

HARMONIC INC
Form 10-Q
May 11, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

☒ Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended April 1, 2016

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

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

Delaware 77-0201147
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification Number)
4300 North First Street
San Jose, CA 95134
(408) 542-2500

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☒

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

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

The number of shares of the registrant's Common Stock, \$.001 par value, outstanding on May 2, 2016 was 77,323,115.

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PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HARMONIC INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	April 1, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$56,995	\$126,190
Short-term investments	19,238	26,604
Accounts receivable, net	95,477	69,515
Inventories	42,415	38,819
Prepaid expenses and other current assets	42,318	25,003
Total current assets	256,443	286,131
Property and equipment, net	36,781	27,012
Goodwill	237,899	197,781
Intangibles, net	46,042	4,097
Other long-term assets	33,528	9,936
Total assets	\$610,693	\$524,957
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Other debts and capital lease obligations, current	\$8,843	\$—
Accounts payable	31,774	19,364
Income taxes payable	314	307
Deferred revenue	59,747	33,856
Accrued liabilities	61,192	31,354
Total current liabilities	161,870	84,881
Convertible notes, long-term	99,482	98,295
Other debts and capital lease obligations, long-term	16,464	—
Income taxes payable, long-term	3,933	3,886
Deferred tax liabilities, long-term	1,247	—
Other non-current liabilities	16,424	9,727
Total liabilities	299,420	196,789
Commitments and contingencies (Note 16)		
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; 77,311 and 76,015 shares issued and outstanding at April 1, 2016 and December 31, 2015, respectively	77	76
Additional paid-in capital	2,240,830	2,236,418
Accumulated deficit	(1,929,088)	(1,903,908)
Accumulated other comprehensive loss	(546)	(4,418)
Total stockholders' equity	311,273	328,168
Total liabilities and stockholders' equity	\$610,693	\$524,957

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited, in thousands, except per share data)

	Three months ended	
	April 1, 2016	April 3, 2015
Revenue:		
Product	\$57,644	\$80,473
Services	24,188	23,543
Total net revenue	81,832	104,016
Cost of revenue:		
Product	27,189	35,460
Services	13,989	13,528
Total cost of revenue	41,178	48,988
Total gross profit	40,654	55,028
Operating expenses:		
Research and development	23,563	22,329
Selling, general and administrative	32,870	31,196
Amortization of intangibles	2,365	1,446
Restructuring and related charges	2,612	44
Total operating expenses	61,410	55,015
(Loss) profit from operations	(20,756)	13
Interest (expense) income, net	(2,421)	55
Other expense, net	(9)	(506)
Loss on impairment of long-term investment	(1,476)	(2,505)
Loss before income taxes	(24,662)	(2,943)
Provision for (benefit from) income taxes	518	(286)
Net loss	\$(25,180)	\$(2,657)
Net loss per share:		
Basic and diluted	\$(0.33)	\$(0.03)
Shares used in per share calculation:		
Basic and diluted	76,996	88,655

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited, in thousands)

	Three months ended	
	April 1, 2016	April 3, 2015
Net loss	\$(25,180)	\$(2,657)
Other comprehensive income (loss) before tax:		
Change in unrealized gains (losses) on cash flow hedges:		
Unrealized gains (losses) arising during the period	323	(184)
Losses (gains) reclassified into earnings	78	(49)
	401	(233)
Change in unrealized gains on available-for-sale securities:		
Unrealized gains arising during the period	79	485
Loss reclassified into earnings	1,476	—
	1,555	485
Change in foreign currency translation adjustments	1,934	(984)
Other comprehensive income (loss) before tax	3,890	(732)
Less: Provision for income taxes	18	4
Other comprehensive income (loss), net of tax	3,872	(736)
Total comprehensive losses	\$(21,308)	\$(3,393)

