Lumentum Holdings Inc.
Form 10-K
August 28, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from

to

Commission File Number 001-36861
Lumentum Holdings Inc.
(Exact name of Registrant as specified in its charter)

Delaware	47-3108385
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

400 North McCarthy Boulevard, Milpitas, California 95035
(Address of principal executive offices including Zip code)

(408) 546-5483
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Stock, par value of $0.001 per share	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act:
None
Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

As of December 30, 2017, the aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant was approximately $1,678 million based on the closing sales price of the registrant's common stock as reported on the NASDAQ Stock Market on December 29, 2017 of $48.90 per share. Shares of common stock held by officers, directors and holders of more than five percent of the outstanding common stock have been excluded from this calculation because such persons may be deemed to be affiliates.

As of August 23, 2018, the Registrant had 63.3 million shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the information called for by Part III of this Annual Report on Form 10-K is hereby incorporated by reference from the definitive proxy statement for the Registrant's annual meeting of stockholders, which will be filed with the Securities and Exchange Commission not later than 120 days after the Registrant's fiscal year ended June 30, 2018.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K (this “Annual Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, (the “Exchange Act”). These statements are based on our current expectations and involve risks, uncertainties and assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially from those expressed or implied by such forward-looking statements. These statements relate to, among other things, our markets, products and strategy, sales, gross margins, operating expenses, capital expenditures and requirements, liquidity, product development and R&D efforts, manufacturing plans, litigation, effective tax rates and tax reserves, our corporate and financial reporting structure, our plans for growth and innovation, the successful integration of Oclaro’s business (including personnel) after closing, and expected synergies and non-GAAP earnings accretion from the acquisition of Oclaro, and are often identified by the use of words such as, but not limited to, “anticipate,” “believe,” “can,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “might,” “plan,” “project,” “seek,” “should,” “target,” “will expressions or variations intended to identify forward-looking statements. These statements are based on the beliefs and assumptions of our management, which are in turn based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other important factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled “Risk Factors” included under Part I, Item 1A below. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

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PART I

ITEM 1. BUSINESS

General

Overview

Lumentum Holdings Inc. ("we", "our", "Lumentum" or the "Company") is an industry-leading provider of optical and photonic products defined by revenue and market share addressing a range of end market applications including Optical Communications and Commercial Lasers for manufacturing, inspection and life-science applications. We seek to use our core optical and photonic technology and our volume manufacturing capability to expand into attractive emerging markets that benefit from advantages that optical or photonics-based solutions provide, including 3D sensing for consumer electronics and diode light sources for a variety of consumer and industrial applications. The majority of our customers tend to be original equipment manufacturers ("OEMs") that incorporate our products into their products which then address end-market applications. For example, we sell fiber optic components that our network equipment manufacturer ("NEM") customers assemble into communications networking systems, which they sell to network service providers or enterprises with their own networks. Similarly, many of our customers for our Lasers products incorporate our products into tools they produce, which are used for manufacturing processes by their customers. For 3D sensing, we sell diode lasers to manufacturers of consumer electronics products for mobile, personal computing, and gaming who then integrate our devices within their products, for eventual resale to consumers and also into other industrial applications.

We operate in two reportable segments: Optical Communications ("OpComms") and Commercial Lasers ("Lasers"). We have a global marketing and sales footprint that enables us to address global market opportunities for our products. We have manufacturing capabilities and facilities in North America, Asia-Pacific, and Europe, with employees engaged in R&D, administration, manufacturing, support and sales and marketing activities. Our headquarters are located in Milpitas, California, and we employed approximately 2,930 full-time employees around the world as of June 30, 2018.

Lumentum was incorporated in Delaware as a wholly owned subsidiary of JDS Uniphase Corporation ("JDSU") on February 10, 2015, and is comprised of the former communications and commercial optical products ("CCOP") segment and WaveReady product lines of JDSU. In August 2015, we became an independent publicly-traded company through the distribution by JDSU to its stockholders of 80.1% of our outstanding common stock (the "Separation"). Each JDSU stockholder of record as of the close of business on July 27, 2015, received one share of Lumentum common stock for every five shares of JDSU common stock held on such date. JDSU was renamed Viavi Solutions Inc. ("Viavi") and at the time of distribution, retained ownership of 19.9% of Lumentum's outstanding shares. Since the Separation, Viavi has sold a significant portion of its shares and is no longer a significant shareholder of Lumentum.

Our business traces its origins to Uniphase Corporation, which was formed in 1979, and became publicly traded in 1992. Uniphase was originally a supplier of commercial lasers, and later, a leading supplier of optical transmission products. In 1999, JDS Fitel Inc., a pioneer in products for fiber optic networking which was formed in 1981, merged with Uniphase to become JDSU, a global leader in optical networking. Subsequent acquisitions by JDSU broadened the depth and breadth of the OpComms and Lasers businesses, as well as the intellectual property, technology and product offerings, of what is now Lumentum. Notable amongst these acquisitions in the OpComms business were Agility Communications, Inc. in 2005 and Picolight, Inc. in 2007 which respectively brought widely tunable, long wavelength laser technology for metro and long haul networking applications and short wavelength vertical-cavity surface-emitting lasers ("VCSELs") for enterprise, datacenter networking, and 3D sensing applications. The fundamental laser component technologies which we acquired through these acquisitions, form the basis of virtually all optical networks today and we believe will continue to do so for the foreseeable future. These technologies will enable us to develop highly integrated products to satisfy our communications customers' ever increasing needs for smaller, lower power and lower cost optical products. Notable acquisitions in the Lasers business were Lightwave Electronics Corporation in 2005 and Time-Bandwidth Products Inc. ("Time-Bandwidth") in 2014. Both of these Lasers acquisitions brought high power pulsed solid-state laser products and technology to our business, which address the micro laser machining market and expanded our addressable market.

Industry Trends and Business Risks

Our business is driven by end-market applications which benefit from the performance advantages that optical solutions enable.

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The OpComms markets we serve are experiencing continually increasing needs for higher data transmission speeds, fiber optic network capacity and network agility. This is driven by rapid growth in both the number of higher bandwidth broadband connections, notably those associated with mobile devices, such as high-definition video, online gaming, cloud computing and the number and scale of datacenters that require fiber optic links to enable the higher speeds and increased scale necessary to deliver high bandwidth video and other services. Our technology, which was originally developed for communications applications is also finding use in other emerging market opportunities including 3D sensing applications that employ our laser technology in mobile devices, computers, augmented and virtual reality and other consumer electronics devices. Additionally, our products are used in emerging automotive, industrial, security, safety and surveillance applications.

In the Lasers markets, customer demand is driven by the need to enable faster, higher precision volume manufacturing techniques with lower power consumption, reduced manufacturing footprint and increased productivity. These capabilities are critical as industries develop products that are smaller and lighter, increasing productivity and yield and lowering their energy consumption.

Our optical and laser solutions, developed in close collaboration with OEM partners, are well positioned to meet demand resulting from these trends. We do, however, expect to continue to encounter a number of industry and market risks and uncertainties. These risks and uncertainties may limit our visibility, and consequently, our ability to predict future revenue, profitability and general financial performance, and could create quarter over quarter variability in our financial measures. For example, the demand environment in China has fluctuated significantly in recent years, and has created volatility and uncertainty in our future demand. We cannot predict when or to what extent these uncertainties will be resolved. Our revenues, profitability and general financial performance may also be affected by: (i) pricing pressures, particularly within our OpComms markets, due to, among other things, a highly concentrated customer base, increasing competition, particularly from Asia-Pacific-based competitors, and a general commoditization trend for certain products; (ii) high product mix variability which affects revenue and gross margin; (iii) fluctuations in customer buying patterns, which cause volatility in demand, revenue and profitability; and (iv) the current trend of communication industry consolidation, which is expected to continue, that directly affects our customer bases and adds additional risk and uncertainty to our financial and business projections.

Reportable Segments

We are an industry leading provider of optical and photonic products defined by revenue and market share addressing a range of end-market applications including optical communications and commercial lasers. We have two operating segments: OpComms and Lasers. The two operating segments were primarily determined based on how the Chief Operating Decision Maker ("CODM") views and evaluates our operations. Operating results are regularly reviewed by the CODM to make decisions about resources to be allocated to the segments and to assess their performance. Other factors, including market separation and customer specific applications, go-to-market channels, products and manufacturing, are considered in determining the formation of these operating segments. We do not track all of our property, plant, and equipment by operating segments. For the geographic identification of these assets, refer to "Note 19. Operating Segments and Geographic Information".

The table below discloses the percentage of our total net revenue attributable to our two reportable segments. In addition, it discloses the percentage of our total net revenue attributable to product offerings within the OpComms segment:

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Optical Communications:	84.9 %	85.6 %	84.3 %
Telecom	38.1 %	61.0 %	61.5 %
Datacom	12.1 %	20.1 %	18.1 %
Consumer and Industrial	34.7 %	4.5 %	4.7 %
Lasers	15.1 %	14.4 %	15.7 %

For further information regarding our operating segments, please refer to “Note 19. Operating Segments and Geographic Information” in the Notes to Consolidated Financial Statements.

OpComms

Markets

Our OpComms products address the following markets: telecommunications (“Telecom”), data communications (“Datacom”) and consumer and industrial (“Consumer and Industrial”).

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Our OpComms products include a wide range of components, modules and subsystems to support and maintain customers including carrier networks for access (local), metro (intracity), long-haul (city-to-city and worldwide) and submarine (undersea). Additionally, our products address enterprise, cloud, and data center applications, including storage-access networks (“SANs”), local-area networks (“LANs”) and wide-area networks (“WANs”). These products enable the transmission and transport of video, audio and text data over high-capacity fiber-optic cables. We maintain leading positions in these fast growing OpComms markets through our extensive product portfolio, including reconfigurable optical add/drop multiplexers (“ROADMs”), tunable 10-gigabit small form-factor pluggable transceivers and tunable small form-factor pluggable transceivers. Our 10G, 40G legacy transceivers and a growing portfolio of 100G pluggable transceivers support LAN/SAN/WAN needs and the cloud for customers building enterprise and hyperscale data center networks. Additionally, we are engaging customers in the sale of laser chips for use in the manufacture of high-speed transceivers.

In the Consumer and Industrial market, our OpComms products include laser light sources, which are integrated into 3D sensing platforms being used in applications for mobile devices, gaming, computers, and other consumer electronics devices. New emerging applications include virtual and augmented reality, as well as automotive and industrial segments. Our products include VCSELs and edge emitting lasers which are used in 3D sensing depth imaging systems. These systems simplify the way people interact with technology by enabling the use of natural user interfaces. Systems are used for biometric identification, surveillance, and process efficiency, among numerous other application spaces. Emerging applications for this technology include various mobile device applications, autonomous vehicles, self-navigating robotics and drones in industrial applications and 3D capture of objects coupled with 3D printing. In addition, our industrial diode lasers are used primarily as pump sources for pulsed and CW Fiber Lasers.

Customers

Our OpComms customers include Accelink, Alphabet (formerly Google), Apple, Arista, Arris, Ciena, Cisco Systems, Coriant, ECI, Facebook, FiberHome, Fujitsu, HiSilicon, Huawei Marine, Huawei Technologies, Infinera, Microsoft, NEC, Nokia Networks (including Alcatel-Lucent International), O-Net, Oplink, Padtec, TE Subcom, and Yahoo.

During fiscal 2018, 2017, and 2016, net revenue generated from a single customer which represented 10% or more of our total net revenue of the applicable fiscal year is summarized in the table below:

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
APPLE	30.0%	*	*
HUAWEI	11.0%	16.7%	17.1%
CIENA	11.0%	18.5%	17.1%
CISCO	*	12.4%	13.0%

*Represents less than 10% of total net revenue

Trends

To remain competitive, network operators worldwide must offer broader suites of digital services. To do this, they are migrating to Internet-protocol (“IP”) networks and expanding long-haul, metro regional and metro access networks, which effectively deliver broadband services while lowering capital and operating costs of dense-wavelength-division multiplexing networks.

The growing demand for capacity encourages the adoption of OpComms products across the Datacom and Telecom markets. Demand for capacity in the Datacom market is driven by the growing needs of LANs and WANs. Growth in Datacom is also driven by web and cloud services companies that are expanding data center infrastructure, increasing the need for network capacity within and between these data centers.

Demand in the Telecom market is driven by new bandwidth-intensive applications that can result in sudden and severe changes in demand almost anywhere on the network. Increasing agility in optical networks by employing ROADMs, wavelength selective switches, wavelength tunable transmission products and other agile optical products provides an effective way to respond to unpredictable bandwidth demands and to manage expenses. With more agile optical networks, a network operator can add capacity by using remote management applications rather than dispatching technicians to perform manual operations in the field.

In addition, the high-end routers, switches and cross-connect equipment that must handle legacy and internet-protocol traffic are becoming increasingly complex in order to meet higher bandwidth, scalability, speed and reliability needs. Products must provide higher levels of functionality and performance in compact designs that must also meet requirements for quality, reliability, and cost.

Deployment of fiber closer to the end user increases the availability of high-bandwidth services and we expect it will result in increased demand on the metro regional and long-haul networks into which these services feed. The dynamically reconfigurable nature of today's agile networks enables lower operating costs and other competitive advantages, allowing service providers to use and scale network capacity more flexibly, streamline service provisioning, accelerate rerouting around points of failure and modify network topology through simple point-and-click network management systems.

