

Fabrinet
Form 10-Q
May 09, 2012
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended March 30, 2012 March 30, 2012

OR

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 001-34775

FABRINET

(Exact name of registrant as specified in its charter)

Edgar Filing: Fabrinet - Form 10-Q

Cayman Islands (State or other jurisdiction of incorporation or organization)	Not Applicable (I.R.S. Employer Identification No.)
Walker House 87 Mary Street George Town Grand Cayman	
Cayman Islands (Address of principal executive offices)	KY1-9005 (Zip Code)
+66 2-524-9600	
(Registrant's telephone number, including area code)	

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 (the Exchange Act) 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 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if 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

As of April 27, 2012, the registrant had 34,467,757 ordinary shares, \$0.01 par value, outstanding.

Table of Contents

FABRINET

FORM 10-Q

QUARTER ENDED MARCH 30, 2012

Table of Contents

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	3
<u>Unaudited Condensed Consolidated Balance Sheets as of March 30, 2012 and June 24, 2011</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations for the three and nine months ended March 30, 2012 and March 25, 2011</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended March 30, 2012 and March 25, 2011</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	33
<u>Item 4. Controls and Procedures</u>	34
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	34
<u>Item 1A. Risk Factors</u>	34
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	50
<u>Item 6. Exhibits</u>	50
<u>Signature</u>	51
<u>Exhibit Index</u>	52

Table of Contents**PART I: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****FABRINET****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands of U.S. dollars, except share data)	March 30, 2012	June 24, 2011
Assets		
Current assets		
Cash and cash equivalents	\$ 125,410	\$ 127,282
Trade accounts receivable, net	118,484	117,705
Inventories, net	98,877	106,467
Investment in leases		448
Deferred tax assets	3,948	1,308
Prepaid expenses and other current assets	7,046	4,466
Total current assets	353,765	357,676
Non-current assets		
Property, plant and equipment, net	96,391	75,410
Intangibles, net	466	892
Investment in leases		1,163
Deferred tax assets	1,871	1,953
Deposits and other non-current assets	662	681
Total non-current assets	99,390	80,099
Total assets	\$ 453,155	\$ 437,775
Liabilities and Shareholders Equity		
Current liabilities		
Long-term loans from banks, current portion	\$ 9,668	\$ 4,398
Trade accounts payable	75,274	92,563
Construction payable	4,236	2,475
Income tax payable	820	1,858
Deferred tax liability	1,283	1,056
Accrued payroll, profit sharing and related expenses	6,997	7,677
Accrued expenses	4,412	3,986
Other payables	8,353	3,796
Liabilities to third parties due to flood losses	61,198	
Total current liabilities	172,241	117,809
Non-current liabilities		
Long-term loans from banks, non-current portion	31,328	11,979
Severance liabilities	5,015	4,478
Other non-current liabilities	2,054	1,982
Total non-current liabilities	38,397	18,439

Edgar Filing: Fabrinet - Form 10-Q

Total liabilities	210,638	136,248
Commitments and contingencies (Note 13)		
Shareholders' equity		
Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of March 30, 2012 and June 24, 2011)		
Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 34,466,754 shares and 34,207,579 shares issued and outstanding as of March 30, 2012 and June 24, 2011, respectively)	345	342
Additional paid-in capital	64,727	59,816
Retained earnings	177,445	241,369
Total shareholders' equity	242,517	301,527
Total Liabilities and Shareholders' equity	\$ 453,155	\$ 437,775

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

Table of Contents**FABRINET****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands of U.S. dollars, except share data)	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Revenues	\$ 139,019	\$ 194,851	\$ 421,975	\$ 553,222
Cost of revenues	(124,138)	(169,528)	(375,281)	(482,460)
Gross profit	14,881	25,323	46,694	70,762
Selling, general and administrative expenses	(6,586)	(7,516)	(18,543)	(18,294)
Other expenses in relation to flood	(55,623)		(95,888)	
Operating (loss) income	(47,328)	17,807	(67,737)	52,468
Interest income	209	143	628	355
Interest expense	(64)	(81)	(206)	(282)
Foreign exchange gain (loss), net	714	342	1,314	(706)
Other income	57	65	213	80
(Loss) income before income taxes	(46,412)	18,276	(65,788)	51,915
Income tax benefit (expense)	87	(1,613)	1,864	(4,241)
Net (loss) income	\$ (46,325)	\$ 16,663	\$ (63,924)	\$ 47,674
(Loss) earnings per share				
Basic	\$ (1.35)	\$ 0.49	\$ (1.86)	\$ 1.41
Diluted	(1.35)	0.49	(1.86)	1.39
Weighted average number of ordinary shares outstanding (thousands of shares)				
Basic	34,440	33,969	34,353	33,833
Diluted	34,440	34,232	34,353	34,345

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

Table of Contents**FABRINET****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands of U.S. dollars)	Nine Months Ended	
	March 30, 2012	March 25, 2011
Cash flows from operating activities		
Net (loss) income for the period	\$ (63,924)	\$ 47,674
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation	6,995	6,445
Amortization of intangibles	288	382
Gain on disposal of property, plant and equipment	(7)	(31)
Allowance for doubtful accounts and warranties	(23)	119
Unrealized gain on exchange rate and fair value of derivative	(1,364)	(718)
Share-based compensation	3,930	2,658
Deferred income tax	(2,331)	(417)
Provision for uncertain tax position and severance liabilities, net of payments	688	169
Inventory obsolescence	528	298
Loss from written-off assets and liabilities to third parties due to flood losses	83,871	
Changes in operating assets and liabilities		
Trade accounts receivable	(807)	(19,638)
Inventories	(9,550)	(10,204)
Other current assets and non-current assets	(2,758)	(245)
Trade accounts payable	(17,289)	(5,911)
Income tax payable	(1,038)	1,107
Other current liabilities and non-current liabilities	2,929	2,914
Net cash provided by operating activities	138	24,602
Cash flows from investing activities		
Purchase of property, plant and equipment	(26,394)	(15,761)
Purchase of intangibles	(17)	(171)
Purchase of assets for lease under direct financing leases	(2,940)	(1,583)
Proceeds from direct financing leases	1,217	268
Proceeds from disposals of property, plant and equipment	22	111
Net cash used in investing activities	(28,112)	(17,136)
Cash flows from financing activities		
Receipts of long-term loans from banks	28,000	
Repayments of long-term loans from banks	(3,381)	(4,421)
Proceeds from initial public offering, net		26,319
Proceeds from issuance of ordinary shares under employee share option plan	984	1,365
Net cash provided by financing activities	25,603	23,263
Net (decrease) increase in cash and cash equivalents	(2,371)	30,729
Movement in cash and cash equivalents		
Cash and cash equivalents at beginning of period	127,282	84,942
(Decrease) increase in cash and cash equivalents	(2,371)	30,729
Effect of exchange rate on cash and cash equivalents	499	748
Cash and cash equivalents at end of period	\$ 125,410	\$ 116,419

Edgar Filing: Fabrinet - Form 10-Q

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

Table of Contents

FABRINET

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business and organization

General

Fabrinet (Fabrinet or the Company) was incorporated on August 12, 1999, and commenced operations on January 1, 2000. The Company is an exempted company incorporated with limited liability, and is domiciled in the Cayman Islands, British West Indies. Fabrinet and its direct and indirect subsidiaries are referred to as the Group .

The Group provides precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (OEMs) of complex products, such as optical communication components, modules and sub-systems, industrial lasers and sensors. The Group offers a broad range of advanced optical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, integration and full product assembly and test. The Group focuses primarily on the production of low-volume, high-mix products.

The Company has the following direct and indirect subsidiaries:

Fabrinet Co., Ltd., (Fabrinet Thailand) incorporated in Thailand on September 27, 1999;

Fabrinet USA, Inc., incorporated in the U.S. in the State of California on October 12, 1999;

FBN New Jersey Manufacturing, Inc., incorporated in the U.S. in the State of Delaware on May 11, 2005;

Fabrinet China Holdings, incorporated in Mauritius and CASIX Inc., incorporated in the People s Republic of China, which were both acquired on May 29, 2005;

Fabrinet Pte. Ltd., incorporated in Singapore on November 14, 2007; and

Fabrinet AB, incorporated in Sweden on September 29, 2010.

Asia Pacific Growth Fund III, L.P. held 26.2% and 26.5% of the Company s share capital (fully diluted) as of March 30, 2012 and June 24, 2011, respectively.

2. Accounting policies

Basis of presentation

The condensed consolidated financial statements of Fabrinet included herein have been prepared on a basis consistent with the June 24, 2011 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These condensed consolidated financial statements should be read in conjunction with the June 24, 2011 audited consolidated financial statements and notes thereto. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America (U.S.

Edgar Filing: Fabrinet - Form 10-Q

GAAP). Fabrinet's results of operations for the three and nine months ended March 30, 2012 and March 25, 2011 are not necessarily indicative of future operating results.

The preparation of the Group's consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amount of total revenues and expense during the year. The Group bases estimates on historical experience and various assumptions about the future that are believed to be reasonable based on available information. The Group's reported financial position or results of operations may be materially different under different conditions or when using different estimates and assumptions, particularly with respect to significant accounting policies, which are discussed below. Significant assumptions are used in accounting for business combinations, share-based compensation, allowance for doubtful accounts, income taxes and inventory obsolescence, among others. In addition, as the Company continues to assess the extent of the impact on the Company's operations of the flooding in Thailand that occurred in October-November 2011, the Company has made estimates and assumptions in the

Table of Contents

determination of losses and recoveries recognized in the condensed consolidated financial statements. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates. In the event that estimates or assumptions prove to differ from actual results, adjustments will be made in subsequent periods to reflect more current information.

Fiscal years

The Group utilizes a 52-53 week fiscal year ending on the Friday closest to June 30. The three months ended March 30, 2012 and March 25, 2011 each consisted of 13 weeks. The nine months ended March 30, 2012 and March 25, 2011 consisted of 40 weeks and 39 weeks, respectively. Fiscal year 2012 will be comprised of 53 weeks and will end on June 29, 2012.

Concentration of credit risk

Financial instruments that potentially subject the Group to concentrations of credit risk consist of cash and cash equivalents and accounts receivable.

As of March 30, 2012, the Group's cash and cash equivalents were held in deposits and highly liquid products with maturities of three months or less with banks with credit ratings of A minus or above. The Group had four customers and five customers that each contributed to 10% or more of its total accounts receivable as of March 30, 2012 and June 24, 2011, respectively.

Accounts receivable include amounts due from companies that are monitored by the Group for credit worthiness. Management has implemented a program to closely monitor near term cash collection and credit exposures and believes no material loss will be incurred.

