

HARMONIC INC  
Form 10-Q  
August 10, 2016  
Table of Contents

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 July 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 August 1, 2016 was 78,030,325.

---

Table of Contents

TABLE OF CONTENTS

PART I

<u>ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)</u>	<u>3</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>36</u>
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>47</u>
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	<u>49</u>

PART II

<u>ITEM 1. LEGAL PROCEEDINGS</u>	<u>50</u>
<u>ITEM 1A. RISK FACTORS</u>	<u>50</u>
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>70</u>
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	<u>70</u>
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	<u>70</u>
<u>ITEM 5. OTHER INFORMATION</u>	<u>70</u>
<u>ITEM 6. EXHIBITS</u>	<u>70</u>
<u>SIGNATURES</u>	<u>71</u>

Table of Contents

## PART I

## FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## HARMONIC INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except per share data)

	July 1, 2016	December 31, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$51,516	\$126,190
Short-term investments	13,760	26,604
Accounts receivable, net	102,668	69,515
Inventories	36,624	38,819
Prepaid expenses and other current assets	43,317	25,003
Total current assets	247,885	286,131
Property and equipment, net	36,517	27,012
Goodwill	235,369	197,781
Intangibles, net	39,638	4,097
Other long-term assets	28,635	9,936
Total assets	\$588,044	\$524,957
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Other debts and capital lease obligations, current	\$7,829	\$—
Accounts payable	35,794	19,364
Income taxes payable	139	307
Deferred revenue	62,679	33,856
Accrued liabilities	52,346	31,354
Total current liabilities	158,787	84,881
Convertible notes, long-term	100,712	98,295
Other debts and capital lease obligations, long-term	16,190	—
Income taxes payable, long-term	3,980	3,886
Deferred tax liabilities, long-term	957	—
Other non-current liabilities	15,341	9,727
Total liabilities	295,967	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; 78,015 and 76,015 shares issued and outstanding at July 1, 2016 and December 31, 2015, respectively	78	76
Additional paid-in capital	2,245,120	2,236,418
Accumulated deficit	(1,949,767)	(1,903,908)
Accumulated other comprehensive loss	(3,354)	(4,418)
Total stockholders' equity	292,077	328,168
Total liabilities and stockholders' equity	\$588,044	\$524,957

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

Table of Contents

HARMONIC INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (Unaudited, in thousands, except per share data)

	Three months ended		Six months ended	
	July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Revenue:				
Product	\$77,413	\$77,447	\$135,057	\$157,920
Services	32,158	25,656	56,346	49,199
Total net revenue	109,571	103,103	191,403	207,119
Cost of revenue:				
Product	44,049	35,977	71,238	71,437
Services	14,482	12,741	28,471	26,269
Total cost of revenue	58,531	48,718	99,709	97,706
Total gross profit	51,040	54,385	91,694	109,413
Operating expenses:				
Research and development	26,507	21,816	50,070	44,145
Selling, general and administrative	36,516	31,281	69,386	62,477
Amortization of intangibles	4,232	1,446	6,597	2,892
Restructuring and related charges	1,903	185	4,515	229
Total operating expenses	69,158	54,728	130,568	109,743
Loss from operations	(18,118 )	(343 )	(38,874 )	(330 )
Interest (expense) income, net	(2,651 )	17	(5,072 )	72
Other income (expense), net	332	59	323	(447 )
Loss on impairment of long-term investment	—	—	(1,476 )	(2,505 )
Loss before income taxes	(20,437 )	(267 )	(45,099 )	(3,210 )
Provision for income taxes	242	727	760	441
Net loss	\$(20,679)	\$(994 )	\$(45,859 )	\$(3,651 )
Net loss per share:				
Basic and diluted	\$(0.27 )	\$(0.01 )	\$(0.59 )	\$(0.04 )
Shares used in per share calculation:				
Basic and diluted	77,342	88,426	77,168	88,541

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

Table of Contents

## HARMONIC INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in thousands)

	Three months ended		Six months ended	
	July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Net loss	\$ (20,679 )	\$ (994 )	\$ (45,859 )	\$ (3,651 )
Other comprehensive income (loss) before tax:				
Change in unrealized gains (losses) on cash flow hedges:				
Unrealized gains (losses) arising during the period	(165 )	516	158	332
Losses (gains) reclassified into earnings	22	(138 )	100	(187 )
	(143 )	378	258	145
Change in unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) arising during the period	(49 )	460	30	945
Loss reclassified into earnings	—	—	1,476	—
	(49 )	460	1,506	945
Change in foreign currency translation adjustments	(2,611 )	582	(677 )	(402 )
Other comprehensive income (loss) before tax	(2,803 )	1,420	1,087	688
Less: Provision for (benefit from) income taxes	5	(10 )	23	(6 )
Other comprehensive income (loss), net of tax	(2,808 )	1,430	1,064	694
Total comprehensive income (losses)	\$ (23,487 )	\$ 436	\$ (44,795 )	\$ (2,957 )

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

Table of Contents

HARMONIC INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited, in thousands)