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Three months ended	
	April 1, 2016	April 3, 2015
Cash flows from operating activities:		
Net loss	\$(25,180)	\$(2,657)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangibles	2,783	1,907
Depreciation	3,317	3,493
Stock-based compensation	3,094	4,134
Amortization of discount on convertible debt	1,187	—
Restructuring, asset impairment and loss on retirement of fixed assets	1,675	3
Loss on impairment of long-term investment	1,476	2,505
Provision for excess and obsolete inventories	418	454
Allowance for doubtful accounts, returns and discounts	739	(367)
Excess tax benefits from stock-based compensation	—	(120)
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	(10,894)	(1,353)
Inventories	(51)	775
Prepaid expenses and other assets	(6,078)	(13,062)
Accounts payable	(3,890)	3,380
Deferred revenue	24,963	10,105
Income taxes payable	(13)	(501)
Accrued and other liabilities	1,046	(6,819)
Net cash (used in) provided by operating activities	(5,408)	1,877
Cash flows from investing activities:		
Acquisition of business, net of cash acquired	(69,532)	—
Proceeds from maturities of investments	7,394	9,648
Purchases of property and equipment	(2,664)	(3,651)
Purchases of long-term investments	—	(85)
Net cash (used in) provided by investing activities	(64,802)	5,912
Cash flows from financing activities:		
Payment of convertible debt issuance costs	(582)	—
Increase in other debts and capital leases	262	—
Repayment of other debts and capital leases	(114)	—
Payments for repurchase of common stock	—	(5,182)
Proceeds from common stock issued to employees	2,074	6,110
Payment of tax withholding obligations related to net share settlements of restricted stock units	(955)	(2,078)
Excess tax benefits from stock-based compensation	—	120
Net cash provided by (used in) financing activities	685	(1,030)
Effect of exchange rate changes on cash and cash equivalents	330	(135)
Net (decrease) increase in cash and cash equivalents	(69,195)	6,624
Cash and cash equivalents at beginning of period	126,190	73,032
Cash and cash equivalents at end of period	\$56,995	\$79,656

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

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HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. (“Harmonic,” or the “Company”) considers necessary for a fair statement of the results of operations for the interim periods covered and the consolidated financial condition of the Company at the date of the balance sheets. This Quarterly Report on Form 10-Q should be read in conjunction with the Company’s audited consolidated financial statements contained in the Company’s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 24, 2016 (the “2015 Form 10-K”). The interim results presented herein are not necessarily indicative of the results of operations that may be expected for the full fiscal year ending December 31, 2016, or any other future period. The Company’s fiscal quarters are based on 13-week periods, except for the fourth quarter, which ends on December 31.

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

Use of Estimates

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

Business Combination

The Company applies the acquisition method of accounting for business combinations to its acquisition of Thomson Video Networks (“TVN”), which closed on February 29, 2016. (See Note 3, “Business Acquisition” for additional information on TVN acquisition). Under this method of accounting, all assets acquired and liabilities assumed are recorded at their respective fair values at the date of the completion of the transaction. Determining the fair value of assets acquired and liabilities assumed requires management’s judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, intangibles and other asset lives, among other items. Fair value is defined as the price that would be received in a sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). Market participants are assumed to be buyers and sellers in the principal (most advantageous) market for the asset or liability. Additionally, fair value measurements for an asset assume the highest and best use of that asset by market participants. As a result, the Company may have been required to value the acquired assets at fair value measurements that do not reflect its intended use of those assets. Use of different estimates and judgments could yield different results. Any excess of the purchase price over the fair value of the net assets acquired is recognized as goodwill.

The accounting for the TVN acquisition is based on currently available information and is considered preliminary. Although the Company believes that the assumptions and estimates it has made are reasonable and appropriate, they are based in part on historical experience and information that may be obtained from the management of the acquired company and are inherently uncertain. Unanticipated events and circumstances may occur that may affect the accuracy or validity of such assumptions, estimates, or actual results. As a result, during the measurement period, which may be up to one year from the acquisition date, the Company may record adjustments to the assets acquired and liabilities assumed with the corresponding offset to goodwill. Upon the conclusion of the measurement period or final determination of the values of assets acquired or liabilities assumed, whichever comes first, any subsequent adjustments are recorded in the Company’s Condensed Consolidated Statements of Operations.

Significant Accounting Policies

The Company's significant accounting policies are described in Note 2 to its audited Consolidated Financial Statements included in the 2015 Form 10-K. There have been no significant changes to these policies during the three months ended April 1, 2016.

