
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark one)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the quarterly period ended April 1, 2005.

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.

(Exact name of Registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77-0201147

(I.R.S. Employer
Identification Number)

549 Baltic Way
Sunnyvale, CA 94089
(408) 542-2500

(Address, including zip code, and telephone number, including area code, of principal executive offices)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of April 28, 2005, there were 73,100,064 shares of the Registrant's Common Stock outstanding.

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HARMONIC INC.

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PART I

FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

HARMONIC INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(In thousands, except par value amounts)	April 1, 2005	December 31, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 31,661	\$ 26,603
Short-term investments	72,893	74,004
Accounts receivable, net of allowances of \$5,980 and \$5,126	55,777	64,148
Inventories	43,237	41,763
Prepaid expenses and other current assets	9,479	8,504
Total current assets	213,047	215,022
Property and equipment, net of accumulated depreciation of \$67,679 and \$65,747	19,809	19,611
Goodwill, intangibles and other assets	9,684	7,723
Total Assets	<u>\$ 242,540</u>	<u>\$ 242,356</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 967	\$ 1,067
Accounts payable	23,834	22,381
Income taxes payable	6,476	7,099
Deferred revenue	21,693	15,469
Accrued liabilities	36,253	51,894
Total current liabilities	89,223	97,910
Long-term debt, less current portion	986	1,272
Accrued excess facilities costs, long-term	22,903	24,085
Other non-current liabilities	11,152	8,532
Total liabilities	<u>124,264</u>	<u>131,799</u>
Commitments and contingencies (Notes 13 and 14)		
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: 73,094 and 72,286 shares issued and outstanding	73	72
Capital in excess of par value	2,045,826	2,039,738
Accumulated deficit	(1,927,279)	(1,928,984)
Accumulated other comprehensive loss	(344)	(269)
Total stockholders' equity	<u>118,276</u>	<u>110,557</u>
Total Liabilities and Stockholders' Equity	<u>\$ 242,540</u>	<u>\$ 242,356</u>

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

HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	Three Months Ended	
	April 1, 2005	April 2, 2004
Net sales	\$ 72,915	\$ 55,106
Cost of sales	<u>45,868</u>	<u>33,219</u>
Gross profit	<u>27,047</u>	<u>21,887</u>
Operating expenses:		
Research and development	9,459	8,850
Selling, general and administrative	15,325	13,994
Amortization of intangibles	<u>958</u>	<u>1,933</u>
Total operating expenses	<u>25,742</u>	<u>24,777</u>
Income (loss) from operations	1,305	(2,890)
Interest income, net	522	452
Other expense, net	<u>(49)</u>	<u>(39)</u>
Income (loss) before income taxes	<u>1,778</u>	<u>(2,477)</u>
Provision for income taxes	<u>72</u>	<u>100</u>
Net income (loss)	<u>\$ 1,706</u>	<u>\$ (2,577)</u>
Net income (loss) per share:		
Basic	<u>\$ 0.02</u>	<u>\$ (0.04)</u>
Diluted	<u>\$ 0.02</u>	<u>\$ (0.04)</u>
Shares used to compute net income (loss) per share:		
Basic	<u>72,839</u>	<u>71,713</u>
Diluted	<u>74,375</u>	<u>71,713</u>

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	
	April 1, 2005	April 2, 2004
Cash flows from operating activities:		
Net income (loss)	\$ 1,706	\$ (2,577)
Adjustments to reconcile net income (loss) to cash used in operating activities:		
Amortization of intangibles	1,730	3,473
Depreciation	2,080	2,461
Stock-based compensation	5	8
Benefit from excess and obsolete inventories	(51)	(667)
Loss on disposal of fixed assets	89	89
Deferred income taxes	—	3
Changes in assets and liabilities:		
Accounts receivable	9,148	6,259
Inventories	(120)	(5,200)
Prepaid expenses and other assets	2,419	107
Accounts payable	1,109	317
Deferred revenue	8,106	(4,726)
Income taxes payable	(566)	(26)
Accrued excess facilities costs	(1,147)	(1,164)
Accrued and other liabilities	(16,605)	(2,782)
Net cash provided by (used in) operating activities	<u>7,903</u>	<u>(4,425)</u>
Cash flows from investing activities:		
Purchases of investments	(19,787)	(22,561)
Proceeds from sale of investments	20,747	21,780
Acquisition of property and equipment, net	(1,815)	(1,647)
Acquisition of BTL, net of cash acquired	(5,955)	—
Net cash used in investing activities	<u>(6,810)</u>	<u>(2,428)</u>
Cash flows from financing activities:		
Borrowings under bank line and term loan	—	228
Repayments under bank line and term loan	(386)	(421)
Repayments of capital lease obligations	(32)	—
Proceeds from issuance of common stock, net	4,243	1,958
Net cash provided by financing activities	<u>3,825</u>	<u>1,765</u>
Effect of exchange rate changes on cash and cash equivalents	<u>140</u>	<u>37</u>
Net increase (decrease) in cash and cash equivalents	5,058	(5,051)
Cash and cash equivalents at beginning of period	<u>26,603</u>	<u>41,877</u>
Cash and cash equivalents at end of period	<u>\$ 31,661</u>	<u>\$ 36,826</u>
Supplemental disclosure of cash flow information:		
Interest paid during the period	\$ 51	\$ 21
Income tax payments, net	\$ 127	\$ 152
Non-cash investing and financing activities:		
Issuance of restricted common stock to BTL shareholders	\$ 1,831	\$ —

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

HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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 statement 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 16, 2005. 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, 2005, 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 — Summary of Significant Accounting Policies

Stock Based Compensation. Harmonic accounts for employee stock option plans in accordance with Accounting Principles Board No. 25 (APB 25), "Accounting for Stock Issued to Employees," and has adopted the disclosure requirements under SFAS No. 148, "Accounting for Stock-Based Compensation — Transition and Disclosure," which was issued in December 2002. If charges for Harmonic's stock plans had been determined based on the fair value method at the grant dates, as prescribed in SFAS No. 123, "Accounting for Stock-Based Compensation," the Company's net loss and net loss per share would have been as follows:

	(In thousands, except per share data)		Three Months Ended	
	April 1, 2005	April 2, 2004	April 1, 2005	April 2, 2004
Net income (loss) as reported	\$ 1,706	\$ (2,577)		
Deduct: Employee stock expense included in net income (loss), net of related tax effects	—	—		
Add: Total stock expense determined under fair value based method for all awards, net of related tax effects	(2,182)	(2,603)		
Pro forma net loss	\$ (476)	\$ (5,180)		
Basic and Diluted net income (loss) per share:				
As reported	\$ 0.02	\$ (0.04)		
Pro forma	\$ (0.01)	\$ (0.07)		

Note 3 — BTL Acquisition

On February 25, 2005, Harmonic purchased all of the issued and outstanding shares of Broadcast Technology Limited, or BTL, a private UK company, for a purchase consideration of £4.0 million, or approximately \$7.6 million. The purchase consideration consisted of a payment of £3.0 million in cash and the issuance of 169,112 shares of Harmonic common stock. In addition, Harmonic paid approximately \$0.3 million in transaction costs for a total transaction price of approximately \$7.9 million. The addition of BTL will expand our product line to include professional video/audio receivers and decoders. This will enable us to increase our distribution capabilities through expansion into new geographic regions. These factors contributed to a purchase price exceeding the fair value of BTL's net tangible and intangible assets acquired; as a result, we have recorded goodwill in connection with this transaction.

The BTL acquisition was accounted for under SFAS No. 141 and certain specified provisions of SFAS No. 142. The results of operations of BTL are included in our Condensed Consolidated Statements of Operations from February 25, 2005, the date of acquisition. The following table summarizes the allocation of the purchase price based on the estimated fair value of the tangible assets acquired and the liabilities assumed at the date of acquisition (in thousands):

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Cash acquired	\$ 149
Other tangible assets acquired	2,508
Amortizable intangible assets:	
Existing technology	2,050
Customer relationships	540
Tradenames/trademarks	320
Order backlog	60
Goodwill	3,745
Total assets acquired	9,372
Liabilities assumed	(568)
Deferred tax liability for acquired intangibles	(891)
Net assets acquired	<u>\$ 7,913</u>

Identified intangible assets, including existing technology and customer relationships are being amortized over their useful lives of 3 years; tradename/trademarks are being amortized over their useful lives of 2 years; and order backlog is being amortized over its useful life of 3 months.

The residual purchase price of \$3.7 million has been recorded as goodwill and allocated to the Convergent Systems reporting unit. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. The goodwill as a result of this acquisition is not expected to be deductible for tax purposes. In accordance with SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill relating to the acquisition of BTL is not being amortized and will be tested for impairment annually or whenever events indicate that an impairment may have occurred.

Supplemental pro forma information is not provided since the acquisition of BTL was not material to the Company's results.

Note 4 — Cash, Cash Equivalents and Investments

At April 1, 2005 and December 31, 2004, cash, cash equivalents and short-term investments are summarized as follows:

(In thousands)	April 1, 2005	December 31, 2004
Cash and cash equivalents	\$ 31,661	\$ 26,603
Short-term investments:		
Less than one year	49,500	49,373
Due in 1-2 years	23,393	24,631
Total short-term investments	72,893	74,004
Total cash, cash equivalents and short-term investments	<u>\$ 104,554</u>	<u>\$ 100,607</u>

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
April 1, 2005				
U.S. government debt securities	\$ 27,788	\$ —	\$ (173)	\$ 27,615
Corporate debt securities	41,620	5	(347)	41,278
Other debt securities	4,000	—	—	4,000
Total	<u>\$ 73,408</u>	<u>\$ 5</u>	<u>\$ (520)</u>	<u>\$ 72,893</u>
December 31, 2004				
U.S. government debt securities	\$ 23,526	\$ —	\$ (111)	\$ 23,415
Corporate debt securities	43,341	—	(252)	43,089
Other debt securities	7,500	—	—	7,500
Total	<u>\$ 74,367</u>	<u>\$ —</u>	<u>\$ (363)</u>	<u>\$ 74,004</u>

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

Note 5 — Inventories

(In thousands)	April 1, 2005	December 31, 2004
Raw materials	\$ 14,487	\$ 13,171
Work-in-process	3,536	4,085
Finished goods	25,214	24,507
	<u>\$ 43,237</u>	<u>\$ 41,763</u>

Note 6 — Goodwill and Identified Intangibles

Harmonic accounts for goodwill and other identified intangibles in accordance with 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 and the testing of existing goodwill and other intangibles for impairment at least annually. Management believes that the operating divisions, Broadband Access Networks, or BAN, and Convergent Systems, or CS, represent the Company's reporting units and CS is the only reporting unit with goodwill and intangible assets. The following is a summary of goodwill and intangible assets as of April 1, 2005 and December 31, 2004:

	April 1, 2005			December 31, 2004		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)					
Identified intangibles:						
Developed core technology	\$ 29,847	\$ (27,917)	\$ 1,930	\$ 29,059	\$ (27,220)	\$ 1,839
Customer base	31,909	(31,818)	91	33,295	(31,000)	2,295
Trademark and tradename	4,219	(3,919)	300	4,076	(3,794)	282
Supply agreement	3,512	(2,982)	530	3,107	(2,892)	215
Subtotal of identified intangibles	69,487	(66,636)	2,851	69,537	(64,906)	4,631
Goodwill	5,525	—	5,525	1,780	—	1,780
Total goodwill and other intangibles	<u>\$ 75,012</u>	<u>\$ (66,636)</u>	<u>\$ 8,376</u>	<u>\$ 71,317</u>	<u>\$ (64,906)</u>	<u>\$ 6,411</u>

The acquisition of BTL resulted in an increase in goodwill and intangible assets of \$3.7 million and \$3.0 million, respectively, during the three months ended April 1, 2005. In addition, intangible assets decreased by \$3.0 million during the three months ended April 1, 2005 from the reversal of a reserve for a DiviCom pre-acquisition uncertain tax provision.

