REFINITIV STREETEVENTS

EDITED TRANSCRIPT

Q1 2021 Harmonic Inc Earnings Call

EVENT DATE/TIME: MAY 03, 2021 / 9:00PM GMT

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

CORPORATE PARTICIPANTS

David Hanover
Patrick J. Harshman *Harmonic Inc. - President, CEO & Director*
Sanjay Kalra *Harmonic Inc. - Senior VP & CFO*

CONFERENCE CALL PARTICIPANTS

George Charles Notter *Jefferies LLC, Research Division - MD & Equity Research Analyst*
Joseph Lima Cardoso *JPMorgan Chase & Co, Research Division - Analyst*
Simon Matthew Leopold *Raymond James & Associates, Inc., Research Division - Research Analyst*
Steven Bruce Frankel *Colliers Securities LLC, Research Division - Senior VP & Director of Research*
Timothy Patrick Long *Barclays Bank PLC, Research Division - MD and Senior Technology Hardware & Networking Analyst*
Timothy Paul Savageaux *Northland Capital Markets, Research Division - MD & Senior Research Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q1 2021 Harmonic Earnings Conference call. (Operator Instructions) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, Mr. David Hanover. Please go ahead, sir.

David Hanover

Thank you, operator. Hello, everyone, and thank you for joining us today for Harmonic's First Quarter 2021 Financial Results Conference Call. With me are Patrick Harshman, President and Chief Executive Officer; and Sanjay Kalra, Chief Financial Officer.

Before we begin, I'd like to point out that in addition to our audio portion of the webcast, we've also provided slides to this webcast, which you may see by going to our webcast on our Investor Relations website.

Now turning to Slide 2. During this call, we will provide projections and other forward-looking statements regarding future events or future financial performance of the company. Such statements are only current expectations, and actual events or results may differ materially. We refer you to documents Harmonic filed with the SEC, including our most recent 10-Q and 10-K reports and the forward-looking statements section of today's preliminary results press release. These documents identify important risk factors which can cause actual results to differ materially from those contained in our projections or forward-looking statements.

And please note that unless otherwise indicated, the financial metrics we provide you on this call are determined on a non-GAAP basis. These metrics, together with corresponding GAAP numbers and a reconciliation to GAAP, are contained in today's press release, which we posted on our website and filed with the SEC on Form 8-K. We will also discuss historical, financial and other statistical information regarding our business and operation, and some of this information is included in the press release. The remainder of the information will be available on a recorded version of this call or on our website.

And now I'll turn the call over to our CEO, Patrick Harshman. Patrick?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Well, thanks, David, and welcome, everyone, to our first quarter call. Harmonic delivered another solid quarter with seasonally strong new bookings and solid year-over-year revenue, earnings and cash growth. And both our Cable Access and Video segments again contributed meaningfully, and both carried substantial backlog and deferred revenue until the remainder of the year.

For Cable Access, the story is continued scaling by existing customers and new customer wins, driving 79% year-over-year segment revenue growth. For our Video business, demand for both our broadcast and streaming solutions remained healthy, enabling us to deliver 29% year-over-year segment revenue growth.

Big picture, Harmonic continues to respond well to both current challenges and opportunities, leveraging and continuing to invest in

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

differentiated technologies, deep customer relationships and an extraordinary global team. All of this translates into strong market momentum and an increasing growth outlook for the remainder of the year.

So focusing first on our Cable Access segment. We delivered another strong quarter. We were commercially deployed with 53 cable operators worldwide, up 96% from the first quarter of 2020. And these deployments scale to serve over 3 million cable modems, up 127% year-over-year. Segment revenue was $41.3 million, up 72% from a year ago. And although margin sagged somewhat as we had a heavier mix of DAA hardware in the quarter and our hardware was impacted by higher costs, we, nonetheless, again, delivered positive segment operating margin.

Looking ahead, we're well positioned to continue this pace of revenue growth. We see broad market momentum for next-generation, multi-gigabit broadband solutions, spanning fiber, cable and wireless, and the emergence of cloud-native software working in concert with an open distributed access architecture as the winning formula.

And within Cable, Harmonic's cloud-native and DAA solutions continue to be way out in front of the rest of the market. It's gratifying to have been recently recognized by the Dell'Oro Group as the market leader in these next-generation technologies.

To fully leverage our unique position, we're focused on 3 interrelated growth vectors: working with existing customers to scale CableOS deployment across their entire footprints; winning new customers from large Tier 1s to world broadband players; and expanding our addressable market to include fiber-to-the-home and fiber-to-the-business. We saw good progress in all 3 of these initiatives during the first quarter.

Regarding customers who are already actively deploying CableOS, deployments are going really well. The pace is accelerating, and yet our solution has been rolled out to less than 6% of their combined footprints, which means we still have huge growth runway ahead of us with these already deploying customers.

Regarding adding new customers, we also continue to make good progress. We received an initial multimillion-dollar purchase order from a new Tier 1 international operator, and we won several new regional and rural North America broadband customers during the quarter.

And regarding fiber-to-the-home, we closed our first deal in North America and have seen steady growth in our global sales pipeline with engagements spanning a diverse group of larger cable operators and smaller rural broadband players. Underlying all this activity, we continue to invest heavily in new technology and services. And based on insights from our ongoing deployments, we're adding compelling new functionality to our cloud-native software core support for new applications such as mobile backhaul. And we're engaged in innovative joint efforts with public cloud players around new edge cloud capabilities. And of course, our converged cable plus fiber-to-the-home solution continues to be a key R&D initiative.