Recent accounting pronouncements

In December 2011, the Financial Accounting Standards Board (FASB or the Board) issued the Accounting Standards Update No. 2011-12 Comprehensive Income (Topic 220) Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05. Under the amendments in Update 2011-05 entities are required to present reclassification adjustments and the effect of those reclassification adjustments on the face of the financial statements where net income is presented, by component of net income , and on the face of the financial statements where other comprehensive income is presented, by component of other comprehensive income for both annual and interim financial periods. The amendments in this Update supersede changes to those paragraphs in Update 2011-05 that pertain to how, when, and where reclassification adjustments are presented. All other requirements in Update 2011-05 are not affected by this amendment, including the requirement to report comprehensive income either in a single continuous financial statement or in two separate but consecutive financial statements. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. Early adoption is permitted. This new guidance is not expected to have an impact on the Company's presentation, financial position, and results of operations.

In December 2011, the FASB issued the Accounting Standards Update No. 2011-11 Balance Sheet (Topic 210) Disclosures about Offsetting Assets and Liabilities. The amendments in this Update will enhance disclosures required by U.S. GAAP by requiring improved information about financial instruments and derivative instruments that are either (1) offset in accordance with either Section 210-20-45 or Section 815-10-45 or (2) subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45. Information about offsetting and related arrangements will enable users of an entity's financial statements to understand the effect of those arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments in the scope of this Update. This guidance is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. The Company does not expect that the adoption of this guidance will have an effect on its unaudited condensed consolidated financial statements.

In December 2011, the FASB issued the Accounting Standards Update No. 2011-10 Property, Plant, and Equipment (Topic 360) Derecognition of in Substance Real Estate- a Scope Clarification, a consensus of the FASB Emerging Issues Task Force. Under the amendments in this Update, when a parent (reporting entity) ceases to have a controlling financial

Table of Contents

interest (as described in Subtopic 810-10) in a subsidiary that is in substance real estate as a result of default on the subsidiary's nonrecourse debt, the reporting entity should apply the guidance in Subtopic 360-20 to determine whether it should derecognize the in substance real estate. Generally, a reporting entity would not satisfy the requirements to derecognize the in substance real estate before the legal transfer of the real estate to the lender and the extinguishment of the related nonrecourse indebtedness. That is, even if the reporting entity ceases to have a controlling financial interest under Subtopic 810-10, the reporting entity would continue to include the real estate, debt, and the results of the subsidiary's operations in its consolidated financial statements until legal title to the real estate is transferred to legally satisfy the debt. This guidance is effective for fiscal years and interim periods within those years, beginning on or after June 15, 2012. Early adoption is permitted. The Company will adopt this guidance in the first quarter of fiscal year 2013, and is currently evaluating the impact, if any, its adoption will have on its unaudited condensed consolidated financial statements.

3. (Loss) earnings per ordinary share

Basic (loss) earnings per ordinary share are computed by dividing reported net (loss) income by the weighted average number of ordinary shares outstanding during each period.

	Three Months Ended	
	March 30, 2012	March 25, 2011
Net (loss) income attributable to shareholders	\$ (46,325)	\$ 16,663
Weighted average number of ordinary shares outstanding (thousands of shares)	34,440	33,969
Basic (loss) earnings per ordinary share (in dollars)	\$ (1.35)	\$ 0.49

	Nine Months Ended	
	March 30, 2012	March 25, 2011
Net (loss) income attributable to shareholders	\$ (63,924)	\$ 47,674
Weighted average number of ordinary shares outstanding (thousands of shares)	34,353	33,833
Basic (loss) earnings per ordinary share (in dollars)	\$ (1.86)	\$ 1.41

Diluted (loss) earnings per ordinary share are computed by dividing reported net (loss) income by the weighted average number of ordinary shares and dilutive ordinary equivalent shares outstanding during each period. Dilutive ordinary equivalent shares consist of share options and restricted shares. Diluted (loss) earnings per ordinary share is calculated as follows:

	Three Months Ended	
	March 30, 2012	March 25, 2011
Net (loss) income used to determine diluted (loss) earnings per ordinary share	\$ (46,325)	\$ 16,663
Weighted average number of ordinary shares outstanding (thousands of shares)	34,440	33,969
Adjustment for incremental shares arising from the assumed exercise of share options and vesting of restricted share units (thousands of shares)	*	263
Weighted average number of ordinary shares for diluted (loss) earnings per ordinary share (thousands of shares)	34,440	34,232
Diluted (loss) earnings per ordinary share (in dollars)	\$ (1.35)	\$ 0.49

* Loss per ordinary share for the three months ended March 30, 2012 was computed using the weighted average number of ordinary shares outstanding during the period in accordance with the antidilutive provisions of ASC 260-10-45, therefore 218,193 shares have been excluded.

Table of Contents

	Nine Months Ended	
	March 30, 2012	March 25, 2011
Net (loss) income used to determine diluted (loss) earnings per ordinary share	\$ (63,924)	\$ 47,764
Weighted average number of ordinary shares outstanding (thousands of shares)	34,353	33,833
Adjustment for incremental shares arising from the assumed exercise of share options and vesting of restricted share units (thousands of shares)	*	512
Weighted average number of ordinary shares for diluted (loss) earnings per ordinary share (thousands of shares)	34,353	34,345
Diluted (loss) earnings per ordinary share (in dollars)	\$ (1.86)	\$ 1.39

* Loss per ordinary share for the nine months ended March 30, 2012 was computed using the weighted average number of ordinary shares outstanding during the period in accordance with the antidilutive provisions of ASC 260-10-45, therefore 214,816 shares have been excluded.

4. Fair value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy is established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

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.

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 Group utilizes 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.

The following table sets forth the Group's applicable liabilities measured at fair value on a recurring basis as of March 30, 2012:

	Fair Value Measurements at Reporting Date Using			Total Balance
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Liabilities				
Derivative liabilities		89		89
Total liabilities measured at fair value	\$	\$ 89	\$	\$ 89

The above derivative liabilities are classified in accrued expenses on the condensed consolidated balance sheet.

Table of Contents

The following table sets forth the Group's applicable liabilities measured at fair value on a recurring basis as of June 24, 2011:

	Fair Value Measurements at Reporting Date Using			Total Balance
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Liabilities				
Derivative liabilities		966		966
Total liabilities measured at fair value	\$	\$ 966	\$	\$ 966

The above derivative liabilities are classified in accrued expenses on the consolidated balance sheet.

5. Allowance for doubtful accounts

The activities and balances for allowance for doubtful accounts for the nine months ended March 30, 2012 and March 25, 2011 were as follows:

	Balance at beginning of period	Charged to expenses during the period	Balance at end of period
Nine months ended March 30, 2012	\$ 79	\$ 28	\$ 107
Nine months ended March 25, 2011	\$ 41	\$ 67	\$ 108

6. Inventories

	March 30, 2012	June 24, 2011
Raw materials	\$ 45,496	\$ 47,172
Work in progress	41,254	46,190
Finished goods	8,303	9,651
Goods in transit	6,554	5,656
	\$ 101,607	\$ 108,669
<u>Less</u> Inventory obsolescence	(2,730)	(2,202)
Inventories, net	\$ 98,877	\$ 106,467

In the three months ended March 30, 2012, the Group wrote off inventories of \$1,094, of which \$772 were raw materials and \$322 were work in progress and finished goods, damaged due to the flooding in Thailand during October-November 2011 (see Note 15). In the nine months ended March 30, 2012, the Group wrote off inventories of \$16,612, of which \$11,243 were raw materials and \$5,369 were work in progress and finished goods, damaged due to the flooding in Thailand during October-November 2011. These amounts have been included in Other expenses in relation to flood in the condensed consolidated statements of operations.

Table of Contents**7. Investment in leases**

Investment in direct financing leases primarily consists of manufacturing equipment. The following lists the components of the Company's investment in direct financing leases as of March 30, 2012 and June 24, 2011:

	March 30, 2012	June 24, 2011
Total minimum lease payments receivable	\$ 3,522	\$ 2,026
Estimated residual values of leased equipment		
Investment in direct financing leases	\$ 3,522	\$ 2,026
Less: unearned income	(186)	(415)
	\$ 3,336	\$ 1,611
Less: written-off of investment in direct financing leases	(3,336)	
Net investment in direct financing leases	\$	\$ 1,611

In the second quarter of fiscal 2012, all investment in leases of \$3,336 were written-off, as they were damaged due to the flooding in Thailand during October-November 2011. This amount has been included in other expenses in relation to flood in the condensed consolidated statements of operations.

8. Intangibles

The following tables present details of the Group's intangibles:

	Gross Carrying Amount	March 30, 2012 Accumulated Amortization	Net
Software	\$ 3,456	\$ (2,990)	\$ 466
Total intangibles	\$ 3,456	\$ (2,990)	\$ 466

	Gross Carrying Amount	June 24, 2011 Accumulated Amortization	Net
Software	\$ 3,594	\$ (2,702)	\$ 892
Total intangibles	\$ 3,594	\$ (2,702)	\$ 892

The Group recorded amortization expense relating to intangibles of \$89 and \$129 for the three months ended March 30, 2012 and March 25, 2011, respectively, and \$288 and \$382 for the nine months ended March 30, 2012 and March 25, 2011, respectively.

Based on the carrying amount of intangibles as of March 30, 2012, and assuming no future impairment of the underlying assets, the estimated future amortization at the end of each fiscal year in June is as follows:

Edgar Filing: Fabrinet - Form 10-Q

2012	\$ 86
2013	217
2014	93
2015	64
2016	5
Thereafter	1
Total amortization	\$ 466

Table of Contents**9. Borrowings**

Bank borrowings and long-term debt was comprised of the following:

	March 30, 2012	June 24, 2011
Short-term bank borrowings	\$	\$
Long-term loans from banks	40,996	16,377
Total borrowings	\$ 40,996	\$ 16,377
<i>Long-term loans from banks consisted of:</i>		
Current portion	\$ 9,668	\$ 4,398
Non-current portion	31,328	11,979

At March 30, 2012 and June 24, 2011, the Group had outstanding borrowings under long-term loan agreements with banks totaling \$40,996 and \$16,377, respectively, which consisted of:

Contract	Amount				
No.	March 30, 2012	June 24, 2011	Interest rate per annum (%)	Conditions	Repayment term
1	\$ 30,000	\$ 2,000	LIBOR + 2.8% per annum	Repayable in quarterly installments within 6 years	June 2012 -March 2017
2	10,996	13,747	SIBOR + 1.5% per annum	Repayable in quarterly installments within 8 years	May 2009 -February 2015
3		630	SIBOR + 1.5% per annum	Repayable in semi-annual installments within 7 years	June 2005 -November 2011
Total	\$ 40,996	\$ 16,377			

Certain of the long-term loans are secured by certain property, plant and equipment. The carrying amount of assets secured and pledged as collateral was \$23,004 and \$34,946 as of March 30, 2012 and June 24, 2011, respectively. The carrying amounts of borrowings approximate their fair value.

Interest expense relating to a long-term loan from a bank for the development of a new factory site, Pinehurst Building 6, of \$169 and \$257 was capitalized in construction in progress for the three and nine months ended March 30, 2012, respectively.

