UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended March 29, 2002

OR

[ ] Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from __________ to __________

Commission File No. 0-25826

HARMONIC INC.

(formerly Harmonic Lightwaves, Inc.)

(Exact name of Registrant as specified in its charter)

Delaware	**77-0201147**
(State of incorporation)	(I.R.S. Employer Identification No.)

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 [X] No [ ]

As of April 26, 2002 there were 59,546,961 shares of the Registrant’s Common Stock outstanding.

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SIGNATURE

HARMONIC INC.

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PART I — FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

HARMONIC INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PAR VALUE AMOUNTS)

	MARCH 29, 2002	DECEMBER 31, 2001
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 37,274	$ 36,005
Short-term investments	14,678	18,272
Accounts receivable, net	45,602	34,402
Inventories	26,126	30,944
Deferred income taxes	7,019	9,065
Prepaid expenses and other assets	7,049	9,775
Total current assets	137,748	138,463
Property and equipment, net	42,073	45,755
Goodwill, intangibles and other assets	47,942	53,838
	$ 227,763	$ 238,056
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 1,424	$ 1,281
Accounts payable	10,629	10,296
Income taxes payable	6,064	2,804
Accrued liabilities	57,905	57,474
Total current liabilities	76,022	71,855
Long-term debt, less current portion	1,385	1,465
Deferred income taxes	7,019	9,065
Accrued excess facility costs	18,619	19,563
Other non-current liabilities	1,196	1,054
Total liabilities	104,241	103,002
Stockholders’ equity:		
Preferred stock, $.001 par value, 5,000 shares authorized; no shares issued or outstanding	—	—
Common Stock, $.001 par value, 150,000 shares authorized; 59,492 and 59,063 shares issued and outstanding	59	59
Capital in excess of par value	1,961,539	1,959,043
Accumulated deficit	(1,838,219)	(1,824,207)
Accumulated other comprehensive income	143	159
Total stockholders’ equity	123,522	135,054
	$ 227,763	$ 238,056

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

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HARMONIC INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED	
	MARCH 29, 2002	MARCH 30, 2001
Net sales	$ 54,032	$ 40,274
Cost of sales	38,269	51,034
Gross profit (loss)	15,763	(10,760)
Operating expenses:		
Research and development	11,119	15,502
Selling, general and administrative	15,321	21,682
Amortization of intangibles	2,828	3,096
Total operating expenses	29,268	40,280
Loss from operations	(13,505)	(51,040)
Interest and other income (expense), net	(7)	1,556
Loss before income taxes	(13,512)	(49,484)
Provision for (benefit from) income taxes	500	(819)
Net loss	$ (14,012)	$ (48,665)
Net loss per share Basic and Diluted	$ (0.24)	$ (0.84)
Weighted average shares Basic and Diluted	59,476	58,161

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

HARMONIC INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(UNAUDITED)

	THREE MONTHS ENDED	
	MARCH 29, 2002	MARCH 30, 2001
Cash flows from operating activities:		
Net loss	$ (14,012)	$ (48,665)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:		
Amortization of intangibles	5,850	5,109
Depreciation	4,172	4,237
Impairment and loss on disposal of fixed assets	624	1,432
Deferred income taxes	155	(1,319)
Changes in assets and liabilities:		
Accounts receivable	(11,201)	26,502
Inventories	4,817	16,167
Prepaid expenses and other assets	2,620	2,440
Accounts payable	333	(6,032)
Income taxes payable	3,267	7,802
Accrued excess facility costs	(943)	—
Accrued and other liabilities	573	7,630
Net cash provided by (used in) operating activities	(3,745)	15,303
Cash flows from investing activities:		
Acquisition of property and equipment	(1,114)	(16,682)
Proceeds from sale of investments	5,803	66,893
Purchases of investments	(2,232)	(38,386)
Net cash provided by investing activities	2,457	11,825
Cash flows from financing activities:		
Borrowings under bank line of credit	346	—
Repayments under bank line of credit	(283)	—
Proceeds from issuance of common stock, net	2,496	1,862
Net cash provided by financing activities	2,559	1,862
Effect of exchange rate changes on cash and cash equivalents	(2)	(169)
Net increase in cash and cash equivalents	1,269	28,821
Cash and cash equivalents at beginning of period	36,005	13,505
Cash and cash equivalents at end of period	$ 37,274	$ 42,326
Supplemental disclosure of cash flow information:		
Interest expense	$ 87	$ —
Income tax refunds, net	$ (3,046)	$ (20,472)

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

HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 — BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. (the “Company”) considers necessary for a fair presentation of the results of operations for the unaudited interim periods covered and the consolidated financial condition of the Company at the date of the balance sheets. The quarterly financial information is unaudited. 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 18, 2002. 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, 2002, 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.

NOTE 2 — NEW ACCOUNTING PRONOUNCEMENTS

On January 1, 2002, the Company adopted SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”, which addresses financial accounting and reporting for the impairment or disposal of long-lived assets. This Statement supersedes SFAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of”, and the accounting and reporting provisions of APB Opinion No. 30, “Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions” for the disposal of a segment of a business. The adoption of SFAS No. 144 had no effect on the Company’s results of operations or its financial position.

NOTE 3 — CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents are comprised of highly liquid investment-grade investments with original maturities of three months or less at the date of purchase. Investments are comprised of state, municipal and county obligations and corporate debt securities with lives ranging from three months to two years. The Company classifies its investments as available for sale in accordance with SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” and states its investments at estimated fair value, with material unrealized gains and losses reported in other comprehensive income. The specific identification method is used to determine the cost of securities disposed of, with realized gains and losses reflected in other income and expense. Investments are anticipated to be used for current operations and are, therefore, classified as current assets, even though maturities may extend beyond one year. At March 29, 2002 all short-term investments mature in less than one year. At December 31, 2001, short-term investments of $0.5 million had maturities greater than one year.

NOTE 4 — DERIVATIVE FINANCIAL INSTRUMENTS

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The Company enters into foreign currency forward exchange contracts (“forward contracts”) to manage exposure related to accounts receivable denominated in foreign currencies. The Company does not enter into derivative financial instruments for trading purposes. The Company had outstanding forward contracts totaling approximately $0.5 million at March 29, 2002. The open contracts mature at various dates through May 22, 2002 and hedge certain foreign currency transaction exposures in the British Pound Sterling and the Euro. The unrealized gains and losses on the forward contracts at March 29, 2002 were negligible.