Our optical products are well positioned to meet these demands. Our innovation has resulted in products that have more functionality, are less than half the size, require less power and are more cost-effective than our historical products, particularly in the area of photonic integrated circuits. Higher levels of integration have also led to development of our Super Transport Blade, which delivers all transport functions (wavelength switching, pre-amplification, post-amplification, optical supervisory channel and monitoring) in a single, integrated platform, essentially replacing three blades with one.

Strategy

In our OpComms segment, we are focused on technology leadership through collaborative innovation with our customers, cost leadership and functional integration. We endeavor to align the latest technologies with industry leading, scalable manufacturing and operations to drive the next phase of optical communications technologies and products for Telecom and Datacom applications that are faster, more agile and more reliable, making us a valuable business and technology partner for NEMs, consumer electronic companies, cloud service providers and data center operators.

Competition

We compete against various public and private companies in the markets we serve. Publicly traded companies providing optical communications components include II-VI, Acacia Communications, Accelink, ams AG, Applied Optoelectronic, Finisar, Foxconn Interconnect Technology, Furukawa Electric, Neophotonics, Oclaro, and Sumitomo Electric Industries. Private companies and subsidiaries of public companies providing optical communications components include Fujitsu Optical Components - a subsidiary of Fujitsu, Innolight Technology, Nistica - a subsidiary of Fujikura, and O-Net.

Offerings

In addition to a full selection of active and passive components, we offer increasing levels of functionality and integration in modules, circuit packs and subsystems for transmission, amplification, wavelength management and more.

In the Telecom market, we provide transmission and transport solutions for optical networks that make up the backbone of the wireline Telecom infrastructure, thereby enabling the internet. Transmission products, such as our tunable transponder, transceiver and transmitter modules, transmit and receive high-speed data signals at the ingress/egress points of the network. These products use dense wavelength division multiplexing technology to enable high capacity (from 20 to 40Tb/s in the C-Band) links driven by increasing internet demand. We also offer components including tunable lasers, receivers and modulators to address the higher end of these same network applications.

Our transport products, such as ROADMs, amplifiers and optical channel monitors provide switching, routing and conditioning of signals. We also make components for transport, including 980nm, multi-mode and Raman pumps for optical amplifiers, and passive components. Passive components include switches, attenuators, photodetectors, gain flattening filters, isolators, wavelength-division multiplexing ("WDM") filters, arrayed waveguide gratings ("AWGs"), multiplex/de-multiplexers and integrated passive modules.

Our innovation led to the Super Transport Blade, which integrates all major optical transport functions into a single-slot blade. This all-in-one solution reduces the size, cost and power requirements of optical components, incorporates nano wavelength selective switch technology and enables greater chassis density and a smaller footprint.

In the Datacom market, which relies on storing, moving and manipulating vast amounts of data, we offer transmission products, such as our optical transceivers for Fiber Channel and Ethernet applications. Our transceivers are also used to connect servers, switches, routers and other information technology infrastructure critical for today's email, enterprise resource planning and other cloud services such as streaming of high definition and 4k video.

Our integrated fiber optic transceivers provide cost effective and scalable connectivity and are used in the hardware that runs many of the applications people use daily such as email, social networking, cloud storage, online gaming and streaming video. They are available in several hot-pluggable form factors and allow for very compact, high-density hardware designs.

For the high 100G data rate, we offer several technologies to balance technical and commercial requirements. For high volume, short distance applications we developed our VCSELs. VCSELs are ideal for short reaches because they are low power consumption, low cost and highly scalable. For high-performance, longer distance applications we have our distributed feedback laser (“DFB”)

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and electro-absorption modulated laser (“EML”). Our individual lasers and compact laser arrays offer an innovative solution for the LANs, SANs, broadband Internet and metro-area network as well as hyperscale datacenter applications.

Our 3D sensing technology enables real time depth information to any photo or video image. This represents a fundamental transition for image capture akin to the transition from monochrome to color and gives devices the ability to see the world around them in three dimensions. The immediate applications include full body imaging for gaming, 3D scanning for space mapping and facial recognition for security. Emerging applications for this technology include various mobile device applications, autonomous vehicles, self-navigating robotics and drones in industrial applications and 3D capture of objects coupled with 3D printing. 3D sensing can be applied to any device with a camera. The technologies to achieve accurate and stable 3D sensing are converging to laser based solutions. We are a leading supplier of the critical laser illumination sources for 3D sensing systems being used in applications for gaming, computing, mobile devices, and home entertainment.

Lasers

Markets

Our Lasers products serve our customers in markets and applications such as sheet metal processing, general manufacturing, biotechnology, graphics and imaging, remote sensing, and precision machining such as drilling in printed circuit boards, wafer singulation, glass cutting and solar cell scribing.

Our Lasers products are used in a variety of OEM applications including diode-pumped solid-state, fiber, diode, direct-diode and gas lasers such as argon-ion and helium-neon lasers. Fiber lasers provide kW-class output powers combined with excellent beam quality and are used in sheet metal processing and metal welding applications. Diode-pumped solid-state lasers provide excellent beam quality, low noise and exceptional reliability and are used in biotechnology, graphics and imaging, remote sensing, materials processing and precision machining applications. Diode and direct-diode lasers address a wide variety of applications, including laser pumping, thermal exposure, illumination, ophthalmology, image recording, printing, plastic welding and selective soldering. Gas lasers such as argon-ion and helium-neon lasers provide a stable, low-cost and reliable solution over a wide range of operating conditions, making them well suited for complex, high-resolution OEM applications such as flow cytometry, DNA sequencing, graphics and imaging and semiconductor inspection.

We also provide high-powered and ultrafast lasers for the industrial and scientific markets. Manufacturers use high-power, ultrafast lasers to create micro parts for consumer electronics and to process semiconductor, LED, and other types of chips. Use of ultrafast lasers for micromachining applications is being driven primarily by the increasing use of consumer electronics and connected devices globally.

Our portfolio of Lasers products includes components and subsystems used in a variety of OEM applications that range in output power from milliwatts to kilowatts and include ultraviolet, visible and infrared wavelengths. We support customer applications in the biotechnology, graphics and imaging, remote sensing, materials processing and other precision machining areas.

Customers

Our Lasers customers include Amada, ASML Holding, Beckman Coulter, Becton, Dickinson and Company, DISCO, Electro Scientific Industries, EO Technics, Han’s Laser Technology, and KLA-Tencor. During fiscal 2018, 2017, and 2016, we did not have any single customer attributable to our Lasers segment that generated net revenue of 10% or more of our total net revenue for the applicable fiscal year.

Trends

As technology advances, industries such as consumer electronics manufacturing increasingly turn to lasers when they need more precision, higher productivity and energy efficient, or “green,” alternatives for problems that cannot be solved by mechanical, electronic or other means. For example, these industries are using lasers to develop products that are smaller and lighter to increase productivity and yield and to lower their energy consumption. Lasers have been used for years to help achieve the scale and precision needed in semiconductor processing. In biotech applications, lasers have been instrumental for advances (and new standard procedures) in cytology, hematology, genome sequencing and crime scene investigations, among others. We believe the long-term trends in these industries will likely lead to increased demand for lasers.

Sheet metal processing and metal welding applications are increasingly using kW-class fiber lasers instead of kW-class CO_2 lasers. Fiber lasers generate higher productivity at lower cost in such applications because they exhibit lower power consumption, better quality and generally lower user maintenance costs.

In addition, demand continues for electronic products, as well as products and components in other industries, with greater functionality while becoming smaller, lighter and less expensive. Innovative / Next generation product designs require precise micromachining and materials processing, such as micro bending, soldering and welding. At the scale and processing speed needed, lasers are replacing mature mechanical tools such as drills for minute holes, or "vias," in printed circuit boards and saws and scribes for singulating silicon wafers, resulting in greater precision and productivity. As these trends continue, we believe that manufacturers and other industries will increase their reliance on lasers in order to maintain or increase their competitiveness.

We believe we are well-positioned with key OEM providers of laser solutions to these industries. We continue to develop our laser portfolio to offer smaller and more cost-effective products designed specifically for the performance, integration, reliability and support needs of our OEM customers.

Strategy

In our Lasers segment, we leverage our long-term relationships with OEM customers to drive commercial laser innovation. Using established manufacturing, engineering, lasers and photonics expertise, we deliver products that meet cost-of-ownership and reliability needs while delivering on volume production demands.

Competition

We compete against various public and private companies in the commercial laser markets we serve. Publicly traded companies providing commercial laser products include Coherent and IPG Photonics.

Offerings

Our broad range of Lasers products includes diode-pumped solid-state, fiber, diode, direct-diode and gas lasers such as argon-ion and helium-neon lasers. Diode-pumped solid-state and fiber lasers that provide excellent beam quality, low noise and exceptional reliability are used in biotechnology, graphics and imaging, remote sensing, materials processing and precision machining applications. Diode and direct-diode lasers address a wide variety of applications, including laser pumping, thermal exposure, illumination, ophthalmology, image recording, printing, plastic welding and selective soldering. Gas lasers such as argon-ion and helium-neon lasers provide a stable, low-cost and reliable solution over a wide range of operating conditions, making them well suited for complex, high-resolution OEM applications such as flow cytometry, DNA sequencing, graphics and imaging and semiconductor inspection.

Acquisitions

We evaluate strategic opportunities regularly and, where appropriate, may acquire additional businesses, products, or technologies that are complementary to, or broaden the markets for our products. We believe we have strengthened our business model by expanding our addressable markets, customer base and expertise, diversifying our product portfolio and fortifying our core businesses from acquisitions as well as through organic initiatives.

On March 11, 2018, we entered into an Agreement and Plan of Merger (the "Merger Agreement") with Oclaro, Inc. ("Oclaro"), Prota Merger Sub, Inc., and Prota Merger, LLC, pursuant to which we will acquire Oclaro and Oclaro will become a wholly-owned subsidiary of Lumentum. In accordance with the terms of the Merger Agreement, each issued and outstanding share of Oclaro common stock will be exchanged for $5.60 in cash and 0.0636 of a share of Lumentum common stock, subject to the conditions and restrictions set forth in the Merger Agreement. The total transaction consideration was approximately $1.8 billion as of the date of the Merger Agreement. Oclaro stockholders will own approximately 16% of the combined company following the closing. Oclaro's stockholders approved the Merger Agreement on July 10, 2018 and we have received approval for the transaction under the Hart-Scott Rodino Act in the United States. We are in the process of obtaining antitrust approval in China. The Merger Agreement contains certain termination rights for both Lumentum and Oclaro. The Merger Agreement further provides that upon termination of the Merger Agreement under specified circumstances relating to failure to obtain regulatory approvals, Lumentum may be required to pay Oclaro a termination fee of $80 million.

As of August 23, 2018, the total transaction consideration was expected to be approximately $1.7 billion, which would be funded by a combination of $700 million in Lumentum common stock, $500 million in new debt, and the remaining amount from the cash balances of the combined company.

In February 2017, we completed the acquisition of a privately held company to enhance our manufacturing and vertical integration capabilities. We acquired all of the outstanding shares of the company for a total purchase consideration of $8.7 million. In connection with the acquisition, we paid upfront cash consideration of $5.1 million, incurred liabilities of $2.7 million contingent upon the achievement of certain production targets being achieved within 36 months following the acquisition date, and retained $0.9 million of the purchase price as security for the seller's indemnification obligations, which was fully paid to the seller subsequent to the year ended June 30, 2018.

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Restructuring Programs

We continue to engage in targeted restructuring plans primarily intended to reduce costs, consolidate our operations, rationalize the manufacturing of our products and align our business in response to market needs. We have focused on improving efficiencies and reducing costs by consolidating operations where appropriate, while taking into consideration our current investment strategy, product offerings, core competencies, opportunities to enhance cost efficiency and the availability of alternative manufacturers, as appropriate.

Please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Note 14. Restructuring and Related Charges” in the Notes to Consolidated Financial Statements for information on restructuring charges.

Research and Development

During fiscal 2018, 2017 and 2016, we incurred R&D expenses of $156.8 million, $148.3 million and $141.1 million, respectively. The number of employees engaged in R&D was approximately 587 as of June 30, 2018, 598 as of July 1, 2017 and 570 as of July 2, 2016.

We devote substantial resources to R&D for the development of new and enhanced products to serve our markets. Once the design of a product is complete, our engineering efforts shift to enhancing both product performance and our ability to manufacture it in greater volume and at lower cost.

In our OpComms segment, we are maintaining our capability to provide products throughout the network, while focusing on several important sub-segments. We are increasing our emphasis on Datacom products, such as 100G and 400G transceivers while we continue to maintain strong investments in Telecom components and modules such as ROADMs and tunable devices needed for long-haul and metro markets. We are also responding to our customers’ requests for higher levels of integration, including the integration of optics, electronics and software in our modules, subsystems and circuit packs. We are providing optical technology for 3D sensing systems that simplify the way that people interact with technology. These solutions are initially being used in computing, mobile, and industrial applications, including automotive applications.

In our Lasers segment, we continue to develop new product offerings in both solid-state and fiber lasers that take advantage of technologies and components we develop. These products are targeted at serving customers engaging in biotechnology, graphics and imaging, remote sensing, and materials processing and precision micromachining markets.