	Six months ended	
	July 1, 2016	July 3, 2015
Cash flows from operating activities:		
Net loss	\$(45,859)	\$(3,651)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Amortization of intangibles	8,322	3,439
Depreciation	7,737	6,930
Stock-based compensation	5,862	8,018
Amortization of discount on convertible debt	2,417	—
Restructuring, asset impairment and loss on retirement of fixed assets	1,687	252
Loss on impairment of long-term investment	1,476	2,505
Deferred income taxes, net	38	—
Provision for excess and obsolete inventories	5,203	843
Allowance for doubtful accounts, returns and discounts	697	(713)
Excess tax benefits from stock-based compensation	—	(22)
Other non-cash adjustments, net	144	—
Changes in operating assets and liabilities, net of effects of acquisition:		
Accounts receivable	(16,000)	(1,222)
Inventories	3,158	(595)
Prepaid expenses and other assets	(4,148)	(11,635)
Accounts payable	2,168	6,415
Deferred revenue	25,956	9,833
Income taxes payable	(122)	(815)
Accrued and other liabilities	(7,029)	(5,994)
Net cash (used in) provided by operating activities	(8,293)	13,588
Cash flows from investing activities:		
Acquisition of business, net of cash acquired	(72,989)	—
Purchases of investments	—	(12,986)
Proceeds from maturities of investments	12,842	15,744
Purchases of property and equipment	(7,708)	(7,505)
Purchases of long-term investments	—	(85)
Net cash used in investing activities	(67,855)	(4,832)
Cash flows from financing activities:		
Payment of convertible debt issuance costs	(582)	—
Increase in other debts and capital leases	5,972	—
Repayment of other debts and capital leases	(6,524)	—
Payments for repurchase of common stock	—	(12,171)
Proceeds from common stock issued to employees	3,737	9,133
Payment of tax withholding obligations related to net share settlements of restricted stock units	(1,034)	(2,642)
Excess tax benefits from stock-based compensation	—	22
Net cash provided by (used in) financing activities	1,569	(5,658)
Effect of exchange rate changes on cash and cash equivalents	(95)	(81)
Net (decrease) increase in cash and cash equivalents	(74,674)	3,017
Cash and cash equivalents at beginning of period	126,190	73,032
Cash and cash equivalents at end of period	\$51,516	\$76,049

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

Table of Contents

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 six months ended July 1, 2016.

7

---

Table of Contents

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 addition, the FASB issued ASU 2016-08, ASU 2016-10, and ASU 2016-12 in March 2016, April 2016, and May 2016, respectively, to help provide interpretive clarifications on the new guidance in ASC Topic 606, Revenue from Contracts with Customers. The Company is in the process of assessing the impact these interpretive clarifications will 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.

In June 2016, the FASB issued new guidance that changes the impairment model for most financial assets and certain other instruments. For trade receivables and other instruments, the Company will be required to use a new forward-looking “expected loss” model. Additionally, credit losses on available-for-sale debt securities should be recorded through an allowance for credit losses limited to the amount by which fair value is below amortized cost. The new guidance 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 impact of adopting this new accounting guidance on its consolidated financial statements.

Table of Contents

## 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”), 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 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. The Company adopted this accounting standard update beginning in the first quarter of fiscal 2016. The adoption of this standard update did not have a material 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.

In September 2015, the FASB issued new guidance related to business combinations. The new guidance requires that any adjustments to provisional amounts in a business combination be recorded in the period such adjustments are determined, rather than retrospectively adjusting previously reported amounts. The Company adopted the amendments beginning in the first quarter of fiscal 2016. The adoption did not have a material 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. In the first quarter of 2016, the Company recorded a provisional purchase price of \$84.6 million, including an estimated contingent consideration of approximately \$8.0 million. In the second quarter of 2016, the Company recorded a \$2.1 million reduction to the contingent consideration upon finalizing the pending post-closing adjustments and as a result, the purchase price was reduced to \$82.5 million. Pursuant to the Securities Purchase Agreement entered into between the Company and the other parties thereto, dated February 11, 2016 (“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 Company believes that its acquisition of TVN has strengthened, and will continue 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

Table of Contents

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 as of July 1, 2016 was as follows (in thousands):

## Assets:

Cash and cash equivalents	\$7,063
Accounts receivable, net	14,923
Inventories	3,462
Prepaid expenses and other current assets	4,442
Property and equipment, net	9,988
French R&D tax credit receivables <sup>(1)</sup>	26,421
Other long-term assets	1,824
Total assets	\$68,123

## Liabilities:

Other debts and capital leases, current	8,362
Accounts payable	13,963
Deferred revenue	2,504
Accrued liabilities	18,524
Other debts and capital leases, long-term	16,087
Other long-term liabilities	6,415
Deferred tax liabilities	952
Total liabilities	\$66,807

Goodwill	37,630
Intangibles	43,600
Total purchase consideration	\$82,546

(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	21,400
Customer relationships	5 years	18,000
In-process research and development <sup>(1)</sup>	N/A	—
Trade name	4 years	600
		\$43,600

(1) By the end of the second quarter of 2016, the Company completed the TVN in-process research and development activities and as a result, the in-process research and development of \$1.0 million was reclassified to developed technology.

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 \$37.6 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.

10

---

Table of Contents

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.

The Company also acquired an indefinite lived asset of \$1.0 million which represents the fair value of in-process research and development activities that were estimated to be completed within six months of the acquisition date. The related research and development efforts were completed by the end of the second quarter of 2016 and the Company determined that it has become a finite lived intangible asset (developed technology) with an estimated useful life of four years.