The long-term loans prescribe maximum ratios of debt to equity and minimum levels of debt service coverage ratios. As of March 30, 2012 and June 24, 2011, the Group was in compliance with its long-term loan agreements. In addition to financial ratios, certain of the Group's packing credits and long-term loans include customary events of default. There is no requirement for the Group to maintain a lock-box arrangement under these agreements. As such, the non-current portions of the long-term loans are classified as non-current liabilities in the condensed consolidated balance sheet.

The movements of long-term loans were as follows for the nine months ended March 30, 2012 and March 25, 2011:

	Nine Months Ended March 30, 2012	March 25, 2011
Opening net book amount	\$ 16,377	\$ 20,385
Additional loans during the period	28,000	
Repayment during the period	(3,381)	(4,421)

Edgar Filing: Fabrinet - Form 10-Q

Closing net book amount	\$ 40,996	\$ 15,964
-------------------------	-----------	-----------

Table of Contents

As of March 30, 2012, future maturities of long-term debt were as follows at the end of each fiscal year in June:

2012	\$ 2,417
2013	9,668
2014	9,668
2015	8,743
2016	6,000
Thereafter	4,500
Total	\$ 40,996

Credit facilities:

Undrawn available credit facilities at March 30, 2012 and June 24, 2011 totaled:

	March 30, 2012	June 24, 2011
Bank borrowings:		
Short-term loans	\$ 50,412	\$ 50,450
Long-term loans		28,000

10. Income tax

The Group has implemented FASB ASC Topic 740, Income Taxes (FASB ASC 740). As of March 30, 2012, the liability for uncertain tax positions including accrued interest and penalties increased to \$1,854 (June 24, 2011: \$1,703). The Group does not expect any material changes to the estimated amount of liability associated with its uncertain tax positions within the next 12 months.

The Group files several income tax returns in U.S. and foreign tax jurisdictions. The tax years from 2007 to 2011 remain open to examination by U.S. and state tax authorities, and the tax years from 2007 to 2011 remain open to examination by the foreign tax authorities.

The Group's income tax is recognized based on the best estimate of the expected annual income tax rate for the full fiscal year of each entity in the Group. The effective tax rate for the Group for the three months ended March 30, 2012 and March 25, 2011 was (0.2)% (tax benefit) and 9% of net income, respectively. The effective tax rate for the Group for the nine months ended March 30, 2012 and March 25, 2011 was (3)% (tax benefit) and 8% of net income, respectively. The decrease in effective tax rate during the three and nine months ended March 30, 2012, as compared to the three and nine months ended March 25, 2011, was due to the effects of the reassessment of the Group's projected full year effective tax rate to take into account the impact on the Group's operations of the flooding in Thailand that occurred in October and November 2011, resulting in the recording of additional deferred tax assets of \$0.8 million and \$3.2 million for the three and nine months ended March 30, 2012, respectively, and the impact of an income tax rate change for the Company's subsidiary in China, resulting in a reduction in income tax expense of \$0.3 million for the three months ended March 30, 2012.

Further, on December 21, 2011, the Thailand Revenue Department announced a reduction in corporate income tax rates for tax periods beginning on or after January 1, 2012. As a result of the announcement, enacted corporate income tax rates for the Company's subsidiary in Thailand will be reduced from 30% in fiscal 2012 to 23%, 20% and 20% in fiscal 2013, 2014 and 2015, respectively. As a result of this change, the Company's deferred tax balance and income tax expense decreased by a net amount of \$121 during the three months ended December 30, 2011.

On March 16, 2012, the Company's subsidiary in China received a certificate with an approval date of October 21, 2011, granting the subsidiary a tax privilege to reduce its corporate income tax rate from 25% to 15%. This privilege is retroactive to January 1, 2011 and valid for three years from January 1, 2011 to December 31, 2013, subject to renewal at the end of each three year period. As a result of this change, deferred tax assets have decreased by \$500, deferred tax liabilities decreased by \$106, income tax payable decreased by \$697, and income tax expense reduced by \$303 during the three months ended March 30, 2012. The impact of this tax rate benefit on net income per share (basic and diluted) is \$0.009 for the three months ended March 30, 2012.

Table of Contents**11. Share-based compensation***Share-based compensation*

FASB ASC Topic 718, Compensation-Stock Compensation (FASB ASC 718) requires companies to recognize the cost of employee service received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. In determining the grant date fair value of those awards, the Group is required to make estimates of the fair value of the Group's ordinary shares, expected dividends to be issued, expected volatility of the Group's shares, expected forfeitures of the awards, risk-free interest rates for the expected term of the awards, expected terms of the awards, and the vesting period of the respective awards. FASB ASC 718 requires forfeitures to be estimated at the time of grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates.

The effect of recording share-based compensation expense for the three and nine months ended March 30, 2012 and March 25, 2011 was as follows:

	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Share-based compensation expense by type of award:				
Share options	\$ 935	\$ 1,102	\$ 3,005	\$ 2,280
Restricted shares	404	136	925	378
Total share-based compensation expense	1,339	1,238	3,930	2,658
Tax effect on share-based compensation expense				
Net effect on share-based compensation expense	\$ 1,339	\$ 1,238	\$ 3,930	\$ 2,658

Share-based compensation expense was recorded in the condensed consolidated statements of operations as follows: cost of revenues of \$381 and \$440 for the three months ended March 30, 2012 and March 25, 2011, respectively, and \$1,292 and \$918 for the nine months ended March 30, 2012 and March 25, 2011, respectively; and SG&A expenses of \$958 and \$798 for the three months ended March 30, 2012 and March 25, 2011, respectively, and \$2,638 and \$1,740 for the nine months ended March 30, 2012 and March 25, 2011, respectively. The Group did not capitalize any share-based compensation expense as part of any asset costs during the three and nine months ended March 30, 2012 and March 25, 2011.

Share-based award activity

Share options have been granted to directors and employees. As of March 30, 2012, there were 194,269 share options outstanding under the Amended and Restated 1999 Share Option Plan (the 1999 Plan). Additional option grants may not be made under the 1999 Plan.

On March 12, 2010, the Company's shareholders adopted the 2010 Performance Incentive Plan (the 2010 Plan), and on December 20, 2010, the Company's shareholders adopted an amendment to the 2010 Plan to increase the number of ordinary shares authorized for issuance under the 2010 Plan. A total of 2,000,000 ordinary shares are authorized for issuance under the 2010 Plan, plus any shares subject to share options under the 1999 Plan outstanding as of June 24, 2010, that expire, are canceled or terminate after such date. As of March 30, 2012, there were an aggregate of 1,424,859 share options outstanding, 194,833 restricted share units outstanding and 328,020 ordinary shares available for future grant under the 2010 Plan.

Share options

The Company's board of directors has the authority to determine the type of option and the number of shares subject to an option. Options generally vest and become exercisable over four years and expire, if not exercised, within 7 years of the grant date. In the case of a grantee's first grant, 25 percent of the underlying shares subject to an option vest 12 months

Table of Contents

after the vesting commencement date and 1/48 of the underlying shares vest monthly over each of the subsequent 36 months. In the case of any additional grants to a grantee, 1/48 of the underlying shares subject to an option vest monthly over four years, commencing one month after the vesting commencement date.

The following summarizes share option activity under the 1999 Plan:

	Number of Shares Underlying Options Nine Months Ended		Weighted-Average Exercise Price Per Share Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Shares underlying options outstanding at beginning of the period	423,205	858,005	\$ 4.34	\$ 3.66
Granted				
Exercised	(222,656)*	(397,787)	3.56	2.91
Forfeited	(5,180)	(4,392)	5.98	5.07
Expired	(1,100)	(5,900)	5.75	2.78
Shares underlying options outstanding at end of the period	194,269	449,926	5.19	4.33
Shares underlying options exercisable at end of the period	122,777	291,157	\$ 4.86	\$ 3.62

* Included in the exercised number are 1,000 share options exercised on March 29, 2012, but not settled as of March 30, 2012.

The following summarizes information for share options outstanding as of March 30, 2012 under the 1999 Plan:

	Number of Shares Underlying Options	Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
	1,000	\$ 2.00	0.50	
	4,925	2.25	0.87	
	3,100	2.75	1.42	
	1,600	3.00	1.44	
	20,021	3.50	1.76	
	3,605	4.25	2.42	
	8,815	4.75	2.67	
	11,156	5.00	2.88	
	5,480	5.25	3.10	
	26,750	5.50	3.41	
	103,617	5.75	4.55	
	4,200	6.25	5.10	
Options outstanding	194,269		3.67	2,433
Options exercisable	122,777		3.17	1,578

As of March 30, 2012, \$74 of estimated share-based compensation expense related to share options under the 1999 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 1.61 years.

Table of Contents

The following summarizes share option activity under the 2010 Plan:

	Number of Shares Underlying Options Nine Months Ended		Weighted-Average Exercise Price Per Share Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Shares underlying options outstanding at beginning of the period	925,921		\$ 17.37	\$
Granted	584,837	992,367	14.84	17.24
Exercised	(11,619)	(12,290)	16.60	16.83
Forfeited	(73,143)	(57,534)	17.33	16.83
Expired	(1,137)		16.80	
Shares underlying options outstanding at end of the period	1,424,859	922,543	16.34	17.27
Shares underlying options exercisable at end of the period	336,862	71,838	\$ 16.81	\$ 16.96

The following summarizes information for share options outstanding as of March 30, 2012 under the 2010 Plan:

	Number of Shares Underlying Options	Exercise Price	Weighted Average Remaining Contractual Life (years)	Aggregate Intrinsic Value
	40,000	\$ 13.77	5.40	
	730,201	16.83	5.54	
	30,000	15.05	5.60	
	35,544	25.50	5.79	
	13,550	26.16	5.85	
	20,000	23.62	6.10	
	213,528	15.16	6.39	
	305,326	14.12	6.62	
	31,160	19.36	6.87	
	5,550	18.60	6.92	
Options outstanding	1,424,859		5.95	\$ 2,521
Options exercisable	336,862		5.68	\$ 446

As of March 30, 2012, \$3,109 of estimated share-based compensation expense related to share options under the 2010 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 3.14 years.

Restricted share units

Restricted share units may be granted under the 2010 Plan. Restricted share units granted to non-employee directors generally cliff vest 100% on the first of January, approximately 1 year from the grant date. Restricted share units granted to executives generally vest as to 1/4th of the shares over 4 years on each anniversary of the vesting commencement date.

Table of Contents

The following summarizes restricted share unit activity under the 2010 Plan:

	Number of Shares Underlying Restricted Share Units		Weighted-Average Grant Date Fair Value Per Share	
	Nine Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Unvested balance at beginning of the period	25,900		\$ 21.62	\$
Granted	211,266	43,420	14.37	18.47
Issued	(25,900)	(17,520)	21.62	13.82
Vested				
Forfeited	(16,433)		14.00	
Unvested balance at end of the period	194,833	25,900	\$ 14.40	\$ 21.62

As of March 30, 2012, \$1,782 of estimated share-based compensation expense related to restricted share units under the 2010 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 3.09 years.