NOTE 5 — INVENTORIES

In Thousands	MARCH 29, 2002	DECEMBER 31, 2001
	(Unaudited)	
Raw materials	$ 14,490	$ 12,302
Work-in-process	2,813	3,920
Finished goods	8,823	14,722
	$ 26,126	$ 30,944

NOTE 6 — GOODWILL AND OTHER INTANGIBLES

As of January 1, 2002, Harmonic adopted SFAS No. 142, “Goodwill and Other Intangible Assets”, which requires, among other things, that goodwill and intangible assets with indefinite useful lives no longer be amortized. In addition, the standard includes provisions for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, and the testing for impairment of existing goodwill and other intangibles at least annually. In accordance with this statement, the Company reassessed the classification of its goodwill and intangible assets, and reclassified $0.2 million of assembled workforce, net of accumulated amortization and tax effects, to goodwill. As of January 1, 2002, the Company ceased the amortization of goodwill.

The Company has two operating segments, Broadband Access Networks, or BAN, and Convergent Systems, or CS. Management believes these operating segments represent the Company’s reporting units for purposes of applying SFAS No. 142. CS is the only reporting unit with goodwill and intangible assets. During the quarter ended March 29, 2002, the Company performed the transitional goodwill impairment test for the CS reporting unit. The fair value of CS, which was based on the operation’s future discounted cash flows, exceeded its carrying amount, including goodwill, and therefore, the goodwill was determined not to be impaired.

The following is a summary of reported net loss and loss per share as adjusted to exclude amortization of goodwill and assembled workforce for the three month periods ended March 29, 2002 and March 30, 2001:

	THREE MONTHS ENDED	
In Thousands (Unaudited)	MARCH 29, 2002	MARCH 30, 2001
Reported net loss	$ (14,012)	$ (48,665)
Goodwill amortization	—	187
Assembled workforce amortization	—	463
Adjusted net loss	$ (14,012)	$ (48,015)
Basic and diluted net loss per share:		
Reported net loss	$ (0.24)	$ (0.84)
Goodwill amortization	—	—
Assembled workforce amortization	—	.01

In Thousands (Unaudited)	THREE MONTHS ENDED MARCH 29, 2002	THREE MONTHS ENDED MARCH 30, 2001
Adjusted net loss per share	$ (0.24)	$ (0.83)

The following is a summary of goodwill and intangible assets as of March 29, 2002 and December 31, 2001:

In Thousands	MARCH 29, 2002 (Unaudited)			DECEMBER 31, 2001		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Identified intangibles:						
Developed core technology	$ 29,059	$ (10,638)	$ 18,421	$ 29,059	$ (7,849)	$ 21,210
Customer base	33,295	(11,260)	22,035	33,295	(8,738)	24,557
Trademark and tradename	4,076	(1,374)	2,702	4,076	(1,068)	3,008
Assembled workforce	—	—	—	2,285	(1,907)	378
Supply agreement	3,107	(1,048)	2,059	3,107	(815)	2,292
Subtotal of identified intangibles	69,537	(24,320)	45,217	71,822	(20,377)	51,445
Goodwill:						
Goodwill	2,225	(668)	1,557	2,225	(668)	1,557
Assembled workforce reclassified	2,130	(1,907)	223	—	—	—
Subtotal of goodwill	4,355	(2,575)	1,780	2,225	(668)	1,557
Total goodwill and other intangibles	$ 73,892	$ (26,895)	$ 46,997	$ 74,047	$ (21,045)	$ 53,002

NOTE 7 — CREDIT FACILITIES AND LONG-TERM DEBT

Harmonic has a bank line of credit facility, which provides for borrowings up to $10.0 million with a $6.0 million secured equipment term loan sub-limit. The facility, which is available until April 2003, contains certain financial and other covenants, with which Harmonic was in compliance at March 29, 2002. Borrowings pursuant to the line bear interest at the bank's prime rate (prime rate plus 2.0% — 3.0% under the equipment term loan), are payable monthly, and are secured by Harmonic's assets. As of March 29, 2002, the Company had outstanding borrowings of $2.8 million under its equipment term loan, of which $0.3 million was borrowed during the first quarter of 2002. The term loan bears interest at 7.75% to 10.0% annually on outstanding borrowings which mature at various dates through September 2004. Harmonic also has a bank facility, which provides for the sale of trade receivables on a non-recourse basis up to $12.5 million and expires in April 2003. Trade receivables sold under the facility are discounted based on the bank's prime rate plus 1.5% for North American customers and 2.0% for all other customers. At March 29, 2002, and December 31, 2001, $12.5 million and $5.7 million, respectively, were available under the trade receivable facility.

NOTE 8 — NET LOSS PER SHARE

The basic net loss per share is computed by dividing the net loss attributable to common stockholders for the period by the weighted average number of common shares outstanding during the period. The diluted net loss per share is the same as the basic net loss per share for the three months ended March 29, 2002 and March 30, 2001 because common shares issuable upon the exercise of stock options are only considered when their effect would be dilutive. During the three month periods ended March 29, 2002 and March 30, 2001, 4.3 million and 7.6 million of weighted average options, respectively, were excluded from the net loss per share computations because their effect was antidilutive.

NOTE 9 — EMPLOYEE STOCK PURCHASE PLAN

Harmonic believes that it had insufficient shares reserved for issuance under its 1995 Employee Stock Purchase Plan (the "1995 ESPP") to cover all forecasted purchases under offering periods that have commenced and which continue through June 2003. In March 2002, the Harmonic board of directors adopted the 2002

Employee Stock Purchase Plan (the “2002 ESPP”), subject to stockholder approval, which is intended to replace the 1995 ESPP. If the 2002 ESPP is approved by stockholders, the 1995 ESPP will be terminated on or before July 1, 2002. The board of directors adopted the 2002 ESPP because the approval of additional shares for the 1995 ESPP could have resulted in future non-cash compensation charges which, depending on the future market price per share of the Company’s common stock, could have been significant.