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NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

New standards to be implemented

In May 2014, the Financial Accounting Standards Board (“FASB”) issued new authoritative guidance for revenue recognition, requiring an entity to recognize the amount of revenue that reflects the consideration to which it expects to be entitled for the transfer of promised goods or services to customers. The updated standard will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective and permits the use of either the retrospective or cumulative effect transition method. The original effective date for this new standard would have required the Company to adopt it beginning in its first quarter of fiscal 2017. In August 2015, the FASB issued an accounting standard update for the deferral of the effective date by one year to December 15, 2017 for interim and annual reporting periods beginning after that date and permits early adoption, but not before the original effective date of December 15, 2016. Accordingly, the Company may adopt the standard in either its first quarter of fiscal 2017 or fiscal 2018. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The Company is currently evaluating the timing of its adoption and the impact of this new revenue standard on its consolidated financial statements. In March 2016, the FASB issued additional authoritative guidance clarifying its implementation guidance on principal versus agent considerations when determining whether to report revenue gross versus net. The Company is in the process of assessing the impact this additional guidance is expected to have upon adoption, including determining the adoption method.

In July 2015, the FASB issued an accounting standard update that requires inventory to be measured at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2017 and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

In January 2016, the FASB issued an accounting standard update which requires equity investments to be measured at fair value with changes in fair value recognized in net income and simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. The accounting standard update also updates certain presentation and disclosure requirements. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2018 and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

In February 2016, the FASB amended the existing accounting standard for lease accounting. Under this guidance, lessees and lessors should apply a “right-of-use” model in accounting for all leases (including subleases) and eliminate the concept of operating leases and off-balance sheet leases. This new accounting standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The new standard will be effective for the Company beginning in the first quarter of fiscal 2019 and early adoption is permitted. The Company is currently evaluating the methods and impact of adopting this new accounting standard on its consolidated financial statements.

In March 2016, the FASB issued an accounting standard update to clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. An entity performing the assessment under the amendments is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. The standard will be effective for the Company beginning in the first quarter of fiscal 2017 and early adoption is permitted. The adoption of this accounting standard update is not expected to have any impact on the financial statements of the Company.

In March 2016, the FASB issued an accounting standard update for the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2017 and early adoption is permitted. The Company is currently evaluating the methods and impact of adopting the new accounting standard on its consolidated financial statements.

Standards Implemented

In April 2015, the FASB issued an accounting standard update that requires debt issuance costs to be presented as a direct deduction from the carrying amount of the related debt liability, consistent with the presentation of debt discounts. Prior to this accounting update, debt issuance costs were required to be presented as deferred charge assets, separate from the related debt liability. This accounting standard update does not change the recognition and measurement requirements for debt issuance costs. The Company early-adopted this accounting standard update as of the end of its fiscal 2015 in connection with the issuance of convertible senior notes in December 2015 (see Note 11, “Convertible Notes, Other Debts and Capital Leases”),

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resulting in the classification of \$3.2 million of unamortized debt issuance costs as a deduction from long-term liability on its Consolidated Balance Sheet at December 31, 2015. Other than this transaction, the adoption of this accounting standard update did not have an impact on the Company's consolidated financial statements.

In November 2015, the FASB issued an accounting standard update that all deferred tax assets and liabilities, along with any related valuation allowance, be classified as non-current on the balance sheet. The Company prospectively early-adopted this accounting standard update as of the end of its fiscal 2015, resulting in \$15.9 million of net deferred tax assets, along with its related valuation allowance, being classified as non-current on its Consolidated Balance Sheet at December 31, 2015. Other than this reclassification, the adoption of this accounting standard update did not have an impact on the Company's consolidated financial statements.

