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 June 29, 2007

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission File No. 0-25826

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)**

549 Baltic Way
Sunnyvale, CA 94089
(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 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" (as defined in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer ☐ **Accelerated filer** ☑ **Non-accelerated filer** ☐

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 outstanding of the Registrant's Common Stock, $.001 par value, was 79,765,014 on July 27, 2007.

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PART I

FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

HARMONIC INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(In thousands, except par value amounts)	June 29, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,421	$ 33,454
Short-term investments	60,798	58,917
Accounts receivable, net of allowances of $4,791 and $4,471	62,476	64,674
Inventories	42,508	42,116
Prepaid expenses and other current assets	16,387	12,807
Total current assets	203,590	211,968
Property and equipment, net	14,011	14,816
Goodwill	37,204	37,141
Intangibles, net	14,483	16,634
Other assets	1,415	1,403
Total assets	$ 270,703	$ 281,962
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ —	$ 460
Accounts payable	16,716	33,863
Income taxes payable	480	7,098
Deferred revenue	28,844	29,052
Accrued liabilities	37,756	44,097
Total current liabilities	83,796	114,570
Accrued excess facilities costs, long-term	13,403	16,434
Income taxes payable, long-term	8,040	—
Other non-current liabilities	7,045	5,824
Total liabilities	112,284	136,828
Commitments and contingencies (Notes 15,16 and 17)		
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; 79,410 and 78,386 shares issued and outstanding	79	78
Capital in excess of par value	2,086,992	2,078,863
Accumulated deficit	(1,928,442)	(1,933,708)
Accumulated other comprehensive loss	(210)	(99)
Total stockholders' equity	158,419	145,134
Total liabilities and stockholders' equity	$ 270,703	$ 281,962

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

HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share amounts)	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Product sales	$ 64,066	$ 46,662	$ 130,022	$ 98,446
Service revenue	7,216	6,608	11,497	11,045
Net sales	71,282	53,270	141,519	109,491
Product cost of sales	37,501	29,061	78,417	63,242
Service cost of sales	3,216	2,603	5,385	4,763
Total cost of sales	40,717	31,664	83,802	68,005
Gross profit	30,565	21,606	57,717	41,486
Operating expenses:				
Research and development	9,605	9,585	20,597	19,533
Selling, general and administrative	15,771	15,979	31,446	31,692
Amortization of intangibles	111	43	222	135
Total operating expenses	25,487	25,607	52,265	51,360
Income (loss) from operations	5,078	(4,001)	5,452	(9,874)
Interest income, net	990	1,175	1,986	2,167
Other expense, net	7	128	(16)	36
Income (loss) before income taxes	6,075	(2,698)	7,422	(7,671)
Provision for (benefit from) income taxes	(174)	205	57	380
Net income (loss)	$ 6,249	$ (2,903)	$ 7,365	$ (8,051)
Net income (loss) per share				
Basic	$ 0.08	$ (0.04)	$ 0.09	$ (0.11)
Diluted	$ 0.08	$ (0.04)	$ 0.09	$ (0.11)
Weighted average shares				
Basic	79,361	74,167	79,164	74,134
Diluted	80,480	74,167	80,304	74,134

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

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HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(In thousands)	Six Months Ended	
	June 29, 2007	June 30, 2006
Cash flows from operating activities:		
Net income (loss)	$ 7,365	$ (8,051)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Amortization of intangibles	2,151	458
Depreciation	3,347	3,993
Stock-based compensation	2,786	3,130
Net loss (gain) on disposal and impairment of fixed assets	(60)	20
Changes in assets and liabilities, net of effect of acquisition:		
Accounts receivable, net	2,172	7,630
Inventories	(383)	7,564
Prepaid expenses and other assets	(3,706)	(3,731)
Accounts payable	(16,913)	(3,129)
Deferred revenue	1,622	(3,248)
Income taxes payable	(664)	319
Accrued excess facilities costs	(2,646)	(2,335)
Accrued and other liabilities	(5,054)	698
Net cash provided by (used in) operating activities	(9,983)	3,318
Cash flows from investing activities:		
Purchases of investments	(53,843)	(39,431)
Proceeds from sales of investments	51,928	49,024
Acquisition of property and equipment	(2,482)	(2,404)
Acquisition costs related to the merger of Entone Technologies, Inc.	(2,466)	—
Net cash provided by (used in) investing activities	(6,863)	7,189
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	5,329	2,145
Repayments under bank line and term loan	(460)	(418)
Repayments of capital lease obligations	(43)	(41)
Net cash provided by financing activities	4,826	1,686
Effect of exchange rate changes on cash and cash equivalents	(13)	(41)
Net increase (decrease) in cash and cash equivalents	(12,033)	12,152
Cash and cash equivalents at beginning of period	33,454	37,818
Cash and cash equivalents at end of period	$ 21,421	$ 49,970
Supplemental disclosure of cash flow information:		
Income tax payments, net	$ 768	$ 138
Interest paid during the period	$ 66	$ 59

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

HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Basis of Presentation

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. ("Harmonic," the "Company" or "we") considers necessary for a fair presentation 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 15, 2007. 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, 2007, or any other future period. The Company's fiscal quarters end on the Friday nearest the calendar quarter end, 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.

Use of Estimates. The preparation of the consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Note 2: Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" (SFAS No. 157). This statement clarifies the definition of fair value, establishes a framework for measuring fair value, and expands the disclosures on fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We have not determined the effect, if any, the adoption of this statement in the first quarter of 2008 will have on our results of operations or financial position.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, e.g., debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS 159, changes in fair value are recognized in earnings. SFAS 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by Harmonic in the first quarter of fiscal 2008. Harmonic currently is determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS 159 will have on its consolidated results of operations and financial condition.

The Company adopted Financial Standards Accounting Board Interpretation No. 48, "Accounting for Uncertainty in Income Taxes — an Interpretation of FASB Statement No. 109" (FIN 48) on January 1, 2007. FIN 48 clarifies the

accounting and reporting for uncertainties in income tax law. FIN 48 prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. See Note 10 for additional information, including the effects of adoption on the Company's condensed consolidated financial statements.

Note 3: Entone Acquisition

On December 8, 2006, Harmonic acquired Entone Technologies, Inc., or Entone, pursuant to the terms of an Agreement and Plan of Merger (the "Merger Agreement") dated August 21, 2006. Under the terms of the merger agreement, Entone spun off its consumer premise equipment business, or CPE business, to Entone's existing stockholders prior to closing. Entone then merged into Harmonic, and Harmonic acquired Entone's VOD business, which includes the development, sale and support of head-end equipment (software and hardware) and associated services for the creation, distribution and delivery of on-demand television programming to operators who offer such programming to businesses and consumers. Harmonic believes Entone's software solution, which facilitates the provisioning of personalized video services including video-on-demand, network personal video recording, time-shifted television and targeted advertisement insertion, will enable Harmonic to expand the scope of solutions we can offer to cable, satellite and telco/IPTV service providers in order to provide an advanced and uniquely integrated delivery system for the next generation of both broadcast and personalized IP-delivered video services. These opportunities, along with the established Asia-based software development workforce, were significant factors to the establishment of the purchase price, which exceeded the fair value of Entone's net tangible and intangible assets acquired resulting in the amount of goodwill we have recorded with this transaction. Management has made a preliminary allocation of the estimated purchase price to the tangible and intangible assets acquired and liabilities assumed based on various preliminary estimates. The allocation of the estimated purchase price is preliminary pending finalization of various estimates and analyses.

The purchase price of $49.0 million included $26.2 million in cash, $20.1 million of stock issued, consisting of 3,579,715 shares of Harmonic common stock, $0.2 million in stock options assumed, and $2.5 million of transaction costs. Stock options to purchase Harmonic common stock totaling 175,342 shares were issued to reflect the conversion of all outstanding Entone options for continuing employees. The fair value of Harmonic's stock options issued to Entone employees were valued at $925,000 using the Black-Scholes options pricing model of which $697,000 represented unearned stock-based compensation, which is being recorded as compensation expense as services are provided by optionholders, and $228,000 was recorded as purchase consideration. As part of the terms of the Merger Agreement, Harmonic was obligated to purchase a convertible note with a face amount of $2.5 million in the new spun off private company subject to closing of an initial round of equity financing in which at least $4 million is invested by third parties. This note was funded in July 2007.

The Entone acquisition was accounted for under SFAS No. 141 and certain specified provisions of SFAS No. 142. The results of operations of Entone are included in Harmonic's Consolidated Statements of Operations from December 8, 2006, the date of acquisition. The following table summarizes the preliminary allocation of the

purchase price based on the estimated fair value of the tangible assets acquired and the liabilities assumed at the date of acquisition:

	(in thousands)
Cash acquired	$ —
Accounts receivable	297
Inventory	184
Fixed assets	313
Other tangible assets acquired	22
Amortizable intangible assets:	
Existing technology	11,600
Core technology	2,800
Customer relationships	1,700
Tradenames/trademarks	800
Goodwill	32,412
Total assets acquired	50,128
Accounts payable	(855)
Deferred revenue	(166)
Other accrued liabilities	(146)
Net assets acquired	$ 48,961

The purchase price was allocated as set forth in the table above. The "Income Approach" which includes an analysis of the markets, cash flows and risks associated with achieving such cash flows, was the primary method used in valuing the identified intangibles acquired. The Discounted Cash Flow method was used to estimate the fair value of the acquired existing technology and customer relationships. The Royalty Savings Method was used to estimate the fair value of the acquired core technology and trademarks/trade names. In the Royalty Savings Method, the value of an asset is estimated by capitalizing the royalties saved because the Company owns the asset. Expected cash flows were discounted at the Company's weighted average cost of capital of 18%. Identified intangible assets, including existing technology and core technology are being amortized over their useful lives of three to four years; tradename/trademarks are being amortized over their useful lives of five years; and customer relationships are being amortized over its useful life of six years.

The residual purchase price of $32.4 million has been recorded as goodwill. The goodwill as a result of this acquisition is not expected to be deductible for tax purposes. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill relating to the acquisition of Entone is not being amortized and will be tested for impairment annually or whenever events indicate that an impairment may have occurred.

The following unaudited pro forma financial information presented below summarizes the combined results of operations as if the merger had been completed as of the beginning of January 1, 2006. The unaudited pro forma financial information for the three and six months ended June 30, 2006 combines the results for Harmonic for the three and six months ended June 30, 2006, and the historical results of Entone's VOD business for the three and six months ended June 30, 2006. The pro forma financial information is presented for informational purposes only and does not purport to be indicative of what would have occurred had the merger actually been completed on such date or of results which may occur in the future.

(in thousands, except per share data)	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
Net sales	$ 55,019	$ 111,574
Net loss	$ (4,544)	$ (12,329)
Net loss per share – basic	$ (0.06)	$ (0.17)
Net loss per share – diluted	$ (0.06)	$ (0.17)

Note 4: Cash, Cash Equivalents and Investments

At June 29, 2007 and December 31, 2006, cash, cash equivalents and short-term investments are summarized as follows (in thousands):

	June 29, 2007	December 31, 2006
Cash and cash equivalents	$ 21,421	$ 33,454
Short-term investments:		
Less than one year	44,380	54,724
Due in 1-2 years	16,418	4,193
Total short-term investments	60,798	58,917
Total cash, cash equivalents and short-term investments	$ 82,219	$ 92,371

The following is a summary of available-for-sale securities (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
June 29, 2007				
U.S. government debt securities	$ 19,257	$ 8	$ (31)	$ 19,234
Corporate debt securities	35,047	8	(41)	35,014
Other debt securities	6,550	—	—	6,550
Total	$ 60,854	$ 16	$ (72)	$ 60,798
December 31, 2006				
U.S. government debt securities	$ 17,187	$ —	$ (36)	$ 17,151
Corporate debt securities	38,678	38	(25)	38,691
Other debt securities	3,075	—	—	3,075
Total	$ 58,940	$ 38	$ (61)	$ 58,917

Impairment of Investments

We monitor our 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. In order to determine whether a decline in value is other-than-temporary, we evaluate, among other factors: the duration and extent to which the fair value has been less than the carrying value; our financial condition and business outlook, including key operational and cash flow metrics, current market conditions and future trends in our industry; our relative competitive position within the industry; and our intent and ability to retain the investment for a period of time sufficient to allow any anticipated recovery in fair value.

In accordance with FASB Staff Position Nos. 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" ("FSP FAS 115-1"), the following table summarizes the fair value and gross unrealized losses related to available-for-sale securities, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, as of June 29, 2007 (in thousands):

	Less than 12 months		Greater than 12 months		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
U.S. Government debt securities	$ 12,583	$ (23)	$ 3,492	$ (8)	$ 16,075	$ (31)
Corporate debt securities	19,414	(41)	749	—	20,163	(41)
Total	$ 31,997	$ (64)	$ 4,241	$ (8)	$ 36,238	$ (72)

The decline in the estimated fair value of these investments relative to amortized cost is primarily related to changes in interest rates and is considered to be temporary in nature.

Note 5: Inventories

(In thousands)	June 29, 2007	December 31, 2006
Raw materials	$ 11,166	$ 12,845
Work-in-process	4,306	3,759
Finished goods	27,036	25,512
	$ 42,508	$ 42,116

Note 6: Goodwill and Identified Intangibles

The following is a summary of goodwill and intangible assets as of June 29, 2007 and December 31, 2006 (in thousands):

	June 29, 2007			December 31, 2006		
	Gross Carrying Amount *	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identified intangibles:						
Developed core technology	$ 44,367	$ (32,135)	$ 12,232	$ 44,322	$ (30,160)	$ 14,162
Customer relationships	33,613	(32,072)	1,541	33,611	(31,929)	1,682
Trademark and tradename	5,038	(4,328)	710	5,031	(4,241)	790
Supply agreement	3,544	(3,544)	—	3,532	(3,532)	—
Subtotal of identified intangibles	86,562	(72,079)	14,483	86,496	(69,862)	16,634
Goodwill	37,204	—	37,204	37,141	—	37,141
Total goodwill and other intangibles	$ 123,766	$ (72,079)	$ 51,687	$ 123,637	$ (69,862)	$ 53,775

* Cumulative foreign currency translation adjustments, reflecting movement in the functional currencies of the underlying international entities, totaled approximately $0.2 million for intangible assets as of June 29, 2007 and December 31, 2006.

The changes in the carrying amount of goodwill for the six months ended June 29, 2007 are as follows (in thousands):

	Goodwill
Balance as of January 1, 2007	$ 37,141
Purchase price adjustments	—
Foreign currency translation adjustments	63
Balance as of June 29, 2007	$ 37,204

For the three and six months ended June 29, 2007, the Company recorded a total of $1.1 million and $2.2 million of amortization expense for identified intangibles, of which $1.0 million and $2.0 million was included in cost of sales, respectively. For the three and six months ended June 30, 2006, the Company recorded a total of $0.2 million and $0.5 million of amortization expense for identified intangibles, of which $0.2 million and $0.3 million was included in cost of sales, respectively. The estimated future amortization expense of purchased intangible assets with definite lives for the next five years is as follows (in thousands):

Years Ending December 31,	Amounts
2007 (remaining 6 months)	$ 2,151
2008	4,302
2009	4,237
2010	3,094
2011	433
2012	266
Total	$ 14,483

Note 7: Restructuring and Excess Facilities

In 2001 and 2002 excess facilities charges totaling $44.3 million were recorded due to the Company's reduced headcount, difficult business conditions and a weak local commercial real estate market.

As of June 29, 2007, accrued excess facilities cost totaled $20.1 million, of which $6.7 million was included in current accrued liabilities and $13.4 million in other non-current liabilities. The Company incurred cash outlays of $3.2 million during the first six months of 2007 principally for lease payments, property taxes, insurance and other maintenance fees related to vacated facilities. Harmonic expects to pay approximately $3.5 million of excess facility lease costs, net of estimated sublease income, for the remainder of 2007 and to pay the remaining $16.6 million, net of estimated sublease income, over the remaining lease terms through September 2010.

Harmonic reassesses this liability quarterly and adjusts as necessary based on changes in the timing and amounts of expected sublease rental income. In the fourth quarter of 2005 the excess facilities liability was decreased by $1.1 million due to subleasing a portion of an unoccupied building for the remainder of the lease.

During the second quarter of 2006, the Company streamlined its senior management team primarily in the U.S. operations and recorded severance and other costs of approximately $1.0 million. We expect the remaining payments related to these actions to be paid by the end of the third quarter of 2007.

During the third quarter of 2006, the Company recorded a charge in selling, general and administrative expenses for excess facilities of $3.9 million. This charge relates to two buildings which were vacated during the third quarter in connection with a plan to make more efficient use of our Sunnyvale campus in accordance with applicable provisions of FAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." In addition, during the third quarter of 2006 the Company revised its estimate of expected sublease income with respect to previously vacated facilities and recorded a credit of $1.7 million in accordance with applicable provisions of EITF 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)."

During the first quarter of 2007, the Company recorded a charge in selling, general and administrative expenses for excess facilities of $0.4 million. This charge primarily relates to two buildings in the UK which were vacated during the first quarter of 2007 in connection with the closure of the manufacturing and research and development activities of Broadcast Technology Limited, or BTL, in accordance with applicable provisions of FAS No. 146. The Company expects to record an additional charge in the third quarter of 2007 for an additional building in the UK in connection with the closure of BTL.

The following table summarizes restructuring activities (in thousands):

	Management Reduction	Excess Facilities	Campus Consolidation	BTL Closure	Total
Balance at December 31, 2006	$ 394	$17,184	$ 5,514	$ —	$23,092
Provisions/(recoveries)	(18)	—	232	336	550
Cash payments, net of sublease income	(298)	(2,184)	(1,015)	(15)	(3,512)
Balance at June 29, 2007	$ 78	$15,000	$ 4,731	$ 321	$20,130

Note 8: Credit Facilities and Long-Term Debt

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to $20.0 million that matures on March 5, 2008. In March 2007, Harmonic paid in full the outstanding balance of its secured term loans for equipment and canceled this term loan feature as part of the renewal process for the bank line of credit. As of June 29, 2007, other than standby letters of credit and guarantees (Note 15), there were no amounts outstanding under the line of credit facility and there were no borrowings in 2006 or 2007. This facility, which was amended and restated in March 2007, contains financial and other covenants including the requirement for Harmonic to maintain cash, cash equivalents and short-term investments, net of credit extensions, of not less than $30.0 million. If Harmonic is unable to maintain this cash, cash equivalents and short-term investments balance or satisfy the additional affirmative covenant requirements, Harmonic would be in noncompliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise its remedies under the facility which include declaring all obligations immediately due and payable and disposing of the collateral if obligations were not repaid. At June 29, 2007, Harmonic was in compliance with the covenants under this line of credit facility. The March 2007 amendment resulted in the Company paying a fee of $10,000 and requiring payment of approximately $20,000 of additional fees if the Company does not maintain an unrestricted deposit of $20.0 million with the bank. Future borrowings pursuant to the line bear interest at the bank's prime rate (8.25% at June 29, 2007). Borrowings are payable monthly and are collateralized by all of Harmonic's assets except intellectual property.

Note 9: Benefit Plans

Stock Option Plans. Harmonic has reserved 11,533,000 shares of Common Stock for issuance under various employee stock option plans. The options are granted for periods not exceeding ten years and generally vest 25% at one year from date of grant, and an additional 1/48 per month thereafter. Stock options are granted at the fair market value of the stock at the date of grant. Beginning on February 27, 2006, option grants had a term of seven years. Certain option awards provide for accelerated vesting if there is a change in control. Certain option awards granted to former Entone employees in 2006 had a term of ten years from the original Entone date of grant and are fully exercisable at the date of grant and, to the extent not vested, become restricted shares subject to repurchase. At June 29, 2007 there were no restricted shares outstanding.

Director Option Plans. In May 2002, Harmonic's stockholders approved the 2002 Director Option Plan (the "Plan"), replacing the 1995 Director Option Plan. The Plan provides for the grant of non-statutory stock options to certain non-employee directors of Harmonic pursuant to an automatic, non-discretionary grant mechanism. Options are granted at fair market value of the stock at the date of grant for periods not exceeding ten years. Initial grants generally vest monthly over three years, and subsequent grants generally vest monthly over one year. In June 2006, Harmonic's stockholders approved an amendment to the Plan and increased the maximum number of shares of common stock authorized for issuance over the term of the Plan by an additional 300,000 shares to 700,000 shares and reduced the term of future option granted under the Plan to seven years. Harmonic has a total of 714,000 shares

of Common Stock reserved for issuance under the Plan.

The following table summarizes activities under the Plans:

	Shares Available for Grant	Stock Options Outstanding	Weighted Average Exercise Price
	(In thousands except exercise price)		
Balance at December 31, 2006	3,632	9,249	$ 11.50
Options granted	(2,060)	2,060	8.32
Options exercised	—	(623)	6.04
Options canceled	550	(550)	12.37
Options expired	—	(11)	31.53
Balance at June 29, 2007	2,122	10,125	11.12
Options vested and exercisable as of June 29, 2007		6,267	$ 13.53
Options vested and expected-to-vest as of June 29, 2007		9,433	$ 11.42

The weighted-average fair value of options granted for the six months ended June 29, 2007 was $4.46.

The following table summarizes information regarding stock options outstanding at June 29, 2007:

	Stock Options Outstanding			Stock Options Exercisable	
Range of Exercise Prices	Number Outstanding at June 29, 2007	Weighted-Average Remaining Contractual Life (Years)	Weighted-Average Exercise Price	Number Exercisable at June 29, 2007	Weighted Average Exercise Price
	(In thousands, except exercise price and life)				
$ 0.19 - 5.66	1,271	5.7	$ 3.74	921	$ 3.60
5.67 – 5.87	1,923	6.3	5.86	772	5.86
5.88 – 8.20	2,326	6.1	7.91	484	7.08
8.21 – 9.29	2,013	5.1	9.00	1,554	9.05
9.44 – 14.50	1,127	4.0	10.71	1,071	10.74
15.00 – 25.50	1,026	2.6	23.64	1,026	23.64
25.81 – 121.68	439	2.3	54.02	439	54.02
	10,125	5.1	$ 11.12	6,267	$ 13.53

The weighted-average remaining contractual life for all exercisable stock options at June 29, 2007 was 4.3 years. The weighted-average remaining contractual life of all vested and expected-to-vest stock options at June 29, 2007 was 5.0 years.

Aggregate pre-tax intrinsic value of options outstanding and exercisable at June 29, 2007 was $8.1 million. The aggregate intrinsic value of stock options vested and expected-to-vest net of estimated forfeitures was $13.4 million at June 29, 2007. Aggregate pre-tax intrinsic value represents the difference between our closing price on the last trading day of the fiscal period, which was $8.87 as of June 29, 2007, and the exercise price multiplied by the number of options outstanding or exercisable. The intrinsic value of exercised stock options is calculated based on the difference between the exercise price and the current market value at the time of exercise. The aggregate intrinsic value of exercised stock options was $0.4 million and $2.3 million during the three and six months ended June 29, 2007, respectively.

Employee Stock Purchase Plan. In May 2002, Harmonic's stockholders approved the 2002 Employee Stock Purchase Plan (the "2002 Purchase Plan") replacing the 1995 Employee Stock Purchase Plan effective for the offering period beginning on July 1, 2002. In May 2004, Harmonic's stockholders approved an amendment to the 2002 Purchase Plan and increased the maximum number of shares of common stock authorized for issuance over the term of the 2002 Purchase Plan by an additional 2,000,000 shares. In June 2006, Harmonic's stockholders approved

an amendment to the 2002 Purchase Plan to increase the maximum number of shares of common stock available for issuance under the 2002 Purchase Plan by an additional 2,000,000 shares to 5,500,000 shares and reduce the term of future offering periods to six months, which became effective for the offering period beginning January 1, 2007. The 2002 Purchase Plan enables employees to purchase shares at 85% of the fair market value of the Common Stock at the beginning of the offering period or end of the purchase period, whichever is lower. Offering periods and purchase periods generally begin on the first trading day on or after January 1 and July 1 of each year. The 2002 Purchase Plan is intended to qualify as an "employee stock purchase plan" under Section 423 of the Internal Revenue Code. During the first six months of 2007 and 2006, the number of shares of stock issued under the purchase plans were 401,061 and 411,324 shares at weighted average prices of $3.90 and $4.18, respectively. The weighted-average fair value of each right to purchase shares of common stock granted under the purchase plans were $2.14 and $1.70 for the first six months of 2007 and 2006, respectively. At June 29, 2007, 2,082,434 shares were reserved for future issuances under the 2002 Purchase Plan.

Retirement/Savings Plan. Harmonic has a retirement/savings plan which qualifies as a thrift plan under Section 401(k) of the Internal Revenue Code. This plan allows participants to contribute up to 20% of total compensation, subject to applicable Internal Revenue Service limitations. Harmonic makes 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. Such amounts totaled $0.1 million and $0.2 million in the three and six months periods ended June 29, 2007.

Stock-based Compensation

The following table summarizes stock-based compensation costs on our Condensed Consolidated Statements of Operations for the three and six months ended June 29, 2007 and June 30, 2006:

(In thousands)	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Employee stock-based compensation in:				
Cost of sales	$ 256	$ 268	$ 464	$ 542
Research and development expense	485	451	875	973
Sales, general and administrative expense	696	783	1,157	1,613
Total employee stock-based compensation in operating expense	1,181	1,234	2,032	2,586
Total employee stock-based compensation	1,437	1,502	2,496	3,128
Amount capitalized as inventory	(2)	38	14	38
Total other stock-based compensation(1)	141	1	290	2
Total stock-based compensation	$ 1,576	$ 1,541	$ 2,800	$ 3,168

(1) Other stock-based compensation represents charges related to non-employee stock options.

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The fair value of each option grant is estimated on the date of grant using the Black-Scholes multiple option pricing model with the following weighted average assumptions:

	Employee Stock Options			
	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Expected life (years)	4.75	4.75	4.75	4.75
Volatility	59%	72%	59%	76%
Risk-free interest rate	4.8%	4.9%	4.7%	4.6%
Dividend yield	0.0%	0.0%	0.0%	0.0%

	Employee Stock Purchase Plan			
	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Expected life (years)	0.5	0.8	0.5	0.8
Volatility	52%	69%	52%	69%
Risk-free interest rate	4.9%	3.7%	4.9%	3.7%
Dividend yield	0.0%	0.0%	0.0%	0.0%

The expected term for stock options and the ESPP represents the weighted-average period that the stock options are expected to remain outstanding. We derived the expected term using the SAB 107 simplified method for stock options and historical data for the ESPP. As alternative sources of data become available in order to determine the expected term we will incorporate these data into our assumption.

We use the historical volatility over the expected term of the options and the ESPP offering period to estimate the expected volatility. We believe that the historical volatility, at this time, represents fairly the future volatility of its common stock. We will continue to monitor relevant information to measure expected volatility for future option grants and ESPP offering periods.

The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of our employee stock options. The dividend yield assumption is based on our history and expectation of dividend payouts.

Note 10: Income Taxes

We adopted the provisions of Financial Standards Accounting Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes (“FIN 48”) an interpretation of FASB Statement No. 109 (“SFAS 109”) on January 1, 2007. The effect of this pronouncement on the Company’s retained earnings as of January 1, 2007 was a decrease in retained earnings of $2.1 million for interest and penalties. At the date of adoption of January 1, 2007, we had $7.1 million of unrecognized tax benefits which included $0.7 million of unrecognized tax benefits that were fully offset by a valuation allowance. The amount of interest and penalties at the adoption date was approximately $2.1 million. The Company historically had a $6.4 million balance in current taxes payable. As a result of the adoption of FIN 48, the FIN 48 liability of $6.4 million was reclassified to long-term taxes payable.

For the six months ended June 29, 2007, the Company has accrued $0.3 million of interest and reversed $0.8 million of FIN 48 liability upon the expiration of the statute of limitation in foreign jurisdictions. The Company does not anticipate a significant change in unrecognized tax benefits within the next twelve months.

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

As of June 29, 2007, we have accrued $0.3 million of interest related to uncertain tax positions. The cumulative balance as of June 29, 2007 of interest and penalties related to uncertain tax positions is approximately $2.4 million.

The tax years 2001-2006 remain open to examination by the major taxing jurisdictions to which we are subject.

Note 11: Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders for the period by the weighted average number of the common shares outstanding during the period. The diluted net loss per share is the same as basic net loss per share for the three and six months ended June 29, 2007 because

potential common shares, such as common shares issuable upon the exercise of stock options, are only considered when their effect would be dilutive.

The following table shows the potentially dilutive shares, consisting of options, for the periods presented that were excluded from the net income (loss) computations because their effect was antidilutive (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Potentially dilutive options outstanding	6,561	6,521	9,944	10,797

Following is a reconciliation of the numerators and denominators of the basic and diluted net loss per share computations (in thousands, except per share data):

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Net income (loss) (numerator)	$ 6,249	$ (2,903)	$ 7,365	$ (8,051)
Shares calculation (denominator):				
Weighted average shares outstanding — basic	79,361	74,167	79,164	74,134
Effect of dilutive securities:				
Potential common stock relating to stock options	1,119	—	1,140	—
Average shares outstanding — diluted	80,480	74,167	80,304	74,134
Net income (loss) per share — basic	$ 0.08	$ (0.04)	$ 0.09	$ (0.11)
Net income (loss) per share — diluted	$ 0.08	$ (0.04)	$ 0.09	$ (0.11)

Note 12: Comprehensive Income (Loss)

The Company’s total comprehensive income (loss) was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Net income (loss)	$ 6,249	$ (2,903)	$7,365	$(8,051)
Change in unrealized gain (loss) on investments, net	(26)	44	(20)	91
Foreign currency translation	(95)	81	(90)	106
Total comprehensive income (loss)	$ 6,128	$ (2,778)	$7,255	$(7,854)

Note 13: Segment Information

We operate our business in one reportable segment, which is the design, manufacture and sales of products and systems that enable network operators to efficiently deliver broadcast and on-demand video services that include digital audio, video-on-demand and high definition television as well as high-speed internet access and telephony. Operating segments are defined as components of an enterprise that engage in business activities for which separate financial information is available and evaluated by the chief operating decision maker in deciding how to allocate resources and assessing performance. Our chief operating decision maker is our Chief Executive Officer.

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Our revenue by geographic region, based on the location at which each sales originates, is summarized as follows:

Geographic Information (in thousands):

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Net sales:				
United States	$38,705	$26,949	$ 81,027	$ 52,602
International	32,577	26,321	60,492	56,889
Total	$71,282	$53,270	$141,519	$109,491

Note 14: Related Party

A director of Harmonic was also a director of Terayon Communication Systems Inc., until Terayon's merger with Motorola in July 2007, and the Company purchases products for resale from Terayon. Product purchases from Terayon were approximately $0.1 million and $1.0 million for the three and six months ended June 29, 2007, respectively. Product purchases from Terayon were approximately $0.9 million and $1.6 million, for the three and six months ended June 30, 2006, respectively. As of June 29, 2007 and December 31, 2006, Harmonic had liabilities to Terayon of approximately $0.2 million and $1.0 million, respectively, for inventory purchases.

A recently appointed director of Harmonic is also a director of JDS Uniphase Corporation, from whom the Company purchases products used in the manufacture of our products. Product purchases from JDS Uniphase were approximately $0.1 million and $0.4 million for the three and six months ended June 29, 2007, respectively. As of June 29, 2007, Harmonic had liabilities to JDS Uniphase of approximately $0.1 million.

Note 15: Guarantees

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

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Balance at beginning of the period	$ 5,869	$ 6,058	$ 6,061	$ 6,166
Accrual for warranties	871	979	1,580	2,021
Adjustments for pre-existing warranties	422	—	422	—
Warranty costs incurred	(1,106)	(1,019)	(2,007)	(2,169)
Balance at end of the period	$ 6,056	$ 6,018	$ 6,056	$ 6,018

Standby Letters of Credit. As of June 29, 2007, the Company's financial guarantees consisted of standby letters of credit outstanding, which were principally related to customs bond requirements and state requirements imposed on employers. The maximum amount of potential future payments under these arrangements was $0.7 million.

Indemnification. Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and customers for specified intellectual property matters pursuant to certain contractual arrangements, subject to certain limitations. The scope of these indemnities varies, but in some instances, includes indemnification for damages and expenses (including reasonable attorneys' fees). There have been no claims against us for indemnification pursuant to any of these arrangements and, accordingly, no amounts have been accrued in respect of the indemnification provisions through June 29, 2007.

Guarantees. As of June 29, 2007, Harmonic had no other guarantees outstanding.

Note 16: Commitments

Convertible Note. As part of the terms of the Agreement and Plan of Merger with Entone Technologies, Inc., Harmonic was obligated to purchase a convertible note with a face amount of $2.5 million in the new spun off private company subject to its closing of an initial round of equity financing in which at least $4 million is invested by third parties. This note was funded in July 2007.

Note 17: Legal Proceedings

Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its officers and directors (some of whom are no longer with Harmonic) were filed in or removed to the United States District Court (the "District Court") for the Northern District of California. The actions subsequently were consolidated.

A consolidated complaint, filed on December 7, 2000, was brought on behalf of a purported class of persons who purchased Harmonic's publicly traded securities between January 19 and June 26, 2000. The complaint also alleged claims on behalf of a purported subclass of persons who purchased C-Cube securities between January 19 and May 3, 2000. In addition to Harmonic and certain of its officers and directors, the complaint also named C-Cube Microsystems Inc. and several of its officers and directors as defendants. The complaint alleged that, by making false or misleading statements regarding Harmonic's prospects and customers and its acquisition of C-Cube, certain defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"). The complaint also alleged that certain defendants violated Section 14(a) of the Exchange Act and Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (the "Securities Act") by filing a false or misleading registration statement, prospectus, and joint proxy in connection with the C-Cube acquisition.

On July 3, 2001, the District Court dismissed the consolidated complaint with leave to amend. An amended complaint alleging the same claims against the same defendants was filed on August 13, 2001. Defendants moved to dismiss the amended complaint on September 24, 2001. On November 13, 2002, the District Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the District Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a notice of appeal on July 1, 2003. The appeal was heard by a panel of three judges of the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit") on February 17, 2005.

On November 8, 2005, the Ninth Circuit panel affirmed in part, reversed in part, and remanded for further proceedings the decision of the District Court. The Ninth Circuit affirmed the District Court's dismissal of the plaintiffs' fraud claims under Sections 10(b), 14(a), and 20(a) of the Exchange Act with prejudice, finding that the plaintiffs failed to adequately plead their allegations of fraud. The Ninth Circuit reversed the District Court's dismissal of the plaintiffs' claims under Sections 11 and 12(a)(2) of the Securities Act, however, finding that those claims did not allege fraud and therefore were subject to only minimal pleading standards. Regarding the secondary liability claim under Section 15 of the Securities Act, the Ninth Circuit reversed the dismissal of that claim against Anthony J. Ley, Harmonic's Chairman and former Chief Executive Officer, and affirmed the dismissal of that claim against Harmonic, while granting leave to amend. The Ninth Circuit remanded the surviving claims to the District Court for further proceedings.

On November 22, 2005, both the Harmonic defendants and the plaintiffs petitioned the Ninth Circuit for a rehearing of the appeal. On February 16, 2006 the Ninth Circuit denied both petitions. On May 17, 2006 the plaintiffs filed an amended complaint on the issues remanded for further proceedings by the Ninth Circuit, to which the Harmonic defendants responded with a motion to dismiss certain claims and to strike certain allegations. On December 11, 2006, the Court granted the motion to dismiss with respect to the Section 12(a)(2) claim against the individual Harmonic defendants and granted the motion to strike, but denied the motion to dismiss the Section 15 claim. A case management conference was held on January 25, 2007, at which the Court set a trial date in August 2008, with discovery to close in February 2008. The Court also ordered the parties to attend a settlement conference with a

magistrate judge or a private mediation before June 30, 2007. A mediation session was held on May 24, 2007 at which the parties were unable to reach a settlement.

A derivative action purporting to be on behalf of Harmonic was filed against its then-current directors in the Superior Court for the County of Santa Clara on September 5, 2000. Harmonic also was named as a nominal defendant. The complaint is based on allegations similar to those found in the securities class action and claims that the defendants breached their fiduciary duties by, among other things, causing Harmonic to violate federal securities laws. The derivative action was removed to the United States District Court for the Northern District of California on September 20, 2000. All deadlines in this action were stayed pending resolution of the motions to dismiss the securities class action. On July 29, 2003, the Court approved the parties' stipulation to dismiss this derivative action without prejudice and to toll the applicable limitations period pending the Ninth Circuit's decision in the securities action. Pursuant to the stipulation, defendants have provided plaintiff with a copy of the mandate issued by the Ninth Circuit in the securities action.

A second derivative action purporting to be on behalf of Harmonic was filed in the Superior Court for the County of Santa Clara on May 15, 2003. It alleges facts similar to those previously alleged in the securities class action and the federal derivative action. The complaint names as defendants former and current Harmonic officers and directors, along with former officers and directors of C-Cube Microsystems, Inc., who were named in the securities class action. The complaint also names Harmonic as a nominal defendant. The complaint alleges claims for abuse of control, gross mismanagement, and waste of corporate assets against the Harmonic defendants, and claims for breach of fiduciary duty, unjust enrichment, and negligent misrepresentation against all defendants. On July 22, 2003, the Court approved the parties' stipulation to stay the case pending resolution of the appeal in the securities class action. Following the decision of the Ninth Circuit discussed above, on May 9, 2006, defendants filed demurrers to this complaint. The plaintiffs then filed an amended complaint on July 10, 2006, which names only the Harmonic defendants. The defendants filed demurrers to the amended complaint and reply briefs are due September 13, 2007. A case management conference and hearing are scheduled for October 5, 2007.

Based on its review of the surviving claims in the securities class actions, Harmonic believes that it has meritorious defenses and intends to defend itself vigorously. There can be no assurance, however, that Harmonic will prevail. No estimate can be made of the possible range of loss associated with the resolution of this contingency, and accordingly, Harmonic has not recorded a liability. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4859016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

Harmonic is involved in other litigation and may be subject to claims arising in the normal course of business. In the opinion of management the amount of ultimate liability with respect to these matters in the aggregate will not have a material adverse effect on the Company or its operating results, financial position or cash flows.

Note 18: Subsequent Event

On July 25, 2007, Harmonic announced that it had entered into a definitive agreement to acquire Rhozet Corporation, a privately held company based in Santa Clara, California. Harmonic completed the acquisition of Rhozet on July 31, 2007. Rhozet offers software-based universal transcoding solutions that facilitate the creation of multi-format video for Internet, mobile and broadcast applications. The purchase consideration of approximately $15.5 million was comprised of approximately $5.3 million in cash and the issuance of approximately 1.1 million shares of Harmonic common stock with a value of $10.2 million, as set forth in the definitive agreement.

Item 2. ***Management's Discussion and Analysis of Financial Condition and Results of Operations***

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements related to our expectation that the acquisition of Entone will enable us to expand the scope of solutions we offer to cable, satellite and IPTV providers; our expectation that the majority of our net sales will be to relatively few customers for the foreseeable future; our expectation that international sales will continue to account for a significant portion of our net sales for the foreseeable future; our expectation that the completion of the closure of the facilities we occupied in the UK as a result of the BTL acquisition will result in an additional charge to excess facilities in the third quarter of 2007; our expectation that we will record approximately $2.0 million in amortization of intangibles in cost of sales in the remaining six months of 2007 due to the acquisition of Entone; our expectation that we will record a total of approximately $0.2 million in amortization of intangibles in operating expenses in the remaining six months of 2007 due to the acquisition of Entone; our expectation that capital expenditures will be in the range of $5 million to $6 million during 2007; our belief that our existing liquidity sources, including our bank line of credit facility, will satisfy our requirements for at least the next twelve months; our belief that near-term changes in exchange rates will not have a material impact on our operating results, financial position and liquidity; our belief that a 10% change in interest rates would not have a material impact on our financial conditions, results of operations or cash flows; our expectation that sales to cable television, satellite and telecommunications operators will constitute a significant portion of net sales for the foreseeable future; our expectation that SFAS 123(R) will continue to negatively impact our earnings and may affect our ability to raise capital on acceptable terms; our expectation that our operations will be affected by new environmental laws and regulations on an ongoing basis; our belief that any ultimate liability of Harmonic with respect to certain litigation arising in the normal course of business will not, in the aggregate, have a material adverse effect on us or our operating results, financial position or cash flows; and our expectation that operating results are likely to fluctuate in the future. These statements involve risks and uncertainties as well as assumptions that, if they were to never materialize or prove incorrect, could cause actual results to differ materially from those projected, expressed or implied in the forward-looking statements. These risks and uncertainties include those set forth under "Risk Factors" below and elsewhere in this Quarterly Report on Form 10-Q and that are otherwise described from time to time in Harmonic's filings with the Securities and Exchange Commission.