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 July 1, 2016, \$18.3 million of revenue and \$6.9 million of gross margin from TVN were included in the Company’s Condensed Consolidated Statement of Operations. For the six months ended July 1, 2016, \$21.2 million of revenue and \$7.1 million of gross margin from TVN were included in the Company’s Condensed Consolidated Statement of Operations. Since the Company is in the process of integrating TVN’s operations, the Company believes it is impracticable to determine TVN’s stand-alone income(loss) from operations and net income(loss) and these measures are not meaningful representations of TVN’s stand-alone performance.

## Acquisition-and integration-related expenses

As a result of the TVN acquisition, the Company incurred acquisition-and integration-related expenses in aggregate of \$3.4 million and \$6.5 million for the three and six months ended July 1, 2016, respectively. These costs consisted of acquisition-related costs which include outside legal, accounting and other professional services as well as integrated-related costs which include incremental costs resulting from the TVN acquisition that are not expected to generate future benefits once the integration is fully consummated. These costs are expensed as incurred.

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

	Acquisition-related		Integration-related	
	Three months ended July 1, 2016	Six months ended July 1, 2016	Three months ended July 1, 2016	Six months ended July 1, 2016
Product cost of revenue	\$ —	\$ —	\$ 433	\$ 491
Research and development	—	—	500	550
Selling, general and administrative	885	3,321	1,585	2,137
Total acquisition- and integration-related expenses in operating expenses	885	3,321	2,085	2,687
Total acquisition- and integration-related expenses	\$ 885	\$ 3,321	\$ 2,518	\$ 3,178

## 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 unaudited pro forma combined results are provided for illustrative purpose only and are not indicative of the Company’s actual consolidation results.



The pro forma adjustments primarily relate to the amortization of acquired intangibles and interest expense related to financing arrangements. In addition, the unaudited pro forma net loss for the three and six months ended July 3, 2015 was adjusted to include \$3.4 million and \$6.5 million of acquisition- and integration- related expenses, respectively; and \$5.7 million and \$8.1 million reduction in revenue related to the fair value adjustment of deferred revenue. The unaudited pro forma net loss for the six months ended July 1, 2016 was adjusted to exclude \$6.5 million of acquisition- and integration- related expenses. These adjustments exclude the income tax impact.

Table of Contents

	Three months ended July 3, 2015	Six months ended July 1, 2016	July 3, 2015
	(in millions, except per share amounts)		
Net revenue	\$127.3	\$200.1	\$243.9
Net loss	(8.9 )	(40.3 )	(27.9 )
Net loss per share-basic and diluted	\$(0.10 )	\$(0.52 )	\$(0.31 )

## NOTE 4: 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 July 1, 2016				
Corporate bonds	\$ 13,752	\$ 9	\$ (1 )	\$ 13,760
Total short-term investments	\$ 13,752	\$ 9	\$ (1 )	\$ 13,760
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):

	July 1, 2016	December 31, 2015
Less than one year	\$12,424	\$19,642
Due in 1 - 2 years	1,336	6,962
Total short-term investments	\$13,760	\$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 and six months ended July 1, 2016 and July 3, 2015 were not material.

The Company's investments in equity securities of other privately and publicly held companies were \$5.4 million as of both July 1, 2016 and December 31, 2015, and such investments 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 July 1, 2016.

As of July 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.

Table of Contents

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 \$1.8 million at both July 1, 2016 and December 31, 2015, and Vislink’s accumulated unrealized loss, net of taxes was \$60,000 and \$1.5 million at July 1, 2016 and December 31, 2015, respectively.

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. In the second quarter of 2016, based on Vislink’s stock price on July 1, 2016, the Company recorded an unrealized loss of \$60,000, net of taxes, on the Vislink investment included in the Consolidated Balance Sheet as a component of “Accumulated other income (loss)”. Although at July 1, 2016, Vislink’s stock price did not deviate significantly from the reduced cost basis as at April 1, 2016, since July 6, 2016, Vislink’s stock price has decreased by approximately 50%. The Company will continue to monitor Vislink’s stock price and financial performance. A sustained decline in Vislink’s stock price may lead to further impairment later in 2016. The Company’s remaining maximum exposure to loss from the Vislink investment at July 1, 2016 was limited to its reduced investment cost of \$1.8 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.

Table of Contents

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 July 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 July 1, 2016 (in thousands):

	Carrying Value	Maximum exposure to loss <sup>(1)</sup>
VJU	\$ —	\$ —
EDC <sup>(2)</sup>	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 July 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 July 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)

14

---

Table of Contents

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 Accumulated Other Comprehensive Income (Loss) and Condensed Consolidated Statements of Operations were as follows (in thousands):

	Financial Statement Location	Three months ended		Six months ended	
		July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Derivatives designated as hedging instruments:					
Gains (losses) in AOCI on derivatives (effective portion)	AOCI	\$(165)	\$516	\$158	\$332
Gains (losses) reclassified from AOCI into income (effective portion)	Cost of Revenue	\$(3 )	\$19	\$(13 )	\$26
	Operating Expense	(19 )	119	(87 )	161
	Total	\$(22 )	\$138	\$(100)	\$187
Losses recognized in income on derivatives (ineffectiveness portion and amount excluded from effectiveness testing)	Other income (expense), net	\$(22 )	\$(10 )	\$(49 )	\$(52 )
Derivatives not designated as hedging instruments:					
Gains (losses) recognized in income	Other income (expense), net	\$(50 )	\$133	\$(334)	\$385