And finally, we're not immune to the global supply chain constraints. We're seeing shortages of several key components and related significantly higher costs, impacting more significantly our DAA and shelf hardware products. We're working hard to overcome these challenges. And as a result, while we expect higher costs and lower margins for these products for the balance of 2021, we're not backing off of our revenue growth target. We're aggressively seizing new opportunities to expand our DAA footprint and correspondingly raising our top line guidance.

And summarizing for Cable Access, Harmonic delivered another strong quarter. Global broadband market trends are favorable. Near-term demand is healthy. Our early customers are successfully scaling. And we continue to add new customers, both large and small. The future of broadband access technology is clearly cloud-native core software, powering a flexible distributed access network. And as a primary architect of this new model, Harmonic's broadband access future remains bright.

Turning now to our Video segment. We followed up a strong second half of 2020 with another solid quarter. First quarter segment revenue was $70.3 million, up 29% year-over-year and up 5% from the first quarter of 2019, indicating growth that is more than just post-pandemic recovery. Gross margin was 55.1%, and segment operating margin was 5.4%, impressively demonstrating continued

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

profitability despite business transformation headwinds.

As you know, our key strategic transformation is from a purely broadcast technology and associated CapEx business model to a mix of broadcast CapEx and streaming sales with recurring revenue. Demand for high-quality live streaming solutions continues to grow, evidenced by a strong sales pipeline, several new Streaming SaaS wins, and our near record backlog in deferred revenue.

During the quarter, we signed net 7 new Streaming SaaS customers, mostly customers that are new to Harmonic, bringing the total number of media companies on our streaming platform to 97, which is up 72% year-over-year. Approximately 1/4 of these customers are still in the process of fully launching their new streaming services, underlying our continued streaming growth expectations.

As a recent example, a prominent new sport streaming service that we signed in 2020 went live with us just a couple of weeks ago, and is already delivering millions of daily ad impressions with even higher ad volumes anticipated as the service expands. So if the ad insertion portion of our SaaS solution is charged on an impression volume, or CPM, the associated growth opportunity for this part of our video business is becoming more compelling.

While streaming is the main headline, a secondary headline is revitalized broadcast demand. We're seeing a general rebound in broadcast project activity worldwide, which we believe we're capturing an increasing share. We're also seeing 5G bandwidth reclamation continuing to be a catalyst for both near-term business and longer-term opportunity creation globally. And during the first quarter, we continued to execute our announced program with SES and several new 5G bandwidth reclamation projects came into focus, new projects that we now expect to contribute to the second half of the year and 2022.

We're correspondingly raising our Video segment revenue guidance modestly for the full year. Looking further ahead, we believe the success in the industry is seeing with the C-band initiative is opening the door to a broader opportunity for wholesale IP video distribution via terrestrial fiber rather than satellite networks, a positive trend for sustained video broadcast investment.

So in summary, we delivered another strong Video quarter, characterized by solid revenue growth, gross margin, operating profit, new wins and bookings This performance highlights the resilience of our video business, our industry-leading technology and our growing success extending our brands from the realm of high-end broadcast to high-performance cloud streaming and SaaS. Leveraging our strong backlog and deferred revenue and a robust video sales pipeline, we're moving forward through 2021 with real market momentum and conviction in our Video growth plan.

So let me now turn the call over to you, Sanjay, for a closer look at our financial results and outlook.

Sanjay Kalra ***Harmonic Inc. - Senior VP & CFO***

Thanks, Patrick, and thank you all for joining us today. Before I discuss our quarterly results and outlook, I'd like to remind everyone that the financial results I'll be referring to are provided on a non-GAAP basis. As David mentioned earlier, our Q1 press release and earnings presentation includes reconciliations of the non-GAAP financial measures to GAAP that are discussed on this call.

For the first quarter of 2021, we delivered solid results, generally above our guidance ranges. We reported Q1 revenues of $111.6 million, up 42.3% year-over-year and gross margin of 50.4%, a 150 basis point improvement year-over-year. Operating margin was 4.5%, comprised of 3.1% for Cable Access and 5.4% for Video. And we generated adjusted EBITDA of $9.1 million and EPS of $0.04. We also had seasonally strong bookings during the quarter with a book-to-bill ratio of 0.9. As a result, we ended Q1 with a solid backlog and deferred revenue of $274.3 million, positioning us well for the remainder of the year.

Now I will review our first quarter financials in more detail. Turning to Slide 7. Total company Q1 revenue was $111.6 million, a 42.3% increase compared to $78.4 million in Q1 '20. As Patrick mentioned, we continue to see increased traction in our Cable Access business, ending Q1 with 53 commercial deployments with a sequential growth of 20%, compared to 44 at December 31 and up 96% year-over-year. Cable Access revenue was $41.3 million, up 72.1%, compared to $24 million in Q1 2020.

In our Video segment, we reported Q1 revenue of $70.3 million, up 29.2% compared to $54.4 million in the prior year period. We continue

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

to see recovering video activity worldwide during the quarter, including continued satellite C-band 5G-related revenue. We had 2 customers representing greater than 10% of total revenue during the quarter. Comcast contributed 23% of total revenue and SES contributed 16%.

As mentioned earlier, gross margin improved to 50.4% in Q1 '21 compared to 48.9% in Q1 '20, up 150 basis points. Cable Access gross margin declined slightly to 42.2% in Q1 '21 compared to 43.3% in Q1 '20, down 110 basis points, reflecting increased supply chain costs and a higher mix of DAA hardware. As previously mentioned, Cable Access operating margin was 3.1%. Video segment gross margin was 55.1% in Q1 compared to 51.3% in Q1 of last year, a 380 basis point recovery to business as usual before the pandemic.