Manufacturing

Our significant manufacturing facilities are located in the United States, Thailand, and Switzerland. In March 2017, we completed the purchase of a property in Thailand for additional manufacturing capacity for our future growth.

On March 30, 2018, we entered into a Transition Services Agreement (“TSA”) with one of our contract manufacturers to wind down the production of our products at their facility in China and to facilitate an orderly transition of manufacturing to our manufacturing facility in Thailand, including the purchase of the manufacturing equipment. Under the terms of the TSA, we are required to pay $5.3 million in cash upon completion of certain milestones related to the purchase of equipment. We are also required to share cost of retention and severance, and to reimburse for certain other direct and indirect costs incurred by our contract manufacturer for transition services provided. As of June 30, 2018, we have not acquired any assets under this TSA. Please refer to “Note 6. Asset Acquisition” in the Notes to Consolidated Financial Statements.

Our significant contract manufacturing partners are located primarily in Thailand, Taiwan and China. Contract manufacturers can save a significant amount of dollars on labor, material and other related production expenses. We rely on the capabilities of our contract manufactures to procure the components and manage the inventory in these locations.

Sources and Availability of Raw Materials

We use various suppliers and contract manufacturers to supply parts and components for the manufacture and support of multiple product lines. Although our intention is to establish at least two sources of supply for materials whenever possible, for certain components we have sole or limited source supply arrangements. We may not be able to procure these components from alternative sources at acceptable prices and quality within a reasonable time, or at all; therefore, the risk of loss or interruption of such arrangements could impact our ability to deliver certain products on a timely basis.

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Intellectual Property

Intellectual property rights that apply to our various products include patents, trade secrets and trademarks. We do not intend to broadly license our intellectual property rights unless we can obtain adequate consideration or enter into acceptable patent cross-license agreements. As of June 30, 2018, we owned 636 U.S. patents and 255 foreign patents with expiration dates ranging from July 2018 through June 2037, and had 193 patent applications pending throughout the world.

Seasonality

Our revenue may be influenced on a quarter to quarter basis by customer demand patterns and new product introductions. Some of our products may be incorporated into consumer electronic products, which are subject to seasonality and fluctuations in demand.

Backlog

Backlog consists of purchase orders for products for which we have assigned shipment dates.

As of June 30, 2018, our backlog was $370.6 million, as compared to $218.4 million as of July 1, 2017. Due to possible changes in product delivery schedules and cancellation of product orders, and because our sales often reflect orders shipped in the same quarter in which they are received, our backlog at any particular date is not necessarily indicative of actual revenue or the level of orders for any succeeding period.

Employees

As of June 30, 2018, we employed approximately 2,930 full-time employees including approximately 1,900 employees in manufacturing, 587 employees in R&D and 443 employees in SG&A.

Outside of the United States, our business is subject to labor laws that differ from those in the United States. We follow the statutory requirements of those countries where we operate. We consider our employee relations to be good.

Environmental

Our R&D, manufacturing and distribution operations involve the use of hazardous substances and are regulated under international, federal, state and local laws governing health and safety and the environment. We apply strict standards for protection of the environment and occupational health and safety to sites inside and outside the United States, even if not subject to regulation imposed by foreign governments. We believe that our properties and operations at our facilities comply in all material respects with applicable environmental laws and occupational health and safety laws. However, the risk of environmental liabilities cannot be completely eliminated and there can be no assurance that the application of environmental and health and safety laws will not require us to incur significant expenditures. We are also regulated under a number of international, federal, state and local laws regarding recycling, product packaging and product content requirements. The environmental, product content/disposal and recycling laws are gradually becoming more stringent and may cause us to incur significant expenditures in the future.

In connection with the Separation, we agreed to indemnify Viavi for any liability associated with contamination from past operations at all properties transferred to us from Viavi, to the extent the resulting issues primarily related to our business. We have not been presented with any claims to date.

International Operations

During fiscal 2018, 2017 and 2016, net revenue from customers outside the United States based on the geographic region and country where our product is initially shipped, represented 90.8%, 85.2% and 82.0% of net revenue, respectively. In certain circumstances customers may request shipment of our products to a contract manufacturer in one country, which may differ from the location of their end customers. During fiscal 2018, our net revenue from Hong Kong, Mexico, South Korea, and Japan represented 14.7%, 11.7%, 11.7%, and 15.6% of our consolidated net revenue, respectively. During fiscal 2017, our net revenue from Hong Kong, Mexico, and Japan represented 22.6%, 18.5% and 9.9% of our consolidated net revenue, respectively. During fiscal 2016, our net revenue from Hong Kong, Mexico and Japan represented 23.7%, 12.5% and 10.3% of our consolidated net revenue, respectively. Our net revenue is primarily denominated in U.S. dollars, including our net revenue from customers outside the United States based on customer shipment locations as presented above.

As of June 30, 2018 and July 1, 2017, long-lived assets, namely our net property, plant and equipment, located outside of the United States comprised 68.2% and 67.8% of our total property, plant and equipment, net, respectively. As of

June 30, 2018,

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22.8% and 35.0% of our net property, plant and equipment were located in China and Thailand, respectively. As of July 1, 2017, 30.1% and 31.2% of our net property, plant and equipment were located in China and Thailand, respectively.

Please refer to "Note 19. Operating Segments and Geographic Information" in the Notes to Consolidated Financial Statements. For information regarding risks associated with our international operations, see "Item 1A. Risk Factors."

Available Information

Our website is located at www.lumentum.com, and our investor relations website is located at www.investor.lumentum.com. Copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to these reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act, as amended, are available free of charge on our investor relations website as soon as reasonably practicable after we file such material electronically with or furnish it to the Securities and Exchange Commission (the "SEC"). The SEC also maintains a website that contains our SEC filings at www.sec.gov.

Investors and others should note that we routinely use the Investors section of our website to announce material information to investors and the marketplace. While not all of the information that the Company posts on its corporate website is of a material nature, some information could be deemed to be material. Accordingly, the Company encourages investors, the media and others interested in the Company to review the information that it shares on www.lumentum.com. Information in, or that can be accessed through, our website is not incorporated into this Form 10-K.

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ITEM 1A. RISK FACTORS

Investors in our securities should carefully consider all of the relevant factors disclosed by us, including the following factors that could affect our results of operations, financial condition or stock price.

Risks Related to Our Business

Changing technology and intense competition require us to continuously innovate while controlling product costs, and our failure to do so may result in decreased revenues and profitability.

The markets in which we operate are dynamic and complex, and our success depends upon our ability to deliver both our current product offerings and new products and technologies on time and at acceptable prices to our customers. The markets for our products are characterized by rapid technological change, frequent new product introductions, substantial capital investment, changes in customer requirements, continued price pressures and a constantly evolving industry. Historically, these pricing pressures have led to a continued decline of average selling prices across our business. The development of new, technologically advanced products is a complex and uncertain process requiring high levels of innovation and the accurate prediction of technological and market trends. The introduction of new products also requires significant investment to ramp up production capacity, for which benefit may not be realized if we are not successful in the production of such products or if customer demand does not develop as expected. Ramping of production capacity also entails risks of delays which can limit our ability to realize the full benefit of new product introductions. We cannot assure you that we will be able to identify, develop, manufacture, market or support new or enhanced products successfully, if at all, or on a timely basis. We also cannot assure you that potential markets for our new products will materialize on the timelines we anticipate, or at all, or that our technology will meet our customers' specifications. Our future performance will depend on the successful development, introduction, deployment and market acceptance of new and enhanced features and products that meet our customers' current and future needs.

The market for optical communications products in particular has matured over time and these products have increasingly become subject to commoditization. Both legacy competitors as well as new entrants, predominantly Asia-based competitors, have intensified market competition in recent years leading to pricing pressure. To preserve our revenues and product margin structures, we remain reliant on an integrated customer and market approach that anticipates end customer needs as Telecom and Datacom requirements evolve. We also must continue to develop more advanced, differentiated products that command a premium with customers, while conversely continuing to focus on streamlining product costs for established legacy products. If we fail to continue to develop enhanced or new products, or over time are unable to adjust our cost structure to continue to competitively price more mature products, our financial condition and results of operations could be materially and adversely affected.

Continued competition in our markets may lead to an accelerated reduction in our prices, revenues and market share.

The end markets for optical products have experienced significant industry consolidation during the past few years. As a result, the markets for optical subsystems and components are highly competitive. Our current competitors include a number of domestic and international public and private companies, many of which may have substantially greater financial, technical, marketing and distribution resources and brand name recognition than we have. These competitors include II-VI, Acacia Communications, Applied Optoelectronics, Coherent, Finisar, Foxconn Interconnect Technology, Fujitsu Optical Components, Furukawa Electric, InnoLight Technology, IPG Photonics, Neophotonics, Source Photonics, and Sumitomo Electric Industries. We may not be able to compete successfully against either current or future competitors. Our competitors may continue to enter markets or gain or retain market share through introduction of new or improved products or with aggressive low pricing strategies that may impact the efficacy of our approach. Additionally, if significant competitors were to merge or consolidate, they may be able to offer a lower cost structure through economies of scale that we may be unable to match and which may intensify competition in the various markets. Increased competition could result in significant price erosion, reduced revenue, lower margins or loss of market share, any of which would significantly harm our business.

We rely on a limited number of customers for a significant portion of our sales; and the majority of our customers do not have contractual purchase commitments.

We have consistently relied on a small number of customers for a significant portion of our sales and in certain of our markets, such as 3D sensing, this customer concentration is particularly acute. We expect that this customer concentration will continue in the future and we expect that our growth prospects will continue to be concentrated in a small number of customers. Many of our customers purchase products under purchase orders or under contracts that do not contain volume purchase commitments. Some customers provide us with their expected forecasts for our products several months in advance, but these customers may decrease, cancel or delay purchase orders already in place, including on short notice, and the impact of any such actions may be intensified given our dependence on a limited number of large customers. In addition, changes in the business requirements, vendor selection, project prioritization, financial prospects, capital resources, and expenditures, or purchasing behavior (including product mix purchased or timing of purchases) of our key customers, or any real or perceived quality issues related to the products that we sell to such customers, could significantly decrease our sales to such customers or could lead to delays or cancellations of planned purchases of our products or services, which increases the risk of quarterly fluctuations in our revenues and operating results. Further, we may be required to purchase raw materials, increase production capacity or make other changes to our business to accommodate certain large customers. If forecasted orders do not materialize, we may need to reduce investment in R&D activities, we may fail to optimize our manufacturing capacity, we may incur liabilities with our suppliers for reimbursement of capital expenditures, or we may have excess inventory. In addition, if we incur expenses in response to forecasted demand and do not have a corresponding increase in revenue, our profitability may suffer. Any of these factors could adversely affect our business, financial condition and results of operations.

The manufacturing of our products may be adversely affected if our contract manufacturers and suppliers fail to meet our production requirements or if we are unable to manufacture certain products in our manufacturing facilities.

We rely on several independent contract manufacturers to supply us with certain products. For many products, a particular contract manufacturer may be the sole source of the finished-good products. We depend on these manufacturers to meet our production and capacity requirements and to provide quality products to our customers. Despite rigorous testing for quality, both by us and the contract manufacturers to whom we sell products, we may receive and ship defective products. We may incur significant costs to correct defective products which could result in the loss of future sales, indemnification costs or costs to replace or repair the defective products, litigation and damage to our reputation and customer relations. Defective products may also cause diversion of management attention from our business and product development efforts.

Additionally, the ability of our contract manufacturers to fulfill their obligations may be affected by natural disasters, changes in legal requirements, labor strikes and other labor unrest and economic, political or other forces that are beyond our control. For example, we recently experienced a labor strike at one of our contract manufacturers which threatened the contract manufacturer’s ability to fulfill its product commitments to us and, in turn, our ability to fulfill our obligations to our customers. Further, certain of our contract manufacturers are located in China, which exposes us to risks associated with Chinese laws and regulations, such as those related to import and export policies, tariffs, taxation and intellectual property. Chinese laws and regulations are subject to frequent change, and if our contract manufacturers are unable to obtain or retain the requisite legal permits or otherwise to comply with Chinese legal requirements, we may be forced to obtain products from other manufacturers or to make other operational changes, including transferring our manufacturing to another manufacturer or to our Thailand manufacturing facility. Any such developments could have a material impact on our ability to meet our customers’ expectations and may materially impact our operating results. In 2018, the United States imposed tariffs on the import of certain products manufactured in China, and has proposed further tariffs, which could increase costs associated with the manufacture of our products in China and negatively impact our sales levels and profit margins.

In addition, some of our purchase commitments with contract manufacturers are not cancellable which may impact our earnings if customer forecasts driving these purchase commitments do not materialize and we are unable to sell the products to other customers. Alternatively, our contract manufacturers may not be able to meet our demand which would inhibit our ability to meet customer demand and maintain or grow our revenues. Furthermore, it could be costly and require a long period of time to move products from one contract manufacturer to another which could result in interruptions in supply and adversely impact our financial condition and results of operations.

We manufacture some of the components that we provide to our contract manufacturers, along with our own finished goods, in our Thailand and San Jose, California manufacturing facilities. For some of the components and finished good products we are the sole manufacturer. Our manufacturing processes are highly complex, and issues are often difficult to detect and correct. From time to time we have experienced problems achieving acceptable yields in our manufacturing facilities, resulting in delays in the availability of our products. In addition, if we experience problems with our manufacturing facilities, it would be costly and require a long period of time to move the manufacture of these components and finished good products to a different facility or contract manufacturer which could then result in interruptions in supply, and would likely materially impact our financial condition and results of operations.