The Company anticipates the AOCI balance of \$12,000 at July 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):

	July 1, 2016	December 31, 2015
Derivatives designated as cash flow hedges:		
Purchase	\$6,001	\$12,984
Derivatives not designated as hedging instruments:		
Purchase	\$4,048	\$6,942
Sell	\$14,854	\$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):



Table of Contents

	Balance Sheet Location	Asset Derivatives		Balance Sheet Location	Derivative Liabilities	
		July 1, 2016	December 31, 2015		July 1, 2016	December 31, 2015
Derivatives designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	\$ 23	\$ 13	Accrued Liabilities	\$ 51	\$ 281
		\$ 23	\$ 13		\$ 51	\$ 281
Derivatives not designated as hedging instruments:						
Foreign currency contracts	Prepaid expenses and other current assets	\$ 36	\$ 100	Accrued Liabilities	\$ 74	\$ 90
		\$ 36	\$ 100		\$ 74	\$ 90
Total derivatives		\$ 59	\$ 113		\$ 125	\$ 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 July 1, 2016, information related to the offsetting arrangements was as follows (in thousands):

	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	\$ 59	—	\$ 59	\$ (36 )	—	\$ 23
Derivative Liabilities	\$ 125	—	\$ 125	\$ (36 )	—	\$ 89

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 July 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

Table of Contents

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 \$100.9 million and \$123.1 million as of July 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 July 1, 2016 were \$24.0 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 as of July 1, 2016 is 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. The Company's liability for TVN contingent consideration was \$2.5 million and \$8.0 million, respectively, as of July 1, 2016 and April 1, 2016. The \$5.5 million reduction in the second quarter of 2016 was primarily due to a \$3.5 million partial settlement and a \$2.0 million adjustment upon finalizing the pending post-closing adjustments. The liabilities for the assumed TVN employee equity plans of approximately \$2.9 million were fully paid in the second quarter of 2016 and there were no other outstanding amounts under these plans at July 1, 2016.

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

Table of Contents

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

	Level 1	Level 2	Level 3	Total
As of July 1, 2016				
Cash equivalents				
Money market funds	\$8,433	\$—	\$—	—\$8,433
Short-term investments				
Corporate bonds	—	13,760	—	13,760
Prepays and other current assets				
Time deposit pledged for credit card facility	—	580	—	580
Derivative assets	—	59	—	59
Other assets				
Long-term investment	1,810	—	—	1,810
Total assets measured and recorded at fair value	\$10,243	\$14,399	\$—	—\$24,642
Accrued liabilities				
Derivative liabilities	—	125	—	125
Total liabilities measured and recorded at fair value	\$—	\$125	\$—	—\$125
	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	\$—	—\$371

## NOTE 8: BALANCE SHEET COMPONENTS

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

	July 1, 2016	December 31, 2015
Accounts receivable, net:		
Accounts receivable	\$107,558	\$73,855
Less: allowances for doubtful accounts, returns and discounts	(4,890 )	(4,340 )
Total	\$102,668	\$69,515

Table of Contents

	July 1, 2016	December 31, 2015
Prepaid expenses and other current assets:		
Prepaid inventories to contract manufacturer <sup>(1)</sup>	\$8,500	\$ 8,500
Prepaid maintenance, royalty, rent and property taxes	6,530	5,974
Other Prepayments	7,242	2,762
Deferred cost of revenue	10,353	4,601
French R&D tax credits receivable <sup>(2)</sup>	6,203	—
Restricted cash <sup>(3)</sup>	1,328	1,093
Other	3,161	2,073
Total	\$43,317	\$ 25,003

(1) From time to time, the Company makes advance payment to a supplier for future inventory in order to secure more favorable pricing. The Company anticipates that this amount will be offset in the first quarter of 2017 against the accounts payable owed to this supplier.

(2) The Company's acquired TVN subsidiary in France (the "TVN French Subsidiary") participates in the French Crédit d'Impôt Recherche ("CIR") program (the "R&D tax credits") which allows companies to monetize eligible research expenses. The French R&D tax credits can be used to offset against income tax payable to the French government in each of the four years after being incurred, or if not utilized, are recoverable in cash. The amount of French R&D tax credits recoverable are subject to audit by the French government and during the second quarter of 2016, the French government approved the 2012 claim and refunded \$5.8 million to the TVN French Subsidiary. The remaining R&D tax credit receivables at July 1, 2016 were approximately \$23.1 million and are expected to be recoverable from 2017 through 2020 with \$6.2 million reported under "Prepaid and other Current Assets" and \$16.9 million reported under "Other Long-term Assets" on the Company's Condensed Consolidated Balance Sheets. Pursuant to the TVN Purchase Agreement, the Company is indemnified by the selling shareholders with respect to the validity and recoverability of the outstanding TVN French Subsidiary R&D tax credit receivables.

(3) The restricted cash balances are primarily held as cash collateral security for certain bank guarantees. 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. Additionally, as of July 1, 2016, the Company recorded approximately \$1.1 million of restricted cash for the bank guarantee associated with the TVN French Subsidiary's office building lease. This amount is reported under "Other Long-term Assets" on the Company's Condensed Consolidated Balance Sheets.

