HARMONIC INC
Form 10-Q
May 08, 2013
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended March 29, 2013

¨ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File No. 000-25826

HARMONIC INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0201147**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification Number)**

4300 North First Street

San Jose, CA 95134

(408) 542-2500

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares of the registrant s Common Stock, $.001 par value, outstanding on April 19, 2013 was 113,262,063.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

HARMONIC INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

	March 29, 2013	December 31, 2012
	(In thousands, except par value amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 118,464	$ 96,670
Short-term investments	109,790	104,506
Accounts receivable, net	95,692	85,920
Inventories	46,385	64,270
Deferred income taxes	20,145	21,870
Prepaid expenses and other current assets	28,977	23,636
Total current assets	419,453	396,872
Property and equipment, net	37,201	38,122
Goodwill	197,820	212,518
Intangibles, net	51,414	58,447
Other assets	9,256	11,572
Total assets	$ 715,144	$ 717,531
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 22,815	$ 25,447
Income taxes payable		1,797
Deferred revenue	31,575	33,235
Accrued liabilities	42,294	42,415
Total current liabilities	96,684	102,894
Income taxes payable, long-term	50,669	49,309
Other non-current liabilities	11,732	11,915
Total liabilities	159,085	164,118
Commitments and contingencies (Note 14)		
Stockholders equity:		
Preferred stock, $0.001 par value, 5,000 shares authorized; no shares issued or outstanding		
Common stock, $0.001 par value, 150,000 shares authorized; 114,336 and 114,193 shares issued and outstanding at March 29, 2013 and December 31, 2012, respectively	114	114
Additional paid-in capital	2,429,631	2,432,790
Accumulated deficit	(1,872,605)	(1,879,026)
Accumulated other comprehensive loss	(1,081)	(465)

Total stockholders equity		556,059		553,413
Total liabilities and stockholders equity	$	715,144	$	717,531

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

3

Table of Contents

HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	Three months ended	
	March 29, 2013	**March 30, 2012**
	(In thousands, except per share amounts)	
Product revenue	$ 82,475	$ 99,498
Service revenue	19,197	16,941
Net revenue	101,672	116,439
Product cost of revenue	45,237	59,176
Service cost of revenue	10,270	6,801
Total cost of revenue	55,507	65,977
Gross profit	46,165	50,462
Operating expenses:		
Research and development	25,251	26,763
Selling, general and administrative	33,269	31,403
Amortization of intangibles	2,088	2,179
Restructuring and related charges	424	
Total operating expenses	61,032	60,345
Loss from operations	(14,867)	(9,883)
Interest income, net	64	119
Other income (expense), net	(167)	403
Loss from continuing operations before income taxes	(14,970)	(9,361)
Benefit from income taxes	(5,467)	(626)
Loss from continuing operations	(9,503)	(8,735)
Income from discontinued operations, net of tax (including gain on disposal of $14,956, net of tax, for the three months ended March 29, 2013)	15,924	1,207
Net Income (loss)	$ 6,421	$ (7,528)
Basic net income (loss) per share from:		
Continuing operations	$ (0.08)	$ (0.07)
Discontinued operations	$ 0.14	$ 0.01
Net Income (loss)	$ 0.06	$ (0.06)
Diluted net income (loss) per share from:		
Continuing operations	$ (0.08)	$ (0.07)
Discontinued operations	$ 0.14	$ 0.01

Net Income (loss)	$	0.06	$	(0.06)
Shares used in per share calculation:				
Basic		115,219		117,275
Diluted		115,219		117,275

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

4

Table of Contents

HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(UNAUDITED)

	Three months ended	
	March 29, 2013	March 30, 2012
	(In thousands)	
Net income (loss)	$ 6,421	$ (7,528)
Other comprehensive income (loss), net of tax:		
Changes in cumulative translation adjustments	(624)	314
Foreign currency translation adjustments	(624)	314
Changes in unrealized gain (loss) on investment arising during the period	5	39
Gain on investments	5	39
Other comprehensive (loss) income before tax	(619)	353
Income tax (benefit) provision related to items of other comprehensive income (loss)	(3)	15
Other comprehensive income (loss), net of tax	(616)	338
Comprehensive income (loss)	$ 5,805	$ (7,190)