For the three months ended April 1, 2005 and April 2, 2004, the Company recorded a total of \$1.7 million and \$3.5 million, respectively, of amortization expense for identified intangibles, of which \$0.8 million and \$1.5 million, respectively, was included in cost of sales. The estimated future amortization expense of purchased intangible assets with definite lives for the next four years is as follows (in thousands):

Years Ending December 31,	Amounts
2005 (remaining nine months)	\$ 927
2006	917
2007	863
2008	144
Total	<u>\$ 2,851</u>

Note 7 — Credit Facilities and Long-Term Debt

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings of up to approximately \$14.0 million, including \$4.0 million for equipment under a secured term loan. This facility, which was amended and restated in December 2004, expires in December 2005, contains financial and other covenants including the requirement for Harmonic to maintain cash, cash equivalents and short-term investments, net of credit extensions, of not less than \$50.0 million. If Harmonic is unable to maintain this cash, cash equivalents and short-term investments balance or satisfy the additional affirmative covenant requirements, Harmonic would be in noncompliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise its remedies under the facility which include declaring all obligations immediately due and payable and disposing of the collateral if obligations were not repaid. At April 1, 2005, Harmonic was in compliance with the covenants under this line of credit facility. Future borrowings pursuant to the line bear interest at the bank's prime rate (5.75% as of April 1, 2005) or prime plus 0.5% for equipment borrowings. Borrowings are payable monthly and are collateralized by all of Harmonic's assets. As of April 1, 2005, \$2.0 million was outstanding under the equipment term loan portion of this facility. The term loan is payable

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monthly, including principal and interest at 6.25% per annum on outstanding borrowings as of April 1, 2005 and matures at various dates through December 2007. Other than standby letters of credit and guarantees (Note 13), there were no other outstanding borrowings or commitments under the line of credit facility as of April 1, 2005.

Note 8 — Net Income/(Loss) Per Share

Basic net income/(loss) per share is computed by dividing the net income/(loss) attributable to common stockholders for the period by the weighted average number of the common shares outstanding during the period. The diluted net loss per share is the same as the basic net loss per share for the three months ended April 2, 2004 because potential common shares, such as common shares issuable upon the exercise of stock options, are only considered when their effect would be dilutive. During the three month periods ended April 1, 2005 and April 2, 2004, 3.8 million and 5.6 million, of weighted average antidilutive securities, including options, were excluded from the net income (loss) per share computations, respectively, because their effect is antidilutive.

Following is a reconciliation of the numerators and denominators of the basic and diluted net loss per share computations:

(In thousands, except per share data)	Three Months Ended	
	April 1, 2005	April 2, 2004
Net income (loss) (numerator)	\$ 1,706	\$ (2,577)
Shares calculation (denominator):		
Weighted average shares outstanding — basic	72,839	71,713
Effect of Dilutive Securities:		
Potential Common Stock relating to stock options	1,536	—
Average shares outstanding — diluted	74,375	71,713
Net income (loss) per share — basic	\$ 0.02	\$ (0.04)
Net income (loss) per share — diluted	\$ 0.02	\$ (0.04)

Note 9 — Comprehensive Income/(Loss)

The Company's total comprehensive income/(loss) was as follows:

	In thousands	Three Months Ended	
		April 1, 2005	April 2, 2004
Net income/(loss)		\$ 1,706	\$ (2,577)
Change in unrealized gain/(loss) on investments, net		(94)	24
Foreign currency translation		19	(154)
Total comprehensive income/(loss)		\$ 1,631	\$ (2,707)

Note 10 — Restructuring and Excess Facilities

During 2001, Harmonic recorded a charge for excess facilities costs of \$21.8 million. As a result of uncertain market conditions and lower sales during the second half of 2002, the Company changed its estimates related to accrued excess facilities with regard to the expected timing and amount of sublease income due to the substantial surplus of vacant commercial space in the San Francisco Bay Area. In connection with these actions, Harmonic recorded an additional excess facilities charge of \$22.5 million, net of expected sublease income, to selling, general and administrative expenses during the second half of 2002.

As of April 1, 2005, accrued excess facilities cost totaled \$28.3 million of which \$5.4 million was included in current accrued liabilities and \$22.9 million in other non-current liabilities. The Company incurred cash outlays of \$1.1 million, net of \$0.2 million of sublease income, during the first three months of 2005 principally for lease payments, property taxes, insurance and other maintenance fees related to vacated facilities. Harmonic expects to pay approximately \$3.6 million of excess facility lease costs, net of estimated sublease income, for the remainder of 2005 and to pay the remaining \$24.7 million, net of estimated sublease income, over the remaining lease terms

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through September 2010. Harmonic reassesses this liability quarterly and adjusts as necessary based on changes in the timing and amounts of expected sublease rental income or changes in other assumptions due to changes in market conditions.

The following table summarizes restructuring activities:

In thousands

	<u>Excess Facilities</u>
Balance at December 31, 2004	29,421
Provisions	—
Cash payments, net of sublease income	<u>(1,146)</u>
Balance at April 1, 2005	<u>\$ 28,275</u>

Note 11 — 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. The Company has been organized into two operating segments: BAN, for fiber optic systems, and CS, for digital video systems. Each segment has its own management team directing its product development, marketing strategies and its customer service requirements. A separate sales force generally supports both segments with appropriate product and market specialization as required.

The results of the reportable segments are derived directly from Harmonic's management reporting system. These results reported below are based on Harmonic's method of internal reporting and are not necessarily presented in conformity with generally accepted accounting principles. Management measures the performance of each segment based on several metrics, including revenue and income or loss from segment operations. These results are used, in part, to evaluate the performance of, and allocate resources to each of the segments. Income (loss) from segment operations excludes intangible amortization expense, corporate expenses, excess facilities charges, eliminations, and interest and other income, net. Corporate expenses and excess facilities charges include human resources, legal, finance and other corporate departments, and intercompany eliminations. Net income or loss, and assets and liabilities are not internally reported by business segment.

Segment Sales and Profit:

	In thousands	<u>Three Months Ended</u>	
		<u>April 1, 2005</u>	<u>April 2, 2004</u>
Net sales:			
Convergent Systems (CS)		\$ 56,586	\$ 35,796
Broadband Access Networks (BAN)		16,329	19,310
Total net sales		<u>\$ 72,915</u>	<u>\$ 55,106</u>
Income (loss) from segment operations:			
Convergent Systems		\$ 9,491	\$ 2,930
Broadband Access Networks		(2,106)	1,970
Income (loss) from segment operations		7,385	4,900
Amortization of intangibles		(1,730)	(3,473)
Interest and other income, net		473	413
Corporate expenses and eliminations		(4,350)	(4,317)
Income (loss) before income taxes		<u>\$ 1,778</u>	<u>\$ (2,477)</u>

Note 12 — Related Party

A director of Harmonic since January 2002 is a director of Terayon Communications, with whom the Company signed a reseller agreement for certain products. Product purchases from Terayon were approximately \$8.8 million and \$1.0 million for the three months ended April 1, 2005 and April 2, 2004, respectively. As of April 1, 2005 and

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December 31, 2004, Harmonic had liabilities to Terayon of approximately \$6.4 million and \$0.2 million, respectively, for inventory purchases.

Note 13 — Guarantees

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

	In thousands	Three Months Ended	
		April 1, 2005	April 2, 2004
Balance at beginning of the period		\$ 5,429	\$ 4,886
Accrual for warranties		1,400	1,254
Warranty costs incurred		(1,242)	(1,352)
BTL acquisition		21	—
Balance at end of period		\$ 5,608	\$ 4,788

Standby Letters of Credit. As of April 1, 2005 the Company's financial guarantees consisted of standby letters of credit outstanding, which were principally related to customs bond requirements and corporate purchase cards. The maximum amount of potential future payments under these arrangements was \$0.9 million.

Indemnifications. Harmonic is obligated to indemnify its officers and the members of its Board of Directors pursuant to the requirements of its bylaws and contractual indemnity agreements. Harmonic also indemnifies some of its suppliers and customers for specified intellectual property rights pursuant to certain parameters and restrictions. The scope of these indemnities varies, but in some instances, includes indemnification for damages and expenses (including reasonable attorneys' fees). There have been no claims for indemnification and, accordingly, no amounts have been accrued in respect of the indemnifications provisions through April 1, 2005.

Guarantees. As of April 1, 2005, Harmonic had no other guarantees outstanding.

Note 14 — Legal Proceedings

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

A consolidated complaint, filed on December 7, 2000, was brought on behalf of a purported class of persons who purchased Harmonic's publicly traded securities between January 19 and June 26, 2000. The complaint also alleged claims on behalf of a purported subclass of persons who purchased C-Cube securities between January 19 and May 3, 2000. In addition to Harmonic and certain of its officers and directors, the complaint also named C-Cube Microsystems Inc. and several of its officers and directors as defendants. The complaint alleged that, by making false or misleading statements regarding Harmonic's prospects and customers and its acquisition of C-Cube, certain defendants violated sections 10(b) and 20(a) of the Securities Exchange Act 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. On November 13, 2002, the Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a

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notice of appeal on July 1, 2003. The U.S. Court of Appeals for the Ninth Circuit heard oral arguments on February 17, 2005, but has not ruled on the appeal yet.