NOTE 3: BUSINESS ACQUISITION

On February 29, 2016, the Company, through its wholly-owned subsidiary Harmonic International AG, completed its acquisition of 100% of the share capital and voting rights of TVN, a global leader in advanced video compression solutions headquartered in Rennes, France, for approximately \$84.6 million in cash. The purchase price consideration is provisional as it is still pending post-closing adjustments as set forth in the Securities Purchase Agreement entered into between the Company and the other parties thereto, dated February 11, 2016, ("TVN Purchase Agreement"). The \$84.6 million provisional purchase price included an estimate for the contingent consideration of approximately \$8.0 million, which has not been paid to date. Pursuant to the TVN Purchase Agreement, \$13.5 million of the purchase consideration may remain in escrow for a period of up to 18 months and relates to certain indemnification obligations of TVN's former equity holders. The TVN acquisition was primarily funded with cash proceeds from the issuance of convertible senior notes by the Company in December 2015. (See Note 11, "Convertible Notes, Other Debts and Capital Leases" for additional information on the notes).

The acquisition of TVN is intended to strengthen the Company's competitive position in the video infrastructure market as well as to enhance the depth and scale of the Company's research and development ("R&D") and service and support capabilities in the video arena. The Company believes that the combined product portfolios, R&D teams and global sales and service personnel will allow the Company to accelerate innovation for its customers while leveraging greater scale to drive operational efficiencies.

The TVN acquisition has been accounted for using the acquisition method of accounting in accordance with ASC 805, Business Combinations, which requires, among other things, that the assets acquired and liabilities assumed be recognized at their acquisition date fair values, with any excess of the consideration transferred over the estimated fair values of the identifiable net assets acquired recorded as goodwill. The accounting for this business combination is based on currently available information and is considered preliminary.

The provisional purchase price has been allocated on a preliminary basis to tangible and intangible assets acquired and liabilities assumed on the basis of their respective estimated fair values on the acquisition date. The Company will continue to evaluate certain assets, liabilities and tax estimates that are subject to change within the measurement period (up to one year from the acquisition date).

The Company's preliminary allocation of the estimated purchase consideration is as follows (in thousands):

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Assets:

Cash and cash equivalents	\$7,063
Accounts receivable, net	14,581
Inventories	3,462
Prepaid expenses and other current assets	5,628
Property and equipment, net	9,988
French R&D tax credit receivables ⁽¹⁾	26,400
Other long-term assets	1,762
Total assets	\$68,884

Liabilities:

Other debts and capital leases, current	7,859
Accounts payable	14,906
Deferred revenue	2,504
Accrued liabilities	17,635
Other debts and capital leases, long-term	16,589
Income taxes payable, long-term	50
Other long-term liabilities	6,415
Deferred tax liabilities	1,216
Total liabilities	\$67,174

Goodwill	39,206
Intangibles	43,670
Total purchase consideration	\$84,586

(1) See Note 8, “Balance Sheet Components-Prepaid expenses and other current assets” for more information on French R&D tax credit receivables”.

The following table presents details of the intangible assets acquired through this business combination (in thousands, except years):

	Estimated Useful Life (in years)	Fair Value
Backlog	6 months	\$3,600
Developed technology	4 years	20,000
Customer relationships	5 years	18,500
In-process research and development	N/A	980
Trade name	4 years	590
		\$43,670

Acquired identifiable intangible assets were valued using the income method and are amortized on a straight line basis over their respective estimated useful lives. Goodwill of \$39.2 million arising from the acquisition was derived from expected benefits from the business synergies to be derived from the combined entities and the experienced workforce who joined the Company in connection with the acquisition. The goodwill will be assigned to the Company’s video reporting unit and it is not expected to be deductible for income tax purposes.

The amortization for the developed technology is recorded in “Cost of revenues” for product and the amortization for the remaining intangibles is recorded in “Amortization of intangibles”, which are part of operating expenses, on the Condensed Consolidated Statement of Operations. The intangibles assets acquired will be assigned to the Company’s video reporting unit and are not expected to be deductible for income tax purposes.

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The Company also has an indefinite lived asset of \$980,000 which represents the fair value of in-process research and development activities. Once the related research and development efforts are completed, the Company will determine whether the asset will continue to be an indefinite lived asset or it has become a finite lived asset and apply the appropriate accounting accordingly. The in-process R&D efforts are estimated to be completed within three to six months of the acquisition date.