NOTE 10 — COMPREHENSIVE LOSS

The Company’s total comprehensive loss was as follows:

In Thousands (Unaudited)	THREE MONTHS ENDED MARCH 29, 2002	THREE MONTHS ENDED MARCH 30, 2001
Net loss	$ (14,012)	$ (48,665)
Change in unrealized loss on investments, net	(14)	(111)
Foreign currency translation	(2)	(169)
Total comprehensive loss	$ (14,028)	$ (48,945)

NOTE 11 — RESTRUCTURING AND EXCESS FACILITIES

In response to a significant reduction in customer capital spending, principally weak cable spending on transmission upgrades, and the resulting adverse impact on Harmonic’s operating results, the Company implemented a series of cost control measures to improve operating efficiencies during 2001. These measures included a plan to exit additional excess facilities and to consolidate operations, principally on Harmonic’s Sunnyvale, California campus. In 2001, a total excess facilities charge of $30.1 million was recorded to operating expenses for facilities that Harmonic does not intend to occupy, has exited or plans to exit in 2002 and does not expect to reoccupy.

As of March 29, 2002, accrued excess facility costs totaled $21.9 million. The cash outlay in the first quarter of 2002 was $0.9 million, net of sublease income. The Company anticipates a cash outlay of approximately $3.0 million for the remainder of 2002, net of estimated sublease income, and to pay the remaining $18.9 million, net of estimated sublease income, over the next nine years. Harmonic reassesses this liability on a quarterly basis based on changes in the timing and amounts of expected sublease rental income.

NOTE 12 — SEGMENT REPORTING

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. Harmonic is organized as two operating segments, Broadband Access Networks, or BAN, for fiber optic systems, and Convergent Systems, or CS, for digital headend systems. Each of these operating segments require their own development and marketing strategies and therefore have separate management teams, with a worldwide sales and professional services and systems support organization supporting both divisions.

The results of the reportable segments are derived directly from the Company’s management reporting system. These results reported below are based on Harmonic’s method of internal reporting and are not necessarily in conformity with generally accepted accounting principles. Management measures performance of each segment

based on several metrics, including revenue, and income or loss from operations. These results are used, in part, to evaluate the performance of, and allocate resources to each of the segments. Net income or loss, and assets and liabilities are not internally reported by business segment.

In Thousands (Unaudited)	THREE MONTHS ENDED MARCH 29, 2002	THREE MONTHS ENDED MARCH 30, 2001
Net sales:		
Broadband Access Networks	$ 21,812	$ 18,805
Convergent Systems	32,220	21,469
Total net sales	$ 54,032	$ 40,274
Loss from segment operations:		
Broadband Access Networks	$ (941)	$ (22,775)
Convergent Systems	(2,962)	(17,284)
Loss from segment operations	(3,903)	(40,059)
Amortization of goodwill and other intangibles	(5,850)	(5,109)
Interest and other income (expense), net	(7)	1,556
Corporate and unallocated costs, and eliminations	(3,752)	(5,872)
Loss before income taxes	$ (13,512)	$ (49,484)

NOTE 13 — LEGAL PROCEEDINGS

Securities Litigation

On May 3, 2000 Harmonic completed the acquisition of C-Cube Microsystems, Inc., or C-Cube, for approximately $1.8 billion in common stock. Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its current and former officers and directors were filed in or removed to the United States 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 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 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 by filing a false or misleading registration statement, prospectus, and joint proxy in connection with the C-Cube acquisition.

On July 3, 2001, the 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. Pursuant to the Court's July 3, 2001 order, no hearing on the motions will be held unless the Court sets one.

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 actions 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 have been stayed pending resolution of the motions to dismiss the securities actions. At an April 5, 2002 case management conference, the court continued the conference until June 7, 2002. The court stated that the parties need not appear if no decision on the motions to dismiss the securities action had been issued by that date.

Based on its review of the complaints filed in the securities class action, Harmonic believes that it has meritorious defenses and intends to defend itself vigorously. There can be no assurance, however, that Harmonic will prevail. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position and liquidity.

In November 2001, Harmonic was sued in Tennessee state court by a company alleging breach of contract and breach of a Tennessee statute relating to retailers and suppliers. The suit has a claim for $2.5 million and other unspecified damages, lost profits and attorneys' fees. The suit has since been removed to Federal Court and a trial date has been set for June 2003. Harmonic believes that it has meritorious defenses and will defend the suit vigorously. However, Harmonic cannot assure you that an unfavorable outcome will not adversely impact its business, operating results, financial position and liquidity.

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 and Section 21E of the Securities Exchange Act of 1934, including statements regarding future results, future revenue, gross margins and profits, and expense levels, future capital expenditures, future cash flows, future interest income, future tax provisions, future borrowing capability and future liquidity. Actual results could differ materially from those projected in the forward-looking statements as a result of a number of factors, including those set forth under "Factors That May Affect Future Results of Operations" below and elsewhere in this Form 10-Q.

Overview

Harmonic designs, manufactures and sells a variety of broadband solutions that allow communications service providers around the world to deliver video, voice and data to their subscribers. Harmonic's technically advanced fiber optic, digital video and data delivery systems enable network operators to provide a range of interactive and advanced digital services that include digital video, high-speed Internet access, telephony, HDTV, video and audio streaming, and video-on-demand.

Historically, almost all of our sales were derived directly or indirectly from sales of fiber optic transmission systems to cable television operators. With the introduction of digital headend products beginning in 1997, we have broadened our product offering to enable delivery of digital video, voice and data over satellite and wireless networks and cable systems.

In order to further expand our digital systems capability, Harmonic completed its merger with C-Cube Microsystems Inc. in May 2000, pursuant to the terms of a merger agreement dated October 27, 1999. Under the terms of the merger agreement, C-Cube spun off its semiconductor business as a separate publicly traded company, which was subsequently acquired by LSI Logic in June 2001. C-Cube merged into Harmonic and Harmonic therefore acquired C-Cube's DiviCom business, which provides MPEG-2 encoding products and systems for digital television.