A derivative action purporting to be on behalf of Harmonic was filed against its then-current directors in the Superior Court for the County of Santa Clara on September 5, 2000. Harmonic also was named as a nominal defendant. The complaint is based on allegations similar to those found in the securities class action and claims that the defendants breached their fiduciary duties by, among other things, causing Harmonic to violate federal securities laws. The derivative action was removed to the U.S. District Court for the Northern District of California on September 20, 2000. All deadlines in this action were stayed pending resolution of the motions to dismiss the securities class action. On July 29, 2003, the Court approved the parties' stipulation to dismiss this derivative action without prejudice and to toll the applicable limitations period. The limitations period is tolled until fourteen days after (1) defendants provide plaintiff with a copy of the mandate issued by the Ninth Circuit in the securities action or (2) either party provides written notice of termination of the tolling period, whichever is first.

A second derivative action purporting to be on behalf of Harmonic was filed in the Superior Court for the County of Santa Clara on May 15, 2003. It alleges facts similar to those previously alleged in the securities class action and the federal derivative action. The complaint names as defendants former and current Harmonic officers and directors, along with former officers and directors of C-Cube Microsystems, Inc., who were named in the securities class action. The complaint also names Harmonic as a nominal defendant. The complaint alleges claims for abuse of control, gross mismanagement, and waste of corporate assets against the Harmonic defendants, and claims for breach of fiduciary duty, unjust enrichment, and negligent misrepresentation against all defendants. On July 22, 2003, the Court approved the parties' stipulation to stay the case pending resolution of the appeal in the securities class action. Although the parties initially agreed in principle to a dismissal without prejudice on similar terms as in the federal derivative action, after further discussion, the parties decided that the stay currently in place suffices to protect their respective interests.

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

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4,859,016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. Harmonic has not been served in the case. Harmonic is currently evaluating its position with respect to this patent and has engaged in discussions with the plaintiff regarding potential settlement of the matter. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

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

Note 15 — Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board, "FASB," issued Statement No. 151, *Inventory Costs*, to amend the guidance in Chapter 4, *Inventory Pricing*, of FASB Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*. Statement 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) and requires these costs be treated as current period charges. Additionally, Statement 151 requires that allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the production facilities. The provisions of SFAS No. 151 are

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effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the impact of SFAS No. 151 on its financial position, results of operations and liquidity.

In December 2004, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets an amendment of APB Opinion No. 29*. SFAS No. 153 amends the guidance in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, which is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged, with certain exceptions. SFAS No. 153 amends APB Opinion 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of SFAS No. 153 are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not currently believe that Statement 153 will have a significant impact on its financial condition and results of operations.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment*. SFAS No. 123(R) is a revision of FASB SFAS No. 123, *Accounting for Stock-Based Compensation* and supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. As noted in our stock-based compensation accounting policy, the Company does not record compensation expense for stock-based compensation. Under SFAS 123(R), the Company will be required to measure the cost of employee services received in exchange for stock based on the grant-date fair value (with limited exceptions). That cost will be recognized over the period during which an employee is required to provide service in exchange for the award (usually the vesting period). The fair value will be estimated using an option-pricing model. This is effective as of the beginning of the first annual reporting period that begins after June 15, 2005. The Company will adopt SFAS 123(R) at the beginning of fiscal year 2006. The Company is currently in the process of evaluating the impact of SFAS 123(R) on its financial statements, including different option-pricing models.

On March 29, 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) regarding the Staff's interpretation of SFAS 123(R). This interpretation expresses the views of the staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. This SAB provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods, the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of SFAS 123(R) in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of SFAS 123(R), the modification of employee share options prior to adoption of Statement 123(R) and disclosures in Management's Discussion and Analysis subsequent to adoption of SFAS 123(R). The Company will adopt SAB 107 in connection with its adoption of SFAS 123(R), which could have a material impact on our consolidated financial position, results of operations and cash flows.

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 our expectations of continued customer concentration; our expectation that current business trends will result in higher net sales in 2005 than in 2004; our expectation that we will continue to sell an increased amount of third party products to our customers for the next one to two quarters; our expectations regarding a firmer industry capital spending environment, intensifying competition between cable and satellite operators, and the rebuilding or upgrading by telcos of their networks; our expectation that domestic sales will account for the majority of revenues in 2005; our expectation that international sales will continue to account for a significant portion of our net sales for the foreseeable future; our expectations regarding our capital expenditures during 2005; our expectations regarding the amount of amortization expense we will incur during 2005; and our belief that our existing liquidity sources will satisfy our cash requirement for at least the next 12 months. These statements involve risks and uncertainties as well as assumptions that, if they were to never materialize or prove incorrect, could cause actual results to differ materially from those projected, expressed or implied in the forward-looking statements. These risks and uncertainties include those set forth under "Factors That May Affect Future Results of Operations" below and elsewhere in this Quarterly Report on Form 10-Q and that are otherwise described from time to time in Harmonic's filings with the Securities and Exchange Commission.

Overview

Harmonic designs, manufactures and sells digital video systems and fiber optic systems that enable network operators to provide a range of interactive and advanced digital services that include digital video, video-on-demand, or VOD, high definition television (HDTV), high-speed Internet access and telephony. Historically, most of our sales have been derived from sales of digital headend products and fiber optic transmission systems to cable television and satellite operators. We offer digital headend products to enable delivery of digital video, voice and data over satellite and wireless networks and cable systems. We also derive a portion of our revenue, directly or indirectly, from sales of fiber optic transmission systems to cable television operators and from telephone companies that offer video services to their customers.

Harmonic is organized into two operating divisions, Convergent Systems, or CS, for digital video systems, and Broadband Access Networks, or BAN, for fiber optic systems. In the first quarter of 2005, sales of CS products accounted for approximately 78% of net sales, while BAN products accounted for approximately 22% of net sales. Historically, a majority of our net sales have been to relatively few customers, and due in part to the consolidation of ownership of cable television and direct broadcast satellite systems, we expect this customer concentration to continue for the foreseeable future. In the first quarter of 2005, sales to Comcast and Charter Communications accounted for 35% and 10% of net sales, respectively. In the first quarter of 2004, sales to Comcast, Echostar Satellite Corp. and Cox Communications accounted for 14%, 14% and 13% of net sales, respectively.

Industry capital spending has been steadily improving since the beginning of 2003, although it is significantly below the levels seen in 1999 and early 2000. We believe that our sequential quarterly sales increases in 2003, the 36% increase in net sales in 2004 compared to 2003, and the 32% increase in sales in the first quarter of 2005 compared to the first quarter of 2004 reflected a firmer industry capital spending environment worldwide which favorably impacted Harmonic. We believe that this improvement in the industry capital spending environment was, in part, a result of the intensifying competition between cable and satellite operators to offer more channels of digital video and new services, such as VOD and HD television, and an overall improvement in industry capital markets. In addition, the major telcos have begun to implement plans to rebuild or upgrade their networks to offer bundled video, voice and data services. These competitive factors affecting our customers are happening in both the U.S. and international markets and we expect these trends to continue for the remainder of fiscal 2005.

In the first quarter of 2005, we sold an increased volume of third party products. A major customer requested that we bundle certain third party products as part of our solution in greater volumes than we expected. Since sales of these third party products carry a very low profit margin, our overall gross profit was lower than we expected. We anticipate continuing this trend of selling such an increased volume of third party products bundled with our systems for one to two more quarters, and this could adversely impact our gross margins.

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Sales to customers outside of the United States in the first quarter of 2005 represented 36% of our total net sales. A significant portion of international sales are made to distributors and system integrators, which are generally responsible for importing the products and providing installation and technical support and service to customers within their territory. We expect international sales to continue to account for a significant portion of our net sales for the foreseeable future.

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

On February 25, 2005, Harmonic purchased all of the issued and outstanding shares of Broadcast Technology Limited, or BTL, a private UK company, for a purchase consideration of £4.0 million, or approximately \$7.6 million. The purchase consideration consisted of a payment of £3.0 million in cash and the issuance of 169,112 shares of Harmonic common stock. BTL develops, manufactures and distributes professional video/ audio receivers and decoders and has approximately 40 employees.

Results of Operations

Harmonic's historical consolidated statements of operations data for the first quarter of 2005 and 2004 as a percentage of net sales, are as follows:

	Three Months Ended	
	April 1, 2005	April 2, 2004
Net sales	100%	100%
Cost of sales	63	60
Gross profit	37	40
Operating expenses:		
Research and development	13	16
Selling, general and administrative	21	25
Amortization of intangibles	1	4
Total operating expenses	35	45
Income (loss) from operations	2	(5)
Interest and other income (expense), net	—	1
Income (loss) before income taxes	2	(4)
Provision for (benefit from) income taxes	—	—
Net income (loss)	2%	(5)%

Net Sales — Consolidated and Segment

Harmonic's consolidated and segment net sales in the first quarter of 2005 compared with the corresponding period in 2004 is presented in the table below. Also presented is the related dollar and percentage increase (decrease) in consolidated and segment net sales in the first quarter of 2005 compared with the corresponding period in 2004 (in thousands, except percentages).

Segmental Sales Data:	Three Months Ended	
	April 1, 2005	April 2, 2004
Convergent Systems	\$ 56,586	\$ 35,796
Broadband Access Networks	16,329	19,310
Net sales	\$ 72,915	\$ 55,106

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Segmental Sales Data:	Three Months Ended	
	April 1, 2005	April 2, 2004
Convergent Systems increase	\$ 20,790	
Broadband Access Networks decrease	(2,981)	
Total increase	\$ 17,809	
Convergent Systems percent change	58.1%	
Broadband Access Networks percent change	(15.4)%	
Total percent change	32.3%	

Net sales increased in the CS division during the first quarter of 2005 compared to the same period of 2004 principally due to stronger spending by domestic cable customers for major digital headend projects and the continued rollout of new services, such as VOD and HDTV. The CS division sold significantly more third party products that were included with our systems in the first quarter of 2005 compared to the same period of 2004 because a major customer requested that we provide these products as part of our solution. Sales of third party products are expected to remain above historical levels for at least one to two quarters. Encoder sales in the first quarter of 2005 were significantly higher than the first quarter of 2004 but were down from the levels recorded in the fourth quarter of 2004. Telco revenue increased significantly in the first quarter of 2005 compared to the first quarter of 2004 as telcos continue to introduce and expand video services.

