HARMONIC INC
Form 10-Q
November 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)
ý Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended October 2, 2015

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

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

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

4300 North First Street
San Jose, CA 95134
(408) 542-2500
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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	ý
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 ý
The number of shares of the registrant's Common Stock, $.001 par value, outstanding on November 2, 2015 was 87,072,661.

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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)

	October 2, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$61,571	$73,032
Short-term investments	25,990	31,847
Accounts receivable, net	64,128	74,144
Inventories	39,873	32,747
Deferred income taxes, short-term	3,375	3,375
Prepaid expenses and other current assets	31,709	17,539
Total current assets	226,646	232,684
Property and equipment, net	26,619	27,221
Goodwill	197,825	197,884
Intangibles, net	5,628	10,599
Other assets	10,190	12,130
Total assets	$466,908	$480,518
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$16,626	$15,318
Income taxes payable	176	893
Deferred revenue	43,350	38,601
Accrued liabilities	29,139	35,118
Total current liabilities	89,291	89,930
Income taxes payable, long-term	4,296	4,969
Deferred tax liabilities, long-term	3,095	3,095
Other non-current liabilities	10,358	10,711
Total liabilities	107,040	108,705
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; 87,477 and 87,700 shares issued and outstanding at October 2, 2015 and December 31, 2014, respectively	87	88
Additional paid-in capital	2,259,757	2,261,952
Accumulated deficit	(1,896,709)	(1,888,247)
Accumulated other comprehensive loss	(3,267)	(1,980)
Total stockholders' equity	359,868	371,813
Total liabilities and stockholders' equity	$466,908	$480,518

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		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Revenue:				
Product	$57,245	$84,583	$215,165	$259,371
Services	26,060	23,478	75,259	66,311
Total net revenue	83,305	108,061	290,424	325,682
Cost of revenue:				
Product	23,584	41,802	95,021	134,336
Services	13,490	12,831	39,759	35,789
Total cost of revenue	37,074	54,633	134,780	170,125
Total gross profit	46,231	53,428	155,644	155,557
Operating expenses:				
Research and development	21,679	22,803	65,824	70,176
Selling, general and administrative	28,966	32,114	91,443	98,640
Amortization of intangibles	1,446	1,661	4,338	5,329
Restructuring and related charges	397	388	626	821
Total operating expenses	52,488	56,966	162,231	174,966
Loss from operations	(6,257)	(3,538)	(6,587)	(19,409)
Interest income, net	30	47	102	191
Other income (expense), net	148	(261)	(299)	(376)
Loss on impairment of long-term investment	—	—	(2,505)	—
Loss before income taxes	(6,079)	(3,752)	(9,289)	(19,594)
(Benefit from) provision for income taxes	(1,268)	(4,830)	(827)	21,800
Net income (loss)	$(4,811)	$1,078	$(8,462)	$(41,394)
Net income (loss) per share:				
Basic	$(0.05)	$0.01	$(0.10)	$(0.44)
Diluted	$(0.05)	$0.01	$(0.10)	$(0.44)
Shares used in per share calculation:				
Basic	87,991	90,618	88,359	94,113
Diluted	87,991	91,800	88,359	94,113

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

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HARMONIC INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Net income (loss)	$(4,811)	$1,078	$(8,462)	$(41,394)
Other comprehensive income (loss) before tax:				
Change in unrealized losses on cash flow hedges:				
Unrealized loss arising during the period	(550)	—	(218)	—
Gains reclassified into earnings	(127)	—	(314)	—
	(677)	—	(532)	—
Change in unrealized gains (loss) on available-for-sale securities:	(928)	(308)	17	(333)
Change in foreign currency translation adjustments	(364)	(670)	(766)	(440)
Other comprehensive loss before tax	(1,969)	(978)	(1,281)	(773)
Provision for (benefit from) income taxes	12	(7)	6	(12)
Other comprehensive loss, net of tax	(1,981)	(971)	(1,287)	(761)
Total comprehensive income (loss)	$(6,792)	$107	$(9,749)	$(42,155)

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)