Overview

Harmonic designs, manufactures and sells products and systems that enable network operators to efficiently deliver broadcast and on-demand video services that include digital video, video-on-demand (VOD) and high definition television (HDTV) as well as high-speed Internet access and telephony. Historically, the majority of our sales have been derived from sales of video processing solutions and edge and access systems to cable television operators. We also provide our video processing solutions to direct broadcast satellite (DBS) operators and to telephone companies, or telcos, that offer video services to their customers.

In the second quarter and first six months of 2007, Harmonic's net sales increased 34% and 29% compared to the second quarter and first six months of 2006, respectively. The increase in sales in the second quarter and the first six months of 2007 compared to the corresponding periods in 2006 were primarily due to stronger demand from our domestic cable customers for products and solutions related to video-on-demand (VOD) deployments as well as continuing bandwidth and network expansion, and sales of our recently introduced products. Gross margins increased in the second quarter and the first six months of 2007 compared to the corresponding periods in 2006 due to favorable margins from the sale of new products and lower average product costs due to increased manufacturing volumes.

Historically, a majority of our net sales have been to relatively few customers, and due in part to the consolidation of ownership of cable television and direct broadcast satellite systems, we expect this customer concentration to continue for the foreseeable future. In the second quarter of 2007, sales to Comcast accounted for 16% of net sales, and in the second quarter of 2006, sales to Cox Communications accounted for 13% of net sales. In the first six months of 2007, sales to Comcast accounted for 19% of net sales, and in the first six months of 2006 no customer had sales that accounted for more that 10% of sales.

Sales to customers outside of the U.S. in the second quarter and the first six months of 2007 represented 46% and 43% of net sales, respectively, compared to 49% and 52% for the comparable periods in 2006. A significant portion of international sales are made to distributors and system integrators, which are generally responsible for importing the products and providing installation and technical support and service to customers within their territory. Sales denominated in foreign currencies were approximately 6% in the first six months of 2007 compared to 5% for the comparable period of 2006. We expect international sales to continue to account for a significant portion of our net sales for the foreseeable future.

Harmonic often recognizes a significant portion, or the majority, of its revenues in the last month of the quarter. Harmonic establishes its expenditure levels for product development and other operating expenses based on projected sales levels, and expenses are relatively fixed in the short term. Accordingly, variations in timing of sales can cause significant fluctuations in operating results. Harmonic's expenses for any given quarter are typically based on expected sales and if sales are below expectations, our operating results may be adversely impacted by our inability to adjust spending to compensate for the shortfall. In addition, because a significant portion of Harmonic's business is derived from orders placed by a limited number of large customers, the timing of such orders can also cause significant fluctuations in our operating results.

In 2001 and 2002 excess facilities and fixed asset impairment charges totaling $52.6 million were recorded due to the Company's reduced headcount, difficult business conditions and a weak local commercial real estate market. In the fourth quarter of 2005, the excess facilities liability was decreased by $1.1 million due to subleasing a portion of the unoccupied portion of one building for the remainder of the lease. In the third quarter of 2006, we completed our facilities rationalization plan resulting in more efficient use of our Sunnyvale campus and vacated several buildings, some of which were subsequently subleased. This resulted in a net charge for excess facilities of $2.1 million in the third quarter of 2006. Although we entered into new subleases for approximately 60,000 square feet of space in 2004, 30,000 square feet of space in 2005 and approximately 60,000 square feet of space in 2006, in the event we are unable to achieve expected levels of sublease rental income, we will need to revise our estimate of the liability, which could materially impact our financial position, liquidity, cash flows and results of operations.

In the fourth quarter of 2006, we discontinued a decoder product line and announced the closing of our manufacturing operations in the UK. In the first quarter of 2007 we decided to shut down our UK research and development operations and to abandon the facility in which such operations were conducted which resulted in an excess facility charge of $0.3 million for two buildings. We expect to complete the closure of the facility in the third quarter of 2007 which we expect will result in an additional charge to excess facilities.

On December 8, 2006, Harmonic completed its acquisition of the video networking software business of Entone for a total purchase price of $49.0 million. The purchase price consisted of a payment of $26.2 million, the issuance of 3,579,715 shares of Harmonic common stock with a value of $20.1 million, the issuance of 175,342 options to purchase Harmonic common stock with a value of $0.2 million, and $2.5 million of transaction costs. Prior to the closing of the acquisition, Entone spun off its consumer premises equipment, or CPE, business into a separate private company. As part of the terms of the acquisition agreement pursuant to which Harmonic acquired the video networking software business of Entone, Harmonic was obligated to purchase a convertible note with a face amount of $2.5 million in the new spun off private company subject to its closing of an initial round of equity financing in which at least $4 million is invested by third parties. This note was funded in July 2007.

On July 31, 2007, Harmonic announced that it had entered into a definitive agreement to acquire Rhozet Corporation, a privately held company based in Santa Clara, California. Harmonic completed the acquisition of Rhozet on July 31, 2007. Rhozet offers software-based universal transcoding solutions that facilitate the creation of multi-format video for Internet, mobile and broadcast applications. The purchase consideration of approximately $15.5 million was comprised of approximately $5.3 million in cash and the issuance of approximately 1.1 million shares of Harmonic common stock with a value of $10.2 million, as set forth in the definitive agreement.

Critical Accounting Policies, Judgments and Estimates

The preparation of financial statements and related disclosures requires Harmonic to make judgments, assumptions and estimates that affect the reported amounts of assets and liabilities, the disclosure of contingencies and the reported amounts of revenue and expenses in the financial statements and accompanying notes. Material differences may result in the amount and timing of revenue and expenses if different judgments or different estimates were made.

Our significant accounting policies are described in Note 1 to the annual consolidated financial statements as of and for the year ended December 31, 2006, included in our Annual Report on Form 10-K filed with the SEC on March 15, 2007 and notes to condensed consolidated financial statements as of and for the three and six month periods ended June 29, 2007, included herein. Our most critical accounting policies have not changed since December 31, 2006 and include the following:

- Revenue recognition;
- Allowances for doubtful accounts, returns and discounts;
- Valuation of inventories;
- Impairment of long-lived assets;
- Restructuring costs and accruals for excess facilities;
- Assessment of the probability of the outcome of current litigation;
- Accounting for income taxes, and
- Stock-based compensation.

Our accounting policy for income taxes was recently modified due to the adoption of FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109”, or FIN 48, see Note 10 to the Condensed Consolidated Financial Statements on Income Taxes.

Results of Operations

Harmonic's historical consolidated statements of operations data for the second quarter and first six months of 2007 and the second quarter and first six months of 2006 as a percentage of net sales, are as follows:

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Products sales	90%	88%	92%	90%
Service revenue	10	12	8	10
Net sales	100	100	100	100
Product cost of sales	53	55	55	58
Service cost of sales	4	4	4	4
Cost of sales	57	59	59	62
Gross profit	43	41	41	38
Operating expenses:				
Research and development	14	18	15	18
Selling, general and administrative	22	30	22	29
Amortization of intangibles	—	—	—	—
Total operating expenses	36	48	37	47
Income (loss) from operations	7	(7)	4	(9)
Interest income, net	2	2	1	2
Other income (expense), net	—	—	—	—
Income (loss) before income taxes	9	(5)	5	(7)
Provision for (benefit from) income taxes	—	—	—	—
Net income (loss)	9%	(5)%	5%	(7)%

Net Sales — Consolidated

Harmonic's consolidated net sales in the second quarter and first six months of 2007 compared with the corresponding periods in 2006 are presented in the table below. Also presented are the related dollar and percentage increase in consolidated net sales in the second quarter and first six months of 2007 compared with the corresponding periods in 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
Sales Data:	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Video Processing	$ 28,216	$ 20,563	$ 54,166	$ 40,248
Edge and Access	31,117	23,434	66,736	51,886
Software and Other	4,733	2,665	9,120	6,312
Service and Support	7,216	6,608	11,497	11,045
Net sales	$ 71,282	$ 53,270	$141,519	$109,491
Video Processing increase	$ 7,653		$ 13,918	
Edge and Access increase	7,683		14,850	
Software and Other increase	2,068		2,808	
Service and Support increase	608		452	
Total increase	$ 18,012		$ 32,028	
Video Processing percent change	37.2%		34.6%	
Edge and Access percent change	32.8%		28.6%	
Software and Other percent change	77.6%		44.5%	
Service and Support percent change	9.2%		4.1%	
Total percent change	33.8%		29.3%	

Net sales increased in the second quarter of 2007 compared to the same period of 2006 principally due to stronger demand from our domestic cable customers for products and solutions related to video-on-demand (VOD) deployments as well as continuing bandwidth and network expansion, and sales of our recently introduced products. In the video processing product line, encoder sales increased by approximately $6.4 million in the second quarter of 2007 compared to the same period in the prior year due to higher spending by all types of customers. The edge and access products line experienced an increase in net sales of $7.7 million in the second quarter of 2007 compared to the same period in 2006 due to an increase in VOD deployments from domestic cable operators in the second quarter of 2007 compared to the second quarter of 2006. Software and other revenue increased in the second quarter of 2007 compared to the same period of 2006 primarily due to continued network expansion and upgrades, and sales of recently introduced products. Service and support revenue, primarily consisting of maintenance agreements, system integration and customer repairs, increased in the second quarter of 2007 compared to the same period of 2006 principally due to an increased customer base.

Net sales increased in the first six months of 2007 compared to the same period of 2006 principally due to stronger demand from our domestic cable customers for products and solutions related to video-on-demand (VOD) deployments as well as continuing bandwidth and network expansion, and sales of our newly introduced products. In the video processing product line, encoder sales were higher by approximately $10.4 million and stream processing products sales were higher by approximately $6.0 million in the first six months of 2007 compared to the same period in the prior year due to higher spending across all types of customers except telco. The edge and access products line experienced an increase in net sales of $15.7 million in the first six months of 2007 compared to the same period in 2006 due to an increase in VOD deployments from domestic cable operators in the first six months of 2007. Software and other revenue increased in the first six months of 2007 compared to the same period of 2006 primarily due to continued network expansion and upgrades, and sales of recently introduced products. Service and support revenue, consisting of maintenance agreements, system integration and customer repairs, increased in the first six months of 2007 compared to the same period of 2006 principally due to an increased customer base.

Net Sales — Geographic

Harmonic's domestic and international net sales in the second quarter and first six months of 2007 compared with the corresponding periods in 2006 are presented in the table below. Also presented are the related dollar and percentage increase in domestic and international net sales in the second quarter and first six months of 2007 compared with the corresponding periods in 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
Geographic Sales Data:	**June 29, 2007**	**June 30, 2006**	**June 29, 2007**	**June 30, 2006**
U.S.	$ 38,705	$ 26,949	$ 81,027	$ 52,602
International	32,577	26,321	60,492	56,889
Net sales	$ 71,282	$ 53,270	$141,519	$109,491
U.S. increase	$ 11,756		$ 28,425	
International increase	6,256		3,603	
Total increase	$ 18,012		$ 32,028	
U.S. percent change	43.6%		54.0%	
International percent change	23.8%		6.3%	
Total percent change	33.8%		29.3%	

The increased U.S. sales in the second quarter and first six months of 2007 compared to the corresponding periods in 2006 was principally due to stronger demand from our domestic satellite and cable customers for products and solutions related to VOD deployments as well as continued bandwidth and network expansion, and sales of recently introduced products. For example, sales to Comcast increased by $8.8 million and $16.8 million in the second quarter and first six months of 2007 compared to the corresponding periods of 2006, respectively.

International sales in the second quarter and the first six months of 2007 increased compared to the corresponding periods in 2006 primarily due to stronger demand from satellite and cable customers for network expansion, primarily in the South American and Asian markets. We expect that international sales will continue to account for a significant portion of our net sales for the foreseeable future.

Gross Profit

Harmonic's gross profit and gross profit as a percentage of consolidated net sales in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 are presented in the tables below. Also presented are the related dollar and percentage increases in gross profit in the second quarter and first six months of

2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Gross profit	$30,565	$21,606	$57,717	$41,486
As a % of net sales	42.9%	40.6%	40.8%	37.9%
Increase	$ 8,959		$16,231	
Percent change	41.5%		39.1%	

The increase in gross profit in the second quarter of 2007 as compared to the corresponding period of 2006 was primarily due to increased sales, partially offset by increased expense of $0.8 million from amortization of intangibles. The gross margin percentage of 42.9% in the second quarter of 2007 compared to 40.6% in the second quarter of 2006 was higher primarily due to higher gross margin on recently introduced products, partially offset by increased expense from amortization of intangibles.

The increase in gross profit in the first six months of 2007 as compared to the first six months of 2006 was primarily due to increased sales, partially offset by increased expense of $1.7 million from amortization of intangibles. The gross margin percentage of 40.8% in the first six months of 2007 compared to 37.9% in the first six months of 2006 was higher primarily due to higher gross margin on recently introduced products, which was partially offset by increased expense from amortization of intangibles.

In the first six months of 2007, $2.0 million of amortization of intangibles was included in cost of sales compared to $0.3 million in the first six months of 2006. The higher amortization in the first six months of 2007 was due to the amortization of intangibles arising from the Entone acquisition which was completed in the fourth quarter of 2006. We expect to record approximately $2.0 million in amortization of intangibles in cost of sales in the remaining six months of 2007 due to the acquisition of Entone. Additional amortization of intangibles is expected to be recorded in the remaining six months of 2007 when the acquisition of Rhozet Corporation is completed.

Research and Development

Harmonic's research and development expense and the expense as a percentage of consolidated net sales in the second quarter and first six months of 2007, as compared with the corresponding periods of 2006, are presented in the table below. Also presented are the related dollar and percentage increases in research and development expense in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Research and development expense	$9,605	$9,585	$20,597	$19,533
As a % of net sales	13.5%	18.0%	14.6%	17.8%
Increase	$ 20		$ 1,064	
Percent change	0.2%		5.4%	

Research and development expense was flat in the second quarter of 2007 as compared to the same period in 2006, although there were lower facility and overhead expenses of $0.6 million and lower consulting expenses of $0.2 million, which were substantially offset by increased compensation costs of $0.7 million. The increased compensation costs in the second quarter of 2007 were related to the increased headcount associated with the acquisition of Entone in December 2006 and higher incentive compensation expenses.

The increase in research and development expense in the first six months of 2007 as compared to the first six months of 2006 was primarily the result of increased compensation costs of $2.1 million, which was partially offset by lower facility and overhead expenses of $0.9 million and decreased use of prototype materials of $0.3 million associated with the development of new products. The increased compensation costs in the first six months of 2007

were related to the increased headcount associated with the acquisition of Entone in December 2006 and higher incentive compensation expenses.

Selling, General and Administrative

Harmonic's selling, general and administrative expense and the expense as a percentage of consolidated net sales in the second quarter and first six months of 2007, as compared with the corresponding periods of 2006, are presented in the table below. Also presented are the related dollar and percentage decreases in selling, general and administrative expense in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Selling, general and administrative expense	$15,771	$15,979	$31,446	$31,692
As a % of net sales	22.1%	30.0%	22.2%	28.9%
Decrease	$ (208)		$ (246)	
Percent change	(1.3)%		(0.8)%	

The decrease in selling, general and administrative expense in the second quarter of 2007 compared to the same period in 2006 was primarily a result of lower overhead and facilities expenses of $0.4 million and lower third party commissions of $0.3 million, partially offset by higher legal expenses of $0.3 million resulting from acquisition and personnel expenses and increased travel expenses of $0.1 million associated with selling activities.

The decrease in selling, general and administrative expense in the first six months of 2007 compared to the first six months of 2006 was primarily a result of lower ongoing overhead and facilities expenses of $0.6 million and lower third party commissions of $0.3 million, partially offset by the excess facilities charge of $0.4 million related to the closure of the BTL facility in the UK and higher legal expenses of $0.3 million resulting from acquisition and personnel expenses.

Amortization of Intangibles

Harmonic's amortization of intangible assets and the expense as a percentage of consolidated net sales in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 are presented in the table below. Also presented are the related dollar and percentage increases in amortization of intangible assets in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Amortization of intangibles	$ 111	$ 43	$ 222	$135
As a % of net sales	0.2%	0.1%	0.2%	0.1%
Increase	$ 68		$ 87	
Percent change	158.1%		64.4%	

The increase in the amortization of intangibles in the second quarter and first six months of 2007 compared to the corresponding periods in 2006 was primarily due to the acquisition of Entone's intangible assets during the fourth quarter of 2006. Harmonic expects to record a total of approximately $0.2 million in amortization of intangibles in operating expenses in the remaining six months of 2007 due to the amortization of intangible assets resulting from the acquisition of Entone. Additional amortization of intangibles is expected to be recorded in the remaining six months of 2007 when the acquisition of Rhozet Corporation is completed.

Interest Income, Net

Harmonic's interest income, net, and interest income, net, as a percentage of consolidated net sales in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006, are presented in the table below. Also presented are the related dollar and percentage decreases in interest income, net, in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Interest income, net	$ 990	$1,175	$1,986	$2,167
As a % of net sales	1.4%	2.2%	1.4%	2.0%
Decrease	$ (185)		$ (181)	
Percent change	(15.7)%		(8.4)%	

The decrease in interest income, net, in the second quarter and first six months of 2007 compared to the corresponding periods of 2006, was due primarily to a lower portfolio balance during the second quarter and first six months of 2007 which was partially offset by lower interest expense on debt.

Other Income (Expense), Net

Harmonic's other income (expense), net, and other income (expense), net, as a percentage of consolidated net sales in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006, are presented in the table below. Also presented is the related dollar and percentage decrease in other income (expense), net, in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Other income (expense)	$ 7	$ 128	$ (16)	$ 36
As a % of net sales	□%	0.2%	□%	□%
Decrease	$ (121)		$ (52)	
Percent change	(94.5)%		(144.4)%	

The decrease in other income (expense), net, in the second quarter and first six months of 2007 compared to the corresponding periods of 2006 was primarily due to foreign exchange losses.

Income Taxes

Harmonic's provision for (benefit from) income taxes, and provision for (benefit from) income taxes as a percentage of consolidated net sales in the second quarter and first six months of 2007, as compared with the corresponding periods of 2006, are presented in the tables below. Also presented are the related dollar and percentage decrease in income taxes in the second quarter and first six months of 2007 as compared with the corresponding periods of 2006 (in thousands, except percentages).

	Three Months Ended		Six Months Ended	
	June 29, 2007	June 30, 2006	June 29, 2007	June 30, 2006
Provision for (benefit from) income taxes	$ (174)	$205	$ 57	$380
As a % of net sales	0.2%	0.4%	□%	0.3%
Decrease	$ (379)		$ (323)	
Percent change	(184.9)%		(85.0)%	

The decrease in the provision for income taxes in the second quarter and first six months of 2007 compared to the same period in 2006 was primarily due to the reversal of a prior year foreign tax provision which was partially offset by a charge for interest on unresolved tax liabilities in the current period.

Liquidity and Capital Resources

	Six Months Ended	
(in thousands)	**June 29, 2007**	**June 30, 2006**
Cash, cash equivalents and short-term investments	$ 82,219	$ 113,534
Net cash provide by (used in) operating activities	$ (9,983)	$ 3,318
Net cash provided by (used in) investing activities	$ (6,863)	$ 7,189
Net cash provided by financing activities	$ 4,826	$ 1,686

As of June 29, 2007, cash, cash equivalents and short-term investments totaled $82.2 million, compared to $92.4 million as of December 31, 2006. Cash used in operations in the first six months of 2007 was $10.0 million, resulting from net income of $7.4 million, adjusted for $8.3 million in non-cash charges and a $25.6 million net change in assets and liabilities. The non-cash charges included depreciation, amortization and stock-based compensation expense. The net change in assets and liabilities included a decrease in accounts payable primarily from the payment of inventory purchases, a decrease in accrued and other liabilities primarily from the payment of merger-related obligations from our DiviCom acquisition in 2000 and the payment of incentive compensation, a decrease in accrued excess facilities costs, an increase in prepaid expenses and other assets primarily from deferred costs on revenue projects, which was partially offset by a decrease in accounts receivable and an increase in deferred revenue.

To the extent that non-cash items increase or decrease our future operating results, there will be no corresponding impact on our cash flows. After excluding the effects of these non-cash charges, the primary changes in cash flows relating to operating activities resulted from changes in working capital. Our primary source of operating cash flows is the collection of accounts receivable from our customers. Our operating cash flows are also impacted by the timing of payments to our vendors for accounts payable and other liabilities. We generally pay our vendors and service providers in accordance with the invoice terms and conditions. In addition, we usually pay our annual incentive compensation to employees in the first quarter.

Net cash used in investing activities was $6.9 million for the six months ended June 29, 2007, resulting primarily from the payment of $2.5 million in merger costs from the Entone acquisition in December 2006, the net purchase of investments of $1.9 million and by $2.5 million of capital expenditures primarily for test equipment. Harmonic currently expects capital expenditures to be in the range of $5 million to $6 million during 2007.

Net cash provided by financing activities was $4.8 million for the six months ended June 29, 2007, resulting primarily from proceeds received of $5.3 million from the exercise of stock options and the sale of our common stock under our ESPP, less the repayment of $0.5 million of the entire remaining outstanding term loan.

Under the terms of the merger agreement with C-Cube, Harmonic is generally liable for C-Cube's pre-merger liabilities. As of June 29, 2007, approximately $6.7 million of pre-merger liabilities remained outstanding and are included in accrued liabilities. We are working with LSI Logic, which acquired C-Cube's spun-off semiconductor business in June 2001 and assumed its obligations, to develop an approach to settle these obligations, a process which has been underway since the merger in 2000. These liabilities represent estimates of C-Cube's pre-merger obligations to various authorities in 9 countries. Harmonic paid $2.4 million in January 2007, but is unable to predict when the remaining obligations will be paid. The full amount of the estimated obligations has been classified as a current liability. To the extent that these obligations are finally settled for less than the amounts provided, Harmonic is required, under the terms of the merger agreement, to refund the difference to LSI Logic. Conversely, if the settlements are more than the remaining $6.7 million pre-merger liability, LSI Logic is obligated to reimburse Harmonic.

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to $20.0 million that matures on March 5, 2008. In March 2007, Harmonic paid in full the outstanding balance of its secured

term loans and canceled this facility as part of the renewal process for the bank line of credit. As of June 29, 2007, other than standby letters of credit and guarantees (Note 15), there were no amounts outstanding under the line of credit facility and there were no borrowings in 2006 or 2007. This facility, which was amended and restated in March 2007, contains financial and other covenants including the requirement for Harmonic to maintain cash, cash equivalents and short-term investments, net of credit extensions, of not less than $30.0 million. If Harmonic is unable to maintain this cash, cash equivalents and short-term investments balance or satisfy the additional affirmative covenant requirements, Harmonic would be in noncompliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise its remedies under the facility which include declaring all obligations immediately due and payable and disposing of the collateral if obligations were not repaid. At June 29, 2007, Harmonic was in compliance with the covenants under this line of credit facility. The March 2007 amendment resulted in the company paying a fee of $10,000 and requiring payment of approximately $20,000 of additional fees if the company does not maintain an unrestricted deposit of $20.0 million with the bank. Future borrowings pursuant to the line bear interest at the bank's prime rate (8.25% at June 29, 2007). Borrowings are payable monthly and are collateralized by all of Harmonic's assets except intellectual property.

Harmonic's cash and investment balances at June 29, 2007 were $82.2 million. We believe that our existing liquidity sources will satisfy our cash requirements for at least the next twelve months. However, we may need to raise additional funds if our expectations are incorrect, to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In April 2005, we filed a registration statement on Form S-3 with the SEC. Pursuant to this registration statement on Form S-3, which has been declared effective by the SEC, we are able to issue registered common stock, preferred stock, debt securities and warrants to purchase common stock from time to time, up to an aggregate of approximately $200 million, subject to market conditions and our capital needs.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital or could require us to issue our stock and dilute existing stockholders. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

Our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including increased market uncertainty surrounding the ongoing U.S. war on terrorism, as well as conditions in capital markets and the cable and satellite industries. There can be no assurance that any financing will be available on terms acceptable to us, if at all.

Off-Balance Sheet Arrangements

None as of June 29, 2007.

Contractual Obligations and Commitments

As part of the terms of the Agreement and Plan of Merger with Entone Technologies, Inc., Harmonic was obligated to purchase a convertible note with a face amount of $2.5 million in the new spun off private company subject to its closing of an initial round of equity financing in which at least $4 million is invested by third parties. This note was funded in July 2007.

There were no material changes in our contractual obligations and rights outside of the ordinary course of business or other material changes in our financial condition during the second quarter of 2007, other than the unrecognized tax benefits associated with the adoption of Financial Accounting Standards Board Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes." The unrecognized tax benefits at June 29, 2007 were $6.3 million whose timing of resolution of which is uncertain.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

Foreign Currency Exchange Risk

Harmonic has a number of international customers each of whose sales are generally denominated in U.S. dollars. Sales denominated in foreign currencies were approximately 6% and 5% of net sales in the second quarter and first six months of 2007 and 2006, respectively. In addition, the Company has various international branch offices that provide sales support and systems integration services. Periodically, Harmonic enters into foreign currency forward exchange contracts, or forward contracts, to manage exposure related to accounts receivable denominated in foreign currencies. Harmonic does not enter into derivative financial instruments for trading purposes. At June 29, 2007, we had a forward contract to sell Euros totaling $4.5 million that matures during the third quarter of 2007. While Harmonic does not anticipate that near-term changes in exchange rates will have a material impact on Harmonic's operating results, financial position and liquidity, Harmonic cannot assure you that a sudden and significant change in the value of local currencies would not harm Harmonic's operating results, financial position and liquidity.

Interest Rate Risk

Exposure to market risk for changes in interest rates relate primarily to Harmonic's investment portfolio of marketable debt securities of various issuers, types and maturities and to Harmonic's borrowings under its bank line of credit facility. Harmonic does not use derivative instruments in its investment portfolio, and its investment portfolio only includes highly liquid instruments with an original maturity of less than two years. These investments are classified as available for sale and are carried at estimated fair value, with material unrealized gains and losses reported in other comprehensive income. There is risk that losses could be incurred if Harmonic were to sell any of its securities prior to stated maturity. A 10% change in interest rates would not have had a material impact on financial conditions, results of operations or cash flows.

Item 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

We maintain "disclosure controls and procedures," as such term is defined in Rule 13a-15(e) under the Exchange Act, that are designed to ensure that information required to be disclosed by us in reports that we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, management recognized that disclosure controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the disclosure controls and procedures are met. Additionally, in designing disclosure controls and procedures, our management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

Based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective.

Changes in internal controls.

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Shareholder Litigation

Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its officers and directors (some of whom are no longer with Harmonic) were filed in or removed to the U.S. District Court for the Northern District of California. The actions subsequently were consolidated.

A consolidated complaint, filed on December 7, 2000, was brought on behalf of a purported class of persons who purchased Harmonic's publicly traded securities between January 19 and June 26, 2000. The complaint also alleged claims on behalf of a purported subclass of persons who purchased C-Cube securities between January 19 and May 3, 2000. In addition to Harmonic and certain of its officers and directors, the complaint also named C-Cube Microsystems Inc. and several of its officers and directors as defendants. The complaint alleged that, by making false or misleading statements regarding Harmonic's prospects and customers and its acquisition of C-Cube, certain defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act. The complaint also alleged that certain defendants violated Section 14(a) of the Exchange Act and Sections 11, 12(a)(2), and 15 of the Securities Act of 1933 (the "Securities Act") by filing a false or misleading registration statement, prospectus, and joint proxy in connection with the C-Cube acquisition.

On July 3, 2001, the District Court dismissed the consolidated complaint with leave to amend. An amended complaint alleging the same claims against the same defendants was filed on August 13, 2001. Defendants moved to dismiss the amended complaint on September 24, 2001. On November 13, 2002, the District Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the District Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a notice of appeal on July 1, 2003. The appeal was heard by a panel of three judges of the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit") on February 17, 2005.

On November 8, 2005, the Ninth Circuit panel affirmed in part, reversed in part, and remanded for further proceedings the decision of the District Court. The Ninth Circuit affirmed the District Court's dismissal of the plaintiffs' fraud claims under Sections 10(b), 14(a), and 20(a) of the Exchange Act with prejudice, finding that the plaintiffs failed to adequately plead their allegations of fraud. The Ninth Circuit reversed the District Court's dismissal of the plaintiffs' claims under Sections 11 and 12(a)(2) of the Securities Act, however, finding that those claims did not allege fraud and therefore were subject to only minimal pleading standards. Regarding the secondary liability claim under Section 15 of the Securities Act, the Ninth Circuit reversed the dismissal of that claim against Anthony J. Ley, Harmonic's Chairman and former Chief Executive Officer, and affirmed the dismissal of that claim against Harmonic, while granting leave to amend. The Ninth Circuit remanded the surviving claims to the District Court for further proceedings.

On November 22, 2005, both the Harmonic defendants and the plaintiffs petitioned the Ninth Circuit for a rehearing of the appeal. On February 16, 2006 the Ninth Circuit denied both petitions. On May 17, 2006 the plaintiffs filed an amended complaint on the issues remanded for further proceedings by the Ninth Circuit, to which the Harmonic defendants responded with a motion to dismiss certain claims and to strike certain allegations. On December 11, 2006, the Court granted the motion to dismiss with respect to the Section 12(a)(2) claim against the individual Harmonic defendants and granted the motion to strike, but denied the motion to dismiss the Section 15 claim. A case management conference was held on January 25, 2007, at which the Court set a trial date in August 2008, with discovery to close in February 2008. The Court also ordered the parties to attend a settlement conference with a magistrate judge or a private mediation before June 30, 2007. A mediation session was held on May 24, 2007 at which the parties were unable to reach a settlement.

A derivative action purporting to be on behalf of Harmonic was filed against its then-current directors in the Superior Court for the County of Santa Clara on September 5, 2000. Harmonic also was named as a nominal defendant. The complaint is based on allegations similar to those found in the securities class action and claims that the defendants breached their fiduciary duties by, among other things, causing Harmonic to violate federal securities laws. The derivative action was removed to the United States District Court for the Northern District of California on September 20, 2000. All deadlines in this action were stayed pending resolution of the motions to dismiss the securities class action. On July 29, 2003, the Court approved the parties' stipulation to dismiss this derivative action without prejudice and to toll the applicable limitations period pending the Ninth Circuit's decision in the securities action. Pursuant to the stipulation, defendants have provided plaintiff with a copy of the mandate issued by the Ninth Circuit in the securities action.

A second derivative action purporting to be on behalf of Harmonic was filed in the Superior Court for the County of Santa Clara on May 15, 2003. It alleges facts similar to those previously alleged in the securities class action and the federal derivative action. The complaint names as defendants former and current Harmonic officers and directors, along with former officers and directors of C-Cube Microsystems, Inc., who were named in the securities class action. The complaint also names Harmonic as a nominal defendant. The complaint alleges claims for abuse of control, gross mismanagement, and waste of corporate assets against the Harmonic defendants, and claims for breach of fiduciary duty, unjust enrichment, and negligent misrepresentation against all defendants. On July 22, 2003, the Court approved the parties' stipulation to stay the case pending resolution of the appeal in the securities class action. Following the decision of the Ninth Circuit discussed above, on May 9, 2006, defendants filed demurrers to this complaint. The plaintiffs then filed an amended complaint on July 10, 2006, which names only the Harmonic defendants. The defendants filed demurrers to the amended complaint and reply briefs are due September 13, 2007. A case management conference and hearing are scheduled for October 5, 2007.

Based on its review of the surviving claims in the securities class actions, Harmonic believes that it has meritorious defenses and intends to defend itself vigorously. There can be no assurance, however, that Harmonic will prevail. No estimate can be made of the possible range of loss associated with the resolution of this contingency, and accordingly, Harmonic has not recorded a liability. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

Other Litigation

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4859016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

Harmonic is involved in other litigation and may be subject to claims arising in the normal course of business. In the opinion of management the amount of ultimate liability with respect to these matters in the aggregate will not have a material adverse effect on the Company or its operating results, financial position or cash flows.

Item 1A. RISK FACTORS

We Depend On Cable, Satellite And Telecom Industry Capital Spending For A Substantial Portion Of Our Revenue And Any Decrease Or Delay In Capital Spending In These Industries Would Negatively Impact Our Resources, Operating Results And Financial Condition And Cash Flows.

A significant portion of Harmonic's sales have been derived from sales to cable television, satellite and telecommunications operators, and we expect these sales to constitute a significant portion of net sales for the foreseeable future. Demand for our products will depend on the magnitude and timing of capital spending by cable

television operators, satellite operators, telephone companies and broadcasters for constructing and upgrading their systems.

These capital spending patterns are dependent on a variety of factors, including:

– access to financing;

– annual budget cycles;

– the impact of industry consolidation;

– the status of federal, local and foreign government regulation of telecommunications and television broadcasting;

– overall demand for communication services and the acceptance of new video, voice and data services;

– evolving industry standards and network architectures;

– competitive pressures, including pricing pressures;

– discretionary customer spending patterns; and

– general economic conditions.

In the past, specific factors contributing to reduced capital spending have included:

– uncertainty related to development of digital video industry standards;

– delays associated with the evaluation of new services, new standards, and system architectures by many operators;

– emphasis on generating revenue from existing customers by operators instead of new construction or network upgrades;

– a reduction in the amount of capital available to finance projects of our customers and potential customers;

– proposed and completed business combinations and divestitures by our customers and regulatory review thereof; - economic and financial conditions in domestic and international markets; and

– bankruptcies and financial restructuring of major customers.

The financial difficulties of certain of our customers and changes in our customers' deployment plans adversely affected our business in recent years. An economic downturn or other factors could also cause additional financial difficulties among our customers, and customers whose financial condition has stabilized may not purchase new equipment at levels we have seen in the past. Financial difficulties among our customers would adversely affect our operating results and financial condition. In addition, industry consolidation has, in the past and may in the future, constrain capital spending among our customers. As a result, we cannot assure you that we will maintain or increase our net sales in the future.

If our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of U.S. cable operators, our revenue may decline and our operating results would be adversely affected.

Our Customer Base Is Concentrated And The Loss Of One Or More Of Our Key Customers, Or a Failure to Diversify Our Customer Base, Could Harm Our Business.

Historically, a majority of our sales have been to relatively few customers, and due in part to the consolidation of ownership of cable television and direct broadcast satellite systems, we expect this customer concentration to continue in the foreseeable future. Sales to our ten largest customers in the first six months of 2007 and the years 2006 and 2005 accounted for approximately 53%, 50% and 54% of net sales, respectively. Although we are attempting to broaden our customer base by penetrating new markets such as the telecommunications and broadcast markets and expand internationally, we expect to see continuing industry consolidation and customer concentration due in part to the significant capital costs of constructing broadband networks. For example, Comcast acquired AT&T Broadband in 2002, thereby creating the largest U.S. cable operator, reaching approximately 22 million subscribers. The sale of Adelphia Communications' cable systems to Comcast and Time Warner Cable has led to further industry consolidation. NTL and Telewest, the two largest cable operators in the UK, completed their merger in 2006. In the DBS market, The News Corporation Ltd. acquired an indirect controlling interest in Hughes Electronics, the parent company of DirecTV in 2003. News Corporation announced its intention to sell its interest in DirecTV to Liberty Media in December 2006. In the telco market, AT&T recently completed its acquisition of Bell South.

In the first six months of 2007 and the years 2006 and 2005, sales to Comcast accounted for 19%, 12% and 18%, respectively, of net sales. The loss of Comcast or any other significant customer or any reduction in orders by Comcast or any significant customer, or our failure to qualify our products with a significant customer could adversely affect our business, operating results and liquidity. In this regard, sales to Comcast declined in 2006 compared to 2005, both in absolute dollars and as a percentage of revenues. The loss of, or any reduction in orders from, a significant customer would harm our business.

In addition, historically we have been dependent upon capital spending in the cable and satellite industry. We are attempting to diversify our customer base beyond cable and satellite customers, principally into the telco market. Major telcos have begun to implement plans to rebuild or upgrade their networks to offer bundled video, voice and data services. While we have recently increased our revenue from telco customers, we are relatively new to this market. In order to be successful in this market, we may need to build alliances with telco equipment manufacturers, adapt our products for telco applications, take orders at prices resulting in lower margins, and build internal expertise to handle the particular contractual and technical demands of the telco industry. In addition, telco video deployments are subject to delays in completion, as video processing technologies and video business models are new to most telcos and many of their largest suppliers. Implementation issues with our products or those of other vendors have caused, and may continue to cause delays in project completion for our customers and delay the recognition of revenue by Harmonic. As a result of these and other factors, we cannot assure you that we will be able to increase our revenues from the telco market, or that we can do so profitably, and any failure to increase revenues and profits from telco customers could adversely affect our business.

Our Operating Results Are Likely To Fluctuate Significantly And May Fail To Meet Or Exceed The Expectations Of Securities Analysts Or Investors, Causing Our Stock Price To Decline.

Our operating results have fluctuated in the past and are likely to continue to fluctuate in the future, on an annual and a quarterly basis, as a result of several factors, many of which are outside of our control. Some of the factors that may cause these fluctuations include:

– the level and timing of capital spending of our customers, both in the U.S. and in foreign markets;

– changes in market demand;

– the timing and amount of orders, especially from significant customers;

– the timing of revenue recognition from solution contracts which may span several quarters;

– the timing of revenue recognition on sales arrangements, which may include multiple deliverables;

– the timing of completion of projects;

– competitive market conditions, including pricing actions by our competitors;

– seasonality, with fewer construction and upgrade projects typically occurring in winter months and otherwise being affected by inclement weather;

– our unpredictable sales cycles;

– the amount and timing of sales to telcos, which are particularly difficult to predict;

– new product introductions by our competitors or by us;

– changes in domestic and international regulatory environments;

– market acceptance of new or existing products;

– the cost and availability of components, subassemblies and modules;

– the mix of our customer base and sales channels;

– the mix of products sold and the effect it has on gross margins;

– changes in our operating expenses and extraordinary expenses;

– the impact of SFAS 123(R), an accounting standard which requires us to record the fair value of stock options as compensation expense;

– the impact of FIN48, a recently adopted accounting interpretation which requires us to expense potential tax, penalties and interest;

– our development of custom products and software;

– the level of international sales; and

– economic and financial conditions specific to the cable, satellite and telco industries, and general economic conditions.

The timing of deployment of our equipment can be subject to a number of other risks, including the availability of skilled engineering and technical personnel, the availability of other equipment such as compatible set top boxes, and our customers' need for local franchise and licensing approvals.

In addition, we often recognize a substantial portion of our revenues in the last month of the quarter. We establish our expenditure levels for product development and other operating expenses based on projected sales levels, and expenses are relatively fixed in the short term. Accordingly, variations in timing of sales can cause significant fluctuations in operating results. As a result of all these factors, our operating results in one or more future periods may fail to meet or exceed the expectations of securities analysts or investors. In that event, the trading price of our common stock would likely decline. In this regard, due to a decrease in gross profit percentage in 2005, and lower than expected sales during the first and second quarters of 2006, we failed to meet our internal expectations, as well as the expectations of securities analysts and investors, and the price of our common stock declined, in some cases significantly.

Our Future Growth Depends on Market Acceptance of Several Emerging Broadband Services, on the Adoption of New Broadband Technologies and on Several Other Broadband Industry Trends.

Future demand for our products will depend significantly on the growing market acceptance of several emerging broadband services, including digital video; VOD; HDTV; mobile video services, very high-speed data services and voice-over-IP (VoIP) telephony.

The effective delivery of these services will depend, in part, on a variety of new network architectures and standards, such as:

– new video compression standards such as MPEG-4/H.264 for both standard definition and high definition services;

– FTTP and DSL networks designed to facilitate the delivery of video services by telcos;

– the greater use of protocols such as IP; and

– the introduction of new consumer devices, such as advanced set-top boxes and personal video recorders (PVRs).

If adoption of these emerging services and/or technologies is not as widespread or as rapid as we expect, or if we are unable to develop new products based on these technologies on a timely basis, our net sales growth will be materially and adversely affected.

Furthermore, other technological, industry and regulatory trends will affect the growth of our business. These trends include the following:

– convergence, or the desire of certain network operators to deliver a package of video, voice and data services to consumers, also known as the "triple play";

– the entry of telcos into the video business;

– growth in HDTV, on-demand services and mobile video;

– the use of digital video by businesses, governments and educators;

– efforts by regulators and governments in the U.S. and abroad to encourage the adoption of broadband and digital technologies; and

– the extent and nature of regulatory attitudes towards such issues as competition between operators, access by third parties to networks of other operators, local franchising requirements for telcos to offer video, and new services such as VoIP.

We Need To Develop And Introduce New And Enhanced Products In A Timely Manner To Remain Competitive.