In addition, for a variety of reasons, including changes in circumstances at our contract manufacturers or our own business strategies, we may be required to, or voluntarily may, transfer the manufacturing of certain products to other manufacturing sites, including our new Thailand manufacturing facility. For example, we are in the process of transitioning the manufacturing of our products with one of our contract manufacturers in China to our Thailand manufacturing facility. As a result of such transfers, our contract manufacturers may prioritize other customers or otherwise be unable to meet our demand. If such transfers are unsuccessful, it could result in interruptions in supply and would likely impact our financial condition and results of operations.

Changes in manufacturing processes are often required due to changes in product specifications, changing customer needs and the introduction of new products. These changes may reduce manufacturing yields at our contract manufacturers and at our own manufacturing facilities, resulting in reduced margins on those products.

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In addition, many of our products are sourced from suppliers based outside of the United States, primarily in Asia. Uncertainty with respect to tax and trade policies, tariffs and government regulations affecting trade between the United States and other countries has recently increased. Major developments in tax policy or trade relations, such as the imposition of tariffs on imported products, could increase our product and product-related costs or require us to seek alternative suppliers, either of which could result in decreased sales or increases product and product-related costs.

If our customers do not qualify our manufacturing lines or the manufacturing lines of our subcontractors for volume shipments, our operating results could suffer.

Certain of our customers do not purchase products, other than limited numbers of evaluation units, prior to qualification of the manufacturing line for volume production. Our existing manufacturing lines, as well as each new manufacturing line, must pass through varying levels of qualification with certain of our customers. Our manufacturing lines have passed our qualification standards, as well as our technical standards. However, some of our customers also require that our manufacturing lines pass their specific qualification standards and that we, and any subcontractors that we may use, be registered under international quality standards. We may encounter quality control issues as a result of relocating our manufacturing lines or introducing new products to fill production. We may be unable to obtain customer qualification of our manufacturing lines or we may experience delays in obtaining customer qualification of our manufacturing lines. If we introduce new contract manufacturing partners and move any production lines from existing internal or external facilities, the new production lines will likely need to be re-qualified with our customers. Any delays or failure to obtain qualifications would harm our operating results and customer relationships.

We depend on a limited number of suppliers for raw materials, packages and components, and any failure or delay by these suppliers in meeting our requirements could have an adverse effect on our business and results of operations.

We purchase raw materials, packages and components from a limited number of suppliers, who are often small and specialized. Additionally, some of our suppliers are our sole sources for certain materials, equipment and components. We depend on the timely and continued supply and quality of the materials, packages and components that our suppliers supply to us. In general, we have not entered into long-term agreements with our suppliers. As a result, these suppliers generally may stop supplying us materials and equipment at any time. Our business and results of operations have been, and could continue to be, adversely affected by this dependency. Specific concerns we periodically encounter with our sole suppliers or limited number of suppliers include receipt of defective parts or contaminated materials, stoppages or delays of supply, insufficient resources to supply our requirements, substitution of more expensive or less reliable materials, increases in the price of supplies, and an inability to obtain reduced pricing from our suppliers in response to competitive pressures. Any disruption in the supply of the raw materials, packaging or components used in the manufacture and delivery of our products could have a material adverse impact on our business, financial condition and results of operations.

We contract with a number of large OEM and end-user service providers and product companies that have considerable bargaining power, which may require us to agree to terms and conditions that could have an adverse effect on our business or ability to recognize revenues.

Large OEM and end-user service providers and product companies comprise a significant portion of our customer base. These customers generally have greater purchasing power than smaller entities and, accordingly, often request and receive more favorable terms from suppliers, including us. As we seek to expand our sales to existing customers and acquire new customers, we may be required to agree to terms and conditions that are favorable to our customers and that may affect the timing of our ability to recognize revenue, increase our costs and have an adverse effect on our business, financial condition, and results of operations. Furthermore, large customers have increased buying power and ability to require onerous terms in our contracts with them, including pricing, warranties, and indemnification terms. If we are unable to satisfy the terms of these contracts, it could result in liabilities of a material nature, including litigation, damages, additional costs, loss of market share and loss of reputation. Additionally, the terms these large customers require, such as most-favored nation or exclusivity provisions, may impact our ability to do business with other customers and generate revenues from such customers.

Our products may contain defects that could cause us to incur significant costs, divert our attention from product development efforts and result in a loss of customers.

Our products are complex and defects may be found from time to time. Networking products in particular frequently contain undetected software or hardware defects when first introduced or as new versions are released. In addition, our products are often embedded in or deployed in conjunction with our customers’ products which incorporate a variety of components produced by third parties. As a result, when problems occur, it may be difficult to identify the source of the problem. These problems may cause us to incur significant damages or warranty and repair costs, divert the attention of our engineering personnel from our product development efforts and cause significant customer relation problems or loss of customers, all of which would harm our business.

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We are subject to risks arising from our international operations, which may adversely affect our business, financial condition, and results of operations.

We derive a majority of our revenue from our international operations, and we plan to continue expanding our business in international markets in the future. In addition, we have extensive international manufacturing capabilities through third-party contract manufacturers, as well as through our own international facilities, with employees engaged in R&D, administration, manufacturing, support and sales and marketing activities.

As a result of our international operations, in addition to similar risks we face in our U.S. operations, we are affected by economic, business, regulatory, social, and political conditions in foreign countries, including the following:

- changes in general IT spending;
- the imposition of government controls, inclusive of critical infrastructure protection;
- changes in or limitations imposed by trade protection laws or other regulatory orders or requirements in the United States or in other countries, including tariffs, sanctions, or other costs or requirements which may affect our ability to import or export our products from various countries;
- varying and potentially conflicting laws and regulations;
- fluctuations in local economies;
- wage inflation or a tightening of the labor market;
- political developments of foreign nations; and
- the impact of the following on service provider and government spending patterns as well as our contract and internal manufacturing: political considerations, unfavorable changes in tax treaties or laws, unfavorable events that affect foreign currencies, natural disasters, epidemic disease, labor unrest, earnings expatriation restrictions, misappropriation of intellectual property, military actions, acts of terrorism, political and social unrest and difficulties in staffing and managing international operations.

Since the beginning of 2018, there has been increasing rhetoric, in some cases coupled with legislative or executive action, from several U.S. and foreign leaders regarding the possibility of instituting tariffs against foreign imports of certain materials. More specifically, the United States and China have applied tariffs to certain of each other’s exports. The institution of trade tariffs both globally and between the United States and China specifically carries the risk of negatively impacting overall economic conditions, which could have negative repercussions on the Company. Furthermore, imposition of tariffs could cause a decrease in the sales of our products to customers located in China or other customers selling to Chinese end users, which would directly impact our business.

Any or all of these factors could have a material adverse impact on our business, financial condition, and results of operations.

Moreover, local laws and customs in many countries differ significantly from or conflict with those in the United States or other countries in which we operate. In many foreign countries, particularly in those with developing economies, it is common for others to engage in business practices that are prohibited by our internal policies and procedures or U.S. regulations applicable to us. There can be no assurance that our employees, contractors, channel partners and agents will not take actions in violation of our policies and procedures, which are designed to ensure compliance with U.S. and foreign laws and policies. Violations of laws or key control policies by our employees, contractors, channel partners, or agents could result in termination of our relationships with customers and suppliers, financial reporting problems, fines and/or penalties for us, or prohibition on the importation or exportation of our products, and could have a material adverse effect on our business, financial condition and results of operations.

We face a number of risks related to our strategic transactions.

We have made acquisitions of other businesses or technologies in the past and we will continue to review and may pursue acquisition and other strategic opportunities, for example, our proposed acquisition of Oclaro announced in March 2018. Such strategic transactions involve numerous risks, including the following:

- diversion of management’s attention from normal daily operations of the business;
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unforeseen expenses, delays or conditions imposed upon the acquisition or transaction, including due to required regulatory approvals or consents;

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- unanticipated changes in the combined business due to potential divestitures or other requirements imposed by antitrust regulators;
- unanticipated changes in the acquired business, including due to regulatory action or changes in the operating results or financial condition of the business;
- the ability to retain and obtain required regulatory approvals, licenses and permits;
- difficulties and costs in integrating the operations, technologies, products, IT and other systems, facilities and personnel of the purchased businesses;
- loss of customers, suppliers or partners;
- potential difficulties in completing projects associated with in-process R&D;
- an acquisition or strategic transaction may not further our business strategy as we expected or we may overpay for, or otherwise not realize the expected return on, our investments;
- we may face unanticipated liabilities or our exposure for known contingencies and liabilities may exceed our estimates;
- insufficient net revenue to offset increased expenses associated with acquisitions;
- potential loss of key employees of the acquired companies or difficulty maintaining our company culture;
- difficulty forecasting revenues and margins;
- dilution of our current stockholders as a result of any issuance of equity securities as acquisition consideration;
- expenditure of cash that would otherwise be available to operate our business;
- incurrence of indebtedness on terms that are unfavorable to us, limit our operational flexibility or that we are unable to repay;
- incurrence or assumption of contingent liabilities, known or unknown, including potential lawsuits, infringement actions or similar liabilities; and
- incurrence of impairment charges related to goodwill or other intangibles.

If we are unable to successfully manage any of these risks in relation to any future acquisitions, including our acquisition of Oclaro, our business, financial condition and results of operations could be adversely impacted.

Changes in demand and customer requirements for our products may reduce manufacturing yields, which could negatively impact our profitability.

Manufacturing yields depend on a number of factors, including the volume of production due to customer demand and the nature and extent of changes in specifications required by customers for which we perform design-in work. Changes in manufacturing processes required as a result of changes in product specifications, changing customer needs, introduction of new product lines and changes in contract manufacturers may reduce manufacturing yields, resulting in low or negative margins on those products. Moreover, an increase in the rejection rate of products during the quality control process, before, during or after manufacture, results in lower gross margins from lower yields and additional rework costs. Any reduction in our manufacturing yields will adversely affect our gross margins and could have a material impact on our operating results.

We incorporated changes to our international corporate structure in the fiscal third quarter of 2018 in order to further reduce our effective tax rate. We have not operationalized the new international structure to the full extent possible at this time due to various factors including the pending acquisition of Oclaro, which could significantly impact our existing tax strategy. If we are unable to fully adopt a new international structure or if it is successfully challenged by the U.S. or foreign tax authorities, we may be unable to realize the anticipated tax savings which could materially and adversely affect our operating results.

We initiated a new international corporate structure more closely aligned with our international operations during the fiscal third quarter of 2018. The new corporate structure is intended to reduce our overall effective tax rate through changes among our wholly-owned subsidiaries in how we use our intellectual property, and how we structure our international procurement and sales operations. The new structure includes legal entities located in jurisdictions with income tax rates lower than the U.S. statutory tax rate. The intercompany arrangements are intended to result in income earned by such entities in accordance with arm's-length

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principles and commensurate with functions performed, risks assumed and ownership of valuable corporate assets. We have not operationalized the new structure to the full extent possible at this time due to various factors including the pending acquisition of Oclaro, which could significantly impact our existing tax strategy. We are currently in the process of evaluating the Oclaro transaction's impact to our tax structure and, depending on the outcome, we may make modifications to the new structure in order to achieve better tax and operational efficiency.

We have agreed to reimburse Viavi for certain tax liabilities and related costs that may be incurred by Viavi, under certain circumstances, as a result of implementing the new corporate structure or a modified structure in the future. In addition, the implementation of such a structure has required us to incur expenses, and may require that we incur additional expenses, for which we may not realize the anticipated benefit or it may take us several years to fully realize the anticipated benefit.

If the new structure is not accepted by the applicable taxing authorities, if changes in domestic and international tax laws negatively impact the structure, if the acquisition of Oclaro prevents us from implementing a tax efficient structure, or if we do not operate our business consistent with the new structure and applicable tax provisions, we may fail to achieve the financial and operational efficiencies that we anticipate as a result of the new structure, and our business, financial condition and operating results may be materially and adversely affected.

Changes in tax laws or ceasing to qualify for tax holiday in Thailand could have a material adverse effect on our business, cash flow, results of operations or financial conditions.

As a multinational corporation, we are subject to income taxes as well as non-income based taxes, in both the U.S. and various foreign jurisdictions. Significant uncertainties exist with respect to the amount of our tax liabilities, including those arising from potential changes in laws in the countries in which we do business and the possibility of adverse determinations with respect to the application of existing laws. Many judgments are required in determining our worldwide provision for income taxes and other tax liabilities, and we are under audit by various tax authorities, which often do not agree with positions taken by us on our tax returns. Any unfavorable resolution of these uncertainties may have a significant adverse impact on our tax rate.