	Nine months ended	
	October 2, 2015	September 26, 2014
Cash flows from operating activities:		
Net loss	$(8,462)	$(41,394)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangibles	4,971	18,378
Depreciation	10,143	12,641
Stock-based compensation	11,845	12,720
Loss on impairment of long-term investment	2,505	—
Deferred income taxes, net	—	31,782
Provision for excess and obsolete inventories	1,234	2,013
Allowance for doubtful accounts, returns and discounts	576	(116)
Excess tax benefits from stock-based compensation	—	(194)
Other non-cash adjustments, net	354	1,108
Changes in operating assets and liabilities:		
Accounts receivable	9,440	(472)
Inventories	(7,936)	2,401
Prepaid expenses and other assets	(13,817)	(5,321)
Accounts payable	1,772	(786)
Deferred revenue	5,237	7,770
Income taxes payable	(1,372)	(8,292)
Accrued and other liabilities	(7,926)	(4,717)
Net cash provided by operating activities	8,564	27,521
Cash flows from investing activities:		
Purchases of investments	(20,714)	(26,599)
Proceeds from maturities of investments	26,534	43,236
Proceeds from sales of investments	—	7,408
Purchases of property and equipment	(10,393)	(8,859)
Purchases of long-term investments	(85)	(5,867)
Restricted cash	(1,091)	—
Net cash (used in) provided by investing activities	(5,749)	9,319
Cash flows from financing activities:		
Payments for repurchase of common stock	(20,007)	(86,407)
Proceeds from common stock issued to employees	9,255	4,357
Payment of tax withholding obligations related to net share settlements of restricted stock units	(3,288)	(3,116)
Excess tax benefits from stock-based compensation	—	194
Net cash used in financing activities	(14,040)	(84,972)
Effect of exchange rate changes on cash and cash equivalents	(236)	(169)
Net decrease in cash and cash equivalents	(11,461)	(48,301)
Cash and cash equivalents at beginning of period	73,032	90,329
Cash and cash equivalents at end of period	$61,571	$42,028

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 2, 2015 (the "2014 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, 2015, 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.

Significant Accounting Policies

The Company's significant accounting policies are described in Note 2 to its audited Consolidated Financial Statements included in the 2014 Form 10-K. There have been no significant changes to these policies during the nine months ended October 2, 2015.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

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. On August 12, 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 permitted early adoption of the standard, but not before the original effective date of December 15, 2016. The Company has not yet selected a transition method and it is currently evaluating the effect that the updated standard will have on its consolidated financial statements and related disclosures.

In August 2014, the FASB issued new authoritative guidance related to the disclosures around going concern. The new guidance specifies management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The new guidance will be effective for the Company beginning in the fourth quarter of fiscal 2016 and early adoption is permitted. The Company is currently evaluating the impact of adopting this new accounting standard but does not expect that it will have a material effect on its consolidated financial statements.

In November 2014, the FASB issued an accounting standard update for determining when separation of certain embedded derivative features in a hybrid financial instrument is required. An entity will continue to evaluate whether the economic characteristics and risks of the embedded derivative feature are clearly and closely related to those of the host contract, among other relevant criteria. The amendments clarify how current GAAP should be interpreted in

evaluating the economic characteristics and risks of a host contract in a hybrid financial instrument that is issued in the form of a share. The accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2016 and early adoption is

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permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

In February 2015, the FASB issued an accounting standard update that changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2016 and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

In April 2015, the FASB issued an accounting standard update on whether a cloud computing arrangement includes a software license. The guidance requires the accounting for a cloud computing arrangement that includes a software license element to be consistent with the accounting for acquisition of other software licenses. Cloud computing arrangement without software licenses are to be accounted for as a service contract. This accounting standard update will be effective for the Company beginning in the first quarter of fiscal 2016 and early adoption is permitted. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

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.

NOTE 3: 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 October 2, 2015				
State, municipal and local government agencies bonds	$2,502	$1	$—	$2,503
Corporate bonds	23,484	15	(12)	23,487
Total short-term investments	$25,986	$16	$(12)	$25,990
As of December 31, 2014				
State, municipal and local government agencies bonds	$13,946	$16	$(1)	$13,961
Corporate bonds	17,899	3	(16)	17,886
Total short-term investments	$31,845	$19	$(17)	$31,847

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

	October 2, 2015	December 31, 2014
Less than one year	$20,545	$30,946
Due in 1 - 2 years	5,445	901
Total short-term investments	$25,990	$31,847

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 and nine months ended October 2, 2015 and September 26, 2014 were not material.