The results of operations of TVN are included in the Company's Condensed Consolidated Statements of Operations beginning February 29, 2016. For the three months ended April 1, 2016, \$2.9 million of revenue and \$5.5 million of net loss from TVN is included in the Company's Condensed Consolidated Statement of Operations. For the three months ended April 1, 2016, the Company incurred \$3.1 million of acquisition-and integration-related expenses. These costs, which the Company expensed as incurred, consisted primarily of professional fees payable to financial and legal advisors.

Acquisition-and integration-related expenses for the TVN acquisition is summarized in the table below (in thousands):

	Three months ended April 1, 2016
Product cost of revenue	\$ 58
Research and development	50
Selling, general and administrative	2,988
Total acquisition and integration-related expenses in operating expenses	3,038
Total acquisition and integration-related expenses	\$ 3,096

Pro Forma Financial Information

The following unaudited pro forma summary presents consolidated information of the Company as if the acquisition of TVN had occurred on January 1, 2015, the beginning of the comparable prior annual period. The pro forma adjustments primarily relate to acquisition- and integration-related costs, amortization of acquired intangibles and interest expense related to financing arrangements. The unaudited pro forma combined results are provided for illustrative purpose only and are not indicative of the Company's actual consolidation results.

	Three months ended April 1, April 3, 2016 2015 (in millions, except per share amounts)
Net revenue	\$90.6 \$114.8
Net loss	(24.9) (19.6)
Net loss per share-basic and diluted	\$(0.32) \$(0.22)

NOTE 4: SHORT-TERM INVESTMENTS

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

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	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of April 1, 2016				
Corporate bonds	18,141	6	(9)	18,138
Commercial paper	1,100	—	—	1,100
Total short-term investments	\$ 19,241	\$ 6	\$ (9)	\$ 19,238
As of December 31, 2015				
Corporate bonds	25,557	—	(52)	25,505
Commercial paper	1,099	—	—	1,099
Total short-term investments	\$ 26,656	\$ —	\$ (52)	\$ 26,604

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

	April 1, 2016	December 31, 2015
Less than one year	\$ 15,429	\$ 19,642
Due in 1 - 2 years	3,809	6,962
Total short-term investments	\$ 19,238	\$ 26,604

These available-for-sale investments are presented as "Current Assets" in the Condensed Consolidated Balance Sheets as they are available for current operations. Realized gains and losses from the sale of investments for each of the three months ended April 1, 2016 and April 3, 2015 were not material.

As of April 1, 2016 and December 31, 2015, \$5.5 million and \$5.4 million, respectively, of investments in equity securities of other privately and publicly held companies were considered as long-term investments and were included in "Other assets" in the Condensed Consolidated Balance Sheet. (See Note 5, "Investments in Other Equity Securities" for additional information).

Impairment of Short-term 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 April 1, 2016.

As of April 1, 2016, there were no individual available-for-sale securities in a material unrealized loss position and the amount of unrealized losses on the total investment balance was insignificant.

NOTE 5: INVESTMENTS IN OTHER EQUITY SECURITIES

From time to time, the Company may acquire certain equity investments for the promotion of business objectives and these investments are classified as long-term investments and included in "Other assets" in the Condensed Consolidated Balance Sheet.

On September 2, 2014, the Company acquired a 3.3% interest in Vislink plc ("Vislink"), a U.K. public company listed on the AIM exchange in London, for \$3.3 million. The investment in Vislink is being accounted for as a cost method investment as the Company does not have significant influence over the operational and financial policies of Vislink.

Since the Vislink investment is also an available-for-sale security, its value is marked to market for the difference in fair value at period end. The carrying value of Vislink was \$1.9 million and \$1.8 million as of April 1, 2016 and December 31, 2015, respectively, and Vislink's accumulated unrealized loss, net of taxes was \$1.5 million at December 31, 2015.

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The Company assessed this available-for-sale investment that was in a gross unrealized loss position on an individual basis to determine if the decline in fair value was other than temporary. The assessment as to the nature of a decline in fair value is based on, among other things, the length of time and the extent to which the market value has been less than the Company's cost basis; the financial condition and near-term prospects of the investment; and the Company's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery in market value. As a result of these assessments, it was determined that the decline in fair value of Vislink investment at December 31, 2015 was not other than temporary primarily due to the relatively short duration in which the fair value of the Vislink investment was less than the Company's cost basis, and, as a result, the Company did not record any impairment charges as of December 31, 2015. Vislink's \$1.5 million accumulated unrealized loss, net of taxes, at December 31, 2015 was included in the Condensed Consolidated Balance Sheets as a component of "Accumulated other comprehensive income (loss)".