Increasingly, countries around the world are actively considering or have enacted changes in relevant tax, accounting and other laws, regulations and interpretations. In particular, the Tax Cuts and Jobs Act (the "Tax Act") contains many significant changes to the U.S. tax laws that affected our fiscal year ended June 30, 2018, and which will continue to affect our fiscal years thereafter. The changes include, but are not limited to, (1) a reduction in the U.S. federal corporate tax rate (resulting in a blended corporate rate of 28% for our fiscal year ended June 30, 2018, and a rate of 21% for our fiscal years thereafter); (2) a mandatory deemed repatriation tax ("Transition Tax") on certain deferred income of foreign subsidiaries that, if the taxpayer so elects, is payable over eight years; (3) bonus depreciation that allows full expensing of qualified property; (4) elimination of the corporate alternative minimum tax; (5) addition of the Base Erosion and Anti-Abuse Tax ("BEAT"), a new minimum tax on taxable income adjusted for certain base erosion payments; (6) a general elimination of U.S. federal income taxes on dividends from foreign subsidiaries; (7) a new provision to currently tax Global Intangible Low-Taxed Income ("GILTI"); (8) a new limitation on deductible interest expense; (9) the repeal of the domestic production activity deduction; (10) limitations on the deductibility of certain executive compensation; (11) limitations on the use of foreign tax credits ("FTCs") to reduce U.S. income tax liability; and (12) limitations on net operating losses generated in the taxable years beginning after December 31, 2017, to 80 percent of taxable income.

The reduction in the U.S. federal statutory rate is expected to positively impact our federal cash tax liability. However, the ultimate impact is subject to the effect of other complex provisions in the Tax Act (including the BEAT and GILTI), which we are currently reviewing, and it is possible that any impact of BEAT, GILTI, or other provisions of the Tax Act could significantly reduce, or outweigh, the benefit of the reduction in the U.S. federal statutory rate. Due to the uncertain practical and technical application of many of these provisions, we made reasonable estimates of the effects and recorded provisional amounts where possible for the fiscal year ending June 30, 2018. The U.S. Treasury Department and the Internal Revenue Service (IRS), and other standards-setting bodies may issue guidance on how the provisions of the Tax Act will be applied that is different from our interpretation. The Tax Act requires complex computations not previously required or produced, and significant judgments and assumptions in the interpretation of the law were made in producing our provisional estimates. As we complete our analyses, and interpret any additional guidance, we may adjust the provisional amounts we have recorded, and those adjustments may materially impact our provision for income taxes in the period in which the adjustments are made. We also anticipate that uncertainty in the application of the Tax Act to our ongoing operations as well as possible adverse future law changes attributable to changes in the U.S. political environment could have an adverse impact on our future tax rate. Other countries also continue to consider enacting new laws, which could adversely affect us. The foregoing items could increase our future tax expense, could change our future intentions regarding reinvestment of foreign earnings, and could have a material adverse effect on our business, financial condition and results of operations.

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The income and non-income tax regimes we are subject to or operate under are unsettled and may be subject to significant change. Changes in tax laws or tax rulings, or changes in interpretations of existing laws, could materially affect our financial position and results of operations. Many countries in Europe, as well as a number of other countries and organizations, have recently proposed or recommended changes to existing tax laws or have enacted new laws that could increase our tax obligations where we do business or require us to change the manner in which we operate our business. The Organization for Economic Cooperation and Development has been working on a Base Erosion and Profit Sharing Project, and issued in 2015, and is expected to continue to issue, guidelines and proposals that may change various aspects of the existing framework under which our tax obligations are determined in many of the countries in which we do business.

During fiscal 2018, our subsidiary in Thailand operated under a tax holiday. The tax holiday will expire in fiscal 2025 unless extension is granted by the Thailand government and we continue to meet the requirements thereunder. If we do not meet the tax holiday requirements, if we are not granted extension by the Thailand government, or if we decide not to apply for extension of the tax holiday, income earned in Thailand will be subject to higher statutory income tax rate, which may cause our effective tax rate to increase and reduce our liquidity and cash flow.

Our operating results may be subject to volatility due to fluctuations in foreign currency.

We are exposed to foreign exchange risks with regard to our international operations which may affect our operating results. Since we conduct business in currencies other than U.S. dollars but report our financial results in U.S. dollars, we face exposure to fluctuations in currency exchange rates. Although we price our products primarily in U.S. dollars, a portion of our operating expenses are incurred in foreign currencies. For example, a portion of our expenses are denominated in U.K. pound sterling and Japanese yen. Fluctuations in the exchange rate between these currencies and, to a lesser extent, other currencies in which we collect revenues and/or pay expenses could have a material effect on our future operating results. If the value of the U.S. dollar depreciates relative to certain other foreign currencies, it would increase our costs as expressed in U.S. dollars. Conversely, if the U.S. dollar strengthens relative to other currencies, such strengthening could raise the relative cost of our products to non-U.S. customers, especially as compared to foreign competitors, and could reduce demand.

Although we intend to hedge for a portion of our foreign currency exposure, significant fluctuations in exchange rates between the U.S. dollar and foreign currencies may adversely affect our net income. Additionally, hedging programs rely on our ability to forecast accurately and could expose us to additional risks that could adversely affect our financial condition and results of operations.

Our ability to develop, market, and sell products could be harmed if we are unable to retain or hire key personnel.

Our future success depends upon our ability to recruit and retain the services of executive, engineering, sales and marketing, and support personnel. The supply of highly qualified individuals, in particular engineers in very specialized technical areas, or sales people specializing in the service provider, enterprise and commercial laser markets, is limited and competition for such individuals is intense. None of our officers or key employees is bound by an employment agreement for any specific term. The loss of the services of any of our key employees, the inability to attract or retain personnel in the future or delays in hiring required personnel and the complexity and time involved in replacing or training new employees, could delay the development and introduction of new products, and negatively impact our ability to market, sell, or support our products.

We may be unable to successfully implement our acquisitions strategy or integrate acquired companies and personnel with existing operations.

We have in the past acquired several companies, and have announced that we signed a definitive agreement to acquire Oclaro. We may continue to expand and diversify our operations with additional acquisitions. We may be unable to identify or complete prospective acquisitions for many reasons, including increasing competition from other potential acquirers, the effects of consolidation in our industries and potentially high valuations of acquisition candidates. In addition, applicable antitrust laws and other regulations may limit our ability to acquire targets or force us to divest an acquired business. If we are unable to identify suitable targets or complete acquisitions, our growth prospects may suffer, and we may not be able to realize sufficient scale and technological advantages to compete effectively in all markets.

To the extent we are successful in making acquisitions, we may be unsuccessful in integrating acquired companies or product lines with existing operations, or the integration may be more difficult or more costly than anticipated. Some of the risks that may affect our ability to integrate or realize any anticipated benefits from acquired companies, businesses or assets include those associated with:

- unexpected losses of key employees of the acquired company;
- conforming the acquired company’s standards, processes, procedures and controls with our operations, including integrating Enterprise Resource Planning (“ERP”) systems and other key business applications;

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- coordinating new product and process development;
- increasing complexity from combining operations;
- increasing the scope, geographic diversity and complexity of our operations;
- difficulties in consolidating facilities and transferring processes and know-how; and
- diversion of management's attention from other business concerns.

In connection with acquisitions, we may:

- use a signification portion of our available cash;
- issue equity securities, which would dilute current stockholders' percentage ownership;
- incur significant debt;
- incur or assume contingent liabilities, known or unknown, including potential lawsuits, infringement actions or similar liabilities;
- incur impairment charges related to goodwill or other intangibles; and
- face antitrust or other regulatory inquiries or actions.

In addition, the market price of our common stock could be adversely affected if the effect of any acquisitions on our consolidated financial results is dilutive or is below the market's or financial analysts' expectations, or if there are unanticipated changes in the business or financial performance of the target company or the combined company. Any failure to successfully integrate acquired businesses may disrupt our business and adversely impact our business, financial condition and results of operations.

We may require additional capital to support business growth, and this capital might not be available on acceptable terms, if at all.

We intend to continue to make investments to support our business growth and may require additional funds to respond to business challenges, including to support product development and introduce new products, address new markets, engage in strategic transactions and partnerships, improve or expand our operating infrastructure or acquire complementary businesses and technologies. In March 2018, we entered into a commitment letter (the "Commitment Letter") with Deutsche Bank Securities Inc. and Deutsche Bank AG New York, New York Branch (the "Commitment Party"), pursuant to which, subject to the terms and conditions set forth therein, the Commitment Party has committed to provide a senior secured term loan facility in an aggregate principal amount of up to $550 million. In March 2017, we issued and sold a total of $450 million in aggregate principal amount of Convertible Senior Notes due in 2024 (the "2024 Notes") and we may in the future engage in additional equity or debt financings to secure additional funds. If we raise additional funds through future issuances of equity, equity-linked or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing we secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. We may not be able to obtain additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be harmed.

Our ability to hire and retain employees may be negatively impacted by changes in immigration laws, regulations and procedures.

Foreign nationals who are not U.S. citizens or permanent residents constitute an important part of our U.S. workforce, particularly in the areas of engineering and product development. Our ability to hire and retain these workers and their ability to remain and work in the United States are impacted by laws and regulations, as well as by procedures and enforcement practices of various government agencies. Changes in immigration laws, regulations or procedures, including those that may be enacted by the current U.S. presidential administration, may adversely affect our ability to hire or retain such workers, increase our operating expenses and negatively impact our ability to deliver our products and services.

Any failure, disruption or security breach of our information technology infrastructure or information management systems could have an adverse impact on our business and operations.

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Our business depends significantly on effective and efficient information management systems, and the reliability and security of our information technology infrastructure are essential to the health and expansion of our business. For example, the information gathered and processed by our information management systems assists us in managing our supply chain, monitoring customer accounts, and protecting our proprietary and confidential business information, plans, trade secrets, and intellectual property, among other things. In addition, these systems may also contain personal data or other protected information about our employees, our customers' employees, or others. We must continue to expand and update this infrastructure in response to our changing requirements as well as evolving security standards and risks.

In some cases, we may rely upon third-party providers of hosting, support and other services to meet our information technology requirements. Any failure to manage, expand and update our information technology infrastructure, including our ERP system and other applications, any failure in the extension implementation or operation of this infrastructure, or any failure by our hosting and support partners or other third-party service providers in the performance of their services could materially harm our business. In addition, we have partnered with third parties to support our information technology systems and to help design, build, test, implement and maintain our information management systems. Our merger, acquisition and divestiture activity may also require transitions to or from, and the integration of, various information management systems within our overall enterprise architecture, including our ERP system and other applications. Those systems that we acquire may also pose security risks of which we are unaware or unable to mitigate, particularly during the transition of these systems.

Like other companies, we are subject to ongoing attempts by malicious actors, including through hacking, malware, ransomware, denial-of-service attacks, social engineering, exploitation of internet-connected devices, and other attacks, to obtain unauthorized access or acquisition of confidential information or otherwise affect service reliability and threaten the confidentiality, integrity and availability of information on our systems. We have been in the past, and may be in the future, subject to social engineering and other cybersecurity attacks. Further, our third party service providers may have been and may be in the future subject to such attacks. In addition, actions by our employees, service providers, partners, contractors or others, whether malicious or in error, could affect the security of our systems. Additionally, while our security systems are designed to maintain the physical security of our facilities and information systems, accidental or willful security breaches or other unauthorized access by third parties to our facilities or our information systems could lead to misappropriation of proprietary and confidential information. Despite our implementation of security measures, our systems and those of our third-party service providers are vulnerable to damage from these types of attacks or errors. In addition, our systems may be impacted by natural disasters, terrorism or other similar disruptions. Any system failure, accident or security breach affecting us or our third-party providers could result in disruptions to our operations and loss of or unauthorized access or damage to our data or in inappropriate disclosure of confidential information. Any actual or alleged disruption to, or security breach affecting, our systems or those of our third-party partners could cause significant damage to our reputation, lead to theft of our protected intellectual property and trade secrets, result in legal obligations or liability, affect our relationships with our customers, and ultimately harm our business. In addition, we may be required to incur significant costs to protect against or mitigate damage caused by these disruptions or security breaches in the future.

Our revenues, operating results, and cash flows may fluctuate from period to period due to a number of factors, which makes predicting financial results difficult.

Spending on optical communication and laser products is subject to cyclical and uneven fluctuations, which could cause our financial results to fluctuate unevenly and unpredictably. It can be difficult to predict the degree to which end-customer demand and the seasonality and uneven sales patterns of our OEM partners or other customers will affect our business in the future, particularly as we or they release new or enhanced products. While our fourth fiscal quarters are typically strongest, future buying patterns may differ from historical seasonality. Further, if the mix of revenue changes, it may also cause results to differ from historical seasonality. Accordingly, our quarterly and annual revenues, operating results, cash flows, and other financial and operating metrics may vary significantly in the future, and the results of any prior periods should not be relied upon as an indication of future performance.

Our operating results may be adversely affected by unfavorable economic and market conditions.

Adverse changes to and uncertainty in the global economy may lead to decreased demand for our products and revenue fluctuations, increased price competition for our products, and may increase the risk of excess and obsolete inventories and higher overhead costs as a percentage of revenue. Declines or uncertainty in particular geographic regions, such as China or Europe, may impact IT-related spending generally and consequently, lead to lower growth or a decline in our markets. The loss or delay of orders from any of our more significant customers could cause our revenue and profitability to suffer. The impact of economic challenges on the global financial markets could further negatively impact our operations by affecting the solvency of our customers, the solvency of our key suppliers or the ability of our customers to obtain credit to finance purchases of our products. If economic conditions deteriorate or remain uncertain, our financial condition and results of operations would likely be materially and adversely impacted.