As of October 2, 2015 and December 31, 2014, $6.2 million and $8.6 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 4, "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

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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 October 2, 2015.
As of October 2, 2015, 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 4: 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, for $3.3 million, and also made a $3.3 million prepayment for future software license purchases. 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 $2.6 million as of each of October 2, 2015 and December 31, 2014, and Vislink’s accumulated unrealized loss, net of taxes was $(0.7) million as of each of October 2, 2015 and December 31, 2014. The accumulated unrealized loss is included in the Condensed Consolidated Balance Sheets as a component of “Accumulated other comprehensive income (loss)”. As of October 2, 2015, there was no outstanding balance in the prepayment to Vislink for future software license purchase. The Company determined that there were no indicators existing at October 2, 2015 that would indicate that the Vislink investment was impaired. As of October 2, 2015, the Company’s maximum exposure to loss from the Vislink investment was limited to its initial investment cost of $3.3 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

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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 October 2, 2015 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 October 2, 2015 (in thousands):

	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 October 2, 2015, 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 October 2, 2015 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 5: 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		Nine months ended	
		October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Derivatives designated as hedging instruments:					
Losses in AOCI on derivatives (effective portion)	AOCI	$(550)	$—	$(218)	$—
Gains reclassified from AOCI into income (effective portion)	Cost of Revenue	$18	$—	$44	$—
	Operating Expense	109	—	270	—
	Total	$127	$—	$314	$—
Loss recognized in income on derivatives (ineffectiveness portion and amount excluded from effectiveness testing)	Other income (expense), net	$(5)	$—	$(57)	$—
Derivatives not designated as hedging instruments:					
Gains (losses) recognized in income	Other income (expense), net	$(165)	$(95)	$220	$(201)

The Company anticipates the AOCI balance of $(221,000) at October 2, 2015, relating to net unrealized losses 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):

	October 2, 2015	December 31, 2014
Derivatives designated as cash flow hedges:		
Purchase	$14,280	$16,903
Derivatives not designated as hedging instruments:		
Purchase	$8,244	$1,043
Sell	$7,827	$4,925

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	
		October 2, 2015	December 31, 2014		October 2, 2015	December 31, 2014
Derivatives designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	$60	$ 329	Accrued Liabilities	$291	$ —
		$60	$ 329		$291	$ —
Derivatives not designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	$117	$ 12	Accrued Liabilities	$35	$ 7
		$117	$ 12		$35	$ 7
Total derivatives		$177	$ 341		$326	$ 7

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 October 2, 2015, information related to the offsetting arrangements was as follows (in thousands):

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	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	Gross Amounts of Derivatives Not Offset in the Condensed Consolidated Balance Sheets		
				Financial Instrument	Cash Collateral Pledged	Net Amount
Derivative Assets	$177	—	$177	$(169)	—	$8
Derivative Liabilities	$326	—	$326	$(169)	—	$157

As of December 31, 2014, there was no potential effect of rights of offset associated with the outstanding foreign currency forward contracts that would result in a net derivative asset or net derivative liability.

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 nine months ended October 2, 2015, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.

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

	Level 1	Level 2	Level 3	Total
As of October 2, 2015				
Cash equivalents				
Money market funds	$14,062	$—	$—	$14,062
Short-term investments				
State, municipal and local government agencies bonds	—	2,503	—	2,503
Corporate bonds	—	23,487	—	23,487
Prepaids and other current assets				
Time deposit pledged for credit card facility	—	580	—	580
Derivative assets	—	177	—	177
Other assets				
Long-term investment	2,587	—	—	2,587
Total assets measured and recorded at fair value	$16,649	$26,747	$—	$43,396
Accrued liabilities				
Derivative liabilities	$—	$326	$—	$326
Total liabilities measured and recorded at fair value	$—	$326	$—	$326

	Level 1	Level 2	Level 3	Total
As of December 31, 2014				
Cash equivalents				
Money market funds	$23,121	$—	$—	$23,121
Short-term investments				
State, municipal and local government agencies bonds	—	13,961	—	13,961
Corporate bonds	—	17,886	—	17,886
Prepaids and other current assets				
Derivative assets	—	341	—	341
Other assets				
Long-term investment	2,606	—	—	2,606
Total assets measured and recorded at fair value	$25,727	$32,188	$—	$57,915
Accrued liabilities				
Derivative liabilities	$—	$7	$—	$7
Total liabilities measured and recorded at fair value	$—	$7	$—	$7

NOTE 7: BALANCE SHEET COMPONENTS

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

	October 2, 2015	December 31, 2014
Accounts receivable, net:		
Accounts receivable	$67,304	$81,201
Less: allowances for doubtful accounts, returns and discounts	(3,176)	(7,057)
Total	$64,128	$74,144