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

Table of Contents

HARMONIC INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	Three months ended March 29, 2013	March 30, 2012
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	$ 6,421	$ (7,528)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Amortization of intangibles	7,033	7,539
Depreciation	4,040	3,798
Stock-based compensation	3,986	4,800
Gain on sale of discontinued operations, net of tax	(14,956)	
Loss on impairment of fixed assets	101	
Deferred income taxes	(204)	(1,262)
Provision for inventories	567	784
Allowance for doubtful accounts, returns and discounts	1,116	(180)
Excess tax benefits from stock-based compensation		(73)
Other non-cash adjustments, net	408	(8)
Changes in assets and liabilities:		
Accounts receivable	(10,888)	(1,683)
Inventories	6,832	4,320
Prepaid expenses and other assets	(8,597)	1,892
Accounts payable	(2,796)	936
Deferred revenue	2,667	2,740
Income taxes payable	(1,257)	(929)
Accrued and other liabilities	(216)	(7,255)
Net cash (used in) provided by operating activities	(5,743)	7,891
Cash flows from investing activities:		
Purchases of investments	(25,908)	(36,654)
Proceeds from maturities of investments	16,249	18,791
Proceeds from sales of investments	4,000	1,042
Acquisition of property and equipment	(4,274)	(3,715)
Proceeds from sale of discontinued operations, net of selling costs	44,336	
Net cash provided by (used in) investing activities	34,403	(20,536)
Cash flows from financing activities:		
Payments for repurchase of common stock	(9,268)	
Proceeds from issuance of common stock, net	2,508	2,479
Excess tax benefits from stock-based compensation		73
Net cash (used in) provided by financing activities	(6,760)	2,552
Effect of exchange rate changes on cash and cash equivalents	(106)	129
Net increase (decrease) in cash and cash equivalents	21,794	(9,964)
Cash and cash equivalents at beginning of period	96,670	90,983

Cash and cash equivalents at end of period	$ 118,464	$ 81,019

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

Table of Contents

HARMONIC INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1: BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements, in the opinion of management, include all adjustments (consisting only of normal recurring adjustments) which Harmonic Inc. (Harmonic, or the Company) considers necessary for a fair statement of the results of operations for the interim periods covered and the consolidated financial condition of the Company at the date of the balance sheets. This Quarterly Report on Form 10-Q should be read in conjunction with the Company s audited consolidated financial statements contained in the Company s Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 1, 2013 (2012 Form 10-K). The interim results presented herein are not necessarily indicative of the results of operations that may be expected for the full fiscal year ending December 31, 2013, or any other future period. The Company s fiscal quarters are based on 13-week periods, except for the fourth quarter which ends on December 31.

The condensed consolidated financial statements include the accounts of the Company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. The year-end condensed balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America (US GAAP).

Discontinued Operations. On March 5, 2013, the Company completed the sale of its cable access HFC business to Aurora Networks (Aurora) for $46.0 million in cash. The Consolidated Statements of Operations have been retrospectively adjusted to present the cable access HFC business as discontinued operations, as described in Note 3 Discontinued Operations . Unless noted otherwise, all discussions herein with respect to the Company s unaudited condensed consolidated financial statements relate to the Company s continuing operations.

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

Significant Accounting Policies. The Company s significant accounting policies are described in Note 2 to its audited Consolidated Financial Statements included in its 2012 Form 10-K. There have been no significant changes to these policies during the three months ended March 29, 2013.

Reclassifications. From time to time the Company reclassifies certain prior period balances to conform to the current year presentation. These reclassifications have no material impact on previously reported total assets, total liabilities, stockholders equity, results of operations or cash flows.

NOTE 2: RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the FASB issued Accounting Standard Update (ASU) 2011-11, Disclosures about offsetting assets and liabilities . This guidance enhances disclosure requirements about the nature of an entity s right to offset. The new guidance requires the disclosure of the gross amounts subject to rights of set-off, amounts offset in accordance with the accounting standards followed, and the related net exposure. The new guidance became effective for the Company beginning in the first quarter of fiscal 2013 and it did not have any impact on the Company s Consolidated Financial Statements.

In July 2012, the FASB issued ASU 2012-2, Intangibles - Goodwill and Other , which allows an entity to first assess qualitative factors to determine whether it is more likely than not that an indefinite-lived asset is impaired for determining whether it is necessary to perform the quantitative impairment test. The guidance is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. This accounting standard update became effective for the Company beginning in the first quarter of fiscal 2013, and it did not have any impact on the Company s Consolidated Financial Statements.

Table of Contents

In February 2013, the FASB issued ASU 2013-2, Comprehensive Income , which requires reclassification adjustments from other comprehensive income to be presented either in the financial statements or in the notes to the financial statements. The Company adopted this new guidance in the first quarter of 2013 and included the required disclosures.

In March 2013, the FASB issued ASU 2013-4, Obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date . The update provides requirements for the recognition, measurement and disclosure of an entity s reasonable expectation of its obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. This guidance requires an entity to disclose the nature and amount of any such obligation as well as other information about the obligation. The guidance is effective for the Company beginning in the first quarter of fiscal 2014 and should be applied prospectively. The Company does not expect the adoption of ASU 2013-04 will have a material impact on its financial position, results of operations or cash flows.