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If we have insufficient proprietary rights or if we fail to protect our rights, our business would be materially harmed.
We seek to protect our products and product roadmaps in part by developing and/or securing proprietary rights relating to those products, including patents, trade secrets, know-how and continuing technological innovation. The steps we take to protect our intellectual property may not adequately prevent misappropriation or ensure that others will not develop competitive technologies or products. Other companies may be investigating or developing technologies that are similar to our own. It is possible that patents may not be issued from any of our pending applications or those we may file in the future and, if patents are issued, the claims allowed may not be sufficiently broad to deter or prohibit others from making, using or selling products that are similar to ours, or such patents could be invalidated or ruled unenforceable. We do not own patents in every country in which we sell or distribute our products, and thus others may be able to offer identical products in countries where we do not have intellectual property protections. In addition, the laws of some territories in which our products are or may be developed, manufactured or sold, including Europe, Asia-Pacific or Latin America, may not protect our products and intellectual property rights to the same extent as the laws of the United States. Any patents issued to us may be challenged, invalidated or circumvented. Additionally, we are currently a licensee for a number of third-party technologies including software and intellectual property rights from academic institutions, our competitors and others, and we are required to pay royalties to these licensors for the use thereof. In the future, if such licenses are unavailable or if we are unable to obtain such licenses on commercially reasonable terms, we may not be able to rely on such third-party technologies which could inhibit our development of new products, impede the sale of some of our current products, substantially increase the cost to provide these products to our customers, and could have a significant adverse impact on our operating results.
We also seek to protect our important trademarks by endeavoring to register them in certain countries. We have not registered our trademarks in every country in which we sell or distribute our products, and thus others may be able to use the same or confusingly similar marks in countries where we do not have trademark registrations. We have adopted Lumentum as a house trademark and trade name for our company, and are in the process of establishing rights in this name and brand. We have also adopted the Lumentum logo as a house trademark for our company, and are in the process of establishing rights in this brand. The Lumentum brand is the subject of trademark applications in the United States or other jurisdictions, but the trademarks have not yet proceeded to registration. The efforts we take to register and protect trademarks, including the Lumentum brand, may not be sufficient or effective. Although we will seek to obtain trademark registrations for the Lumentum brand, it is possible we may not be able to protect our brand through registration in one or more jurisdictions, for example, the applicable governmental authorities may not approve the registration. Furthermore, even if the applications are approved, third parties may seek to oppose or otherwise challenge registration. There is the possibility that, despite efforts, the scope of the protection obtained for our trademarks, including the Lumentum brand, will be insufficient or that a registration may be deemed invalid or unenforceable in one or more jurisdictions throughout the world.
Further, a breach of our information technology infrastructure could result in the misappropriation of intellectual property, business plans or trade secrets. Any failure of our systems or those of our third-party service providers could result in unauthorized access or acquisition of such proprietary information, and any actual or perceived security breach could cause significant damage to our reputation and adversely impact our relationships with our customers.
Our products may be subject to claims that they infringe the intellectual property rights of others, the resolution of which may be time-consuming and expensive, as well as require a significant amount of resources to prosecute, defend, or make our products non-infringing.
Lawsuits and allegations of patent infringement and violation of other intellectual property rights occur regularly in our industry. We have in the past received, and anticipate that we will receive in the future, notices from third parties claiming that our products infringe upon their proprietary rights, with two distinct sources of such claims becoming increasingly prevalent. First, large technology companies, including some of our customers and competitors, are seeking to monetize their patent portfolios and have developed large internal organizations that may approach us with demands to enter into license agreements. Second, patent-holding companies that do not make or sell products (often referred to as “patent trolls”) may claim that our products infringe upon their proprietary rights. We respond to these claims in the course of our business operations. The litigation or settlement of these matters, regardless of the merit of

the claims, could result in significant expense and divert the efforts of our technical and management personnel, regardless of whether or not we are successful. If we are unsuccessful, we could be required to expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation. We may not be successful in such development, or such licenses may not be available on commercially reasonable terms, or at all. Without such a license, or if we are the subject of an exclusionary order, our ability to make our products could be limited and we could be enjoined from future sales of the infringing product or products, which could adversely affect our revenues and operating results. Additionally, we often indemnify our customers against claims of infringement related to our products and may incur significant expenses to defend against such claims. If we are unsuccessful defending against such claims, we may be required to indemnify our customers against any damages awarded.

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We also face risks that third parties may assert trademark infringement claims against us in one or more jurisdictions throughout the world related to our Lumentum and Oclaro brands and/or other trademarks. The litigation or settlement of these matters, regardless of the merit of the claims, could result in significant expense and divert the efforts of our technical and management personnel, regardless of whether or not we are successful. If we are unsuccessful, trademark infringement claims against us could result in significant monetary liability or prevent us from selling some or all of our products or services under the challenged trademark. In addition, resolution of claims may require us to alter our products, labels or packaging, license rights from third parties, or cease using the challenged trademark altogether, which could adversely affect our revenues and operating results.

We face certain litigation risks that could harm our business.

From time to time we have been, and in the future we may become, subject to various legal proceedings and claims that arise in or outside the ordinary course of business. The results of legal proceedings are difficult to predict. Moreover, many of the complaints filed against us may not specify the amount of damages that plaintiffs seek, and we therefore may be unable to estimate the possible range of damages that might be incurred should these lawsuits be resolved against us. While we may be unable to estimate the potential damages arising from such lawsuits, certain of them assert types of claims that, if resolved against us, could give rise to substantial damages. Thus, an unfavorable outcome or settlement of one or more of these lawsuits could have a material adverse effect on our financial condition, liquidity and results of operations. Even if these lawsuits are not resolved against us, the uncertainty and expense associated with unresolved lawsuits could seriously harm our business, financial condition and reputation. Litigation is generally costly, time-consuming and disruptive to normal business operations. The costs of defending these lawsuits have been significant in the past, will continue to be costly and may not be covered by our insurance policies. The defense of these lawsuits could also result in continued diversion of our management's time and attention away from business operations, which could harm our business. For additional discussion regarding litigation, see "Part I, Item 3. Legal Proceedings."

Lawsuits have been filed against us, Oclaro, its directors, and certain other parties challenging the Merger, and an adverse judgment in such lawsuits, or any similar lawsuit, may prevent the Merger from being consummated or from being consummated within the expected timeframe.

As described in greater detail in "Part I, Item 3. Legal Proceedings" in this Annual Report on Form 10-K, we, along with Oclaro, Oclaro's directors, and certain other parties were named as defendants in two putative class action lawsuits. One of the lawsuits was filed in the United States District Court for the Northern District of California and the other was filed in the United States District Court for the District of Delaware. Both have been voluntarily dismissed with prejudice.

Oclaro and its directors were also named as defendants in five additional lawsuits, including two putative class actions, each of which was filed in the United States District Court for the Northern District of California. Four of these five additional lawsuits have been dismissed. Three of the dismissals were with prejudice and one was without prejudice. We were not named as a defendant in these five lawsuits.

Each of the above-referenced lawsuits was filed by purported stockholders of Oclaro to challenge the Merger. The plaintiffs have sought, among other things, injunctive relief preventing the parties from consummating the Merger, rescission of the transactions contemplated by the Merger Agreement should they be consummated, and litigation costs, including attorneys' fees, as well as damages to be awarded to the plaintiff and any class if the Merger is consummated. One of the conditions to consummating the Merger is the absence of any order, judgment or injunction enjoining or otherwise prohibiting consummation of the Merger in any jurisdiction that is material to the business or operations of us or Oclaro. Consequently, if the remaining plaintiff - or any plaintiff who subsequently files a similar lawsuit - is successful in obtaining an injunction preventing the parties from consummating the Merger, such injunction may prevent the Merger from being completed in the expected timeframe, or at all. This lawsuit and any other subsequently filed similar lawsuits could also have a material adverse effect on our business, results of operations and financial condition.

Our products incorporate and rely upon licensed third-party technology, and if licenses of third-party technology do not continue to be available to us or are not available on terms acceptable to us, our revenues and ability to develop and introduce new products could be adversely affected.

We integrate licensed third-party technology into certain of our products. From time to time, we may be required to license additional technology from third-parties to develop new products or product enhancements. Third-party licenses may not be available or continue to be available to us on commercially reasonable terms. The failure to comply with the terms of any license, including free open source software, may result in our inability to continue to use such license. Our inability to maintain or re-license any third-party licenses required in our products or our inability to obtain third-party licenses necessary to develop new products and product enhancements, could potentially require us to develop substitute technology or obtain substitute technology of lower quality or performance standards or at a greater cost, any of which could delay or prevent product shipment and harm our business, financial condition, and results of operations.

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We are subject to laws and other regulations worldwide including with respect to environmental matters, securities laws, privacy and data protection, compliance with which could increase our expenses and harm our operating results. Our operations and our products are subject to various federal, state and foreign laws and regulations, including those governing pollution and protection of human health and the environment in the jurisdictions in which we operate or sell our products. These laws and regulations govern, among other things, wastewater discharges and the handling and disposal of hazardous materials in our products. Our failure to comply with current and future environmental or health or safety requirements could cause us to incur substantial costs, including significant capital expenditures, to comply with such environmental laws and regulations and to clean up contaminated properties that we own or operate. Such clean-up or compliance obligations could result in disruptions to our operations. Additionally, if we are found to be in violation of these laws, we could be subject to governmental fines or civil liability for damages resulting from such violations. These costs could have a material adverse impact on our financial condition or operating results.

From time to time new regulations are enacted, and it is difficult to anticipate how such regulations will be implemented and enforced. We continue to evaluate the necessary steps for compliance with regulations as they are enacted. These regulations include, for example, the Registration, Evaluation, Authorization and Restriction of Chemicals (“REACH”), the Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Directive (“RoHS”) and the Waste Electrical and Electronic Equipment Directive (“WEEE”) enacted in the European Union which regulate the use of certain hazardous substances in, and require the collection, reuse and recycling of waste from, certain products we manufacture. These regulations and similar legislation may require us to re-design our products to ensure compliance with the applicable standards, for example by requiring the use of different types of materials, which could have an adverse impact on the performance of our products, add greater testing lead-times for product introductions or other similar effects. We believe we comply with all such legislation where our products are sold and we continuously monitor these laws and the regulations being adopted under them to determine our responsibilities.

In addition, pursuant to Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the SEC has promulgated rules requiring disclosure regarding the use of certain “conflict minerals” that are mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer’s efforts to prevent the sourcing of such minerals. Complying with these disclosure requirements involves substantial diligence efforts to determine the source of any conflict minerals used in our products and may require third-party auditing of our diligence process. These efforts may demand internal resources that would otherwise be directed towards operations activities.

Since our supply chain is complex, we may face reputational challenges if we are unable to sufficiently verify the origins of the conflict minerals used in our products. Additionally, if we are unable to satisfy those customers who require that all of the components of our products are determined to be conflict free, they may choose a competitor’s products which could materially impact our financial condition and operating results.

Additionally, we are subject to laws and regulations with respect to personal data we collect from our employees, customers, and others. These laws and regulations are subject to frequent modifications and updates and require ongoing supervision. For example, the European Union adopted a General Data Protection Regulation (“GDPR”) that became effective in May 2018, and has established new, and in some cases more stringent, requirements for data protection in Europe, and which provides for substantial penalties for noncompliance. We have made certain modifications to our practices in order to comply with these or other requirements, and may be required to make additional modifications in order to comply with these or other requirements relating to privacy and data protection in the future, each of which may require us to incur significant costs and expenses. Additionally, California enacted legislation in June 2018, the California Consumer Privacy Act (“CCPA”), which will, among other things, require covered companies to provide new disclosures to California consumers when it goes into effect on January 1, 2020. Legislators have stated that they intend to propose amendments to the CCPA before it goes into effect, and it remains unclear what, if any, modifications will be made to this legislation or how it will be interpreted. The effects of the CCPA are potentially significant, however, and may require us to modify our data processing practices and policies and to incur substantial costs and expenses in an effort to comply. Laws and regulations relating to privacy and data protection continue to evolve in various jurisdictions, with existing laws and regulations subject to new and differing interpretations and new laws and regulations being proposed and adopted. It is possible that our practices may be deemed not to comply with those privacy and data protection legal requirements that apply to us now or in the future. Further, in June 2016, a referendum was passed in the United Kingdom to leave the European Union, commonly referred to as “Brexit.” This created an uncertain political and economic environment in the United Kingdom and other European Union countries, even though the formal process for leaving the European Union may take years to complete and may not ultimately be effectuated. For example, while the United Kingdom has enacted a Data Protection Bill that substantially implements GDPR, which became law in May 2018, there remains uncertainty with regard to whether the European Union will view this regulation as adequate under GDPR and how data transfers between the United Kingdom and the European Union will be regulated.

Our failure or perceived failure to comply with any of the foregoing legal and regulatory requirements could result in increased costs for our products, monetary penalties, damages to our reputation, government inquiries and investigations, and legal action. Furthermore, the legal and regulatory requirements that are applicable to our business are subject to change from time to time, which increases our monitoring and compliance costs and the risk that we may fall out of compliance. Additionally, we may be required to ensure that our suppliers comply with applicable laws and regulations. If we or our suppliers fail to comply with such laws or regulations, we could face sanctions for such noncompliance, and our customers may refuse to purchase our products, which would have a material adverse effect on our business, financial condition and results of operations.