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Prepaid expenses and other current assets:		
Prepaid inventories to contract manufacturer[1]	$14,200	$—
Prepaid software license to Vislink[2]	—	1,233
Other Prepayments	10,963	9,713
Deferred cost of revenue	2,794	2,524
Income tax receivable	1,914	2,316
Restricted cash[3]	1,091	—
Other	747	1,753
Total	$31,709	$17,539

(1) During the first quarter of 2015, the Company made a $14.2 million advance payment for future inventory requirements to a supplier in order to secure more favorable pricing. The Company anticipates that this amount will begin to offset in the fourth quarter of 2015 through the second quarter of 2016 against the accounts payable owed to this supplier.
(2) The prepaid inventories were related to prepayment for software licenses made to Vislink (see Note 4, "Investments in Other Equity Securities" for additional information on Vislink).
(3) The Company has restricted cash of $0.5 million that serves as collateral for rent guarantees on certain operating leases in Israel. Additionally, the Company holds $0.6 million of restricted cash as collateral for its corporate card credit facility in Switzerland. These restricted funds are invested in bank deposits and cannot be withdrawn from the Company's accounts without the prior written consent of the applicable secured party.

Inventories:		
Raw materials	$2,400	$1,422
Work-in-process	1,526	1,255
Finished goods	35,947	30,070
Total	$39,873	$32,747
Property and equipment, net:		
Furniture and fixtures	$7,820	$7,691
Machinery and equipment	120,067	116,031
Leasehold improvements	10,307	8,140
Property and equipment, gross	138,194	131,862
Less: accumulated depreciation and amortization	(111,575)	(104,641)
Total	$26,619	$27,221

NOTE 8: GOODWILL AND IDENTIFIED INTANGIBLE ASSETS

Goodwill

The following table presents goodwill by reportable segments (in thousands):

	Video	Cable Edge	Total
As of December 31, 2014	$136,975	$60,909	$197,884
Foreign currency translation adjustment	(41)	(18)	(59)
As of October 2, 2015	$136,934	$60,891	$197,825

Identified Intangible Assets

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

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	Range of Useful Lives	October 2, 2015			December 31, 2014		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identifiable intangibles:							
Developed core technology	4-6 years	$136,145	$ (136,059)	$86	$136,145	$(135,426)	$ 719
Customer relationships/contracts	5-6 years	67,098	(62,434)	4,664	67,098	(58,784)	8,314
Maintenance agreements and related relationships	6-7 years	7,100	(6,222)	878	7,100	(5,534)	1,566
Total identifiable intangibles		$210,343	$ (204,715)	$5,628	$210,343	$(199,744)	$ 10,599

Amortization expense for the identifiable purchased intangible assets for the three and nine months ended October 2, 2015 and September 26, 2014 was allocated as follows (in thousands):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Included in cost of revenue	$86	$3,851	$633	$13,049
Included in operating expenses	1,446	1,661	4,338	5,329
Total amortization expense	$1,532	$5,512	$4,971	$18,378

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,			
2015 (remaining three months)	$86	$1,446	$1,532
2016	—	4,096	4,096
Total future amortization expense	$86	$5,542	$5,628

NOTE 9: RESTRUCTURING AND RELATED CHARGES

The Company implemented several restructuring plans in the past few years. The goal of these plans was to bring operational expenses to appropriate levels relative to its net revenues, while simultaneously implementing extensive company-wide expense control programs.

The Company accounts for its restructuring plans under the authoritative guidance for exit or disposal activities. The restructuring and asset impairment charges are included in “Product cost of revenue” and “Operating expenses-restructuring and related charges” in the Condensed Consolidated Statements of Operations. The following table summarizes the restructuring and related charges (in thousands):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Restructuring and related charges in:				
Product cost of revenue	$113	$15	$113	$94
Operating expenses-Restructuring and related charges	397	388	626	821
Total restructuring and related charges	$510	$403	$739	$915

Harmonic 2015 Restructuring

In the fourth quarter of 2014, the Company approved a new restructuring plan (the “Harmonic 2015 Restructuring Plan”) to reduce 2015 operating costs and the planned restructuring activities involve headcount reduction, exiting certain operating

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facilities and disposing of excess assets. The Company started the restructuring activities pursuant to this plan in the fourth quarter of 2014 and expects to complete its actions by end of 2015. The Company recorded $2.2 million of restructuring and asset impairment charges under this plan in the fourth quarter of 2014 consisting of a $1.1 million fixed asset impairment charge related to software development costs incurred for a discontinued information technology ("IT") project, $0.6 million of severance and benefits related to the termination of 19 employees worldwide, $0.3 million of excess material costs associated with the termination of a research and development project and $0.1 million of other charges. The Company recorded $510,000 and $739,000 of restructuring charges under this plan, in the three and nine months ended October 2, 2015, respectively. Such restructuring charges consisted of severance and benefits related to the termination of 22 employees.