Broadband communications markets are characterized by continuing technological advancement, changes in customer requirements and evolving industry standards. To compete successfully, we must design, develop, manufacture and sell new or enhanced products that provide increasingly higher levels of performance and reliability. However, we may not be able to successfully develop or introduce these products if our products:

– are not cost effective;

– are not brought to market in a timely manner;

– are not in accordance with evolving industry standards and architectures;

– fail to achieve market acceptance; or

– are ahead of the market.

We are currently developing and marketing products based on new video compression standards. Encoding products based on the MPEG-2 compression standards have represented a significant portion of our sales since the acquisition of DiviCom in 2000. New standards, such as MPEG-4/H.264 have been adopted which provide significantly greater compression efficiency, thereby making more bandwidth available to operators. The availability of more bandwidth is particularly important to those DBS and telco operators seeking to launch, or expand, HDTV services. Harmonic has developed and launched products, including HD encoders, based on these new standards in order to remain competitive and is devoting considerable resources to this effort. There can be no assurance that these efforts will be successful in the near future, or at all, or that competitors will not take significant market share in HD encoding. At the same time, Harmonic needs to devote development resources to the existing MPEG-2 product line which its cable customers continue to require.

Also, to successfully develop and market certain of our planned products for digital applications, we may be required to enter into technology development or licensing agreements with third parties. We cannot assure you that we will be able to enter into any necessary technology development or licensing agreement on terms acceptable to us, or at all. The failure to enter into technology development or licensing agreements when necessary could limit our ability to develop and market new products and, accordingly, could materially and adversely affect our business and operating results.

Broadband Communications Markets Are Characterized By Rapid Technological Change.

Broadband communications markets are relatively immature, making it difficult to accurately predict the markets' future growth rates, sizes or technological directions. In view of the evolving nature of these markets, it is possible that cable television operators, telephone companies or other suppliers of broadband wireless and satellite services will decide to adopt alternative architectures or technologies that are incompatible with our current or future products. Also, decisions by customers to adopt new technologies or products are often delayed by extensive evaluation and qualification processes and can result in delays in sales of current products. If we are unable to design, develop, manufacture and sell products that incorporate or are compatible with these new architectures or technologies, our business will suffer.

The Markets In Which We Operate Are Intensely Competitive And Many Of Our Competitors Are Larger And More Established.

The markets for fiber optics systems and digital video systems are extremely competitive and have been characterized by rapid technological change and declining average selling prices. Pressure on average selling prices was particularly severe during the most recent economic downturn as equipment suppliers competed aggressively for customers' reduced capital spending. Harmonic's competitors for fiber optic products include corporations such as Motorola, Cisco Systems and C-Cor. In our video processing and edge and access products, we compete broadly with products from vertically integrated system suppliers including Motorola, Cisco Systems, Tandberg Television and Thomson Multimedia, and in certain product lines with a number of smaller companies. In February 2007, Ericsson launched a bid for Tandberg Television and in April 2007, Ericsson completed the acquisition of Tandberg.

Many of our competitors are substantially larger and have greater financial, technical, marketing and other resources than Harmonic. Many of these large organizations are in a better position to withstand any significant reduction in capital spending by customers in these markets. They often have broader product lines and market focus and may not be as susceptible to downturns in a particular market. In addition, many of our competitors have been in operation longer than we have and therefore have more long-standing and established relationships with domestic and foreign customers. We may not be able to compete successfully in the future, which would harm our business.

If any of our competitors' products or technologies were to become the industry standard, our business could be seriously harmed. For example, new standards for video compression are being introduced and products based on these standards are being developed by Harmonic and certain competitors. If our competitors are successful in

bringing these products to market earlier, or if these products are more technologically capable than ours, then our sales could be materially and adversely affected. In addition, companies that have historically not had a large presence in the broadband communications equipment market have begun recently to expand their market share through mergers and acquisitions. The continued consolidation of our competitors could have a significant negative impact on us. Further, our competitors, particularly competitors of our digital and video broadcasting systems business, may bundle their products or incorporate functionality into existing products in a manner that discourages users from purchasing our products or which may require us to lower our selling prices resulting in lower gross margins.

If Sales Forecasted For A Particular Period Are Not Realized In That Period Due To The Unpredictable Sales Cycles Of Our Products, Our Operating Results For That Period Will Be Harmed.

The sales cycles of many of our products, particularly our newer products and products sold internationally, are typically unpredictable and usually involve:

– a significant technical evaluation;

– a commitment of capital and other resources by cable, satellite, and other network operators;

– time required to engineer the deployment of new technologies or new broadband services;

– testing and acceptance of new technologies that affect key operations; and

– test marketing of new services with subscribers.

For these and other reasons, our sales cycles generally last three to nine months, but can last up to 12 months. If orders forecasted for a specific customer for a particular quarter do not occur in that quarter, our operating results for that quarter could be substantially lower than anticipated. In this regard, our sales cycles with our current and potential satellite and telco customers are particularly unpredictable. Orders may include multiple elements, the timing of delivery of which may impact the timing of revenue recognition. Additionally, our sales arrangements may include testing and acceptance of new technologies and the timing of completion of acceptance testing is difficult to predict and may impact the timing of revenue recognition. Quarterly and annual results may fluctuate significantly due to revenue recognition policies and the timing of the receipt of orders. For example, revenue from two significant customer orders in the third quarter of 2004 was delayed due to these factors until the fourth quarter of 2004, and delays in the completion of certain projects underway with our international telco customers in the second quarter of 2006 resulted in lower revenue.

In addition, a significant portion of our revenue is derived from solution sales that principally consist of and include the system design, manufacture, test, installation and integration of equipment to the specifications of Harmonic’s customers, including equipment acquired from third parties to be integrated with Harmonic’s products. Revenue forecasts for solution contracts are based on the estimated timing of the system design, installation and integration of projects. Because the solution contracts generally span several quarters and revenue recognition is based on progress under the contract, the timing of revenue is difficult to predict and could result in lower than expected revenue in any particular quarter.

We Must Be Able To Manage Expenses And Inventory Risks Associated With Meeting The Demand Of Our Customers.

If actual orders are materially lower than the indications we receive from our customers, our ability to manage inventory and expenses may be affected. If we enter into purchase commitments to acquire materials, or expend resources to manufacture products, and such products are not purchased by our customers, our business and operating results could suffer. In this regard, our gross margins and operating results have been in the past adversely affected by significant charges for excess and obsolete inventories.

In addition, we must carefully manage the introduction of next generation products in order to balance potential inventory risks associated with excess quantities of older product lines and forecasts of customer demand for new

products. For example, in 2005, we wrote down approximately $8.4 million for obsolete and excess inventory, with a major portion of the write-down being the result of product transitions in certain product lines. We also wrote down $1.1 million in 2006 as a result of the end of life of a product line. There can be no assurance that we will be able to manage these product transitions in the future without incurring write-downs for excess inventory or having inadequate supplies of new products to meet customer expectations.

We Face Risks Associated With Having Important Facilities And Resources Located In Israel.

Harmonic maintains a facility in Caesarea in the State of Israel with a total of 70 employees as of June 29, 2007, or approximately 12% of our workforce. The employees at this facility consist principally of research and development personnel. In addition, we have pilot production capabilities at this facility consisting of procurement of subassemblies and modules from Israeli subcontractors and final assembly and test operations. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel. Any recurrence of the recent conflict in Israel and Lebanon could have a direct effect on our business or that of our Israeli subcontractors, in the form of physical damage or injury, reluctance to travel within or to Israel by our Israeli and foreign employees, or the loss of employees to active military duty. Most of our employees in Israel are currently obligated to perform annual reserve duty in the Israel Defense Forces and several have been called for active military duty recently. In the event that more employees are called to active duty, certain of our research and development activities may be adversely affected and significantly delayed. In addition, the interruption or curtailment of trade between Israel and its trading partners could significantly harm our business. Terrorist attacks and hostilities within Israel, the hostilities between Israel and Hezbollah, the election of Hamas representatives to a majority of the seats in the Palestinian Legislative Council and the recent conflict between Hamas and Fatah in Gaza have also heightened these risks. We cannot assure you that current tensions in the Middle East will not adversely affect our business and results of operations, and we cannot predict the effect of events in Israel on Harmonic in the future.

We Depend On Our International Sales And Are Subject To The Risks Associated With International Operations, Which May Negatively Affect Our Operating Results.

Sales to customers outside of the U.S. in the first six months of 2007 and the years 2006 and 2005 represented 43%, 49% and 40% of net sales, respectively, and we expect that international sales will continue to represent a meaningful portion of our net sales for the foreseeable future. Furthermore, a substantial portion of our contract manufacturing occurs overseas. Our international operations, the international operations of our contract manufacturers, and our efforts to increase sales in international markets, are subject to a number of risks, including:

- changes in foreign government regulations and telecommunications standards;
- import and export license requirements, tariffs, taxes and other trade barriers;
- fluctuations in currency exchange rates;
- difficulty in collecting accounts receivable;
- potential tax issues;
- the burden of complying with a wide variety of foreign laws, treaties and technical standards;
- difficulty in staffing and managing foreign operations;
- political and economic instability, including risks related to terrorist activity; and
- changes in economic policies by foreign governments.

Certain of our international customers have accumulated significant levels of debt and have undertaken reorganizations and financial restructurings, including bankruptcy proceedings. Even if these restructurings are completed, we cannot assure you that these customers will be in a position to purchase new equipment at levels we have seen in the past.

While our international sales and operating expenses have typically been denominated in U.S. dollars, fluctuations in currency exchange rates could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in sales or profitability in that country. A significant portion of our European business is denominated in Euros, which may subject us to increased foreign currency risk. Gains and losses on the conversion to U.S. dollars of accounts receivable, accounts payable and other monetary assets and liabilities arising from international operations may contribute to fluctuations in operating results.

Furthermore, payment cycles for international customers are typically longer than those for customers in the U.S. Unpredictable sales cycles could cause us to fail to meet or exceed the expectations of security analysts and investors for any given period. In addition, foreign markets may not further develop in the future. Any or all of these factors could adversely impact our business and results of operations.

Changes in Telecommunications Legislation and Regulations Could Harm Our Prospects And Future Sales.

Changes in telecommunications legislation and regulations in the U.S. and other countries could affect the sales of our products. In particular, regulations dealing with access by competitors to the networks of incumbent operators could slow or stop additional construction or expansion by these operators. Local franchising and licensing requirements may slow the entry of telcos into the video business. Increased regulation of our customers' pricing or service offerings could limit their investments and consequently the sales of our products. Changes in regulations could have a material adverse effect on our business, operating results, and financial condition.

Competition For Qualified Personnel, Particularly Management Personnel, Can Be Intense. In Order To Manage Our Growth, We Must Be Successful In Addressing Management Succession Issues And Attracting And Retaining Qualified Personnel.

Our future success will depend, to a significant extent, on the ability of our management to operate effectively, both individually and as a group. We must successfully manage transition and replacement issues that may result from the departure or retirement of members of our senior management. For example, in May 2006 we announced that our then Chairman, President and Chief Executive Officer, Anthony J. Ley, had retired from his position as President and Chief Executive Officer effective immediately, and that he was being succeeded by our then Executive Vice President, Patrick J. Harshman. In addition, in November 2006, we announced that our Senior Vice President of Operations and Quality, Israel Levi, retired from his position and was succeeded by Charles Bonasera as Vice President of Operations. We cannot assure you that transitions of management personnel will not cause disruption to our operations or customer relationships, or a decline in our financial results.

In addition, we are dependent on our ability to retain and motivate high caliber personnel, in addition to attracting new personnel. Competition for qualified management, technical and other personnel can be intense, and we may not be successful in attracting and retaining such personnel. Competitors and others have in the past and may in the future attempt to recruit our employees. While our employees are required to sign standard agreements concerning confidentiality and ownership of inventions, we generally do not have employment contracts or non-competition agreements with any of our personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel, particularly senior management and engineers and other technical personnel, could negatively affect our business.

Accounting Standards And Stock Exchange Regulations Related To Equity Compensation Could Adversely Affect Earnings, Affect Our Ability To Raise Capital And Affect Our Ability To Attract And Retain Key Personnel.

Since our inception, we have used stock options as a fundamental component of our employee compensation packages. We believe that our stock option plans are an essential tool to link the long-term interests of stockholders and employees, especially executive management, and serve to motivate management to make decisions that will, in

the long run, give the best returns to stockholders. The Financial Accounting Standards Board (FASB) issued FAS 123(R) that requires us to record a charge to earnings for employee stock option grants and employee stock purchase plan rights for all periods from January 1, 2006. This standard has negatively impacted and will continue to negatively impact our earnings and may affect our ability to raise capital on acceptable terms. For the six months ended June 29, 2007, stock-based compensation expense recognized under SFAS 123(R) was $2.8 million, which consisted of stock-based compensation expense related to employee equity awards and employee stock purchases.

In addition, regulations implemented by NASDAQ requiring stockholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new accounting standards make it more difficult or expensive to grant options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

We Are Exposed To Additional Costs And Risks Associated With Complying With Increasing And New Regulation Of Corporate Governance And Disclosure Standards.

We are spending an increased amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, SEC regulations and NASDAQ rules. Particularly, Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal control over financial reporting, and attestation of the effectiveness of our internal control over financial reporting by management and the Company's independent registered public accounting firm in connection with the filing of the annual report on Form 10-K for each fiscal year. We have documented and tested our internal control systems and procedures and have made improvements in order for us to comply with the requirements of Section 404. This process required us to hire additional personnel and outside advisory services and has resulted in significant additional expenses. While our assessment of our internal control over financial reporting resulted in our conclusion that as of December 31, 2006, our internal control over financial reporting was effective, we cannot predict the outcome of our testing in future periods. If we conclude in future periods that our internal control over financial reporting is not effective or if our independent registered public accounting firm is unable to provide an unqualified opinion as of future year-ends, investors may lose confidence in our financial statements, and the price of our stock may suffer.

We May Need Additional Capital In The Future And May Not Be Able To Secure Adequate Funds On Terms Acceptable To Us.

We have generated substantial operating losses since we began operations in June 1988. We have been engaged in the design, manufacture and sale of a variety of broadband products since inception, which has required, and will continue to require, significant research and development expenditures. As of June 29, 2007 we had an accumulated deficit of $1.9 billion. These losses, among other things, have had and may have an adverse effect on our stockholders' equity and working capital.

We believe that our existing liquidity sources will satisfy our cash requirements for at least the next twelve months including our contractual obligation to invest $2.5 million in Entone's CPE business, which was funded in July 2007, the payment of $5.3 million as the cash portion of the Rhozet Corporation acquisition, and final settlement and payment of C-Cube's pre-merger liabilities. However, we may need to raise additional funds if our expectations are incorrect, to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. In April 2005, we filed a registration statement on Form S-3 with the SEC. Pursuant to this registration statement on Form S-3, which has been declared effective by the SEC, we are able to issue registered common stock, preferred stock, debt securities and warrants to purchase common stock from time to time, up to an aggregate of approximately $200 million, subject to market conditions and our capital needs. Our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including conditions in capital markets and the cable, telecom and satellite industries. There can be no assurance that such financing will be available on terms acceptable to us, if at all.

In addition, we actively review potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. Any future transaction of this nature could require potentially significant amounts of capital to finance the acquisition and related expenses as well as to

integrate operations following a transaction, and could require us to issue our stock and dilute existing stockholders. If adequate funds are not available, or are not available on acceptable terms, we may not be able to take advantage of market opportunities, to develop new products or to otherwise respond to competitive pressures.

We may raise additional financing through public or private equity offerings, debt financings or additional corporate collaboration and licensing arrangements. To the extent we raise additional capital by issuing equity securities, our stockholders may experience dilution. To the extent that we raise additional funds through collaboration and licensing arrangements, it may be necessary to relinquish some rights to our technologies or products, or grant licenses on terms that are not favorable to us. If adequate funds are not available, we will not be able to continue developing our products.

If Demand For Our Products Increases More Quickly Than We Expect, We May Be Unable To Meet Our Customers' Requirements.

If demand for our products increases, the difficulty of accurately forecasting our customers' requirements and meeting these requirements will increase. For example, we had insufficient quantities of certain products to meet customer demand late in the second quarter of 2006 and, as a result, our revenues were lower than internal and external expectations. Forecasting to meet customers' needs and effectively managing our supply chain is particularly difficult in connection with newer products. Our ability to meet customer demand depends significantly on the availability of components and other materials as well as the ability of our contract manufacturers to scale their production. Furthermore, we purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources. Our ability to meet customer requirements depends in part on our ability to obtain sufficient volumes of these materials in a timely fashion. Also, in recent years, in response to lower net sales and the prolonged economic recession, we significantly reduced our headcount and other expenses. As a result, we may be unable to respond to customer demand that increases more quickly than we expect. If we fail to meet customers' supply expectations, our net sales would be adversely affected and we may lose business.

We Purchase Several Key Components, Subassemblies And Modules Used In The Manufacture Or Integration Of Our Products From Sole Or Limited Sources, And We Are Increasingly Dependent On Contract Manufacturers.

Many components, subassemblies and modules necessary for the manufacture or integration of our products are obtained from a sole supplier or a limited group of suppliers. For example, we depend on a small private company for certain video encoding chips which are incorporated into several new products. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our increased reliance on subcontractors involves several risks, including a potential inability to obtain an adequate supply of required components, subassemblies or modules and reduced control over pricing, quality and timely delivery of components, subassemblies or modules. In particular, certain optical components have in the past been in short supply and are available only from a small number of suppliers, including sole source suppliers. While we expend resources to qualify additional component sources, consolidation of suppliers in the industry and the small number of viable alternatives have limited the results of these efforts. We do not generally maintain long-term agreements with any of our suppliers. Managing our supplier and contractor relationships is particularly difficult during time periods in which we introduce new products and during time periods in which demand for our products is increasing, especially if demand increases more quickly than we expect. Furthermore, from time to time we assess our relationship with our contract manufacturers. In 2003, we entered into a three-year agreement with Plexus Services Corp. as our primary contract manufacturer. This agreement has automatic annual renewals unless prior notice is given and has been renewed until October 2007.

Difficulties in managing relationships with current contract manufacturers, could impede our ability to meet our customers' requirements and adversely affect our operating results. An inability to obtain adequate deliveries or any other circumstance that would require us to seek alternative sources of supply could negatively affect our ability to ship our products on a timely basis, which could damage relationships with current and prospective customers and harm our business. We attempt to limit this risk by maintaining safety stocks of certain components, subassemblies and modules. As a result of this investment in inventories, we have in the past and in the future may be subject to risk of excess and obsolete inventories, which could harm our business, operating results, financial position and liquidity. In this regard, our gross margins and operating results in the past were adversely affected by significant excess and obsolete inventory charges.

Cessation Of The Development And Production Of Video Encoding Chips By C-Cube's Spun-off Semiconductor Business May Adversely Impact Us.

Our DiviCom business, which we acquired in 2000, and the C-Cube semiconductor business (acquired by LSI Logic in June 2001) collaborated on the production and development of two video encoding microelectronic chips prior to our acquisition of the DiviCom business. In connection with the acquisition, Harmonic and the spun-off semiconductor business of C-Cube entered into a contractual relationship under which Harmonic has access to certain of the spun-off semiconductor business technologies and products on which the DiviCom business depends for certain product and service offerings. The current term of this agreement is through October 2007, with automatic annual renewals unless terminated by either party in accordance with the agreement provisions. On July 27, 2007, LSI announced that it had completed the sale of its consumer products business (which includes the design and manufacture of encoding chips) to Magnum Semiconductor. If the spun-off semiconductor business is not able to or does not sustain its development and production efforts in this area, our business, financial condition, results of operations and cash flow could be harmed.

We Need To Effectively Manage Our Operations And The Cyclical Nature Of Our Business.

The cyclical nature of our business has placed, and is expected to continue to place, a significant strain on our personnel, management and other resources. We reduced our work force by approximately 44% between December 31, 2000 and December 31, 2003 due to reduced industry spending and demand for our products. If demand for products increases significantly, we may need to increase our headcount, as we did during 2004, adding 33 employees. In the first quarter of 2005, we added 42 employees in connection with our acquisition of BTL, and in connection with the consolidation of our two operating divisions in December 2005, we reduced our workforce by approximately 40 employees. Following the closure of our BTL operations in the first quarter of 2007, we reduced our headcount by 29 employees in the UK. Our purchase of the video networking software business of Entone in December 2006 resulted in the addition of 43 employees, most of whom are based in Hong Kong, and we added approximately 15 employees on July 31, 2007, in connection with the completion of our acquisition of Rhozet Corporation. Our ability to manage our business effectively in the future, including any future growth, will require us to train, motivate and manage our employees successfully, to attract and integrate new employees into our overall operations, to retain key employees and to continue to improve our operational, financial and management systems.

We Are Subject To Various Environmental Laws And Regulations That Could Impose Substantial Costs Upon Us And May Adversely Affect Our Business, Operating Results And Financial Condition.

Some of our operations use substances regulated under various federal, state, local and international laws governing the environment, including those governing the management, disposal and labeling of hazardous substances and wastes and the cleanup of contaminated sites. We could incur costs and fines, third-party property damage or personal injury claims, or could be required to incur substantial investigation or remediation costs, if we were to violate or become liable under environmental laws. The ultimate costs under environmental laws and the timing of these costs are difficult to predict.

We also face increasing complexity in our product design as we adjust to new and future requirements relating to the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling, and disposal of certain products. For example, the European Parliament and the Council of the European Union have enacted the Waste Electrical and Electronic Equipment (WEEE) directive, effective August 13, 2005, which regulates the collection, recovery, and recycling of waste from electrical and electronic products, and the Restriction on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, effective July 1, 2006, which bans the use of certain hazardous materials including lead, mercury, cadmium, hexavalent chromium, and polybrominated biphenyls (PBBs), and polybrominated diphenyl ethers (PBDEs) that exceed certain specified levels. For some products, substituting particular components containing regulated hazardous substances is more difficult or costly, and redesign efforts could result in production delays. Selected electronic products that we maintain in inventory may be rendered obsolete if not in compliance with the new environmental laws, and we may have unfulfilled sales orders, which could negatively impact our ability to generate revenue from those products. Legislation similar to RoHS and WEEE has been or may be enacted in other jurisdictions, including in the United States, Japan, and China. Our failure to comply with these laws could result in our being directly or indirectly liable for costs, fines or penalties and third-party claims, and could jeopardize our ability to conduct business in such countries. We also expect that our operations will be affected by

other new environmental laws and regulations on an ongoing basis. Although we cannot predict the ultimate impact of any such new laws and regulations, they will likely result in additional costs or decreased revenue, and could require that we redesign or change how we manufacture our products, any of which could have a material adverse effect on our business.

We Are Liable For C-Cube's Pre-Merger Liabilities, Including Liabilities Resulting From The Spin-Off Of Its Semiconductor Business.

Under the terms of the merger agreement with C-Cube, Harmonic is generally liable for C-Cube's pre-merger liabilities. As of June 29, 2007, approximately $6.7 million of pre-merger liabilities remained outstanding and are included in accrued liabilities. We are working with LSI Logic, which acquired C-Cube's spun-off semiconductor business in June 2001 and assumed its obligations, to develop an approach to settle these obligations, a process which has been underway since the merger in 2000. These liabilities represent estimates of C-Cube's pre-merger obligations to various authorities in 9 countries. Harmonic paid $2.4 million in January 2007, but is unable to predict when the remaining obligations will be paid. The full amount of the estimated obligations has been classified as a current liability. To the extent that these obligations are finally settled for less than the amounts provided, Harmonic is required, under the terms of the merger agreement, to refund the difference to LSI Logic. Conversely, if the settlements are more than the remaining $6.7 million pre-merger liability, LSI Logic is obligated to reimburse Harmonic.

The merger agreement stipulates that Harmonic will be indemnified by the spun-off semiconductor business if the cash reserves are not sufficient to satisfy all of C-Cube's liabilities for periods prior to the merger. If for any reason, the spun-off semiconductor business does not have sufficient cash to pay such taxes, or if there are additional taxes due with respect to the non-semiconductor business and Harmonic cannot be indemnified by LSI Logic, Harmonic generally will remain liable, and such liability could have a material adverse effect on our financial condition, results of operations or cash flows.

We May Be Subject To Risks Associated With Acquisitions.

We have made, continue to consider making and may make investments in complementary companies, products or technologies. For example, on December 8, 2006, we acquired the video networking software business of Entone Technologies, Inc., and on July 31, 2007, we completed the acquisition of Rhozet Corporation. In connection with these and other acquisition transactions, we could have difficulty assimilating or retaining the acquired companies' key personnel and operations, integrating the acquired technology or products into ours or complying with internal control requirements of the Sarbanes-Oxley Act as a result of an acquisition.

We also may face challenges in achieving the strategic objectives, cost savings or other benefits from these acquisitions and difficulties in expanding our management information systems to accommodate the acquired business. For example, we recently closed all operations and product lines related to Broadcast Technology Limited, which we acquired in 2005. Such difficulties could disrupt our ongoing business, distract our management and employees and significantly increase our expenses. Moreover, our operating results may suffer because of acquisition-related expenses, amortization of intangible assets and impairment of acquired goodwill or intangible assets. Furthermore, we may have to incur debt or issue equity securities to pay for any future acquisitions, or to provide for additional working capital requirements, the issuance of which could be dilutive to our existing shareholders. If we are unable to successfully address any of these risks, our business, financial condition or operating results could be harmed.

Our Failure To Adequately Protect Our Proprietary Rights May Adversely Affect Us.

We currently hold 38 issued U.S. patents and 19 issued foreign patents, and have a number of patent applications pending. Although we attempt to protect our intellectual property rights through patents, trademarks, copyrights, licensing arrangements, maintaining certain technology as trade secrets and other measures, we cannot assure you that any patent, trademark, copyright or other intellectual property rights owned by us will not be invalidated, circumvented or challenged, that such intellectual property rights will provide competitive advantages to us or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. We cannot assure you that others will not develop technologies that are similar or superior to our technology, duplicate

our technology or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or may do business in the future.

We believe that patents and patent applications are not currently significant to our business, and investors therefore should not rely on our patent portfolio to give us a competitive advantage over others in our industry. We believe that the future success of our business will depend on our ability to translate the technological expertise and innovation of our personnel into new and enhanced products. We generally enter into confidentiality or license agreements with our employees, consultants, vendors and customers as needed, and generally limit access to and distribution of our proprietary information. Nevertheless, we cannot assure you that the steps taken by us will prevent misappropriation of our technology. In addition, we have taken in the past, and may take in the future, legal action to enforce our patents and other intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. Such litigation could result in substantial costs and diversion of resources and could negatively affect our business, operating results, financial position or cash flows.

In order to successfully develop and market certain of our planned products for digital applications, we may be required to enter into technology development or licensing agreements with third parties. Although many companies are often willing to enter into technology development or licensing agreements, we cannot assure you that such agreements will be negotiated on terms acceptable to us, or at all. The failure to enter into technology development or licensing agreements, when necessary, could limit our ability to develop and market new products and could cause our business to suffer.

We Or Our Customers May Face Intellectual Property Infringement Claims From Third Parties.

Harmonic’s industry is characterized by the existence of a large number of patents and frequent claims and related litigation regarding patent and other intellectual property rights. In particular, leading companies in the telecommunications industry have extensive patent portfolios. From time to time, third parties, including these leading companies, have asserted and may assert exclusive patent, copyright, trademark and other intellectual property rights against us or our customers. Indeed, a number of third parties, including leading companies, have asserted patent rights to technologies that are important to us.

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic’s products infringe U.S. Patent No. 4859016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic’s business, operating results, financial position or cash flows.

Our suppliers and customers may receive similar claims. We have agreed to indemnify some of our suppliers and customers for alleged patent infringement. The scope of this indemnity varies, but, in some instances, includes indemnification for damages and expenses (including reasonable attorney’s fees).

We Are The Subject Of Securities Class Action Claims And Other Litigation Which, If Adversely Determined, Could Harm Our Business And Operating Results.

Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its officers and directors (some of whom are no longer with Harmonic) were filed in or removed to the United States District Court (the “District Court”) for the Northern District of California. The actions subsequently were consolidated.

A consolidated complaint, filed on December 7, 2000, was brought on behalf of a purported class of persons who purchased Harmonic’s publicly traded securities between January 19 and June 26, 2000. The complaint also alleged

claims on behalf of a purported subclass of persons who purchased C-Cube securities between January 19 and May 3, 2000. In addition to Harmonic and certain of its officers and directors, the complaint also named C-Cube Microsystems Inc. and several of its officers and directors as defendants. The complaint alleged that, by making false or misleading statements regarding Harmonic's prospects and customers and its acquisition of C-Cube, certain defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act. The complaint also alleged that certain defendants violated Section 14(a) of the Exchange Act and Sections 11, 12(a)(2), and 15 of the Securities Act by filing a false or misleading registration statement, prospectus, and joint proxy in connection with the C-Cube acquisition.

On July 3, 2001, the District Court dismissed the consolidated complaint with leave to amend. An amended complaint alleging the same claims against the same defendants was filed on August 13, 2001. Defendants moved to dismiss the amended complaint on September 24, 2001. On November 13, 2002, the District Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the District Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a notice of appeal on July 1, 2003. The appeal was heard by a panel of three judges of the United States Court of Appeals for the Ninth Circuit (the "Ninth Circuit") on February 17, 2005.

On November 8, 2005, the Ninth Circuit panel affirmed in part, reversed in part, and remanded for further proceedings the decision of the District Court. The Ninth Circuit affirmed the District Court's dismissal of the plaintiffs' fraud claims under Sections 10(b), 14(a), and 20(a) of the Exchange Act with prejudice, finding that the plaintiffs failed to adequately plead their allegations of fraud. The Ninth Circuit reversed the District Court's dismissal of the plaintiffs' claims under Sections 11 and 12(a)(2) of the Securities Act, however, finding that those claims did not allege fraud and therefore were subject to only minimal pleading standards. Regarding the secondary liability claim under Section 15 of the Securities Act, the Ninth Circuit reversed the dismissal of that claim against Anthony J. Ley, Harmonic's Chairman and former Chief Executive Officer, and affirmed the dismissal of that claim against Harmonic, while granting leave to amend. The Ninth Circuit remanded the surviving claims to the District Court for further proceedings.

On November 22, 2005, both the Harmonic defendants and the plaintiffs petitioned the Ninth Circuit for a rehearing of the appeal. On February 16, 2006 the Ninth Circuit denied both petitions. On May 17, 2006 the plaintiffs filed an amended complaint on the issues remanded for further proceedings by the Ninth Circuit, to which the Harmonic defendants responded with a motion to dismiss certain claims and to strike certain allegations. On December 11, 2006, the Court granted the motion to dismiss with respect to the Section 12(a)(2) claim against the individual Harmonic defendants and granted the motion to strike, but denied the motion to dismiss the Section 15 claim. A case management conference was held on January 25, 2007, at which the Court set a trial date in August 2008, with discovery to close in February 2008. The Court also ordered the parties to attend a settlement conference with a magistrate judge or a private mediation before June 30, 2007. A mediation session was held on May 24, 2007 at which the parties were unable to reach a settlement.

A derivative action purporting to be on behalf of Harmonic was filed against its then-current directors in the Superior Court for the County of Santa Clara on September 5, 2000. Harmonic also was named as a nominal defendant. The complaint is based on allegations similar to those found in the securities class action and claims that the defendants breached their fiduciary duties by, among other things, causing Harmonic to violate federal securities laws. The derivative action was removed to the United States District Court for the Northern District of California on September 20, 2000. All deadlines in this action were stayed pending resolution of the motions to dismiss the securities class action. On July 29, 2003, the Court approved the parties' stipulation to dismiss this derivative action without prejudice and to toll the applicable limitations period pending the Ninth Circuit's decision in the securities action. Pursuant to the stipulation, defendants have provided plaintiff with a copy of the mandate issued by the Ninth Circuit in the securities action.

A second derivative action purporting to be on behalf of Harmonic was filed in the Superior Court for the County of Santa Clara on May 15, 2003. It alleges facts similar to those previously alleged in the securities class action and the federal derivative action. The complaint names as defendants former and current Harmonic officers and directors, along with former officers and directors of C-Cube Microsystems, Inc., who were named in the securities class

action. The complaint also names Harmonic as a nominal defendant. The complaint alleges claims for abuse of control, gross mismanagement, and waste of corporate assets against the Harmonic defendants, and claims for breach of fiduciary duty, unjust enrichment, and negligent misrepresentation against all defendants. On July 22, 2003, the Court approved the parties' stipulation to stay the case pending resolution of the appeal in the securities class action. Following the decision of the Ninth Circuit discussed above, on May 9, 2006, defendants filed demurrers to this complaint. The plaintiffs then filed an amended complaint on July 10, 2006, which names only the Harmonic defendants. The defendants filed demurrers to the amended complaint and reply briefs are due September 13, 2007. A case management conference and hearing are scheduled for October 5, 2007.

Based on its review of the surviving claims in the securities class actions, Harmonic believes that it has meritorious defenses and intends to defend itself vigorously. There can be no assurance, however, that Harmonic will prevail.

In addition, in July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4859016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it.

No estimate can be made of the possible range of loss associated with the resolution of each of these claims, and, accordingly, Harmonic has not recorded a liability. An unfavorable outcome of any of these litigation matters could require that we pay substantial damages, or, in connection with any intellectual property infringement claims, could require that we pay ongoing royalty payments or could prevent us from selling certain of our products. In addition, we may decide to settle any litigation, which could cause us to incur significant costs. An unfavorable outcome or settlement of these litigation matters could have a material adverse effect on our business, operating results, financial position or cash flows.

The Terrorist Attacks Of 2001 And The Ongoing Threat Of Terrorism Have Created Great Uncertainty And May Continue To Harm Our Business.

Current conditions in the U.S. and global economies are uncertain. The terrorist attacks in the U.S. in 2001 and subsequent terrorist attacks in other parts of the world have created many economic and political uncertainties that have severely impacted the global economy, and have adversely affected our business. For example, following the 2001 terrorist attacks in the U.S., we experienced a further decline in demand for our products after the attacks. The long-term effects of the attacks, the situation in Iraq and the ongoing war on terrorism on our business and on the global economy remain unknown. Moreover, the potential for future terrorist attacks has created additional uncertainty and makes it difficult to estimate the stability and strength of the U.S. and other economies and the impact of economic conditions on our business.

We Rely On A Continuous Power Supply To Conduct Our Operations, And Any Electrical And Natural Gas Crisis Could Disrupt Our Operations And Increase Our Expenses.

We rely on a continuous power supply for manufacturing and to conduct our business operations. Interruptions in electrical power supplies in California in the early part of 2001 could recur in the future. In addition, the cost of electricity and natural gas has risen significantly. Power outages could disrupt our manufacturing and business operations and those of many of our suppliers, and could cause us to fail to meet production schedules and commitments to customers and other third parties. Any disruption to our operations or those of our suppliers could result in damage to our current and prospective business relationships and could result in lost revenue and additional expenses, thereby harming our business and operating results.

The Markets In Which We, Our Customers And Suppliers Operate Are Subject To The Risk Of Earthquakes And Other Natural Disasters.

Our headquarters and the majority of our operations are located in California, which is prone to earthquakes, and some of the other locations in which we, our customers and suppliers conduct business are prone to natural disasters. In the event that any of our business centers are affected by any such disasters, we may sustain damage to our operations and properties and suffer significant financial losses. Furthermore, we rely on third party manufacturers for the production of many of our products, and any disruption in the business or operations of such manufacturers could adversely impact our business. In addition, if there is a major earthquake or other natural disaster in any of the locations in which our significant customers are located, we face the risk that our customers may incur losses, or

sustained business interruption and/or loss which may materially impair their ability to continue their purchase of products from us. A major earthquake or other natural disaster in the markets in which we, our customers or suppliers operate could have a material adverse effect on our business, financial condition, results of operations and cash flows.

Our Stock Price May Be Volatile.

The market price of our common stock has fluctuated significantly in the past, and is likely to fluctuate in the future. In addition, the securities markets have experienced significant price and volume fluctuations and the market prices of the securities of technology companies have been especially volatile. Investors may be unable to resell their shares of our common stock at or above their purchase price. In the past, companies that have experienced volatility in the market price of their stock have been the object of securities class action litigation.

Some Anti-Takeover Provisions Contained In Our Certificate Of Incorporation, Bylaws And Stockholder Rights Plan, As Well As Provisions Of Delaware Law, Could Impair A Takeover Attempt.

Harmonic has provisions in its certificate of incorporation and bylaws, each of which could have the effect of rendering more difficult or discouraging an acquisition deemed undesirable by the Harmonic Board of Directors. These include provisions:

– authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to Harmonic common stock;

– limiting the liability of, and providing indemnification to, directors and officers;

– limiting the ability of Harmonic stockholders to call and bring business before special meetings;

– requiring advance notice of stockholder proposals for business to be conducted at meetings of Harmonic stockholders and for nominations of candidates for election to the Harmonic Board of Directors;

– controlling the procedures for conduct and scheduling of Board and stockholder meetings; and

– providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

These provisions, alone or together, could delay hostile takeovers and changes in control or management of Harmonic.

In addition, Harmonic has adopted a stockholder rights plan. The rights are not intended to prevent a takeover of Harmonic, and we believe these rights will help Harmonic's negotiations with any potential acquirers. However, if the Board of Directors believes that a particular acquisition is undesirable, the rights may have the effect of rendering more difficult or discouraging that acquisition. The rights would cause substantial dilution to a person or group that attempts to acquire Harmonic on terms or in a manner not approved by the Harmonic Board of Directors, except pursuant to an offer conditioned upon redemption of the rights.

As a Delaware corporation, Harmonic also is subject to provisions of Delaware law, including Section 203 of the Delaware General Corporation law, which prevents some stockholders holding more than 15% of our outstanding common stock from engaging in certain business combinations without approval of the holders of substantially all of our outstanding common stock.

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

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

On July 31, 2007, Harmonic completed the acquisition of Rhozet Corporation by a merger transaction. In connection with the acquisition, Harmonic paid an aggregate consideration of approximately $15.5 million, which was comprised of (i) approximately $2.53 million in cash and approximately 1,099,790 shares of Harmonic's common stock in exchange for all of the issued and outstanding capital stock of Rhozet, and (ii) approximately $2.76 million of cash to be paid, at such time as provided in the definitive agreement related to such acquisition, to the holders of options to acquire Rhozet's common stock that were outstanding immediately prior to the effective time of the merger. In connection with such sale of its common stock, Harmonic relied upon the exemption from registration provided by Section 4(2) of the Securities Act of 1933, as amended.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Annual Meeting of Stockholders of the Company, held on June 13, 2007, the following matters were acted upon by the stockholders of the Company:

1. The election of Anthony J. Ley, Patrick J. Harshman, E. Floyd Kvamme, William F. Reddersen, Lewis Solomon, and David R. Van Valkenburg as directors of the Company, each to hold office for a one-year term or until a successor is elected and qualified;
2. Ratification of the appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm of the Company for the fiscal year ending December 31, 2007.

The number of shares of Common Stock outstanding and entitled to vote at the Annual Meeting was 79,402,871 and 70,402,871 shares were represented in person or by proxy. The results of the voting on each of the matters presented to stockholders at the Annual Meeting are set forth below:

	Votes For	Votes Withheld
Proposal 1–		
Election of Directors		
Anthony J. Ley	68,159,919	2,242,952
Patrick J. Harshman	68,802,698	1,600,173
E. Floyd Kvamme	68,426,220	1,976,651
William F. Reddersen	69,505,773	897,098
Lewis Solomon	69,538,515	864,356
David R. Van Valkenburg	69,268,332	1,134,539

	Votes For	Votes Against	Abstain
Proposal 2–			
Ratification of appointment of PricewaterhouseCoopers LLP as the independent public accounting firm of Harmonic for the year ending December 31, 2007	68,388,697	1,918,717	95,457

Item 5. OTHER INFORMATION

None.

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Item 6. EXHIBITS

Exhibit Number	Exhibit Index
10.1	Agreement and Plan of Merger by and among Rhozet Corporation, Dusseldorf Acquisition Corporation, Harmonic Inc. and David Trescot, as shareholder representative, dated July 25, 2007
31.1	Section 302 Certification of Principal Executive Officer
31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Principal Executive Officer
32.2	Section 906 Certification of Principal Financial Officer

SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant, Harmonic Inc., a Delaware corporation, has duly caused this Quarterly Report on Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Sunnyvale, State of California, on August 3, 2007.

HARMONIC INC.

By: /s/ Robin N. Dickson
Robin N. Dickson
Chief Financial Officer
(Principal Financial and Accounting Officer)

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31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Principal Executive Officer
32.2	Section 906 Certification of Principal Financial Officer

Exhibit 10.1

AGREEMENT AND PLAN OF MERGER

BY AND AMONG

RHOZET CORPORATION

DUSSELDORF ACQUISITION CORPORATION

HARMONIC, INC.