By May 2016, Vislink's stock price had continued to be below the Company's cost basis for approximately seven months. The prolonged decline in Vislink's stock price led the Company to conclude the impairment was other than temporary. Furthermore, the Company's assessment of Vislink's near-term prospects based on Vislink's recent financial performance suggest that Vislink's stock price may not recover to the Company's original cost basis in 2016. As a result, the Company recorded an impairment charge in the first quarter of 2016 of \$1.5 million reflecting the new reduced cost basis of the Vislink investment at April 1, 2016. The Company's remaining maximum exposure to loss from the Vislink investment at April 1, 2016 was limited to its reduced investment cost of \$1.9 million.

Unconsolidated Variable Interest Entities

VJU

On September 26, 2014, the Company acquired a 19.8% interest in VJU iTV Development GmbH ("VJU"), a software company based in Austria, for \$2.5 million. Since VJU's equity is deemed not sufficient to permit it to finance its activities without additional support from its shareholders, VJU is considered a variable interest entity ("VIE"). The Company determined that it is not the primary beneficiary of VJU because its financial interest in VJU's equity and its research and development agreement with VJU do not empower the Company to direct VJU's activities that will most significantly impact VJU's economic performance. VJU is accounted for as a cost method investment as the Company does not have significant influence over the operational and financial policies of VJU.

The Company attended a VJU board meeting on March 5, 2015 as an observer. At that meeting, the Company was made aware of significant decreases in VJU's business prospects, VJU's existing working capital and prospects for additional funding, compared to the prior information the Company had received from VJU. Based on the Company's assessment, the Company determined that its investment in VJU was impaired on an other-than-temporary basis. Factors considered included the severity of the impairment and recent events specific to VJU. Based on the Company's assessment of VJU's expected cash flows, the entire investment is expected to be non-recoverable. As a result, the Company recorded an impairment charge of \$2.5 million in the first quarter of 2015. The Company's impairment loss in VJU is limited to its initial cost of investment of \$2.5 million as well as the \$0.1 million research and development cost expensed in September 2014.

At VJU's shareholders meeting held on October 15, 2015, additional contributions by existing shareholders were approved. The Company did not provide additional contributions to VJU, and as a result, the Company's equity interest in VJU decreased from to 19.8% to 9.9%.

EDC

On October 22, 2014, the Company acquired an 18.4% interest in Encoding.com, Inc. ("EDC"), a video transcoding service company headquartered in San Francisco, California, for \$3.5 million by purchasing EDC's Series B preferred stock. Since EDC's equity is deemed not sufficient to permit it to finance its activities without additional support from its shareholders, EDC is considered a VIE. The Company determined that it is not the primary beneficiary of EDC because its financial interest in EDC's equity does not empower the Company to direct EDC's activities that will most

significantly impact EDC's economic performance. In addition, the Company determined that its investment in EDC's Series B preferred stock does not have the risk and reward characteristics that are substantially similar to EDC's common stock. Therefore, Harmonic does not hold an investment in EDC's common stock or in-substance common stock. According to the applicable accounting guidance, the EDC investment is accounted for as a cost-method investment. The Company determined that there were no indicators existing at April 1, 2016 that would indicate that the EDC investment was impaired.

The following table presents the carrying values and maximum exposure of the unconsolidated VIEs as of April 1, 2016 (in thousands):

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	Carrying Value	Maximum exposure to loss ⁽¹⁾
VJU	\$ —	\$ —
EDC ⁽²⁾	3,593	3,593
Total	\$ 3,593	\$ 3,593

(1) The Company did not provide financial support to any of its unconsolidated VIEs and as of April 1, 2016, there were no explicit arrangements or implicit variable interests that could require the Company to provide financial support to any of its unconsolidated VIEs.

(2) The Company's maximum exposure to loss with respect to EDC as of April 1, 2016 was limited to a total investment cost of \$3.6 million, including \$0.1 million of transaction costs.