The merger closed on May 3, 2000, and Harmonic has consolidated the results of the DiviCom business in its financial statements from that date forward. The merged company has been organized into two operating divisions, Broadband Access Networks, or BAN, for fiber optic systems and Convergent Systems, or CS, for digital headend systems. While the two divisions have been organized generally around the pre-merger Harmonic fiber optics systems and the DiviCom digital headend systems, respectively, these divisions do not correspond to the pre-merger companies in significant ways. For example, some of Harmonic's product lines are now part of the CS division.

Harmonic's net sales increased 34% in the first quarter of 2002 compared to the first quarter of 2001 reflecting increased sales in each division. CS division sales increased 50% in the first quarter of 2002 compared to the first quarter of 2001 principally due to sales of new next-generation digital products including the MV50 encoder and Narrowcast Services Gateway, or NSG, which commenced volume shipment in the second quarter of 2001. BAN

division sales increased 16% in the first quarter of 2002 compared to the first quarter of 2001 due to higher spending on network upgrades by certain domestic cable operators.

While sales increased significantly in the first quarter of 2002, sales remain below levels achieved by Harmonic and DiviCom in 1999 and early 2000 as industry capital spending generally remains weak, particularly for BAN products. BAN division sales have decreased significantly from the third quarter of 2000 and were 57% lower in 2001 than in 2000. This was due to weak cable industry spending on transmission upgrades, particularly reduced spending by AT&T Broadband and RCN. These two customers accounted for a total of 23% of sales in 2000 compared to a combined total of less than 5% of sales in 2001 and the first quarter of 2002. CS division sales from the second quarter of 2000 through the first quarter of 2001, consisting principally of DiviCom products, were below DiviCom's sales levels in 1999 and the first quarter of 2000. The lower CS sales were attributable principally to reduced spending by satellite operators.

In order to reduce operating losses, Harmonic implemented a series of measures to control costs and improve operating efficiencies during 2001 including a 30% reduction in our work force. The operating results in 2001 included charges of $75.6 million, consisting of $39.2 million for excess and obsolete inventories, $30.1 million for excess facility costs, $3.3 million for fixed asset impairment, and $3.0 million for severance and other costs. Harmonic expects to report a loss, excluding amortization of intangibles, at least through the second quarter of 2002 due to challenging market conditions and uncertainty of the capital spending plans of our customers, particularly domestic satellite and certain European customers.

The provisions for excess and obsolete inventories resulted from significant reductions in the demand for our products, principally BAN division products; in accordance with our policy we established provisions for inventory levels in excess of our demand forecasts. We recorded excess facility charges for facilities that we no longer occupy, do not intend to occupy, or will vacate during 2002. We plan to sublease these facilities and have estimated the associated loss based on the expected timing and amount of sublease income.

Due to lower than expected sales during each quarter from the second quarter of 2000 through the first quarter of 2001, Harmonic failed to meet the expectations of securities analysts, and the price of our common stock declined significantly. See "Factors That May Affect Our Future Operations — 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."

Results of Operations

Net Sales

Harmonic's net sales increased 34% from $40.3 million in the first quarter of 2001 to $54.0 million in the first quarter of 2002. The increase reflected higher sales in each division. CS division sales increased 50% in the first quarter of 2002 compared to the first quarter of 2001 principally due to sales of new next-generation digital products including the MV50 encoder and Narrowcast Services Gateway, or NSG, which commenced volume shipment in the second quarter of 2001. BAN division sales increased 16% in the first quarter of 2002 compared to the first quarter of 2001 due to higher spending on network upgrades by certain domestic cable operators. Harmonic's domestic sales represented 69% of net sales for the first quarter of 2002 compared to 44% for the first quarter of 2001 and 60% for all of 2001. The higher percentage of domestic sales in the first quarter of 2002 compared to the first quarter of 2001 was due to shipments of the new digital products being concentrated in the United States, increased purchases of BAN products by domestic operators and generally weaker business conditions outside of the United States than a year ago.

Gross Profit

Gross profit increased from a gross loss of $10.8 million (-27% of net sales) in the first quarter of 2001 to a gross profit of $15.8 million (29% of net sales) in the first quarter of 2002. The increase in gross profit was primarily due to increased sales and associated higher fixed cost absorption as a result of higher production levels. In addition, approximately $19 million of the increase in gross profit was attributable to the recording of inventory provisions in the first quarter of 2001, of which approximately $11 million related to streamlining of product lines and reducing the number of products with low margins or volumes. Gross margins, excluding special charges and amortization of intangibles, increased from 8% in the first quarter of 2001 to 35% in the first quarter of 2002, and have increased sequentially over the past four quarters.

Harmonic believes that further improvements in gross margins will depend upon higher sales volumes or the possible sale of excess and obsolete inventories for which the cost basis was previously written down.

Research and Development

Research and development expenses decreased from $15.5 million (38% of net sales) in the first quarter of 2001 to $11.1 million (21% of net sales) in the first quarter of 2002. The decreases were primarily due to a reduction in headcount associated with the cost control measures which were implemented in 2001. The decrease in research and development as a percentage of sales was also attributable to increased net sales. Harmonic anticipates that research and development expenses will not change significantly in absolute dollars in 2002, although they may vary as a percentage of net sales.

Selling, General and Administrative

Selling, general and administrative expenses decreased from $21.7 million (54% of net sales) in the first quarter of 2001 to $15.3 million (28% of net sales) in the first quarter of 2002. The decreases were primarily due to a reduction in headcount associated with the 2001 work force reductions and lower promotional expenses. The decrease in selling, general and administrative expenses as a percentage of sales was also attributable to increased net sales. Harmonic anticipates that selling, general and administrative expenses will not change significantly in absolute dollars in 2002, although they may vary as a percentage of net sales.

Goodwill and Other Intangibles

During the first quarter of 2001, the Company recorded $3.1 million of amortization expense related to goodwill and other intangibles. Amortization expense decreased to $2.8 million in the first quarter of 2002 following adoption, effective January 1, 2002 of Statement of Financial Accounting Standards, or SFAS No. 142 “Goodwill and Other Intangible Assets,” which requires, among other things, the discontinuance of goodwill amortization. See Note 6 to the notes to Unaudited Condensed Financial Statements for the quarter ended March 29, 2002.

