terminated by either party if it does not close by March 29, 2013. If this sale closes, the Business s results of operations prior to the closing date will be recorded as part of discontinued operations in the Consolidated Statements of Operations in the Company s Form 10-Q for the quarter ending March 29, 2013. The estimated carrying value of the Business s net assets as of December 31, 2012 is as follows:

| | | December 31, 2012 |
|---|---|---|
| | | (in thousands) |
| Inventories | $ | 11,162 |
| Prepaid expenses and other current assets | | 89 |
| Current assets | $ | 11,251 |
| Property and equipment, net | $ | 1,123 |
| Goodwill | | 14,864 |
| Long-term assets | | 15,987 |
| Deferred Revenues | $ | 3,333 |
| Accrued liabilities | | 916 |
| Current liabilities | $ | 4,249 |

Table of Contents

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

The following table sets forth our unaudited quarterly Consolidated Statement of Operations data for each of the eight quarters ended December 31, 2012. In management s opinion, the data has been prepared on the same basis as the audited Consolidated Financial Statements included in this report, and reflects all necessary adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of this data.

| | Fiscal 2012 | | | |
|---|---|---|---|---|
| | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| | (In thousands, except per share amounts) | | | |
| **Quarterly Data:** | | | | |
| Net revenues | $ 127,721 | $ 132,634 | $ 136,682 | $ 133,427 |
| Gross profit | 53,662 | 57,578 | 59,904 | 65,411 |
| Income (loss) from operations | (8,657) | (2,395) | (949) | 2,694 |
| Net income (loss) | $ (7,528) | $ 17 | $ (8,230) | $ 4,804 |
| Net income (loss) per share basic | $ (0.06) | $ 0.00 | $ (0.07) | $ 0.04 |
| Net income (loss) per share diluted | $ (0.06) | $ 0.00 | $ (0.07) | $ 0.04 |

| | Fiscal 2011 | | | |
|---|---|---|---|---|
| | 1st Quarter | 2nd Quarter | 3rd Quarter | 4th Quarter |
| | (In thousands, except per share amounts) | | | |
| **Quarterly Data:** | | | | |
| Net revenues | $ 132,835 | $ 133,996 | $ 138,871 | $ 143,630 |
| Gross profit | 61,855 | 61,828 | 63,961 | 66,870 |
| Income (loss) from operations | (87) | 1,393 | 3,840 | 6,627 |
| Net income | $ 516 | $ 390 | $ 3,546 | $ 4,327 |
| Net income per share basic | $ 0.00 | $ 0.00 | $ 0.03 | $ 0.04 |
| Net income per share diluted | $ 0.00 | $ 0.00 | $ 0.03 | $ 0.04 |

Table of Contents

**Item 9.** ***CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE***
None.

**Item 9A.** ***CONTROLS AND PROCEDURES***
**EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES.**

We maintain disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, 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 Annual Report on Form 10-K, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective.

**MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING.**

Our management s report on our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) and the related attestation report of our independent registered public accounting firm are included on pages 60 and 61, respectively, of this Annual Report on Form 10-K, and are incorporated herein by reference.

**CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING.**

There was no change in our internal control over financial reporting that occurred during the fourth quarter of fiscal year 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B.** ***OTHER INFORMATION***
None.

**Table of Contents**

## PART III

Certain information required by Part III is omitted from this Annual Report on Form 10-K pursuant to Instruction G to Exchange Act Form 10-K, and the Registrant will file its definitive Proxy Statement for its 2013 Annual Meeting of Stockholders, pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended (the 2013 Proxy Statement ), not later than 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K, and certain information included in the 2013 Proxy Statement is incorporated herein by reference.

### Item 10. *DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE*

Information concerning our directors required by this item will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

Information concerning our executive officers required by this item will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

Information relating to compliance with Section 16(a) of the Securities Exchange Act of 1934 will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

Information concerning our audit committee and our audit committee financial expert will be set forth in our 2013 Proxy Statement and is incorporated herein by reference.

Harmonic has adopted a Code of Business Conduct and Ethics for Senior Operational and Financial Leadership (the Code ), which applies to its Chief Executive Officer, its Chief Financial Officer, its Corporate Controller and other senior operational and financial management. The Code is available on the Company s website at www.harmonicinc.com.

Harmonic intends to satisfy the disclosure requirement under Form 8-K regarding an amendment to, or waiver from, a provision of this Code of Ethics by posting such information on our website, at the address specified above, and, to the extent required by the listing standards of the NASDAQ Global Select Market, by filing a Current Report on Form 8-K with the Securities and Exchange Commission disclosing such information.