AND WITH RESPECT TO ARTICLES VII, VIII AND IX ONLY

DAVID TRESCOT

AS SHAREHOLDER REPRESENTATIVE

Dated as of July 25, 2007

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THIS AGREEMENT AND PLAN OF MERGER (the "**Agreement**") is made and entered into as of July 25, 2007 by and among Harmonic, Inc., a Delaware corporation ("**Parent**"), Dusseldorf Acquisition Corporation, a California corporation and a wholly-owned subsidiary of Parent ("**Sub**"), Rhozet Corporation, a California corporation (the "**Company**"), and with respect to **Article VII, Article VIII** and **Article IX** hereof only, David Trescot as shareholder representative (the "**Shareholder Representative**").

RECITALS

A. The Boards of Directors of each of Parent, Sub and the Company believe it is advisable and in the best interests of each corporation and its respective shareholders that Parent acquire the Company through the statutory merger of Sub with and into the Company (the "**Merger**") and, in furtherance thereof, have approved this Agreement and the Merger.

B. Pursuant to the Merger, among other things, and subject to the terms and conditions of this Agreement, all of the issued and outstanding capital stock of the Company shall be converted into the right to receive the consideration set forth herein.

C. Immediately prior to the Merger, all of the issued and outstanding options to purchase capital stock of the Company shall be converted by the Company and the holders of such options into the right to receive an amount in cash equal to the consideration to be paid to holders of the Company's capital stock in connection with the Merger, and shall be terminated.

C. A portion of the consideration otherwise payable by Parent in connection with the Merger shall be held back by Parent as partial security for the indemnification obligations set forth in this Agreement.

D. The Company, on the one hand, and Parent and Sub, on the other hand, desire to make certain representations, warranties, covenants and other agreements in connection with the Merger.

E. On or prior to the execution and delivery of this Agreement, as a material inducement to Parent and Sub to enter into this Agreement, the Company shall have obtained the irrevocable approval of the Merger, this Agreement and the transactions contemplated thereby (i) by the Company's Board of Directors and (ii) by the holders of at least a majority of the issued and outstanding shares of capital stock of the Company, voting together on an as-converted to common stock basis.

F. Prior to the Effective Time, as a material inducement to Parent and Sub to consummate the transactions contemplated by this Agreement, each of the Key Employees shall enter into an Employment Agreement, substantially in one of the applicable forms attached hereto as **Exhibit A** (an "**Employment Agreement**"), with Parent to be effective as of the Effective Time.

G. The Merger is intended to qualify as a reorganization within the meaning of Section 368(a) of the Internal Revenue Code of 1986, as amended (the "**Code**"), and this Agreement is intended to constitute a "plan of reorganization" within the meaning of the regulations promulgated under Section 368 of the Code.

NOW, THEREFORE, in consideration of the mutual agreements, covenants and other premises set forth herein, the mutual benefits to be gained by the performance thereof, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged and accepted, the parties hereby agree as follows:

ARTICLE I

THE MERGER

1.1 ***The Merger***. At the Effective Time (as defined in **Section 1.2** hereof) and subject to and upon the terms and conditions of this Agreement and the applicable provisions of the Corporations Code of the State of California ("**California Law**"), Sub shall be merged with and into the Company, the separate corporate existence of Sub shall cease, and the Company shall continue as the surviving corporation and as a wholly-owned subsidiary of Parent. The surviving corporation after the Merger is sometimes referred to hereinafter as the "**Surviving Corporation**."

1.2 ***Effective Time***. Unless this Agreement is earlier terminated pursuant to **Section 8.1** hereof, the closing of the Merger (the "**Closing**") will take place as soon as practicable following the date upon which all of the conditions set forth in **Article VI** hereof other than those that by their nature may only be satisfied or waived at the Closing, have been satisfied or waived, at the offices of Wilson Sonsini Goodrich & Rosati, Professional Corporation, at 650 Page Mill Road, Palo Alto, California, U.S.A., unless another time or place is mutually agreed upon in writing by Parent and the Company. The date upon which the Closing actually occurs shall be referred to herein as the "**Closing Date**." On the Closing Date, the parties hereto shall cause the Merger to be consummated by the filing of certain officers' certificates and an agreement of merger in substantially the form attached hereto as **Exhibit B**, with the Secretary of State of the State of California (the "**Certificate of Merger**"), in accordance with the applicable provisions California Law (the time of the acceptance of such filing by the Secretary of State of the State of California shall be referred to herein as the "**Effective Time**").

1.3 ***Effect of the Merger***. At the Effective Time, the effect of the Merger shall be as set forth in this Agreement and as provided in the applicable provisions of California Law. Without limiting the generality of the foregoing, and subject thereto, at the Effective Time, except as otherwise agreed to pursuant to the terms of this Agreement, all of the property, rights, privileges, powers and franchises of the Company and Sub shall vest in the Surviving Corporation, and all debts, liabilities and duties of the Company and Sub shall become the debts, liabilities and duties of the Surviving Corporation.

1.4 ***Articles of Incorporation and Bylaws***.

(a) Unless otherwise determined by Parent prior to the Effective Time, the articles of incorporation of the Surviving Corporation shall be amended and restated as of the Effective Time to be identical to the articles of incorporation of Sub as in effect immediately prior to the Effective Time, until thereafter amended in accordance with California Law and as provided in such articles of incorporation; *provided, however*, that at the Effective Time, **Article I** of the articles of incorporation of the Surviving Corporation shall be amended and restated in its entirety to read as follows: "The name of the corporation is Rhozet Corporation."

(b) Unless otherwise determined by Parent prior to the Effective Time, the bylaws of the Surviving Corporation shall be amended and restated at the Effective Time to be identical to the bylaws of Sub, as in effect immediately prior to the Effective Time (other than any express references to the name of Sub in such bylaws, which shall be amended to refer to the Surviving Corporation) until thereafter amended in accordance with California Law and as provided in the articles of incorporation of the Surviving Corporation and such bylaws.

1.5 ***Directors and Officers***.

(a) ***Directors of Surviving Corporation***. Unless otherwise determined by Parent prior to the Effective Time, the directors of Sub immediately prior to the Effective Time shall be the directors of the Surviving Corporation immediately after the Effective Time, each to hold the office of a director of the Surviving Corporation in accordance with the provisions of California Law and the articles of incorporation and bylaws of the Surviving Corporation until their successors are duly elected and qualified.

(b) ***Officers of Surviving Corporation***. Unless otherwise determined by Parent prior to the Effective Time, the officers of Sub immediately prior to the Effective Time shall be the officers of the Surviving Corporation immediately after the Effective Time, each to hold office in accordance with the provisions of the bylaws of the Surviving Corporation.

1.6 ***Effect of Merger on the Capital Stock of the Constituent Corporations***.

(a)(i) ***Definitions***. For all purposes of this Agreement, the following terms shall have the following respective meanings:

"***Aggregate Consideration Amount***" shall mean $15,500,000.

"***Aggregate Common Stock Consideration Amount***" equals the Aggregate Consideration Amount minus the Option Cash.

"***Business Day***" shall mean each day that is not a Saturday, Sunday or other day on which Parent is closed for business or banking institutions located in San Francisco, California are authorized or obligated by law or executive order to close.

"***Cash Component of the Common Stock Consideration***" shall mean, for each share of Company Common Stock, an amount equal to the quotient of the Merger Cash divided by the Total Outstanding Common Shares (rounded to the nearest one-hundred thousandth (0.00001) of a cent (with 0.000005 of a cent and above rounded up).

"Closing Merger Consideration" shall mean, with respect to each share of Company Common Stock held by a Shareholder, an amount of consideration equal to (i) (A) the Stock Component of the Common Stock Consideration, and (B) the Cash Component of the Common Stock Consideration, minus (ii) the Holdback Amount.

"***Common Stock Consideration***" shall mean (i) the Stock Component of the Common Stock Consideration and (ii) the Cash Component of the Common Stock Consideration.

"***Company Capital Stock***" shall mean the Company Common Stock and all other shares of capital stock, if any, of the Company, taken together.

"***Company Common Stock***" shall mean shares of common stock, without reference to par value per share, of the Company.

"***Company Material Adverse Effect***" shall mean any change, event or effect that is materially adverse to the business, assets, financial condition, results of operations or prospects of the Company and its Subsidiaries, taken as a whole.

"***Company Options***" shall mean all issued and outstanding options to purchase or otherwise acquire Company Capital Stock listed on Disclosure Schedule 2.2(c) held by any employee, consultant or director of the Company or its Subsidiaries.

"***Holdback Amount***" shall mean, with respect to each share of Company Common Stock held by a Shareholder, (i) the number of shares of Parent Common Stock equal to the quotient obtained by dividing (A) the quotient obtained by dividing (x) the product of .801 multiplied by the Total Holdback Amount, by (y) the Trading Price, by (B) the Total Outstanding Common Shares, and (ii) an amount in cash equal to the quotient obtained by dividing (A) the product of .199 multiplied by the Total Holdback Amount by (B) the Total Outstanding Common Shares.

"***Key Employees***" shall mean the employees of Company and any of its Subsidiaries identified on **Schedule 1.6(a)(ii)** hereto.

"***Knowledge***" or "***Known***" shall mean, with respect to the Company, the knowledge of any of the officers, members of the boards of directors or senior managers of the Company or its Subsidiaries after reasonable inquiry of those persons employed by the Company or the Subsidiaries with administrative or operational responsibility for such matter.

"***Lien***" shall mean any lien, pledge, charge, claim, mortgage, security interest or other encumbrance of any sort.

"***Merger Cash***" shall mean an amount in cash equal to the product of (i) 0.199 multiplied by (ii) the Aggregate Common Stock Consideration Amount, rounded to the nearest whole cent (with 0.5 of a cent rounded down), subject to adjustment as set forth in **Section 1.11**.

"***Merger Shares***" shall mean the number of shares of Parent Common Stock equal to the quotient obtained by dividing the Merger Shares Value by the Trading Price, rounded down to the nearest whole share.

"***Merger Shares Value***" shall mean an amount equal to the product of (i) 0.801 multiplied by (ii) the Aggregate Common Stock Consideration Amount, rounded to the nearest whole cent (with 0.5 of a cent rounded down), subject to adjustment as set forth in **Section 1.11**.

"***Option Cash***" shall mean an amount in cash equal to the product of (i) the Aggregate Consideration Amount multiplied by (ii) the quotient obtained by dividing the Total Outstanding Options by the Total Outstanding Shares, rounded to the nearest whole cent (with 0.5 of a cent rounded down).

"***Parent Common Stock***" shall mean shares of the common stock, par value $0.001 per share, of Parent.

"***Parent Material Adverse Effect***" shall mean any change, event or effect that is materially adverse to the business, assets, financial condition or results of operations of Parent; *provided*, *however*, that in no event shall any of the following, alone or in combination with any of the others, be deemed to constitute, nor shall any of the following be taken into account in determining whether there has been or will be, a Parent Material Adverse Effect: (i) any change or changes in the price per share of Parent Common Stock or a change in the trading volume of Parent Common Stock; (ii) any occurrence or occurrences relating to the industry in which Parent operates, other than that which affects Parent and its subsidiaries, taken as a whole, disproportionately; (iii) failing to meet or otherwise satisfy analyst or other third party expectations relating to the results of

Parent's operations; or (iv) any occurrence or occurrences that proximately results from the public announcement of this Agreement.

"***Parent's Accountants***" shall mean PricewaterhouseCoopers LLC, independent accountants of Parent.

"***Permitted Liens***" shall mean (i) statutory liens for taxes that are not yet due and payable, (ii) statutory liens to secure obligations to landlords, lessors or renters under leases or rental agreements, (iii) deposits or pledges made in connection with, or to secure payment of, workers' compensation, unemployment insurance or similar programs mandated by applicable law, (iv) statutory liens in favor of carriers, warehousemen, mechanics and materialmen, to secure claims for labor, materials or supplies and other like liens, and (v) liens in favor of customs and revenue authorities arising as a matter of applicable law to secure payments of customs duties in connection with the importation of goods.

"***Person***" shall mean an individual or entity, including a partnership, a limited liability company, a corporation, an association, a joint stock company, a trust, a joint venture, an unincorporated organization, or a Governmental Entity (or any department, agency, or political subdivision thereof).

"***Plan***" shall mean the Company's 2006 Stock Plan, as amended to date.

"***Pro Rata Portion***" shall mean, with respect to each Shareholder (other than a Shareholder holding Dissenting Shares who does not effectively withdraw or lose such Shareholder's dissenter's rights as contemplated by **Section 1.7(b)** hereof), an amount equal to the quotient of (i) the sum of (A) the product of the number of Merger Shares to which such Shareholder is entitled pursuant to **Section 1.6** hereof multiplied by the Trading Price, plus (B) the amount of Merger Cash, in each case issuable pursuant to **Section 1.6** hereof in respect of the shares of Company Capital Stock owned by such Shareholder as of the Effective Time, divided by (ii) the sum of (A) the product of the aggregate number of Merger Shares to be issued to Shareholders multiplied by the Trading Price, plus (B) the aggregate amount of the Merger Cash to be paid to Shareholders, in each case excluding such Merger Shares and Merger Cash that would otherwise be issued to Shareholders if they had not effectively withdrawn or lost their dissenters' rights as contemplated by **Section 1.7(b)** hereof).

"***SEC***" shall mean the United States Securities and Exchange Commission.

"***Securities Act***" shall mean the United States Securities Act of 1933, as amended.

"***Shareholder***" shall mean any holder of any Company Common Stock immediately prior to the Effective Time.

"***Stock Component of the Common Stock Consideration***" shall mean, for each share of Company Common Stock, a fraction of a share of Parent Common Stock equal to the quotient of the Merger Shares divided by the Total Outstanding Common Shares, rounded to the nearest one-hundred thousandth (0.00001) (with amounts 0.000005 and above rounded down).

"***Total Consideration***" shall mean the Merger Cash and the Merger Shares.

"***Total Holdback Amount***" shall mean $2,325,000 of the Aggregate Common Stock Consideration Amount.

"***Total Outstanding Options***" shall mean all Company Options that are outstanding immediately prior to the Effective Time.

"***Total Outstanding Common Shares***" shall mean the aggregate number of shares of Company Common Stock issued and outstanding immediately prior to the Effective Time.

"***Total Outstanding Shares***" shall mean the sum of the Total Outstanding Common Shares, plus the Total Outstanding Options.

"***Trading Price***" shall mean $9.272 (as adjusted as appropriate to reflect any stock splits, stock dividends, combinations, reorganizations, reclassifications or similar events).

(ii) ***Other Capitalized Terms***. For all purposes of and under this agreement, the following capitalized term shall have the respective meanings ascribed thereto in the section of this Agreement set forth opposite each such capitalized term below:

Capitalized Term	Section
401(k) Fees	2.23(q)
401(k) Plan	5.18
Acquisition Proposal	4.2(a)
Action of Divestiture	5.4(a)
Agreed-Upon Loss	7.4(f)(v)
Agreement	Recitals
Balance Sheet Date	2.7
Articles of Incorporation	2.1(a)
le plan (the "A/R **Plan**	1.6(i)(i)
California Law	1.1
Certificate of Merger	1.2
CFRA	2.23(a)
Charter Documents	2.1(a)
Closing	1.2
Closing Accounts Receivable Statement	1.6(i)(i)
Closing Date	1.2
Closing Statement of Assumed Liabilities	1.6(i)(i)
COBRA	2.23(a)
Code	Recitals
Company	Recitals
Company Accounts Collected Report	1.6(i)(ii)
Company Assumed Liabilities Report	1.6(i)(ii)
Company Authorizations	2.18
Company Employee Plan	2.23(a)
Company Intellectual Property	2.15(a)
Company Options	1.6(a)(i)
Company Product	2.15(a)
Company Registered Intellectual Property	2.15(b)
Company Certificates	1.8(c)
Conflict	2.5
Contract, Contracts	2.5

Capitalized Term	Section
Copyrights	2.15(a)
Current Balance Sheet	2.7
Customer Information	2.14(f)
Disclosure Schedule	Article II
Dissenting Share Payments	1.7(c)
Dissenting Shares	1.7(a)
DOL	2.23(a)
Effective Time	1.2
Employee	2.23(a)
Employee Agreement	2.23(a)
Employment Agreement	Recitals
Equipment	2.14(e)
ERISA	2.23(a)
ERISA Affiliate	2.23(a)
Exchange Agent	1.8(a)
Exchange Documents	1.8(c)
Export Approvals	2.26(a)
Final Assumed Liability Adjustment	1.6(i)(iii)(3)
Final Assumed Liability Differential	1.6(i)(iii)(3)
Financials	2.7
FIRPTA Compliance Certificate	5.21
FMLA	2.23(a)
Governmental Entity	2.6
HIPAA	2.23(a)
Holdback Distribution Date	7.4(c)(i)
Indemnified Parties	7.2(a)
“Independent Accounting Firm	1.6(i)(iii)(2)
Information Statement	5.6(b)
Initial Survival Date	7.1
In-Licenses	2.15(p)
Intellectual Property Rights	2.15(a)
International Employee Plan	2.23(a)
International Employees	2.23(a)
IP Licenses	2.15(q)
IRS	2.23(a)
Lease Agreements	2.14(b)
Leased Real Property	2.14(a)
Lock-up Agreement	Recitals
Loss, Losses	7.2(a)
Material Contract, Material Contracts	2.16(b)
Merger	Recitals
Nondisclosure Agreement	5.2
Object Code	2.15(a)
Objection Notice	7.4(e)
Officer’s Certificate	7.4(d)(iv)
Open Source License	2.15(a)
Open Source Materials	2.15(a)
Option Consideration	1.6(c)(i)

Capitalized Term	Section
Parent	Recitals
Parent SEC Filings	3.6
Patent	2.15(a)
Pension Plan	2.23(a)
Registered Intellectual Property	2.15(a)
Returns	2.12(b)(i)
Rule 145	5.22
Rule 145 Affiliate	5.22
Source Code	2.15(a)
Spreadsheet	5.19
Shareholder Certificate	5.7(c)
Shareholder Representative	Recitals
Shareholder Representative Expenses	7.5(b)
Sub	Recitals
Subsequent Survival Date	7.1
Subsidiary	2.3
Surviving Corporation	1.1
Tax, Taxes	2.12(a)
Technology	2.15(a)
Terminated Agreements	5.11(a)
Third Party Claim	7.4(g)
Trade Secrets	2.15(a)
Trademarks	2.15(a)
Unresolved Claims	7.4(c)(i)

(b) ***Effect on Capital Stock***. At the Effective Time, by virtue of the Merger and without any action on the part of Sub, the Company or the holders of shares of Company Capital Stock or Company Options, and upon the terms and subject to the conditions set forth in this **Section 1.6** and throughout this Agreement, including the holdback provisions set forth in **Article VII** hereof, the following shall occur:

(i) ***Company Common Stock***. Each outstanding share of Company Common Stock issued and outstanding immediately prior to the Effective Time (other than Dissenting Shares) will be cancelled and extinguished and will be converted automatically into the right to receive, upon surrender of the certificate representing such shares of Common Stock in the manner provided in **Section 1.8** hereof, the Common Stock Consideration.

(ii) ***Aggregation of Parent Common Stock***. For purposes of calculating the number of shares of Parent Common Stock issuable and the amount of cash payable to each Shareholder pursuant to this **Section 1.6(b)**, all shares of the Company Common Stock held by each Shareholder shall be aggregated on a certificate-by-certificate basis prior to such calculation. The aggregate number of shares of Parent Common Stock issuable and the amount of cash payable to each Shareholder in respect of all share certificates held by such Shareholder shall be rounded down to the nearest whole number of shares of Parent Common Stock and nearest whole cent, respectively; *provided, however*, that the maximum number of shares of Parent Common Stock issuable pursuant to the Merger shall not exceed the Merger Shares and the maximum amount of cash payable pursuant to the Merger shall not exceed the Merger Cash; and

(iii) ***Merger Consideration Available at Closing.*** Subject to the procedures set forth in **Section 1.8** and to the holdback provisions set forth in **Section 1.6(b)(iv)**, at Closing each Shareholder shall receive, for each share of Company Common Stock held by such Shareholder, the Closing Merger Consideration.

(iv) ***Holdback Amount.*** At Closing, for each share of Company Common Stock held by a Shareholder, Parent shall withhold the Holdback Amount, up to all of which (if any) may be issued or paid at the Holdback Distribution Date (as defined below). Prior to the Holdback Distribution Date, the number of shares of Parent Common Stock issuable and the cash payable comprising the Total Holdback Amount shall be subject to reduction as indemnity to compensate Indemnified Parties (as defined below) for any and all Losses (as defined below) pursuant to Article VII hereof. The portion of the Total Holdback Amount that Parent shall distribute to the Shareholders on the Holdback Distribution Date shall be that number of shares of Parent Common Stock reserved at Closing and cash, if any, comprising the Total Holdback Amount following all reductions for aggregate Losses by Indemnified Parties pursuant to Article VII prior to the Holdback Distribution Date.

(v) Notwithstanding anything set forth in this **Section 1.6(b)**, any Dissenting Shares will be treated as set forth in **Section 1.7** hereof, any unexercised Company Options shall be treated as provided for in **Section 1.6(c)** below and any Company Capital Stock held by the Company or any direct or indirect Subsidiary of the Company shall be treated as provided for in **Section 1.6(e)**.

(c) ***Treatment of Company Options***.

(i) Immediately prior to the Effective Time, each Company Option then outstanding under the Plan, shall by virtue of the Merger and without any action on the part of the holder thereof, be cancelled, extinguished and converted automatically into the right to receive an amount in cash from the Company equal to the quotient obtained by dividing (x) Option Cash by (y) the Total Outstanding Options (the "**Option Consideration**"), which amount shall be payable by the Company no earlier than January 1, 2008 and no later than January 8, 2008 (the "**Option Payment Date**"). As soon as practicable (and in no event more than five (5) calendar days) after the Option Payment Date, the Company shall pay to each holder of a Company Option the Option Consideration required to be paid to any such holder pursuant to this **Section 1.6(c)**. Disclosure Schedule 2.2(c) shall list the name of each holder of Company Options as of the date hereof and, for each such Company Option (i) the exercise price, (ii) whether such Company Option qualifies as an incentive stock option under Section 422 of the Code, (iii) the date of grant, (iv) the vesting commencement date, (v) the vesting schedule, and (vi) the expiration date; provided, however, that the Company shall process such payments through its payroll system and deduct (x) all applicable income and payroll taxes required to be withheld or deducted and (y) the employer's portion of all payroll taxes required to be paid by the Company in connection with such payments to holders of Company Options.

(ii) At the Effective Time, each Company stock option that is not listed on Disclosure Schedule 2.2(c) shall be cancelled and extinguished and shall not be entitled to receive any consideration pursuant to this Agreement.

(d) ***Cancellation of Company Owned Stock***. Each share of Company Capital Stock held by the Company or any direct or indirect subsidiary of the Company immediately prior to the Effective Time shall be cancelled and extinguished as of the Effective Time.

(e) ***Withholding Taxes***. The Company, and on its behalf Parent and the Surviving Corporation, shall be entitled to deduct and withhold from any consideration payable or otherwise deliverable pursuant to this Agreement to any Person such amounts as may be required to be deducted or withheld therefrom under any provision of federal, state, local or foreign tax law or under any applicable legal requirement. Any such amounts shall be withheld or deducted from the Merger Cash payable to the Shareholder, provided that if such Merger Cash is insufficient to satisfy the full amount to be withheld or deducted, the remainder shall be satisfied out of the Merger Shares issuable to the Shareholder. The number of Merger Shares, if any, to be used to satisfy the remaining amount required to be so deducted or withheld shall be determined by dividing such remaining amount by the Closing Price, rounded to the nearest whole share (with 0.5 of a share rounded up). To the extent such amounts are so deducted or withheld, such amounts shall be treated for all purposes under this Agreement as having been paid to the Person to whom such amounts would otherwise have been paid.

(f) ***Shareholder Loans***. In the event that any Shareholder has outstanding loans from the Company or any of its Subsidiaries as of the Effective Time, the consideration payable to such Shareholder pursuant to this **Section 1.6** shall be reduced by an amount equal to the sum of the outstanding principal plus accrued interest of such Shareholder's loans as of the Effective Time. Any such amounts shall be deducted from the Merger Cash payable to the Shareholder, provided that if such Merger Cash is insufficient to satisfy the full amount of the outstanding principal plus accrued interest, the remainder shall be satisfied out of the Merger Shares issuable to the Shareholder. The number of Merger Shares, if any, to be used to satisfy the remaining amount of the outstanding principal and interest shall be determined by dividing such remaining amount by the Trading Price, rounded to the nearest whole share (with 0.5 of a share rounded up). Such loans shall be satisfied as to the amount by which the consideration is reduced pursuant to this **Section 1.6(f)**. To the extent the consideration payable to such Shareholder is so reduced, such amount shall be treated for all purposes under this Agreement as having been paid to such Shareholder.

(g) ***Capital Stock of Sub***. Each share of capital stock of Sub issued and outstanding immediately prior to the Effective Time shall be converted into and exchanged for one validly issued, fully paid and nonassessable share of capital stock of the Surviving Corporation. Each stock certificate of Sub evidencing ownership of any such shares shall continue to evidence ownership of such shares of capital stock of the Surviving Corporation.

(h) ***Shares Subject to Vesting***. Each share of Parent Common Stock issued in exchange for shares of Company Common Stock shall also be unvested and subject to the same repurchase option, risk of forfeiture or other terms and conditions set forth in the Plan, as applicable, and the agreements relating thereto, as in effect immediately prior to the Effective Time (including any requirement that any unvested shares be held in escrow), and the certificate representing such shares of Parent Common Stock may accordingly be marked with appropriate legends in the discretion of Parent.

(i) ***Aggregate Common Stock Consideration Amount Adjustment***.

(i) ***Closing Reports.*** No later than two (2) Business Days prior to the Closing Date, the Company shall deliver to Parent a statement of accounts receivable as of the Closing Date (the "**Closing Accounts Receivable Statement**") and a statement, prepared in good faith, of the estimated amount of Assumed Liabilities (as defined below) of the Company as of the Closing Date (the "**Closing Statement of Assumed Liabilities**"), which statements shall be in form and substance reasonably satisfactory to Parent. As used in this **Section 1.6**, "**Assumed Liabilities**" shall mean the total liabilities of the Company as of the Closing Date, determined in accordance with GAAP (other than the Option Cash, which is a liability of the

Company that will be assumed by Parent in connection with the Merger, but shall not be referred to in this **Section 1.6** as an "Assumed Liability"), for the following types of liability, (i) accounts payable, (ii) accrued expenses, (iii) payroll and benefits of Persons who will be employees of the Company as of the Closing, (iv) $255,000 payable to persons who are holders of Company Options as of the date hereof in accordance with the terms of the Company's accounts receivable plan (the "**A/R Plan**"), and (v) certain payables identified and agreed by the parties, as well as any payroll or related Taxes.

(ii) ***Post-Closing Reports.*** Within fifty (50) calendar days following the Closing Date, Parent shall furnish the Shareholder Representative with a report which shall set forth, in reasonable detail, the amount of Assumed Liabilities of the Company as of the Closing Date (the "**Company Assumed Liabilities Report**"). In making such determination, Parent shall prepare a balance sheet of the Company as of the Closing Date and shall include such balance sheet as part of the Company Assumed Liabilities Report. Furthermore, within fifty (50) calendar days following the Closing Date, Parent shall furnish the Shareholder Representative with a report which shall set forth the amounts collected by Parent or the Company since the Closing Date with respect to accounts that were set forth on the Closing Accounts Receivable Statement (the "**Company Accounts Collected Report**").

(iii) ***Disputes***.

(1) Subject to clause (2) of this **Section 1.6(i)(iii)**, the Company Assumed Liabilities Report and the Company Accounts Collected Report shall be final, binding and conclusive on the Parent, the Shareholder Representative and the Shareholders.

(2) The Shareholder Representative may dispute any amounts reflected on the Company Assumed Liabilities Report (but not on the Company Accounts Collected Report), but only to the extent the amount of Assumed Liabilities set forth therein exceeds the estimated amount of Assumed Liabilities set forth in the Closing Statement of Assumed Liabilities and only on the basis that the amounts reflected therein were not arrived at in accordance with GAAP or were arrived at based on mathematical or clerical error; *provided, however,* that the Shareholder Representative shall have notified the Parent in writing as to each disputed item, specifying the estimated amount thereof in dispute and setting forth, in reasonable detail, the basis for such dispute, within ten (10) Business Days of the Parent's delivery of such Company Assumed Liabilities Report. In the event of such a dispute, the Parent independent auditors ("**Parent's Accountants**") and the Company's former accountants (which shall have been retained by the Shareholder Representative) shall attempt to reconcile their differences, and any resolution by them as to any disputed amounts shall be final, binding and conclusive on the parties thereto. If the Parent's Accountants and the Company's former accountants are unable to reach a resolution to such dispute within twenty (20) Business Days after receipt of written notice of such dispute, the dispute shall be submitted to an independent accounting firm of international reputation ("**Independent Accounting Firm**") mutually acceptable to Parent and Shareholder Representative, which shall within twenty (20) Business Days after submission, determine and report to the Parent and Shareholder Representative the resolution of such disputed items, and such report shall be final, binding and conclusive on the Parent and the Shareholder Representative and the Shareholders.

(3) The Company Assumed Liabilities Report shall be deemed final for purposes of this **Section 1.6(h)** upon the earliest of (x) failure of the Shareholder Representative to notify Parent of a dispute within ten (10) Business Days of Parent's delivery of the Company Assumed Liabilities Report, (y) the resolution of all disputes by the Parent's Accountants and the Company's former accountants, and (z) the resolution of all disputes by the Independent Accounting Firm. If the difference between the amounts set forth on the Company Accounts Collected Report minus the amount of Assumed Liabilities as set

forth in the Company Assumed Liabilities Report as deemed final by the parties (the "**Final Assumed Liability Differential**") is greater than zero (a positive amount), then within five (5) Business Days of the Company Assumed Liabilities Report being deemed final, Parent shall make payment of an amount equal to such difference to the Total Holdback Amount; *provided*, *however*, that such amount shall not be used to compensate Indemnified Parties for any Losses suffered and shall only be applied towards Shareholder Representative Expenses pursuant to **Section 7.5(b)**. If the Final Assumed Liability Differential is less than zero (a negative amount) (such amount, the "**Final Assumed Liability Adjustment**"), such amount shall be paid from the Total Holdback Amount in accordance with **Section 7.4(d)**.

1.7 ***Dissenting Shares***.

(a) Notwithstanding any other provisions of this Agreement to the contrary, any shares of Company Capital Stock held by a holder who has demanded and perfected appraisal or dissenters' rights for such shares in accordance with California Law and who, as of the Effective Time, has not effectively withdrawn or lost such holder's dissenters' rights (the "**Dissenting Shares**") shall not be converted into or represent a right to receive the applicable consideration set forth in **Section 1.6** hereof, but the holder thereof shall only be entitled to such rights as are provided by California Law.

(b) Notwithstanding the provisions of **Section 1.7(a)** hereof, if any holder of Dissenting Shares who is otherwise entitled to exercise dissenters' rights under the California Law shall effectively withdraw or lose (through failure to perfect or otherwise) such holder's dissenters' rights under California Law then, as of the later of the Effective Time and the occurrence of such event, such holder's shares shall automatically be converted into and represent only the right to receive the consideration for Company Capital Stock, as applicable, set forth in **Section 1.6** hereof, without interest thereon, and subject to the provisions of **Section 1.8** and **Section 7.4** hereof, upon surrender of the certificate representing such shares. Any such holder of shares of Company Capital Stock who shall effectively withdraw or lose such dissenters' rights shall execute and deliver to Parent the Shareholder Certificate substantially in the form attached hereto as **Exhibit C**, as required under **Section 7.2** hereof prior to such holder's receipt of the applicable consideration pursuant to **Section 1.6** hereof.

(c) The Company shall give Parent (i) prompt notice of any written demand for the exercise of dissenters' rights, withdrawals of such demands, and any other instruments served to or received by the Company pursuant to the applicable provisions of California Law, and (ii) the opportunity to participate in all negotiations and proceedings with respect to such demands. The Company shall not, except with the prior written consent of Parent, make any payment with respect to any such demands or offer to settle or settle any such demands. Any communication to be made by the Company to any Shareholder with respect to such demands shall be submitted to Parent in advance and shall not be presented to any Shareholder prior to the Company receiving Parent's consent. Notwithstanding the foregoing, to the extent that Parent, the Surviving Corporation or the Company (i) makes any payment or payments in respect of any Dissenting Shares in excess of the consideration that otherwise would have been payable in respect of such shares in accordance with this Agreement or (ii) incurs any Losses (including attorneys' and consultants' fees, costs and expenses and including any such fees, costs and expenses incurred in connection with investigating, defending against or settling any action or proceeding) in respect of any Dissenting Shares (excluding payments for such shares) ((i) and (ii) together "**Dissenting Share Payments**"), Parent shall be entitled to recover under the terms of **Article VII** hereof the amount of such Dissenting Share Payments to the extent that such Dissenting Share Payments exceed the consideration that such dissenting Shareholders would have received in the Merger had no Dissenting Share Payments been made.

1.8 ***Surrender of Certificates***.

(a) ***Exchange Agent***. The Secretary of Parent, or a Person selected by Parent, shall serve as the exchange agent (the "**Exchange Agent**") for the Merger.

(b) ***Parent to Provide Parent Common Stock and Cash***. As soon as reasonably practicable (but in any event within five (5) Business Days) following the Closing Date, Parent shall make available to the Exchange Agent for exchange in accordance with this **Article I** the Closing Merger Consideration, comprising shares of Parent Common Stock issuable and cash payable pursuant to **Section 1.6(b)(iii)** hereof in exchange for outstanding shares of Company Common Stock. Parent shall reserve the Total Holdback Amount pursuant to **Section 1.6(b)(iv)**, comprising shares of Parent Common Stock issuable and cash payable on Holdback Distribution Date, subject to reduction as required to satisfy the indemnification obligations pursuant to **Article VII**.

(c) ***Exchange Procedures***. As soon as reasonably practicable (but in any event within five (5) Business Days) following the Closing Date, Parent or the Exchange Agent shall mail a letter of transmittal in Parent's standard form to each Shareholder at the address set forth opposite each such person's name on the Spreadsheet. After receipt of such letter of transmittal and any other customary documents that Parent or the Exchange Agent may reasonably require in order to effect the exchange (the "**Exchange Documents**"), the Shareholders will surrender the certificates representing their shares of Company Common Stock (the "**Company Certificates**") to the Exchange Agent for cancellation together with duly completed and validly executed Exchange Documents. Upon surrender of a Company Certificate for cancellation to the Exchange Agent, or such other agent or agents as may be appointed by Parent, together with such Exchange Documents, duly completed and validly executed in accordance with the instructions thereto, subject to the terms of **Section 1.8(e)** hereof, the holder of such Company Certificate shall be entitled to receive from the Exchange Agent in exchange therefor, no later than thirty (30) days thereafter, a certificate representing the number of whole shares of Parent Common Stock and the cash payment to which such holder is entitled pursuant to **Section 1.6** hereof (less such holder's respective portion of the Total Holdback Amount to be held back pursuant to **Section 1.8(b)** hereof and **Article VII** hereof, if any), and the Company Certificate so surrendered shall be cancelled. Until so surrendered, each Company Certificate outstanding after the Effective Time will be deemed, for all corporate purposes thereafter, to evidence only the right to receive the number of full shares of Parent Common Stock and cash into which such shares of Company Common Stock shall have been so converted. No portion of the Total Consideration will be paid to the holder of any unsurrendered Company Certificate with respect to shares of Company Common Stock formerly represented thereby until the holder of record of such Company Certificate shall surrender such Company Certificate and the Exchange Documents pursuant hereto.

(d) ***Distributions With Respect to Unexchanged Shares***. No dividends or other distributions declared or made after the Effective Time with respect to Parent Common Stock with a record date after the Effective Time will be paid to the holder of any unsurrendered Company Certificate with respect to the shares of Parent Common Stock represented thereby until the holder of record of such Company Certificate shall surrender such Company Certificate. Subject to applicable law, following surrender of any such Company Certificate, there shall be paid to the record holder of the certificates representing whole shares of Parent Common Stock issued in exchange therefor, without interest, at the time of such surrender, the amount of dividends or other distributions with a record date after the Effective Time theretofore paid with respect to such whole shares of Parent Common Stock.

(e) ***Transfers of Ownership***. If any certificate for shares of Parent Common Stock is to be issued in a name other than that in which the Company Certificate surrendered in exchange therefor is registered it will be a condition of the issuance or delivery thereof that the certificate so surrendered will be properly endorsed and otherwise in proper form for transfer and that the person requesting such exchange will have paid to Parent or any agent designated by it any transfer or other taxes required by reason of the issuance of a certificate for shares of Parent Common Stock in any name other than that of the registered holder of the certificate surrendered, or established to the satisfaction of Parent or any agent designated by it that such tax has been paid or is not payable.

(f) ***No Liability***. Notwithstanding anything to the contrary in this **Section 1.8**, neither the Exchange Agent, the Surviving Corporation, nor any party hereto shall be liable to a holder of shares of Company Capital Stock for any amount paid to a public official pursuant to any applicable abandoned property, escheat or similar law.

1.9 ***No Further Ownership Rights in Company Capital Stock***. The shares of Parent Common Stock issued and cash paid in respect of the surrender for exchange of shares of Company Capital Stock in accordance with the terms hereof, and the cash payable by the Company in respect of the cancellation and extinguishment of the Company Options, shall be deemed to be full satisfaction of all rights pertaining to such shares of Company Capital Stock and Company Options, and there shall be no further registration of transfers on the records of the Surviving Corporation of shares of Company Capital Stock or Company Options which were outstanding immediately prior to the Effective Time. If, after the Effective Time, Company Certificates are presented to the Surviving Corporation for any reason, they shall be cancelled and exchanged as provided in this **Article I**.

1.10 ***Lost, Stolen or Destroyed Certificates***. In the event any Company Certificates with respect to Company Common Stock shall have been lost, stolen or destroyed, the Exchange Agent shall issue in exchange for such lost, stolen or destroyed certificates, upon the making of an affidavit of that fact by the holder thereof, such amount, if any, as may be required pursuant to **Section 1.6** hereof; *provided*, *however*, that Parent may, in its discretion and as a condition precedent to the issuance thereof, require the Shareholder who is the owner of such lost, stolen or destroyed certificates to either (i) deliver a bond in such amount as it may direct or (ii) provide an indemnification agreement in form and substance acceptable to Parent, against any claim that may be made against Parent or the Exchange Agent with respect to the certificates alleged to have been lost, stolen or destroyed.

1.11 ***Taking of Necessary Action; Further Action***. If at any time after the Effective Time, any further action is necessary or desirable to carry out the purposes of this Agreement and to vest the Surviving Corporation with full right, title and possession to all assets, property, rights, privileges, powers and franchises of the Company, Parent and the Surviving Corporation and the officers and directors of Parent and the Surviving Corporation are fully authorized in the name of their respective corporations or otherwise to take, and will take, all such lawful and necessary action.

1.12 ***Treatment as Reorganization***. Parent and Company hereby adopt this Agreement as a "plan of reorganization" within the meaning of Section 1.368-2(g) and 1.368-3(a) of the United States Treasury Regulations and agree to report the Merger as a reorganization within the meaning of Section 368(a) of the Code to the extent permitted by applicable law. Notwithstanding the foregoing, Parent makes no representations or warranties to the Company, the Company Shareholders or to any other securityholder of the Company regarding the tax treatment of the Merger or any of the tax consequences to the Company, the Company Shareholders or any other securityholder of the Company relating to the Merger, this Agreement, or

any of the other transactions or agreements contemplated hereby. The Company and the Company Shareholders acknowledge that they and the other securityholders are relying solely on their own tax advisors in connection with the Merger, this Agreement and the other transaction and agreements contemplated hereby.

1.12 ***Adjustment to Merger Consideration***. Notwithstanding anything else in this Agreement to the contrary, immediate prior to the payment of the Closing Merger consideration, the number of Merger Shares shall be increased, and the amount of Merger Cash shall be decreased to the minimum extent necessary so that the fraction, the numerator of which is the product of the Merger Shares and the average of the high and low trading price of Parent common stock on the Closing Date ("**Closing Share Value**"), and the denominator of which is the sum of the Closing Share Value and the Merger Cash, equals or exceeds eighty and one-tenths percent (80.1%). For purposes of the foregoing, any adjustments to the number of Merger Shares and the amount of Merger Cash shall be made by reference to the Trading Price. A similar adjustment shall be made with respect to the cash, if any, to be paid to shareholders exercising dissenter's rights.

ARTICLE II

REPRESENTATIONS AND WARRANTIES OF THE COMPANY

The Company hereby represents and warrants to Parent and Merger Sub, subject to such exceptions as are specifically disclosed in the Company Disclosure Schedule (each of which disclosures, in order to be effective, shall clearly reference the appropriate section and, if applicable, subsection of this **Article II** to which it relates and each of which disclosures shall be deemed to be incorporated by reference into the representations and warranties made in this **Article II** delivered by the Company to Parent concurrently with the execution of this Agreement (the "**Disclosure Schedule**", dated as of the date hereof, as follows:

2.1 ***Organization of the Company***.