12. Shareholders equity***Share capital***

The Company's authorized share capital is 500,000,000 ordinary shares, par value of \$0.01 per ordinary share, and 5,000,000 preferred shares, par value of \$0.01 per preferred share.

For the nine months ended March 30, 2012, the Company issued 233,275 ordinary shares upon exercise of options, for cash consideration at a weighted average exercise price of \$4.21 per share, and issued 25,900 ordinary shares upon full vesting of restricted share units. All such issued shares are fully paid.

For the nine months ended March 25, 2011, the Company issued 410,077 ordinary shares upon exercise of options, for cash consideration at a weighted average exercise price of \$3.33 per share, and issued 17,520 ordinary shares upon full vesting of restricted share units. All such issued shares are fully paid.

13. Commitments and contingencies***Bank guarantees***

As of March 30, 2012 and June 24, 2011, there were outstanding bank guarantees given by banks on behalf of Fabrinet Thailand for electricity usage and other normal business amounting to \$682 and \$686, respectively.

Operating lease commitments

The Group leases a portion of its capital equipment, and certain land and buildings for its facilities in Thailand, China and New Jersey, under operating lease arrangements that expire in various years through 2015. Rental expense under these operating leases amounted to \$1,487 and \$1,443 for the nine months ended March 30, 2012 and March 25, 2011, respectively.

As of March 30, 2012, the future minimum lease payments due under non-cancelable leases were as follows at the end of each fiscal year in June:

Edgar Filing: Fabrinet - Form 10-Q

2012	\$ 287
2013	781
2014	181
2015	59
2016	15
Total minimum operating lease payments	\$ 1,323

Table of Contents**Purchase obligations**

Purchase obligations represent legally-binding commitments to purchase inventory and other commitments made in the normal course of business to meet operational requirements. Although open purchase orders are considered enforceable and legally binding, the terms generally give the Group the option to cancel, reschedule and/or adjust its requirements based on its business needs prior to the delivery of goods or performance of services. Obligations to purchase inventory and other commitments are generally expected to be fulfilled within one year.

As of March 30, 2012, there was an outstanding commitment to third parties relating to the development of a new factory site, Pinehurst Building 6, of \$3,238.

Indemnification of directors and officers

Cayman Islands law does not limit the extent to which a company's memorandum and articles of association may provide for indemnification of directors and officers, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. The Company's amended and restated memorandum and articles of association provide for indemnification of directors and officers for actions, costs, charges, losses, damages and expenses incurred in their capacities as such, except that such indemnification does not extend to any matter in respect of any fraud or dishonesty that may attach to any of them.

In accordance with the Company's form of indemnification agreement for its directors and officers, the Company has agreed to indemnify its directors and officers against certain liabilities and expenses incurred by such persons in connection with claims by reason of their being such a director or officer. The Company has a director and officer liability insurance policy that may enable it to recover a portion of any future amounts paid under the indemnification agreements.

14. Business segments and geographic information

The Group evaluates its reportable segments in accordance with FASB ASC Topic 280, Segment Reporting. Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Group's chief operating decision maker is Fabrinet's board of directors. As of March 30, 2012, the Group operated and internally managed a single operating segment. Accordingly, the Group does not accumulate discrete information with respect to separate product lines and does not have separate reportable segments.

The Group operates primarily in three geographic regions: North America, Asia-Pacific and Europe. The following tables present total revenues by geographic regions:

	Three Months Ended	
	March 30, 2012	March 25, 2011
North America	\$ 72,775	\$ 78,515
Asia-Pacific	43,327	74,546
Europe	22,917	41,790
	\$ 139,019	\$ 194,851
	Nine Months Ended	
	March 30, 2012	March 25, 2011
North America	\$ 213,016	\$ 231,858
Asia-Pacific	134,691	214,872
Europe	74,268	106,492
	\$ 421,975	\$ 553,222

Table of Contents

Total revenues are attributed to a particular geographic area based on the bill-to location of the customer. As of March 30, 2012, the Group had approximately \$164 of long-lived assets based in North America, with the substantial remainder of assets based in Asia-Pacific.

15. Other expenses in relation to flood

The Company suspended production at all of its manufacturing facilities in Thailand from October 17, 2011, through December 2011 as a result of severe flooding in Thailand. Company personnel, insurance adjusters and forensic equipment experts have completed an initial assessment of the damage to inventory, property and equipment, including consigned inventory and assets held by the Company on behalf of customers, as well as the impact of business interruption to the Company. As a result of such assessment, the Company has recorded provisions associated with losses of \$48.5 million with respect to customer-owned equipment and machinery in the third quarter of fiscal 2012. Cumulative flood related losses recognized to date amount to \$95.9 million.

The following is a summary of all known costs incurred as a result of this event recognized in the condensed consolidated statements of operations for the three and nine months ended March 30, 2012:

	Three Months Ended March 30, 2012	Nine Months Ended March 30, 2012
Loss from written-off owned inventories	\$ 1,094	\$ 16,612
Loss from written-off leased building improvements		1,431
Loss from written-off owned machinery and equipment		1,098
Loss from written-off investments in lease and prepayment		3,532
Loss from consigned inventories	1,064	11,748
Loss from consigned machinery and equipment	48,450	48,450
Estimated restoration cost of leased building		1,000
Payroll and other expenses	2,421	7,328
Flood protection, salvage and increased expenses	2,594	4,689
Total	\$ 55,623	\$ 95,888

Prior to December 31, 2011, the Company maintained insurance coverage providing for reimbursement for losses resulting from certain perils, including flood damage, subject to specified exclusions and limitations such as coinsurance, facilities location sub-limits and other policy limitations and covenants. As of March 30, 2012, the Company had submitted claims for business interruption losses incurred during the three months ended December 30, 2011. Subsequently, on March 31, 2012 the Company filed a claim for inventory losses, and on April 19, 2012 the Company filed a claim for owned and consigned equipment. The Company has not yet submitted its building and property insurance claim. As the Company has only recently submitted its insurance claims to its insurers, the insurers have not yet provided an indication of their analysis of the Company's claims or the amounts that the carriers believe that the Company should recover under the Company's policies, if any. Therefore, the Company has not recorded any recovery income. The Company will recognize insurance recoveries as and if they become realizable.

Because its property and casualty insurance policies for calendar year 2011 expired on December 31, 2011, the Company procured new insurance policies on January 1, 2012. The Company's current property and casualty insurance, effective January 1, 2012, covers loss or damage to the Company's property and third-party property over which it has custody and control, as well as losses associated with business interruption. The Company maintains approximately \$118 million in coverage for equipment across all of its manufacturing campuses in Thailand and another approximately \$135 million in aggregate coverage for inventory located at all of its facilities in Thailand. This includes flood insurance for equipment (but not inventory) with an aggregate limit of \$120 million effective as of April 15, 2012. These amounts include coverage for customer-owned assets that are under the Company's care, custody and control. The Company also maintains an additional approximately \$60 million

Table of Contents

in coverage against building damage in Thailand and approximately \$124 million in business interruption loss. All such coverage (including the Company's flood insurance) is subject to exclusions and limitations similar to the Company's pre-January 1, 2012 insurance. The Company's subsidiary in China also maintains insurance for its property in China, with approximately \$22 million in coverage for equipment, approximately \$8 million in coverage for inventory and approximately \$1 million in coverage for its buildings. Such coverage is also subject to policy exclusions and limitations.

16. Subsequent events

As part of the Group's ongoing efforts to achieve greater efficiencies in all areas of its business, during the fourth quarter of fiscal 2012, the Group implemented a reduction in workforce and incurred expenses of approximately \$2.2 million, which represented severance cost and benefits incurred for the termination of approximately 200 employees in accordance with contractual obligations under local regulations.

Table of Contents

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In addition to historical information, 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. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

our goals and strategies;

our and our customers' estimates regarding future revenues, operating results, expenses, capital requirements and liquidity and our needs for additional financing;

our future capital expenditures;

expansion of our manufacturing capacity, including into new geographies;

the growth rates of our existing markets and potential new markets;

our and our customers' and our suppliers' ability to respond successfully to technological or industry developments;

our suppliers' estimates regarding future costs;

our ability to increase our penetration of existing markets and penetrate new markets;

our plans to diversify our sources of revenues;

trends in the optical communications, industrial lasers and sensors markets, including trends to outsource the production of components used in those markets;

our ability to attract and retain a qualified management team and other qualified personnel and advisors;

the impact that the flooding in Thailand will have on the industry and our business, including the availability of components from our suppliers, the expected costs and expenses that we will continue to incur in connection with our recovery efforts, and our ability to recover expected amounts from our insurance carriers;

Edgar Filing: Fabrinet - Form 10-Q

expectations regarding the impact of the Thailand flooding and our insurance recoveries on our results of operations and liquidity;
and

competition in our existing and new markets.

These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and, in particular, the risks discussed under the heading "Risk Factors" in Part II, Item 1A of this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

Overview

We provide precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (OEMs) of complex products such as optical communication components, modules and sub-systems, industrial lasers and sensors. We offer a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, final assembly and test. We focus primarily on low-volume production of a wide variety of high complexity products, which we refer to as "low-volume, high-mix". Based on our experience with, and feedback from, customers, we believe we are a global leader in providing these services to the optical communications market.

Our customer base includes companies in complex industries that require advanced precision manufacturing capabilities, such as optical communications, industrial lasers and sensors. The products that we manufacture for our OEM customers include: selective switching products; tunable transponders and transceivers; active optical cables; solid state, diode-pumped, gas and fiber lasers; and sensors. In many cases, we are the sole outsourced manufacturing partner used by our customers for the products that we produce for them.

We also design and fabricate application-specific crystals, prisms, mirrors, laser components, substrates and other custom and standard borosilicate, clear fused quartz, and synthetic fused silica glass products. We incorporate our customized optics and glass into many of the products we manufacture for our OEM customers, and we also sell customized optics and glass in the merchant market.

Table of Contents**Thailand Flooding**

We suspended production at all of our manufacturing facilities in Thailand from October 17, 2011 through December 2011 because of severe flooding in Thailand. Company personnel, insurance adjusters and forensic equipment experts have completed an initial assessment of the damage to inventory, property and equipment, including consigned inventory and assets held by us on behalf of customers, as well as the impact of business interruption to us. As a result of such assessment, we have recorded provisions associated with losses of \$48.5 million with respect to customer-owned equipment and machinery in the third quarter of fiscal 2012. Cumulative flood related losses recognized to date amount to \$95.9 million.