	July 1, 2016	December 31, 2015
Inventories:		
Raw materials	\$7,824	\$ 5,421
Work-in-process	1,186	1,950
Finished goods	15,640	19,827
Service-related spares	11,974	11,621
Total	\$36,624	\$ 38,819

	July 1, 2016	December 31, 2015
Property and equipment, net:		
Furniture and fixtures	\$9,026	\$ 7,808
Machinery and equipment	96,257	93,010
Capitalized software	34,428	29,391
Leasehold improvements	13,891	10,000
Property and equipment, gross	153,602	140,209
Less: accumulated depreciation and amortization	(117,085)	(113,197)

Total \$36,517 \$27,012

19

---

Table of Contents

	July 1, 2016	December 31, 2015
Accrued Liabilities:		
Accrued employee compensation and related expenses	\$ 18,379	\$ 12,083
Accrued sales and use tax and property taxes	3,540	1,743
Accrued TVN contingent consideration <sup>(1)</sup>	2,483	—
Accrued warranty	5,095	3,913
Accrued royalty payments	2,487	873
Contingent inventory reserves	3,649	1,315
Customer deposits and accrued customer rebates	4,319	1,851
Others	12,394	9,576
Total	\$52,346	\$ 31,354

(1) The TVN acquisition is subject to post-closing adjustments as set forth in the TVN Purchase Agreement to be determined within 90 days from the acquisition date in amounts capped to (i) the difference between €76 million (approximately \$83.3 million as converted from euros into U.S. dollars using an agreed upon average exchange rate) and \$75 million, with respect to an adjustment based on TVN's 2015 revenue, and (ii) up to \$5 million with respect to an adjustment based on TVN's 2015 backlog that ships during the first half of 2016. During the second quarter of 2016, the Company paid \$3.5 million upon the finalization of the revenue and working capital adjustments. The remaining backlog adjustment amount has been finalized at \$2.5 million and will be paid in the third quarter of 2016.

**NOTE 9: GOODWILL AND IDENTIFIED INTANGIBLE ASSETS****Goodwill**

Goodwill represents the difference between the purchase price and the estimated fair value of the identifiable assets acquired and liabilities assumed. The Company tests for goodwill impairment at the reporting unit level on an annual basis, or more frequently if events or changes in circumstances indicate that the asset is more likely than not impaired. The Company's annual goodwill impairment test is performed in the fiscal fourth quarter, with a testing date at the end of October.

In the first quarter of 2016, the Company preliminary recorded additional goodwill of \$39.2 million related to the TVN acquisition based on the preliminary allocation of the estimated purchase consideration. The Company adjusted the goodwill to \$37.6 million in the second quarter of 2016 primarily due to a \$2.0 million reduction in the estimate of the contingent purchase consideration, and, to a lesser extent, changes to certain assets, liabilities and tax estimates. (See Note 3, "Business Acquisition" for additional information). 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). Goodwill from the TVN acquisition was assigned to the Video reporting unit.

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

	Video	Cable Edge	Total
As of December 31, 2015	\$ 136,904	\$ 60,877	\$ 197,781
Preliminary estimate of goodwill from TVN acquisition	37,630	—	37,630
Foreign currency translation adjustment	26	(68 )	(42 )
As of July 1, 2016	\$ 174,560	\$ 60,809	\$ 235,369

The Company performs its annual goodwill impairment review of its two reporting units, which are the same as its operating segments, during the fourth fiscal quarter of 2015. The 2015 annual testing concluded that goodwill was not impaired as the Video and Cable Edge reporting units had estimated fair values in excess of their carrying value by approximately 87% and 42%, respectively.

A significant decline in a company's stock price may suggest that an adverse change in the business climate may have caused the fair value of one or more reporting units to fall below their carrying value. During the second quarter of 2016, the sustained decline in the Company's stock price led to a triggering event for goodwill impairment assessment. As of July 1, 2016, with a closing stock price of \$3.01 on the NASDAQ stock exchange, the Company's market capitalization was approximately \$235 million. As this market capitalization was less than the Company's net book value, further analysis was performed to determine if an impairment exists. When assessing goodwill for impairment, the Company used multiple



valuation methodologies to determine its enterprise value. The valuation methods used included the Company's market capitalization adjusted for a control premium and the Company's discounted cash flow analysis, which involves making significant assumptions and estimates, including expectations of the Company's future financial performance, the Company's weighted average cost of capital and the Company's interpretation of currently enacted tax laws. Based on the impairment test performed, management determined that the Company's goodwill was not impaired as of July 1, 2016. The Company believes that the fluctuation in market capitalization is driven by general market movement and not Company specific factors.

The Company has not recorded any impairment charges related to goodwill for any prior periods.

#### Intangible Assets

In the six months ended July 1, 2016, the gross amount for intangible assets increased \$43.8 million due to the TVN acquisition. The following is a summary of intangible assets (in thousands):

	Weighted Average Remaining Life (Years)	July 1, 2016			December 31, 2015		
		Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed core technology	3.7	\$32,489	\$(12,695)	\$19,794	\$10,987	\$(10,987)	\$—
Customer relationships/contracts	4.4	47,286	(29,392)	17,894	29,200	(25,752)	3,448
Trademarks and trade names	3.7	603	(50)	553	—	—	—
Maintenance agreements and related relationships	0.2	5,500	(5,309)	191	5,500	(4,851)	649
Order Backlog	0.2	3,617	(2,411)	1,206	—	—	—
Total identifiable intangibles		\$89,495	\$(49,857)	\$39,638	\$45,687	\$(41,590)	\$4,097

The TVN in-process research and development efforts were completed by the end of the second quarter of 2016 and the Company determined that it has become a finite lived intangible asset (developed technology) with an estimated useful life of four years.