The following table summarizes the activity in the Harmonic 2015 restructuring accrual during the nine months ended October 2, 2015 (in thousands):

	Severance and benefits	Other charges	Total
Balance at December 31, 2014	$305	$17	$322
Restructuring charges	759	—	759
Adjustments to restructuring provisions	(14)	(6)	(20)
Cash payments	(543)	(11)	(554)
Balance at October 2, 2015	$507	$—	$507

Harmonic 2013 Restructuring

The Company implemented a series of restructuring plans in 2013 to reduce costs and improve efficiencies. These restructuring plans extended to actions taken through the third quarter of fiscal 2014. As a result, the Company recorded restructuring charges of $2.2 million and $0.9 million in fiscal 2013 and fiscal 2014, respectively. The restructuring charges in the three and nine months ended September 26, 2014 were $403,000 and $915,000, respectively, under these plans, consisting of severance and benefits related to the termination of 25 employees worldwide, costs associated with exiting from a research and development project, as well as costs associated with vacating from an excess facility in France. For a complete discussion of the restructuring actions related to the 2013 restructuring plans, see Note 11, "Restructuring and Asset Impairment Charges" of Notes to Consolidated Financial Statements in the 2014 Form 10-K.

NOTE 10: CREDIT FACILITIES

On December 22, 2014, the Company entered into a Credit Agreement (the "Credit Agreement") with JPMorgan Chase Bank, N.A. ("JPMorgan") for a $20.0 million revolving credit facility, with a sublimit of $10.0 million for the issuance of commercial and standby letters of credit on the Company's behalf. Revolving loans under the Credit Agreement may be borrowed, repaid and re-borrowed until December 22, 2015, at which time all amounts borrowed must be repaid. There were no borrowings under the Credit Agreement during the nine months ended October 2, 2015. As of October 2, 2015, the amount available for borrowing under this facility, net of $0.5 million of standby letters of credit, was $19.5 million.

The revolving loan bears interest, at the Company's election, at either (a) an adjusted LIBOR rate for a term of one, two or three months, plus an applicable margin of 1.75% or (b) the prime rate plus an applicable margin of -1.30%, provided that such rate shall not be less than the one month adjusted LIBOR rate, plus 2.5%. In the event that the balance of the Company's accounts held with JPMorgan falls below $30.0 million in aggregate total worldwide consolidated cash and short-term investments (the "Consolidated Cash Threshold") for five consecutive business days, the Company is obligated to pay a one-time facility fee of $50,000 to JPMorgan. The Company is also obligated to pay JPMorgan a non-usage fee equal to the average daily unused portion of the credit facility multiplied by a per annum rate of 0.25% if, during any calendar month, the balance in the Company's accounts held with JPMorgan falls below the Consolidated Cash Threshold for five consecutive business days.

The Company will pay a letter of credit fee with respect to any letters of credit issued under the Credit Agreement in an amount equal to (a) in the case of a standby letter of credit, the maximum amount available to be drawn under such standby letter of credit multiplied by a per annum rate of 1.75% and (b) in the case of a commercial letter of credit, the greater of $100 or 0.75% of the original maximum available amount of such commercial letter of credit. The Company will also pay other customary transaction fees and costs in connection with the issuance of letters of credit under the Credit Agreement.

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Obligations under the Credit Agreement are secured only by a pledge of 66.67% of the Company's equity interests in its foreign subsidiary, Harmonic International AG. Additionally, to the extent that the Company in the future forms any direct or indirect, domestic, material subsidiaries, those subsidiaries will be required to provide a guaranty of the Company's obligations under the Credit Agreement.

The Credit Agreement contains customary affirmative and negative covenants, including covenants that limit the Company's and its subsidiaries' ability to, among other things, incur indebtedness, grant liens, merge or consolidate, dispose of assets, make investments or pay dividends, in each case subject to certain exceptions. The Company is also required to maintain, on a consolidated basis, total cash and marketable securities of at least $35.0 million and EBITDA of at least $20.0 million determined on a rolling four-quarter basis. As of October 2, 2015, the Company was in compliance with the covenants under the Credit Agreement.