Our sales may decline if we are unable to obtain government authorization to export certain of our products, and we may be subject to legal and regulatory consequences if we do not comply with applicable export control laws and regulations.

Exports of certain of our products are subject to export controls imposed by the U.S. government and administered by the U.S. Departments of State and Commerce. In certain instances, these regulations may require pre-shipment authorization from the administering department. For products subject to the Export Administration Regulations (“EAR”) administered by the Department of Commerce’s Bureau of Industry and Security, the requirement for a license is dependent on the type and end use of the product, the final destination, the identity of the end user and whether a license exception might apply. Virtually all exports of products subject to the International Traffic in Arms Regulations (“ITAR”) administered by the Department of State’s Directorate of Defense Trade Controls, require a license. Certain of our fiber optics products are subject to EAR and certain of our RF-over-fiber products, as well as certain products and technical data, are developed with government funding, and are currently subject to ITAR. Products and the associated technical data developed and manufactured in our foreign locations are subject to export controls of the applicable foreign nation.

Given the current global political climate, obtaining export licenses can be difficult and time-consuming. Failure to obtain export licenses for these shipments could significantly reduce our revenue and materially adversely affect our business, financial condition and results of operations. Compliance with U.S. government regulations also subjects us to additional fees and costs. The absence of comparable restrictions on competitors in other countries may adversely affect our competitive position.

Further, there is increased attention from the government, the media and regarding potential threats to U.S. national security and foreign policy relating to certain foreign entities, particularly Chinese entities, and the imposition of enhanced restrictions or sanctions regarding the export of our products or on specific foreign entities that would restrict their ability to do business with U.S. companies may materially adversely affect our business. For example, in April 2018, Zhongxing Telecommunications Equipment Corporation and ZTE Kangxun Communications Ltd. (collectively “ZTE”) were added to the U.S. Departments of Commerce’s Bureau of Industry and Security’s List of Denied Persons, which imposed a seven year denial of export privileges against ZTE. However, in July 2018, the denial of export privileges was suspended and ZTE was removed from the List of Denied Persons. We are aware that certain of our customers have been investigated by the U.S. government in the past and may be in the future.

Our association with customers that are or become subject to U.S. regulatory scrutiny or export restrictions could negatively impact our business. Governmental actions such as these could subject us to actual or perceived reputational harm among current or prospective investors, suppliers or customers, customers of our customers, other parties doing business with us, or the general public. Any such reputational harm could result in the loss of investors, suppliers or customers, which could harm our business, financial condition, operating results or prospects.

In addition, certain of our significant customers and suppliers have products that are subject to U.S. export controls, and therefore these customers and suppliers may also be subject to legal and regulatory consequences if they do not comply with applicable export control laws and regulations. Such regulatory consequences could disrupt our ability to obtain components from our suppliers, or to sell our products to major customers, which could significantly increase our costs, reduce our revenue and materially adversely affect our business, financial condition and results of operations.

If we fail to maintain an effective system of disclosure controls and internal control over financial reporting, our ability to produce timely and accurate financial statements or comply with applicable regulations could be impaired.

As a public company, we are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, or the Exchange Act, the Sarbanes-Oxley Act of 2002, as amended, or the Sarbanes-Oxley Act, and Nasdaq listing requirements. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, we have expended, and anticipate that we will continue to expend, significant resources, including accounting-related costs and significant management oversight.

Any failure to develop or maintain effective controls, or any difficulties encountered in their implementation or improvement, could cause us to delay reporting of our financial results, be subject to one or more investigations or enforcement actions by state

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or federal regulatory agencies, stockholder lawsuits or other adverse actions requiring us to incur defense costs, pay fines, settlements or judgments. Any such failures could also cause investors to lose confidence in our reported financial and other information, which would likely have a negative effect on the trading price of our common stock. In addition, if we are unable to continue to meet these requirements, we may not be able to remain listed on the NASDAQ stock market.

We face a number of risks related to our Separation from Viavi, including those associated with ongoing indemnification obligations and tax and accounting-related risks, which could adversely affect our business, financial condition, results of operations and cash flows.

In August 2015, we became an independent publicly-traded company through the distribution by JDS Uniphase Corporation ("JDSU") to its stockholders of 80.1% of our outstanding common stock (the "Separation"). The Separation and Distribution Agreement dated as of July 31, 2015 by and among JDSU, Lumentum Holdings Inc. and Lumentum Operations LLC (the "Separation Agreement") requires that we indemnify Viavi, and that Viavi indemnify us, for certain specified liabilities related to the Separation. Among other things, we are obligated to indemnify Viavi against certain tax-related liabilities that may result from the breach of any of our representations or covenants made in connection with the Separation. Our indemnification obligations are not subject to maximum loss clauses and, if we are required to indemnify Viavi under the circumstances set forth in the Separation Agreement, we may be subject to substantial liabilities. Furthermore, third parties could seek to hold us responsible for any of the liabilities that Viavi has agreed to indemnify us for, and there can be no assurance that the indemnity from Viavi will be sufficient to protect us against the full amount of such liabilities, or that Viavi will be able to fully satisfy its indemnification obligations.

Risks Related to Our Common Stock

Our stock price may be volatile and may decline regardless of our operating performance.

Our common stock is listed on NASDAQ under the symbol "LITE". Since shares of our common stock commenced trading on the NASDAQ stock market in August 2015, the reported high and low closing prices of our common stock per the NASDAQ Global Select Market has ranged from $14.12 to $73.20, through June 30, 2018. The market price of our common stock may fluctuate significantly due to a number of factors, some of which may be beyond our control, including:

- actual or anticipated fluctuations in our quarterly or annual operating results;
- changes in earnings estimates by securities analysts or our ability to meet those estimates;
- the operating and stock price performance of other comparable companies;
- a shift in our investor base;
- the financial performance of other companies in our industry;
- success or failure of our business strategy;
- credit market fluctuations which could negatively impact our ability to obtain financing as needed;
- changes to the regulatory and legal environment in which we operate;
- announcements by us, competitors, customers, or our contract manufacturers of significant acquisitions or dispositions, including our recently announced merger with Oclaro;
- investor perception of us and our industry;
- changes in accounting standards, policies, guidance, interpretations or principles;
- litigation or disputes in which we may become involved;
- overall market fluctuations; sales of our shares by our officers, directors, or significant stockholders;
- the timing and amount of dividends and share repurchases, if any; and
- general economic and market conditions and other external factors.

In addition, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many technology companies. Stock prices of many technology companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities class action litigation following periods of market volatility. If we were to become involved in securities

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litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business, results of operations, financial condition and cash flows.

Our proposed acquisition of Oclaro may not be completed, which could negatively affect our share price and our future business and financial results.

In March 2018, we announced that we signed a merger agreement to acquire Oclaro. Our and Oclaro's obligations to consummate the merger with Oclaro (the "Merger") are subject to the satisfaction or waiver of certain conditions. These conditions include, among other customary conditions, adoption by Oclaro stockholders of the Merger Agreement, which occurred on July 10, 2018, no action being taken by any governmental entity having jurisdiction enjoining or otherwise prohibiting consummation of the Merger or instituting proceedings seeking the same, no law having been passed by any governmental entity making the consummation of the Merger illegal, receipt of certain specified regulatory approvals in the United States and the People's Republic of China, which closing condition was satisfied with respect to the United States on April 4, 2018 when the parties received early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), approval by NASDAQ for listing of the shares of our common stock to be issued in the Merger, accuracy of representations and warranties of the parties to the applicable standard provided by the Merger Agreement, no event occurring that had or would reasonably be expected to have a Material Adverse Effect (as defined below in the Merger Agreement) on us or Oclaro, compliance by the parties with their covenants in the Merger Agreement in all material respects and the effectiveness of the registration statement relating to the Merger, which occurred on May 31, 2018.

Additionally, a portion of the cash consideration to be paid in connection with the Merger is being funded with the proceeds of debt financing commitments obtained by us. Although obtaining the proceeds of any debt financing, including the financing under the Commitment Letter, is not a condition to the consummation of the Merger, any failure by us to obtain any portion of the debt financing contemplated by the Commitment Letter (or any alternative financing) may result in the failure of the Merger to be consummated.

In addition, if the Merger is not completed on or before 5:00 p.m. Pacific Time on December 11, 2018 (subject to a potential extension to March 11, 2019), either we or Oclaro may choose to terminate the Merger Agreement. We or Oclaro may also elect to terminate the Merger Agreement in certain other circumstances, and the parties can mutually decide to terminate the Merger Agreement at any time prior to the closing of the Merger, before or after Merger has been approved by Oclaro's stockholders, as applicable.

If the Merger is terminated or otherwise not completed, we would not realize any of the expected benefits of the Merger and may suffer other consequences that could adversely affect our business, results of operations and stock price, including, among others:

- we could be required to pay a termination fee of up to $80.0 million under specified circumstances relating to failure to obtain regulatory approvals;
- we will have incurred and may continue to incur costs relating to the Merger, many of which are payable by us whether or not the Merger is completed;
- matters related to the Merger (including integration planning) require substantial commitments of time and resources by our management team and numerous others throughout our organization, which could otherwise have been devoted to other opportunities;
- we are, and may continue to be, subject to legal proceedings related to the Merger or the failure to complete the Merger, which could be time consuming and expensive, could divert our management's attention away from our regular business and, if any lawsuit is adversely resolved against us, could have a material adverse effect on our financial condition;
- the failure to complete the Merger may result in negative publicity and a negative perception of us in the investment community, which could negative impact on our stock price; and
- any disruptions to our business resulting from the announcement and pendency of the Merger, including any adverse changes in our relationships with our customers, suppliers, partners or employees, may continue to intensify in the event the Merger is not consummated.

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The Merger is subject to the expiration of an applicable waiting period under, and the receipt of approvals, consents or clearances from, antitrust regulatory authorities in the People's Republic of China that may impose conditions that could have an adverse effect on us or, if not obtained, could prevent completion of the Merger.

Before the Merger may be completed, the waiting period (or extension thereof) applicable to the Merger must have expired or been terminated, and any approvals, consents or clearances required in connection with the Merger must have been obtained, in each case, under the antitrust and competition laws of the People's Republic of China. In deciding whether to grant the required regulatory approval, consent or clearance, the relevant governmental authorities will consider the effect of the Merger on competition within their jurisdiction, and other considerations they may deem appropriate. The terms and conditions of the approvals, consents and clearances that are granted may impose requirements, limitations or costs or place restrictions on the conduct of our business, any of which may adversely affect our financial position and prospects and our ability to achieve the cost savings and other synergies projected to result from the Merger.

The terms and conditions of the approvals, consents and clearances that are granted may impose requirements, limitations or costs or place restrictions on the conduct of our business, any of which may adversely affect our financial position and prospects and our ability to achieve the cost savings and other synergies projected to result from the Merger.

We face risks if the Merger is completed, including those related to the integration of Oclaro's business, our cash resources and financial results, undisclosed liabilities, and employee and customer retention.

If the Merger is completed, we will be required to devote significant management attention and resources to integrating the business practices and operations of Oclaro with our business. Due to legal restrictions, we and Oclaro have only been able to conduct limited planning regarding the integration of Oclaro into our business after completion of the Merger and we have not yet determined the exact nature of how the businesses and operations of Oclaro will be run following the Merger. Potential difficulties we may encounter as part of the integration process include those related to the costs of integration and compliance, diversion of management's attention, our ability to create and enforce uniform standards, controls, procedures, policies and information systems, potential unknown liabilities, and unforeseen increased expenses or delays.

In connection with the Merger, we have agreed to pay an aggregate cash purchase price of approximately $416 million from the combined company's balance sheet. We have further entered into a commitment letter with Deutsche Bank Securities Inc. and Deutsche Bank AG New York, New York Branch (the "Commitment Party"), pursuant to which, subject to the terms and conditions set forth therein, the Commitment Party has committed to provide a senior secured term loan facility in an aggregate principal amount of up to $550 million with a provision for additional senior secured term loans in an aggregate principal amount not to exceed $250 million (collectively, the "Term Loan Facilities"). The use of a significant portion of our cash and the incurrence of substantial indebtedness in connection with the financing of the Merger will reduce our liquidity, and may limit our flexibility in responding to other business opportunities and increase our vulnerability to adverse economic and industry conditions.

Our due diligence review of Oclaro in connection with the Merger may not have discovered undisclosed liabilities of Oclaro. If Oclaro has undisclosed liabilities, Lumentum as a successor owner may be responsible for such undisclosed liabilities. Such undisclosed liabilities could have an adverse effect on the business and results of operations and may adversely affect the value of our common stock after the consummation of the Merger.

The Merger may also result in significant charges or other liabilities that could adversely affect our results of operations, such as cash expenses and non-cash accounting charges incurred in connection with our acquisition and/or integration of the business and operations of Oclaro. In addition, our failure to identify or accurately assess the magnitude of certain liabilities we are assuming in the Merger could result in unexpected litigation or regulatory exposure, unfavorable accounting charges, unexpected increases in taxes due, a loss of anticipated tax benefits or other adverse effects on our business, results of operations, financial condition or cash flows.

Uncertainties about the Merger may cause our or Oclaro's current and prospective employees to experience uncertainty about their futures. These uncertainties may impair our ability to retain, recruit or motivate key management, engineering, technical and other personnel. Similarly, our or Oclaro's existing or prospective customers, suppliers and/or partners may delay, defer or cease purchasing products or services from or providing products or services to us or Oclaro; delay or defer other decisions concerning us or Oclaro; or otherwise seek to change the terms on which they do business with us or Oclaro. Any of the above could harm us and/or Oclaro, and thus decrease the benefits we expect to receive from the Merger.