Moving down the income statement on Slide 8. Q1 '21 operating expenses were $51.1 million compared to $47.9 million in Q1 '20. The year-over-year increase was primarily due to increased Cable Access research and development and services and sales and marketing for both segments as we continue to invest in our growth initiatives. The secondary reason for the increase was the conversion of some employee incentive compensation from stock to cash, as I will explain further when I discuss our guidance.

We reported operating profit for the first quarter of $5.1 million, comprised of $1.3 million from Cable Access and $3.8 million from Video. This is a substantial year-over-year improvement compared to an operating loss of $9.5 million in Q1 '20. Adjusted EBITDA for the first quarter was $9.1 million, reflecting contributions of $3 million from Cable Access and $6.1 million from Video. This compares to an adjusted EBITDA loss of $7 million in Q1 '20 and translates to Q1 EPS of $0.04, compared to Q1 '20 EPS loss of $0.10.

We ended the quarter with a diluted weighted average count of 103.2 million for shares, compared to 100.3 million in Q4 '20. The sequential increase is primarily due to the issuance of 2 million shares to employees for vested restricted stock units, ESPP purchases and performance-based compensation and 0.9 million shares for convertible debt valuation as a result of our increased average stock price.

Q1 bookings were $96.3 million, a 26.2% increase compared to $76.3 million in Q1 '20. It was encouraging to see another quarter of year-over-year bookings growth during the first quarter, demonstrating continued strong demand for our differentiated technology solutions.

Turning to Slide 9. We'll now discuss our liquidity position and balance sheet. We ended Q1 with cash of $100.8 million compared to $71.7 million at the end of Q1 '20 and $98.6 million at December 31. The $2.2 million sequential cash increase is comprised of $1.7 million cash generated from operations, primarily attributable to the profitability in both our businesses, net of $3.6 million cash used in the purchase of fixed assets and $4.7 million received from common stocks sold to employees under our ESPP and from stock option exercises.

Our days sales outstanding at the end of Q1 was 69 days compared to 107 days in Q1 2020. The year-over-year decrease in DSO reflects continued overall collection improvements and the timing difference of certain large receivables. Our days inventory on hand were 58 days at the end of Q1 compared to 78 days at the end of Q1 2020. At the end of Q1, our total backlog and deferred revenue was $274.3 million compared to $207.9 million at the end of Q1 2020, and a record $290.5 million at the end of Q4 '20, reflecting a sequential decrease of 6%. Our near record backlog and deferred revenue reflects both increasing commitments for our large cable customers and our growing video streaming SaaS businesses. We are pleased to be maintaining a strong level of high-quality backlog.

Know that historically, about 80% to 90% of our backlog in deferred revenue gets converted to revenue within a rolling 1-year period. Also, the deferred revenue component of our total backlog in deferred revenue was 27% at the end of Q1 compared to 27% at the end of Q1 2020, demonstrating that revenue conversion of backlog and deferred revenue continued at levels consistent with our expectations.

As mentioned on previous calls, not included in our backlog is additional contractually agreed CableOS business with 3 of our Tier 1 cable customers. At the end of Q1 '21, this incremental amount was approximately $156 million, down from $158 million last quarter as approximately $2 million went through the purchase order process and therefore, moved into bookings.

Taking these CableOS contracts into account, we have total future contracted revenues of $430.3 million. This provides us with a solid foundation for the remainder of 2021 and into 2022.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Now I'll turn to our non-GAAP guidance for 2021 on Slide 10. While COVID-19-related uncertainty and volatility still exists, our customer activity and pipeline have substantially recovered since the height of the pandemic. On the other hand, we are contending with a somewhat unprecedented global supply chain situation, creating both costs and production timing challenges. Based on extensive conversations with our key customers and supply chain partners and internal analysis, we expect the demand recovery will continue throughout the balance of 2021 with our typically seasonally stronger Q4 and second half, and that meeting this demand will likely be somewhat at higher cost, particularly for our Cable Access hardware products.

For the full year of 2021, we expect total company net revenue in the range of $435 million to $480 million. At the high end, this reflects upwardly revised growth expectations for both segments. Gross margin in the range of 50.6% to 52%, at the midpoint of our guidance. This represents a decline of 120 basis points year-over-year. This reflects a slight increase in Video gross margins and a lower gross margin on Cable, which I will elaborate on shortly.

Operating expenses range from $209 million to $218 million, an increase from previous annual guidance due to increased Cable Access research and development expenses and the decision to settle certain employee incentive compensation payouts with cash instead of stock, reducing dilution. The latter was a decision recently made with our Board considering our stronger cash position and operating plan.

Adjusted EBITDA to range from $25.1 million to $45.7 million, an increase of approximately 49% year-over-year at midpoint. EPS will range from $0.06 to $0.24, an effective tax rate of 10%, a weighted average diluted share count of approximately 104.7 million and finally, cash at the end of the year is expected to come in between $110 million to $120 million.

On Slide 11, I will focus on total company guidance for the second quarter. Revenue in the range of $102 million to $112 million. At the midpoint of our guidance, this reflects an increase of 45% compared to Q2 last year. Gross margin in the range of 48.7% to 50.6%. At midpoint of our guidance, this reflects a decline of 195 basis points compared to Q2 last year. Operating expenses to range from $52 million to $54 million due to the reasons mentioned previously. Adjusted EBITDA to range from $0.8 million to $5.8 million versus a loss of $2.8 million in Q2 last year. EPS to range from a loss of $0.03 to a profit of $0.01 per share; an effective tax rate of 10%; a weighted average diluted share count of approximately 101.2 million to 104.2 million. And finally, cash at the end of Q2 is expected to range from $90 million to $100 million.