Each reporting period, the Company reviews all of its unconsolidated VIE investments to determine whether there are any reconsideration events that may result in the Company being a primary beneficiary of any unconsolidated VIE which would then require the Company to consolidate the VIE. The Company also reviews all of its cost-method investments in each reporting period to determine whether a significant event of change in circumstances has occurred that may have an adverse effect on the fair value of each investment.

NOTE 6: DERIVATIVES AND HEDGING ACTIVITIES

The Company uses forward contracts to manage exposures to foreign currency exchange rates. The Company's primary objective in holding derivative instruments is to reduce the volatility of earnings and cash flows associated with fluctuations in foreign currency exchange rates and the Company does not use derivative instruments for trading purposes. The use of derivative instruments expose the Company to credit risk to the extent that the counterparties may be unable to meet their contractual obligations, as such, the potential risk of loss with any one counterparty is closely monitored by the Company.

Derivatives Designated as Hedging Instruments (Cash Flow Hedges)

Beginning in December 2014, the Company entered into forward currency contracts to hedge forecasted operating expenses and service costs related to employee salaries and benefits denominated in Israeli shekels ("ILS") for its subsidiaries in Israel. These ILS forward contracts mature generally within 12 months and are designated as cash flow hedges. For derivatives that are designated as hedges of forecasted foreign currency denominated operating expenses and service costs, the Company assesses effectiveness based on changes in spot currency exchange rates. Changes in spot rates on the derivative are recorded as a component of "Accumulated other comprehensive income (loss)" ("AOCI") in the Condensed Consolidated Balance Sheets until such time as the hedged transaction impacts earnings. The change in fair value of the forward points, which reflects the interest rate differential between the two countries on the derivative, is excluded from the effectiveness assessment. Gains or losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

Derivatives Not Designated as Hedging Instruments (Balance Sheet Hedges)

Balance sheet hedges consist of foreign currency forward contracts, mature generally within three months, are carried at fair value and they are used to minimize the short-term impact of foreign currency exchange rate fluctuation on cash and certain trade and inter-company receivables and payables. Changes in the fair value of these foreign currency forward contracts are recognized in "Other income (expense), net" in the Condensed Consolidated Statement of Operations and are largely offset by the changes in the fair value of the assets or liabilities being hedged.

The locations and amounts of designated and non-designated derivative instruments' gains and losses reported in the Company's Condensed Consolidated Statements of Operations were as follows (in thousands):

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	Financial Statement Location	Three months ended	
		April 1, 2016	April 3, 2015
Derivatives designated as hedging instruments:			
Gains (losses) in AOCI on derivatives (effective portion)	AOCI	\$(323)	\$184
Gains (losses) reclassified from AOCI into income (effective portion)	Cost of Revenue	\$(10)	\$7
	Operating Expense	(68)	42
	Total	\$(78)	\$49
Losses recognized in income on derivatives (ineffectiveness portion and amount excluded from effectiveness testing)	Other income (expense), net	\$(27)	\$(42)
Derivatives not designated as hedging instruments:			
Gains (losses) recognized in income	Other income (expense), net	\$(284)	\$252

The Company anticipates the AOCI balance of \$155,000 at April 1, 2016, relating to net unrealized gains from cash flow hedges, will be reclassified to earnings within the next twelve months.

The U.S. dollar equivalents of all outstanding notional amounts of foreign currency forward contracts are summarized as follows (in thousands):

	April 1, 2016	December 31, 2015
Derivatives designated as cash flow hedges:		
Purchase	\$9,003	\$12,984
Derivatives not designated as hedging instruments:		
Purchase	\$3,182	\$6,942
Sell	\$7,931	\$11,332

The locations and fair value amounts of the Company's derivative instruments reported in its Condensed Consolidated Balance Sheets are as follows (in thousands):

	Balance Sheet Location	Asset Derivatives		Balance Sheet Location	Derivative Liabilities	
		April 1, 2016	December 31, 2015		April 1, 2016	December 31, 2015
Derivatives designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	\$123	\$13	Accrued Liabilities	\$1	\$281
		\$123	\$13		\$1	\$281
Derivatives not designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	\$41	\$100	Accrued Liabilities	\$21	\$90
		\$41	\$100		\$21	\$90
Total derivatives		\$164	\$113		\$22	\$371