Net sales decreased in the BAN division in the first quarter of 2005 as compared to the same period in 2004 principally due to lower shipments to domestic cable customers, which was partially offset by increased revenue from products sold to telcos for fiber-to-the-premises projects. The decrease in domestic sales also was partially offset by a moderate improvement in spending by international cable operators. Transmitter, node and receiver revenue decreased in the first quarter of 2005 compared to the first quarter of 2004 principally due to lower demand by domestic cable customers. This decrease was partially offset by increased revenue from shipments of our optical products to telcos for fiber-to-the-premises projects.

Net Sales — Geographic

Harmonic's domestic and international net sales in the first quarter of 2005 compared with the corresponding period in 2004 are presented in the table below. Also presented is the related dollar and percentage increase (decrease) in domestic and international net sales in the first quarter of 2005 compared with the corresponding period in 2004 (in thousands, except percentages).

Geographic Sales Data:	Three Months Ended	
	April 1, 2005	April 2, 2004
U.S.	\$ 46,374	\$ 36,768
International	26,541	18,338
Net sales	\$ 72,915	\$ 55,106
U.S. increase	\$ 9,606	
International increase	8,203	
Total Increase	\$ 17,809	
U.S. percent change	26.1%	
International percent change	44.7%	
Total percent change	32.3%	

The increased U.S. sales in the first quarter of 2005 compared to the corresponding period in 2004 was principally due to stronger spending by domestic cable customers for major digital headend projects and the continued rollout of new services, such as VOD and HDTV. Also, revenue from sales to telcos increased in the first quarter of 2005 compared to the first quarter of 2004 as shipments of our optical products for domestic fiber-to-the-premises projects increased.

International sales in the first quarter of 2005 increased significantly compared to the corresponding period in 2004 and remained strong in the international cable markets, especially the European cable market as international cable operators continued to implement digital video solutions. The increased international sales in the first quarter of 2005 as compared to the same period of 2004, was also due to increased international capital spending primarily in

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Europe and Asia. As a result of these factors, we expect that international sales will continue to account for a significant portion of our net sales for the foreseeable future.

Gross Profit

Harmonic's gross profit and gross profit as a percentage of consolidated net sales in the first quarter of 2005 as compared with the corresponding prior year period of 2004 are presented in the tables below. Also presented is the related dollar and percentage increase in gross profit in the first quarter of 2005 as compared with the corresponding period of 2004 (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Gross profit	\$ 27,047	\$ 21,887
As a % of net sales	37.1%	39.7%
Increase	\$ 5,160	
Percent change	23.6%	

The increase in gross profit in the first quarter of 2005 as compared to the corresponding period of 2004 was primarily due to higher sales. The gross margin percentage of 37.1% in the first quarter of 2005 compared to 39.7% in the first quarter of 2004 decreased primarily due to an increase in sales of third party products, which carry a significantly lower margin, to our end customers, and to a lesser extent by higher manufacturing costs due to expenses associated with the expansion of our FTTP product production, unrecovered manufacturing costs from lower BAN production levels, and a less favorable mix of products sold. The higher rate of sales of third party products to our end customers is expected to continue for at least one to two quarters which could adversely impact our gross margins.

In the first quarter of 2005, \$0.8 million of amortization of intangibles was included in cost of sales compared to \$1.5 million in the first quarter of 2004. The lower amortization in the first quarter of 2005 was due to the intangibles arising from the DiviCom acquisition becoming fully amortized during the quarter. We expect to record approximately \$0.5 million in amortization of intangibles in cost of sales in the remaining nine months of 2005 due to the acquisition of BTL in February 2005.

Research and Development

Harmonic's research and development expense and the expense as a percentage of consolidated net sales in the first quarter of 2005, as compared with the corresponding period of 2004, are presented in the table below. Also presented is the related dollar and percentage increase in research and development expense in the first quarter of 2005 as compared with the corresponding period of 2004 (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Research and development expense	\$ 9,459	\$ 8,850
As a % of net sales	13.0%	16.1%
Increase	\$ 609	
Percent change	6.9%	

The increase in research and development expense in the first quarter of 2005 as compared to the same period in 2004 was primarily the result of increased compensation costs of \$1.1 million primarily from headcount increases, which was partially offset by lower costs for services provided by third parties of \$0.3 million.

Selling, General and Administrative

Harmonic's selling, general and administrative expense and the expense as a percentage of consolidated net sales in the first quarter of 2005, as compared with the corresponding period of 2004, are presented in the table below. Also presented is the related dollar and percentage increase in selling, general and administrative expense in the first

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quarter of 2005 as compared with the corresponding period of 2004 (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Selling, general and administrative expense	\$ 15,325	\$ 13,994
As a % of net sales	21.0%	25.4%
Increase	\$ 1,331	
Percent change	9.5%	

The increase in selling, general and administrative expense in the first quarter of 2005 compared to the same period in 2004 was primarily a result of increased accounting and corporate governance costs of \$0.5 million, increased compensation costs of \$0.4 million, and increased selling costs of \$0.2 million. The increased compensation and selling costs in the first quarter of 2005 compared to the first quarter of 2004 was primarily due to higher commissions from the increased sales, as well as higher sales related travel expenses and increased headcount in the sales and marketing areas.

Amortization of Intangibles

Hammonic's amortization of intangible assets in operating expenses and the expense as a percentage of consolidated net sales in the first quarter of 2005 as compared with the corresponding period of 2004 are presented in the table below (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Amortization of intangibles	\$ 958	\$ 1,933
As a % of net sales	1.3%	3.5%

The decrease in the amortization of intangibles in the first quarter of 2005 compared to the same period in 2004 was primarily due to the completion of amortization of the DiviCom intangible assets during the first quarter of 2005. Hammonic expects to record a total of approximately \$0.4 million in amortization of intangibles in operating expenses in the remaining nine months of 2005 due to the intangible assets resulting from the acquisition of BTL in February 2005.

Interest Income, Net

Hammonic's interest income, net, and interest income, net, as a percentage of consolidated net sales in the first quarter of 2005 as compared with the corresponding period of 2004, are presented in the table below. Also presented is the related dollar and percentage increase in interest income, net, in the first quarter of 2005 as compared with the corresponding period of 2004 (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Interest income, net	\$ 522	\$ 452
As a % of net sales	0.7%	0.8%
Increase	\$ 70	
Percent change	15.5%	

The increase in interest income, net, in the first three months of 2005 compared to the corresponding period of 2004, was due primarily to a larger cash and short-term investment portfolio during the respective period of 2005 as compared to 2004 and to a lesser extent higher interest rates, and was partially offset by higher interest expense in the first quarter of 2005 compared to the same period in 2004 due to a higher debt balance.

Other Income (Expense), Net

Hammonic's other income (expense), net, and other income (expense), net, as a percentage of consolidated net sales in the first quarter of 2005 as compared with the corresponding period of 2004, are presented in the table below.

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Also presented is the related dollar and percentage decrease in other income (expense), net, in the first quarter of 2005 as compared with the corresponding periods of 2004 (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Other income (expense)	\$ (49)	\$ (39)
As a % of net sales	(0.1)%	(0.1)%
Decrease	\$ (10)	
Percent change	(25.6)%	

The increase in other expense, net, in the first quarter of 2005 compared to the same period of 2004 was primarily due to losses in 2005 from foreign exchange compared to a gain from foreign exchange in 2004, which was partially offset by lower corporate fees.

Income Taxes

Harmonic's provision for income taxes, and provision for income taxes as a percentage of consolidated net sales in the first quarter of 2005, as compared with the corresponding period of 2004, are presented in the tables below (in thousands, except percentages).

	Three Months Ended	
	April 1, 2005	April 2, 2004
Provision for income taxes	\$ 72	\$ 100
As a % of net sales	0.1%	0.2%

The decrease in the provision for income taxes in the first quarter of 2005 compared to the corresponding prior year period was due to lower foreign income taxes.

Segments

Harmonic's management uses income or loss from segment operations as its measure of segment profitability. Income or loss from segment operations excludes intangible amortization expense, corporate expenses, including excess facilities charges, and interest income, net, and other income (expense), net. See Note 11 of Notes to Condensed Consolidated Financial Statements.

Fluctuations in net sales by operating segment are discussed more extensively in the section above entitled *Net Sales — Consolidated and Segment*

Harmonic's income (loss) from segment operations and the income (loss) as a percentage of consolidated net sales in the first quarter of 2005, as compared with the corresponding period of 2004, are presented in the table below. Also presented is the related dollar and percentage increase in segment operations results in the first quarter of 2005 as compared with the corresponding periods of 2004 (in thousands, except percentages).

Convergent Systems (CS)	Three Months Ended	
	April 1, 2005	April 2, 2004
Income from segment operations	\$ 9,491	\$ 2,930
As a % of net segment sales	16.8%	8.2%
Increase	\$ 6,561	
Percent change	223.9%	

The increase in CS income from segment operations in the first quarter of 2005 compared to the same period of 2004, was primarily due to higher sales and lower third party manufacturing costs, partially offset by a less favorable margin on the mix of products sold, and an increase in operating expenses as compared to the same period of 2004. The lower gross margin was primarily caused by the increase in sales of third-party products to the end customers,

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which have a significantly lower gross margin than sales of our own products. The 2005 increase in operating expenses in the first quarter of 2005 was a result of higher research and development expenses and selling expenses as compared to the same period of 2004.

Broadband Access Networks (BAN)	Three Months Ended	
	April 1, 2005	April 2, 2004
Income (loss) from segment operations	\$ (2,106)	\$ 1,970
As a % of net segment sales	(12.9)%	10.2%
Decrease	\$ (4,076)	
Percent change	(206.9)%	

BAN incurred a loss from segment operations in the first quarter of 2005 compared to income in the same period in 2004, was primarily due to lower sales and increased manufacturing costs. Sales decreased by \$3.0 million in the first quarter of 2005 compared to the same period in 2004 resulting in lower gross margin. As a result of lower BAN sales, the lower production levels resulted in unrecovered manufacturing costs during the first quarter of 2005. In addition, manufacturing costs increased due to expenses associated with the expansion of our FTTP product production. BAN results for the first quarter of 2004 included a benefit of \$0.6 million related to products sold for which the cost basis had been written down in prior years and the first quarter of 2005 had no significant benefits.