The following is a summary of all known costs incurred as a result of this event recognized in the condensed consolidated statements of operations for the three and nine months ended March 30, 2012:

	Three Months Ended March 30, 2012	Nine Months Ended March 30, 2012
Loss from written-off owned inventories	\$ 1,094	\$ 16,612
Loss from written-off leased building improvement		1,431
Loss from written-off owned machinery and equipment		1,098
Loss from written-off investments in lease and prepayment		3,532
Loss from consigned inventories	1,064	11,748
Loss from consigned machinery and equipment	48,450	48,450
Estimated restoration cost of leased building		1,000
Payroll and other expenses	2,421	7,328
Flood protection, salvage and increased expenses	2,594	4,689
Total	\$ 55,623	\$ 95,888

To date, we have recognized \$95.9 million in losses. Over the next two fiscal quarters, we expect to incur additional business interruption losses. Prior to December 31, 2011, we maintained insurance coverage providing for reimbursement for losses resulting from certain perils, including flood damage, subject to specified exclusions and limitations such as coinsurance, facilities location sub-limits and other policy limitations and covenants. As of March 30, 2012, we had submitted claims for business interruption losses incurred during the three months ended December 30, 2011. Subsequently, on March 31, 2012, we filed a claim for inventory losses and on April 19, 2012 we filed a claim for owned and consigned equipment. Our claims for losses submitted through April 19, 2012 total \$96 million. We plan to submit our building and property insurance claim during the fourth quarter of fiscal 2012 and expect to submit additional business interruption claims for the fourth quarter of fiscal 2012 and the first quarter of fiscal 2013. As we have only recently submitted our insurance claims to our insurers, the insurers have not yet provided an indication of their analysis of our claims or the amounts they believe that we should recover under our policies.

Based on information that we have at this time, we believe that we will ultimately recover a majority of our losses. However, the aggregate amount that we will ultimately recover for our losses may be materially reduced due to a number of exclusions and limitations in our policies (such as coinsurance, facilities location sub-limits, and other policy limitations and covenants). We believe, however, that although the difference between our aggregate claims and our insurance recoveries may ultimately be material, this will not materially and adversely affect our financial condition or results of operations.

Because our insurance policies for calendar year 2011 expired on December 31, 2011, we procured new insurance policies on January 1, 2012. Our current property and casualty insurance, effective January 1, 2012, covers loss or damage to our property and third-party property over which we have custody and control, as well as losses associated with business interruption. We maintain approximately \$118 million in coverage for equipment across all of our manufacturing campuses in Thailand and another approximately \$135 million in aggregate coverage for inventory located at all of our facilities in Thailand. This includes flood insurance for equipment (but not inventory) with an aggregate limit of \$120 million effective as of April 15, 2012. These amounts include coverage for customer-owned assets that are under our care, custody and control. We also maintain an additional approximately \$60 million in coverage against building damage in Thailand and approximately \$124 million in business interruption loss. All

Table of Contents

such coverage (including our flood insurance) is subject to exclusions and limitations similar to our pre-January 1, 2012 insurance. Our subsidiary in China also maintains insurance for its property in China, with approximately \$22 million in coverage for equipment, approximately \$8 million in coverage for inventory and approximately \$1 million in coverage for its buildings. Such coverage is also subject to policy exclusions and limitations.

Revenues

Our total revenues decreased by \$55.8 million, or 28.7%, to \$139.0 million for the three months ended March 30, 2012, as compared to \$194.9 million for the three months ended March 25, 2011. Our total revenues decreased by \$131.2 million, or 23.7%, to \$422.0 million for the nine months ended March 30, 2012, as compared to \$553.2 million for the nine months ended March 25, 2011. This is primarily due to the flooding events described above. We generated substantially all of our total revenues during the three and nine months ended March 30, 2012 from the optical communications, industrial lasers and sensors markets. Our revenues from products for markets other than the optical communications market have continued to increase. Our revenues from lasers, sensors and other markets as a percentage of total revenues increased from 20.5% for the three months ended March 25, 2011, to 33.1% for the three months ended March 30, 2012, and from 20.4% for the nine months ended March 25, 2011, to 29.2% for the nine months ended March 30, 2012. We expect that industrial lasers and sensors will continue to represent an increasing portion of our revenues in the future. Because our share of the available business in the industrial lasers and sensors end-markets is presently small, we hope to grow our business in those end-markets in excess of industry growth forecasts.

We believe our ability to expand our relationships with existing customers and attract new customers is due to a number of factors, including our broad range of complex engineering and manufacturing service offerings, flexible low-cost manufacturing platform, process optimization capabilities, advanced supply chain management, excellent customer service and experienced management team. We expect the prices we charge for the products we manufacture for our customers to decrease over time due in part to competitive market forces. However, we believe we will be able to maintain favorable pricing for our services due to our ability to reduce cycle time, adjust our product mix by focusing on more complicated products, improve yields, and reduce material costs for the products we manufacture. We believe these capabilities have enabled us to help our OEM customers reduce their manufacturing costs while maintaining or improving the design, quality, reliability and delivery times for their products.

Revenues by Geography

We generate revenues from three geographic regions: North America, Asia-Pacific and Europe. Revenues are attributed to a particular geographic area based on the bill-to location of our customers, notwithstanding that our customers may ultimately ship their products to end customers in a different geographic region. Virtually all of our revenues are derived from our manufacturing facilities in Asia-Pacific.

The percentage of our revenues generated from the bill-to location outside of North America has decreased from 58.1% in the nine months ended March 25, 2011 to 49.5% in the nine months ended March 30, 2012, primarily as a result of decreasing sales in Asia-Pacific and Europe. We expect that an increasing portion of our revenues will come from the bill-to location outside of North America in the future.

The following table presents total revenues, by percentage, by geographic regions:

	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
North America	52.3%	40.3%	50.5%	41.9%
Asia-Pacific	31.2	38.3	31.9	38.8
Europe	16.5	21.4	17.6	19.3
	100.0%	100.0%	100.0%	100.0%

Table of Contents***Our Contracts***

We enter into supply agreements with our customers that generally have an initial term of up to three years. Although there are no minimum purchase requirements in our supply agreements, our customers do provide us with rolling forecasts of their demand requirements. Our supply agreements generally include provisions for pricing and periodic review of pricing, consignment of our customer's unique production equipment to us and sharing benefits from cost-savings derived from our efforts. We are generally required to purchase materials, which may include long lead-time materials, to meet the stated demands of our customers. After procuring materials, we manufacture products for our customers based on purchase orders that contain terms regarding product quantities, delivery locations and delivery dates. Our customers generally are obligated to purchase finished goods that we have manufactured according to their demand requirements. Materials that are not consumed by our customers within a specified period of time or are no longer required due to a product's cancellation or end-of-life are typically designated as excess or obsolete inventory under our contracts. Once materials are designated as either excess or obsolete inventory, our customers are typically required to purchase such inventory from us even if they have chosen to cancel production of the related products.

Cost of Revenues

The key components of our cost of revenues are material costs, employee costs, and infrastructure-related costs. Material costs generally represent the majority of our cost of revenues. Several of the materials we require to manufacture products for our customers are customized for their products and, in many instances, sourced from a single supplier, or in some cases our own subsidiaries. Shortages from sole-source suppliers due to yield loss, quality concerns and capacity constraints, among other factors, may increase our expenses and negatively impact our gross profit margin or total revenues in a given quarter. Material costs include scrap material. Historically, our rate of scrap diminishes during a product's life cycle due to process, fixturing and test improvement and optimization.

A second significant element of cost of revenues is employee costs, including: indirect employee costs related to design, configuration and optimization of manufacturing processes for our customers, quality testing, materials testing and other engineering services; and direct costs related to our manufacturing employees. Direct employee costs include employee salaries, insurance and benefits, merit-based bonuses, recruitment, training and retention. Historically, our employee costs have increased primarily due to increases in the number of employees necessary to support our growth and, to a lesser extent, costs to recruit, train and retain employees. Salary levels in Thailand and the PRC, the fluctuation of the Thai baht and RMB against our functional currency, the U.S. dollar, and our ability to retain our employees significantly impact our cost of revenues. We expect our employee costs to increase as wages continue to increase in Thailand and the PRC. For example, effective April 1, 2012, the Thai government increased minimum daily wages from 215 Thai baht to 300 Thai baht. Wage increases may impact our ability to sustain our competitive advantage and may reduce our profit margin. We seek to mitigate these cost increases through improvements in employee productivity, employee retention and asset utilization.

Our infrastructure costs are comprised of depreciation, utilities, and facilities management and overhead costs. Most of our facility leases are long-term agreements. Our depreciation costs are comprised of buildings and fixed assets, primarily at our Pinehurst Campus in Thailand, and capital equipment located at each of our manufacturing locations.

In fiscal 2011, the compensation committee of our board of directors approved an executive incentive plan with quantitative objectives, based on achieving certain revenue and earnings per share milestones for the fiscal year, and qualitative objectives. Bonuses under the executive incentive plan were paid after the end of fiscal 2011. Charges included in cost of revenues for merit-based bonus distributions to employees under these plans were \$0.5 million and \$0.7 million during the three months ended March 30, 2012 and March 25, 2011, respectively, and \$1.6 million and \$1.5 million during the nine months ended March 30, 2012 and March 25, 2011, respectively.

Share-based compensation expense included in cost of revenues was \$0.4 million and \$0.4 million for the three months ended March 30, 2012 and March 25, 2011, respectively, and \$1.3 million and \$0.9 million for the nine months ended March 30, 2012 and March 25, 2011, respectively.

We do not expect to incur significant incremental costs of revenue as a result of our continued diversification into the industrial lasers and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities. However, we do expect to incur incremental costs of revenue as a result of our planned expansion into new geographic markets, though we are not able to determine the extent of these incremental expenses.

Table of Contents

Selling, General and Administrative Expenses

Our selling, general and administrative expenses, or SG&A expenses, primarily consist of corporate employee costs for sales and marketing, general and administrative and other support personnel, including amounts previously paid under our Employee Profit Sharing Plan, research and development expenses related to the design of customized optics and glass, travel expenses, legal and other professional fees, share-based compensation expense, and other general expenses not related to cost of revenues. In fiscal 2012, we expect our SG&A expenses to increase as we continue to respond to the requirements of being a public company, including increased expenses associated with: preparing and filing required reports under the U.S. securities laws; comprehensively documenting and assessing our system of internal controls and maintaining our disclosure controls and procedures as a result of the requirements of the Sarbanes-Oxley Act; competitively compensating our board of directors; and insuring against additional risks associated with being a public company.

Charges included in SG&A expenses for merit-based bonus compensation distributed to employees and senior staff were \$0.3 million and \$0.7 million during the three months ended March 30, 2012 and March 25, 2011, respectively, and \$0.5 million and \$1.7 million during the nine months ended March 30, 2012 and March 25, 2011, respectively. The decrease in merit-based bonus compensation during the three and nine months ended March 30, 2012, as compared to the three and nine months ended March 25, 2011, was due to the reversal of accrued executive bonuses of \$0.6 million in our second fiscal quarter and no accrued executive bonuses for the three months ended March 30, 2012.