Stock-Based Compensation

Harmonic believes that it has insufficient shares reserved for issuance under its 1995 Employee Stock Purchase Plan (the “1995 ESPP”) to cover all forecasted purchases under offering periods that have commenced and which run through June 2003. In March 2002, the Harmonic board of directors adopted the 2002 Employee Stock Purchase Plan (the “2002 ESPP”), subject to stockholder approval, which is intended to replace the 1995 ESPP. If the 2002 ESPP is approved by stockholders, the 1995 ESPP will be terminated on or before July 1, 2002. The board of directors adopted the 2002 ESPP because the approval of additional shares for the 1995 ESPP could have resulted in future non-cash compensation charges which, depending on the future market price per share of the Company’s common stock, could have been significant.

Interest and Other Income, Net

Interest and other income, net, decreased from $1.6 million in the first quarter of 2001 to a nominal expense in the first quarter of 2002. The decrease was due primarily to lower interest income resulting from a reduction of approximately 48% in average cash and short-term investment balances and lower interest rates. In addition, the Company had interest expenses in the first quarter of 2002 on borrowings under its equipment term loan and trade receivable facility which offset interest income. The Company had no interest expense in the first quarter of 2001.

Income Taxes

A provision for income tax expense of $0.5 million was recorded for the first quarter of 2002 principally due to establishment of a valuation allowance for deferred tax assets and foreign taxes. For the first quarter of 2001 the Company recorded a benefit from income taxes because of non-deductible goodwill and intangible amortization, which was partially offset by a provision for foreign taxes. In 2002, the Company expects to have an annual tax provision of approximately $2 million due to foreign income taxes.

Liquidity and Capital Resources

As of March 29, 2002, cash and cash equivalents and short term investments totaled $52.0 million compared to $54.3 million as of December 31, 2001. Cash used in operations was $3.7 million in the first quarter of 2002 compared to cash provided by operations of $15.3 million in the first quarter of 2001. The increase in cash used in operations, despite a significantly reduced net loss, was primarily due to an increase in accounts receivable in the first quarter of 2002 compared to a substantial decrease in the first quarter of 2001, a smaller decrease in inventory in the first quarter of 2002 than in the comparable quarter of 2001 and an increase in accrued liabilities in the first quarter of 2001. The increase in accrued liabilities related to income tax refunds of $22.4 million which were received during the first quarter of 2001 and which were partially offset by a decrease in other accrued liabilities. Under the terms of the merger agreement with C-Cube, Harmonic is generally liable for C-Cube's pre-merger tax liabilities. Approximately $21 million of pre-merger tax liabilities remain outstanding and Harmonic expects final settlement, and payment, of these obligations to a variety of taxing authorities and LSI Logic during 2002.

Additions to property, plant and equipment were $16.7 million and $1.1 million in the first quarters of 2001 and 2002, respectively. The decrease from 2001 was due principally to expenditures during the first quarter of 2001 for leasehold improvements and related furniture, fixtures and equipment in connection with relocation of former DiviCom employees to new facilities in Sunnyvale, and the implementation of a new enterprise resource planning (ERP) software system. Harmonic expects capital expenditures to be approximately $10 million during 2002.

Harmonic has a bank line of credit facility, which provides for borrowings up to $10.0 million with a $6.0 million secured equipment term loan sub-limit. The facility, which is available until April 2003, contains certain financial and other covenants, with which Harmonic was in compliance at March 29, 2002. Borrowings pursuant to the line bear interest at the bank's prime rate (prime rate plus 2.0%-3.0% under the equipment term loan), are payable monthly, and are secured by Harmonic's assets. As of March 29, 2002, the Harmonic had outstanding borrowings of $2.8 million under its equipment term loan, of which $0.3 million was borrowed during the first quarter of 2002. The term loan bears interest at 7.75% to 10.0% annually on outstanding borrowings which mature at various dates through September 2004. Harmonic also has a facility which provides for the sale of trade receivables on a non-recourse basis up to $12.5 million and expires in April 2003. Trade receivables sold under the facility are discounted based on the bank's prime rate plus 1.5% for North American customers and 2.0% for all other customers. At March 29, 2002 and December 31, 2001, $12.5 million and $5.7 million, respectively, were available under the trade receivable facility.

While Harmonic expects to report a loss, excluding amortization of intangibles, at least through the second quarter of 2002, we believe that our existing liquidity sources, including our bank line of credit and trade receivable sale facilities, will satisfy our requirements for at least the next twelve months. We may need to raise additional funds if our estimates change or prove inaccurate or in order for us to take advantage of unanticipated opportunities or to strengthen our financial position. On March 18, 2002, Harmonic filed a registration statement on Form S-3 with the Securities and Exchange Commission, or SEC. This shelf registration statement, which was declared effective by the SEC in April 2002, will allow Harmonic to issue various types of securities, including common stock, preferred stock, debt securities and warrants to purchase common stock from time to time, up to an aggregate of $150 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 increased market uncertainty following the terrorist attacks of September 11, 2001 and the ongoing U.S. war on terrorism as well as conditions in capital markets. There can be no assurance that any financing will be available on terms acceptable to us, if at all. See Factors That May Affect Future Results of Operations, "Risk Factors — We May Need Additional Capital In The Future And May Not Be Able To Secure Adequate Funds On Terms Acceptable To Us."

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 subsidiaries each of whose sales are generally denominated in U.S. dollars. Following implementation of the Euro in January 2002, we expect a higher proportion of our European business to be denominated in Euros which may subject us to increased foreign currency exchange risk. In addition, the Company has various international branch offices, which provide sales support and systems integration services. While Harmonic does not anticipate that near-term changes in exchange rates will have a material impact on future 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 the Company were to sell any of its securities prior to stated maturity.

FACTORS THAT MAY AFFECT FUTURE RESULTS OF OPERATIONS

We Depend On Cable And Satellite 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.

Prior to the merger with C-Cube, almost all of Harmonic's historic sales had been derived from sales to cable television operators and we expect these sales to constitute a significant portion of net sales for the foreseeable future. Almost all of the DiviCom business' historic sales had been derived from sales to satellite operators, telephone companies and cable operators. Demand for our products will depend on the magnitude and timing of capital spending by cable television operators, satellite operators, broadcasters and telephone companies for constructing and upgrading of 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;
- discretionary customer spending patterns;
- general economic conditions.