On March 5, 2013, the FASB issued ASU 2013-05, Parent s Accounting for the Cumulative Translation Adjustment upon De-recognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity . The ASU addresses accounting for a cumulative translation adjustment when a parent either sells a part or all of its investment in a foreign entity or no longer holds a controlling financial interest in a subsidiary or group of assets that is a nonprofit activity or a business within a foreign entity. The guidance is effective for the Company beginning in the first quarter of fiscal 2014 and should be applied prospectively. The Company does not expect the adoption of ASU 2013-05 will have a material impact on its financial position, results of operations or cash flows.

NOTE 3: DISCONTINUED OPERATIONS

On February 18, 2013, the Company entered into an Asset Purchase Agreement with Aurora pursuant to which the Company agreed to sell its cable access HFC business for $46.0 million in cash. On March 5, 2013, the sale transaction closed and the Company received gross proceeds of $46.0 million from the sale and recorded a net gain of $15.0 million in connection with the sale.

In accordance with ASC 205 Presentation of financial statements Discontinued Operations , a business is classified as a discontinued operation when : (i) the operations and cash flows of the business can be clearly distinguished and have been or will be eliminated from our ongoing operations; (ii) the business has either been disposed of or is classified as held for sale; and (iii) the Company will not have any significant continuing involvement in the operations of the business after the disposal transactions.

On March 5, 2013, the Company entered into a transition service agreement (TSA) with Aurora to provide contract manufacturing for up to five months and other various support, including providing order fulfillment, taking warranty calls, attending to product returns from customers, providing cost accounting analysis, receiving payments from customers and remitting such payments to Aurora for up to two months. The TSA fees are a fixed amount per month and were determined based on the Company s estimated cost of delivering the transition services. In addition, on April 24, 2013, the Company and Aurora signed a sublease agreement for the Company s Milpitas warehouse for the remaining period of the lease. The Company determined that the cash flows generated from these transactions are both insignificant and are considered indirect cash flows. As a result, the sale of the cable access HFC business is appropriately presented as discontinued operations. The TSA billing to Aurora in the three months ended March 29, 2013 totaled $328,000, and it was recorded in the Consolidated Statements of Operations under income from continuing operations as an offset to the expenses incurred to deliver the transition services. The table below provides details on the income statement caption under which the TSA billing was recorded (in thousands):

	Three months ended March 29, 2013	
Product cost of revenue	$	175
Research and development		9
Selling, general and administrative		144
Total TSA billing to Aurora	$	328

Included within the Prepaid expenses and other current assets ending balance at March 29, 2013 on the Consolidated Balance Sheet is $1.7 million due from Aurora for purchases made on Aurora s behalf and $3.0 million in receivables from customers invoiced on Aurora s behalf. Included within the Accrued liabilities ending balance at March 29, 2013 is $1.4 million payable to third party vendors for purchases made on Aurora s behalf and $2.9 million due to Aurora primarily for invoicing to customers made on Aurora s behalf.

8

Table of Contents

The Company recorded a gain of $15.0 million in connection with the sale of the cable access HFC business, calculated as follows (in thousands):

Gross Proceeds		$ 46,000
Less : carrying value of net assets		
Inventories, net	$ 10,487	
Prepaid expenses and other current assets	612	
Property and equipment, net	1,133	
Goodwill de-recognized	14,547	
Deferred revenue	(4,499)	
Accrued liabilities	(939)	
Total net assets sold and de-recognized		$ 21,341
Less : selling cost		$ 2,469
Less : Tax effect		$ 7,234
Gain on disposal, net of tax		$ 14,956

Since the Company has one reporting unit, upon the sale of the cable access HFC business, approximately $14.5 million of the carrying value of goodwill was allocated to the cable access HFC business based on the relative fair value of the cable access HFC business to the fair value of the Company. The remaining carrying value of goodwill as of March 29, 2013 was tested for impairment, and the Company determined that goodwill was not impaired as of March 29, 2013.

The results of operations associated with the cable access HFC business are presented as discontinued operations in the Company s Consolidated Statements of Operations for all periods presented. Revenue and the components of net income related to the discontinued operations for the three months ended March 29, 2013 and March 30, 2012 were as follows:

	Three months ended	
	March 29, 2013	**March 30, 2012**
Revenue	$ 9,556	$ 11,282
Operating income	$ 834	$ 1,226
Less: (Benefit from) provision for income taxes	(134)	19
Add: Gain on disposal, net of tax	14,956	
Income from discontinued operations, net of taxes	$ 15,924	$ 1,207