(a) The Company is a corporation duly organized, validly existing and in good standing under the laws of the State of California. The Company has the corporate power to own its properties and to carry on its business as currently conducted and as currently contemplated to be conducted. The Company is duly qualified or licensed to do business and in good standing as a foreign corporation in each jurisdiction in which the character or location of its assets or properties (whether owned, leased or licensed) or the nature of its business make such qualifications necessary. The Company has delivered a true and correct copy of its Articles of incorporation, as amended to date (the "**Articles of Incorporation**") and bylaws, as amended to date, each in full force and effect on the date hereof (collectively, the "**Charter Documents**"), to Parent. The Board of Directors of the Company has not approved or proposed any amendment to any of the Charter Documents.

(b) **Section 2.1(b)** of the Disclosure Schedule lists the directors and officers of the Company as of the date hereof, separately noting which of such directors and officers has any rights to indemnification from the Company and the scope and duration of such rights and also separately lists any other Person with rights to indemnification from the Company. The operations now being conducted by the Company are not now and have never been conducted by the Company under any other name.

(c) **Section 2.1(c)** of the Disclosure Schedule lists every state or foreign jurisdiction in which the Company has Employees or facilities or otherwise conducts its business.

2.2 ***Company Capital Structure.***

(a) As of the date of this Agreement, the authorized capital stock of the Company consists of 10,000,000 shares of Company Common Stock, of which 2,298,500 shares are issued and outstanding. As of the date hereof, the capitalization of the Company is as set forth in **Section 2.2(a)** of the Disclosure Schedule. The Company Capital Stock is held by the persons with the domicile addresses and in the amounts set forth in **Section 2.2(a)** of the Disclosure Schedule which further sets forth for each such person the number of shares held, class and/or series of such shares and the number of the applicable stock certificates representing such shares. All outstanding shares of Company Capital Stock are duly authorized, validly issued, fully paid and non-assessable and were not issued in violation of, and are not subject to, preemptive rights created by statute, the Charter Documents, or any agreement to which the Company is a party or by which it is bound. All outstanding shares of Company Capital Stock and Company Options have been issued or repurchased (in the case of shares that were outstanding and repurchased by the Company or any shareholder of the Company) in compliance with all applicable federal, state, foreign, or local statutes, laws, rules, or regulations, including federal and state securities laws, and were issued, transferred and repurchased (in the case of shares that were outstanding and repurchased by the Company or any shareholder of the Company) in accordance with any right of first refusal or similar right or limitation, including those in the Charter Documents. Except as contemplated in **Section 1.6(c)(i)** with respect to Company Options, the Company does not have any liability (contingent or otherwise) or claim, loss, damage, deficiency, cost or expense relating to or arising out of the issuance or repurchase of any Company Capital Stock or Company Options, or out of any agreements or arrangements relating thereto (including any amendment of the terms of any such agreement or arrangement). There are no declared or accrued but unpaid dividends with respect to any shares of Company Capital Stock. The Company has no other capital stock authorized, issued or outstanding.

(b) **Section 2.2(b)** of the Disclosure Schedule sets forth for all holders of Company Common Stock, the name of the holder of such Company Common Stock, the repurchase price of such Company Common Stock, the date of purchase of such Company Common Stock and the vesting schedule for such Company Common Stock, including the extent vested to date, whether the vesting of such Company Common Stock is subject to acceleration as a result of the transactions contemplated by this Agreement or any other events (including a complete description of any such acceleration provisions) and whether, to the Knowledge of the Company, the holder has made a timely election with the Internal Revenue Service under Section 83(b) of the Code with respect to such Company Common Stock.

(c) Except for the Plan, neither the Company nor any of its Subsidiaries has ever adopted, sponsored or maintained any stock option plan or any other plan or agreement providing for equity compensation to any person. The Company has reserved 500,000 shares of Company Common Stock for issuance to employees and directors of, and consultants to, the Company or any of its Subsidiaries upon the issuance of stock or the exercise of options granted under the Plan, of which (i) 500,000 shares are issuable, as of the date hereof, upon the exercise of outstanding, unexercised options granted under the Plan, (ii) 500,000 shares have been issued upon the exercise of options or purchase of restricted stock granted under the Plan and remain outstanding as of the date hereof and (iii) no shares remain available for future grant. As of the date hereof, all Company Options have been issued under the Plan. Except as described above, there are no other Company Options outstanding. **Section 2.2(c)** of the Disclosure Schedule sets forth for each outstanding Company Option, the name of the holder of such option, the type of entity of such holder, and any ultimate parent entity of such holder, if not an individual, the domicile address of such holder, the number of shares of Company Capital Stock issuable upon the exercise of such option or warrant, the exercise price of such option or warrant, the date of grant of such option or warrant, the vesting schedule for such option or

warrant, including the extent vested to date and whether the vesting of such option or warrant is subject to acceleration as a result of the transactions contemplated by this Agreement or any other events (including an accurate summary of any such acceleration provisions), whether such option was issued under the Plan and whether such option is a nonstatutory option or intended to qualify as an incentive stock option as defined in Section 422 of the Code. The terms of the Plan and the applicable agreements for each Company Option permit the assumption or substitution of options to purchase Parent Common Stock as provided in this Agreement, without the consent or approval of the holders of such securities, the Shareholders or otherwise and, if so assumed, without any acceleration of the exercise schedules or vesting provisions in effect for such Company Options. True and complete copies of all forms of agreements used by the Company to grant Company Options have been provided to Parent and such forms of agreements and instruments have not been amended, modified or supplemented, and there are no agreements to amend, modify or supplement such agreements or instruments from the forms thereof provided to Parent.

(d) Except for the Company Options listed on **Section 2.2(c)** of the Disclosure Schedule, there are no options, warrants, calls, rights, convertible securities, commitments or agreements of any character, written or oral, to which the Company or any of its Subsidiaries is a party or by which the Company is bound obligating the Company to issue, deliver, sell, repurchase or redeem, or cause to be issued, delivered, sold, repurchased or redeemed, any shares of the capital stock of the Company or obligating the Company to grant, extend, accelerate the vesting of, change the price of, otherwise amend or enter into any such option, warrant, call, right, commitment or agreement except for repurchases of restricted Company Common Stock upon termination of employment. There are no outstanding or authorized stock appreciation, phantom stock, profit participation, or other similar rights with respect to the Company or any of its Subsidiaries. Except as contemplated hereby, there are no voting trusts, proxies, or other agreements or understandings with respect to the voting stock of the Company or any of its Subsidiaries. There are no agreements to which the Company or any of its Subsidiaries is a party relating to the registration, sale or transfer (including agreements relating to rights of first refusal, co-sale rights or “drag-along” rights) of any Company Capital Stock. As a result of the Merger, Parent will be the sole record and beneficial holder of all issued and outstanding Company Capital Stock and all rights to acquire or receive any shares of Company Capital Stock, whether or not such shares of Company Capital Stock are outstanding.

(e) No employee, officer, director or shareholder of the Company or member of his or her immediate family is indebted to the Company, nor is the Company indebted to any of them other than (i) for payment of salary for services rendered, (ii) reimbursement for reasonable expenses incurred on behalf of the Company and (iii) for other standard employee benefits made generally available to all employees.

(f) Upon the receipt of the Requisite Shareholder Vote, the allocation of the Merger Shares set forth in **Section 1.6(b)** will be consistent with the Articles of Incorporation of the Company.

2.3 ***Subsidiaries***. **Section 2.3(a)** of the Disclosure Schedule lists each corporation, limited liability company, partnership, association, joint venture or other business entity in which the Company owns, or has owned, any shares of capital stock or holds, or has held, any interest in, or otherwise controls, or has controlled, directly or indirectly. **Section 2.3(b)** of the Disclosure Schedule lists each corporation, limited liability company, partnership, association, joint venture or other business entity of which the Company owns, directly or indirectly, more than 50% of the stock or other equity interest entitled to vote on the election of the members of the board of directors or similar governing body (each, a “**Subsidiary**”). Each entity listed on **Section 2.3(a)** of the Disclosure Schedule that is no longer in existence has been duly dissolved in accordance with its charter documents and the laws of the jurisdiction of its incorporation or organization and there are no outstanding liabilities or obligations (outstanding, contingent or otherwise), including taxes, with respect to

any such entity. Each Subsidiary is a corporation duly organized, validly existing and in good standing under the laws of the jurisdiction of its incorporation or organization. Each Subsidiary has the corporate power to own its properties and to carry on its business as currently conducted and as currently contemplated to be conducted. Each Subsidiary is duly qualified or licensed to do business and in good standing as a foreign corporation in each jurisdiction in which the character or location of its assets or properties (whether owned, leased or licensed) or the nature of its business make such qualifications necessary. A true and correct copy of each Subsidiary's charter documents and bylaws, each as amended to date and in full force and effect on the date hereof, has been delivered to Parent. **Section 2.3(c)** of the Disclosure Schedule lists the directors and officers of each Subsidiary as of the date of this Agreement. All of the outstanding shares of capital stock of each Subsidiary are owned of record and beneficially by the Company. All outstanding shares of stock of each Subsidiary are duly authorized, validly issued, fully paid and non-assessable and not subject to preemptive rights created by statute, the charter documents or bylaws of such Subsidiary, or any agreement to which such Subsidiary is a party or by which it is bound, and have been issued in compliance with all applicable legal requirements. There are no options, warrants, calls, rights, commitments or agreements of any character, written or oral, to which any Subsidiary is a party or by which it is bound obligating the Subsidiary to issue, deliver, sell, repurchase or redeem, or cause to be issued, sold, repurchased or redeemed, any shares of the capital stock of such Subsidiary or obligating such Subsidiary to grant, extend, accelerate the vesting of, change the price of, otherwise amend or enter into any such option, warrant, call right, commitment or agreement. There are no outstanding or authorized stock appreciation, phantom stock, profit participation, or other similar rights with respect to any of the Subsidiaries. Neither the Company nor any Subsidiary has agreed or is obligated to make any future investment in or capital contribution to any Person.

2.4 ***Authority***. The Company has all requisite power and authority to enter into this Agreement and to consummate the transactions contemplated hereby and thereby. The execution and delivery of this Agreement and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of the Company and no further action is required on the part of the Company to authorize the Agreement and the transactions contemplated hereby and thereby, subject only to the approval of this Agreement and the transactions contemplated hereby by the Shareholders. The vote required to approve this Agreement and the transactions contemplated hereby by the Shareholders is set forth in **Section 2.4** of the Disclosure Schedule. This Agreement and the transactions contemplated hereby have been unanimously approved by the Board of Directors of the Company. This Agreement has been duly executed and delivered by the Company and assuming the due authorization, execution and delivery by the other parties hereto and thereto, constitute the valid and binding obligations of the Company enforceable against it in accordance with its terms.

2.5 ***No Conflict***. The execution and delivery by the Company of this Agreement and the consummation of the transactions contemplated hereby and thereby, will not conflict with or result in any violation of or default under (with or without notice or lapse of time, or both) or give rise to a right of termination, cancellation, modification or acceleration of any obligation or loss of any benefit under (any such event, a "**Conflict**") (i) any provision of the Charter Documents or the organizational documents of any of its Subsidiaries, as amended, (ii) any mortgage, indenture, lease, contract, covenant, plan, insurance policy or other agreement, instrument or commitment, permit, concession, franchise or license (each a "**Contract**" and collectively the "**Contracts**") to which the Company or any of its Subsidiaries is a party or by which any of their respective properties or assets (whether tangible or intangible) are bound, or (iii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to the Company or any of its Subsidiaries or any of their respective properties or assets (whether tangible or intangible). **Section 2.5** of the Disclosure Schedule sets forth all necessary notices, consents, waivers and approvals as are required under any Contracts in connection with the Merger, or for any such Contract to remain in full force and effect without limitation,

modification or alteration after the Effective Time so as to preserve all rights of, and benefits to, the Company and its Subsidiaries, as the case may be, under such Contracts from and after the Effective Time. Following the Effective Time, the Surviving Corporation will be permitted to exercise all of its rights under the Contracts without the payment of any additional amounts or consideration other than ongoing fees, royalties or payments which the Company or any of its Subsidiaries, as the case may be, would otherwise be required to pay pursuant to the terms of such Contracts had the transactions contemplated by this Agreement not occurred.

2.6 ***Consents***. No consent, notice, waiver, approval, order or authorization of, or registration, declaration or filing with any court, administrative agency or commission or other federal, state, county, local or other foreign governmental authority, instrumentality, agency or commission (each, a "**Governmental Entity**") or any third party, including a party to any Material Contract with the Company or any of its Subsidiaries (so as not to trigger any Conflict), is required by, or with respect to, the Company or any of its Subsidiaries in connection with the execution and delivery of this Agreement or the consummation of the transactions contemplated hereby and thereby, except for (i) such consents, notices, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable securities laws, (ii) such consents, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under the foreign merger control regulations identified on **Section 2.6** of the Disclosure Schedule, (iii) the filing of the Certificate of Merger with the Secretary of State of the State of California, (iv) the adoption of this Agreement and approval of the transactions contemplated by this Agreement by the Shareholders and (v) the consents identified on **Section 2.5** of the Disclosure Schedule.

2.7 ***Company Financial Statements***. **Section 2.7** of the Disclosure Schedule sets forth the Company's (i) unaudited consolidated balance sheet as of June 30, 2007 (the "**Balance Sheet Date**"), and the related consolidated statements of income, cash flow and shareholders' equity for the twelve (12) month period then ended (the "**Financials**"). The Financials are true and correct in all material respects and present fairly the Company's consolidated financial condition, operating results and cash flows as of the dates and during the periods indicated therein, except that the Financials have been prepared in accordance with the cash method accounting, which do not reflect the Company's consolidated financial condition, operating results and cash flows in accordance with generally accepted accounting principles. The Company's unaudited consolidated balance sheet as of the Balance Sheet Date is referred to hereinafter as the "**Current Balance Sheet**."

2.8 ***Internal Controls***. The Company and each of its Subsidiaries has established and uses its commercially reasonable efforts to adhere to and enforce, a system of internal accounting controls designed to ensure the reliability of financial reporting and the preparation of financial statements in accordance with the cash method of accounting (including the Financials), including policies and procedures that (i) require the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company and its Subsidiaries, (ii) provide assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with the cash method of accounting, and that receipts and expenditures of the Company and its Subsidiaries are being made only in accordance with appropriate authorizations of management and the Board of Directors of the Company and (iii) provide assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the assets of the Company and its Subsidiaries. Neither the Company nor any of its Subsidiaries (including any Employee thereof) has identified or been made aware of (i) any significant deficiency or material weakness in the system of internal accounting controls utilized by the Company and its Subsidiaries, (ii) any fraud or other wrongdoing that involves the Company's management or other Employees who have a role in the preparation

of financial statements or the internal accounting controls utilized by the Company and its Subsidiaries or (iii) any claim or allegation regarding any of the foregoing.

2.9 ***No Undisclosed Liabilities***. Neither the Company nor any of its Subsidiaries has any liability, indebtedness, obligation, expense, claim, deficiency, guaranty or endorsement of any type, whether accrued, absolute, contingent, matured, unmatured or other (whether or not required to be reflected in financial statements in accordance with the cash method of accounting), except for those which (i) have been reflected in the Current Balance Sheet or, (ii) have arisen in the ordinary course of business consistent with past practices since the Balance Sheet Date and prior to the date hereof and are reflected in the Closing Statement of Assumed Liabilities.

2.10 ***No Changes***. Since the Balance Sheet Date, there has not been, occurred or arisen any:

(a) material transaction by the Company or any of its Subsidiaries except in the ordinary course of business as conducted on that date and consistent with past practices;

(b) modifications, amendments or changes to the Charter Documents or the organizational documents of any Subsidiary;

(c) expenditure, transaction or commitment exceeding $20,000 individually or $50,000 in the aggregate or any commitment or transaction of the type described in **Section 2.13** hereof in any case by the Company or any of its Subsidiaries;

(d) payment, discharge, waiver or satisfaction, in any amount in excess of $20,000 in any one case, or $50,000 in the aggregate, of any claim, liability, right or obligation (absolute, accrued, asserted or unasserted, contingent or otherwise of the Company or any of its Subsidiaries), other than payments, discharges or satisfactions in the ordinary course of business of liabilities reflected or reserved against in the Current Balance Sheet;

(e) destruction of, damage to, or loss of any material assets (whether tangible or intangible), material business or material customer of the Company or any of its Subsidiaries (whether or not covered by insurance);

(f) employment dispute, including claims or matters raised by any individual, Governmental Entity, or any workers' representative organization, bargaining unit or union regarding labor trouble or claim of wrongful discharge or other unlawful employment or labor practice or action with respect to the Company or any of its Subsidiaries;

(g) adoption or change in accounting methods or practices (including any change in depreciation or amortization policies or rates) by the Company or any of its Subsidiaries;

(h) adoption of or change in any election in respect of Taxes, adoption or change in any accounting method in respect of Taxes, agreement or settlement of any claim or assessment in respect of Taxes, or extension or waiver of the limitation period applicable to any claim or assessment in respect of Taxes;

(i) revaluation by the Company or any of its Subsidiaries of any of its assets (whether tangible or intangible), including writing down the value of inventory or writing off notes or accounts receivable;

(j) except as set forth in **Section 2.10(j)** of the Disclosure Schedule, any declaration, setting aside or payment of a dividend or other distribution (whether in cash, stock or property) in respect of any Company Capital Stock or the capital stock of any Subsidiary, or any split, combination or reclassification in respect of any shares of Company Capital Stock or the capital stock of any Subsidiary, or any issuance or authorization of any issuance of any other securities in respect of, in lieu of or in substitution for shares of Company Capital Stock or the capital stock of any Subsidiary, or any direct or indirect repurchase, redemption, or other acquisition by the Company of any shares of Company Capital Stock or the capital stock of any Subsidiary (or options, warrants or other rights convertible into, exercisable or exchangeable therefor), except in accordance with the agreements evidencing Company Options or Company Common Stock subject to vesting;

(k) except as expressly provided for in this Agreement, including without limitation, the Company's obligation to pay deferred compensation as provided for in **Section 1.6(b)(i)(i)** of this Agreement, increase in or other change to the salary or other compensation payable or to become payable by the Company or any of its Subsidiaries to any of their respective officers, directors, employees, consultants or advisors, or the declaration, payment or commitment or obligation of any kind for the payment (whether in cash or equity) by the Company or any of its Subsidiaries of a severance payment, termination payment, bonus or other additional salary or compensation to any such person;

(l) material agreement, contract, covenant, instrument, lease, license or commitment to which the Company or any of its Subsidiaries is a party or by which it or any of its assets (whether tangible or intangible) are bound or any termination, extension, amendment or modification of the terms of any material agreement, contract, covenant, instrument, lease, license or commitment to which the Company or any of its Subsidiaries is a party or by which it or any of their assets are bound;

(m) sale, lease, license or other disposition of any of the assets (whether tangible or intangible) or properties of the Company or any of its Subsidiaries, including the sale of any accounts receivable of the Company or any of its Subsidiaries, or any creation of any security interest in such assets or properties other than in the ordinary course of business consistent with past practices;

(n) loan by the Company or any of its Subsidiaries to any Person except for advances to employees for travel and business expenses in the ordinary course of business consistent with past practices, or purchase by the Company or any of its Subsidiaries of any debt securities of any Person or amendment to the terms of any outstanding loan agreement;

(o) incurring by the Company or any of its Subsidiaries of any indebtedness, amendment of the terms of any outstanding loan agreement, guaranteeing by the Company or any of its Subsidiaries of any indebtedness, issuance or sale of any debt securities of the Company or any of its Subsidiaries or guaranteeing of any debt securities of others, except for advances to employees for travel and business expenses in the ordinary course of business consistent with past practices;

(p) waiver or release of any right or claim of the Company or any of its Subsidiaries, including any waiver, release or other compromise of any account receivable of the Company or any of its Subsidiaries;

(q) (i) commencement or settlement of any lawsuit by the Company or any of its Subsidiaries, or (ii) commencement, settlement, notice or, to the Knowledge of the Company, threat of any lawsuit or proceeding or other investigation against the Company or any of its Subsidiaries or relating to any

of their businesses, properties or assets, or to the Knowledge of the Company, any reasonable basis for any of the foregoing;

(r) notice of any claim or potential claim of ownership, interest or right by any person other than the Company or any of its Subsidiaries of the Company Intellectual Property owned by or developed or created by the Company or any of its Subsidiaries or of infringement by the Company or any of its Subsidiaries of any other Person's Intellectual Property;

(s) issuance, grant, delivery, sale or purchase, or proposal, contract or agreement to issue, grant, deliver, sell or purchase, by the Company or any of its Subsidiaries, of any shares of Company Capital Stock or shares of capital stock of any of its Subsidiaries or securities convertible into, or exercisable or exchangeable for, shares of Company Capital Stock or shares of capital stock of any of its Subsidiaries, or any subscriptions, warrants, options, rights or securities to acquire any of the foregoing, except for (i) issuances of Company Capital Stock upon the exercise of Company Options or (ii) prior to the date hereof, the grant of restricted Company Common Stock or options to purchase Company Common Stock to employees of the Company under the Plan;

(t) (i) sale, lease, license or transfer of any Company Intellectual Property or execution, modification or amendment of any agreement with respect to Company Intellectual Property with any Person or with respect to the Intellectual Property of any Person except in the ordinary course of business consistent with past practice, or (ii) purchase or license of any Intellectual Property or execution, modification or amendment of any agreement with respect to the Intellectual Property of any Person, (iii) agreement or modification or amendment of an existing agreement with respect to the development of any Intellectual Property with a third party (other than entering into Employee Proprietary Information Agreements with new employees), or (iv) change in pricing or royalties set or charged by the Company or any of its Subsidiaries to its customers or licensees or in pricing or royalties set or charged by Persons who have licensed Intellectual Property to the Company or any of its Subsidiaries;

(u) agreement or modification to any Contract pursuant to which any other party is or was granted marketing, distribution, development, manufacturing or similar rights of any type or scope with respect to any products or technology of the Company or any of its Subsidiaries;

(v) event or condition of any character that has had or is reasonably likely to have a Company Material Adverse Effect;

(w) purchase or sale of any interest in real property, granting of any security interest in any real property or lease, license, sublease or other occupancy of any Leased Real Property or other real property by the Company or any of its Subsidiaries;

(x) acquisition by the Company or any Subsidiary or agreement by the Company or any Subsidiary to acquire by merging or consolidating with, or by purchasing any assets or equity securities of, or by any other manner, any business or corporation, partnership, association or other business organization or division thereof, or other acquisition or agreement to acquire any assets or any equity securities that are material, individually or in the aggregate, to the business of the Company or its Subsidiaries;

(y) grant by the Company or any Subsidiary of any severance or termination pay (in cash or otherwise) to any Employee, including any officer, except payments made pursuant to written agreements disclosed in the Disclosure Schedule;

(z) except as expressly provided for in this Agreement, adoption or amendment of any Company Employee Plan, execution or amendment of any Employee Agreement, or payment or agreement by the Company or any Subsidiary to pay any bonus or special remuneration to any director or employee, or increase or modify the salaries, wage rates or other compensation (including any equity-based compensation) of any Employee other than as may be required by applicable laws;

(aa) execution of any strategic alliance, affiliate or joint marketing arrangement or agreement by the Company or any Subsidiary;

(bb) any action to accelerate the vesting schedule of any Company Options or Company Common Stock;

(cc) hiring, promotion, demotion or termination or other change to the employment status or title of any employees;

(dd) alteration of any interest of the Company or any Subsidiary in a Subsidiary or any corporation, association, joint venture, partnership or business entity in which the Company or any Subsidiary directly or indirectly holds any interest;

(ee) cancellation, amendment or renewal of any insurance policy of the Company or any Subsidiary; or

(ff) agreement by the Company or any of its Subsidiaries, or any officer or employees on behalf of the Company or any of its Subsidiaries, to do any of the things described in the preceding clauses (a) through (ee) of this **Section 2.10** (other than negotiations with Parent and its representatives regarding the transactions contemplated by this Agreement).

2.11 ***Accounts Receivable.***

(a) The Company has made available to Parent a list of all accounts receivable of the Company and its Subsidiaries as of the Balance Sheet Date, together with an aging schedule indicating a range of days elapsed since invoice.

(b) All of the accounts receivable of the Company and its Subsidiaries arose in the ordinary course of business, are carried at values determined in accordance with the cash method of accounting, are not subject to any valid set-off or counterclaim, do not represent obligations for goods sold on consignment, on approval or on a sale-or-return basis or subject to any other repurchase or return arrangement and are collectible except to the extent of reserves therefor set forth in the Current Balance Sheet or, for receivables arising subsequent to the Balance Sheet Date, as reflected on the books and records of the Company (which receivables are recorded in accordance with the cash method of accounting). No person has any Lien on any accounts receivable of the Company and its Subsidiaries and no request or agreement for deduction or discount has been made with respect to any accounts receivable of the Company and its Subsidiaries.

2.12 ***Tax Matters.***

(a) ***Definition of Taxes***. For the purposes of this Agreement, the term "**Tax**" or, collectively, "**Taxes**" shall mean (i) any and all federal, state, local and foreign taxes, assessments and other governmental charges, duties, impositions and liabilities, including taxes based upon or measured by gross

receipts, income, profits, sales, use and occupation, and value added, ad valorem, transfer, franchise, withholding, payroll, recapture, employment, excise and property taxes as well as public imposts, fees and social security charges (including health, unemployment, workers' compensation and pension insurance), together with all interest, penalties and additions imposed with respect to such amounts, (ii) any liability for the payment of any amounts of the type described in clause (i) of this **Section 2.12(a)** as a result of being a member of an affiliated, consolidated, combined or unitary group for any period, and (iii) any liability for the payment of any amounts of the type described in clauses (i) or (ii) of this **Section 2.12(a)** as a result of any express or implied obligation to indemnify any other person or as a result of any obligation under any agreement or arrangement with any other person with respect to such amounts and including any liability for taxes of a predecessor entity.

(b) ***Tax Returns and Audits***.

(i) The Company and each of its Subsidiaries have (a) prepared and timely filed all required federal, state, local and foreign returns, estimates, information statements and reports ("**Returns**") relating to any and all Taxes concerning or attributable to the Company or any of its Subsidiaries or their respective operations and such Returns are true and correct and have been completed in accordance with applicable law and (b) timely paid all Taxes they are required to pay or established adequate reserves on the Current Balance Sheet for such Taxes.

(ii) The Company and each of its Subsidiaries have withheld with respect to their respective Employees and other third parties, all federal, state and foreign income Taxes and social security charges and similar fees, Federal Insurance Contribution Act, Federal Unemployment Tax Act and other Taxes required to be withheld, and have timely paid all such Taxes to the appropriate authorities.

(iii) Neither the Company nor any of its Subsidiaries has been delinquent in the payment of any Tax, nor is there any Tax deficiency outstanding, assessed or proposed against the Company or any of its Subsidiaries, nor has the Company or any of its Subsidiaries executed any waiver of any statute of limitations on or extending the period for the assessment or collection of any Tax.

(iv) No audit or other examination of any Return of the Company or any of its Subsidiaries is presently in progress, nor has the Company or any of its Subsidiaries been notified of any request for such an audit or other examination.

(v) As of the date of the Current Balance Sheet, neither the Company nor any of its Subsidiaries has any liabilities for unpaid Taxes which have not been accrued or reserved on the Current Balance Sheet, whether asserted or unasserted, contingent or otherwise, and neither the Company nor any of its Subsidiaries has incurred any liability for Taxes since the Balance Sheet Date other than in the ordinary course of business.

(vi) The Company has provided to Parent or its legal counsel, copies of all Returns for the Company and its Subsidiaries filed for the previous four taxable years.

(vii) There are (and immediately following the Effective Time there will be) no Liens on the assets of the Company or any of its Subsidiaries relating to or attributable to Taxes other than Permitted Liens. Neither the Company nor any of its Subsidiaries has Knowledge of any basis for the assertion of any claim relating or attributable to Taxes which, if adversely determined, would result in any Lien (other than Permitted Liens) on the assets of the Company or any of its Subsidiaries.

(viii) None of the Company's or any of its Subsidiaries' assets is treated as "tax-exempt use property," within the meaning of Section 168(h) of the Code.

(ix) Neither the Company nor any of its Subsidiaries has (a) ever been a member of an affiliated group (within the meaning of Code §1504(a)) filing a consolidated federal income Tax Return (other than a group the common parent of which was Company), (b) ever been a party to any Tax sharing, indemnification or allocation agreement, (c) any liability for the Taxes of any person (other than Company or any of its Subsidiaries), under Treasury Regulation §1.1502-6 (or any similar provision of state, local or foreign law), as a transferee or successor, by contract or agreement, or otherwise and (d) ever been a party to any joint venture, partnership or other arrangement that could be treated as a partnership for Tax purposes.

(x) The Company's and each of its Subsidiaries' tax basis in their respective assets for purposes of determining its future amortization, depreciation and other income Tax deductions is accurately reflected on the Company's and its Subsidiaries' Tax books and records.

(xi) Neither the Company nor any of its Subsidiaries has been, at any time, a "United States Real Property Holding Corporation" within the meaning of Section 897(c)(2) of the Code.

(xii) No adjustment relating to any Return filed by the Company or any of its Subsidiaries has been proposed formally or, to the Knowledge of the Company, informally by any Tax authority to the Company or any of its Subsidiaries or any representative thereof.

(xiii) Neither the Company nor any of its Subsidiaries has constituted either a "distributing corporation" or a "controlled corporation" in a distribution of stock intended to qualify for tax-free treatment under Section 355 of the Code (x) in the two years prior to the date of this Agreement or (y) in a distribution which could otherwise constitute part of a "plan" or "series of related transactions" (within the meaning of Section 355(e) of the Code) in conjunction with the Merger.

(xiv) None of the Company or any of its Subsidiaries has engaged in a "reportable transaction" as set forth in Treas. Reg. §1.6011-4(b), or any transaction that is the same or substantially similar to one of the types of transactions that the Internal Revenue Service has determined to be a Tax avoidance transaction and identified by notice, regulation, or other form of published guidance as a "listed transaction," as set forth in Treasury Regulation Section 1.6011-4(b)(2).

(xv) The Company is and has at all times been resident for Tax purposes in its place of incorporation or formation and is not and has not at any time been treated as resident in any other jurisdiction for any Tax purpose (including any income tax treaty). The Company is not subject to Tax in any jurisdiction other than its place of incorporation or formation by virtue of having a branch, permanent establishment or other place of business or by virtue of having a source of income in that jurisdiction, except for royalty income for which any income Tax is satisfied through withholding. The Company is not liable for any Tax as the agent of any other person or business and does not constitute a permanent establishment or other place of business of any other person, business or enterprise for any Tax purpose.

(xvi) The Company will not be required to include any material income or gain or exclude any material deduction or loss from taxable income for any taxable year after the Closing Date as a result of (a) any change in method of accounting under Section 481(c) of the Code, closing agreement under Section 7121 of the Code, deferred intercompany gain or excess loss account under Treasury Regulations

under Section 1502 of the Code (or in each case, under any similar provision of applicable law), (b) installment sale or open transaction disposition or (c) prepaid amount.

(xvii) No relief (including by way of deduction, reduction, set-off, exemption or otherwise) from, against or in respect of any Tax or charge has been claimed by or given to the Company or any of its Subsidiaries which could be withdrawn, postponed, restricted or otherwise lost as a result of any act, omission, event or circumstance arising or occurring at any time before the date hereof or as a result of entering into this Agreement.

(xviii) No power of attorney (or similar authority) relating to Tax matters, Tax audits or Returns has been granted with respect to the Company or any of its Subsidiaries.

(xix) The prices for any property or services (or for use of any property) charged by or to the Company or any of its Subsidiaries are arm's length prices for purposes of any applicable transfer pricing laws, including Treasury Regulations promulgated under Section 482 of the Code.

(xx) No claim has been made by any governmental entity in any jurisdiction where the Company or any of its Subsidiaries does not file Returns that the Company or any such Subsidiary may be subject to taxation by that jurisdiction.

(xxi) The Company and each of its Subsidiaries have complied in all respects with all applicable laws relating to the withholding and payment of Taxes (including withholding of Taxes pursuant to Sections 1441, 1442, 3121 and 3402 of the Code or any comparable provision of any state, local or foreign laws) and have, within the time and in the manner prescribed by applicable law, withheld from and paid over to the proper taxing authorities all amounts required to be so withheld and paid over under such laws.

(c) ***Executive Compensation Tax***. There is no contract, agreement, plan or arrangement to which the Company or any of its Subsidiaries is a party, including the provisions of this Agreement, covering any Employee of the Company or any of its Subsidiaries, which, individually or collectively, could give rise to the payment of any amount that would not be deductible pursuant to Sections 280G, 404 or 162(m) of the Code or that would give rise to a penalty under Section 409A of the Code.

2.13 ***Restrictions on Business Activities***. There is no agreement (non-competition or otherwise), commitment, judgment, injunction, order or decree to which the Company or any of its Subsidiaries is a party or otherwise binding upon the Company or any of its Subsidiaries which has or may reasonably be expected to have the effect of prohibiting or impairing any business practice of the Company or any of its Subsidiaries, any acquisition of property (tangible or intangible) by the Company or any of its Subsidiaries, the conduct of business by the Company or any of its Subsidiaries, or otherwise limiting the freedom of the Company or any of its Subsidiaries to engage in any line of business or to compete with any person. Without limiting the generality of the foregoing, neither the Company nor any of its Subsidiaries has entered into any agreement under which the Company or any of its Subsidiaries is restricted from selling, licensing, manufacturing or otherwise distributing any of its technology or products or from providing services to customers or potential customers or any class of customers, in any geographic area, during any period of time, or in any segment of the market.

2.14 ***Title to Properties; Absence of Liens and Encumbrances; Condition of Equipment; Customer Information.***

(a) Neither the Company nor any of its Subsidiaries owns any real property, nor has the Company or any of its Subsidiaries ever owned any real property. **Section 2.14(a)** of the Disclosure Schedule sets forth a complete and accurate list of all real property currently leased, subleased or licensed by or from the Company or any of its Subsidiaries or otherwise used or occupied by the Company or any of its Subsidiaries for the operation of their business (the "**Leased Real Property**"), and a copy of each lease, license, sublease or other occupancy right and each amendment thereto.

(b) The Company has provided Parent true, correct and complete copies of all leases, lease guaranties, subleases, agreements for the leasing, use or occupancy of, or otherwise granting a right in or relating to the Leased Real Property, including all amendments, terminations and modifications thereof ("**Lease Agreements**"); and there are no other Lease Agreements for real property affecting the Leased Real Property or to which Company or any of its Subsidiaries is bound, other than those identified in **Section 2.14(a)** of the Disclosure Schedule. All such Lease Agreements are valid and effective in accordance with their respective terms, and there is not, under any of such leases, any existing default, no rentals are past due, or event of default (or event which with notice or lapse of time, or both, would constitute a default). Neither the Company nor any of its Subsidiaries has received any notice of a default, alleged failure to perform, or any offset or counterclaim with respect to any such Lease Agreement, which has not been fully remedied and withdrawn. There are no other parties occupying or with a right to occupy, the Leased Real Property, except as set forth in **Section 2.14(a)** of the Disclosure Schedule. Neither the Company nor any of its Subsidiaries owes brokerage commissions or finders fees with respect to any such Leased Real Property or would owe any such fees if any existing Lease Agreement were renewed pursuant to any renewal options contained in such Lease Agreements.

(c) The Leased Real Property is in good operating condition and repair, free from structural, physical and mechanical defects, is maintained in a manner consistent with standards generally followed with respect to similar properties, and is structurally sufficient and otherwise suitable for the conduct of the business as presently conducted. Neither the operation of the Company or any of its Subsidiaries on the Leased Real Property nor, to the Company's Knowledge, such Leased Real Property, including the improvements thereon, violate in any material respect any applicable building code, zoning requirement or statute relating to such property or operations thereon. There is not existing, the Company has not received any notice of, and to the Knowledge of the Company, there is not presently contemplated or proposed, any eminent domain, condemnation or similar action, or, to the Company's Knowledge, zoning action or proceeding, with respect to any portion of the Leased Real Property.

(d) The Company and each of its Subsidiaries has good and valid title to, or, in the case of leased properties and assets, valid leasehold interests in, all of its tangible properties and assets, real, personal and mixed, used or held for use in its business, free and clear of any Liens, except (i) as reflected in the Current Balance Sheet, (ii) such imperfections of title and encumbrances, if any, which do not detract from the value or interfere with the present use of the property subject thereto or affected thereby and (iii) Permitted Liens.

(e) All material items of equipment (the "**Equipment**") owned or leased by the Company or any of its Subsidiaries is in good operating condition, regularly and properly maintained, subject to normal wear and tear.

(f) The Company and each of its Subsidiaries has sole and exclusive ownership, free and clear of any Liens, of all customer lists, customer contact information, customer correspondence and customer licensing and purchasing histories relating to its current and former customers (the "**Customer**

Information”). No person other than the Company or its wholly owned Subsidiaries possesses any claims or rights with respect to use of the Customer Information.

2.15 ***Intellectual Property.***

(a) ***Definitions***. For all purposes of this Agreement, the following terms shall have the following respective meanings:

“***Company Intellectual Property***” shall mean any and all Technology and Intellectual Property Rights that are owned or purported to be owned by or exclusively licensed to the Company or its Subsidiaries.

“***Company Product***” shall mean all products, technologies and services developed (including products, technologies and services under development), owned, made, provided, distributed, imported, sold or licensed by or on behalf of the Company and any of its Subsidiaries.

“***Intellectual Property Rights***” shall mean common law and statutory rights anywhere in the world arising under or associated with (i) patents, patent applications and inventors’ certificates (“**Patent**”), (ii) copyrights, copyright registrations and copyright applications, “moral” rights and mask work rights (“**Copyrights**”), (iii) the protection of trade and industrial secrets and confidential information (“**Trade Secrets**”), (iv) trademarks, trade names and service marks (“**Trademarks**”), (iv) other proprietary rights relating or with respect to the protection of Technology, (vi) divisions, continuations, renewals, reissuances and extensions of the foregoing (as applicable) and (vii) analogous rights to those set forth above, including the right to enforce and recover damages for the infringement or misappropriation of for any of the foregoing.

“***Object Code***” shall mean software, including GDSII files, substantially or entirely in binary form, which is intended to be directly executable by a computer after suitable processing and linking but without the intervening steps of compilation or assembly or from which semiconductor mask works can be derived.

“***Open Source Materials***” shall mean all software or other material that is distributed as “free software”, “open source software” or under a similar licensing or distribution terms (an “**Open Source License**”), including, but not limited to, the GNU General Public License (GPL), GNU Lesser General Public License (LGPL), Mozilla Public License (MPL), BSD licenses, the Artistic License, the Netscape Public License, the Sun Community Source License (SCSL) the Sun Industry Standards License (SISL) and the Apache License.

“***Registered Intellectual Property***” shall mean applications, registrations and filings for Intellectual Property Rights that have been registered, filed, certified or otherwise perfected or recorded with or by any state, government or other public or quasi public legal authority.

“***Source Code***” shall mean software and code, including RTL, other than Object Code form, including related comments and annotations, help text, data and data structures, instructions and procedural, object oriented and other code, which may be printed out or displayed in human readable form or from which Object Code can be derived by compilation or otherwise.

“***Technology***” shall mean any or all of the following (i) works of authorship including computer programs, Source Code, and executable code, RTL, GDSII files, whether embodied in

software, firmware or otherwise, architecture, documentation, designs, files, records, and data, (ii) inventions (whether or not patentable), discoveries, improvements, and technology, (iii) proprietary and confidential information, trade secrets and know how, (iv) databases, data compilations and collections and technical data, (v) logos, trade names, trade dress, trademarks and service marks, (vi) domain names, web addresses and sites, (vii) tools, methods and processes, (viii) devices, prototypes, schematics, breadboards, netlists, maskworks, test methodologies, verilog files, emulation and simulation reports, test vectors and hardware development tools, and (ix) any and all instantiations of the foregoing in any form and embodied in any media.

(b) **Section 2.15(b)** of the Disclosure Schedule sets forth as of the date hereof a true, complete and correct list of all Registered Intellectual Property owned by or filed in the name of Company or any of its Subsidiaries (collectively the "**Company Registered Intellectual Property**"). The Company Registered Intellectual Property is valid and subsisting (except with respect to applications), and has not expired or been cancelled, or abandoned. There are no actions that must be taken by the Company or any of its Subsidiaries within 120 days of the date hereof, including the payment of any registration, maintenance or renewal fees or the filing of any documents, applications or certificates for the purposes of maintaining, perfecting or preserving or renewing any Company Registered Intellectual Property.