NOTE 11: EMPLOYEE BENEFIT PLANS

Harmonic grants stock options and restricted stock units ("RSUs") pursuant to stockholder approved equity incentive plans. These equity incentive plans are described in detail in Note 14, "Employee Benefit Plans" of Notes to Consolidated Financial Statements in the 2014 Form 10-K.

Stock Options and Restricted Stock Units

The following table summarizes the Company's stock option and RSU unit activity during the nine months ended October 2, 2015 (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, 2014	7,480	7,255	$6.65	2,241	$ 6.40
Authorized	—	—	—	—	—
Granted	(4,000)	1,156	7.58	1,895	7.17
Options exercised	—	(748)	5.32	—	—
Shares released	—	—	—	(1,526)	6.47
Forfeited or cancelled	1,887	(1,606)	8.05	(189)	6.79
Balance at October 2, 2015	5,367	6,057	$6.62	2,421	$ 6.99

The following table summarizes information about stock options outstanding as of October 2, 2015 (in thousands, except per share amounts):

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Vested and expected to vest	5,777	$6.60	4.1	$994
Exercisable	3,634	6.44	3.2	968

The intrinsic value of options vested and expected to vest and exercisable as of October 2, 2015 is calculated based on the difference between the exercise price and the fair value of the Company's common stock as of October 2, 2015. The intrinsic value of options exercised 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 intrinsic value of options exercised during the three and nine months ended October 2, 2015 was $28,000 and $1.7 million, respectively. The intrinsic value of options exercised during the three and nine months ended September 26, 2014 was $0.3 million and $0.7 million, respectively.

The following table summarizes information about RSUs outstanding as of October 2, 2015 (in thousands, except per share amounts):

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	Number of Shares Underlying Restricted Stock Units	Weighted Average Remaining Vesting Period (Years)	Aggregate Fair Value
Vested and expected to vest	1,859	0.8	$10,856

The fair value of RSUs vested and expected to vest as of October 2, 2015 is calculated based on the fair value of the Company's common stock as of October 2, 2015.

Employee Stock Purchase Plan

The 2002 Employee Stock Purchase Plan ("ESPP") provides for the issuance of common stock 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 July 1 of each year. Employees may participate through payroll deductions of 1% to 10% of their earnings. In the event that there are insufficient shares in the plan to fully fund the issuance, the available shares will be allocated across all participants based on their contributions relative to the total contributions received for the offering period.

401(k) Plan

The Company 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. The Company has made discretionary contributions to the plan of 25% of the first 4% contributed by eligible participants, up to a maximum contribution per participant of $1,000 per year. The contributions for the nine months ended October 2, 2015 and September 26, 2014 were $342,000 and $354,000, respectively.

NOTE 12: STOCK-BASED COMPENSATION

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

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Stock-based compensation in:				
Cost of revenue	$433	$612	$1,383	$1,751
Research and development expense	1,074	1,219	3,249	3,589
Selling, general and administrative expense	2,320	2,521	7,213	7,380
Total stock-based compensation in operating expense	3,394	3,740	10,462	10,969
Total stock-based compensation	$3,827	$4,352	$11,845	$12,720

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.

Stock Options

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

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Expected term (years)	4.60	4.70	4.70	4.70
Volatility	37 %	40 %	38 %	40 %
Risk-free interest rate	1.5 %	1.8 %	1.6 %	1.7 %
Expected dividends	0.0 %	0.0 %	0.0 %	0.0 %

The expected term represents the weighted-average period that the stock options are expected to remain outstanding. The computation of the expected term was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. 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 options granted was $2.01 and $2.48 for the three months ended October 2, 2015 and September 26, 2014, respectively. The weighted-average fair value per share of options granted was $2.63 and $2.36 for the nine months ended October 2, 2015 and September 26, 2014, respectively.

The fair value of all stock options vested during each of the three months ended October 2, 2015 and September 26, 2014 was $0.6 million. The fair value of all stock options vested during the nine months ended October 2, 2015 and September 26, 2014 was $2.5 million and $2.6 million, respectively.

There were no realized tax benefits attributable to stock options exercised in jurisdictions where this expense is deductible for tax purposes for the nine months ended October 2, 2015. The total realized tax benefit attributable to stock options exercised during the nine months ended September 26, 2014 was $194,000.

Restricted Stock Units

The aggregate fair value of all RSUs issued during the three months ended October 2, 2015 and September 26, 2014 were $2.2 million and $2.7 million, respectively. The aggregate fair value of all RSUs issued during the nine months ended October 2, 2015 and September 26, 2014 were $9.9 million and $10.0 million, respectively.