We do not expect to incur material incremental SG&A expenses as a result of our continued diversification into the industrial lasers and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities. However, we do expect to incur incremental SG&A expenses as a result of our planned expansion into new geographic markets, though we are not able to determine the extent of these incremental expenses.

Additional Financial Disclosures

Foreign Exchange

As a result of our international operations, we are exposed to foreign exchange risk arising from various currency exposures primarily with respect to the Thai baht. Although a majority of our total revenues is denominated in U.S. dollars, a substantial portion of our payroll as well as certain other operating expenses are incurred and paid in Thai baht. The exchange rates between the Thai baht and the U.S. dollar have fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We report our financial results in U.S. dollars and our results of operations have been and may continue to be negatively impacted due to Thai baht appreciation against the U.S. dollar. Smaller portions of our expenses are incurred in a variety of other currencies, including RMB, Canadian dollars, Euros and Japanese yen, the appreciation of which may also negatively impact our financial results.

In addition, we are exposed to foreign exchange risk in connection with the credit facility and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the Bank) in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency interest rate swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. As of March 30, 2012, we had drawn down the entire \$30.0 million available under the credit facility. Borrowings and interest under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. Under the terms of the cross currency swap arrangement, amounts drawn in Thai baht have been converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of 3-month U.S. LIBOR plus 2.8% per annum.

In order to manage the risks arising from fluctuations in foreign currency exchange rates, we use derivative financial instruments. We may enter into short-term forward foreign currency contracts to help manage currency exposures associated with certain assets and liabilities, primarily short-term obligations. The forward exchange contracts have generally ranged from one to six months in original maturity, and no forward exchange contract has had an original maturity greater than one year. All

Table of Contents

foreign currency exchange contracts are recognized on the balance sheet at fair value. As we do not apply hedge accounting to these instruments, the derivatives are recorded at fair value through earnings. The gains and losses on our forward contracts generally offset losses and gains on the assets, liabilities and transactions economically hedged and, accordingly, generally do not subject us to the risk of significant accounting losses.

As of March 30, 2012 and June 24, 2011, we had outstanding foreign currency assets and liabilities in Thai baht and RMB as follows:

	March 30, 2012			June 24, 2011		
	Currency	\$	%	Currency	\$	%
(in thousands, except percentages)						
Assets						
Thai baht	866,553	28,098	67.5	425,872	13,904	50.9
RMB	85,098	13,520	32.5	85,478	13,411	49.1
		41,618	100.0		27,315	100.0
Liabilities						
Thai baht	887,179	28,767	88.3	669,367	21,853	79.6
RMB	23,893	3,796	11.7	36,303	5,607	20.4
		32,563	100.0		27,460	100.0

The Thai baht assets represent cash and cash equivalents, accounts receivable, deposits and other current assets. The Thai baht liabilities represent trade accounts payable, accrued expenses and other payables. We manage our exposure to fluctuations in foreign exchange rates by the use of foreign currency contracts and offsetting assets and liabilities denominated in the same currency in accordance with management's policy. As of March 30, 2012, there was \$30 million in selling forward contracts outstanding on the Thai baht payables. As of June 24, 2011, there was \$30 million in selling forward contracts outstanding on the Thai baht payables and an undrawn committed loan in Thai baht equivalent to \$28 million.

The RMB assets represent cash and cash equivalents, accounts receivable and other current assets. The RMB liabilities represent trade accounts payable, accrued expenses and other payables. As of March 30, 2012 and June 24, 2011, there was none and \$4.0 million, respectively, in selling RMB to U.S. dollar forward contracts.

Currency Regulation and Dividend Distribution

Foreign exchange regulation in the PRC is primarily governed by the following rules:

Foreign Currency Administration Rules, as amended on August 5, 2008, or the Exchange Rules;

Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules; and

Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, as promulgated by the State Administration of Foreign Exchange, or SAFE, on August 29, 2008, or Circular 142. Under the Exchange Rules, RMB is freely convertible into foreign currencies for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. However, conversion of RMB for capital account items, such as direct investments, loans, security investments and repatriation of investments, is still subject to the approval of SAFE.

Under the Administration Rules, foreign-invested enterprises may only buy, sell or remit foreign currencies at banks authorized to conduct foreign exchange business after providing valid commercial documents and relevant supporting documents and, in the case of capital account item transactions, obtaining approval from SAFE. Capital investments by foreign-invested enterprises outside of the PRC are also subject to

Edgar Filing: Fabrinet - Form 10-Q

limitations, which include approvals by the Ministry of Commerce, SAFE and the State Development and Reform Commission.

Table of Contents

Circular 142 regulates the conversion by a foreign-invested company of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that the registered capital of a foreign-invested enterprise settled in RMB converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the registered capital of foreign-invested enterprises settled in RMB converted from foreign currencies. The use of such RMB capital may not be changed without SAFE's approval and may not be used to repay RMB loans if the proceeds of such loans have not been used.

On January 5, 2007, SAFE promulgated the Detailed Rules for Implementing the Measures for the Administration on Individual Foreign Exchange, or the Implementation Rules. Under the Implementation Rules, PRC citizens who are granted share options by an overseas publicly-listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures.

In addition, the General Administration of Taxation has issued circulars concerning employee share options. Under these circulars, our employees working in the PRC who exercise share options will be subject to PRC individual income tax. Our PRC subsidiary has obligations to file documents related to employee share options with relevant tax authorities and withhold individual income taxes of those employees who exercise their share options.

In addition, our transfer of funds to our subsidiaries in Thailand and the PRC are each subject to approval by governmental authorities in case of an increase in registered capital, or subject to registration with governmental authorities in case of a shareholder loan. These limitations on the flow of funds between us and our subsidiaries could restrict our ability to act in response to changing market conditions.

Income Tax

Our effective tax rate is a function of the mix of tax rates in the various jurisdictions in which we do business. We are domiciled in the Cayman Islands. Under the current laws of the Cayman Islands, we are not subject to tax in the Cayman Islands on income or capital gains. We have received this undertaking for a 20-year period ending August 24, 2019, and after the expiration date, we may request a renewal with the office of the Clerk of the Cabinet for another twenty years.

Throughout the period of our operations in Thailand, we have generally received income tax and other incentives from the Thailand Board of Investment. While we did not receive any income tax incentive for our operations in Thailand during fiscal 2010, we began receiving a new tax exemption in July 2010 for a five-year period for income generated from new products manufactured at our Pinehurst Building 5. In addition, on December 21, 2011, the Thailand Revenue Department announced a reduction in corporate income tax rates for tax periods beginning on or after January 1, 2012. As a result of the announcement, corporate income tax rates for our Thai subsidiary will be reduced from 30% in fiscal 2012 to 23%, 20% and 20% in fiscal 2013, 2014 and 2015, respectively.

On March 16, 2012, our subsidiary in China received a certificate with an approval date of October 21, 2011, granting the subsidiary a tax privilege to reduce its corporate income tax rate from 25% to 15%. This privilege is retroactive to January 1, 2011 and valid for three years from January 1, 2011 to December 31, 2013, subject to renewal at the end of each three year period.

Critical Accounting Policies and Use of Estimates

We prepare our condensed consolidated financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities on the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Because the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our condensed consolidated financial statements as their application places the most significant demands on our management's judgment.

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended June 24, 2011. There were no material changes to our critical accounting policies during the three and nine months ended March 30, 2012.

Table of Contents**Results of Operations**

The following table sets forth a summary of our unaudited condensed consolidated statements of operations. We believe that period-to-period comparisons of operating results should not be relied upon as indicative of future performance. Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
	(in thousands)			
Revenues	\$ 139,019	\$ 194,851	\$ 421,975	\$ 553,222
Cost of revenues	(124,138)	(169,528)	(375,281)	(482,460)
Gross profit	14,881	25,323	46,694	70,762
Selling, general and administrative expenses	(6,586)	(7,516)	(18,543)	(18,294)
Other expenses in relation to flood	(55,623)		(95,888)	
Operating (loss) income	(47,328)	17,807	(67,737)	52,468
Interest income	209	143	628	355
Interest expense	(64)	(81)	(206)	(282)
Foreign exchange gain (loss), net	714	342	1,314	(706)
Other income	57	65	213	80
(Loss) income before income taxes	(46,412)	18,276	(65,788)	51,915
Income tax benefit (expense)	87	(1,613)	1,864	(4,241)
Net (loss) income	\$ (46,325)	\$ 16,663	\$ (63,924)	\$ 47,674

The following table sets forth a summary of our unaudited condensed consolidated statements of operations as a percentage of total revenues for the periods indicated.

	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	(89.3)	(87.0)	(88.9)	(87.2)
Gross profit	10.7	13.0	11.1	12.8
Selling, general and administrative expenses	(4.7)	(3.9)	(4.4)	(3.3)
Other expenses in relation to flood	(40.0)		(22.7)	
Operating (loss) income	(34.0)	9.1	(16.0)	9.5
Interest income (loss)	0.1	0.1	0.1	0.1
Interest expense	(0.1)	(0.1)	(0.1)	(0.1)
Foreign exchange gain (loss), net	0.5	0.2	0.3	(0.1)
Other income	0.1	0.1	0.1	0.1
(Loss) income before income taxes	(33.4)	9.4	(15.6)	9.5
Income tax benefit (expense)	0.1	(0.8)	0.4	(0.8)
Net (loss) income	(33.3)%	8.6%	(15.2)%	8.7%

The following table sets forth our revenues by end market for the periods indicated.

Edgar Filing: Fabrinet - Form 10-Q

	Three Months Ended		Nine Months Ended	
	March 30, 2012	March 25, 2011	March 30, 2012	March 25, 2011
	(in thousands)			
Optical communications	\$ 93,034	\$ 154,844	\$ 298,877	\$ 440,369
Lasers, sensors and other	45,985	40,007	123,098	112,853
Total	\$ 139,019	\$ 194,851	\$ 421,975	\$ 553,222

Table of Contents

We operate and internally manage a single operating segment. As such, discrete information with respect to separate product lines and segments is not accumulated.

Comparison of Three and Nine Months Ended March 30, 2012 to Three and Nine Months Ended March 25, 2011***Total revenues***

Our total revenues decreased by \$55.9 million, or 28.7%, to \$139.0 million for the three months ended March 30, 2012, as compared to \$194.9 million for the three months ended March 25, 2011. This decrease was primarily due to (1) the effects of severe flooding in Thailand during October and November 2011, including cessation of production at our Chokchai facilities and the temporary suspension of production at our Pinehurst facilities, and (2) reduced customer demand for our optical communications manufacturing services during the quarter ended December 30, 2011. Revenues from optical communications products represented 66.9% of our total revenues for the three months ended March 30, 2012, as compared to 79.5% for the three months ended March 25, 2011.