Amortization expense for the identifiable purchased intangible assets for the three and six months ended July 1, 2016 and July 3, 2015 was allocated as follows (in thousands):

	Three months ended		Six months ended	
	July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Included in cost of revenue	\$1,307	\$86	\$1,725	\$547
Included in operating expenses	4,232	1,446	6,597	2,892
Total amortization expense	\$5,539	\$1,532	\$8,322	\$3,439

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,			
2016 (remaining six months)	\$ 2,688	\$ 4,295	\$6,983
2017	5,376	3,768	9,144
2018	5,376	3,768	9,144
2019	5,376	3,768	9,144
2020	978	3,642	4,620
Thereafter	—	603	603
Total future amortization expense	\$ 19,794	\$ 19,844	\$39,638

#### NOTE 10: 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 asset impairment charges (in thousands):

	Three months ended	Six months ended	July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Restructuring and asset impairment charges in:						
Product cost of revenue	\$6	\$ —	\$(23	)	\$ —	
Operating expenses-Restructuring and related charges	1,903	185	4,515	229		
Total restructuring and related charges	\$1,909	\$ 185	\$4,492	\$ 229		

#### Harmonic 2016 Restructuring

In the first quarter of 2016, the Company implemented a new restructuring plan (the “Harmonic 2016 Restructuring Plan”) to streamline the corporate organization, thereby reducing operating costs by consolidating duplicative resources in connection with the acquisition of TVN. The planned activities have primarily resulted, and will primarily result, in cash expenditures related to severance and related benefits and exiting certain operating facilities and disposing of excess assets. The Company anticipates spending approximately \$22 million to \$24 million in 2016, in aggregate, on the Harmonic 2016 Restructuring Plan and TVN acquisition- and integration-related expenses. The activities under the Harmonic 2016 Restructuring Plan are expected to take at least 12 months to complete and the estimated synergies from this plan and the TVN integration effort is approximately \$20 million to \$22 million, which the Company anticipates within two years.

The Company recorded \$1.9 million and \$4.5 million of restructuring and related charges under the Harmonic 2016 Restructuring Plan, in the three and six months ended July 1, 2016, respectively. The restructuring and related charges in the three months ended July 1, 2016 consisted of \$1.9 million of severance and benefits for the termination of eight employees worldwide. The restructuring and related charges in the six months ended July 1, 2016 consisted of \$1.4 million of costs related to the Company exiting an excess facility at its U.S. headquarters, \$3.0 million of severance and benefits for the termination of 21 employees worldwide and \$0.2 million of other charges. The Company incurred \$3.4 million and \$6.5 million of TVN acquisition- and integration-related expenses in the three and six months ended July 1, 2016, respectively. (See Note 3, “Business Acquisition” for additional information on TVN acquisition-and integration-related expenses).

In January 2016, the Company exited an excess facility at its U.S. headquarters in San Jose, California and recorded \$1.4 million in facility exit costs. The Company accounts for facility exit costs in accordance with ASC 420, "Exit or Disposal Cost Obligations", which requires that a liability for such costs be recognized and measured initially at fair value on the cease-use

Table of Contents

date based on remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized, reduced by the estimated sublease rentals that could be reasonably obtained even if it is not the intent to sublease. The fair value of these liabilities is based on a net present value model using a credit-adjusted risk-free rate. The liability will be paid out over the remainder of the leased properties' terms, which continue through August 2020. Actual sublease terms may differ from the estimates originally made by the Company. Any future changes in the estimates or in the actual sublease income could require future adjustments to the liabilities, which would impact net income in the period the adjustment is recorded. As of the cease-use date, the fair value of this restructuring liability totaled \$2.5 million. Offsetting these charges was an adjustment for deferred rent liability relating to this space of \$1.1 million.

In the second quarter of 2016, the Company initiated a consultative process with the works council for the acquired French subsidiary and applicable union representatives to establish a voluntary departure plan to enable French employees of TVN to voluntarily terminate with certain benefits. The Company expects the consultation process and the terms of the voluntary departure plan to be finalized in the third quarter of 2016.

The following table summarizes the activity in the Company's restructuring accrual related to the Harmonic 2016 Restructuring Plan during the six months ended July 1, 2016 (in thousands):

	Excess facilities	Severance and benefits (1)	Other charges	Total
Charges for 2016 Harmonic Restructuring Plan	\$ 1,418	\$ 2,893	\$ 246	\$ 4,557
Reclassification of deferred rent	1,087	—	—	1,087
Cash payments	(468 )	(1,331 )	—	(1,799 )
Non-cash write-offs	—	—	(246 )	(246 )
Foreign exchange gain (loss)	—	(5 )	—	(5 )
Balance at July 1, 2016	\$ 2,037	\$ 1,557	\$ —	\$ 3,594

(1) The Company anticipates that the remaining severance and benefits accrual at July 1, 2016 will be substantially paid out by the end of 2016.