Employee Stock Purchase Plan

The value of the stock purchase rights 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. The weighted average fair value of the Company's ESPP shares at purchase dates was estimated using the following weighted average assumptions during the nine months ended October 2, 2015 and September 26, 2014:

	Purchase Period Ending			
	December 31, 2015	June 30, 2015	December 31, 2014	June 30, 2014
Expected term (years)	0.50	0.50	0.50	0.50
Volatility	32 %	35 %	33 %	28 %
Risk-free interest rate	0.1 %	0.1 %	0.1 %	0.1 %
Expected dividends	0.0 %	0.0 %	0.0 %	0.0 %
Estimated weighted average fair value per share at purchase date	$1.64	$1.75	$1.84	$1.70

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

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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.

Unrecognized Stock-Based Compensation

As of October 2, 2015, the Company had approximately $14.7 million of unrecognized stock-based compensation expense related to the unvested portion of its stock options and RSUs that is expected to be recognized over a weighted-average period of approximately 1.9 years.

NOTE 13: INCOME TAXES

The Company reported the following operating results for the periods presented (in thousands):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Loss before income taxes	$(6,079)	$(3,752)	$(9,289)	$(19,594)
(Benefit from) provision for income taxes	(1,268)	(4,830)	(827)	21,800
Effective income tax rate	20.9%	128.7%	8.9%	(111.3)%

The Company operates in multiple jurisdictions and its profits are taxed pursuant to the tax laws of these jurisdictions. The Company’s effective income tax rate may be affected by changes in, or interpretations of tax laws and tax agreements in any given jurisdiction, utilization of net operating loss and tax credit carry forwards, changes in geographical mix of income and expense, and changes in management’s assessment of matters such as the ability to realize deferred tax assets, as well as recognition of uncertain tax benefits, the effects of the statute of limitations, or settlement with tax authorities.

The Company’s effective income tax rate of 8.9% for the nine months ended October 2, 2015 was lower than the U.S. federal statutory rate of 35% primarily due to a difference in foreign tax rates and the Company’s U.S. losses generated in the nine months ended October 2, 2015 receiving no tax benefit as a result of a full valuation allowance against all of its U.S. deferred tax assets as well as adjustments relating to its 2014 U.S. federal tax return filed in September 2015 and the reversal of uncertain tax positions resulting from the expiration of the statute of limitations. The impairment of the VJU investment (see Note 4, "Investments in Other Equity Securities") received no tax benefit.

The Company’s effective income tax rate of (111.3)% for the nine months ended September 26, 2014 differed from the U.S. federal statutory rate of 35%, primarily due to a $28.7 million increase in the valuation allowance against U.S. federal, California, and other state deferred tax assets. The increased valuation allowance was a result of a history of operating losses in recent years that has led to uncertainty with respect to the Company’s ability to realize certain of its net deferred tax assets, of which $4.2 million and $24.5 million were recorded in the third and second quarter of 2014, respectively. This unfavorable impact was offset in part by net tax benefits of $8.5 million associated with the release of tax reserves for uncertain tax positions as a result of the expiration of statute of limitations, which were released in the third quarter of 2014.

The Company files U.S. federal and 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 2011 through 2014 tax years generally remain subject to examination by most state tax authorities in the United States. The Company’s income tax return for 2012 is currently under examination by the U.S. Internal Revenue Service, which commenced in August 2015, and the 2013 through 2014 tax years remain subject to examination by the U.S. federal tax authority. In August 2015, the Company was notified by the County of Santa Clara, California, of a new property tax audit for the 2012 through 2015 tax years. The Company is in the process of appealing a $1.6 million assessment for underpayment of property tax and associated interest relating to a previous audit cycle which commenced in 2013, for the 2007 through 2011 tax years. In connection with the previous audit cycle, the Company has made several advance payments to the Santa Clara County aggregating $1.8 million, of which $0.6 million was recorded in operating expenses in prior years and the remainder $1.2 million was included in “Prepaid and other current assets” on our Condensed Consolidated Balance Sheet as of October 2, 2015, as we expect a tax refund for this amount. The Company expects to settle the appeal in early 2016. In significant foreign jurisdictions, the 2006 through 2014 tax years generally remain subject to examination by their respective tax authorities. A subsidiary of the Company is

under audit for the 2012 and 2013 tax years, which commenced in the first quarter of 2015, by the Israel tax authority. If, upon the conclusion of these audits, the ultimate determination of taxes owed in the United States or Israel is for an amount in excess of the tax provision the Company has recorded in the applicable period, the Company's overall tax expense, effective tax rate, operating results and cash flow could be materially and adversely impacted in the period of adjustment.