### Item 11. *EXECUTIVE COMPENSATION*

The information required by this item will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

### Item 12. *SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS*

Information related to security ownership of certain beneficial owners and security ownership of management and related stockholder matters will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

### Item 13. *CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE*

The information required by this item will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

### Item 14. *PRINCIPAL ACCOUNTING FEES AND SERVICES*

The information required by this item will be set forth in the 2013 Proxy Statement and is incorporated herein by reference.

**Table of Contents**

## PART IV

### Item 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

1. *Financial Statements.* See Index to Consolidated Financial Statements in Item 8 on page 60 of this Annual Report on Form 10-K.

2. *Financial Statement Schedules.* Financial statement schedules have been omitted because the information is not required to be set forth herein, is not applicable or is included in the financial statements or notes thereto.

3. *Exhibits.* The documents listed in the Exhibit Index of this Annual Report on Form 10-K are filed herewith or are incorporated by reference in this Annual Report on Form 10-K, in each case as indicated therein.

Table of Contents

## SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant, Harmonic Inc., a Delaware corporation, has duly caused this Annual Report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of San Jose, State of California, on March 1, 2013.

**HARMONIC INC.**

By: /s/ PATRICK J. HARSHMAN
Patrick J. Harshman
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ PATRICK J. HARSHMAN | President & Chief Executive Officer (Principal Executive Officer) | March 1, 2013 |
| (Patrick J. Harshman) | | |
| /s/ CAROLYN V. AVER | Chief Financial Officer | March 1, 2013 |
| (Carolyn V. Aver) | (Principal Financial and Accounting Officer) | |
| /s/ LEWIS SOLOMON | Chairman | March 1, 2013 |
| (Lewis Solomon) | | |
| /s/ HAROLD L. COVERT | Director | March 1, 2013 |
| (Harold L. Covert) | | |
| /s/ PATRICK GALLAGHER | Director | March 1, 2013 |
| (Patrick Gallagher) | | |
| /s/ E. FLOYD KVAMME | Director | March 1, 2013 |
| (E. Floyd Kvamme) | | |
| /s/ WILLIAM REDDERSEN | Director | March 1, 2013 |
| (William Reddersen) | | |
| /s/ SUSAN G. SWENSON | Director | March 1, 2013 |
| (Susan G. Swenson ) | | |
| /s/ MITZI REAUGH | Director | March 1, 2013 |
| (Mitzi Reaugh) | | |

Table of Contents

## EXHIBIT INDEX

The following Exhibits to this report are filed herewith or, as shown below, are incorporated herein by reference.

| Exhibit Number | |
|---|---|
| 3.1(iii) | Certificate of Incorporation of Harmonic Inc., as amended |
| 3.2(xxiv) | Amended and Restated Bylaws of Harmonic Inc. |
| 4.1(i) | Form of Common Stock Certificate |
| 4.3 (iv) | Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of Harmonic Inc. |
| 10.1(i)* | Form of Indemnification Agreement |
| 10.2(xvi)* | 1995 Stock Plan, as amended on June 27, 2012 |
| 10.3(i)* | 1995 Director Option Plan and form of Director Option Agreement |
| 10.5(v)* | 1999 Non-statutory Stock Option Plan |
| 10.6(ii) | Lease Agreement for 603-611 Baltic Way, Sunnyvale, California |
| 10.7(ii) | Lease Agreement for 1322 Crossman Avenue, Sunnyvale, California |
| 10.8(ii) | Lease Agreement for 646 Caribbean Drive, Sunnyvale, California |
| 10.9(ii) | Lease Agreement for 632 Caribbean Drive, Sunnyvale, California |
| 10.10(ii) | First Amendment to the Lease Agreement for 549 Baltic Way, Sunnyvale, California |
| 10.11(xvi)* | 2002 Board Stock Plan, as amended on June 27, 2012 |
| 10.12(xxiii)* | 2002 Employee Stock Purchase Plan and Form of Subscription Agreement, as amended on June 22, 2011 |
| 10.15(vi)* | Change of Control Severance Agreement between Harmonic Inc. and Patrick Harshman, effective May 30, 2006 |
| 10.21(vii)* | Change of Control Severance Agreement between Harmonic Inc. and Charles Bonasera, effective April 24, 2007 |
| 10.22(vii)* | Change of Control Severance Agreement between Harmonic Inc. and Neven Haltmayer, effective April 19, 2007 |
| 10.27(xi) | Agreement and Plan of Merger among Harmonic Inc., Sunrise Acquisition Ltd., and Scopus Video Networks Ltd., dated December 22, 2008 |
| 10.28(xii)* | Harmonic Inc. 2002 Director Stock Plan Restricted Stock Unit Agreement |
| 10.29(xii) | Professional Service Agreement between Harmonic Inc. and Plexus Services Corp., dated September 22, 2003 |
| 10.30(xii) | Amendment, dated January 6, 2006, to the Professional Services Agreement for Manufacturing between Harmonic Inc. and Plexus Services Corp., dated September 22, 2003 |
| 10.31(xii) | Addendum 1, dated November 26, 2007, to the Professional Services Agreement between Harmonic Inc. and Plexus Services Corp., dated September 22, 2003 |
| 10.32(viii)* | Change of Control Severance Agreement between Harmonic Inc. and Nimrod Ben-Natan, effective April 11, 2008 |