**Harmonic 2015 Restructuring**

In the fourth quarter of 2014, the Company implemented a restructuring plan (the "Harmonic 2015 Restructuring Plan") to reduce 2015 operating costs and the planned restructuring activities involve headcount reduction, exiting certain operating facilities and disposing of excess assets. The Company recorded \$2.2 million and \$1.5 million of restructuring and impairment charges under the Harmonic 2015 Restructuring Plan in fiscal 2014 and 2015, respectively, consisting primarily of severance and benefits for the termination of 56 employees worldwide as well as a fixed asset impairment charge related to software development costs incurred for a discontinued information technology ("IT") project. No new activities are anticipated in 2016 for the Harmonic 2015 Restructuring Plan and the remaining restructuring accrual for this plan is expected to be fully settled in the third quarter of 2016.

The following table summarizes the activity in the Company's restructuring accrual related to the Harmonic 2015 Restructuring Plan during the six months ended July 1, 2016 (in thousands):

	Severance and benefits (2)
Balance at December 31, 2015	\$ 264
Adjustments to restructuring provisions	(65 )

Cash payments	(194 )
Balance at July 1, 2016	\$ 5

(2) The Company anticipates that the remaining restructuring accrual as of July 1, 2016 will be fully settled in the third quarter of 2016.

NOTE 11: CONVERTIBLE NOTES, OTHER DEBTS AND CAPITAL LEASES

4.00% Convertible Senior Notes

23

---

Table of Contents

In December 2015, the Company issued \$128.25 million aggregate principal amount of unsecured convertible senior notes due 2020 (the “offering” or “Notes”, as applicable) through a private placement with a financial institution. The Notes do not contain any financial covenants. The Notes bear interest at a fixed rate of 4.00% per year, payable semiannually in arrears on June 1 and December 1 of each year, beginning on June 1, 2016. The Notes will mature on December 1, 2020, unless earlier repurchased or converted. The Company incurred approximately \$4.1 million of debt issuance cost, of which \$3.5 million was paid in 2015 and the remainder was paid in the first quarter of 2016.

Concurrent with the closing of the offering, the Company used \$49.9 million of the net proceeds to repurchase 11.1 million shares of the Company’s common stock from purchasers of the offering in privately negotiated transactions effected through the initial purchaser or its affiliate as the Company’s agent. Additionally, the Company used the remaining net proceeds from the offering to fund the TVN acquisition, which closed on February 29, 2016.

Subject to satisfaction of certain conditions and during certain periods, the Notes will be convertible at the option of holders into cash, shares of the Company’s common stock or a combination thereof, at the Company’s election, at an initial conversion rate of 173.9978 shares of Common Stock per \$1,000 principal amount of Notes (which is equivalent to an initial conversion price of approximately \$5.75 per share). The conversion rate and the corresponding conversion price will be subject to adjustment upon the occurrence of certain events.

Prior to September 1, 2020, the Notes will be convertible only under the following circumstances: (1) during any fiscal quarter commencing after the fiscal quarter ending on April 1, 2016 (and only during such fiscal quarter), if the last reported sale price of the Company’s common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the conversion price of the Notes on each applicable trading day; (2) during the five business day period after any five consecutive trading day period (the “ measurement period ”) in which the trading price per \$1,000 principal amount of Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company’s common stock and the conversion rate on each such trading day; or (3) upon the occurrence of specified corporate events. Commencing on September 1, 2020 until the close of business on the second scheduled trading day immediately preceding the maturity date, the Notes will be convertible in multiples of \$1,000 principal amount regardless of the foregoing circumstances.

If a fundamental change occurs, holders of the Notes may require the Company to purchase all or any portion of their Notes for cash at a repurchase price equal to 100% of the principal amount of the Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the fundamental change repurchase date. In addition, if specific corporate events occur prior to the maturity date, the conversion rate may be increased for a holder who elects to convert the Notes in connection with such a corporate event.

In accounting for the issuance of the Notes, the Company separated the Notes into liability and equity components. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the initial proceeds of the Notes as a whole. The difference between the initial proceeds of the Notes and the liability component (the “debt discount”) of \$26.9 million is amortized to interest expense using the effective interest method over the term of the Notes. The equity component of the Notes is included in additional paid-in capital in the Consolidated Balance Sheets and is not remeasured as long as it continues to meet the conditions for equity classification.

In accounting for the transaction costs related to the issuance of the Notes, the Company allocated the total amount of \$4.1 million incurred to the liability and equity components using the same proportions as the proceeds from the Notes. Transaction costs attributable to the liability component were \$3.2 million and were recorded as a direct deduction from the carrying amount of the debt liability in long-term liability in the Condensed Consolidated Balance Sheets and are being amortized to interest expense in the Condensed Consolidated Statements of Operations using the effective interest method over the term of the Notes. Transaction costs attributable to the equity component were \$0.9 million and were netted with the equity component of the Notes in additional paid-in capital in the Condensed Consolidated Balance Sheets.