Starting this fiscal year, we will be augmenting our segment guidance to include segment gross margin, operating expense and adjusted EBITDA, corresponding to our existing practice of providing these segment metrics in our reported quarterly results.

On Slide 12, I will discuss guidance for our Video segment for the full year and the second quarter. For the full year 2021, we expect Video revenue in the range of $260 million to $280 million. At the midpoint of our guidance, this reflects 11% growth year-over-year, attributable to both rebounding broadcast market demand and growth in streaming. Gross margins in the range of 55% to 57%. At the midpoint of our guidance, this represents a 150 basis point improvement over last year, mainly due to improved product mix. Operating expenses are expected to be between $138 million to $143 million, an increase of 7% versus last year. Most of the increase is due to increased sales expenses tied to our higher projected revenue. Adjusted EBITDA in the range of $13.5 million to $25.1 million, an increase of 135% over last year at the midpoint.

For Q2, we expect Video revenue in the range of $57 million to $62 million. At the midpoint of our guidance, this represents approximately 25% growth over Q2 last year. We expect EBIT gross margin in the range of 54% to 56%, which, at the midpoint, is a 20 basis point improvement from Q2 last year. Operating expenses to range from $34 million to $35 million, an increase of 14% over Q2 last year, due primarily to increased sales expenses as mentioned previously. Adjusted EBITDA to range from a negative $1.3 million to a positive $1.6 million.

On Slide 13, I will review guidance for our Cable segment for full year and the second quarter. For the full year 2021, we currently expect Cable Access revenue in the range of $175 million to $200 million. At the midpoint of our guidance, this reflects a 38% growth year-over-year. This growth is driven by strong momentum with our existing customers as we accelerate deployment as well as new

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

customer growth and modest converged fiber-to-the-home revenue. Gross margins in the range of 44% to 45%, a 440 basis point decline versus last year at the midpoint, due primarily to increased costs related to supply chain headwinds and an increased mix of DAA hardware. Operating expenses are expected to be between $71 million to $75 million, an increase of 33% versus last year. Most of the increase is due to increased research and development and sales and marketing expenses. Adjusted EBITDA in the range of $11.6 million to $20.6 million, an increase of 3% over last year at the midpoint.

For Q2, we currently expect Cable Access revenue in the range of $45 million to $50 million. At the midpoint of our guidance, this reflects 79% growth for Cable over Q2 last year. Gross margin in the range of 42% to 44%. At midpoint of our guidance, this reflects a 270 basis point reduction over Q2 last year, for all the reasons mentioned previously for the full year gross margin guidance. Operating expenses to range from $18 million to $19 million. At the midpoint of our guidance, this reflects a 42% increase over Q2 last year, primarily due to increased research and development and sales and marketing expenses. Adjusted EBITDA to range from $2.1 million to $4.2 million.

In closing, again, we are grateful for our team's continued dedication and strong performance during the first quarter. We continue to execute on our strategic priorities, positioning our Cable Access and Video streaming businesses for long-term success.

With that, thank you, everyone. And now I'll turn it back to Patrick for final remarks before we open up the call for questions.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Okay. Thanks, Sanjay. We want to conclude by reviewing our strategic priorities for the year.

For our Cable Access business, our objectives are accelerated expansion of existing Tier 1 deployments; entering new global operators, particularly additional Tier 1s; and expanding our addressed market through CableOS's new converged on DOCSIS to fiber-to-the-premises capabilities. We're pushing forward aggressively despite near-term cost challenges.

For Video segment, our objectives are accelerating the growth of our streaming and SaaS customer base and usage; capitalizing on the coming transformation of traditional media and broadcast infrastructure globally; and delivering both top and bottom line growth. Putting it all together, we aim to create value to deliver industry-leading solutions and to enable superior subscriber experiences worldwide.

And finally, we're pleased to announce that later in May, we will be hosting 2 special investor events, a deep dive into our Cable Access business and associated multiyear outlook; and a similar deep dive and multi-year outlook for our Video business. We're featuring additional members of our executive management team. We expect the dates to be finalized shortly, and hope that you all join us.

And with that, I would now like to open up the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Samik Chatterjee from JPMorgan.

Joseph Lima Cardoso ***JPMorgan Chase & Co, Research Division - Analyst***

This is Joe Cardoso on for Samik Chatterjee. My first question is on your guidance, kind of more of a clarification. You always obviously spent a large portion of the prepared remarks mentioning the supply constraints and implications on the higher costs. I'm just curious if you guys are seeing any implications on the supply constraints on your top line? And basically, are you being impacted by your ability to supply customers and whether you're baking any of that into your full year guide?

Sanjay Kalra ***Harmonic Inc. - Senior VP & CFO***

Yes. In terms of top line and the supply chain, we have factored in any risk we consider in our guidance range. So our guidance range completely entails the risk we consider at this point for this supply chain.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Joseph Lima Cardoso ***JPMorgan Chase & Co, Research Division - Analyst***

I guess, if I could just follow-up there. Are you seeing any implications on your ability to supply customers currently? Or is that not already -- you have not [seen] that yet today?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

We've not dealt with that to date. If I can step in, we have not dealt with that to date. I think the current situation creates a ceiling. It's not to say we're not working to remove that, but it does create a little bit of a ceiling on the upside. What we're talking about today is going beyond our guidance of last -- that we gave last quarter. So we're fortunate that we don't see any reduced expectations. But if your question is, is the sky the limit? Right now, the sky is not the limit. And there is a scenario where demand may outstrip supply. But right now, the supply that we see, we think we can manage and actually manage to deliver a little bit of upside. Albeit, as we've said a couple of times, at higher than originally anticipated costs simply entailed with getting that done.