(c) Except as set forth in **Section 2.15(c)** of the Disclosure Schedule, all Company Intellectual Property is owned exclusively by Company or one or more of its Subsidiaries free and clear of any Liens. Neither the Company nor any of its Subsidiaries has transferred ownership of, in whole or in part, or granted an exclusive license to, any third party, of any Intellectual Property Rights that are or were Company Intellectual Property.

(d) Except as set forth on **Section 2.15(d)** of the Disclosure Schedule, all Company Intellectual Property used in or necessary to the conduct of Company's business as presently conducted or currently contemplated to be conducted by the Company was written and created solely by either (i) employees of the Company acting within the scope of their employment who have validly and irrevocably assigned all of their rights, including all Intellectual Property Rights therein, to the Company or (ii) by third parties who have validly and irrevocably assigned all of their rights, including all Intellectual Property Rights therein, to the Company, and no third party owns or has any rights to any of the Company Intellectual Property.

(e) Except as set forth in **Section 2.15(e)** of the Disclosure Schedule, there is no pending or, to the Company's Knowledge, threatened (and at no time since the date of the Company's incorporation has there been pending any) suit, arbitration or other adversarial proceeding before any court, government agency or arbitral tribunal or in any jurisdiction alleging that any activities or conduct of the Company's or any of its Subsidiaries' business infringes or will infringe upon, violate or constitute the unauthorized use of the Intellectual Property Rights of any third party or challenging the ownership, validity, enforceability or registerability of any Company Intellectual Property. The Company is not party to any settlements, covenants not to sue, consents, decrees, stipulations, judgments, or orders resulting from suits, actions or similar legal proceedings which (i) restrict the Company's or any of its Subsidiaries' rights to use, license or transfer any Company Intellectual Property, (ii) restrict the conduct of the business of the Company or any of its Subsidiaries in order to accommodate any third party's Intellectual Property Rights, or (iii) compel or require the Company or any of its Subsidiaries to license or transfer any Company Intellectual Property.

(f) The conduct of the business of the Company and its Subsidiaries (including the making, using, selling, offering, performing and distributing any products or services) has not, and does not as

currently conducted, infringe upon, violate or constitute the unauthorized use of any Intellectual Property Rights owned by any third party.

(g) The Company and its Subsidiaries have taken reasonable measures to protect the proprietary nature of the Intellectual Property Rights owned by the Company or such Subsidiary that is material to the business of the Company and its Subsidiaries as currently conducted.

(h) All Company Intellectual Property is, and following the transactions contemplated hereby shall be freely transferable, alienable and exportable without the consent of, or notice to any Governmental Entity or third party or the payment of any kind.

(i) No third party that has licensed Intellectual Property or Intellectual Property Rights to the Company or any of its Subsidiaries has ownership rights or license rights to improvements or derivative works made by the Company or any of its Subsidiaries in such Intellectual Property that has been licensed to the Company or any of its Subsidiaries.

(j) No government funding, facilities or resources of a university, college, other educational institution or research center or funding from third parties was used in the development of the Company Intellectual Property. No Governmental Entity, university, college, other educational institution or research center has any claim or right in or to the Company Intellectual Property.

(k) The Company is not and has never been a member or promoter of, or a contributor to, any industry standards body or similar organization that could require or obligate the Company to grant or offer to any other person any license or right to any Company Intellectual Property.

(l) To the Company's Knowledge, no third party is misappropriating, infringing, diluting or violating any material Company Intellectual Property. Neither Company nor any of its Subsidiaries has brought any claims, suits, arbitrations or other adversarial proceedings before any court, government agency or arbitral tribunal against any third party with respect to any Company Intellectual Property which remain unresolved as of the date hereof.

(m) Except as set forth in **Section 2.15(m)** of the Disclosure Schedule, neither the Company nor any of its Subsidiaries has (i) granted, or is obligated to grant, access or rights to any of its Source Code in or for any Company Product, (ii) made its Source Code for any Company Product subject to any Open Source License or combined or distributed any Company Products with Open Source Materials, or (iii) licensed or has granted a third party the right to obtain any Source Code for or in any Company Product (including in any such case any conditional right to access or under which the Company has established any escrow arrangement for the storage and conditional release of any Source Code). None of the Company Products contains any third party software subject to an Open Source License.

(n) Except as set forth in **Section 2.15(n)** of the Disclosure Schedule, neither the Company nor any of its Subsidiaries has any obligation to pay any third party any royalties or other fees in excess of $20,000 in the aggregate in calendar year 2007 with respect to any Intellectual Property Rights of a third party and no obligation to pay such royalties or other fees will result from the execution and delivery by the Company of this Agreement and the consummation of the transactions contemplated by this Agreement.

(o) **Section 2.15(o)** of the Disclosure Schedule lists all Contracts whereby the Company has agreed to, or assumed, any obligation or duty to warrant, indemnify, reimburse, hold harmless, guaranty or

otherwise assume or incur any obligation or liability or provide a right of rescission with respect to the infringement or misappropriation by the company, any of its Subsidiaries or such other person of the Intellectual Property Rights of any person other than the Company or any of its Subsidiaries.

(p) **Section 2.15(p)** of the Disclosure Schedule list all Contracts pursuant to which a third party has licensed to the Company or any of its Subsidiaries any Intellectual Property Right or Technology ("**In-Licenses**") other than Contracts with respect to Technology that is commercially available for an aggregate fee of less than $10,000.00.

(q) **Section 2.15(q)** Disclosure Schedule list all Contracts pursuant to which the Company or any of its Subsidiaries has granted a third party or affiliate any rights or licenses to any Company Intellectual Property other than non-exclusive licenses granted in the ordinary course in connection with the sale or distribution of Company Products ("**Out-Licenses**"; together with the In-Licenses, the "**IP Licenses**").

(r) Neither the Company nor any of its Subsidiaries is in violation of any IP License that is material to the business of the Company or any of its Subsidiaries or where the breach thereof is likely to result in a claim by or against the Company. The consummation of the transactions contemplated hereby will not result or cause (i) the breach by the Company or any of its Subsidiaries of any IP License, (ii) the impairment or restriction of any right or licenses granted to the Company or any of its Subsidiaries under an In-License, or (iii) the Company or any of its Subsidiaries to grant, or expand the scope of a prior grant, of any rights to any material Company Intellectual Property to a third party (including by the release of any Source Code of Company).

(s) **Section 2.15(s)** of the Disclosure Schedule lists all (i) Contracts pursuant to which any third party supplies components to the Company that are used in the production of Company Products, (ii) Contracts with distributors of Company Products, (iii) Contracts with the top ten (10) suppliers as measured in accordance with Section 2.29(a) and (iv) Contracts with the top ten (10) customers as measured in accordance with Section 2.29(b).

(t) **Section 2.15(t)** of the Disclosure Schedule lists all Company Products. The Company has provided Parent a schedule of product releases which schedule is included in **Section 2.15(t)** of the Disclosure Schedule. The Company has a good faith reasonable belief that it can achieve the release of products on such schedule of product releases and is not currently aware of any change in its circumstances or other fact that has occurred that would cause it to believe that it will be unable to meet such release schedule.

(u) Except for the warranties and indemnities contained in those contracts and agreements set forth in **Section 2.15(u)** of the Disclosure Schedule and warranties implied by law (other than non-exclusive licenses granted in connection with the sale of Company Products or related support and maintenance agreements that have been entered into in the ordinary course of business consistent with past practices that do not materially differ in substance from the Company's standard forms of agreement including attachments (copies of which have been provided to Parent)), neither the Company nor any of its Subsidiaries has given any warranties or indemnities relating to products or technology sold or services rendered by the Company or any of its Subsidiaries.

(v) Neither this Agreement nor the transactions contemplated by this Agreement, including any assignment to Parent by operation of law as a result of the Merger of any contracts or agreements to which the Company or any of its Subsidiaries is a party, will result in: (i) Parent, any of its subsidiaries or the Surviving Corporation granting to any third party any right to or with respect to any

Intellectual Property Rights owned by, or licensed to, any of them prior to the Closing, (ii) Parent, any of its subsidiaries or the Surviving Corporation, being bound by, or subject to, any non-compete or other material restriction on the operation or scope of their respective businesses, or (iii) Parent, any of its subsidiaries or the Surviving Corporation being obligated to pay any royalties or other material amounts, or offer any discounts, to any third party in excess of those payable by, or required to be offered by, any of them, respectively, in the absence of this Agreement or the transactions contemplated hereby.

2.16 ***Agreements, Contracts and Commitments***. Except as set forth in **Section 2.16** of the Disclosure Schedule (specifying the appropriate paragraph):

(a) Neither the Company nor any of its Subsidiaries is a party to, nor is it bound by:

(i) any employment, contractor or consulting agreement, contract or commitment with an employee or individual consultant, contractor, or salesperson, any agreement, contract or commitment to grant any severance or termination pay (in cash or otherwise) to any employee, or any contractor, consulting or sales agreement, contract, or commitment with a firm or other organization except (1) on the Company's standard form of offer letter or (2) as otherwise may be required by applicable law;

(ii) any agreement or plan, including any stock option plan, stock appreciation rights plan or stock purchase plan, any of the benefits of which will be increased, or the vesting of benefits of which will be accelerated, by the occurrence of any of the transactions contemplated by this Agreement or the value of any of the benefits of which will be calculated on the basis of any of the transactions contemplated by this Agreement;

(iii) any fidelity or surety bond or completion bond;

(iv) any lease of personal property having a value in excess of $20,000 individually or $50,000 in the aggregate;

(v) any agreement of indemnification or guaranty except for the warranties and indemnities (a) contained in those contracts and agreements set forth in **Section 2.16(a)(v)** of the Disclosure Schedule (other than non-exclusive licenses granted in connection with the sale of Company products or related support and maintenance agreements that have been entered into in the ordinary course of business consistent with past practices that do not materially differ in substance from the Company's standard forms of agreement including attachments (copies of which have been provided to Parent)), and (b) warranties implied by law;

(vi) any agreement, contract or commitment relating to capital expenditures and involving future payments in excess of $20,000 individually or $50,000 in the aggregate;

(vii) any agreement, contract or commitment relating to the disposition or acquisition of assets or any interest in any business enterprise outside the ordinary course of the Company's business;

(viii) any mortgages, indentures, guarantees, loans or credit agreements, security agreements or other agreements or instruments relating to the borrowing of money or extension of credit;

(ix) any purchase order for the purchase of materials involving in excess of $20,000 individually or $50,000 in the aggregate;

(x) any construction contracts;

(xi) any dealer, distribution, joint marketing, strategic alliance, affiliate or development agreement (other than non-exclusive licenses granted in connection with the sale of Company products or related support and maintenance agreements that have been entered into in the ordinary course of business that do not materially differ in substance from the Company's standard forms agreement including attachments (copies of which have been provided to Parent));

(xii) any agreement, contract or commitment to alter the Company's interest in any Subsidiary, corporation, association, joint venture, partnership or business entity in which the Company directly or indirectly holds any interest;

(xiii) any sales representative, original equipment manufacturer, manufacturing, value added, remarketer, reseller, or independent software vendor, or other agreement for use or distribution of the products, technology or services of the Company or any of its Subsidiaries (other than non-exclusive licenses granted in connection with the sale of Company products or related support and maintenance agreements that have been entered into in the ordinary course of business that do not materially differ in substance from the Company's standard forms agreement including attachments (copies of which have been provided to Parent); or

(xiv) any other agreement, contract or commitment that involves $20,000 individually or $50,000 in the aggregate or more and is not cancelable without penalty within 30 days.

(b) Each Material Contract to which the Company or any of its Subsidiaries is a party or any of their respective properties or assets (whether tangible or intangible) is subject is a valid and binding agreement of the Company or its Subsidiaries, as the case may be, enforceable against each of the parties thereto in accordance with its terms, and is in full force and effect with respect to the Company or the applicable Subsidiary and, to the Knowledge of the Company, any other party thereto. The Company and each of its Subsidiaries are in compliance with and have not breached, violated or defaulted under, or received notice that they have breached, violated or defaulted under, any of the terms or conditions of any such Material Contract, nor to the Knowledge of the Company is any party obligated to the Company or any of its Subsidiaries pursuant to any such Contract subject to any breach, violation or default thereunder, nor does the Company have Knowledge of any event that with the lapse of time, giving of notice or both would constitute such a breach, violation or default by the Company, its Subsidiaries or any such other party. True and complete copies of each Material Contract disclosed in the Disclosure Schedule or required to be disclosed pursuant to this **Section 2.16** (each a "**Material Contract**" and collectively, the "**Material Contracts**") have been delivered to Parent.

(c) The Company and each of its Subsidiaries have fulfilled all material obligations required pursuant to each Material Contract to have been performed by the Company prior to the date hereof, and, without giving effect to the Merger, the Company will fulfill, when due, all of its obligations under the Material Contracts that remain to be performed after the date hereof.

(d) All outstanding indebtedness of the Company or its Subsidiaries may be prepaid without penalty.

2.17 ***Interested Party Transactions***. Except as set forth in **Section 2.17** of the Disclosure Schedule, no officer or director or, to the Company's Knowledge, other Shareholder of the Company or any

of its Subsidiaries (nor any parent, sibling, descendant or spouse of any of such persons, or any trust, partnership or corporation in which any of such persons has or has had an interest), has or has had, directly or indirectly, (i) an interest in any entity which furnished or sold, or furnishes or sells, services, products, technology or Intellectual Property that the Company or any of its Subsidiaries furnishes or sells, or proposes to furnish or sell, or (ii) any interest in any entity that purchases from or sells or furnishes to the Company or any of its Subsidiaries, any goods or services, or (iii) a beneficial interest in any Contract to which the Company or any of its Subsidiaries is a party; *provided*, *however*, that ownership of no more than one percent (1%) of the outstanding voting stock of a publicly traded corporation shall not be deemed to be an "interest in any entity" for purposes of this **Section 2.17**. To the Company's Knowledge, there are no agreements, contracts, or commitments with regard to contribution or indemnification between or among any of the Shareholders.

2.18 ***Governmental Authorization***. Each consent, license, permit, grant or other authorization (i) pursuant to which the Company or any of its Subsidiaries currently operates or holds any interest in any of their respective properties, or (ii) which is required for the operation of the Company's or any of its Subsidiaries' business as currently conducted or currently contemplated to be conducted or the holding of any such interest (collectively, "**Company Authorizations**") has been issued or granted to the Company and each Subsidiary, as the case may be. The Company and its Subsidiaries are and have been at all times in compliance, in all material respects, with all Company Authorizations. The Company Authorizations are in full force and effect and constitute all Company Authorizations required to permit the Company and its Subsidiaries to operate or conduct their respective businesses or hold any interest in their respective properties or assets.

2.19 ***Litigation***. There is no action, suit, claim or proceeding of any nature pending, or to the Knowledge of the Company, threatened, against the Company or any of its Subsidiaries, their properties (tangible or intangible) or any of their officers or directors, nor to the Knowledge of the Company is there any reasonable basis therefor. There is no investigation or other proceeding pending or, to the Knowledge of the Company, threatened, against the Company or any of its Subsidiaries, any of their respective properties (tangible or intangible) or any of their officers or directors by or before any Governmental Entity, nor to the Knowledge of the Company is there any reasonable basis therefor. No Governmental Entity has at any time challenged or questioned the legal right of the Company or any of its Subsidiaries to conduct their respective operations as presently or previously conducted or as currently contemplated to be conducted. There is no action, suit, claim or proceeding of any nature pending or, to the Knowledge of the Company, threatened, against any Person who has a contractual right or a right pursuant to California Law to indemnification from the Company related to facts and circumstances existing prior to the Effective Time, nor are there, to the Knowledge of the Company, any facts or circumstances that would give rise to such an action, suit, claim or proceeding.

2.20 ***Minute Books***. The minutes of the Company and each of its Subsidiaries delivered to counsel for Parent contain complete and accurate records of all actions taken, and summaries of all meetings held, by the Shareholders, the Board of Directors of the Company and its Subsidiaries (and any committees thereof) since the time of incorporation of the Company and each of its Subsidiaries, as the case may be. At the Closing, the minute books of the Company and each of its Subsidiaries will be in the possession of the Company.

2.21 ***Environmental Matters.***

(a) ***Hazardous Material***. Except as would not be reasonably likely to result in a material liability to the Company or any of its Subsidiaries, neither the Company nor any of its Subsidiaries has: (i) operated any underground storage tanks at any property that the Company or any of its Subsidiaries has at any time owned, operated, occupied or leased, or (ii) released any amount of any substance that has been designated by any Governmental Entity or by applicable foreign, federal, state or local law to be radioactive, toxic, hazardous or otherwise a danger to health or the environment, including, without limitation, PCBs, asbestos, petroleum, toxic mold, urea-formaldehyde and all substances listed as hazardous substances pursuant to the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended, or defined as a hazardous waste pursuant to the United States Resource Conservation and Recovery Act of 1976, as amended, and the regulations promulgated pursuant to said laws, but excluding office and janitorial supplies properly and safely maintained, (a "**Hazardous Material**"). Except as would not be reasonably likely to result in a material liability to the Company or any of its Subsidiaries, no Hazardous Materials are present, as a result of the actions of the Company or any of its Subsidiaries or any affiliate of the Company, or, to the Company's Knowledge, as a result of any actions of any third party or otherwise, in, on or under any property, including the land and the improvements, ground water and surface water thereof, that the Company or any of its Subsidiaries has at any time owned, operated, occupied or leased. Neither the Company nor any of its Subsidiaries currently sells (i) any products containing Hazardous Materials that will be banned or restricted by the Restrictions on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (2002/95/EC) directive ("**RoHS**") or (ii) any products for which it is required to pay a waste fee under California law. To the Knowledge of the Company, there are no facts or circumstances likely to prevent or delay the ability of the Company or any of its Subsidiaries to comply, when required, with RoHS. The Company and its Subsidiaries are in compliance in all material respects with the registration and labeling requirements of the Waste Electrical and Electronic Equipment Directive (2002/96/EC).

(b) ***Hazardous Materials Activities***. The Company and each of its Subsidiaries have conducted all Hazardous Material Activities in compliance in all material respects with all applicable Environmental Laws and in a manner that would not be reasonably likely to result in material liability to the Company or any of its Subsidiaries. The Hazardous Materials Activities of the Company and its Subsidiaries prior to the Closing have not resulted in the exposure of any person to a Hazardous Material in a manner which has caused or could reasonably be expected to cause an adverse health effect to any such person. For the purposes of this **Section 2.21(b)**, the term "**Hazardous Materials Activities**" shall mean the transfer, recycling, storage, use, treatment, manufacture, removal, remediation, release, exposure of others to, sale, or distribution of any Hazardous Material or any product or waste containing a Hazardous Material, or product manufactured with Ozone depleting substances, including, without limitation, any required labeling, payment of waste fees or charges (including so-called e-waste fees) and compliance with any product take-back or product content requirements.

(c) ***Permits***. The Company and each of its Subsidiaries currently hold all environmental approvals, permits, licenses, clearances and consents (the "**Environmental Permits**") necessary for the conduct of their Hazardous Material Activities, and other businesses of each of the Company and each of its Subsidiaries as such activities and businesses are currently being conducted and as currently contemplated to be conducted.

(d) ***Environmental Liabilities***. No action, proceeding, revocation proceeding, amendment procedure, writ, injunction or claim is pending, or to the Knowledge of the Company, threatened, concerning any Environmental Permit, Hazardous Material or any Hazardous Materials Activity of the

Company or any of its Subsidiaries. The Company has no Knowledge of any fact or circumstance that could involve the Company or any of its Subsidiaries in any environmental litigation or impose upon the Company or any of its Subsidiaries any environmental liability.

(e) ***Reports and Records***. The Company and each of its Subsidiaries have delivered to Parent all records in the Company's or each such Subsidiary's possession, custody or control concerning the Hazardous Materials Activities of the Company and each of its Subsidiaries relating to their business and all environmental audits and environmental assessments of any Leased Real Property, or otherwise in the possession, custody or control of the Company or any of its Subsidiaries. The Company and each of its Subsidiaries have complied with all environmental disclosure obligations imposed by applicable law with respect to this transaction.

2.22 ***Brokers' and Finders' Fees***. Neither the Company nor any of its Subsidiaries has incurred, nor will it incur, directly or indirectly, any liability for brokerage or finders' fees or agents' commissions, fees related to investment banking or similar advisory services or any similar charges in connection with the Agreement or any transaction contemplated hereby, nor will Parent or the Surviving Corporation incur, directly or indirectly, any such liability based on arrangements made by or on behalf of the Company. **Section 2.22(a)** of the Disclosure Schedule sets forth the principal terms and conditions of any agreement, written or oral, with respect to such fees.

2.23 ***Employee Benefit Plans and Compensation.***

(a) ***Definitions***. For purposes of this Agreement, the following terms shall have the following meanings:

"***CFRA***" shall mean the California Family Rights Act of 1993, as amended.

"***COBRA***" shall mean the Consolidated Omnibus Budget Reconciliation Act of 1985, as amended.

"***Company Employee Plan***" shall mean any plan, program, policy, practice, contract, agreement or other arrangement providing for compensation, severance, termination pay, deferred compensation, performance awards, stock or stock-related awards, welfare benefits, fringe benefits or other employee benefits or remuneration of any kind, whether written, unwritten or otherwise, funded or unfunded, including, but not limited to, each "employee benefit plan," within the meaning of Section 3(3) of ERISA which is or has been maintained, contributed to, or required to be contributed to, by the Company, any of its Subsidiaries or any ERISA Affiliate for the benefit of any Employee, and with respect to which the Company, any of its Subsidiaries or any ERISA Affiliate has or may have any liability or obligation.

"***DOL***" shall mean the United States Department of Labor.

"***Employee***" shall mean any current or former employee, consultant or director of the Company, any of its Subsidiaries or any ERISA Affiliate.

"***Employee Agreement***" shall mean each management, employment, severance, consulting, contractor, relocation, repatriation, expatriation, loan, visa, work permit or other agreement, or contract (including, any offer letter or any agreement providing for acceleration of Company Options or Company Common Stock) between the Company, any of its Subsidiaries or any ERISA Affiliate and any Employee.

"***ERISA***" shall mean the Employee Retirement Income Security Act of 1974, as amended.

"***ERISA Affiliate***" shall mean any other Person under common control with the Company or any of its Subsidiaries within the meaning of Section 414(b), (c), (m) or (o) of the Code, and the regulations issued thereunder.

"***FMLA***" shall mean the Family Medical Leave Act of 1993, as amended.

"***HIPAA***" shall mean the Health Insurance Portability and Accountability Act of 1996, as amended.

"***International Employee Plan***" shall mean each Company Employee Plan or Employee Agreement that has been adopted or is maintained by the Company, any of its Subsidiaries or any ERISA Affiliate, whether formally or informally or with respect to which the Company, any of its Subsidiaries or any ERISA Affiliate will or may have any liability with respect to Employees who perform services outside the United States.

"***International Employees***" means any Employee who performs services outside of the United States and whose principal place of employment is outside the United States.

"***IRS***" shall mean the United States Internal Revenue Service.

"***PBGC***" shall mean the United States Pension Benefit Guaranty Corporation.

"***Pension Plan***" shall mean each Company Employee Plan that is an "employee pension benefit plan," within the meaning of Section 3(2) of ERISA.

(b) ***Schedule***. **Section 2.23(b)(1)** of the Disclosure Schedule contains an accurate and complete list of each Company Employee Plan and each Employee Agreement. Neither Company nor any of its Subsidiaries has made any plan or commitment to establish any new Company Employee Plan or Employee Agreement, to modify any Company Employee Plan or Employee Agreement (except to the extent required by law or to conform any such Company Employee Plan or Employee Agreement to the requirements of any applicable law), or to enter into any Company Employee Plan or Employee Agreement except for entering into at-will offer letters for Persons to be employees in the United States or entering into Employment Agreements with International Employees in each case as previously disclosed to Parent in writing, or as required by this Agreement. **Section 2.23(b)(2)** of the Disclosure Schedule sets forth a table setting forth the name and annual base salary of each employee of the Company and each of its Subsidiaries as of the date hereof. To the Knowledge of the Company, no employee listed on **Section 2.23(b)(2)** of the Disclosure Schedule intends to terminate his or her employment for any reason. **Section 2.23(b)(3)** of the Disclosure Schedule contains an accurate and complete list of all Persons that currently have a consulting or advisory relationship with the Company or any of its Subsidiaries.

(c) ***Documents***. The Company and each of its Subsidiaries has provided to Parent (i) correct and complete copies of all documents embodying each Company Employee Plan and each Employee Agreement including all amendments thereto and all related trust documents, (ii) the three most recent annual reports (Form Series 5500 and all schedules and financial statements attached thereto), if any, required under ERISA or the Code in connection with each Company Employee Plan, (iii) if the Company Employee Plan is funded, the most recent annual and periodic accounting of Company Employee Plan assets,

(iv) the most recent summary plan description together with the summary(ies) of material modifications thereto, if any, required under ERISA with respect to each Company Employee Plan, (v) all material written agreements and contracts relating to each Company Employee Plan, including administrative service agreements and group insurance contracts, (vi) all communications material to any Employee or Employees relating to any Company Employee Plan and any proposed Company Employee Plan, in each case, relating to any amendments, terminations, establishments, increases or decreases in benefits, acceleration of payments or vesting schedules or other events which would result in any liability to the Company or any of its Subsidiaries, (vii) all correspondence to or from any governmental agency relating to any Company Employee Plan, (viii) all COBRA forms and related notices, (ix) all policies pertaining to fiduciary liability insurance covering the fiduciaries for each Company Employee Plan, (x) all discrimination tests for each Company Employee Plan for the three most recent plan years, (xi) all registration statements, annual reports and prospectuses prepared in connection with each Company Employee Plan, (xii) all HIPAA Privacy Notices and all Business Associate Agreements to the extent required under HIPAA and (xiii) the most recent IRS determination or opinion letter issued with respect to each Company Employee Plan.

(d) ***Employee Plan Compliance***. The Company and each of its Subsidiaries has performed in all material respects, all obligations required to be performed by them under, is not in default or violation of, and the Company and each of its Subsidiaries has no Knowledge of any default or violation by any other party to, any Company Employee Plan, and each Company Employee Plan has been established and maintained in accordance with its terms and in material compliance with all applicable laws, statutes, orders, rules and regulations, including ERISA or the Code. Any Company Employee Plan intended to be qualified under Section 401(a) of the Code has obtained a favorable determination letter (or opinion letter, if applicable) as to its qualified status under the Code. To the Company's Knowledge, no "prohibited transaction," within the meaning of Section 4975 of the Code or Sections 406 and 407 of ERISA, and not otherwise exempt under Section 408 of ERISA, has occurred with respect to any Company Employee Plan. There are no actions, suits or claims pending or, to the Knowledge of the Company, threatened or reasonably anticipated (other than routine claims for benefits) against any Company Employee Plan or against the assets of any Company Employee Plan. Each Company Employee Plan can be amended, terminated or otherwise discontinued after the Effective Time in accordance with its terms, without liability to Parent, the Company, any of its Subsidiaries or any ERISA Affiliate (other than ordinary administration expenses). There are no audits, inquiries or proceedings pending or to the Knowledge of the Company or any ERISA Affiliates, threatened by the IRS, DOL, or any other Governmental Entity with respect to any Company Employee Plan. Neither the Company, any of its Subsidiaries nor any ERISA Affiliate is currently subject to any penalty or Tax with respect to any Company Employee Plan under Section 502(i) of ERISA or Sections 4975 through 4980 of the Code and no such penalty or tax is reasonably anticipated. The Company and each of its Subsidiaries have timely made all contributions and other payments required by and due under the terms of each Company Employee Plan.

(e) ***No Pension Plan***. Neither the Company, any of its Subsidiaries nor any ERISA Affiliate has ever maintained, established, sponsored, participated in, or contributed to, any Pension Plan subject to Part 3 of Subtitle B of Title I of ERISA, Title IV of ERISA or Section 412 of the Code.

(f) ***No Self-Insured Plan***. Neither the Company, any of its Subsidiaries nor any ERISA Affiliate has ever maintained, established, sponsored, participated in or contributed to any self-insured plan that provides benefits to employees (including any such plan pursuant to which a stop-loss policy or contract applies) and no Company Employee Plan is self-insured.

(g) ***Collectively Bargained, Multiemployer and Multiple-Employer Plan***. At no time has the Company, any of its Subsidiaries or any ERISA Affiliate contributed to or been obligated to contribute to any multiemployer plan (as defined in Section 3(37) of ERISA). Neither the Company, any of its Subsidiaries nor any ERISA Affiliate has at any time ever maintained, established, sponsored, participated in or contributed to any multiple employer plan or to any plan described in Section 413 of the Code.

(h) ***Retiree Obligations***. No Company Employee Plan or Employee Agreement provides, or reflects or represents any liability to provide, retiree life insurance, retiree health or other retiree employee welfare benefits to any person for any reason, except as may be required by COBRA or other applicable statute, and neither the Company nor any of its Subsidiaries has ever represented, promised or contracted (whether in oral or written form) to any Employee (either individually or to Employees as a group) or any other person that such Employee(s) or other person would be provided with retiree life insurance, retiree health or other retiree employee welfare benefits, except to the extent required by statute.

(i) ***COBRA; FMLA; CFRA; HIPAA***. The Company, each of its Subsidiaries and each ERISA Affiliate has, prior to the Effective Time, materially complied with COBRA, FMLA, CFRA and HIPAA.

(j) ***Effect of Transaction***. Neither the execution and delivery of this Agreement nor the consummation of the transactions contemplated hereby or any termination of employment or service in connection therewith will (i) result in any payment (including severance, golden parachute, bonus or otherwise), becoming due to any Employee, (ii) result in any forgiveness of indebtedness, (iii) materially increase any benefits otherwise payable by the Company or any Subsidiary or (iv) result in the acceleration of the time of payment or vesting of any such benefits except as required under Section 411(d)(3) of the Code.

(k) ***Parachute Payments***. There is no agreement, plan, arrangement or other contract covering any Employee that, considered individually or considered collectively with any other such agreements, plans, arrangements or other contracts, will, or could reasonably be expected to, give rise directly or indirectly to the payment of any amount that would be characterized as a "parachute payment" within the meaning of Section 280G(b)(1) of the Code. There is no agreement, plan, arrangement or other contract by which the Company or any of its Subsidiaries is bound to compensate any Employee for excise taxes paid pursuant to Section 4999 of the Code. **Section 2.23(k)** of the Disclosure Schedule lists all persons who the Company reasonably believes are "disqualified individuals" (within the meaning of Section 280G of the Code and the regulations promulgated thereunder) as determined as of the date hereof.

(l) ***Section 409A.*** No compensation shall be includable in the gross income of any Employee as a result of the operation of the Code Section 409A with respect to any arrangements or agreements in effect prior to the Effective Time.

(m) ***Employment Matters***. The Company and each of its Subsidiaries is in compliance in all material respects with all applicable foreign, federal, state and local laws, rules and regulations respecting employment, employment practices, terms and conditions of employment, employee safety and wages and hours, and in each case, with respect to Employees: (i) has withheld and reported all amounts required by law or by agreement to be withheld and reported with respect to wages, salaries and other payments to Employees, (ii) is not liable for any arrears of wages, severance pay or any Taxes or any penalty for failure to comply with any of the foregoing, and (iii) is not liable for any payment to any trust or other fund governed by or maintained by or on behalf of any governmental authority, with respect to unemployment compensation benefits, social security or other benefits or obligations for Employees (other than routine payments to be

made in the normal course of business and consistent with past practice). There are no action, suits, claims or administrative matters pending or threatened against the Company, any of its Subsidiaries, or any of their Employees relating to any Employee, Employee Agreement or Company Employee Plan. There are no pending or threatened or reasonably anticipated claims or actions against Company, any of its Subsidiaries, any Company trustee or any trustee of any Subsidiary under any workers' compensation policy. The services provided by each of the Company's, each Subsidiary's and their ERISA Affiliates' Employees is terminable at the will of the Company and its ERISA Affiliates. To the Knowledge of the Company, neither the Company nor any ERISA Affiliate has direct or indirect liability with respect to any misclassification of any person as an independent contractor rather than as an employee, or with respect to any employee leased from another employer.

(n) ***Labor***. No work stoppage or labor strike against the Company or any of its Subsidiaries is pending, or to the Knowledge of the Company, threatened, or reasonably anticipated. The Company has no Knowledge of any activities or proceedings of any labor union to organize any Employees. There are no actions, suits, claims, labor disputes or grievances pending or threatened or reasonably anticipated relating to any labor matters involving any Employee, including charges of unfair labor practices. Neither the Company nor any of its Subsidiaries has engaged in any unfair labor practices within the meaning of the National Labor Relations Act. Neither the Company nor any of its Subsidiaries does presently, nor has it been in the past, a party to, or bound by, any collective bargaining agreement or union contract with respect to Employees and no collective bargaining agreement is being negotiated by the Company or any of its Subsidiaries. Within the past year as measured from the date of this Agreement, neither the Company nor any of its Subsidiaries has incurred any liability or obligation under the Worker Adjustment and Retraining Notification Act or any similar state or local law that remains unsatisfied.

(o) ***No Interference or Conflict***. To the Knowledge of the Company, no Shareholder, director, officer, Employee or consultant of the Company or any of its Subsidiaries is obligated under any contract or agreement, subject to any judgment, decree, or order of any court or administrative agency that would interfere with such person's efforts to promote the interests of the Company or any of its Subsidiaries or that would interfere with the Company's business. Neither the execution nor delivery of this Agreement, nor the carrying on of the Company's business as presently conducted or proposed to be conducted nor any activity of such officers, directors, Employees or consultants in connection with the carrying on of the Company's business or any of its Subsidiaries' businesses as presently conducted or currently proposed to be conducted will, to the Knowledge of the Company, conflict with or result in a breach of the terms, conditions, or provisions of, or constitute a default under, any contract or agreement under which any of such officers, directors, Employees, or consultants is now bound.

(p) ***International Employee Plan***. Neither the Company, any of its Subsidiaries nor any ERISA Affiliate currently or has it ever had the obligation to maintain, establish, sponsor, participate in, be bound by or contribute to any International Employee Plan.

(q) ***401(k) Fees***. To the Company's Knowledge, the termination of a 401(k) Plan will not trigger liquidation charges, surrender charges or other related fees ("**401(k) Fees**").

2.24 ***Insurance***. **Section 2.24** of the Disclosure Schedule lists all insurance policies and fidelity bonds covering the assets, business, equipment, properties, operations, employees, officers and directors of the Company, any of its Subsidiaries or any ERISA Affiliate, including the type of coverage, the carrier, the amount of coverage, the term and the annual premiums of such policies. There is no claim by the Company or any of its Subsidiaries or any ERISA Affiliate pending under any of such policies or bonds as to which

coverage has been questioned, denied or disputed or that the Company, any of its Subsidiaries or any ERISA Affiliate has a reason to believe will be denied or disputed by the underwriters of such policies or bonds. In addition, there is no pending claim of which its total value (inclusive of defense expenses) will exceed the policy limits. All premiums due and payable under all such policies and bonds have been paid, (or if installment payments are due, will be paid if incurred prior to the Closing Date) and the Company, its Subsidiaries and its ERISA Affiliates are otherwise in material compliance with the terms of such policies and bonds (or other policies and bonds providing substantially similar insurance coverage). Such policies and bonds (or other policies and bonds providing substantially similar coverage) have been in effect since 2001 (with the exception of directors' and officers' insurance, which has been in effect since 2002) and remain in full force and effect. The Company has no Knowledge of threatened termination of, or premium increase with respect to, any of such policies. Neither the Company, any of its Subsidiaries nor any affiliate of either has ever maintained, established, sponsored, participated in or contributed to any self-insurance plan.

2.25 ***Compliance with Laws***. The Company and each of its Subsidiaries has complied in all material respects with, is not in violation of in any material respect, and has not received any notices of violation with respect to, any foreign, federal, state or local statute, law or regulation.

2.26 ***Export Control Laws***. The Company and each of its Subsidiaries has at all times conducted its export transactions in accordance with (i) all applicable U.S. export and re-export controls, including the United States Export Administration Act and Regulations and Foreign Assets Control Regulations and (ii) all other applicable import/export controls in other countries in which the Company conducts business. Without limiting the foregoing:

(a) The Company and each of its Subsidiaries has obtained all export licenses, license exceptions and other consents, notices, waivers, approvals, orders, authorizations, registrations, declarations and filings with any Governmental Entity required for (i) the export and re-export of products, services, software and technologies and (ii) releases of technologies and software to foreign nationals located in the United States and abroad ("**Export Approvals**");

(b) The Company and each of its Subsidiaries is in compliance with the terms of all applicable Export Approvals;

(c) There are no pending or, to the Company's Knowledge, threatened claims against the Company or any Subsidiary with respect to such Export Approvals;

(d) To the Company's Knowledge, there are no actions, conditions or circumstances pertaining to the Company's or any Subsidiary's export transactions that may give rise to any future claims; and

(e) No Export Approvals for the transfer of export licenses to Parent or the Surviving Corporation are required, or such Export Approvals can be obtained expeditiously without material cost.

(f) **Section 2.26(f)** of the Disclosure Schedule sets forth the true, complete and accurate export control classifications applicable to the Company's products, services, software and technologies.

2.27 ***Foreign Corrupt Practices Act***. Neither the Company nor any of its Subsidiaries (including any of their officers, directors, agents, employees or other Person associated with or acting on their behalf) has, directly or indirectly, taken any action which would cause it to be in violation of the Foreign Corrupt

Practices Act of 1977, as amended, or any rules or regulations thereunder, used any corporate funds for unlawful contributions, gifts, entertainment or other unlawful expenses relating to political activity, made any unlawful payment to foreign or domestic government officials or employees or made any bribe, rebate, payoff, influence payment, kickback or other similar unlawful payment.

2.28 ***Warranties; Indemnities***. Except for the warranties and indemnities contained in those contracts and agreements set forth in **Section 2.28** of the Disclosure Schedule (other than non-exclusive licenses granted in connection with the sale of Company products or related support and maintenance agreements that have been entered into in the ordinary course of business consistent with past practices that do not differ from the Company's standard forms of agreement including attachments (copies of which have been provided to Parent)) and warranties implied by law, neither the Company nor any of its Subsidiaries has given any warranties or indemnities relating to products or technology sold or services rendered by the Company or any of its Subsidiaries.

2.29 ***Substantial Customers and Suppliers***.

(a) **Section 2.29(a)** of the Disclosure Schedule lists the 10 largest customers of the Company and its Subsidiaries on the basis of revenues collected or accrued for the twelve month period ending on the Balance Sheet Date.

(b) **Section 2.29(b)** of the Disclosure Schedule lists the 10 largest suppliers of the Company and its Subsidiaries on the basis of cost of goods or services purchased for the twelve month period ending on the Balance Sheet Date.

(c) Except as disclosed in **Section 2.29(c)** of the Disclosure Schedule, no such customer or supplier has (i) ceased or materially reduced its purchases from or sales or provision of services to the Company and its Subsidiaries since the beginning of such twelve month period, (ii) to the Knowledge of the Company, overtly threatened to cease or materially reduce such purchases or sales or provision of services or (iii) to the Knowledge of the Company been threatened with bankruptcy or insolvency.

2.30 ***Complete Copies of Materials***. The Company has delivered true and complete copies of each document (or summaries of same) that has been requested by Parent or its counsel, including all Contracts and other documents listed on the Disclosure Schedule.

2.31 ***Representations Complete***. None of the representations or warranties made by the Company (as modified by the Disclosure Schedule) in this Agreement, and none of the statements made in any exhibit, schedule or certificate furnished by the Company pursuant to this Agreement contains any untrue statement of a material fact or omits to state any material fact necessary in order to make the statements contained herein or therein, in the light of the circumstances under which made, not misleading.

2.32 ***Consent Solicitation***. All information furnished on or in any document mailed, delivered or otherwise furnished or to the be mailed, delivered or otherwise furnished to Shareholders by the Company in connection with the solicitation of their consent to this Agreement and the Merger and the other matters contemplated by **Section 5.7** hereof, did not and will not, as the case may be, contain any untrue statement of a material fact and did not and will not omit to state any material fact necessary in order to make the statements made therein, in light of the circumstances under which made, not misleading.

2.33 ***Director and Officer Indemnification***. There are no pending claims for indemnification that have been made by any officer or director of the Company and, to the Company's Knowledge, there is no reasonable basis therefor.