Liquidity and Capital Resources

As of April 1, 2005, cash and cash equivalents and short-term investments totaled \$104.6 million, compared to \$100.6 million as of December 31, 2004. Cash provided by operations was \$7.9 million in the first three months of 2005, compared to cash used in operations of \$4.4 million in the first three months of 2004. The decreased use of cash in operations in the first three months of 2005 was primarily due to decreased accounts receivable of \$9.1 million, increased deferred revenue of \$8.1 million, lower prepaid expenses of \$2.4 million, depreciation and amortization of \$3.8 million and net income of \$1.7 million, which was partially offset by lower accrued and other liabilities of \$16.6 million. The decreased accounts receivable is primarily due to increased collection efforts and lower sales in the first quarter of 2005 compared to the fourth quarter of 2004. Increased deferred revenue is primarily due to the timing of revenue based on our revenue recognition policy and the completion stage of customers' orders. The increase in prepaid expenses and other assets is primarily due to the acquisition of BTL which resulted in goodwill and intangible assets of \$6.7 million offset by the reduction of the DiviCom intangible assets of \$3.0 million from the reversal of a reserve for a pre-acquisition uncertain tax position. The decrease in accrued and other liabilities is primarily related to the payments made by Harmonic of approximately \$5.8 million in February of 2005 pursuant to a tax sharing agreement between Harmonic and LSI Logic and lower compensation accruals.

On November 3, 2003, Harmonic completed a follow-on public offering of 9.0 million shares of its common stock at a price of \$7.40 per share. The net proceeds were approximately \$62.0 million, which is net of underwriters' fees of \$3.7 million, and related legal, accounting, printing and other expenses totaling approximately \$0.9 million. In connection with this offering, the underwriters exercised their option to purchase 1.35 million additional shares of common stock at \$7.40 per share on November 12, 2003 to cover over-allotments which resulted in additional net proceeds of approximately \$9.4 million. The net proceeds from the offering are being used for general corporate purposes, including payment of existing liabilities, research and development, the development or acquisition of new products or technologies, equipment acquisitions, general working capital and operating expenses.

Under the terms of the merger agreement with C-Cube, Harmonic is generally liable for C-Cube's pre-merger tax liabilities. Approximately \$10.0 million of pre-merger tax liabilities remained outstanding at April 1, 2005 and are included in accrued liabilities. These liabilities represent estimates of C-Cube's pre-merger tax obligations to various tax authorities in 11 countries. We are working with LSI Logic, which acquired the spun-off semiconductor business in June 2001 and assumed its obligations, to settle these obligations, a process which has been underway since the merger in 2000. Harmonic is unable to predict when the remaining obligations will be paid, or in what amount. The full amount of the estimated obligation has been classified as a current liability. To the extent that these obligations are finally settled for less than the amounts provided, Harmonic is required, under the terms of the tax-sharing agreement, to refund the difference to LSI Logic. Conversely, if the settlements are more than the \$10.0 million pre-merger tax liability, LSI is obligated to reimburse Harmonic.

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Additions to property, plant and equipment were \$1.8 million and \$1.6 million in the first three months of 2005 and 2004, respectively. Harmonic currently expects capital expenditures to be approximately \$8 million during 2005.

Harmonic has a bank line of credit facility with Silicon Valley Bank, which provides for borrowings up to \$14.0 million, including \$4.0 million for equipment under a secured term loan. This facility, which was amended and restated in December 2004 and expires in December 2005, contains financial and other covenants, including the requirement for Harmonic to maintain cash, cash equivalents and short-term investments, net of credit extensions, of not less than \$50.0 million. If Harmonic is unable to maintain this cash, cash equivalents and short-term investments balance or satisfy the additional affirmative covenant requirements, Harmonic would be in noncompliance with the facility. In the event of noncompliance by Harmonic with the covenants under the facility, Silicon Valley Bank would be entitled to exercise its remedies under the facility which include declaring all obligations immediately due and payable and disposing of the collateral if obligations were not repaid. At April 1, 2005, Harmonic was in compliance with the covenants under this line of credit facility. Future borrowings pursuant to the line bear interest at the bank's prime rate (5.75% at April 1, 2005) or prime rate plus 0.5% for equipment borrowings. Borrowings are payable monthly and are collateralized by all of Harmonic's assets. As of April 1, 2005, \$2.0 million was outstanding under the equipment term loan portion of this facility. The term loan is payable monthly, including principal and interest at 6.25% per annum on outstanding borrowings as of April 1, 2005 and matures at various dates through December 2007. Other than standby letters of credit and guarantees (Note 13 of Notes to Condensed Consolidated Financial Statements), there were no other outstanding borrowings or commitments under the line of credit facility as of April 1, 2005.

We currently believe that our existing liquidity sources, including the proceeds from the November 2003 stock offering, and our bank line of credit facility, will satisfy our cash requirements for at least the next twelve months, including the final settlement and payment of C-Cube's pre-merger tax liabilities. However, we may need to raise additional funds if our expectations or estimates change or prove inaccurate, or to take advantage of unanticipated opportunities or to strengthen our financial position. The completed stock offering in November 2003 related to a registration statement on Form S-3 that was declared effective by the SEC in April 2002. In April 2005, we filed a registration statement on Form S-3 with the SEC. Pursuant to these registration statements on Form S-3, which have been declared effective by the SEC, we are able to issue various types of registered securities, including common stock, preferred stock, debt securities, and warrants to purchase common stock from time to time, up to an aggregate of approximately \$200 million, subject to market conditions and our capital needs.

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

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 And Cash Flows.

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

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

- access to financing;
- annual budget cycles;

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- the impact of industry consolidation;
- the status of federal, local and foreign government regulation of telecommunications and television broadcasting;
- overall demand for communication services and the acceptance of new video, voice and data services;
- evolving industry standards and network architectures;
- competitive pressures, including pricing pressures;
- discretionary customer spending patterns; and
- general economic conditions.

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

- uncertainty related to development of digital video industry standards;
- delays associated with the evaluation of new services, new standards, and system architectures by many cable and satellite television operators;
- emphasis on generating revenue from existing customers by operators instead of new construction or network upgrades;
- a reduction in the amount of capital available to finance projects of our customers and potential customers;
- proposed business combinations and divestitures by our customers and regulatory review thereof;
- economic and financial conditions in domestic and international markets; and
- bankruptcies and financial restructuring of major customers.

The financial difficulties of certain of our customers and changes in our customers' deployment plans adversely affected our business throughout 2002 and in the first half of 2003. Two of our major domestic customers, Adelphia Communications and Winfirst, declared bankruptcy during the first half of 2002, while NTL, a major international customer, emerged from bankruptcy in 2003. Furthermore, we believe that our net sales to satellite customers were adversely affected by the uncertainty related to the prolonged regulatory review of the proposed acquisition of DIRECTV by EchoStar in 2002, which was ultimately rejected by regulators. These events, coupled with uncertain and volatile capital markets, also pressured the market values of domestic cable operators and restricted their access to capital. This reduced access to funding for new and existing customers caused delays in the timing and scale of deployments of our equipment and also resulted in the postponement or cancellation of certain projects by our customers. Several customers also canceled new projects or delayed new orders to allow them to reduce inventory levels that were in excess of their deployment requirements. We believe that these factors contributed to decreased net sales in both our CS division and our BAN division during the second half of 2002 and the first half of 2003 compared to the first half of 2002.

We believe that the financial condition of many of our customers has stabilized or improved, and our net sales increased in the first quarter of 2005 compared to the same period in 2004, and 2004 compared to 2003. However, another economic downturn or other factors could cause additional financial difficulties among our customers, and customers whose financial condition has stabilized may not purchase new equipment at levels we have seen in the past. Continued financial difficulties among our customers would adversely affect our operating results and financial condition. In addition, industry consolidation has, in the past and may in the future, constrain capital spending among our customers. In this regard, we believe that the proposed sale of Adelphia Communications and the recent privatization of Cox Communications have led to capital spending delays at these customers. We cannot currently

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predict the impact of the proposed sale of Adelphia Communications or the privatization of Cox Communications on our future sales. As a result, we cannot assure you that we will maintain or increase our net sales in the future.

Major U.S. cable operators have indicated that the substantial completion of major network upgrades, which involved significant labor and construction costs, will lead to lower capital expenditures in the future. If our product portfolio and product development plans do not position us well to capture an increased portion of the capital spending of US cable operators, our revenue may decline and our operating results would be adversely affected.

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

Historically, a majority of our sales have been to relatively few customers, and due in part to the consolidation of ownership of cable television and direct broadcast satellite systems, we expect this customer concentration to continue in the foreseeable future. Sales to our ten largest customers in the first quarter of 2005, and the years 2004 and 2003 accounted for approximately 68%, 55% and 65% of net sales, respectively. Although we are attempting to broaden our customer base by penetrating new markets such as the telecommunications and broadcast markets and expand internationally, we expect to see continuing industry consolidation and customer concentration due in part to the significant capital costs of constructing broadband networks. For example, Comcast acquired AT&T Broadband in November 2002, thereby creating the largest U.S. cable operator, reaching approximately 22 million subscribers. In the DBS segment, The News Corporation Ltd. acquired an indirect controlling interest in Hughes Electronics, the parent company of DIRECTV in 2003. In addition, the sale or financial restructuring of companies such as Adelphia Communications and several European operators may lead to further industry consolidation. In the first quarter of 2005 and the years 2004 and 2003, sales to Comcast accounted for 35%, 17% and 32%, respectively, of net sales. In 2002, sales to Charter Communications and Comcast accounted for 18% and 10% of net sales. If Comcast and AT&T Broadband had been combined for all of 2002, total revenues for the combined entity would have been 17% of net sales. The loss of Comcast or any other significant customer or any reduction in orders by Comcast or any significant customer, or our failure to qualify our products with a significant customer could adversely affect our business, operating results and liquidity. In this regard, sales to Comcast declined in 2004 compared to 2003, both in absolute dollars and as a percentage of revenues. The loss of, or any reduction in orders from, a significant customer would harm our business.

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

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

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

- the level and timing of capital spending of our customers, both in the U.S. and in foreign markets;
- changes in market demand;
- the timing and amount of orders, especially from significant customers;
- the timing of revenue recognition from solution contracts which may span several quarters;
- the timing of revenue recognition on sales arrangements, which may include multiple deliverables;
- the need to replace revenue from a major project for a Japanese customer that was completed in 2004 with other domestic or international customers;
- competitive market conditions, including pricing actions by our competitors;
- seasonality, with fewer construction and upgrade projects typically occurring in winter months and otherwise being affected by inclement weather;

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- our unpredictable sales cycles;
- the amount and timing of sales to telcos, which are particularly difficult to predict;
- new product introductions by our competitors or by us;
- changes in domestic and international regulatory environments;
- market acceptance of new or existing products;
- the cost and availability of components, subassemblies and modules;
- the mix of our customer base and sales channels;
- the mix of our products sold;
- changes in our operating expenses and extraordinary expenses;
- the impact of FAS 123R, a new accounting standard which will require us to expense stock options;
- our development of custom products and software;
- the quantity of third-party products we sell, which products carry lower gross margins, compared to our own products;
- the level of international sales; and
- economic and financial conditions specific to the cable and satellite industries, and general economic conditions.