It's a dynamic situation. As Sanjay said, we're quite confident that we've got the resources to deliver within the range that we've talked about.

Is upside on that possible? It is possible. I think it's probably more likely that the demand is there, and then that we'll be able to satisfy the demand. But both of those things are a little bit dynamic, and we'll continue to keep you updated as we move through the year.

Joseph Lima Cardoso ***JPMorgan Chase & Co, Research Division - Analyst***

No, I really appreciate the color. And then I guess, just for my second question, and this is more broader. It looks like there's a bunch of initiatives from governments globally in the pipeline, including RDOF and infrastructure plan in the U.S., there's the U.K.'s Project Gigabit and the European Commission's Broadband Project. Just curious to hear your overall thoughts on these government projects in terms of when do you expect them to materialize? And how is Harmonic positioned to benefit from these investments globally?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Yes. Well, I very much appreciate the question. And as your question has implied, it's -- the world is a big place. And there's a lot of different initiatives with different timing happening all over the place. But I think we can agree the headline is, is that broadband and access to broadband is -- it's a priority issue, from every country, from the United States to the U.K. to Bhutan, right? And so being a participant and being a key supplier of broadband-enabled technology is a great place to be. We think we have an extremely strong position within cable. And as you know, we're working to expand that position to also address fiber.

Our first port of call, if you will, is those cable operators who are expanding in the fiber or has hybrid cable and fiber infrastructures, and we think that, that opportunity substantially expands our addressed market. And as we've discussed before, once we kind of got that in play, we'll -- we think we can expand beyond that.

So we think it's a very attractive environment. We think we're well positioned. We're not targeting the totality of the market today, but we're targeting a growing subset of the broadband market where we can not only participate, but where we really can differentiate ourselves. So we -- we think that the future is pretty exciting, and it's one of the reasons why we're leaning in now, and we're continuing to lean in into investing in both the current and our coming technologies to strengthen our position, not just for 2021 but for the next several years.

And I guess just one last thing. As I mentioned a moment ago, we do plan an investor event to really drill into this topic from both a market and a technology perspective in more detail later on in the month. And I think that, that -- your question really hits on one of the reasons we want to have a slightly more in-depth conversation to talk about what we're doing and the market opportunity that we see.

Joseph Lima Cardoso ***JPMorgan Chase & Co, Research Division - Analyst***

Congrats on the results.

Operator

Our next question comes from Tim Long from Barclays.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Timothy Patrick Long ***Barclays Bank PLC, Research Division - MD and Senior Technology Hardware & Networking Analyst***

Two questions, if I could. First, on the C-band side. It sounds like it's starting to broaden out a little bit more from a customer base. So could you kind of just give us an overview, Patrick, on kind of level of activity there and maybe update us as this moves along? Any changes to the competitive environment?

And then on the cable side, it sounds like a really big pipeline outside of the backlog. So maybe if you could kind of give us a sense as to why you're seeing that growth? Is it a lot of new deployment? Is it traffic growth? What's driving that or competitive wins and maybe a little bit on the slope of the curve to turn that stuff into revenues?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Okay. Thanks for the question. On the C-band stuff, indeed, we're seeing more opportunity. And in particular, we see a couple of substantial new opportunities that really come into focus. And we're -- we see that as beginning to materialize in the second half of the year, and we also see it as high probability for 2022. So I would say that those -- the next wave of opportunity is domestic. And so beyond that, we still see, and we're engaged in a number of conversations around related international opportunities, but I would call those still as not quite in focus and therefore, not yet factored into -- in any way into the guidance we've given.

But from a broader trend, I think that it continues to be promising from our perspective, not only because the government is looking to recover bandwidth, but because the market is waking up to the fact that actually, there's a lot of benefits to moving video traffic over a terrestrial fiber network, personalization, customization, targeted ads, et cetera. So it's a dynamic -- in a positive way, it's a dynamic evolving opportunity that is leading to broader conversations with a number of customers, both domestically and internationally.

There's not really been any change. The last part of that question, Tim, there's not really any change to the competitive environment. We're certainly not the only one. We've seen some deals go to competitors. But we think we're pretty uniquely positioned, and we're really leaned into a couple of very significant additional opportunities.

On the cable front, look, it's a little bit all of the above in your comments. I think that as we touched in the last question, broadband is a must do, whether it's from a consumer perspective, from a government perspective, it's only becoming more important. I think we all see that. And so there's -- there's consumer demand. I think very strong -- and we're seeing strong demand from both our existing customers to go faster. And from your customers, in particular, new customers, as we continue to get success in the market with deployments, there's a virtuous circle. We think we're getting more and more credibility. Perhaps slightly more conservative operators or once we had a little bit more questions about the technology, they're getting more and more comfortable with the deployment volume, the success of the quality of service that we're seeing, and so I think both of those things are factoring into a strength in pipeline.

That being said, at the risk of rambling on here, we've also learned that depending on the environment, this is not necessarily you snap a finger and deploy it overnight. There is a process. And to the comments here, we are -- we're carefully managing our supply chain, and that also it modestly impacts, I would say, the pace of which we can move.