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The Company’s operations in Switzerland are subject to a reduced tax rate under the Switzerland tax holiday which requires various thresholds of investment and employment in Switzerland. The Company has met these various thresholds and the Switzerland tax holiday is effective through the end of 2018.
As of October 2, 2015, the total amount of gross unrecognized tax benefits, including interest and penalties, was approximately $15.9 million, of which $4.3 million would affect the Company’s effective tax rate if the benefits are eventually recognized. The remaining gross unrecognized tax benefit does not affect the Company’s effective tax rate as it relates to positions that would be settled with tax attributes such as net operating loss carryforward or tax credits previously subject to a valuation allowance. The Company recognizes interest and penalties related to unrecognized tax positions in income tax expense. The Company had $0.6 million of gross interest and penalties accrued as of October 2, 2015. The Company will continue to review its tax positions and provide for, or reverse, unrecognized tax benefits as issues arise. As of October 2, 2015, the Company anticipates that the balance of gross unrecognized tax benefits will decrease up to approximately $1.4 million due to expiration of the applicable statues of limitations over the next 12 months.

NOTE 14: INCOME (LOSS) PER SHARE
The following table sets forth the computation of the basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Numerator:				
Net income (loss)	$(4,811)	$1,078	$(8,462)	$(41,394)
Denominator:				
Weighted average shares used to compute net income(loss) per share-basic	87,991	90,618	88,359	94,113
Effect of dilutive securities from stock options, restricted stock units and ESPP	—	1,182	—	—
Weighted average shares used to compute net income(loss) per share-diluted	87,991	91,800	88,359	94,113
Net income (loss) per share:				
Basic	$(0.05)	$0.01	$(0.10)	$(0.44)
Diluted	$(0.05)	$0.01	$(0.10)	$(0.44)

The following table sets forth the potentially dilutive shares from stock options, RSUs and the ESPP, for the periods presented, which were excluded from the net income (loss) per share computations because their effect was anti-dilutive (in thousands):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Potentially dilutive equity awards outstanding	8,817	5,196	9,403	9,321

NOTE 15: SEGMENT INFORMATION
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 Company’s Chief Operating Decision Maker (“CODM”), which for Harmonic is its Chief Executive Officer, in deciding how to allocate resources and assess performance. Prior to the fourth quarter of 2014, the Company operated its business in one reportable segment. In connection with the 2015 annual planning process, the Company changed its operating segments to align with how the CODM expected to evaluate the financial information used to allocate resources and assess performance of the Company. The new reporting structure consists of two operating segments: Video and Cable Edge. As a result, the segment information presented has been conformed to the new operating segments for all prior periods.

The new operating segments were determined based on the nature of the products offered. The Video segment sells video processing and production and playout solutions and services worldwide to broadcast and media companies, streaming new

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media companies, cable operators, and satellite and telecommunications (telco) Pay-TV service providers. The Cable Edge segment sells cable edge solutions and related services to cable operators globally.
The Company does not allocate amortization of intangibles, stock-based compensation, restructuring and asset impairment charges, and certain other non-recurring charges to the operating income for each segment because management does not include this information in the measurement of the performance of the operating segments. A measure of assets by segment is not applicable as segment assets are not included in the discrete financial information provided to the CODM.
The following tables provide summary financial information by reportable segment (in thousands):

	Three months ended		Nine months ended	
	October 2, 2015	September 26, 2014	October 2, 2015	September 26, 2014
Net revenue:				
Video	$71,889	$81,360	$219,378	$239,823
Cable Edge	11,416	26,701	71,046	85,859
Total consolidated net revenue	$83,305	$108,061	$290,424	$325,682
Operating income (loss):				
Video	$3,575	$6,609	$8,386	$9,426
Cable Edge	(3,963)	120	2,582	3,178
Total segment operating income (loss)	(388)	6,729	10,968	12,604
Unallocated corporate expenses*	(510)	(403)	(739)	(915)
Stock-based compensation	(3,827)	(4,352)	(11,845)	(12,720)
Amortization of intangibles	(1,532)	(5,512)	(4,971)	(18,378)
Loss from operations	(6,257)	(3,538)	(6,587)	(19,409)
Non-operating income (expense)	178	(214)	(2,702)	(185)
Loss before income taxes	$(6,079)	$(3,752)	$(9,289)	