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

In addition, we often recognize a substantial portion of our revenues in the last month of the quarter. We establish our expenditure levels for product development and other operating expenses based on projected sales levels, and expenses are relatively fixed in the short term. Accordingly, variations in timing of sales can cause significant fluctuations in operating results. As a result of all these factors, our operating results in one or more future periods may fail to meet or exceed the expectations of securities analysts or investors. In that event, the trading price of our common stock would likely decline. In this regard, due to lower than expected sales during the third quarter of 2002, the first quarter of 2003, and the third quarter of 2004, and due to a change in product mix sold in the first quarter of 2005, we failed to meet our internal expectations, as well as the expectations of securities analysts and investors, and the price of our common stock declined, in some cases significantly.

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

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

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

- FTTP networks;

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- new video compression standards such as MPEG-4/H.264 and Microsoft's Windows Media 9 broadcast profile (VC-1);
- the greater use of protocols such as IP; and
- the introduction of new consumer devices, such as advanced set-top boxes and personal video recorders (PVRs).

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

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

- convergence, or the desire of certain network operators to deliver a package of video, voice and data services to consumers, also known as the "triple play";
- the use of digital video by businesses, governments and educators;
- the privatization of state-owned telcos around the world;
- efforts by regulators and governments in the U.S. and abroad to encourage the adoption of broadband and digital technologies; and
- the extent and nature of regulatory attitudes towards such issues as competition between operators, access by third parties to networks of other operators, and new services such as VoIP.

If, for instance, operators do not pursue the "triple play" as aggressively as we expect, our net sales growth would be materially and adversely affected. Similarly, if our expectations regarding these and other trends are not met, our net sales may be materially and adversely affected.

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

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

- are not cost effective;
- are not brought to market in a timely manner;
- are not in accordance with evolving industry standards and architectures;
- fail to achieve market acceptance; or
- are ahead of the market.

Our CS division is currently developing and marketing products based on new video compression standards. Encoding products based on the current MPEG-2 compression standards have represented a significant portion of the Company's sales since the acquisition of DiviCom in 2000. New standards, such as MPEG-4/H.264 and Microsoft's Windows Media 9 broadcast profile (VC-1), are being adopted which are expected to provide significantly greater compression efficiency, thereby making more bandwidth available to operators. Harmonic is developing products based on these new standards in order to remain competitive and is devoting considerable

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resources to this effort. There can be no assurance that these efforts will be successful in the near future, or at all, or that competitors will not develop their products more quickly than us.

Our BAN division is currently marketing products for FTTP networks which certain telcos have begun to build. Although we believe that a number of our existing products can be deployed successfully in these networks, we will need to devote considerable resources to obtaining orders, qualifying our products and hiring knowledgeable personnel, and we may make significant financial commitments. There can be no assurance that these efforts will be successful in the near future, or at all.

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.

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

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

- a significant technical evaluation;
- a commitment of capital and other resources by cable, satellite, and other network operators;
- time required to engineer the deployment of new technologies or new broadband services;
- testing and acceptance of new technologies that affect key operations; and
- test marketing of new services with subscribers.

For these and other reasons, our sales cycles generally last three to 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. In this regard, our sales cycles with our current and potential satellite and telco customers are particularly unpredictable. Additionally, orders may include multiple elements, the timing of delivery of which may impact the timing of revenue recognition. Quarterly and annual results may fluctuate significantly due to revenue recognition policies and the timing of the receipt of orders. For example, revenue from two significant customer orders in the third quarter of 2004 was delayed due to these factors until the fourth quarter of 2004.

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

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

Sales to customers outside of the U.S. in the first quarter of 2005, and the years 2004 and 2003 represented 36%, 42% and 29% of net sales, respectively, and we expect that international sales will continue to represent a meaningful portion of our net sales for the foreseeable future. Furthermore, a substantial portion of our contract

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manufacturing occurs overseas. Our international operations, the international operations of our contract manufacturers, and our efforts to increase sales in international markets, are subject to a number of risks, including:

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

During 2004, a significant percentage of our international revenues were derived from a major upgrade by a Japanese customer of its satellite facilities. That upgrade has now been completed, and we expect sales to this customer to decline in 2005, which could adversely affect our sales to international customers.

Certain of our international customers have accumulated significant levels of debt and have announced during the past three years, 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 and operating expenses have typically been denominated in U.S. dollars, fluctuations in currency exchange rates could cause our products to become relatively more expensive to customers in a particular country, leading to a reduction in sales or profitability in that country.

Following implementation of the Euro in January 2002, a higher portion of our European business is denominated in Euros, which may subject us to increased foreign currency risk. Gains and losses on the conversion to U.S. dollars of accounts receivable, accounts payable and other monetary assets and liabilities arising from international operations may contribute to fluctuations in operating results. Furthermore, payment cycles for international customers are typically longer than those for customers in the U.S. Unpredictable sales cycles could cause us to fail to meet or exceed the expectations of security analysts and investors for any given period. In addition, foreign markets may not develop in the future. Any or all of these factors could adversely impact our business and results of operations.

Pending Business Combinations And Other Financial And Regulatory Issues Among Our Customers Could Adversely Affect Our Business.

The telecommunications industry has been particularly impacted by the recent economic recession, adverse conditions in capital markets and financial difficulties in both the service and equipment sectors, including bankruptcies. Many of our domestic and international customers accumulated significant levels of debt and announced reorganizations and financial restructurings during the past three years, including bankruptcy filings. In particular, Adelphia Communications, a major domestic cable operator, declared bankruptcy in June 2002. The stock prices of other domestic cable companies came under pressure following the Adelphia bankruptcy due to concerns about debt levels and capital expenditure requirements for new and expanded services, thereby making the raising of capital more difficult and expensive. New operators, such as RCN and WinFirst, also had difficulty in accessing capital markets. Both subsequently filed for bankruptcy. In Europe, rapid consolidation of the cable industry through acquisition also led to significant levels of debt at the major MSOs, and companies such as NTL and UPC went through bankruptcy proceedings. European digital broadcasters, such as ITV Digital, Kirsch and Quiero, also filed for protection from creditors.

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While the capital market concerns about the domestic cable industry have eased, market conditions remain difficult and capital spending plans are generally constrained. It is likely that further industry restructuring will take place via mergers or spin-offs, such as the Comcast/AT&T Broadband transaction in 2002 and the acquisition by The News Corporation Ltd. in December 2003 of an indirect controlling interest in Hughes Electronics, the parent company of DIRECTV. This transaction followed regulatory opposition to the proposed acquisition of DIRECTV by EchoStar. We believe that uncertainty during 2002 regarding the proposed DIRECTV and EchoStar merger adversely affected capital spending by both of these parties as well as other customers. More recently, restructuring of the industry has continued with the privatization of Cox Communications, the planned sale of Adelphia Communications out of bankruptcy to Comcast and Time-Warner, and the proposed sale of Cablevision's VOOOM! satellite assets to Echostar. In addition, further business combinations may occur in our industry, and these further combinations could adversely affect our business. Regulatory issues, financial concerns and business combinations among our customers are likely to significantly affect the industry, its capital spending plans, and our levels of business for the foreseeable future.

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

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

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

Our future success will depend, to a significant extent, on the ability of our management to operate effectively, both individually and as a group. We must successfully manage transition and replacement issues that may result from the departure or retirement of members of our senior management. We are dependent on our ability to retain and motivate high caliber personnel, in addition to attracting new personnel. Competition for qualified management, technical and other personnel can be intense, and we may not be successful in attracting and retaining such personnel. Competitors and others have in the past and may in the future attempt to recruit our employees. While our employees are required to sign standard agreements concerning confidentiality and ownership of inventions, we generally do not have employment contracts or non-competition agreements with any of our personnel. The loss of the services of any of our key personnel, the inability to attract or retain qualified personnel in the future or delays in hiring required personnel, particularly senior management and engineers and other technical personnel, could negatively affect our business.

Recent And Proposed Regulations Related To Equity Compensation Could Adversely Affect Earnings, Affect Our Ability To Raise Capital And Affect Our Ability To Attract And Retain Key Personnel.

Since our inception, we have used stock options as a fundamental component of our employee compensation packages. We believe that our stock option plans are an essential tool to link the long-term interests of stockholders and employees, especially executive management, and serve to motivate management to make decisions that will, in the long run, give the best returns to stockholders. The Financial Accounting Standards Board (FASB) has announced changes to U.S. GAAP that will require us to record a charge to earnings for employee stock option grants and employee stock purchase plan rights for all future periods beginning on January 1, 2006. This regulation will negatively impact our earnings and may affect our ability to raise capital on acceptable terms. In addition, new regulations implemented by The Nasdaq National Market requiring stockholder approval for all stock option plans could make it more difficult for us to grant options to employees in the future. To the extent that new regulations make it more difficult or expensive to grant options to employees, we may incur increased compensation costs, change our equity compensation strategy or find it difficult to attract, retain and motivate employees, each of which could materially and adversely affect our business.

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

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We are spending an increased amount of management time and external resources to comply with changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and Nasdaq Stock Market rules. Particularly, Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal controls over financial reporting, and attestation of the effectiveness of our internal controls over financial reporting by management and the Company's independent registered public accounting firm in connection with the filing of the annual report on Form 10-K for the fiscal year ended December 31, 2004, and with each subsequently filed annual report on Form 10-K. We have documented and tested our internal control systems and procedures and have made improvements in order for us to comply with the requirements of Section 404. This process required us to hire additional personnel and outside advisory services and has resulted in significant additional accounting and legal expenses. While our assessment of our internal controls over financial reporting resulted in our conclusion that as of December 31, 2004, our internal control over financial reporting was effective, we cannot predict the outcome of our testing in future periods. If we conclude in future periods that our internal controls over financial reporting are not effective or if our independent registered public accounting firm is unable to provide an unqualified opinion as of future year-ends, investors may lose confidence in our financial statements, and the price of our stock may suffer.

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

We have generated substantial operating losses since we began operations in June 1988. Although we generated a small net profit in 2004 after several years of losses, future profitability is highly uncertain, and we may never achieve sustained profitable operations. We have been engaged in the design, manufacture and sale of a variety of broadband products since inception, which has required, and will continue to require, significant research and development expenditures. As of April 1, 2005 we had an accumulated deficit of \$1.9 billion. These losses, among other things, have had and may have an adverse effect on our stockholders' equity and working capital.