So -- so strong demand. The competitive position is, I would say, as strong or stronger than ever. And I'd say the transition -- translation of all that into volume deployment is okay. It's not quite as fast as we'd like to see. Supply chain inhibits that a little bit, but it's going okay. And I think if you look at our guidance range, the top end, where year-over-year, it's a respectable number, getting close to 50%. And given everything that's going on in the market and the fact that we're still, in many places, dealing with some pandemic-related issues, et cetera. I think that, that growth and our view that we want to discuss with you all later in the month of multiyear growth. All of that, from our perspective, is quite positive.

Operator

And your next question comes from Simon Leopold from Raymond James.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Simon Matthew Leopold ***Raymond James & Associates, Inc., Research Division - Research Analyst***

I wanted to ask maybe if you could help folks understand the metric that you've been offering on the past several calls regarding the cable modem served. I guess this quarter, you're up to 3 million, and you're talking about 6% or better than 6%, which would imply that the customers have a total of about 50 million. Could you help us understand how you measure that metric? And what stands between basically serving 3 million and 50 million? Is there -- what needs to happen for that number to grow is really what I'm looking for.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Okay. Indeed, you've got it in round numbers, you've got it about right. The people who are actively deploying CableOS today, they have -- they serve about 50 million -- over 50 million cable modem subscribers. They are -- I don't know the right [technology] assignment, they're kind of rebuilding the house, if you will, or repainting the house room by room. And it isn't a flip of the switch kind of thing. There is, at a minimum, in centralized architecture. So there is rewiring and rearchitecting of the main head end.

And where DAA is used, actually, there is deployment of DAA nodes out in the neighborhoods, which means a truck needs to roll, someone needs to go up in a bucket truck or go down into the ground and replace an old node with an existing node, and very often that involves pulling fiber deeper into a neighborhood. So that's the part of the process that is time-consuming. It's not so much our technology itself, but it's making the architectural -- the wiring, the infrastructure, the rest of the infrastructure changes both in the central office, where if you're running our software, core software, on commercial office set of servers, you're moving to that server infrastructure, the data center type of infrastructure off of old legacy chassis. And very often, you're replacing -- deploying fiber deeper in the network.

So that's a time-consuming process. That also takes capital money as well. And it's that process, Simon, that for any given operator, limits the speed. And even the most well-heeled operators with a lot of budget, they -- they're not throwing infinite amount of money [at least] simultaneously. And frankly, in many markets, work crews are somewhat tough to come by, et cetera.

So there is a process of rolling out. And that's why we've always said that even with those customers, we expect to roll out our solution to 100% of their plant. And most of our key customers, we do expect that to be the case. But we expect it to be a several year process, a 3- to 4 year process. And so we're on that curve.

As experience becomes better, we expect the pace to quicken. And we expect our largest customers to be picking up the pace, and that's the biggest part of the growth we're projecting of this coming year, to be clear. But even at a quicker pace, we still expect a several year process for our larger operators to roll out the technology across the entirety of their footprints.

Simon Matthew Leopold ***Raymond James & Associates, Inc., Research Division - Research Analyst***

And then as a follow-up, I wanted to see if maybe we could unpack the gross margin pressure on the Cable Access segment. And certainly, I appreciate you don't have some crystal ball that tells you when the supply chains open up necessarily. But what I'd like to try to understand is what's the impact of supply chain versus product mix? For example, nodes dilute your gross margin versus your software, we understand that. So I guess what I'm trying to understand here is what would you expect the gross margin in that business unit should be in a sort of more normalized nonsupply-constrained market? And do you have a view on when we should get back to those levels?

Sanjay Kalra ***Harmonic Inc. - Senior VP & CFO***

So Simon, appreciate the question. I think as I pointed out in our prepared remarks, they are both pieces to the gross margin. The gross margin decline we are seeing now marginally is substantially due to the supply chain-related costs. At the same time, we are also seeing increased growth in the DAA hardware. So both pieces are there. It's hard to quantify what is the piece of each. But substantially, it's the supply chain cost.

That said, once the supply chain challenges are behind us, we should return back definitely in better margins than where we are

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

expecting for this year. And I think not going in outer years, I think when we talk about the multiyear in our IR event, which Patrick mentioned, I think we can cover the expectation at that time. At this point, we are not going into the '22 margins. But directionally, we should see improvement from where we are this year.

Simon Matthew Leopold ***Raymond James & Associates, Inc., Research Division - Research Analyst***

Is there, I guess, a level that -- should we look at fiscal '20 as kind of a normalized value? Or is that misleading for any reason?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

If I could step in, I mean, I -- our target is to do better than 2020. So I don't think it's a normalized value. Maybe if I could, from a CEO perspective, look, there's a software component, there's a hardware component. The software component is going to be very high margin, right? It's 90 plus percent. Then we've got hardware. And we've always said, or we've said previously, that the hardware has been in the, let's say, mid-30s on average, but that is -- we expect that to be going up with volume as well as design enhancements, et cetera. And long term, that's still our expectation.

I think, yes, we've gone the other way, short term on the hardware, but that is not a fundamental reset. We're paying a lot more to impact it a little bit, as you asked, we're paying a lot more for key components. We're also paying higher assembly and transport costs. So we're kind of getting hit from a number of perspectives. We think none of those hits, though, to be fundamental impairments that go forward indefinitely.

We don't have a crystal ball on the supply chain thing. I mean, right now, I think we expect it to kind of carry over somewhat into 2022. But we would expect -- and again, this is a very [clear] expectation, but we expect some recovery later in 2022. But we certainly hope it's sooner. We don't have a good crystal ball. But what this guidance assumes is that it will be with us through 2021.