ARTICLE III

REPRESENTATIONS AND WARRANTIES OF PARENT AND SUB

Each of Parent and Sub hereby represents and warrants to the Company that on the date hereof and as of the Effective Time, as though made at the Effective Time, as follows:

3.1 ***Organization and Standing***. Parent is a corporation duly organized, validly existing and in good standing under the laws of the State of Delaware. Sub is a corporation duly organized, validly existing and in good standing under the laws of the State of California. Each of Parent and Sub has the corporate power to own its properties and to carry on its business as now being conducted and is duly qualified or licensed to do business and is in good standing as a foreign corporation in each jurisdiction in which the failure to be so qualified or licensed or in good standing would have a Parent Material Adverse Effect.

3.2 ***Authority***. Each of Parent and Sub has all requisite corporate power and authority to enter into this Agreement and to consummate the transactions contemplated hereby and thereby. The execution and delivery by each of Parent and Sub of this Agreement and the consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action on the part of Parent and Sub and no further corporate action is required on the part of the Parent and Sub to authorize the Agreement and the Merger. This Agreement has been duly executed and delivered by Parent and Sub and constitute the valid and binding obligations of Parent and Sub, enforceable against each of Parent and Sub in accordance with their terms.

3.3 ***Consents***. No consent, notice, waiver, approval, order or authorization of, or registration, declaration or filing with, any Governmental Entity or any third party is required by or with respect to Parent or Sub in connection with the execution and delivery of this Agreement or the consummation of the transactions contemplated hereby and thereby, except for (i) such consents, notices, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable securities laws, (ii) such consents, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under applicable foreign merger control regulations, (iii) the filing of the Certificate of Merger with the Secretary of State of the State of California and (iv) such consents, waivers, approvals, orders, authorizations, registrations, declarations and filings which, if not obtained or made, would not have a Parent Material Adverse Effect.

3.4 ***Parent Common Stock***. The Parent Common Stock which constitutes the Merger Shares has been duly authorized, and upon consummation of the transactions contemplated by this Agreement, will be validly issued, fully paid and nonassessable.

3.5 ***No Conflict***. The execution and delivery by Parent and Sub of this Agreement and the consummation of the transactions contemplated hereby and thereby, will not conflict with or result in a Conflict under (i) any provision of the Charter Documents or the organizational documents of Parent or Sub, as amended or (ii) any judgment, order, decree, statute, law, ordinance, rule or regulation applicable to Parent or Sub or any of their material respective properties or assets (whether tangible or intangible).

3.6 ***SEC Documents***. Parent has made available to the Company, by reference to Parent's and the SEC's website, Parent's annual report on Form 10-K for the fiscal year ended December 31, 2006, all quarterly reports on Form 10-Q and reports on Form 8-K and amendments thereto filed by Parent with the SEC since December 31, 2006 and up to the date of this Agreement, if any, and any proxy materials distributed to Parent's stockholders since December 31, 2006 and up to the date of this Agreement, in each case excluding any exhibits or attachments thereto (the "**Parent SEC Filings**"). The Parent SEC Filings (a) conformed, as of the dates of their respective filing with the SEC, in all material respects, to the requirements set forth in the instructions for such forms under the Securities Act and the Exchange Act, and (b) when taken together, did not, as of their respective filing dates, contain any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements contained therein, in light of the circumstances under which they were made, not misleading, except to the extent corrected by a subsequently filed report with the SEC prior to the date hereof. The financial statements of Parent included in the Parent SEC Filings fairly and accurately represented, in all material respects, the consolidated financial condition of Parent as of their respective dates and Parent's consolidated results of operations for the respective periods specified therein were prepared in accordance with GAAP (except as indicated in the notes thereto or, in the case of unaudited statements included in quarterly reports on Form 10-Q, as permitted by Article 10 of Regulation S-X and the rules to Form 10-Q of the SEC, and subject, in the case of unaudited statements, to normal year end audit adjustments).

3.7 ***No Parent Material Adverse Effect***. From June 30, 2007 to the date of this Agreement, there has occurred no event or condition that has had a Parent Material Adverse Effect.

3.8 ***Information Supplied***. The information about Parent or Sub provided by Parent or Sub in writing to the Company expressly for the purposes of furnishing such information on or in any other document mailed, delivered or otherwise furnished to Shareholders by the Company in connection with the solicitation of their consent to this Agreement and the Merger and the other matters contemplated by **Section 5.7** hereof, will not contain, at or prior to the Effective Time, any untrue statement of a material fact and will not omit to state any material fact necessary in order to make the statements made therein, in light of the circumstances under which made, not misleading. Notwithstanding the foregoing, neither Parent nor Sub makes any representation or warranty with respect to any information supplied by the Company which is contained in any of the foregoing documents, provided that such information was supplied by the Company expressly for such purpose.

ARTICLE IV

CONDUCT PRIOR TO THE EFFECTIVE TIME

4.1 ***Conduct of Business of the Company***. During the period from the date of this Agreement and continuing until the earlier of the termination of this Agreement or the Effective Time, the Company agrees to conduct the business of Company and its Subsidiaries, except to the extent that Parent shall otherwise consent in writing in accordance with **Section 4.3** hereof, in the usual, regular and ordinary course in substantially the same manner as heretofore conducted, to pay the debts and Taxes of the Company and its Subsidiaries when due (subject to Parent's review and consent to the filing of any Tax Return, as set forth in **Section 4.1(e)** below), to pay or perform other obligations when due, and to preserve intact the present business organizations of the Company and its Subsidiaries, keep available the services of the present officers and Employees of the Company and its Subsidiaries and preserve the relationships of the Company and its Subsidiaries with customers, suppliers, distributors, licensors, licensees, and others having business dealings with them, all with the goal of preserving substantially unimpaired the goodwill and ongoing businesses of

the Company and its Subsidiaries at the Effective Time. The Company shall promptly notify Parent of any material event or occurrence involving the Company or any of its Subsidiaries that arises during the period from the date of this Agreement and continuing until the earlier of the termination date of this Agreement or the Effective Time. Neither the Company nor any of its Subsidiaries shall, without the prior written consent of Parent, which consent is to be requested in accordance with **Section 4.3** hereof:

(a) cause or permit any modifications, amendments or changes to the Charter Documents or the organizational documents of any Subsidiary;

(b) undertake any expenditure, transaction or commitment not in the ordinary course of business consistent with past practice and exceeding $20,000 individually or $50,000 in the aggregate or any commitment or transaction of the type described in **Section 2.13** hereof (it being understood that ordinary course payroll practice that is consistent with past practice shall not require the consent of Parent);

(c) pay, discharge, waive or satisfy, in an amount in excess of $20,000 in any one case, or $50,000 in the aggregate, any claim, liability, right or obligation (absolute, accrued, asserted or unasserted, contingent or otherwise), other than the payment, discharge or satisfaction in the ordinary course of business of liabilities reflected or reserved against in the Current Balance Sheet or claims, liabilities, rights or obligations (absolute, accrued, asserted or unasserted, contingent or otherwise) incurred or to be incurred in the ordinary course of business;

(d) adopt or change accounting methods or practices (including any change in depreciation or amortization policies or rates) other than as required by GAAP;

(e) make or change any material election in respect of Taxes, adopt or change any accounting method in respect of Taxes, enter into any agreement, settle any claim or assessment in respect of Taxes, or consent to any extension or waiver of the limitation period applicable to any claim or assessment in respect of Taxes or file any Return unless a copy of such Return has been delivered to Parent for review a reasonable time prior to filing and Parent has approved such Return;

(f) revalue any of its assets (whether tangible or intangible), including writing down the value of inventory or writing off notes or accounts receivable;

(g) declare, set aside, or pay any dividends on or make any other distributions (whether in cash, stock or property) in respect of any Company Capital Stock or the capital stock of any Subsidiary, or split, combine or reclassify any Company Capital Stock or the capital stock of any Subsidiary or issue or authorize the issuance of any other securities in respect of, in lieu of or in substitution for shares of Company Capital Stock or the capital stock of any Subsidiary, or directly or indirectly repurchase, redeem or otherwise acquire any shares of Company Capital Stock or the capital stock of any Subsidiary (or options, warrants or other rights convertible into, exercisable or exchangeable for Company Common Stock or the capital stock of any Subsidiary) except in accordance with the agreements evidencing Company Options or Company Common Stock;

(h) increase or otherwise change the salary or other compensation payable or to become payable to any officer, director, employee, consultant or advisor, or make any declaration, payment or commitment or obligation of any kind for the payment (whether in cash or equity) of a severance payment, termination payment, bonus or other additional salary or compensation to any such person except pursuant to

the terms of Employee Agreements or Company Employee Plans in existence on the date of this Agreement and disclosed in **Section 2.23(b)(1)** of the Disclosure Schedule;

(i) sell, lease, license or otherwise dispose of any of the assets or properties of the Company or grant any security interest in any of its properties or assets (other than Company Intellectual Property in accordance with **Section 4.1(o)**), except properties or assets (whether tangible or intangible) which are not Intellectual Property and only in the ordinary course of business and consistent with past practice;

(j) make any loan to any Person or purchase debt securities of any Person or amend the terms of any outstanding loan agreement;

(k) incur any indebtedness for borrowed money, amend the terms of any outstanding loan agreement, guarantee any indebtedness for borrowed money of any Person, issue or sell any debt securities or guarantee any debt securities of any Person;

(l) waive or release any material right or claim of the Company or any of its Subsidiaries, including any write-off or other compromise of any account receivable of the Company or any of its Subsidiaries;

(m) commence or settle any lawsuit, threat of any lawsuit or proceeding or other investigation by or against the Company or any Subsidiary or relating to any of their businesses, properties or assets;

(n) issue, grant, deliver or sell or authorize or propose or contract for the issuance, grant, delivery or sale of, or purchase or propose or contract for the purchase of, any Company Capital Stock or the capital stock of any Subsidiary or any securities convertible into, exercisable or exchangeable for, or subscriptions, rights, warrants or options to acquire, or other agreements or commitments of any character obligating any of them to issue or purchase any such shares or other convertible securities, except for the issuance of Company Capital Stock pursuant to the exercise of outstanding Company Options;

(o) (i) sell, lease, license or transfer to any Person any rights to any Company Intellectual Property or enter into any agreement or modify or amend any existing agreement with respect to any Company Intellectual Property with any Person or with respect to any Intellectual Property of any Person except in the ordinary course of business consistent with past practice, (ii) license any material Intellectual Property outside the ordinary course of business, license any Intellectual Property to be incorporated into any product of the Company, or purchase any Intellectual Property, or enter into any agreement or modify or amend any existing agreement with respect to the Intellectual Property of any Person, (iii) enter into any agreement or modify or amend any existing agreement with respect to the development of any Intellectual Property with a third party, or (iv) propose or consent to any change to pricing or royalties set or charged by the Company or any of its Subsidiaries to its customers or licensees, or the pricing or royalties set or charged by Persons who have licensed Intellectual Property to the Company or any of its Subsidiaries;

(p) enter into or amend any Contract pursuant to which any other party is granted marketing, distribution, development, manufacturing or similar rights of any type or scope with respect to any products or technology of the Company or any of its Subsidiaries;

(q) enter into any agreement to purchase or sell any interest in real property, grant any security interest in any real property, enter into any lease, sublease, license or other occupancy agreement with respect to any real property or alter, amend, modify or terminate any of the terms of any Lease Agreements;

(r) terminate, amend or otherwise modify (or agree to do so), or violate the terms of, any of the Contracts set forth or described in the Disclosure Schedule;

(s) acquire or agree to acquire by merging or consolidating with, or by purchasing any assets or equity securities of, or by any other manner, any business or any corporation, partnership, association or other business organization or division thereof, or otherwise acquire or agree to acquire any assets which are material or any equity securities, individually or in the aggregate, to the business of the Company or any of its Subsidiaries;

(t) grant any severance or termination pay (in cash or otherwise) to any Employee, including any officer, except payments made pursuant to written agreements existing on the date hereof and disclosed in the Disclosure Schedule;

(u) adopt or amend any Company Employee Plan, enter into or amend any Employee Agreement, enter into any employment contract, pay or agree to pay any bonus or special remuneration to any director or Employee, or increase or modify the salaries, wage rates, or other compensation (including any equity-based compensation) of its Employees except payments made pursuant to written agreements outstanding on the date hereof and disclosed in **Section 4.1(u)** of the Disclosure Schedule or to meet the requirements of applicable law or as required by this Agreement;

(v) enter into any strategic alliance, affiliate agreement or joint marketing arrangement or agreement;

(w) take any action to accelerate the vesting schedule of any of the outstanding Company Options or Company Common Stock;

(x) hire, offer to hire or terminate any Employees, or encourage or otherwise cause any Employees to resign from the Company or any of its Subsidiaries;

(y) promote, demote, terminate or otherwise change the employment status or titles of any employee;

(z) alter, or enter into any commitment to alter, its interest in any Subsidiary, corporation, association, joint venture, partnership or business entity in which the Company or any Subsidiary directly or indirectly holds any interest;

(aa) cancel, amend or renew any insurance policy; or

(bb) take, commit, or agree in writing or otherwise to take, any of the actions described in **Sections 4.1(a)** through **4.1(aa)** hereof, or any other action that would (i) prevent the Company from performing, or cause the Company not to perform, its covenants or agreements hereunder or (ii) cause or result in any of its respective representations and warranties contained herein being untrue or incorrect.

4.2 ***No Solicitation***.

(a) Until the earlier of (i) the Effective Time, or (ii) the date of termination of this Agreement pursuant to the provisions of **Section 8.1** hereof, the Company shall not (nor shall the Company permit, as applicable, any of its officers, directors, employees, shareholders, agents, representatives or affiliates to), directly or indirectly, take any of the following actions with any party other than Parent and its designees: (a) solicit, encourage, seek, support, assist, initiate or participate in any inquiry, negotiations or discussions, or enter into any agreement, with respect to any offer or proposal to acquire all or any part of the business, properties, assets or technologies of the Company and its Subsidiaries (other than inventory or licenses in the ordinary course of business of the Company), or any amount of the Company Capital Stock or capital stock of any Subsidiary (whether or not outstanding), whether by merger, purchase of assets, tender offer, license or otherwise, or effect any such transaction (any such offer or proposal, an "**Acquisition Proposal**"), (b) disclose any information not customarily disclosed to any Person concerning the business, technologies or properties of the Company and its Subsidiaries, or afford to any Person access to its or their respective properties, technologies, books or records, not customarily afforded such access, (c) assist or cooperate with any Person in connection with an Acquisition Proposal, other than with respect to the purchase of inventory in the ordinary course of business or (d) enter into any agreement with any person relating to an Acquisition Proposal an shall provided copies of all writings provided by such Person in connection with such Acquisition Proposal. The Company shall immediately cease and cause to be terminated any such negotiations, discussion or agreements (other than with Parent) that are the subject matter of clause (a), (b), (c) or (d) above.

(b) The Company shall notify Parent promptly (but in no event later than 24 hours) after receipt of any Acquisition Proposal, or modification of or amendment to any Acquisition Proposal, or request for nonpublic information relating to the Company or any of its Subsidiaries or for access to the properties, books or records of the Company or any Subsidiary, or notice by any Person that it is considering making, or has made, an Acquisition Proposal. Such notice to Parent shall be made orally and in writing and shall indicate the identity of the Person making the Acquisition Proposal or intending to make or considering making an Acquisition Proposal or requesting non-public information or access to the books and records of the Company or any Subsidiary and the terms of any such Acquisition Proposal or modification or amendment to the Acquisition Proposal. The Company shall keep Parent informed, on a current basis, of any material changes in the status and any material changes or modifications in the terms of any such Acquisition Proposal, indication or request.

(c) The parties hereto agree that irreparable damage would occur in the event that the provisions of this **Section 4.2** were not performed in accordance with their specific terms or were otherwise breached. It is accordingly agreed by the parties hereto that Parent shall be entitled to an immediate injunction or injunctions, without the necessity of proving the inadequacy of money damages as a remedy and without the necessity of posting any bond or other security, to prevent breaches of the provisions of this **Section 4.2** and to enforce specifically the terms and provisions hereof in any court of the United States or any state having jurisdiction, this being in addition to any other remedy to which Parent may be entitled at law or in equity. Without limiting the foregoing, it is understood that any violation of the restrictions set forth above by any officer, director, agent, representative or affiliate of Company shall be deemed to be a breach of this Agreement by Company.

4.3 ***Procedures for Requesting Parent Consent***. If the Company desires to take an action which would be prohibited pursuant to **Section 4.1** hereof without the written consent of Parent, prior to taking such

action the Company may request such written consent by sending an e-mail or facsimile to each of the following individuals:

Patrick J. Harshman
Telephone: (408) 542-2694
Facsimile: (408) 542-2516
E-mail address: patrick.harshman@harmonicinc.com

Robin N. Dickson
Telephone: (408) 542-2661
Facsimile: (408) 542-2516
Email address: robin.dickson@harmonicinc.com

Robert G. Day
Telephone: (650) 493-9300
Facsimile: (650) 493-6811
E-mail address: rday@wsgr.com

ARTICLE V

ADDITIONAL AGREEMENTS

5.1 ***Access to Information***. Until the earlier of the termination of this Agreement or the Effective Time, the Company shall afford Parent and its accountants, counsel and other representatives, reasonable access at reasonable times during the period from the date hereof through the Effective Time to (i) all of the properties (including for the performance of environmental tests or investigations as Parent may desire), books, contracts, commitments and records of the Company and its Subsidiaries, including all Company Intellectual Property (including access to design processes and methodologies and all source code, provided that each individual reviewing source code will enter into a nondisclosure agreement with the Company in a form reasonably acceptable to the Company), (ii) all other information concerning the business, properties and personnel (subject to restrictions imposed by applicable law) of the Company and its Subsidiaries as Parent may reasonably request, and (iii) all Employees of the Company and its Subsidiaries as identified by Parent. Any access to the Company's offices will be subject to the Company's reasonable security measures and insurance requirements. The Company agrees to provide to Parent and its accountants, counsel and other representatives copies of internal financial statements (including Tax Returns and supporting documentation) promptly upon request. Until the earlier of the termination of this Agreement or the Effective Time, Parent will provide the Company with copies of such publicly available information about Parent as the Company may request. No information or knowledge obtained in any investigation pursuant to this **Section 5.1** or otherwise shall affect or be deemed to modify any representation or warranty contained herein or the conditions to the obligations of the parties to consummate the Merger in accordance with the terms and provisions hereof.

5.2 ***Confidentiality***. Each of the parties hereto hereby agrees that the information obtained in any investigation pursuant to **Section 5.1** hereof, or pursuant to the negotiation and execution of this Agreement or the effectuation of the transactions contemplated hereby, shall be governed by the terms of the Mutual Non-Disclosure Agreement dated March 22, 2007 (the "**Nondisclosure Agreement**"), between the Company and Parent. Parent and the Company agree that such information will constitute "Confidential Information" as contemplated by the Nondisclosure Agreement, notwithstanding any failure (i) to specifically designate

such information as “Confidential,” “Proprietary” or some similar designation and (ii) to confirm in writing that information communicated orally is “Confidential Information.” The Company further acknowledges that the Parent Common Stock is publicly traded and that any information obtained during the course of its due diligence could be considered to be material non-public information within the meaning of federal and state securities laws. Accordingly, the Company acknowledges and agrees not to engage in any discussions or correspondence regarding or transactions in the Parent Common Stock in violation of applicable securities laws.

5.3 ***Public Disclosure***. Neither Parent nor the Company (nor any of their respective representatives) shall issue any statement or communication to any third party (other than their agents that are bound by confidentiality restrictions) regarding the subject matter of this Agreement or the transactions contemplated hereby, including, if applicable, the termination of this Agreement and the reasons therefor, without the consent of the other, except that this restriction shall be subject to Parent’s obligation to comply with applicable securities laws and the rules of the Nasdaq Stock Market.

5.4 ***Reasonable Efforts***.

(a) Subject to the terms and conditions provided in this Agreement, each of the parties hereto shall use its reasonable efforts to take promptly, or cause to be taken promptly, all actions, and to do promptly, or cause to be done promptly, all things necessary, proper or advisable under applicable laws and regulations to consummate and make effective the transactions contemplated hereby, to cause all conditions to the obligations of the other parties hereto to effect the Merger to occur, to obtain all necessary waivers, consents, approvals and other documents required to be delivered hereunder and to effect all necessary registrations and filings and to remove any injunctions or other impediments or delays, legal or otherwise, in order to consummate and make effective the transactions contemplated by this Agreement; *provided*, *however*, that Parent shall not be required to agree to (x) any license, sale or other disposition or holding separate (through establishment of a trust or otherwise) of any shares of capital stock or of any business, assets or properties of Parent, its subsidiaries or affiliates or of the Company or its Subsidiaries, (y) the imposition of any limitation on the ability of Parent, its subsidiaries or affiliates or the Company or its Subsidiaries to conduct their respective businesses or own any capital stock or assets or to acquire, hold or exercise full rights of ownership of their respective businesses and, in the case of Parent, the businesses of the Company and its Subsidiaries, or (z) the imposition of any impediment on Parent, its subsidiaries or affiliates or the Company or its Subsidiaries under any statute, rule, regulation, executive order, decree, order or other legal restraint governing competition, monopolies or restrictive trade practices (any such action described in (x), (y) or (z), an “**Action of Divestiture**”). Nothing herein shall require Parent to litigate with any Governmental Entity.

(b) Each party hereto, at the request of another party hereto, shall execute and deliver such other instruments and do and perform such other acts and things as may be reasonably necessary or desirable for effecting completely the consummation of the Merger and the transactions contemplated hereby.

5.5 ***Notification of Certain Matters***. The Company shall give prompt notice to Parent of: (i) the occurrence or non-occurrence of any event, which occurrence or non-occurrence is reasonably likely to cause any representation or warranty of the Company contained in this Agreement to be untrue or inaccurate at or prior to the Effective Time, and (ii) any failure of the Company to comply with or satisfy any covenant, condition or agreement to be complied with or satisfied by it hereunder; *provided*, *however*, that the delivery of any notice pursuant to this **Section 5.5** shall not (a) limit or otherwise affect any remedies available to the party receiving such notice or (b) constitute an acknowledgment or admission of a breach of this Agreement.

No disclosure by the Company pursuant to this **Section 5.5** shall be deemed to amend or supplement the Disclosure Schedule or prevent or cure any misrepresentations, breach of warranty or breach of covenant.

5.6 ***Shareholder Approval***. (a) Immediately following the execution of this Agreement, the Company shall deliver to Parent an action by written consent in a form reasonably acceptable to Parent (a "**Written Consent**") executed by each of the persons listed on **Schedule 5.6** hereof, which Written Consent shall set forth the irrevocable approval of the Merger, this Agreement and the transactions contemplated hereby, which shall also include and constitute the irrevocable approval by such Company Shareholders of: (i) the holdback and indemnification obligations of the Company Shareholders set forth in **Article VII** hereof and (ii) the appointment of David Trescot as the Shareholder Representative.

(b) Following the execution of this Agreement, the Company shall use commercially reasonable efforts to solicit and obtain the Written Consent of the remaining Company Shareholders to approve and adopt the Agreement and approve the Merger. In connection with such Shareholder approval and as soon as practicable after the execution of this Agreement, the Company shall prepare, with the cooperation of Parent, an information statement (the "**Information Statement**") for the purpose of soliciting the Written Consent of the Company Shareholders. The Information Statement shall also constitute a disclosure document for the offer and sale of the Merger Shares in the Merger and shall comply with the information requirements of Rule 502(b) promulgated under the Securities Act so that Parent, if it so chooses, may avail itself of the exemption provided by Rule 506 promulgated under the Securities Act. Each of Parent and the Company agrees to provide promptly to the other such information concerning its business and financial statements and affairs as, in the reasonable judgment of the providing party or its counsel, may be required or appropriate for inclusion in the Information Statement or in any amendments or supplements to the Information Statement. Each of the parties hereto will promptly advise the other parties in writing if at any time prior to the Effective Time either the Company or Parent shall obtain knowledge of any facts that might make it necessary or appropriate to amend or supplement the Information Statement in order to make the statements contained or incorporated by reference therein not misleading or to comply with applicable law. The Board of Directors of the Company shall recommend to the Shareholders that such Shareholders approve and adopt the Agreement and approve the Merger and the transactions contemplated hereby, and the Information Statement shall contain such recommendation, as well as the conclusion of the Board of Directors of the Company that the terms and conditions of the Merger are in the best interests of the Shareholders in the opinion of the Board of Directors. Notwithstanding anything to the contrary contained herein, the Company shall not include in the Information Statement any information with respect to Parent or its affiliates or associates, the form and content of which information shall not have been approved by Parent prior to such inclusion.

5.7 ***Securities Law Compliance***.

(a) ***Issuance of Parent Common Stock***. Each of Parent, Merger Sub and the Company hereto acknowledges and agrees that the shares of Parent Common Stock issuable to the Shareholders pursuant to **Section 1.6** hereof, shall be issued pursuant to an exemption or exemptions from registration under Regulation D promulgated under the Securities Act and the exemption from qualification under the laws of the State of California and other applicable state securities laws. The certificates for shares of Parent Common Stock to be issued in the Merger shall bear appropriate legends to identify such privately placed shares as being restricted under the Securities Act and to comply with applicable state securities laws. The Company acknowledges and understands that Parent is relying upon certain written representations made on behalf of each Shareholder in issuing the shares of Parent Common Stock.

(b) ***Blue Sky Laws.*** As promptly as practical after the date of this Agreement, Parent and Company shall prepare and make such filings as are required under applicable blue sky laws relating to the transactions contemplated by this Agreement. The Company shall assist Parent as may be necessary to comply with the securities and blue sky laws relating to the transactions contemplated by this Agreement .

(c) ***Shareholder Certificate.*** The Company shall deliver or cause to be delivered to Parent, prior to the Closing Date, an executed Shareholder Certificate in substantially the form attached hereto as **Exhibit C** (the "**Shareholder Certificate**") from each Shareholder; *provided*, *however*, the Company shall deliver or cause to be delivered to Parent an executed Shareholder Certificate from each Shareholder listed on **Schedule 5.7(c)** hereto immediately following execution of this Agreement.

(d) ***Registration Statement on Form S-3.*** Parent shall use commercially reasonable efforts to file, as soon as reasonably practicable following the Closing Date, a registration statement on Form S-3 with the SEC covering the resale of the shares of Parent Common Stock issued to the Company Shareholders pursuant to the Merger, provided that if Parent is required to file the Company's financial statements pursuant Form 8-K, then Parent shall use reasonable commercial efforts to file such Form S-3 as soon as reasonably practicable following such filing on Form 8-K, and shall use commercially reasonable efforts to cause such Registration Statement to be declared effective by the SEC as promptly as reasonably practicable after filing and to keep such Registration Statement effective until the earlier of (i) the date on which all securities included in such Registration Statement have been sold or (ii) the 12 month anniversary of the Closing. Any such registration shall be subject to the terms and conditions set forth in the Declaration of Registration Rights attached hereto as **Exhibit D**.

(e) ***Additional Assurances.*** At the request of Parent, the Company shall use its commercially reasonable efforts to cause each Shareholder to execute and deliver to Parent such instruments and do and perform such acts and things as may be necessary or desirable for complying with all applicable securities laws and corporate laws.

(f) ***Board and Shareholder Approval.*** The Board of Directors of the Company shall not alter, modify, change or revoke its unanimous approval of this Agreement, the Merger and the transactions contemplated hereby, nor shall the Board of Directors of the Company encourage or solicit the Shareholders to alter, modify, change or revoke their approval of this Agreement, the Merger and the transactions contemplated hereby.

5.8 ***Merger Notification***.

(a) To the extent applicable, as soon as may be reasonably practicable, the Company and Parent (and any applicable Shareholder of the Company) shall make all filings, notices, petitions, statements, registrations and submissions of information, application or submission of other documents required by any Governmental Entity in connection with the Merger and the transactions contemplated hereby, including: filings required by the merger notification or control laws or regulations of any other applicable jurisdictions identified in **Section 5.8** of the Disclosure Schedule. Each of Parent and the Company shall cause all documents that it is responsible for filing with any Governmental Entity under this **Section 5.8** to comply in all material respects with applicable law.

(b) The Company and Parent (and/or any applicable Shareholder of the Company) each shall promptly (i) supply the others with any information which reasonably may be required in order to effectuate the filings contemplated by **Section 5.8(a)** and (ii) supply any additional information which

reasonably may be required by the competition or merger control authorities of any other jurisdiction and which the parties may reasonably deem appropriate. Except where prohibited by applicable law, the Company shall consult with Parent prior to taking a position with respect to any such filings, shall permit Parent to review and discuss in advance, and consider in good faith the views of Parent in connection with, any analyses, appearances, presentations, memoranda, briefs, white papers, other materials, arguments, opinions and proposals before making or submitting any of the foregoing to any Governmental Entity in connection with any investigations or proceedings in connection with this Agreement or the transactions contemplated hereby, coordinate with Parent in preparing and providing such information and promptly provide Parent (and its counsel) copies of all filings, presentations and submissions (and a summary of oral presentations) made by the Company with any Governmental Entity in connection with this Agreement and the transactions contemplated hereby. Parent shall have principal control over the strategy for interacting with such Governmental Entities in connection with the matters contained in this **Section 5.8**.

(c) Each of Parent and the Company shall notify the other promptly upon the receipt of (i) any comments from any officials of any Governmental Entity in connection with any filings made pursuant hereto and (ii) any request by any officials of any Governmental Entity for amendments or supplements to any filings made pursuant to, or information provided to comply in all materials respect with, applicable law. Whenever any event occurs that is required to be set forth in an amendment or supplement to any filing made pursuant to **Section 5.8(a)**, Parent or the Company, as the case may be, will promptly inform the other of such occurrence and cooperate in filing with the applicable Governmental Entity such amendment or supplement.

5.9 ***Consents***. The Company shall use commercially reasonable best efforts to obtain all necessary consents, waivers and approvals of any parties to any Contract as are required thereunder in connection with the Merger or for any such Contracts to remain in full force and effect, all of which are required to be listed in **Section 2.5** of the Disclosure Schedule, so as to preserve all rights of, and benefits to, the Company under such Contract from and after the Effective Time. Such consents, waivers and approvals shall be in a form acceptable to Parent. In the event that the other parties to any such Contract, including any lessor or licensor of any Leased Real Property, conditions its grant of a consent, waiver or approval (including by threatening to exercise a “recapture” or other termination right) upon the payment of a consent fee, “profit sharing” payment or other consideration, including increased rent payments or other payments under the Contract, the Company shall be responsible for making all payments required to obtain such consent, waiver or approval, and Parent shall be entitled to indemnification for all losses, costs, claims, liabilities and damages arising from the same.

5.10 ***Restrictions on Transfer***. All certificates representing Parent Common Stock deliverable to any Shareholder of the Company pursuant to this Agreement and in connection with the Merger and any certificates subsequently issued with respect thereto or in substitution therefor (including any shares issued or issuable in respect of any such shares upon any stock split, stock dividend, recapitalization, or similar event) shall bear any legend required by the Secretary of State of the State of Delaware or such as are required pursuant to any federal, state, local or foreign law governing such securities.

5.11 ***Termination and Modification of Agreements***.

(a) The Company shall terminate each of the agreements listed on **Schedule 6.2(h)** hereof (the “**Terminated Agreements**”), effective as of and contingent upon the Closing, including sending all required notices, such that each such agreement shall be of no further force or effect immediately following the Effective Time. Upon the Closing, the Company shall have paid all amounts owed under the Terminated Agreements (as a result of the termination of the Terminated Agreements or otherwise), and the

Surviving Corporation will not incur any claim, liability or obligation (absolute, accrued, asserted or unasserted, contingent or otherwise) under any Terminated Agreement following the Closing Date.

(b) The Company shall use commercially reasonable best efforts to amend each of the agreements listed on **Schedule 5.11(b)** hereof, and shall provide such notices or take such other actions as are required to terminate those agreements (or any of them) in accordance with their terms, in each case in accordance with **Schedule 5.11(b)** hereof. The parties expressly acknowledge and agree that the foregoing covenants in this **Section 5.11(b)** shall not require the Company to (i) effect any such amendment or (ii) to terminate any such agreement prior to the later of (x) the Effective Time or (y) the expiration of any notice period that is a condition precedent to any such termination.

5.12 ***Proprietary Information and Inventions Assignment Agreement***. The Company shall cause each current and former employee of the Company or any Subsidiary to have entered into and executed, and each person who becomes an employee of the Company or any Subsidiary after the date hereof and prior to the Closing shall be required by the Company to enter into and execute, an Employee Proprietary Information Agreement in the form of **Schedule 5.12** with the Company and each of its Subsidiaries effective as of such employee's first date of employment or service. The Company shall cause each current and former consultant or contractor of the Company or any Subsidiary (other than any consultant or contractor who did not have any involvement in product research, design, development, engineering, testing, or support or access to proprietary information) to have entered into and executed, and each person who becomes a consultant or contractor of the Company or any Subsidiary after the date hereof and prior to the Closing shall be required by the Company to enter into and execute, a Consultant Proprietary Information Agreement in the form of **Schedule 5.12** with the Company and each of its Subsidiaries effective as of such consultant or contractor's first date of service.

5.13 ***New Employment Benefits***. Employees shall be eligible to receive benefits consistent with Parent's applicable human resources policies. Parent will or will cause the Surviving Corporation or appropriate subsidiary of Parent to give Employees credit under such policies for prior service at the Company for purposes of eligibility and vesting under any plan of Parent intended to qualify within the meaning of Section 401(a) of the Code. The Company shall cause each of the Company and each of its Subsidiaries to terminate effective as of the Closing Date all employment agreements and other arrangements with its employees and contractors.

5.14 ***Intentionally Deleted***.

5.15 ***No Liability for New Employees or Former Employees***. The parties hereto agree that neither Parent nor Sub shall have any liability for (a) any employees hired by the Company after the date hereof and (b) any employees that terminate their employment with the Company after the date hereof, in the event the Merger is not consummated.

5.16 ***Resignation of Officers and Directors***. The Company shall cause each officer and director of the Company and its Subsidiaries to execute a resignation letter effective as of the Effective Time.

5.17 ***83(b) Elections***. The Company shall use its best efforts to deliver to Parent, not less than five (5) Business Days prior to the Closing, copies of all elections filed (or to be filed prior to the Closing) with the Internal Revenue Service under Section 83(b) of the Code in connection with purchases of unvested Company Common Stock occurring after the date hereof together with evidence of timely filing of such election statement with the appropriate Internal Revenue Service Center.

5.18 ***Termination of 401(k) Plan***. Effective as of no later than the Business Day immediately preceding the Closing Date, each of the Company, its Subsidiaries and any ERISA Affiliate (as such term is defined in **Section 2.23** hereof) shall terminate any and all group severance, salary continuation and separation programs and all Company Employee Plans intended to include a Code Section 401(k) arrangement (each, a "**401(k) Plan**") (unless Parent provides written notice to the Company that one or more of such 401(k) Plans shall not be terminated). Unless Parent provides such written notice to the Company, no later than five (5) Business Days prior to the Closing Date, the Company shall provide Parent with evidence that such 401(k) Plan(s) have been terminated (effective as of the day immediately preceding the Closing Date) pursuant to resolutions of the Board of Directors of the Company, its Subsidiaries or such ERISA Affiliate, as the case may be. The form and substance of such resolutions shall be subject to review and approval of Parent. The Company also shall take such other actions in furtherance of terminating such 401(k) Employee Plan(s) as Parent may reasonably require.

5.19 ***Spreadsheet***. The Company shall deliver to Parent and the Exchange Agent a spreadsheet (the "**Spreadsheet**") substantially in the form attached hereto as **Schedule 5.19**, which spreadsheet shall be certified as complete and correct by the Chief Executive Officer and Chief Financial Officer of the Company as of the Closing and which shall include, among other things, as of the Closing, (i) all Shareholders and their respective addresses, the number of shares of Company Capital Stock held by such persons (including whether such shares are Company Common Stock or any other capital stock), the respective certificate numbers, whether such shares of Company Capital Stock are subject to vesting (and if so, for each certificate, the number of shares that are vested as of the Closing), the date of acquisition of such shares, the Pro Rata Portion of Merger Shares to be held back pursuant to **Section 1.6(b)(iv)**, the Pro Rata Portion of Merger Cash (if any) to be held back pursuant to **Section 1.6(b)(iv)**, the number of Merger Shares (if any) to be issued and amount of Merger Cash to be paid to each holder at Closing, outstanding Shareholder loans (if any) to be deducted from any consideration payable to a Shareholder pursuant to **Section 1.6(f)**, and such other information relevant thereto or which the Exchange Agent may reasonably request, and (ii) all holders of Company Options and their respective addresses, the number of shares of Company Capital Stock underlying each such Company Option, the grant dates and exercise prices of such Company Options and the vesting arrangement with respect to such Company Options, the exercise price of each Company Option, and indicating, with respect to each Company Option, whether such Company Option is an incentive stock option or a non-qualified stock option, the amount of Option Consideration to be issued to each holder, and such other information relevant thereto or which Parent may reasonably request. The Company shall deliver the Spreadsheet three (3) Business Days prior to the Closing Date.

5.20 ***Intentionally Deleted***.

5.21 ***FIRPTA Compliance***. On the Closing Date, the Company shall deliver to Parent a properly executed notice and certificate (a "**FIRPTA Compliance Certificate**") in a form reasonably acceptable to Parent for purposes of satisfying Parent's obligations under Treasury Regulation Section 1.1445-2(c)(3).

5.22 ***Affiliate Agreements***. **Schedule 5.22** hereto sets forth those persons who, in the Company's reasonable judgment, are or may be "affiliates" of the Company within the meaning of Rule 145 (each such person, a "**Rule 145 Affiliate**") promulgated under the Securities Act ("**Rule 145**"). The Company shall provide Parent such information and documents as Parent shall reasonably request for purposes of reviewing such list. Parent and Sub shall be entitled to issue appropriate stop transfer instructions to the transfer agent for Parent Common Stock and to place the following legend on the certificates evidencing any Parent Common Stock to be received by such Rule 145 Affiliates pursuant to the terms of this Agreement:

"THE SHARES REPRESENTED BY THIS CERTIFICATE WERE ISSUED IN A TRANSACTION CLOSED ON [DATE] BETWEEN HARMONIC, INC. AND RHOZET CORPORATION TO WHICH RULE 145 APPLIES AND MAY ONLY BE TRANSFERRED IN CONFORMITY WITH RULE 145(d) OR PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933, AS AMENDED, OR IN ACCORDANCE WITH A WRITTEN OPINION OF COUNSEL, REASONABLY ACCEPTABLE TO THE ISSUER IN FORM AND SUBSTANCE, THAT SUCH TRANSFER IS EXEMPT FROM REGISTRATION UNDER THE SECURITIES ACT OF 1933, AS AMENDED."

The legend set forth above shall be removed (by delivery of a substitute certificate without such legend) and Parent shall so instruct its transfer agent, if the Rule 145 Affiliate holding the applicable shares delivers to Parent (i) satisfactory written evidence that the shares have been sold in compliance with Rule 145 (in which case, the substitute certificate shall be issued in the name of the transferee), or (ii) an opinion of counsel, in form and substance reasonably satisfactory to Parent, to the effect that public sale of the shares by the holder thereof is no longer subject to Rule 145.

5.23 ***Employment Agreements***. Each of the Key Employees shall have executed and delivered the appropriate form of Employment Agreement.

ARTICLE VI

CONDITIONS TO THE MERGER

6.1 Conditions to Obligations of Each Party to Effect the Merger. The respective obligations of the Company, Parent and Sub to effect the Merger shall be subject to the satisfaction, at or prior to the Effective Time, of the following conditions:

(a) ***No Order; Injunctions; Restraints; Illegality***. No Governmental Entity shall have enacted, issued, promulgated, enforced or entered any statute, rule, regulation, executive order, decree, injunction, order or other legal restraint (whether temporary, preliminary or permanent) which is in effect and which has the effect of making the Merger illegal or otherwise prohibiting or preventing consummation of the Merger.

(b) ***Federal Securities Law Compliance***. The transactions contemplated by this Agreement relating to the issuance of Parent Common Stock in the Merger shall have satisfied the requirements of one or more exemptions from registration under the Securities Act.

6.2 ***Conditions to the Obligations of Parent and Sub***. The obligations of Parent and Sub to effect the Merger shall be subject to the satisfaction at or prior to the Effective Time of each of the following conditions, any of which may be waived, in writing, exclusively by Parent and Sub:

(a) ***Representations, Warranties and Covenants***. (i) The representations and warranties of the Company in this Agreement (other than the representations and warranties of the Company as of a specified date, which shall be true and correct as of such date, shall have been true and correct on the date they were made and shall be true and correct in all material respects (without giving effect to any limitation as

to "materiality", "Company Material Adverse Effect" or "Knowledge" set forth therein) on and as of the Closing Date as though such representations and warranties were made on and as of such date, and (ii) the Company shall have performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed and complied with by such parties as of the Closing.

(b) ***No Material Adverse Effect***. Since the Balance Sheet Date, there shall not have occurred any event or condition of any character that has had or is reasonably likely to have, either individually or in the aggregate with all such other events or conditions, a Company Material Adverse Effect, determined without regard to whether such change constitutes a breach of a representation or warranty.