Our total revenues decreased by \$131.2 million, or 23.7%, to \$422.0 million for the nine months ended March 30, 2012, as compared to \$553.2 million for the nine months ended March 25, 2011. This decrease was primarily due to (1) the effects of severe flooding in Thailand during October and November 2011, including cessation of production at our Chokchai facilities and the temporary suspension of production at our Pinehurst facilities and (2) reduced customer demand for our optical communications manufacturing services during the previous quarter ended December 30, 2011, partially offset by a \$10.2 million increase in our revenues from non-optical communications products, primarily reflecting the growth of our programs for industrial lasers and sensors customers. Revenues from optical communications products represented 70.8% of our total revenues for the nine months ended March 30, 2012, as compared to 79.6% for the nine months ended March 25, 2011.

Cost of revenues

Our cost of revenues decreased by \$45.4 million, or 26.8%, to \$124.1 million, or 89.3% of total revenues, for the three months ended March 30, 2012, as compared to \$169.5 million, or 87.0% of total revenues, for the three months ended March 25, 2011. The decrease in absolute dollars was primarily in connection with a decrease in revenues due to (1) the effects of severe flooding in Thailand during October and November 2011 and (2) reduced customer demand for our optical communications manufacturing services. Cost of revenues also included share-based compensation expense of \$0.4 million for the three months ended March 30, 2012, as compared to \$0.4 million for the three months ended March 25, 2011.

Our cost of revenues decreased by \$107.2 million, or 22.2%, to \$375.3 million, or 88.9% of total revenues, for the nine months ended March 30, 2012, as compared to \$482.5 million, or 87.2% of total revenues, for the nine months ended March 25, 2011. The decrease in absolute dollars was primarily in connection with a decrease in revenues due to (1) the effects of severe flooding in Thailand during October and November 2011 and (2) reduced customer demand for our optical communications manufacturing services. Cost of revenues also included share-based compensation expense of \$1.3 million for the nine months ended March 30, 2012, as compared to \$0.9 million for the nine months ended March 25, 2011.

Gross profit

Our gross profit decreased by \$10.4 million, or 41.2%, to \$14.9 million, or 10.7% of total revenues, for the three months ended March 30, 2012, as compared to \$25.3 million, or 13.0% of total revenues, for the three months ended March 25, 2011.

Our gross profit decreased by \$24.1 million, or 34.0%, to \$46.7 million, or 11.1% of total revenues, for the nine months ended March 30, 2012, as compared to \$70.8 million, or 12.8% of total revenues, for the nine months ended March 25, 2011.

SG&A expenses

Our SG&A expenses decreased by \$0.9 million, or 12.4%, to \$6.6 million, or 4.7% of total revenues, for the three months ended March 30, 2012, as compared to \$7.5 million, or 3.9% of total revenues, for the three months ended March 25, 2011. Our SG&A expenses decreased in absolute dollars during the three months ended March 30, 2012, as compared to the three months ended March 25, 2011, due primarily to no accrued executive bonus for the three months ended March 30, 2012, as compared to our recognition of \$0.7 million in accrued executive bonuses for the three months ended March 25, 2011. In addition, during the three months ended March 25, 2011, we recognized \$0.6 million in expenses in connection with our secondary public offering in March 2011, and \$0.4 million of severance and other expenses in connection with the separation of an executive from the Company in February 2011. We also recorded share-based compensation charges of \$1.0 million for the three months ended March 30, 2012, as compared to \$0.8 million for the three months ended March 25, 2011.

Table of Contents

Our SG&A expenses increased by \$0.2 million, or 1.4%, to \$18.5 million, or 4.4% of total revenues, for the nine months ended March 30, 2012, as compared to \$18.3 million, or 3.3% of total revenues, for the nine months ended March 25, 2011. Our SG&A expenses increased in absolute dollars during the nine months ended March 30, 2012, as compared to the nine months ended March 25, 2011, due primarily to an increase in business development and research and development spending during the first fiscal quarter and legal expenses of \$0.1 million relating to the filing of a registration statement on Form S-3 during the second fiscal quarter, partially offset by (1) the reversal of accrued executive bonuses recorded during the three months ended September 30, 2011, and (2) the allocation of a portion of payroll expense that we typically record in SG&A expenses to Other expenses in relation to flood because of changes in roles and responsibilities of certain employees who were temporarily assigned to work on flood abatement and recovery efforts. We also recorded share-based compensation charges of \$2.6 million for the nine months ended March 30, 2012, as compared to \$1.7 million for the nine months ended March 25, 2011.

Other expenses in relation to flood

Other expenses in relation to flood for the three months ended March 30, 2012 of \$55.6 million has been recognized to reflect the impact of the flooding in Thailand during October and November 2011. It mainly consisted of losses of \$48.5 million related to damage to customer-owned equipment and machinery, \$2.1 million related to damage to our inventory and customer-owned inventory, and other flood-related expenses of \$5.0 million.

Other expenses in relation to flood for the nine months ended March 30, 2012 of \$95.9 million has been recognized to reflect the impact of the flooding in Thailand during October and November 2011. It mainly consisted of losses of \$48.5 million related to damage to customer-owned equipment and machinery, \$28.4 million related to damage to our inventory and customer-owned inventory, losses of \$4.6 million related to damage to our machinery and equipment, losses of \$2.4 million related to damage to our Chokchai facility, and other flood-related expenses of \$12.0 million.

Operating income(loss)

Our operating income decreased by \$65.1 million to an operating loss of \$(47.3) million, or (34.0)% of total revenues, for the three months ended March 30, 2012, as compared to operating income of \$17.8 million, or 9.1% of total revenues, for the three months ended March 25, 2011.

Our operating income decreased by \$120.2 million to an operating loss of \$(67.7) million, or (16.0)% of total revenues, for the nine months ended March 30, 2012, as compared to operating income of \$52.5 million, or 9.5% of total revenues, for the nine months ended March 25, 2011.

Interest income

Our interest income increased by \$0.1 million to \$0.2 million for the three months ended March 30, 2012, as compared to \$0.1 million for the three months ended March 25, 2011. Our interest income increased by \$0.2 million to \$0.6 million for the nine months ended March 30, 2012, as compared to \$0.4 million for the nine months ended March 25, 2011. The increases were due to increases in cash and cash equivalent balances and increases in interest rates.

Interest expense

Our interest expense decreased by \$17,000 to \$64,000 for the three months ended March 30, 2012, as compared to \$81,000 for the three months ended March 25, 2011. Our interest expense decreased by \$76,000 to \$206,000 for the nine months ended March 30, 2012, as compared to \$282,000 for the nine months ended March 25, 2011. The decreases were due to a decrease in our long-term loan balances for Building 5 due to scheduled repayments.

Income (loss) before income taxes

We recorded loss before income taxes of \$(46.4) million and \$(65.8) million for the three and nine months ended March 30, 2012, respectively, as compared to income before income taxes of \$18.3 million and \$51.9 million for the three and nine months ended March 25, 2011, respectively.

Income tax benefit (expense)

Edgar Filing: Fabrinet - Form 10-Q

Our provision for income tax reflects an effective tax rate of (0.2)% (tax benefit) for the three months ended March 30, 2012, as compared to an effective tax rate of 8.8% for the three months ended March 25, 2011. The decrease in effective tax rate during the three months ended March 30, 2012, as compared to the three months ended March 25, 2011, was due to the effects of

Table of Contents

the reassessment of our projected full year effective tax rate to take into account the impact on our operations of the flooding in Thailand that occurred in October and November 2011, resulting in the recording of additional deferred tax assets of \$0.8 million for the three months ended March 30, 2012 and the impact of an income tax rate change for our subsidiary in China, resulting in a reduction in income tax expense of \$0.3 million for the three months ended March 30, 2012.

Our provision for income tax reflects an effective tax rate of (2.8)% (tax benefit) for the nine months ended March 30, 2012, as compared to an effective tax rate of 8.2% for the nine months ended March 25, 2011. The decrease in effective tax rate during the nine months ended March 30, 2012, as compared to the nine months ended March 25, 2011, was due to the effects of the reassessment of our projected full year effective tax rate to take into account the impact on our operations of the flooding in Thailand that occurred in October and November 2011, resulting in the recording of additional deferred tax assets of \$3.2 million for the nine months ended March 30, 2012 and the impact of an income tax rate change for our subsidiary in China, resulting in a reduction in income tax expense of \$0.3 million for the three months ended March 30, 2012.

Net income (loss)

We recorded a net loss of \$(46.3) million, or (33.3)% of total revenues, for the three months ended March 30, 2012, as compared to net income of \$16.7 million, or 8.6% of total revenues, for the three months ended March 25, 2011, a decrease of \$63.0 million, or 378.0%.

We recorded a net loss of \$(63.9) million, or (15.2)% of total revenues, for the nine months ended March 30, 2012, as compared to net income of \$47.7 million, or 8.6% of total revenues, for the nine months ended March 25, 2011, a decrease of \$111.6 million, or 234.1%.

Liquidity and Capital Resources

Cash Flows and Working Capital

To date, we have primarily financed our operations through cash flow from operations, drawdowns under our commercial loans, and the sale of ordinary shares to investors in March 2000 and in our initial public offering in June 2010. As of March 30, 2012, we had approximately \$125.4 million in cash and cash equivalents and approximately \$41.0 million of outstanding debt. As of March 25, 2011, we had approximately \$116.4 million in cash and cash equivalents and approximately \$16.0 million of outstanding debt.

Our cash and cash equivalents primarily consist of cash on hand, demand deposits and liquid investments with original maturities of three months or less which are placed with banks and other financial institutions. The weighted average interest rate on our cash and cash equivalents was 0.9% and 0.7% for the three months ended March 30, 2012 and March 25, 2011, respectively, and 0.7% and 0.6% for the nine months ended March 30, 2012 and March 25, 2011, respectively.

We expect that our cash position will continue to be materially impacted by expenditures related to recovery from the flooding of our facilities in Thailand and lost revenue. We have and expect to continue to incur certain charges and expenses related to the flooding, and some of these will be cash charges and expenses, such as those described in Note 15 to the Notes to the Unaudited Condensed Consolidated Financial Statements. We also have to pay significantly more for our current property and casualty insurance for our operations in Thailand (See Note 15 to the Notes to the Unaudited Condensed Consolidated Financial Statements). With respect to insurance claims for losses from the Thai flooding, as of April 19, 2012, we have submitted claims for business interruption, equipment and inventory losses and expect to submit our building and property claim during the fourth quarter of fiscal 2012 and additional business interruption insurance claims for the fourth quarter of fiscal 2012 and first quarter of fiscal 2013 after completion of those quarters. Based on information that we have at this time, we believe that we will ultimately recover a majority of our losses. However, the aggregate amount that we will ultimately recover for our losses may be materially reduced due to a number of exclusions and limitations in our policies (such as coinsurance, facilities location sub-limits, and other policy limitations and covenants). We believe, however, that although the difference between our aggregate claims and our insurance recoveries may ultimately be material, this will not materially and adversely affect our financial condition or results of operation.