And again, I want to emphasize the fact that we could probably have higher margins if we were willing to take lower -- deal with lower volumes. But we see a land grab opportunity. We've got real momentum with our solutions. So here, we are leaning in every opportunity we have to deploy DAA hardware out there, which means we are scouring the planet right now for the materials we need, and we're paying top dollar in many cases for that. I think that's the right thing to do strategically. I think capturing real estate is absolutely the right thing in terms of our multiyear growth -- our multiyear growth opportunity, our market leadership opportunity.

Yes, it's costing us the gross margin short term, but I think that -- I think the right way to look at it is, is that we're picking up significant market share. And that's going to be a durable strategic benefit to the business for many years after this near-term cost headwind is behind us.

Operator

We have a question from George Notter from Jefferies.

George Charles Notter ***Jefferies LLC, Research Division - MD & Equity Research Analyst***

I guess I wanted to come back to the C-band discussion from earlier. I think you said you're seeing a broadening out of opportunities. I guess -- I guess the clarification here, are you seeing then some of the 2023 opportunities coming forward then? I guess there's, of course, a deadline, December 5, I think, 2023. And so when you talk about a broadening of opportunities, are those the deals that you're seeing now kind of coming forward? Or are there some other pieces of business that are coming forward that ...

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

No, what we're referring to is something a little bit different, George. Just taking a backup, I know you know this, but others listening may not. I mean, still around the world, a huge amount of video is moved around over satellite networks. And I think in many ways, the philosophy -- our philosophy has been out there, if it ain't broke, don't fix it. Even though intellectually, the question has been out there. Wait a minute, why not be using fiber-based to transport? And I think what we're seeing is, as to the success and what's happening to date with the C-band project, that is causing some of the, let's call it, an ain't broke, don't fix it folks to stop and pause.

So even in the absence of a government conversion plan or pressure, the success of this initiative is opening the door to a different kind of

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

discussion, saying, wait a minute, even if the government isn't bearing down on us and requiring us to abandon satellite, maybe moving more of that traffic to fiber is going to save money on one hand, and on the other hand, maybe it's going to allow a more innovative service delivery offering. So it's the latter that we're referring to, not a pull-in of government driven programs, but rather a growing industry dialogue around whether to leverage this technology more broadly.

George Charles Notter ***Jefferies LLC, Research Division - MD & Equity Research Analyst***

Got it. That's very helpful. I guess I also wanted to ask about maybe one on RDOF. So obviously, the list of awardees is out there for Phase 1. Are there specific operators or customers that you see on that list that are Harmonic customers that create new revenue opportunity for you? Are there specific guys you can identify?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Yes is the short answer. I don't want to suggest that we've got a seat right in the front and center of the auditorium, but the short answer is yes. There are people who are existing customers, and there are people who are in our sales pipeline.

Now to be clear, as we've stated, we're focusing on -- today, we're focusing on a subset. Those are the subset of those folks who own some cable infrastructure as well. So who would be kind of hybrid cable and fiber-to-the-premises operators. But for anyone who is in that category, they're absolutely, which is a subset of the RDOF awardees, they're absolutely part of our go-to-market focus.

Operator

And you have a question from Steven Frankel from Colliers.

Steven Bruce Frankel ***Colliers Securities LLC, Research Division - Senior VP & Director of Research***

Patrick, to what extent is this acceleration in R&D reflecting kind of new projects that you think you need to get to market faster versus kind of just accelerating the pace around existing things you've already targeted?

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

I -- I wish it was one or the other, but it's a mix of both. We do have -- to be frank, and I think we've said it before, every Tier 1 has their own unique stuff, and part of the success formula is kind of adapting before them. And we've got -- we announced a significant Tier 1 last quarter. We've added another one this quarter, and we've got several more Tier 1s in our pipeline. And we are -- we're planning for success with the ones we've recently signed and with the ones that are coming. So there's part of it.

But the second part of it is us looking at what we're learning in existing deployments. What we're seeing, the fiber-to-the-home opportunity we've talked about a couple of times, and the overall momentum. And we're envisioning where the puck is headed. And we see the puck really moving down the ice, if I can stick with that analogy. And so we're -- we think now is the time as to really lean in.

I mean, let's face it. If we spend on R&D in that regard now, it shows up as benefit later in '22 or in 2023. And we've got real growth aspirations for those years. And so we think now is the time. And I...

Steven Bruce Frankel ***Colliers Securities LLC, Research Division - Senior VP & Director of Research***

I guess -- sorry, go ahead.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

No. Go ahead, go ahead. Go ahead.

Steven Bruce Frankel ***Colliers Securities LLC, Research Division - Senior VP & Director of Research***

And then one follow-up, I think I heard you say before that you -- DAA is increasing in mix and it's coming from the Tier 1s. So is it fair to say that those Tier 1 customers that were kind of dipping their toe and doing fits and starts over the last 18 months are now far enough into it that they can kind of put their foot on the accelerator in terms of deployments?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Yes. The pace of employment (sic) [deployment] is definitely increasing. I think that's one thing. I think the other thing is just that a couple of those operators initially started up with several different DAA sources. And we think we're getting a little bit higher market share because of the strength of our particular solution. And again, even at short term higher cost, we think the right thing to do is to lean into that, let's call it, incremental market share opportunity.

We view putting a DAA node out there is gaining valuable real estate. And not just a short-term or -- yes, not just a short-term revenue opportunity, but a real presence in the network opportunity that is what we're leaning into.

Operator

And you have a question from Tim Savageaux from Northland Capital.