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

- uncertainty related to development of digital video and cable modem industry standards;
- delays associated with the evaluation of new services and system architectures by many cable television operators;
- emphasis on generating revenue from existing customers by cable television operators instead of new construction or network upgrades; and
- general economic conditions in domestic and international markets.

Developments in capital markets over the past two years have reduced access to funding for new and existing customers, causing delays in the timing and scale of deployments of our equipment, as well as the postponement or cancellation of certain projects by our customers. In addition, during this same period Harmonic and other vendors received notification from several customers that they were canceling new projects, or delaying new orders to allow them to reduce inventory levels which were in excess of their current deployment requirements.

Certain of our domestic and international customers have accumulated significant levels of debt and have recently announced, or are expected to announce, reorganizations and financial restructurings, including bankruptcy filings. 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. In addition, concerns over recent disclosures of off-balance sheet financing by Adelphia Communications have pressured the market values of domestic cable operators and may further restrict their access to capital. Adelphia accounted for less than 5% of our revenues in 2001 and approximately 5% of revenues in the first quarter of 2002.

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 digital set top boxes, and the need for local zoning and licensing approvals. We believe that changes in our customers' deployment plans have in recent quarters delayed, and may in the future delay, the receipt of new orders or the release of existing backlog. Since the majority of our sales have been to relatively few customers, a delay in equipment deployment at any one customer has in the past and could have a material adverse effect on our sales in a particular quarter. In this regard, the Company's sales decreased each quarter from the second quarter of 2000 through the first quarter of 2001 and were below our expectations in the BAN and CS divisions as well as the expectations of securities analysts, and the price of our Common Stock declined significantly.

Cable television capital spending can be subject to the effects of seasonality, with fewer construction and upgrade projects typically occurring in winter months and otherwise being affected by inclement weather.

BAN division sales have decreased significantly from the third quarter of 2000 and were 57% lower in 2001 than in 2000. This was due to weak cable industry spending on transmission upgrades, particularly reduced spending by AT&T Broadband and RCN. These two customers accounted for a total of 23% of sales in 2000 compared to a combined total of less than 5% of sales in 2001 and the first quarter of 2002. CS division sales from the second quarter of 2000 through the first quarter of 2001, consisting principally of DiviCom products, were below DiviCom's sales levels in 1999 and the first quarter of 2000, and were significantly below our expectations at the time the DiviCom merger was announced in October 1999. The lower CS sales were attributable principally to reduced spending by satellite operators. For a more detailed discussion regarding risks related to AT&T Broadband, Charter Communication, DirecTv and other major customers, see "Our Customer Base Is Concentrated And The Loss Of One Or More Of Our Key Customers Would Harm Our Business. The Loss Of Any Key Customer Would Have A Negative Effect On Our Business."

CS division sales have increased significantly during the past four quarters and were 50% higher in the first quarter of 2002 than in the first quarter of 2001 due principally to demand for our next-generation digital systems such as the Narrowcast Services Gateway, or NSG, and the MV50 encoder. CS sales of the MV50 encoder have benefited over

the past year from the expansion of local channel offerings and compliance with FCC “must carry” regulations by domestic direct broadcast satellite, or DBS, operators. We anticipate that, in light of the announced merger of EchoStar and DirecTV and expectations that operators will add fewer local markets in 2002, our revenue from domestic DBS operators is likely to decline in 2002.

Due to challenging market conditions and uncertainty of the capital spending plans of our customers, particularly domestic satellite and certain European customers, Harmonic expects to report a loss, excluding amortization of intangibles, at least through the second quarter of 2002.

Our Customer Base Is Concentrated And The Loss Of One Or More Of Our Key Customers Would Harm Our Business. The Loss Of Any Key Customer Would Have A Negative Effect On Our Business.

Historically, a majority of our sales and sales of DiviCom 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 2000, 2001, and the first quarter of 2002 accounted for approximately 52%, 49% and 65% of net sales, respectively. Although we are attempting to broaden our customer base by penetrating new markets such as the telco and broadcast markets, 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 and AT&T Broadband, and EchoStar and DirecTV have announced plans to merge. Both combinations are subject to regulatory and shareholder approvals, among other conditions. In the first quarter of 2002, sales to Charter Communications and Cablevision accounted for 16% and 14% of net sales, respectively, compared to l2% and less than 5% of net sales, respectively, for each of these customers in the first quarter of 2001. The loss of Charter Communications, Cablevision, DirecTV or any other significant customer or any reduction in orders by Charter Communications, Cablevision, DirecTV or any significant customer, or our failure to qualify our products with a significant customer could adversely affect our business, operating results and liquidity. We cannot currently predict the impact of the acquisitions of DirecTV by EchoStar, if approved, on our future sales nor can we predict the impact of the AT&T Broadband merger with Comcast, if approved, on our future sales. Our sales are made on a purchase order or system contract basis, and none of our customers has entered into a long-term agreement requiring it to purchase our products. The loss of, or any reduction in orders from, a significant customer would harm 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 customer orders;
- the timing of revenue from systems contracts which may span several quarters;
- competitive market conditions;
- our unpredictable sales cycles;
- 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 our products sold;
- our development of custom products and software;
- the level of international sales; and
- economic conditions specific to the cable and satellite industries, and general economic conditions.

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. In addition, because a significant portion of our 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. Our 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. 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 lower than expected sales in each quarter from the second quarter of 2000 through the first quarter of 2001, 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 significantly.

Following the September 11, 2001 terrorist attacks in New York City and Washington, D.C., the United States and global economies have weakened and may continue to deteriorate, which may impair our ability to ship our products within the United States and internationally, and may result in further decreases in our revenues and cause our stock price to decline. In addition, it is anticipated that in the wake of these events, the United States and global capital markets will experience a period of continuing volatility. These events may have a negative impact on our business as a result of the cautious purchasing behavior of customers.