We believe that the proceeds of the stock offering we completed in November 2003, together with our existing liquidity sources, will satisfy our cash requirements for at least the next twelve months, including the final settlement and payment of C-Cube's pre-merger tax liabilities. However, we may need to raise additional funds if our expectations are incorrect, to fund our operations, to take advantage of unanticipated strategic opportunities or to strengthen our financial position. The stock offering we completed in November 2003 related to a registration statement on Form S-3 declared effective by the SEC in April 2002. In April 2005, we filed a registration statement on Form S-3 with the SEC. Pursuant to these registration statements on Form S-3, which have been declared effective by the SEC, we will continue to be able to issue registered common stock, preferred stock, debt securities and warrants to purchase common stock from time to time, up to an aggregate of approximately \$200 million, subject to market conditions and our capital needs. Our ability to raise funds may be adversely affected by a number of factors relating to Harmonic, as well as factors beyond our control, including conditions in capital markets and the cable, telecom and satellite industries. There can be no assurance that such financing will be available on terms acceptable to us, if at all.

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

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

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

Our net sales increased approximately 32% in the first quarter of 2005 compared to the same period in 2004, and approximately 36% in 2004 from 2003. If demand for our products continues to increase, the difficulty of accurately forecasting our customers' requirements and meeting these requirements will increase. Forecasting to meet customers' needs is particularly difficult in connection with newer products. Our ability to meet customer demand depends significantly on the availability of components and other materials as well as the ability of our contract manufacturers to scale their production. Furthermore, we purchase several key components, subassemblies and modules used in the manufacture or integration of our products from sole or limited sources. Our ability to meet customer requirements depends in part on our ability to obtain sufficient volumes of these materials in a timely fashion. Also, in recent years, in response to lower net sales and the prolonged economic recession, we significantly reduced our headcount and other expenses. As a result, we may be unable to respond to customer demand that increases more quickly than we expect. If we fail to meet customers' supply expectations, our net sales would be adversely affected and we may lose business.

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

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

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

Harmonic maintains a facility in Caesarea in the State of Israel with a total of 65 employees as of April 1, 2005, or approximately 10% of our workforce. The employees at this facility consist principally of research and development personnel involved in development of certain products for the CS division. In addition, we have pilot production capabilities at this facility consisting of procurement of subassemblies and modules from Israeli subcontractors and final assembly and test operations. Accordingly, we are directly influenced by the political, economic and military conditions affecting Israel, and any major hostilities involving Israel or the interruption or curtailment of trade between Israel and its trading partners could significantly harm our business. The September 2001 terrorist attacks, the ongoing U.S. war on terrorism and the terrorist attacks and hostilities within Israel have heightened these risks. We cannot assure you that 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 recently. We cannot predict the effect of these obligations on Harmonic in the future.

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. Pressure on average selling prices was particularly severe during the recent economic downturn as equipment suppliers competed aggressively for customers' reduced capital spending. Harmonic's competitors in the fiber optics systems business include corporations such as C-Cor, Motorola, and Scientific-Atlanta. In the digital and video broadcasting systems business, we compete broadly with vertically integrated system suppliers including Motorola, Scientific-Atlanta, Tandberg Television and Thomson Multimedia, and in certain product lines with Cisco and a number of smaller companies.

Many of our competitors are substantially larger and have greater financial, technical, marketing and other resources than Harmonic. Many of these large organizations are in a better position to withstand any significant reduction in

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capital spending by customers in these markets. They often have broader product lines and market focus and may not be as susceptible to downturns in a particular market. In addition, many of our competitors have been in operation longer than we have and therefore have more long-standing and established relationships with domestic and foreign customers. We may not be able to compete successfully in the future, which 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, new standards for video compression are being introduced and products based on these standards are being developed by Harmonic and certain competitors. If our competitors are successful in bringing these products to market earlier, or if these products are more technologically capable than ours, then our sales could be materially and adversely affected. In addition, companies that have historically not had a large presence in the broadband communications equipment market have begun recently to expand their market share through mergers and acquisitions. The continued consolidation of our competitors could have a significant negative impact on us. Further, our competitors, particularly competitors of our digital and video broadcasting systems business, may bundle their products or incorporate functionality into existing products in a manner that discourages users from purchasing our products or which may require us to lower our selling prices resulting in lower gross margins.

Broadband Communications Markets Are Characterized By Rapid Technological Change.

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

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

Many components, subassemblies and modules necessary for the manufacture or integration of our products are obtained from a sole supplier or a limited group of suppliers. For example, we depend on LSI Logic for video encoding chips. 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 resources 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. Managing our supplier and contractor relationships is particularly difficult during time periods in which we introduce new products and during time periods in which demand for our products is increasing, especially if demand increases more quickly than we expect. Furthermore, from time to time we assess our relationship with our contract manufacturers. In late 2003, we entered into a three-year agreement with Plexus Services Corp. as our primary contract manufacturer. We completed the transition during the summer of 2004. Difficulties in managing relationships with current contract manufacturers, could impede our ability to meet our customers' requirements and adversely affect our operating results. An inability to obtain adequate deliveries or any other circumstance that would require us to seek alternative sources of supply could negatively affect our ability to ship our products on a timely basis, which could damage relationships with current and prospective customers and harm our business. We attempt to limit this risk by maintaining safety stocks of certain components, subassemblies and modules. As a result of this investment in inventories, we have in the past and in the future may be subject to risk of excess and obsolete inventories, which could harm our business, operating results, financial position and liquidity. In this regard, our gross margins and operating results in the past were adversely affected by significant excess and obsolete inventory charges.

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

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The cyclical nature of our business has placed, and is expected to continue to place, a significant strain on our personnel, management and other resources. This strain was 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 44% between December 31, 2000 and December 31, 2003 due to reduced industry spending and demand for our products. If demand for products increases significantly, we may need to increase our headcount, as we did during 2004, adding 33 employees. In the first quarter of 2005, we added 54 employees, including 42 employees in connection with our acquisition of BTL in February 2005. Our ability to manage our business effectively in the future, including any future growth, will require us to train, motivate and manage our employees successfully, to attract and integrate new employees into our overall operations, to retain key employees and to continue to improve our operational, financial and management systems.

We May Be Materially Affected By The WEEE And RoHS Directives.

The European Union has finalized the Waste Electrical and Electronic Equipment (WEEE) directive, which regulates the collection, recovery, and recycling of waste from electrical and electronic products, and the Restrictions on the Use of Certain Hazardous Substances in Electrical and Electronic Equipment (RoHS) directive, which bans the use of certain hazardous materials including lead, mercury, cadmium, chromium, and halogenated flame-retardants. Under WEEE, we will be responsible for financing operations for the collection, treatment, disposal, and recycling of past and future covered products. Because the specific legal requirements have not been finalized, we are presently unable to reasonably estimate the amount of any costs that may be necessary in order to comply with WEEE. We cannot assure you that compliance with WEEE and RoHS will not have a material adverse effect on our financial condition or results of operations.

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

Under the terms of the merger agreement with C-Cube, Harmonic is generally liable for C-Cube's pre-merger tax liabilities. As of April 1, 2005, approximately \$10.0 million of pre-merger tax liabilities remained outstanding and are included in accrued liabilities. We are working with LSI Logic, which acquired C-Cube's spun-off semiconductor business in June 2001 and assumed its obligations, to develop an approach to settle these obligations, a process which has been underway since the merger in 2000. These liabilities represent estimates of C-Cube's pre-merger tax obligations to various tax authorities in 11 countries. Harmonic paid \$5.8 million of these tax obligations in February 2005, but is unable to predict when the remaining tax obligations will be paid, or in what amount. The full amount of the estimated obligation has been classified as a current liability. To the extent that these obligations are finally settled for less than the amounts provided, Harmonic is required, under the terms of the merger agreement, to refund the difference to LSI Logic. Conversely, if the settlements are more than the \$10.0 million pre-merger tax liability after the February 2005 payments, LSI Logic is obligated to reimburse Harmonic.

The merger agreement stipulates that Harmonic will be indemnified by the spun-off semiconductor business if the cash reserves are not sufficient to satisfy all of C-Cube's 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 LSI Logic, Harmonic generally will remain liable, and such liability could have a material adverse effect on our financial condition, results of operations or cash flows.

We May Be Subject To Risks Associated With Other Acquisitions.

We have made, continue to consider making and may make investments in complementary companies, products or technologies. For example, on February 25, 2005, we acquired all of the issued and outstanding shares of Broadcast Technology Ltd., a private U.K. company. In connection with this and other acquisition transactions, we could have difficulty assimilating or retaining the acquired companies' key personnel and operations, integrating the acquired technology or products into ours or complying with internal control requirements of the Sarbanes-Oxley Act as a result of an acquisition. We also may face challenges in achieving the strategic objectives, cost savings or other benefits from these proposed acquisitions and difficulties in expanding our management information systems to accommodate the acquired business. These difficulties could disrupt our ongoing business, distract our

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management and employees and significantly increase our expenses. Moreover, our operating results may suffer because of acquisition-related expenses, amortization of intangible assets and impairment of acquired goodwill or intangible assets. Furthermore, we may have to incur debt or issue equity securities to pay for any future acquisitions, or to provide for additional working capital requirements, the issuance of which could be dilutive to our existing shareholders. If we are unable to successfully address any of these risks, our business, financial condition or operating results could be harmed.

Cessation Of 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 (acquired by LSI Logic in June 2001) 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 has access to certain of the spun-off semiconductor business technologies and products which the DiviCom business previously depended for its product and service offerings. The current term of this agreement is through October 2005, with automatic annual renewal unless terminated by either party in accordance with the agreement provisions. The spun-off semiconductor business is the sole supplier of these chips to Harmonic. Several of these products continue to be important to our business, and we have incorporated these chips into additional products that we have developed. If the spun-off semiconductor business is not able to or does not sustain its development and production efforts in this area our business, financial condition, results of operations and cash flow could be harmed.

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

We currently hold 39 issued U.S. patents and 19 issued foreign patents, and have a number of patent applications pending. Although we attempt to protect our intellectual property rights through patents, trademarks, copyrights, licensing arrangements, maintaining certain technology as trade secrets and other measures, we cannot assure you that any patent, trademark, copyright or other intellectual property rights owned by us will not be invalidated, circumvented or challenged, that such intellectual property rights will provide competitive advantages to us or that any of our pending or future patent applications will be issued with the scope of the claims sought by us, if at all. We cannot assure you that others will not develop technologies that are similar or superior to our technology, duplicate our technology or design around the patents that we own. In addition, effective patent, copyright and trade secret protection may be unavailable or limited in certain foreign countries in which we do business or may do business in the future.