In addition, we cannot yet anticipate when we will begin to receive any recoveries from our insurance carriers for these claims. At the same time, the flooding may impact some of our customers' ability to pay us amounts that they owe us, which could materially impact the timing of the realization of our receivables. Therefore, because of the uncertainty of the timing of these recoveries, the potential impact to our receivables and the fact that we could be required to use significant amounts of our cash to pay for flood-related expenses and losses before we receive any proceeds from our insurers, our liquidity and capital resources could be materially and adversely impacted by such cash outlays until we are able to collect on these recoveries from

Table of Contents

our insurers. Notwithstanding the foregoing, we believe our current cash, cash equivalents and cash generated from operations will be sufficient to meet our working capital and capital expenditure needs for the next 12 months. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

In June 2010, we entered into an agreement to purchase land in Thailand for the construction of Pinehurst Building 6. The land purchase was completed in August 2010 and construction was completed during the fourth quarter of fiscal 2012. As of March 30, 2012, approximately 180,000 square feet of clean room assembly area, divided into 23 manufacturing bays, are available for customer production at Building 6. We believe that our manufacturing capacity at Pinehurst is more than sufficient to meet anticipated production requirements for the remainder of fiscal 2012. We maintain a long-term credit facility associated with construction of production facilities at our Pinehurst campus in Thailand that will come due within the next 60 months. In the three and nine months ended March 30, 2012, we drew down an aggregate of \$12.0 million and \$28.0 million, respectively. We anticipate that our internally generated working capital, along with our cash and cash equivalents will be adequate to repay these obligations.

The following table shows our net cash provided by operating activities, net cash used in investing activities and net cash provided by financing activities for the periods indicated:

(in thousands of U.S. dollars)	Nine Months Ended	
	March 30, 2012	March 25, 2011
		(unaudited)
Net cash provided by operating activities	\$ 138	\$ 24,602
Net cash used in investing activities	(28,112)	(17,136)
Net cash provided by financing activities	25,603	23,263
Net (decrease) increase in cash and cash equivalents	(2,371)	30,729
Cash and cash equivalents, beginning of period	127,282	84,942
Cash and cash equivalents, end of period	125,410	116,419

Operating activities

Net cash provided by operating activities decreased by \$24.5 million, or 99.4%, to \$0.1 million for the nine months ended March 30, 2012, as compared to \$24.6 million for the nine months ended March 25, 2011. The decrease in net cash from operations for the nine months ended March 30, 2012, as compared to the nine months ended March 25, 2011, was primarily due to a decrease in net income and an increase in payments of account payables.

Investing activities

Net cash used in investing activities increased by \$11.0 million, or 64.1%, to \$28.1 million for the nine months ended March 30, 2012, as compared to \$17.1 million for the nine months ended March 25, 2011. The increase in net cash used in investing activities was primarily due to additional progress payments for construction of Pinehurst Building 6 and new equipment purchases to replace flood-damaged equipment.

Financing activities

Net cash provided by financing activities increased by \$2.3 million, or 10.1%, to \$25.6 million for the nine months ended March 30, 2012, as compared to net cash provided by financing activities of \$23.3 million for the nine months ended March 25, 2011. This increase in net cash provided by financing activities was primarily due to proceeds of \$28.0 million under our loan facilities during the nine months ended March 30, 2012, compared to the proceeds from our initial public offering of \$26.3 million during the nine months ended March 25, 2011.

Off-Balance Sheet Commitments and Arrangements

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, we have not entered into any derivative contracts that are not reflected in our condensed consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We also do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

Table of Contents**Recent Accounting Pronouncements**

See Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK***Interest Rate Risk***

We had cash and cash equivalents totaling \$125.4 million and \$127.3 million as of March 30, 2012 and June 24, 2011, respectively. Our exposure to interest rate risk primarily relates to the interest income generated by excess cash invested in highly liquid investments with maturities of three months or less from the original dates of purchase. The cash and cash equivalents are held for working capital purposes. We have not used derivative financial instruments in our investment portfolio. We have not been exposed, nor do we anticipate being exposed, to material risks due to changes in market interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates had declined by 10 basis points during the three and nine months ended March 30, 2012 and the fiscal year ended June 24, 2011, our interest income would have decreased by approximately \$27,000, \$81,000 and \$88,000, respectively, assuming consistent investment levels.

Interest rate risk also refers to our exposure to movements in interest rates associated with our interest bearing liabilities. The interest bearing liabilities are denominated in U.S. dollars and the interest expense is based on the Singapore Inter-Bank Offered Rate, or SIBOR, and the London Inter-Bank Offered Rate, or LIBOR, plus an additional margin, depending on the lending institution. If the SIBOR and the LIBOR had increased by 100 basis points during the three and nine months ended March 30, 2012 and the fiscal year ended June 24, 2011, our interest expense would have increased by approximately \$0.1 million, \$0.3 million and \$0.2 million, respectively, assuming consistent borrowing levels.

Foreign Currency Risk

As a result of our foreign operations, we have significant expenses, assets and liabilities that are denominated in foreign currencies. Substantially all of our employees and most of our facilities are located in Thailand and the PRC. Therefore, a substantial portion of our payroll as well as certain other operating expenses are paid in Thai baht or RMB. The significant majority of our revenues are denominated in U.S. dollars because our customer contracts generally provide that our customers will pay us in U.S. dollars.

As a consequence, our gross profit margins, operating results, profitability and cash flows are adversely impacted when the dollar depreciates relative to the Thai baht or the RMB. We have a particularly significant currency rate exposure to changes in the exchange rate between the Thai baht and the U.S. dollar. We must translate foreign currency-denominated results of operations, assets and liabilities for our foreign subsidiaries to U.S. dollars in our condensed consolidated financial statements. Consequently, increases and decreases in the value of the U.S. dollar compared to such foreign currencies will affect our reported results of operations and the value of our assets and liabilities on our condensed consolidated balance sheets, even if our results of operations or the value of those assets and liabilities has not changed in its original currency. These transactions could significantly affect the comparability of our results between financial periods or result in significant changes to the carrying value of our assets, liabilities and shareholders' equity.

In addition, we are exposed to foreign exchange risk in connection with the credit facility and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the "Bank") in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. As of March 30, 2012, we had drawn down the entire \$30.0 million available under the credit facility. Borrowings and interest under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. Under the terms of the cross currency interest rate swap arrangement, all amounts drawn in Thai baht have been converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of 3-month U.S. LIBOR plus 2.8% per annum.

Table of Contents

We attempt to hedge against these exchange rate risks by entering into hedging contracts that are typically one to six months in duration, leaving us exposed to longer term changes in exchange rates. We realized foreign currency gains of \$0.7 million and \$1.3 million during the three and nine months ended March 30, 2012, and foreign currency gains of \$0.3 million and foreign currency losses of \$0.7 million during the three and nine months ended March 25, 2011. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to incur foreign currency translation adjustments and may incur foreign currency exchange losses. For example, a 10% weakening in the U.S. dollar against the Thai baht and the RMB as of March 30, 2012 and June 24, 2011 would have resulted in an increase in our net dollar position of approximately \$1.0 million and a decrease in our net dollar position of approximately \$0.02 million, respectively. We cannot give any assurance as to the effect that future changes in foreign currency rates will have on our condensed consolidated financial position, operating results or cash flows.

Credit Risk

Credit risk refers to our exposures to financial institutions, suppliers and customers that have in the past and may in the future experience financial difficulty, particularly in light of recent conditions in the credit markets and the global economy. As of March 30, 2012, our cash and cash equivalents were held in deposits and highly liquid investment products with maturities of three months or less with a small number of banks and other financial institutions having credit ratings of A minus or above as determined by Fitch Ratings. We generally monitor the financial performance of our suppliers and customers, as well as other factors that may affect their access to capital and liquidity. Presently, we believe that we will not incur material losses due to our exposures to such credit risk.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our chief executive officer and chief financial officer concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended March 30, 2012 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

From time to time, we may be involved in litigation relating to claims arising in the ordinary course of our business. There are currently no material claims or actions pending or threatened against us.

ITEM 1A. RISK FACTORS

Investing in our ordinary shares involves a high degree of risk. You should carefully consider the following risks and all other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and the related notes, before investing in our ordinary shares. The risks and uncertainties described below are not the only ones we face.

Table of Contents

Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks materialize, our business, financial condition and results of operations could be materially harmed. In that case, the trading price of our ordinary shares could decline, and you may lose some or all of your investment.

Risks Related to Our Business

Severe flooding in Thailand in October and November 2011 resulted in the suspension of production at our Thailand facilities, which has had and will continue to have a material and adverse effect on our business, financial condition and results of operations in the near-term and potentially beyond.

The consequence of the October and November flooding in Thailand and cessation of production in our Chokchai manufacturing facilities have and will continue to adversely affect our business, results of operations and financial condition in the near-term and potentially beyond. Material risks and uncertainties include, but are not limited to, the following:

Insurance. Prior to January 1, 2012, we maintained insurance coverage that provided for reimbursement of losses resulting from flood damage. Under the terms of our policies that were effective during the flooding, our property and casualty insurance covered loss or damage to our property and third-party property over which we have custody and control (the latter of which we refer to as consigned property), as well as losses associated with business interruption and building damage. We completed our initial assessment of losses with respect to business interruption, customer-owned inventory and consigned equipment from our customers, and our own inventory, equipment and facilities. We have recorded losses in our condensed consolidated statements of operations. With respect to these losses, as of April 19, 2012, we have submitted insurance claims for business interruption, equipment and inventory losses and expect to submit our building and property claim during the fourth quarter of fiscal 2012 and additional business interruption insurance claims for the fourth quarter of fiscal 2012 and first quarter of fiscal 2013 after completion of those quarters. A number of exclusions and limitations in our policies (such as coinsurance, facilities location sub-limits and other policy limitations and covenants) may materially reduce the aggregate amount that we will ultimately collect for our losses. Even if we do ultimately recover material amounts from our insurers, there may be a substantial delay between when we pay for flood-related expenses and when we receive proceeds from our insurers as reimbursement for these expenses, which could adversely affect our cash flows and liquidity. We expect that the insurance claims process will also require a significant amount of time from management. Further, as a result of the flooding in Thailand, our property and casualty insurance premiums have risen dramatically in connection with our 2012 annual renewals.

Customers. Given the flooding in Thailand, some customers may choose not to reengage with us simply because of the fear of future flooding in Thailand. Other customers may be so reliant on us for their manufacturing capabilities that the suspension of our operations may have materially and adversely affected their own businesses, which could potentially lead to customer bankruptcies or liquidations. Customer bankruptcies or liquidations would mean less revenue for us and could also require us to write off any accounts receivable and inventory associated with those customers. We may also have disputes with our customers regarding who bears the responsibility for losses of consigned equipment, inventory, business and profits as a result of the flooding or about the scope of our current or future insurance coverage or the value of the assets that have been damaged. O