Table of Contents

NOTE 4: SHORT-TERM INVESTMENTS

The following table summarizes the Company s short-term investments (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
As of March 29, 2013				
Certificates of deposit	$ 1,605	$	$	$ 1,605
State, municipal and local government agencies bonds	59,137	56	(2)	59,191
Corporate bonds	31,062	7	(22)	31,047
Commercial paper	9,944			9,944
U.S. federal government bonds	8,003	1	(1)	8,003
Total short-term investments	$ 109,751	$ 64	$ (25)	$ 109,790
As of December 31, 2012				
Certificates of deposit	$ 1,603	$	$	$ 1,603
State, municipal and local government agencies bonds	59,009	45	(4)	59,050
Corporate bonds	31,568	4	(10)	31,562
Commercial paper	10,287	1		10,288
U.S. federal government bonds	2,003			2,003
Total short-term investments	$ 104,470	$ 50	$ (14)	$ 104,506

The following table summarizes the maturities of the Company s short-term investments (in thousands):

	March 29, 2013	December 31, 2012
Less than one year	$ 84,402	$ 76,779
Due in 1 - 2 years	25,388	27,727
Total short-term investments	$ 109,790	$ 104,506

Realized gains and losses from the sale of investments for the three months ended March 29, 2013 and March 30, 2012 were not material.

Impairment of Investments. The Company monitors its investment portfolio for impairment on a periodic basis. In the event that the carrying value of an investment exceeds its fair value and the decline in value is determined to be other-than-temporary, an impairment charge is recorded and a new cost basis for the investment is established. A decline of fair value below amortized costs of debt securities is considered other-than temporary if the Company has the intent to sell the security or it is more likely than not that the Company will be required to sell the security before recovery of the entire amortized cost basis. At the present time, the Company does not intend to sell its investments that have unrealized losses in accumulated other comprehensive loss. In addition, the Company does not believe that it is more likely than not that it will be required to sell its investments that have unrealized losses in accumulated other comprehensive loss before the Company recovers the principal amounts invested. The Company believes that the unrealized losses are temporary and do not require an-other-than-temporary impairment, based on its evaluation of available evidence as of March 29, 2013.

As of March 29, 2013, there were no individual available-for-sale securities in a material unrealized loss position and the amount of unrealized losses on the total investment balance was insignificant.

NOTE 5: FAIR VALUE MEASUREMENTS

The applicable accounting guidance establishes a framework for measuring fair value and requires disclosure about the fair value measurements of assets and liabilities. This guidance requires the Company to classify and disclose assets and liabilities measured at fair value on a recurring basis, as well as fair value measurements of assets and liabilities measured on a nonrecurring basis in periods subsequent to initial measurement, in a three-tier fair value hierarchy as described below.

The guidance defines fair value as the exchange price that would be received for an asset or paid to transfer a liability, in the principal or most advantageous market for the asset or liability, in an orderly transaction between market participants on the measurement date.

Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The guidance describes three levels of inputs that may be used to measure fair value:

Level 1	Observable inputs that reflect quoted prices for identical assets or liabilities in active markets.

Table of Contents

Level 2 Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company primarily uses broker quotes for valuation of its short-term investments. The forward exchange contracts are classified as Level 2 because they are valued using quoted market prices and other observable data for similar instruments in an active market.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company uses the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities. During the three months ended March 29, 2013, there were no nonrecurring fair value measurements of assets and liabilities subsequent to initial recognition.

The following table sets forth the fair value of the Company s financial assets and liabilities measured at fair value as of March 29, 2013 and December 31, 2012, based on the three-tier fair value hierarchy (in thousands):

	Level 1	Level 2	Level 3	Total
As of March 29, 2013				
Cash equivalents				
Money market funds	$ 62,370	$	$	$ 62,370
U.S. federal government bonds with maturity less than 90 days	2,002			2,002
Short-term investments				
Certificates of deposit		1,605		1,605
State, municipal and local government agencies bonds		59,191		59,191
Corporate bonds		31,047		31,047
Commercial paper		9,944		9,944
U.S. federal government bonds	8,003			8,003
Prepaids and other current assets				
Foreign exchange forward contracts		735		735
Total assets measured and recorded at fair value	$ 72,375	$ 102,522	$	$ 174,897
Accrued liabilities				
Foreign exchange forward contracts	$	$ 63	$	$ 63
Total liabilities measured and recorded at fair value	$	$ 63	$	$ 63

	Level 1	Level 2	Level 3	Total
As of December 31, 2012				
Cash equivalents				
Money market funds	$ 54,923	$	$	$ 54,923
Corporate bonds with maturity less than 90 days		3,614		3,614
U.S. federal government bonds with maturity less than 90 days	3,005			3,005
Short-term investments				
Certificates of deposit		1,603		1,603
State, municipal and local government agencies bonds		59,050		59,050
Corporate bonds		31,562		31,562
Commercial paper		10,288		10,288
U.S. federal government bonds	2,003			