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

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

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

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

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4,859,016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. Harmonic has not been served in the case. Harmonic continues to evaluate its position with respect to this patent and has engaged in discussions with the plaintiff regarding potential settlement of the matter. At this time, Harmonic is unable to determine whether Harmonic will be able to settle this matter on reasonable terms or at all, nor can Harmonic predict the impact of an adverse outcome of this litigation if Harmonic elects to defend against it. Consequently, Harmonic has made no provision in its financial statements for the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

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

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

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

A consolidated complaint, filed on December 7, 2000, was brought on behalf of a purported class of persons who purchased Harmonic's publicly traded securities between January 19 and June 26, 2000. The complaint also alleged claims on behalf of a purported subclass of persons who purchased C-Cube securities between January 19 and May 3, 2000. In addition to Harmonic and certain of its officers and directors, the complaint also named C-Cube Microsystems Inc. and several of its officers and directors as defendants. The complaint alleged that, by making false or misleading statements regarding Harmonic's prospects and customers and its acquisition of C-Cube, certain defendants violated sections 10(b) and 20(a) of the Securities Exchange Act 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. On November 13, 2002, the Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a notice of appeal on July 1, 2003. The U.S. Court of Appeals for the Ninth Circuit heard oral arguments on February 17, 2005, but has not ruled on the appeal yet.

A derivative action purporting to be on behalf of Harmonic was filed against its then-current directors in the Superior Court for the County of Santa Clara on September 5, 2000. Harmonic also was named as a nominal defendant. The complaint is based on allegations similar to those found in the securities class action and claims that the defendants breached their fiduciary duties by, among other things, causing Harmonic to violate federal securities laws. The derivative action was removed to the U.S. District Court for the Northern District of California on September 20, 2000. All deadlines in this action were stayed pending resolution of the motions to dismiss the

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securities class action. On July 29, 2003, the Court approved the parties' stipulation to dismiss this derivative action without prejudice and to toll the applicable limitations period. The limitations period is tolled until fourteen days after (1) defendants provide plaintiff with a copy of the mandate issued by the Ninth Circuit in the securities action or (2) either party provides written notice of termination of the tolling period, whichever is first.

A second derivative action purporting to be on behalf of Harmonic was filed in the Superior Court for the County of Santa Clara on May 15, 2003. It alleges facts similar to those previously alleged in the securities class action and the federal derivative action. The complaint names as defendants former and current Harmonic officers and directors, along with former officers and directors of C-Cube Microsystems, Inc., who were named in the securities class action. The complaint also names Harmonic as a nominal defendant. The complaint alleges claims for abuse of control, gross mismanagement, and waste of corporate assets against the Harmonic defendants, and claims for breach of fiduciary duty, unjust enrichment, and negligent misrepresentation against all defendants. On July 22, 2003, the Court approved the parties' stipulation to stay the case pending resolution of the appeal in the securities class action. Although the parties initially agreed in principle to a dismissal without prejudice on similar terms as in the federal derivative action, after further discussion, the parties decided that the stay currently in place suffices to protect their respective interests.

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. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, Harmonic has not recorded a liability. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4,859,016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. Harmonic has not been served in the case. Harmonic is currently evaluating its position with respect to this patent and has engaged in discussions with the plaintiff regarding potential settlement of the matter. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

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

Current conditions in the U.S. and global economies are uncertain. The terrorist attacks in 2001 created many economic and political uncertainties that have severely impacted the global economy. We experienced a further decline in demand for our products after the attacks. The long-term effects of the attacks, the situation in Iraq and the ongoing war on terrorism on our business and on the global economy remain unknown. Moreover, the potential for future terrorist attacks has created additional uncertainty and makes it difficult to estimate how quickly the U.S. and other economies will recover and our business will improve.

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.

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Our Stock Price May Be Volatile.

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

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

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

- authorizing blank check preferred stock, which could be issued with voting, liquidation, dividend and other rights superior to Harmonic common stock;
- limiting the liability of, and providing indemnification to, directors and officers;
- limiting the ability of Harmonic stockholders to call and bring business before special meetings;
- requiring advance notice of stockholder proposals for business to be conducted at meetings of Harmonic stockholders and for nominations of candidates for election to the Harmonic Board of Directors;
- controlling the procedures for conduct and scheduling of Board and stockholder meetings; and
- providing the board of directors with the express power to postpone previously scheduled annual meetings and to cancel previously scheduled special meetings.

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

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

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

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

ITEM 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 the currencies used by Harmonic's subsidiaries.

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Foreign Currency Exchange Risk

Harmonic has a number of international subsidiaries, each of whose sales and results of operations are generally denominated in U.S. dollars. Sales denominated in foreign currencies were approximately 7% and 4% of net sales in the first quarter of 2005 and the full year of 2004, respectively. In addition, the Company has various international branch offices, which provide sales support and systems integration services. Periodically, Harmonic enters into foreign currency forward exchange contracts (“forward contracts”) to manage exposure related to accounts receivable that are denominated in foreign currencies. Harmonic does not enter into derivative financial instruments for trading purposes. At April 1, 2005, we had a forward exchange contract to sell Euros totaling \$4.0 million that matures during the second quarter of 2005. While Harmonic does not anticipate that near-term changes in exchange rates will have a material impact on future operating results, financial position or cash flows, 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 or cash flows.

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 unrealized gains and losses reported in other comprehensive income. There is a risk that losses could be incurred if the Company were to sell any of its securities prior to such security’s stated maturity. A 10% change in interest rates would not have had a material impact on financial conditions, results of operations or cash flows.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures.

Our chief executive officer and our chief financial officer participated in the evaluation of the effectiveness of the Company’s “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934, as amended (the “Exchange Act”), Rules 13a-15(e) or 15d-15(e)) as of the end of the period covered by this quarterly report, and have concluded that our disclosure controls and procedures are effective based on their evaluation of these controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15.

Changes in internal controls.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that occurred during our last fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II

OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Shareholder Litigation

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

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

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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. On November 13, 2002, the Court issued an opinion granting the motions to dismiss the amended complaint without leave to amend. Judgment for defendants was entered on December 2, 2002. On December 12, 2002, plaintiffs filed a motion to amend the judgment and for leave to file an amended complaint pursuant to Rules 59(e) and 15(a) of the Federal Rules of Civil Procedure. On June 6, 2003, the Court denied plaintiffs' motion to amend the judgment and for leave to file an amended complaint. Plaintiffs filed a notice of appeal on July 1, 2003. The U.S. Court of Appeals for the Ninth Circuit heard oral arguments on February 17, 2005, but has not ruled on the appeal yet.

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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. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, Harmonic has not recorded a liability. An unfavorable outcome of this litigation could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

Other Litigation

On July 3, 2003, Stanford University and Litton Systems filed a complaint in U.S. District Court for the Central District of California alleging that optical fiber amplifiers incorporated into certain of Harmonic's products infringe U.S. Patent No. 4,859,016. This patent expired in September 2003. The complaint seeks injunctive relief, royalties and damages. Harmonic has not been served in the case. Harmonic is currently evaluating its position with respect to this patent and has engaged in discussions with the plaintiff regarding potential settlement of the matter. At this time, we are unable to determine whether we will be able to settle this litigation on reasonable terms or at all, nor

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can we predict the impact of an adverse outcome of this litigation if we elect to defend against it. No estimate can be made of the possible range of loss associated with the resolution of this contingency and accordingly, we have not recorded a liability associated with the outcome of a negotiated settlement or an unfavorable verdict in litigation. An unfavorable outcome of this matter could have a material adverse effect on Harmonic's business, operating results, financial position or cash flows.

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

On February 25, 2005, Harmonic purchased all of the issued and outstanding shares of Broadcast Technology Limited, a private UK company, for a purchase price of approximately £3.0 million in cash and 169,112 shares of Harmonic common stock. Harmonic purchased all of the shares of Broadcast Technology Limited directly from, and paid the consideration therefor directly to, the shareholders of the company. Harmonic relied upon the exemption from registration under the Securities Act provided by Regulation S. Harmonic based its reliance upon Regulation S on the fact that the offer and sale of Harmonic's common stock was made in the United Kingdom, there were no directed selling efforts made by Harmonic in the United States with respect to such securities, and Harmonic required the purchasers of its common stock to agree to such restrictions on resale and other matters as required by Regulation S.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibits.

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

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 10, 2005

HARMONIC INC.
(Registrant)

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

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Exhibit Number	Exhibit Index
31.1	Section 302 Certification of Principal Executive Officer
31.2	Section 302 Certification of Principal Financial Officer
32.1	Section 906 Certification of Principal Executive Officer
32.2	Section 906 Certification of Principal Financial Officer

Certification of Principal Executive Officer
Pursuant to Section 302 of
The Sarbanes-Oxley Act of 2002

I, Anthony J. Ley, Chairman, President and Chief Executive Officer of Harmonic Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harmonic Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2005

By: /s/Anthony J. Ley
Anthony J. Ley
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Certification of Principal Financial Officer
Pursuant to Section 302 of
The Sarbanes-Oxley Act of 2002

I, Robin N. Dickson, Principal Financial Officer of Harmonic Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Harmonic Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2005

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

Harmonic Inc.
Certification of Principal Executive Officer
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

I, Anthony J. Ley, Chairman, President and Chief Executive Officer of Harmonic Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- i. the accompanying quarterly report on Form 10-Q for the quarter ended April 1, 2005, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- ii. the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Harmonic Inc.

This written statement is being furnished to the Securities and Exchange Commission as an exhibit accompanying such Report and shall not be deemed filed pursuant to the Securities Exchange Act of 1934.

Date: May 10, 2005

/s/ Anthony J. Ley
Anthony J. Ley
Chairman, President and Chief Executive Officer (Principal
Executive Officer)

Harmonic Inc.
Certification of Principal Financial Officer
Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

I, Robin N. Dickson, Chief Financial Officer of Harmonic Inc. (the "Company"), certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- i. the accompanying quarterly report on Form 10-Q for the quarter ended April 1, 2005, fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- ii. the information contained in such report fairly presents, in all material respects, the financial condition and results of operations of Harmonic Inc.

This written statement is being furnished to the Securities and Exchange Commission as an exhibit accompanying such Report and shall not be deemed filed pursuant to the Securities Exchange Act of 1934.

Date: May 10, 2005

/s/ Robin N. Dickson
Robin N. Dickson
Chief Financial Officer
(Principal Financial Officer)