Offsetting of Derivative Assets and Liabilities

The Company recognizes all derivative instruments on a gross basis in the Condensed Consolidated Balance Sheets. However, the arrangements with its counterparties allows for net settlement, which are designed to reduce credit risk by permitting net settlement with the same counterparty. As of April 1, 2016, information related to the offsetting

arrangements was as follows (in thousands):

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					Gross Amounts of Derivatives Not Offset in the Condensed Consolidated Balance Sheets	
	Gross Amounts of Derivatives	Gross Amounts of Derivatives Offset in the Condensed Consolidated Balance Sheets	Net Amounts of Derivatives Presented in the Condensed Consolidated Balance Sheets	Financial Instrument	Cash Collateral Pledged	Net Amount
Derivative Assets	\$ 164	—	\$ 164	\$ (9)	—	\$ 155
Derivative Liabilities	\$ 22	—	\$ 22	\$ (9)	—	\$ 13

In connection with foreign currency derivatives entered in Israel, the Company's subsidiaries in Israel are required to maintain a compensating balance with their bank at the end of each month. The compensating balance arrangements do not legally restrict the use of cash and as of April 1, 2016, the total compensating balance maintained was \$2.5 million.

NOTE 7: 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. The fair value of the Company's convertible notes is influenced by interest rates, the Company's stock price and stock market volatility. The estimated fair value of the Company's convertible notes based on a market approach was approximately \$103.8 million and \$123.1 million as of April 1, 2016 and December 31, 2015, respectively, and represents a Level 2 valuation. The Company's other debts and capital leases assumed from the TVN acquisition are classified within Level 2 because these borrowings are not actively traded and the majority of them have a variable interest rate structure based upon market rates currently available to the Company for debt with similar terms and maturities. Additionally, the Company considers the carrying amount of its capital lease obligations

to approximate their fair value because the weighted average interest rate used to formulate the carrying amounts approximates current market rates. The other debts and capital leases outstanding as of April 1, 2016 were \$25.3 million in the aggregate. (See Note 11, "Convertible Notes, Other debts and Capital Leases" for additional information). The Company's liabilities for the TVN contingent consideration under the TVN Purchase Agreement and the assumed TVN employee equity plans as of April 1, 2016 are classified within Level 3 because these valuations are based on management assumptions, including discount rates and estimated probabilities of achievement of certain events which are unobservable in the market. These liabilities were \$8.0 million and \$2.4 million, respectively and are expected to be paid in the second quarter of 2016.

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During the three months ended April 1, 2016, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.

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

	Level 1	Level 2	Level 3	Total
As of April 1, 2016				
Cash equivalents				
Money market funds	\$10,906	\$—	\$	—\$10,906
Short-term investments				
Corporate bonds	—	18,138	—	18,138
Commercial paper	—	1,100	—	1,100
Prepays and other current assets				
Time deposit pledged for credit card facility	—	580	—	580
Derivative assets	—	164	—	164
Other assets				
Long-term investment	1,870	—	—	1,870
Total assets measured and recorded at fair value	\$12,776	\$19,982	\$	—\$32,758
Accrued liabilities				
Derivative liabilities	—	22	—	22
Total liabilities measured and recorded at fair value	\$—	\$22	\$	—\$22
	Level 1	Level 2	Level 3	Total
As of December 31, 2015				
Cash equivalents				
Money market funds	\$53,434	\$—	\$	—\$53,434
U.S. Treasury bills	24,998	—	—	24,998
Short-term investments				
Corporate bonds	—	25,505	—	25,505
Commercial paper	—	1,099	—	1,099
Prepays and other current assets				
Time deposit pledged for credit card facility	—	580	—	580
Derivative assets	—	113	—	113
Other assets				
Long-term investment	1,840	—	—	1,840
Total assets measured and recorded at fair value	\$80,272	\$27,297	\$	—\$107,569
Accrued liabilities				
Derivative liabilities	\$—	\$371	\$	—\$371
Total liabilities measured and recorded at fair value	\$—	\$371	\$	