

Harmonic Inc (HLIT)

Anyone interested in the volatile technology stock of an Emmy award winning company? If so, I may have the company for you.

Thesis

This Emmy Award winning company delivers the best arms to the video on demand war lords. They are a classic pick and shovel provider. On a GAAP basis they entered profitability in Q3 2006 and their finances have shown continuous improvement since then. They appear to have mastered cost management and have diversified their segment internationally and their customer base. This has shown up in increasing revenue and improved margins

Harmonic supply satellite, cable, telcos and broadcast companies both systems and services for video delivery and on demand features. The geek inside me deciphers Harmonic's following techno babble as they supply the best technology to deliver the swelling wave of digital video delivery.

" using our ground-breaking IP-based video compression, stream processing, edge, broadband access and software solutions to deliver the next generation of broadcast and on-demand video services including HDTV, VOD, network PVR and time-shifted TV. Our market-leading systems enable operators to increase revenues and reduce operational expenditures by offering viewers unmatched picture quality and a more personalized experience."

It doesn't matter who wins the video wars, Harmonic supplies to all players. They dominate this niche and with continued high investment in R&D, currently around 14%, are likely to continue dominating.

Harmonic are currently attractively priced, closed 28 April 2008 at \$8.53, with a forward 2008 P/E of 12.18. In my valuations I use analysts' estimates with a healthy whack off the top. I have done this with Harmonic despite believing analysts are still low balling beyond this year and we will see earnings upgrades for 2009 over the coming months. There have already been six earnings upgrades for 2008 in the last week.

They reported excellent [Q1 Earnings](#) last Wednesday, 22 April.

The results were met with a bored yawn by the market.

Their [conference call](#) added to my belief in this company.

Valuation

Harmonic have cash equivalents and short-term investments of \$278.9 million (\$2.93 per diluted share) and no debt.

They are cash flow positive.

Growing top line at around 25% with their guidance calling for 20%.

Earnings growing significantly faster with consensus for 2008 of \$0.70, delivering close to 100% growth.

Earning Based Valuation

I have used the quarterly data which excludes the one-off settlement costs of a 2000 class action. The charge was booked in 2007 with settlement expected in Q2 or 3 2008. This \$6.4M charge is the reason why the 2007 10-K EPS is \$0.29, while the summed quarters is 0.36.

Figures used

- TTM eps is \$0.49.
- Book Value – cash only \$2.93
- Discount Rate – 10%

PIV-ER Calculation	Low	Medium	High
Forecasted Growth Rate	6.50%	9.75%	13.00%
Discounted EPS value	\$ 8.43	\$10.15	\$12.22
BV/Share	2.93	2.93	2.93
Current IV	11.36	13.08	15.15
Weighted Percent	40%	35%	25%
Weighted value	4.54	4.58	3.79
Weighted IV	12.91		
PIV	66.1%		
ER	51.3%		

Alternative P/E Based Analysis

I'm going to cut corners on this one and instead of calculating the past P/E ranges will use BigCharts. You can't tell much from this printer friendly version, <http://tinyurl.com/5kzo58> but from the interactive version I can tell investors have recently been prepared to pay up to a P/E of 40. The current yahoo P/E is 30 based on 2007 diluted eps of \$0.28. My broker shows P/E of 16.5 based on ttm eps of \$0.55. Reuters has P/E of 21.1 based on ttm.

As I'm using the yahoo non-GAAP eps estimates I'll keep the P/Es on the lower side.

2008 FY p/e	eps		
	Low	Average	High
	0.64	0.7	0.74
20	13	14	15
22	14	15	16
24	15	17	18
26	17	18	19
28	18	20	21

Cash Flow

From Reuters

	Company	Industry	Sector	S&P 500
Price to Cash Flow (TTM)	17.30	20.39	20.18	14.47
Price to FCF (TTM)	15.20	37.28	24.47	29.85

Technical Analysis

<http://stockcharts.com/charts/gallery.html?hlit>

Indicators trending up. Above 50 dMA.

RSI trending up near 59.

Behavioural Analysis

Harmonic has a high beta of 2.92 and attracts story stock and momentum players like bees to honey. This causes the volatility and the current opportunity. With the technical indicators now trending up and the recent good earnings release these investors should start to come back to HLIT to try for their quick gains.

Risks

- S&P have a fair value of \$8.10, slightly overvalued, with a low investability quotient of 19%
- Usual technology risks.
- Low insider ownership.
- Customer concentration. In 2007, sales to Comcast and EchoStar accounted for 16% and 12% of net sales, respectively.
- Cash currently provides 20% of earning through interest. While Harmonic has been shrewd acquirers in the past the cash balance does have associated risk of misallocation.

Conclusion

Harmonic represents a good risk to reward investment for the next year. While they are a central player in the worldwide conversion to digital delivery and VOD as a small high tech player their future is not assured. FI Funds will make an initial purchase tonight, Tuesday morning US time, of around 2% of funds. The fund may make further purchases of HLIT up to a maximum of 5% of assets. Despite solid earnings we are currently classifying HLIT as a story stock. The fund will plans on limiting investment in story stocks to 10% of assets.

Filings and other links

Q1 Earnings Release http://www.harmonicinc.com/ah_press_release_print-friendly-v3.cfm?ID=755

Q1 Conference Call Transcript <http://seekingalpha.com/article/73772-harmonic-inc-q1-2008-earnings-call-transcript?page=-1>

Q1 2008 <http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?filingid=5879537&tabindex=2&type=html>

2007 10-K <http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?filingid=5803717&tabindex=2&type=html>

Q4 2007 <http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?filingid=5678608&tabindex=2&type=html>

Q3 07 10-Q <http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?filingid=5501423&tabindex=2&type=html>

Q2 07 10-Q <http://yahoo.brand.edgar-online.com/displayfilinginfo.aspx?filingid=5343132&tabindex=2&type=html>