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

While we expect to report a loss, excluding amortization of intangibles, at least through the second quarter of 2002, we currently believe that our existing liquidity sources, including bank line of credit and trade receivable sale facilities, will satisfy our requirements for at least the next twelve months. We may need to raise additional funds if our estimates change or prove inaccurate or in order for us to take advantage of unanticipated opportunities or to strengthen our financial position. On March 18, 2002, Harmonic filed a registration statement on Form S-3 with the Securities and Exchange Commission, or SEC. This shelf registration statement, which was declared effective by the SEC in April 2002, will allow Harmonic to issue various types of securities, including common stock, preferred stock, debt securities and warrants to purchase common stock from time to time, up to an aggregate of $150 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 increased market uncertainty following the events of September 11, 2001 and the ongoing U.S. war on terrorism as well as conditions in capital markets. There can be no assurance that such financing will be available on terms acceptable to us, if at all.

In addition, we may review other potential acquisitions that would complement our existing product offerings, enhance our technical capabilities or expand our marketing and sales presence. While we have no current agreements or negotiations underway with respect to any potential acquisition, any future transaction of this nature could require potentially significant amounts of capital. 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 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 United States in 1999, 2000 and the first quarter of 2002 represented 36%, 40% and 31%, of net sales, respectively, and we expect that international sales will continue to represent a substantial portion of our net sales for the foreseeable future. Our international operations 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;
- the burden of complying with a wide variety of foreign laws, treaties and technical standards;
- difficulty in staffing and managing foreign operations; and
- political and economic instability.

Certain of our domestic and international customers have accumulated significant levels of debt and have recently announced, or are expected to announce, reorganizations and financial restructurings, including bankruptcy filings. 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 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. Following implementation of the Euro in January 2002, we expect a higher portion of our European business to be 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 United States. 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 develop in the future.

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

Harmonic maintains two facilities in the State of Israel with a total of approximately 75 employees. The personnel at these facilities represent a significant portion of our research and development operations. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel, and any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its present trading partners could significantly harm our business. The September terrorist attacks, the ongoing U.S. war on terrorism and the escalation of terrorist attacks and hostilities within Israel have heightened these risks. We cannot assure you that the protraction or escalation of current tensions in the Middle East will not adversely affect our business and results of operations.

In addition, 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 in recent weeks. We cannot predict the effect of these obligations on Harmonic in the future.

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

From time to time, we receive indications from our customers as to their future plans and requirements to ensure that we will be prepared to meet their demand for our products. If actual orders differ materially from these indications, our ability to manage inventory and expenses may be affected. In addition, if we fail to meet customers' supply expectations, we may lose business from such customers. 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 for the fourth quarter of 2000 and in 2001 were adversely affected by provisions for excess and obsolete inventories of approximately $49 million.

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

The markets for cable television fiber optics systems and digital video broadcasting systems are extremely competitive and have been characterized by rapid technological change and declining average selling prices.

Harmonic's competitors in the cable television fiber optics systems business include corporations such as Arris (a company owned in part by Nortel and Liberty Media), C-Cor.net, Motorola, Philips and Scientific-Atlanta.

In the digital and video broadcasting systems business, we compete broadly with vertically integrated system suppliers including Motorola, Scientific-Atlanta, Tandberg, Thomson Multimedia and Philips, and in certain product lines with Cisco and Terayon and a number of smaller companies.

Most 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 will therefore 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 and competition may 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, U.S. cable operators have to date mostly purchased proprietary digital systems from Motorola and Scientific-Atlanta. While certain operators have made limited purchases of the "open" systems provided by Harmonic, we cannot assure you that our digital products will find broad market acceptance with U.S. cable operators. 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.

Broadband Communications Markets Are Relatively Immature And 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. 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.

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, or
- fail to achieve market acceptance.

In addition, to successfully develop and market our planned products, we must retain and continue to attract personnel with appropriate experience and expertise. Competition for qualified personnel is intense. We may not be successful in retaining and attracting qualified personnel.

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.

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

The growth of our operations and cyclical nature of our business has placed, and is expected to continue to place, a significant strain on our personnel, management and other resources. This strain has been exacerbated by the acquisition of DiviCom and the subsequent loss of numerous employees, including senior management. In addition, we reduced our work force by approximately 30% during 2001 due to reduced industry spending and demand for our products. 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. In particular, in April 2001 we implemented a new management information system. We believe this new system significantly affects many aspects of our business, including accounting, manufacturing operations, purchasing, sales and marketing functions. The successful operation of this system is critical to our business.

Competition For Qualified Personnel Is Intense, And We May Not Be Successful In Attracting And Retaining 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 are dependent on our ability to retain and motivate high caliber personnel, in addition to attracting new personnel. In spite of the current worldwide economic slowdown, competition for qualified technical and other personnel remains intense, particularly in the San Francisco Bay Area and Israel, 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 noncompetition 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 engineers and other technical personnel, could negatively affect our business.

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

The spin-off of C-Cube's semiconductor business gave rise to a significant tax liability of approximately $320 million based on a valuation of the semiconductor business of $1.1 billion. The estimated liability was paid in 2000. Under state law, Harmonic generally is liable for all of C-Cube's debts, including C-Cube's liability for taxes resulting from the spin-off and other pre-merger tax liabilities. C-Cube retained and transferred to Harmonic in the merger an amount of cash and other consideration sufficient to pay this liability as well as all other tax liabilities of C-Cube and its subsidiaries for periods prior to the merger. 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 tax 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 C-Cube, Harmonic generally will remain liable, and such liability could have a material adverse effect on Harmonic. The spun-off semiconductor business was acquired by LSI Logic in June 2001, which assumed these obligations to Harmonic.

Due To The Structure Of The Merger Transaction, Harmonic Is Liable For C-Cube's General Pre-Merger Liabilities And Any Liabilities Relating To C-Cube's Semiconductor Business For Which The Spun-off Semiconductor Business Is Unable To Indemnify Harmonic.

The merger of C-Cube into Harmonic, with Harmonic as the surviving entity, resulted in our assuming all of the liabilities of C-Cube at the time of the merger. Pursuant to the merger agreement, Harmonic is indemnified by the spun-off semiconductor business for liabilities associated with C-Cube's historic semiconductor business. However, if LSI Logic is unable to fulfill its indemnification obligations to Harmonic or if general liability claims not specifically associated with C-Cube's historic semiconductor business are asserted, we would have to assume such obligations. Those obligations could adversely affect our financial condition.