Timothy Paul Savageaux ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

I'll try and be quick here. A couple of questions. First, on the overall topic of deployment accelerating in cable and trying to bridge the gap between 3 million cable modems and 50 million, I think you commented at a recent industry event that you thought that number would be 9 or so by the end of this year, which is a pretty marked acceleration in that context. Now it's interesting to see the guidance increased. I mean, understanding there may not be a linear relationship between that type of acceleration in cable modem served and Harmonics' revenue, should we -- it sounds like we should be thinking more about the high end of the range where you mentioned 50% growth or even that's conservative in light of those targets? And then I have a follow-up on a completely separate topic.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

Well, thanks for the question, Tim. I think you're referring to comments that I made at a recent industry event, which is really targeted at the cable operator community. And they are -- I was not talking specifically about Harmonic, but the industry at large. And as I think you know, while we've -- we think we're ahead of the class on DAA, there are a couple of others who are doing DAA solutions, including DAA solutions that are not tied to virtualized CMTS, et cetera.

So the estimate that I provided there was not a Harmonic number, but it was an overall industry number, domestic as well as international, and certainly, therefore, included a competitor DAA solutions that are out there. So yes, there's a couple of different variables floating around. And further, I will also -- can see that discussing growth forecast with the industry is somewhat different than offering financial guidance. So you've got a couple of different things going on.

I think the good news is, is we are seeing the industry get more and more comfortable with DAA as a technology. And I think important thing that came out of that live reading conference is increased industry conviction that DAA is not only viable, but it's -- it actually increasingly is the way to go.

But yes, one can, therefore, not draw a straight line between those industry projections and our revenue for a couple of reasons that you highlighted as well as what I've just said in terms of overall industry numbers versus Harmonic.

Timothy Paul Savageaux ***Northland Capital Markets, Research Division - MD & Senior Research Analyst***

Okay. And so you did say you thought you were gaining share, but I'll just leave that one there. Second one is, I think there was a brief reference made maybe in the incentive comp discussion about the part of the driver of that being the new kind of cooperation agreement or the Board changes that you've seen. And I wonder if you might comment a little more expansively on that, we also -- I'm going to guess that the more detailed segment guidance and investor days might be a function of that as well. And I guess, at a high level, should we be thinking about these segments increasingly separately for Harmonic Video and Cable Access, both tactically and strategically? And if that were the case, it might make for a shorter press release at least or possibly a shorter call.

But your choice for how to approach it, whether we should be thinking more about strategic activity in Harmonic as a result of that agreement? And what has been the impact to date besides what you mentioned on the call?

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

Sanjay Kalra ***Harmonic Inc. - Senior VP & CFO***

So Tim, let me start with the first one. Let me clarify, this change of incentive comp on from stock to cash has nothing to do with the corporation agreement. This is purely an internal decision. As the Board looked at our plan for the year, we are generating very good cash and the operating profit level we are reaching, we took a decision to convert a piece of our stock comp to cash comp, and it helps marginally reduce the dilution of the company as well. So let me clarify, it has nothing to do with that agreement.

Secondly, in terms of the 2 segments being distinct, we have always reported the 2 segments right from the revenue until operating profit in actual reported results. But by giving the guidance, we have not given the guidance in that transparency. Starting this quarter, we felt the need to do it based on the continuous regular questions during the investor interaction we've had. So we thought it's more transparent, and it provides more visibility of what the segment is doing. And again, this has also nothing to do with any other agreement. So this is more on transparency.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

And Tim, just maybe to follow on, from my perspective. We -- it truly is a cooperation agreement. We value our relationship with Scopia. They've been in the stock for several years, and that's all very good. And so that's a full statement, full stop.

Separately, I think want to underline what Sanjay just said. We've been quite clear over the past several years about how we think about the different pieces of our business and how we're trying to create value in the company. And there really is no strategic change. And, yes, it wouldn't be a mistake to conclude anything strategically from anything we've discussed today. Both of our businesses, we think, have exciting futures and opportunities. You can see that we're investing in both.

I think we've been quite transparent. We've received the question numerous times over the past several years. What's the level of synergy between the 2? We've been quite transparent to say there's modest synergy. It's not overwhelming. The way the company, the management team as well as our Boards will work to create value whatever way we can. But maybe with the 2 business units staying together, or maybe work apart, there's no change in that answer nor in our thinking, that has, over the past several years. We will continue to move forward, looking to create as much value as we can in the overall enterprise, which really means creating as much value as we can in the 2 business segments.

And I'm very pleased coming into this call that we see actually good strategic progress on both sides of the business. I think there's a lot of reason to be encouraged on both sides and to see good futures on both sides of the business.

Operator

And there are no further questions at this time. I'm going to turn the call back over to management for closing remarks.

Patrick J. Harshman ***Harmonic Inc. - President, CEO & Director***

All right. Well, thank you very much all for joining us. We've got a lot of challenges, but a lot of opportunities ahead of us. We look forward to staying in touch with all of you. And in particular, as mentioned, keep an eye out for our planned investor dates in a month or so time. Until then, take care, and we look forward to speaking with you all again soon. Bye-bye.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

DISCLAIMER

Refinitiv reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.

In the conference calls upon which Event Briefs are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT BRIEFS REFLECTS REFINITIV'S SUBJECTIVE CONDENSED PARAPHRASE OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES REFINITIV OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT BRIEF. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2021 Refinitiv. All Rights Reserved.

©2021 Refinitiv. All rights reserved. Republication or redistribution of Refinitiv content, including by framing or similar means, is prohibited without the prior written consent of Refinitiv. 'Refinitiv' and the Refinitiv logo are registered trademarks of Refinitiv and its affiliated companies.