The following table presents the components of the Notes as of July 1, 2016 and December 31, 2015 (in thousands, except for years and percentages):



Table of Contents

	July 1, 2016	December 31, 2015		
Liability:				
Principal amount	\$ 128,250	\$ 128,250		
Less: Debt discount, net of amortization	(24,575 )	(26,732 )		
Less: Debt issuance costs, net of amortization	(2,963 )	(3,223 )		
Carrying amount	\$ 100,712	\$ 98,295		
Remaining amortization period (years)	4.4	4.9		
Effective interest rate on liability component	9.94	% 9.94	%	%

## Equity:

Value of conversion option	\$ 26,925	\$ 26,925		
Less: Equity issuance costs	(863 )	(863 )		
Carrying amount	\$ 26,062	\$ 26,062		

The following table presents interest expense recognized for the Notes (in thousands):

	Three months ended		Six months ended	
	July 1, 2016	July 3, 2015	July 1, 2016	July 3, 2015
Contractual interest expense	\$ 1,282	\$ —	—\$ 2,565	\$ —
Amortization of debt discount	1,098	—	2,157	—
Amortization of debt issuance costs	132	—	260	—
Total interest expense recognized	\$ 2,512	\$ —	—\$ 4,982	\$ —

## Other Debts and Capital Leases

In connection with the TVN acquisition, the Company assumed a variety of debt and credit facilities in France to satisfy the financing requirements of TVN operations. These arrangements are summarized in the table below (in thousands):

	July 1, 2016	
Financing from French government agencies related to various government incentive programs <sup>(1)</sup>	\$	18,977
Term loans <sup>(2)</sup>	1,616	
Secured borrowings <sup>(3)</sup>	1,100	
Obligations under capital leases	2,326	
Total debt obligations	24,019	
Less: current portion	(7,829	)
Long-term portion	\$	16,190

Other than the 4.00% Notes, the Company did not have any other indebtedness as of December 31, 2015.

(1) As of July 1, 2016, the Company's TVN French Subsidiary had an aggregate of \$19.0 million of loans due to various financing programs of French government agencies, \$15.4 million of which is related to loans backed by French R&D tax credit receivables. As of July 1, 2016, the TVN French Subsidiary had an aggregate of \$23.1 million of R&D tax credit receivables from the French government from 2017 through 2020. (See Note 8, "Balance Sheet



Components-Prepaid expenses and other current assets” for more information). The R&D tax loans have a fixed rate of 0.6%, plus EURIBOR 1 month + 1.3% and matures between 2017 through 2019. The remaining loans of \$3.6 million at July 1, 2016 primarily relates to financial support from French government agencies for R&D innovation projects at minimal interest rates and these loans mature between 2020 through 2023.

(2) One of the term loans with a certain financial institution contains annual covenants that require the TVN French Subsidiary to maintain a minimum working capital balance and various other financial covenants and restrictions that limit the French

25

---

Table of Contents

Subsidiary's ability to incur additional indebtedness. The annual covenant is based on French statutory year-end results and the French subsidiary was in compliance for 2015.

(3) The TVN French Subsidiary obtained advances under a credit line with BPI France against a pool of eligible receivables with recourse. The maximum advance under this credit line for receivables is €2 million (approximately \$2.2 million as converted using the exchange rate at July 1, 2016), less applicable fees, and €200,000 (approximately \$0.2 million as converted using the exchange rate at July 1, 2016) of cash is pledged for this program. This credit line was renewed in July 2016 for an additional year with no material change to the terms of the credit agreement. The TVN French Subsidiary also entered into an accounts receivable financing agreement with GE Capital Cofacredit, ("GE") on September 27, 2013, which is subject to automatic renewal unless cancelled. GE advances up to 90% of qualified customer invoices and holds the remaining 10% as a guarantee fund up with a minimum of €80,000 (approximately \$0.1 million as converted using the exchange rate at July 1, 2016). In addition, another 10% of outstanding receivables is set aside in a holdback receivable and released upon payments received from the customers. These arrangements are treated as secured borrowings in accordance with FASB ASC 860, Transfers and Servicing. Future minimum repayments

The table below shows the future minimum repayments of debts and capital lease obligations as of July 1, 2016 (in thousands):

Years ending December 31,	Capital lease obligations	Debt obligations
2016 (remaining six months)	\$ 590	\$ 1,354
2017	1,116	5,622
2018	527	5,779
2019	67	6,662
2020	26	665
Thereafter	—	1,611
Total	\$ 2,326	\$ 21,693

## Credit Facilities

The Company's credit agreement with JPMorgan expired on February 20, 2016 and the Company did not renew the agreement or enter into any new credit agreement.

## NOTE 12: EMPLOYEE BENEFIT PLANS AND STOCK-BASED COMPENSATION

The Company's stock benefit plans include the employee stock purchase plan and current active stock plans adopted in 1995 and 2002 as well as one stock plan in connection with an acquisition in 2010. See Note 13, "Employee Benefit Plans and Stock-based Compensation" of Notes to Consolidated Financial Statements in the 2015 Form 10-K for details pertaining to each plan. The Company also assumed two existing TVN's employee equity benefit plans in connection with the TVN acquisition.

## Stock Options and RSUs

In connection with the Company's acquisition of TVN, the Company agreed to make grants of restricted stock units ("RSUs") with respect to a total of up to 1,750,000 shares (taking into account the share count provision for RSUs in the Company's 1995 Stock Plan). The Company's stockholders approved an amendment to the 1995 Stock Plan at the Company's 2016 annual meeting of stockholders ("2016 Annual Meeting") which increased the number of shares of common stock reserved for issuance under the 1995 Stock Plan by 2,000,000 shares.

The following table summarizes the Company's stock option and RSU activities during the six months ended July 1, 2016 (in thousands, except per share amounts):