We May Be Subject To Risks Associated With Other Acquisitions.

We have made and may make investments in complementary companies, products or technologies. If we make acquisitions, we could have difficulty assimilating or retaining the acquired companies' personnel and operations or integrating the acquired technology or products into ours. These difficulties could disrupt our ongoing business, distract our management and employees and 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, 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 and operating results could be harmed.

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

The DiviCom business and C-Cube semiconductor business collaborated on the production and development of two video encoding microelectronic chips prior to the merger. In connection with the merger, Harmonic and the spun-off semiconductor business entered into a contractual relationship under which Harmonic will have access to certain of the spun-off semiconductor business technologies and products which the DiviCom business previously depended on for its product and service offerings.

However, under the contractual relationships between Harmonic and the spun-off semiconductor business, which was acquired by LSI Logic in June 2001, the semiconductor business does not have a firm commitment to continue the development of video encoding microelectronic chips. As a result, the semiconductor business may choose not to continue future development of the chips for any reason. The semiconductor business may also encounter in the future technological difficulties in the production and development of the chips. If the spun-off semiconductor business is not able to or does not sustain its development and production efforts in this area, we may not be able to fully recognize the benefits of the acquisition. See "Supply, License and Development Agreement" at page 60 of the joint proxy statement filed with the Securities and Exchange Commission on March 23, 2000, for further details of Harmonic's business relationship with the spun-off semiconductor business after the merger.

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;
- capital expenditures;
- time required to engineer the deployment of new technologies or services within broadband networks; and
- testing and acceptance of new technologies that affect key operations.

For these and other reasons, our sales cycles generally last three to six 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.

As a result of the merger, a significant portion of our revenue is derived from solution contracts. A substantial portion of CS division revenues are from solution contracts that include a combination of product sales as well as design, installation and integration services. Revenue forecasts for solution contracts are based on the estimated timing of the 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.

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

We currently hold 39 issued United States patents and 8 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 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 effect our business, operating results, financial position and liquidity.

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 such 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.

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. We expect to increasingly be subject to infringement claims asserted by third parties as the numbers of products and competitors in the telecommunications industry grow. In this regard, since December 2000, we have been in communication with several of Harmonic's customers who have been contacted by one of these leading companies that believes certain of our products require a license under a number of their patents. We currently are reviewing the identified patents to examine whether we consider a license necessary. While it is our understanding that the third party is willing to grant our customers a non-exclusive license under the identified patents, there can be no assurance that the terms of any offered license would be acceptable to our customers or that failure to obtain a license or the costs associated with any license would not cause our operating results to be materially adversely affected.

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

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. Our reliance on sole or limited suppliers, particularly foreign suppliers, and our increased reliance on subcontractors since the merger with C-Cube 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 considerable efforts to qualify additional optical 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 or subcontractors. An inability to obtain adequate deliveries or any other circumstance that would require us to seek alternative sources of supply could affect our ability to ship our products on a timely basis, which could damage relationships with current and prospective customers and harm our business. We attempt to limit this risk by maintaining safety stocks of these 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. In this regard, our gross margins and operating results for the fourth quarter of 2000 and 2001 were adversely affected by excess and obsolete inventory charges of approximately $49 million.

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

On May 3, 2000, Harmonic completed the acquisition of C-Cube for approximately $1.8 billion in common stock. Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its current and former officers and directors were filed in or removed to the United States 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 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 by filing a false or misleading registration statement, prospectus, and joint proxy in connection with the C-Cube acquisition.

On July 3, 2001, the 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. Pursuant to the Court’s July 3, 2001 order, no hearing on the motions will be held unless the Court sets one.

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 actions 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 have been stayed pending resolution of the motions to dismiss the securities actions. At an April 5, 2002 case management conference, the court continued the conference until June 7, 2002. The court stated that the parties need not appear if no decision on the motions to dismiss the securities action had been issued by that date.

Based on its review of the complaints filed in the securities class action, Harmonic believes that it has meritorious defenses and intends to defend itself vigorously. There can be no assurance, however, that Harmonic will prevail. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position and liquidity.

In November 2001, we were sued in Tennessee state court by a company alleging breach of contract and breach of a Tennessee statute relating to retailers and suppliers. The suit has a claim for $2.5 million and other unspecified damages, lost profits and attorneys' fees. The suit has since been removed to Federal Court and a trial date has been set for June 2003. Harmonic believes that it has meritorious defenses and will defend the suit vigorously. However, we cannot assure you that an unfavorable outcome will not adversely impact our business, operating results, financial position and liquidity.

Our Stock Price May Be Volatile.

The market price of our common stock has fluctuated significantly in the past, particularly in recent years, 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.

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.

Our Certificate Of Incorporation And Bylaws And Delaware Law Contain Provisions That Could Discourage A Takeover.

Provisions of our Amended and Restated Certificate of Incorporation, Bylaws, and Delaware law could make it more difficult for a third party to acquire us, even if doing so would be beneficial to our stockholders.

PART II

ITEM 1. LEGAL PROCEEDINGS

On May 3, 2000, Harmonic completed the acquisition of C-Cube Microsystems, Inc., or C-Cube, for approximately $1.8 billion in common stock. Between June 28 and August 25, 2000, several actions alleging violations of the federal securities laws by Harmonic and certain of its current and former officers and directors were filed in or removed to the United States District Court for the Northern District of California. The actions subsequently were consolidated.

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ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits.

None

b) Reports on Form 8-K

A current report on Form 8-K (File No. 000-25826) was filed pursuant to the Securities and Exchange Act of 1934, as amended, on March 18, 2002, to comply with the requirements of Rule 3-05 of Regulation S-X. Consolidated financial statements of net income of the DiviCom business (an operating unit of C-Cube Microsystems Inc.), as of December 31, 1998 and December 31, 1999, and the related consolidated income statements, statements of changes in net investment and cash flows for each of the three years in the period ended December 31, 1999, were filed with such current report.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 13, 2002

HARMONIC INC.
(Registrant)

By: /s/ Robin N. Dickson

Robin N. Dickson
Chief Financial Officer
(Principal Financial and Accounting Officer)