(c) ***280G Shareholder Vote***. With respect to any payments and/or benefits that Parent determines may constitute "parachute payments" under Section 280G of the Code, the Company Shareholders shall have (i) approved, pursuant to the method provided for in the regulations promulgated under Section 280G of the Code, any such "parachute payments" or (ii) shall have voted upon and disapproved such parachute payments, and, as a consequence, such "parachute payments" shall not be paid or provided for in any manner."

(d) ***Dissenters' Rights***. None of the Shareholders shall continue to have a right to exercise appraisal, dissenters' or similar rights under applicable law with respect to their Company Capital Stock by virtue of the Merger.

(e) ***Litigation***. There shall be no action, suit, claim, order, injunction or proceeding of any nature pending, or overtly threatened, (i) against the Company or any Subsidiary, their respective properties or any of their respective officers, directors or subsidiaries arising out of, or in any way connected with, the Merger or the other transactions contemplated by the terms of this Agreement or otherwise seeking any of the results set forth in **Section 6.1(a)** hereof that is reasonably likely to materially and adversely affect the consummation of the Merger or (ii) against the Company or any Subsidiary, their respective properties or any of their respective officers, directors or subsidiaries that has had or is reasonably likely to have a Company Material Adverse Effect.

(f) ***Governmental Approval***. All material approvals from any Governmental Entity deemed appropriate or necessary by Parent shall have been timely obtained, and all filings under applicable blue sky laws relating to the transactions contemplated by this Agreement shall have been made.

(g) ***Third Party Consents***. The Company shall have delivered to Parent all necessary assignments of Contracts and consents, waivers, and approvals of parties to each Contract (including Lease Agreements) set forth on **Schedule 6.2(g)** hereto as are required thereunder for such Contract to remain in full force and effect without limitation, modification or alteration after the Effective Time.

(h) ***Termination of Agreements***. The Company shall have terminated each of those agreements listed on **Schedule 6.2(h)** hereto effective as of and contingent upon the Closing and, from and after the Closing, each such agreement shall be of no further force or effect.

(i) ***Employment Agreements***. Each of the Key Employees shall have executed and delivered to Parent an Employment Agreement and shall not have taken any action which would be prohibited thereby were such agreement in effect at the time of such action and such Employment Agreement shall be in effect as of the Effective Time.

(j) ***Resignation of Officers and Directors***. Parent shall have received a written resignation letter from each of the officers and directors of the Company and its Subsidiaries effective as of the Effective Time in a form acceptable to Parent.

(k) ***Termination of Company Options***. The Company shall have delivered written evidence reasonably acceptable to Parent to the effect that each Company stock option that is not listed on Disclosure Schedule 2.2(c) will be terminated immediately prior to the Effective Time of the Merger.

(l) ***Termination of 401(k) Plans***. Unless Parent has otherwise instructed the Company pursuant to **Section 5.18** hereof, Parent shall have received from the Company evidence reasonably acceptable to Parent that all 401(k) Plans have been terminated pursuant to resolution of the Board of Directors of the Company, each of its Subsidiaries or the ERISA Affiliate, as the case may be (the form and substance of which shall have been subject to review and approval of Parent), effective as of no later than the day immediately preceding the Closing Date.

(m) ***Spreadsheet***. Parent and the Exchange Agent shall have received from the Company three (3) Business Days prior to the Closing Date the Spreadsheet pursuant to **Section 5.17**, which shall have been certified as of the Closing Date as complete and correct by the Chief Executive Officer and the Chief Financial Officer of the Company.

(n) ***Intentionally Deleted***.

(o) ***Securities Filings***. The Company shall have made such securities laws filings required in connection with the lawful issuance and sale of shares of Company Common Stock and Company Options since the date of the Company's incorporation.

(p) ***Certificate of the Company***. Parent shall have received certificates from the Company, validly executed by the Chief Executive Officer and Chief Financial Officer of the Company for and on the Company's behalf, to the effect that, as of the Closing:

(i) the representations and warranties of the Company in this Agreement (other than the representations and warranties of the Company as of a specified date, which were true and correct as of such date) were true and correct on the date they were made and are true and correct in all material respects (without giving effect to any limitation as to "materiality," "Company Material Adverse Effect" or "Knowledge" set forth therein) on and as of the Closing Date as though such representations and warranties were made on and as of such date; and

(ii) the Company has performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed and complied with by such party as of the Closing.

(q) ***Certificate of Secretary of Company***. Parent shall have received a certificate, validly executed by the Secretary of the Company, certifying as to (i) the terms and effectiveness of the Charter Documents, (ii) the valid adoption of resolutions of the Board of Directors of the Company (whereby the Merger and the transactions contemplated hereunder, were unanimously approved by the Board of Directors) and (iii) that the Shareholders constituting the Requisite Shareholder Vote have adopted and approved the Merger, this Agreement and the consummation of the transactions contemplated hereby and approval of any

payments or benefits that may be deemed to constitute a “parachute payment” within the meaning of 280G of the Code.

(r) ***Certificate of Good Standing***. Parent shall have received a long-form certificate of good standing from the Secretary of State of the State of California which is dated within two (2) Business Days prior to Closing with respect to the Company.

(s) ***FIRPTA Certificate***. Parent shall have received a copy of the FIRPTA Compliance Certificate, validly executed by a duly authorized officer of the Company.

6.3 ***Conditions to Obligations of the Company***. The obligations of the Company to effect the Merger shall be subject to the satisfaction at or prior to the Effective Time of each of the following conditions, any of which may be waived, in writing, exclusively by the Company:

(a) ***Representations, Warranties and Covenants***. (i) The representations and warranties of Parent and Sub in this Agreement (other than the representations and warranties of Parent and Sub as of a specified date, which shall be true and correct as of such date) shall have been true and correct when made and shall be true and correct in all material respects (without giving effect to any limitation as to “materiality” or “Parent Material Adverse Effect” set forth therein) on and as of the Closing Date as though such representations and warranties were made on and as of such date, and (ii) each of Parent and Sub shall have performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed and complied with by such parties as of the Closing Date.

(b) ***Certificate of Parent***. The Company shall have received a certificate from Parent executed by a Vice President for and on its behalf to the effect that, as of the Closing:

(i) all representations and warranties made by Parent and Sub in this Agreement (other than the representations and warranties of Parent and Sub as of a specified date, which were true and correct as of such date) were true and correct on the date they were made and are true and correct in all material respects on and as of the Closing Date as though such representations and warranties were made on and as of such date;

(ii) Parent and Sub have performed and complied in all material respects with all covenants and obligations under this Agreement required to be performed or complied with by such parties as of the Closing; and

ARTICLE VII

SURVIVAL OF REPRESENTATIONS AND WARRANTIES; HOLDBACK

7.1 ***Survival of Representations and Warranties***. The representations and warranties of the Company contained in this Agreement, or in any certificate or other instruments delivered pursuant to this Agreement, shall survive for a period of eighteen (18) months following the Closing Date (such date, the “**Initial Survival Date**”); provided that the representations and warranties **Section 2.15** hereof (under the heading “Intellectual Property”) shall survive for a period of thirty-six (36) months following the Closing Date; and provided further that the representations and warranties in **Section 2.2** (under the heading “Company Capital Structure”), **Section 2.4** (under the heading “Authority”), **Section 2.12** hereof (under the heading “Tax Matters”), and **Section 2.23** (under the heading “Employee Benefit Plans and Compensation”)

shall survive until the expiration of the applicable statue of limitations including extensions thereof (the "**Subsequent Survival Date**"); provided further, that in the event of fraud or intentional misrepresentation, the representations or warranties that are the subject of such fraud or intentional misrepresentation shall survive until the expiration of the applicable statute of limitations. The representations and warranties of Parent and Sub contained in this Agreement, or in any certificate or other instrument delivered pursuant to this Agreement shall terminate at the Closing. The covenants and other agreements set forth in this Agreement shall terminate at the Closing, except for the covenants and agreements which by their terms contemplate or require performance following the Closing, each of which shall survive without limitation until complete performance of the terms thereof.

7.2 ***Indemnification***.

(a) By virtue of the consummation of the Merger, the Shareholders agree to jointly and severally indemnify and hold harmless Parent and its officers, directors, affiliates, employees, agents and representatives, including the Surviving Corporation (the "**Indemnified Parties**"), against all claims, losses, liabilities, damages, deficiencies, diminution in value, costs, interest, awards, judgments, penalties and expenses, including reasonable attorneys' and consultants' fees and expenses and including any such reasonable expenses incurred in connection with investigating, defending against or settling any of the foregoing (hereinafter individually a "**Loss**" and collectively "**Losses**") incurred or sustained by the Indemnified Parties, or any of them (including the Surviving Corporation), directly or indirectly, as a result of (i) any breach or inaccuracy of a representation or warranty of the Company contained in this Agreement or any certificates or other instruments delivered by or on behalf of the Company pursuant to this Agreement (provided that, in the event of any such breach or inaccuracy, for purposes of determining the amount of any Loss no effect will be given to any qualification as to "materiality", a "Company Material Adverse Effect" or "Knowledge" contained therein), (ii) any failure by the Company to perform or comply with any covenant applicable to it contained in this Agreement or any certificates or other instruments delivered pursuant to this Agreement, (iii) any fraud in connection with this Agreement or any certificates or other instruments delivered pursuant to this Agreement on the part of the Company, (iv) any Dissenting Share Payments, to the extent that such Dissenting Share Payments exceed the consideration that such dissenting Shareholders would have received in the Merger had no Dissenting Share Payments been made, (v) any Final Assumed Liability Adjustment, (vi) any payment or consideration arising under any consents, waivers or approvals of any party under any agreement as are required in connection with the Merger or for any such agreement to remain in full force or effect following the Effective Time, (vii) any failure of the Spreadsheet to be true and correct in all respects (including with respect to the Option Cash to be paid to Persons who were holders of Company Options immediately prior to the Closing), (viii) any Tax liability of the Company or any Subsidiary or affiliate thereof relating to any period of time before and through the Closing Date (the "**Pre-Closing Period**"), and (ix) any Losses relating to wages, payments, reimbursements, benefits, taxes and any other Losses relating to employees or consultants of the Company relating to the Pre-Closing Period. The Shareholders (including any officer or director of the Company) shall not have any right of contribution, indemnification or right of advancement from the Surviving Corporation or Parent with respect to any Loss claimed by an Indemnified Party.

(b) Any Person committing fraud or any intentional misrepresentation in connection with this Agreement or any certificate or other instrument delivered pursuant to this Agreement, or who has knowledge of the same, shall be severally, and not jointly, liable for, and shall indemnify and hold the Indemnified Parties harmless for, any Losses incurred or sustained by the Indemnified Parties, or any of them (including the Surviving Corporation), directly or indirectly, as a result of such fraud or intentional misrepresentation committed by such Person (or who has actual knowledge of the same).

(c) Subject to **Section 7.2(b)** and **Section 7.3(b)**, the Shareholders shall be jointly and severally liable for, and shall indemnify and hold the Indemnified Parties harmless for, any Losses incurred or sustained by the Indemnified Parties, or any of them (including the Surviving Corporation), directly or indirectly, arising out of any fraud or intentional misrepresentation in connection with this Agreement or any certificate or other instrument delivered pursuant to this Agreement on the part of the Company.

7.3 ***Maximum Payments; Remedy***.

(a) Except as set forth in **Section 7.3(b)** hereof, the maximum amount an Indemnified Party may recover from a Shareholder individually pursuant to the indemnity set forth in **Section 7.2** hereof for Losses shall be limited to such Shareholder's Pro Rata Portion of $9,400,000 of the Aggregate Common Stock Consideration Amount received by all Shareholders.

(b) Notwithstanding anything to the contrary set forth in this Agreement, in the event of Losses arising out of any fraud or intentional misrepresentation by any Person (other than Parent and its affiliates) in connection with this Agreement or any certificates or other instruments delivered pursuant to this Agreement, each Shareholder shall be liable for all such Losses up to the full amount of the Total Consideration received by such Shareholder, provided further that nothing in this Agreement shall limit the liability of any Person (including any Shareholder) for any such Losses if such Person perpetrated such fraud or intentional misrepresentation or had actual knowledge of the same, and nothing in this Agreement shall prevent or limit any right of other Shareholders for contribution from any other Shareholder who perpetrated such fraud or intentional misrepresentations.

(c) Nothing in this **Article VII** shall limit the liability of the Company for any breach by the Company of any representation, warranty or covenant contained in this Agreement, or in any certificates or other instruments delivered pursuant to this Agreement if the Merger does not close.

(d) Notwithstanding anything to the contrary herein, the parties hereto agree and acknowledge that any Indemnified Party may bring a claim for indemnification for any Loss under this **Article VII** notwithstanding the fact that such Indemnified Party had knowledge of the breach, event or circumstance giving rise to such Loss prior to the Closing or waived any condition to the Closing related thereto.

(e) Notwithstanding anything to the contrary herein, nothing shall prohibit Parent from seeking and obtaining recourse against any Shareholder in the event that Parent issues more shares of Parent Common Stock or pays more cash to the Shareholder than the Shareholder is entitled pursuant to **Article I** of this Agreement.

7.4 ***Means of Indemnification***.

(a) ***Holdback***. By virtue of this Agreement and as partial security (subject to **Section 7.4(b)** below) for the indemnity obligations provided for in **Section 7.2** hereof, at the Effective Time, Parent will, with respect to each share of Company Common Stock, withhold the Holdback Amount, without any act of the Shareholders. The Total Holdback Amount shall be available to compensate the Indemnified Parties for any claims by such parties for any Losses suffered or incurred by them and for which they are entitled to recovery under this **Article VII**. Any Loss incurred by the Indemnified Parties on or prior to the Initial Survival Date (or, with respect to certain matters, as set forth in **Section 7.4(c)**, the Distribution Date)

shall result in a reduction in the Total Holdback Amount in a manner as governed by the terms set forth herein.

(b) ***Satisfaction of Claims***. Except to the extent that the Losses resulted from fraud or intentional misrepresentation committed by the Company (in which case recovery of such Losses, at the discretion of an Indemnified Party, may also be pursued directly against the Shareholders, subject to **Section 7.3**) or as otherwise provided in **Section 7.3(b)**, claims by an Indemnified Party for Losses pursuant to this Agreement shall be satisfied first, from the Total Holdback Amount, and once the Total Holdback Amount has been fully paid out or otherwise set aside for previous claims and Shareholder Representative Expenses, second, from the Shareholders on a several and not joint basis for their Pro Rata Portion of such Losses.

(c) ***Distribution at Holdback Distribution Date***.

(i) Promptly following the date that is thirty (30) days after the Initial Survival Date (the "**Holdback Distribution Date**"), one-hundred percent (100%) of the Total Holdback Amount, less any amount in respect of any satisfied and unsatisfied claims specified in any Officer's Certificate (as defined below) ("**Unresolved Claims**") delivered to the Shareholder Representative on or prior to the Holdback Distribution Date with respect to facts and circumstances existing on or prior to the Initial Survival Date (with respect to claims for Losses relating to representations and warranties for which the survival terminates on the Initial Survival Date) or subsequent to the Initial Survival Date but on or prior to the Holdback Distribution Date for all other claims, shall be distributed to the Shareholders in accordance with clause (iii) of this **Section 7.4(c)**.

(ii) In the event that (a) there exist Unresolved Claims following the expiration of the Holdback Distribution Date that relate to one or more Officer's Certificates alleging Losses occurring before the Initial Survival Date, and (b) the amount of Losses incurred by the Indemnified Parties is determined to be less than the amount claimed on all such Officer's Certificates under the objection and conflict procedures in **Section 7.4(e)** and **Section 7.4(e)**, then Parent shall promptly deliver to the Shareholders that portion of such Unresolved Claim(s) that should have been distributed to the Shareholders at the Holdback Distribution Date had such Officer's Certificates alleged the correct amount of Losses finally determined pursuant to **Section 7.4(e)** and **Section 7.4(e)**, which portion of the Total Holdback Amount shall be distributed to the Shareholders in accordance with clause (iii) of this **Section 7.4(c)**.

(iii) Delivery of the Total Holdback Amount or any portion thereof to the Shareholders pursuant to this **Section 7.4(c)** shall be made in proportion to the Shareholders' respective Pro Rata Portions of the remaining portion of the Total Holdback Amount, with the Parent Common Stock delivered to each Shareholder rounded down to the nearest share, and the cash amount delivered to each Shareholder rounded to the nearest whole cent (with $0.005 rounded down).

(d) ***Procedures for Claims for Indemnification.***

(i) Subject to clause (v) of this **Section 7.4(d)**, Parent may not reduce the Total Holdback Amount unless and until Parent delivers an Officer's Certificate to the Shareholder Representative identifying Losses.

(ii) Notwithstanding any provision of this Agreement to the contrary, except as set forth in clause (iii) of this **Section 7.4(d)**, an Indemnified Party may not recover any Losses under

clause (i) of **Section 7.2(a)** hereof unless and until one or more Officer's Certificates identifying such Losses under clause (i) of **Section 7.2(a)** in excess of $75,000 in the aggregate (the "**Basket Amount**") has or have been delivered to the Shareholder Representative as provided in **Section 7.4(d)** hereof, in which case Parent shall be entitled to recover all Losses so identified.

(iii) Parent shall be entitled to recover for, and the Basket Amount shall not apply as a threshold to, any and all claims or payments made with respect to all Losses (a) incurred pursuant to clauses (ii) through (ix) of **Section 7.2(a)** hereof, (b) incurred as a result of any breach or inaccuracy of the representations or warranties set forth in **Section 2.2** (under the heading "Company Capital Structure"), **Section 2.4** (under the heading "Authority"), **Section 2.11** hereof (under the heading "Tax Matters"), **Section 2.15** hereof (under the heading "Intellectual Property"), **Section 2.22** hereof (under the heading "Employee Benefit Plans and Compensation") or as a result of any breach or inaccuracy of any representations or warranties that are the subject of fraud or intentional misrepresentation and (c) that are Agreed Upon-Losses (as defined in **Section 7.4(f)(v)** hereof).

(iv) For the purposes hereof, "**Officer's Certificate**" shall mean a certificate signed by any officer of Parent: (1) stating that an Indemnified Party has paid, sustained, incurred, or properly accrued, or reasonably anticipates that it will have to pay, sustain, incur, or accrue Losses, and (2) specifying in reasonable detail the individual items of Losses included in the amount so stated (and the method of computation of each such item of Loss, if applicable), the date each such item was paid, sustained, incurred, or properly accrued (in accordance with GAAP), or the basis for such reasonably anticipated Loss(es), and (3) the basis for indemnification under **Section 7.2** to which such item of Loss is related (including, if applicable, the specific nature of the misrepresentation, breach of warranty or covenant to which such item is related).

(v) If the Shareholder Representative does not object in writing within the twenty (20) day period after delivery by the Parent of the Officer's Certificate, such failure to so object shall be an irrevocable acknowledgment by the Shareholder Representative and the Shareholders that the Indemnified Party is entitled to the full amount of the claim for Losses set forth in such Officer's Certificate.

(e) ***Objections to Claims***. For a period of twenty (20) days after delivery of an Officer's Certificate pursuant to **Section 7.4(d)**, Parent shall make no deduction for the Total Holdback Amount pursuant to **Section 7.4(d)** hereof (other than Agreed-Upon Losses as described below) unless Parent shall have received written authorization from the Shareholder Representative to make such deduction. After the expiration of such twenty (20) day period, Parent shall deduct from the Total Holdback Amount an amount equal to the amount of Losses claimed in the Officer's Certificate; provided that no such payment may be made if the Shareholder Representative shall object in a written statement to the claim made in the Officer's Certificate (an "**Objection Notice**"), and such Objection Notice shall have been delivered to the Parent prior to the expiration of such twenty (20) day period. Notwithstanding the foregoing, the Shareholder Representative hereby waives the right to object to any claims against the Total Holdback Amount in respect of any Agreed-Upon Loss. The Shareholder Representative hereby authorizes Parent to pay from the Total Holdback Amount all such amounts equal to the amount of Losses claimed in any Officer's Certificate in respect of any Agreed-Upon Loss upon receipt of such Officer's Certificate without regard to the ten (10) day period set forth in this **Section 7.4(e)**.

(f) ***Resolution of Conflicts; Arbitration***.

(i) In case the Shareholder Representative delivers an Objection Notice in accordance with **Section 7.4(e)** hereof (other than in connection with Agreed-Upon Losses as defined in **Section 7.4(f)(v)** hereof, for which the Shareholder Representative has waived the right to object), the Shareholder Representative and Parent shall attempt in good faith to agree upon the rights of the respective parties with respect to each of such claims. If the Shareholder Representative and Parent should so agree, a memorandum setting forth such agreement shall be prepared and signed by both parties and, in the case of a claim against the Total Holdback Amount, shall be furnished to Parent and the Shareholder Representative. The Parent shall be entitled to rely on any such memorandum and make deductions from the Total Holdback Amount in accordance with the terms thereof.

(ii) If no such agreement can be reached after good faith negotiation and prior to thirty (30) days after delivery of an Objection Notice, either Parent or the Shareholder Representative may demand arbitration of the matter unless the amount of the Loss that is at issue is the subject of a pending litigation with a third party, in which event arbitration shall not be commenced until such amount is ascertained or both parties agree to arbitration, and in either such event the matter shall be settled by arbitration conducted by one arbitrator mutually agreeable to Parent and the Shareholder Representative. In the event that, within thirty (30) days after submission of any dispute to arbitration, Parent and the Shareholder Representative cannot mutually agree on one arbitrator, then, within fifteen (15) days after the end of such thirty (30) day period, Parent and the Shareholder Representative shall each select one arbitrator. The two arbitrators so selected shall select a third arbitrator. If the Shareholder Representative fails to select an arbitrator during this fifteen (15) day period, then the parties agree that the arbitration will be conducted by one arbitrator selected by Parent.

(iii) Any such arbitration shall be held in Santa Clara County, California, under the rules then in effect of the American Arbitration Association. The arbitrator(s) shall determine how all expenses relating to the arbitration shall be paid, including the respective expenses of each party, the fees of each arbitrator and the administrative fee of the American Arbitration Association. The arbitrator or arbitrators, as the case may be, shall set a limited time period and establish procedures designed to reduce the cost and time for discovery while allowing the parties an opportunity, adequate in the sole judgment of the arbitrator or majority of the three arbitrators, as the case may be, to discover relevant information from the opposing parties about the subject matter of the dispute. The arbitrator, or a majority of the three arbitrators, as the case may be, shall rule upon motions to compel or limit discovery and shall have the authority to impose sanctions, including attorneys' fees and costs, to the same extent as a competent court of law or equity, should the arbitrators or a majority of the three arbitrators, as the case may be, determine that discovery was sought without substantial justification or that discovery was refused or objected to without substantial justification. The decision of the arbitrator or a majority of the three arbitrators, as the case may be, as to the validity and amount of any claim in such Officer's Certificate shall be final, binding, and conclusive upon the parties to this Agreement and the Shareholders. Such decision shall be written and shall be supported by written findings of fact and conclusions which shall set forth the award, judgment, decree or order awarded by the arbitrator(s), and the Parent shall be entitled to rely on, and make deductions from the Total Holdback Amount in accordance with, the terms of such award, judgment, decree or order as applicable. Within 30 days of a decision of the arbitrator(s) requiring payment by one party to another, such party shall make the payment to such other party, including any deduction from the Total Holdback Amount, as applicable.

(iv) Judgment upon any award rendered by the arbitrator(s) may be entered in any court having jurisdiction. Except as set forth in **Section 7.4(f)(v)** hereof, the forgoing arbitration provision shall apply to any dispute among the Shareholders or any Indemnifying Party and the Indemnified Parties under this **Article VII** hereof, whether relating to claims upon the Total Holdback Amount or to the other indemnification obligations set forth in this **Article VII** (other than with respect to claims for indemnification outside of the Total Holdback Amount pursued directly against any Shareholder or any other Person as permitted by this **Article VII**).

(v) This **Section 7.4(f)** shall not apply to claims against the Total Holdback Amount made in respect of (A) any Dissenting Share Payments to the extent that such Dissenting Share Payments exceed the consideration that such dissenting Shareholders would have received in the Merger has no Dissenting Share Payment been made, and (B) any Final Assumed Liability Adjustment (each of (A) and (B), an "**Agreed-Upon Loss**"). Claims against the Total Holdback Amount made in respect of any Agreed-Upon Loss shall be resolved in the manner described in **Section 7.4(d)** hereof.

(g) ***Third-Party Claims***. In the event Parent becomes aware of a third party claim or other circumstance (other than a claim or circumstance that is the subject of an Agreed-Upon Loss) (a "**Third Party Claim**") which Parent reasonably believes may result in a demand against the Total Holdback Amount or for other indemnification pursuant to this **Article VII**, Parent shall notify the Shareholder Representative of such claim or circumstance, and the Shareholder Representative shall be entitled on behalf of the Shareholders, at their expense, to participate in, but not to determine or conduct, the defense of such Third Party Claim. Parent shall have the right in its sole discretion to conduct the defense of, and to settle, any such claim; *provided, however*, that except with the consent of the Shareholder Representative, no settlement of any such Third Party Claim with third party claimants shall be determinative of the amount of Losses relating to such matter. In the event that the Shareholder Representative has consented to any such settlement, the Shareholders shall have no power or authority to object under any provision of this **Article VII** to the amount of any Third Party Claim by Parent against the Total Holdback Amount or the Shareholders, with respect to such settlement. If there is a Third Party Claim that, if adversely determined would give rise to a right of recovery for Losses hereunder, then any amounts incurred or accrued by the Indemnified Parties in defense of such Third Party Claim, regardless of the outcome of such claim, shall be deemed Losses hereunder. Notwithstanding anything in this Agreement to the contrary, this **Section 7.4(g)** shall not apply to any Third Party Claim that is the subject of an Agreed-Upon Loss. Claims against the Total Holdback Amount made in respect of any Agreed-Upon Loss shall be resolved in the manner described in **Section 7.4(f)(v)** above.

7.5 ***Shareholder Representative***.

(a) By virtue of the approval of the Merger and this Agreement by the Shareholders, each of the Shareholders shall be deemed to have agreed to appoint David Trescot as its agent and attorney-in-fact, as the Shareholder Representative for and on behalf of the Shareholders to give and receive notices and communications, to agree to the adjustment (if any) of the Aggregate Common Stock Consideration Amount pursuant to the terms of **Section 1.6(d)** hereof, to authorize deductions from the Total Holdback Amount in satisfaction of claims by any Indemnified Party, to object to the foregoing adjustments or payments, to agree to, negotiate, enter into settlements and compromises of, and demand arbitration and comply with orders of courts and awards of arbitrators with respect to such claims, to assert, negotiate, enter into settlements and compromises of, and demand arbitration and comply with orders of courts and awards of arbitrators with respect to, any other claim by any Indemnified Party against any Shareholder or by any such Shareholder against any Indemnified Party, any dispute between any Indemnified Party and any such Shareholder, any dispute relating to the Company Assumed Liabilities Report, in each case relating to this

Agreement or the transactions contemplated hereby, and to take all other actions that are either (i) necessary or appropriate in the judgment of the Shareholder Representative for the accomplishment of the foregoing or (ii) specifically mandated by the terms of this Agreement. Such agency may be changed by the Shareholders from time to time upon not less than thirty (30) days prior written notice to Parent; *provided, however*, that the Shareholder Representative may not be removed unless holders of a two-thirds interest of the Total Holdback Amount agree to such removal and to the identity of the substituted agent. Notwithstanding the foregoing, a vacancy in the position of Shareholder Representative may be filled by the holders of a majority in interest of the Total Holdback Amount. No bond shall be required of the Shareholder Representative, and the Shareholder Representative shall not receive any compensation for its services. Notices or communications to or from the Shareholder Representative shall constitute notice to or from the Shareholders.

(b) The Shareholder Representative shall not be liable for any act done or omitted hereunder as Shareholder Representative while acting in good faith and in the exercise of reasonable judgment. The Shareholders shall indemnify the Shareholder Representative and hold the Shareholder Representative harmless against any loss, liability or expense incurred without gross negligence or bad faith on the part of the Shareholder Representative and arising out of or in connection with the acceptance or administration of the Shareholder Representative's duties hereunder, including the reasonable fees and expenses of any legal counsel retained by the Shareholder Representative ("**Shareholder Representative Expenses**"). Following the Holdback Distribution Date, the resolution of all Unresolved Claims and the satisfaction of all claims made by Indemnified Parties for Losses, the Shareholder Representative shall have the right to recover Shareholder Representative Expenses from the Total Holdback Amount prior to any distribution to the Shareholders, and prior to any such distribution, shall deliver to Parent a certificate setting forth the Shareholder Representative Expenses actually incurred and amount in cash to be distributed as satisfaction of such expenses. A decision, act, consent or instruction of the Shareholder Representative, including an amendment, extension or waiver of this Agreement pursuant to **Section 8.3** and **Section 8.5** hereof, shall constitute a decision of the Shareholders and shall be final, binding and conclusive upon the Shareholders; and Parent may rely upon any such decision, act, consent or instruction of the Shareholder Representative as being the decision, act, consent or instruction of the Shareholders. The Parent are hereby relieved from any liability to any person for any acts done by them in accordance with such decision, act, consent or instruction of the Shareholder Representative.

(c) Notwithstanding anything in this Agreement to the contrary, the Shareholder Representative shall have no authority to act on behalf of any Shareholder in connection with any claim by an Indemnified Party seeking recovery for any Losses outside of the Total Holdback Amount.

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

8.1 ***Termination***. Subject to **Section 8.2** hereof, this Agreement may be terminated and the Merger abandoned at any time prior to the Closing:

(a) by mutual agreement of the Company and Parent;

(b) by Parent or the Company if the Closing Date shall not have occurred by forty-five (45) days following the date of this Agreement; *provided, however*, that the right to terminate this Agreement under this **Section 8.1(b)** shall not be available to any party whose action or failure to act has been a principal cause of or resulted in the failure of the Merger to occur on or before such date and such action or failure to

act constitutes breach of this Agreement; provided, further, that if the failure to consummate the Merger by the Termination Date is wholly or in part caused by a delay in (i) any consents, waivers, approvals, orders, authorizations, registrations, declarations and filings as may be required under foreign merger control regulations, or (ii) any consents, notices, waivers, approvals, orders, authorizations, registrations, declarations and filings, and applicable waiting periods, as may be required under applicable blue sky laws, the Termination Date shall be automatically extended, without any action on the part of the parties, on a day-for-day basis by the amount of time necessary to satisfy (i) through (v), as applicable, which extension shall in no event exceed sixty (60) days;

(c) by Parent if any Governmental Entity shall have enacted, issued, promulgated, enforced or entered any statute, rule, regulation, executive order, decree, injunction, order or other legal restraint which is in effect and which has the effect of making the Merger illegal;

(d) by Parent if there shall be any action taken, or any statute, rule, regulation or order enacted, promulgated or issued or deemed applicable to the Merger by any Governmental Entity, which would constitute an Action of Divestiture;

(e) by Parent if it is not in material breach of its obligations under this Agreement and there has been a breach of any representation, warranty, covenant or agreement of the Company contained in this Agreement such that the conditions set forth in **Section 6.2(a)** hereof would not be satisfied and such breach has not been cured within ten (10) calendar days after written notice thereof to the Company; *provided, however*, that no cure period shall be required for a breach which by its nature cannot be cured; or

(f) by the Company if none of the Company or any of its Subsidiaries is in material breach of their respective obligations under this Agreement and there has been a breach of any representation, warranty, covenant or agreement of Parent contained in this Agreement such that the conditions set forth in **Section 6.3(a)** hereof would not be satisfied and such breach has not been cured within ten (10) calendar days after written notice thereof to Parent; *provided, however*, that no cure period shall be required for a breach which by its nature cannot be cured.

8.2 ***Effect of Termination***. In the event of termination of this Agreement as provided in **Section 8.1** hereof, this Agreement shall forthwith become void and there shall be no liability or obligation on the part of Parent, the Company, or its respective officers, directors or Shareholders, if applicable; *provided*, *however*, that each party hereto and each Person shall remain liable for any breaches of this Agreement or in any certificate or other instruments delivered pursuant to this Agreement prior to its termination; and *provided further*, *however*, that the provisions of **Sections 5.2**, **5.3**, **5.15**, **7.3(c)** and **8.3** hereof, **Article IX** hereof and this **Section 8.2** shall remain in full force and effect and survive any termination of this Agreement pursuant to the terms of this **Article VIII**.

8.3 ***Fees and Expenses***. Except as set forth in this **Section 8.3**, all fees and expenses incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such expenses whether or not the Merger is consummated; *provided*, *however*, that Parent and the Company shall share equally the filing fee for the Notification and Report Forms filed with the FTC and DOJ under the HSR Act, and all premerger notification and reports forms under similar applicable laws of other jurisdictions.

8.4 ***Amendment***. This Agreement may be amended by the parties hereto at any time by execution of an instrument in writing signed on behalf of the party against whom enforcement is sought. For

purposes of this **Section 8.4**, the Shareholders agree that any amendment of this Agreement signed by the Shareholder Representative shall be binding upon and effective against the Shareholders whether or not they have signed such amendment.

8.5 ***Extension; Waiver***. At any time prior to the Closing, Parent, on the one hand, and the Company and the Shareholder Representative, on the other hand, may, to the extent legally allowed, (i) extend the time for the performance of any of the obligations of the other party hereto, (ii) waive any inaccuracies in the representations and warranties made to such party contained herein or in any document delivered pursuant hereto, and (iii) waive compliance with any of the covenants, agreements or conditions for the benefit of such party contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in an instrument in writing signed on behalf of such party. For purposes of this **Section 8.5**, the Shareholders agree that any extension or waiver signed by the Shareholder Representative shall be binding upon and effective against all Shareholders whether or not they have signed such extension or waiver.

ARTICLE IX

GENERAL PROVISIONS

9.1 ***Notices***. All notices and other communications hereunder shall be in writing and shall be deemed given if delivered personally or by commercial messenger or courier service, or mailed by registered or certified mail (return receipt requested) or sent via facsimile (with acknowledgment of complete transmission) to the parties at the following addresses (or at such other address for a party as shall be specified by like notice or, if specifically provided for elsewhere in this Agreement such as **Section 4.3**, by email); *provided*, *however*, that notices sent by mail will not be deemed given until received:

(a) if to Parent or Sub, to:

Harmonic, Inc.
549 Baltic Way
Sunnyvale, CA 94089
Attn: Robin N. Dickson
Telephone: (408) 542-2661
Facsimile: (408) 542-2516

with a copy to:

Wilson Sonsini Goodrich & Rosati
Professional Corporation
650 Page Mill Road
Palo Alto, CA 94304
Attention: Jeffey D. Saper, Esq.
Robert G. Day, Esq.
Telephone No.: (650) 493-9300
Facsimile No.: (650) 493-6811

(b) if to the Company or the Shareholder Representative, to:

David Trescot
751 Live Oak Drive
Menlo Park, CA 94025
Attention: David Trescot
Facsimile No.: (408) 432-3334

with a copy to:

Teraoka & Partners LLP
One Embarcadero Center Suite 1020
San Francisco, CA 94111
Attention: Catherine M. Gormley
Facsimile No.: (415) 981-0222

9.2 ***Interpretation***. The words "include," "includes" and "including" when used herein shall be deemed in each case to be followed by the words "without limitation." The table of contents and headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

9.3 ***Counterparts***. This Agreement may be executed in one or more counterparts, all of which shall be considered one and the same agreement and shall become effective when one or more counterparts have been signed by each of the parties and delivered to the other party, it being understood that all parties need not sign the same counterpart.

9.4 ***Entire Agreement; Assignment***. This Agreement, the Exhibits hereto, the Disclosure Schedule, the Nondisclosure Agreement, and the documents and instruments and other agreements among the parties hereto referenced herein: (i) constitute the entire agreement among the parties with respect to the subject matter hereof and supersede all prior agreements and understandings both written and oral, among the parties with respect to the subject matter hereof; (ii) are not intended to confer upon any other person any rights or remedies hereunder; and (iii) shall not be assigned by operation of law or otherwise, except that Parent may assign its rights and delegate its obligations hereunder to its affiliates as long as Parent remains ultimately liable for all of Parent's obligations hereunder. For the avoidance of doubt, the Term Sheet shall be deemed terminated as of the date hereof, and all provisions thereof, including any provisions thereof which by their terms state that they shall survive the termination of the Term Sheet, shall be of no further force and effect.

9.5 ***Severability***. In the event that any provision of this Agreement or the application thereof becomes or is declared by a court of competent jurisdiction to be illegal, void or unenforceable, the remainder of this Agreement will continue in full force and effect and the application of such provision to other persons or circumstances will be interpreted so as reasonably to effect the intent of the parties hereto. The parties further agree to replace such void or unenforceable provision of this Agreement with a valid and enforceable provision that will achieve, to the extent possible, the economic, business and other purposes of such void or unenforceable provision.

9.6 ***Other Remedies***. Except as otherwise expressly set forth herein, any and all remedies herein expressly conferred upon a party will be deemed cumulative with and not exclusive of any other remedy

conferred hereby, or by law or equity upon such party, and the exercise by a party of any one remedy will not preclude the exercise of any other remedy.

9.7 ***Governing Law; Exclusive Jurisdiction***. This Agreement shall be governed by and construed in accordance with the laws of the State of California, regardless of the laws that might otherwise govern under applicable principles of conflicts of laws thereof. Subject to **Section 7.4(f)** hereof, each of the parties hereto irrevocably consents to the exclusive jurisdiction and venue of any court within Santa Clara County, State of California, in connection with any matter based upon or arising out of this Agreement or the matters contemplated herein, agrees that process may be served upon them in any manner authorized by the laws of the State of California for such persons and waives and covenants not to assert or plead any objection which they might otherwise have to such jurisdiction, venue and such process. Subject to **Section 7.4(f)** hereof, each party agrees not to commence any legal proceedings related hereto except in such courts.

9.8 ***Rules of Construction***. The parties hereto agree that they have been represented by counsel during the negotiation and execution of this Agreement and, therefore, waive the application of any law, regulation, holding or rule of construction providing that ambiguities in an agreement or other document will be construed against the party drafting such agreement or document.

9.9 ***Waiver of Jury Trial***. EACH OF THE PARTIES HERETO HEREBY IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY AND ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT, OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE ACTIONS OF ANY PARTY HERETO IN NEGOTIATION, ADMINISTRATION, PERFORMANCE OR ENFORCEMENT HEREOF.

[remainder of page intentionally left blank]

IN WITNESS WHEREOF, Parent, Sub, the Company, and the Shareholder Representative have caused this Agreement to be signed, all as of the date first written above.

HARMONIC INC.

By: /s/ Robin Dickson
Name: Robin Dickson
Title: Chief Financial Officer

RHOZET CORPORATION

By: /s/ David Trescot
Name: David Trescot
Title: Chief Executive Officer

DUSSELDORF ACQUISITION CORPORATION

By: /s/ Patrick Harshman
Name: Patrick Harshman
Title: President

SHAREHOLDER REPRESENTATIVE

/s/ David Trescot
DAVID TRESCOT

Exhibit 31.1

Harmonic Inc.
Certification of Principal Executive Officer
Pursuant to Section 302 of
The Sarbanes-Oxley Act of 2002

I, Patrick J. Harshman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harmonic Inc.:
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2007

By: /s/Patrick J. Harshman
Patrick J. Harshman
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

Harmonic Inc.
Certification of Principal Financial Officer
Pursuant to Section 302 of
The Sarbanes-Oxley Act of 2002

I, Robin N. Dickson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harmonic Inc.:

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 3, 2007

By: /s/Robin N. Dickson
Robin N. Dickson
Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

Harmonic Inc.
Certification of Principal Executive Officer
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

As of the date hereof, I, Patrick J. Harshman, President and Chief Executive Officer of Harmonic Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the quarterly report of the Company on Form 10-Q for the quarter ended June 29, 2007, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company. This written statement is being furnished to the Securities and Exchange Commission as an exhibit accompanying such Report and shall not be deemed filed pursuant to the Securities Exchange Act of 1934, as amended.

Date: August 3, 2007

/s/ Patrick J. Harshman

Patrick J. Harshman
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

Harmonic Inc.
Certification of Principal Financial Officer
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

As of the date hereof, I, Robin N. Dickson, Chief Financial Officer of Harmonic Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the quarterly report of the Company on Form 10-Q for the quarter ended June 29, 2007, as filed with the Securities and Exchange Commission (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended and that information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company. This written statement is being furnished to the Securities and Exchange Commission as an exhibit accompanying such Report and shall not be deemed filed pursuant to the Securities Exchange Act of 1934, as amended.

Date: August 3, 2007

/s/ Robin N. Dickson
Robin N. Dickson
Chief Financial Officer
(Principal Financial Officer)