| **Exhibit**<br><br>**Number** | |
|---|---|
| 10.34(xiv)* | Harmonic Inc. 1995 Stock Plan Restricted Stock Unit Agreement |
| 10.36(xv) | Lease Agreement between Harmonic Inc. and CRP North First Street, L.L.C. dated December 15, 2009 |
| 10.38(xvii)* | Change of Control Agreement between Harmonic Inc. and Carolyn V. Aver, effective June 1, 2010 |
| 10.40(xix) | Agreement and Plan of Reorganization among Harmonic Inc., Orinda Acquisition Corporation, Orinda Acquisition, LLC, Omneon, Inc. and Shareholder Representative Services, LLC, as Representative, dated May 6, 2010 |
| 10.41(xx)* | Omneon Video Networks, Inc. 1998 Stock Option Plan (as amended through February 27, 2007) |
| 10.42(xx)* | Omneon, Inc. 2008 Equity Incentive Plan |
| 10.43(xxi) | Lease Agreement between Omneon, Inc. and Headlands Realty Corporation, dated February 22, 2008 |
| 10.48(xxii) | Loan Agreement, dated August 26, 2011, between Harmonic Inc and Silicon Valley Bank |
| 10.49(xxv) | Amendment No.1 to Loan Agreement between Harmonic Inc. and Silicon Valley Bank |
| 21.1 | Subsidiaries of Harmonic Inc. |
| 23.1 | Consent of Independent Registered Public Accounting Firm |
| 31.1 | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101 | The following materials from Registrant s Annual Report on Form 10-K for the year ended December 31, 2012, formatted in Extensible Business Reporting Language (XBRL): Consolidated Balance Sheets at December 31, 2012 and December 31, 2011; (ii) Consolidated Statements of Operations for the Years Ended December 31, 2012, December 31, 2011 and December 31, 2010; (iii) Consolidated Statements of Comprehensive Income (Loss) for the Years Ended December 31, 2012, December 31, 2011 and December 31, 2010 (iv) Consolidated Statements of Stockholders Equity for the Years Ended December 31, 2012, December 31, 2011 and December 31, 2010, (v) Consolidated Statements of Cash Flows for the Years Ended December 31, 2012, December 31, 2011 and December 31, 2010; and (vi) Notes to Consolidated Financial Statements. |

* Indicates a management contract or compensatory plan or arrangement relating to executive officers or directors of the Company.

(i) Previously filed as an Exhibit to the Company s Registration Statement on Form S-1 No. 33-90752.

(iii) Previously filed as an Exhibit to the Company s Annual Report on Form 10-K for the year ended December 31, 2001.

(iv) Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated July 25, 2002.

| | |
|---|---|
| (v) | Previously filed as an Exhibit to the Company s Current Report on Form S-8 dated June 5, 2003. |
| (vi) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated May 31, 2006. |
| (vii) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated April 25, 2007. |
| (viii) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated April 16, 2008. |
| (xi) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated December 24, 2008. |
| (xii) | Previously filed as an Exhibit to the Company s Current Annual Report on Form 10-K for the year ended December 31, 2008. |
| (xiv) | Previously filed as an Exhibit to the Company s Quarterly Report on Form 10-Q for the quarter ended April 3, 2009. |
| (xv) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated December 18, 2009. |
| (xvi) | Previously filed as an Exhibit to the Company s Registration Statement on Form S-8, dated July 30, 2012. |
| (xvii) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated June 3, 2010. |
| (xix) | Previously filed as an Exhibit to the Company s Quarterly Report on Form 10-Q dated August 10, 2010. |
| (xx) | Previously filed as an Exhibit to the Company s Registration Statement on Form S-8 dated September 21, 2010. |
| (xxi) | Previously filed as an Exhibit to the Company s Annual Report on Form 10-K for the year ended December 31, 2010. |
| (xxii) | Previously filed as an Exhibit to the Company s Current Report on Form 8-K dated September 30, 2011. |
| (xxiii) | Previously filed as an Exhibit to the Company s Definitive Proxy Statement on Schedule 14A dated May 2, 2011. |
| (xxiv) | Previously filed as an Exhibit to the Company s Quarterly Report on Form 10-Q dated August 8, 2012. |
| (xxv) | Previously filed as an Exhibit to the Company s Quarterly Report on Form 10-Q dated November 7, 2012. |