Furthermore, we face indirect reputational and business risks with respect to events that affect Oclaro’s business during the pendency of the transaction and following the closing. For example, Oclaro has publicly disclosed that ZTE has been among its customers. In April 2018, ZTE was added to the BIS’s List of Denied Persons. While ZTE was removed from the List of Denied Persons in July 2018, any of Oclaro’s customers that are, have been or become subject to U.S. regulatory scrutiny or export restrictions could negatively impact our business, including by subjecting us to actual or perceived reputational harm among current

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or prospective investors, suppliers or customers, customers of our customers, other parties doing business with us, or the general public. Any such reputational harm could result in the loss of investors, suppliers or customers, which could harm our business, financial condition, operating results or prospects. Any of these factors could adversely affect our ability following the Merger to maintain relationships with customers, suppliers, employees and other constituencies or its ability to achieve the anticipated benefits of the Merger, including anticipated synergies, or could reduce the earnings or otherwise adversely affect our business and financial results after the Merger.

We do not expect to pay dividends on our common stock.

We do not currently expect to pay dividends on our common stock. The payment of any dividends to our stockholders in the future, and the timing and amount thereof, if any, is within the discretion of our board of directors. Our board of directors' decisions regarding the payment of dividends will depend on many factors, such as our financial condition, earnings, capital requirements, potential debt service obligations or restrictive covenants, industry practice, legal requirements, regulatory constraints and other factors that our board of directors deems relevant.

In addition, because we are a holding company with no material direct operations, we are dependent on loans, dividends and other payments from our operating subsidiaries to generate the funds necessary to pay dividends on our common stock. However, our operating subsidiaries' ability to make such distributions will be subject to their operating results, cash requirements and financial condition and the applicable provisions of Delaware law that may limit the amount of funds available for distribution. Our ability to pay cash dividends may also be subject to covenants and financial ratios related to existing or future indebtedness, and other agreements with third parties.

The obligations of Lumentum Inc. to holders of its Series A Preferred Stock could have a negative impact on holders of our common stock.

Our subsidiary, Lumentum Inc., issued $35.8 million in Series A Preferred Stock to Viavi, which were sold to Amada following the Separation. The Series A Preferred Stock may be converted by Amada into shares of our common stock beginning on the second anniversary of the closing of the stock purchase (absent a change of control of us or similar event) using a conversion price of $24.63, which is equal to 125% of the volume weighted average price per share of our common stock in the five "regular-way" trading days following the Separation. Any shares of our common stock that may be issued upon conversion of the Series A Preferred Stock would dilute the ownership interests of existing stockholders and any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. The Series A Preferred Stock may be redeemed by us upon the third anniversary of the date of issuance or the preferred stockholders may cause us to redeem the Series A Preferred Stock upon the fifth anniversary of the date of issuance.

Cumulative senior dividends on the Series A Preferred Stock will accrue at the annual rate of 2.5%, but will be paid only when and if declared by the board of directors of Lumentum Inc. Our ability to make payments to holders of the Series A Preferred Stock ("Series A Holders") will depend on Lumentum Inc.'s ability to generate cash in the future from operations, financings or asset sales. Lumentum Inc.'s ability to generate cash is subject to general economic, financial, competitive, legislative, regulatory and other factors that we cannot control. The payment of this dividend will reduce the amount of cash otherwise available for distribution by Lumentum Inc. to us for further distribution to our common stockholders or for other corporate purposes. If Lumentum Inc. is in arrears on the payment of dividends to the Series A Holders, (i) Lumentum Inc. will not be able to pay any dividends to us, subject to certain exceptions, and (ii) we will not be able to make any distribution on or repurchase of our common stock.

Certain provisions in our charter and Delaware corporate law could hinder a takeover attempt.

We are subject to the provisions of Section 203 of the DGCL which prohibits us, under some circumstances, from engaging in business combinations with some stockholders for a specified period of time without the approval of the holders of substantially all of our outstanding voting stock. Such provisions could delay or impede the removal of incumbent directors and could make more difficult a merger, tender offer or proxy contest involving us, even if such events could be beneficial, in the short-term, to the interests of our stockholders. In addition, such provisions could limit the price that some investors might be willing to pay in the future for shares of our common stock. Our certificate of incorporation and bylaws contain provisions providing for the limitations of liability and indemnification of our directors and officers, allowing vacancies on our board of directors to be filled by the vote of a majority of the remaining directors, granting our board of directors the authority to establish additional series of preferred stock and to designate the rights, preferences and privileges of such shares (commonly known as “blank check preferred”) and providing that our stockholders can take action only at a duly called annual or special meeting of stockholders, which may only be called by the chairman of the board of directors, the chief executive officer or the board of directors. These provisions may also have the effect of deterring hostile takeovers or delaying changes in control or changes in our management.

Our bylaws designate Delaware courts as the sole and exclusive forum for certain types of actions and proceedings that may be initiated by our stockholders, which could discourage lawsuits against us or our directors and officers.
Our bylaws provide that, unless we consent in writing to an alternative forum, the state or federal courts of Delaware are the sole and exclusive forum for any derivative action or proceeding brought on our behalf; any action asserting breach of fiduciary duty, or other wrongdoing, by our directors, officers or other employees to us or our stockholders; any action asserting a claim against Lumentum pursuant to the Delaware General Corporation Law or our certificate of incorporation or bylaws; any action asserting a claim against Lumentum governed by the internal affairs doctrine; or any action to interpret, apply, enforce or determine the validity of our certificate of incorporation or bylaws. This exclusive forum provision may limit the ability of our stockholders to bring a claim in a judicial forum that such stockholders find favorable for disputes with us or our directors or officers, which may discourage such lawsuits against us or our directors and officers.
Alternatively, if a court outside of Delaware were to find this exclusive forum provision inapplicable to, or unenforceable in respect of, one or more of the specified types of actions or proceedings described above, we may incur additional costs associated with resolving such matters in other jurisdictions, which could adversely affect our business, financial condition or results of operations.
Servicing our 2024 Notes and the Term Loan Facilities may require a significant amount of cash, and we may not have sufficient cash flow or the ability to raise the funds necessary to satisfy our obligations under the 2024 Notes or the Term Loan Facilities, and our current and future indebtedness may limit our operating flexibility or otherwise affect our business.
Our ability to make scheduled payments of the principal of, to pay interest on or to refinance our indebtedness, including the 2024 Notes and, following the closing of the Term Loan Facilities, which is expected to occur substantially concurrently with the closing of the Merger, the Term Loan Facilities, or to make cash payments in connection with any conversion of 2024 Notes or upon any fundamental change if note holders require us to repurchase their notes for cash, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to service our indebtedness and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring indebtedness or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations. In addition, our existing and future indebtedness could have important consequences to our stockholders and significant effects on our business. For example, it could:

- make it more difficult for us to satisfy our debt obligations, including the 2024 Notes and the Term Loan Facilities;
- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- restrict us from exploiting business opportunities;
- place us at a competitive disadvantage compared to our competitors that have less indebtedness; and
- limit our availability to borrow additional funds for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy or other general purposes.

Transactions relating to our 2024 Notes may dilute the ownership interest of existing stockholders, or may otherwise depress the price of our common stock.
If the 2024 Notes are converted by holders, we have the ability under the indenture for the 2024 Notes to deliver cash, equity, common stock, or any combination of cash or common stock, at our election upon conversion of the 2024 Notes. If we elect to deliver common stock upon conversion of the 2024 Notes, it would dilute the ownership interests of existing stockholders. Any sales in the public market of the common stock issuable upon such conversion could adversely affect prevailing market prices of our common stock. In addition, certain holders of the 2024 Notes may engage in short selling to hedge their position in the 2024 Notes. Anticipated future conversions of such 2024 Notes

into shares of our common stock could depress the price of our common stock.

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The terms of the definitive documents governing the Term Loan Facilities will restrict our operations, particularly our ability to respond to changes or to take certain actions.

The definitive documents governing the Term Loan Facilities provided for in the Commitment Letter will contain a number of restrictive covenants that impose operating and financial restrictions on us and may limit its ability to engage in acts that may be in our long-term best interest, including restrictions on the ability to: incur indebtedness, grant liens, undergo certain fundamental changes, dispose of assets, make investments, enter into transactions with affiliates, and make certain restricted payments, in each case subject to limitations and exceptions to be set forth in the definitive documentation for the Term Loan Facilities.

The definitive documentation governing the Term Loan Facilities will also contain customary events of default that include, among other things, certain payment defaults, covenant defaults, cross-defaults to other indebtedness, change of control defaults, judgment defaults, and bankruptcy and insolvency defaults. Such events of defaults may allow the creditors to accelerate the related debt and may result in the acceleration of any other debt to which a cross-acceleration or cross-default provision applies which could have a material adverse effect on our business, operations and financial results. Furthermore, if we are unable to repay the amounts due and payable under the credit agreements, those lenders could proceed against the collateral granted to them to secure that indebtedness which could force us into bankruptcy or liquidation. In the event our lenders accelerated the repayment of the borrowings, we may not have sufficient assets to repay that indebtedness. Any acceleration of amounts due under the credit agreements would likely have a material adverse effect on us. As a result of these restrictions, we may be: limited in how we conduct business; unable to raise additional debt or equity financing to operate during general economic or business downturns; or unable to compete effectively or to take advantage of new business opportunities.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

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ITEM 2. PROPERTIES

We own and lease various properties in the United States and nine other countries around the world. We use the properties for executive and administrative offices, data centers, product development offices, customer service offices and manufacturing facilities. Our corporate headquarters of approximately 126,000 square feet is located in Milpitas, California. As of June 30, 2018, our leased and owned properties in total were approximately 1,200,000 square feet, of which we owned approximately 650,000 square feet, including a 560,000 square feet manufacturing site in Thailand. Larger leased sites include properties located in Canada, China and the United States. We believe our existing properties, including both owned and leased sites, are in good condition and suitable for the conduct of our business.

From time to time we consider various alternatives related to our long-term facilities' needs. While we believe our existing facilities are adequate to meet our immediate needs, it may become necessary to lease, acquire, or sell additional or alternative space to accommodate future business needs.

ITEM 3. LEGAL PROCEEDINGS

We are subject to a variety of claims and suits that arise from time to time in the ordinary course of our business. While management currently believes that resolving claims against us, individually or in the aggregate, will not have a material adverse impact on our financial position, results of operations or cash flows, these matters are subject to inherent uncertainties and management's view of these matters may change in the future. Were an unfavorable final outcome to occur, there exists the possibility of a material adverse impact on our financial position, results of operations or cash flows for the period in which the effect becomes reasonably estimable.

In connection with our acquisition of Oclaro, seven lawsuits were filed by purported stockholders of Oclaro challenging the proposed merger (the "Merger"). Two of the seven suits were putative class actions filed against Oclaro, its directors, Lumentum, Prota Merger Sub, Inc. and Prota Merger, LLC: Nicholas Neinast v. Oclaro, Inc., et al., No. 3:18-cv-03112-VC, in the United States District Court for the Northern District of California (filed May 24, 2018) (the "Neinast Lawsuit"); and Adam Franchi v. Oclaro, Inc., et al., No. 1:18-cv-00817-GMS, in the United States District Court for the District of Delaware (filed June 9, 2018) (the "Franchi Lawsuit). Both the Neinstat Lawsuit and the Franchi Lawsuit were voluntarily dismissed with prejudice.

The other five suits, styled as Gerald F. Wordehoff v. Oclaro, Inc., et al., No. 5:18-cv-03148-NC (the "Wordehoff Lawsuit"), Walter Ryan v. Oclaro, Inc., et al., No. 3:18-cv-03174-VC (the "Ryan Lawsuit"), Jayme Walker v. Oclaro, Inc., et al., No. 5:18-cv-03203-EJD (the "Walker Lawsuit"), Kevin Garcia v. Oclaro, Inc., et al., No. 5:18-cv-03262-VKD (the "Garcia Lawsuit"), and SaiSravan B. Karri v. Oclaro, Inc., et al., No. 3:18-cv-03435-JD (the "Karri Lawsuit" and, together with the other six lawsuits, the "Lawsuits"), were filed in the United States District Court for the Northern District of California on May 25, 2018, May 29, 2018, May 30, 2018, May 31, 2018, and June 9, 2018, respectively. These five Lawsuits named Oclaro and its directors as defendants only and did not name Lumentum. The Wordehoff, Ryan, Walker, and Garcia Lawsuits have been voluntarily dismissed, and the Wordehoff, Ryan, and Walker dismissals were with prejudice. The Karri Lawsuit has not yet been dismissed. The Ryan Lawsuit was, and the Karri Lawsuit is, a putative class action.

The Lawsuits generally alleged, among other things, that Oclaro and its directors violated Section 14(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 14a-9 promulgated thereunder by disseminating an incomplete and misleading Form S-4, including proxy statement/prospectus. The Lawsuits further alleged that Oclaro's directors violated Section 20(a) of the Exchange Act by failing to exercise proper control over the person(s) who violated Section 14(a) of the Exchange Act.

The remaining Lawsuit (the Karri Lawsuit) currently purports to seek, among other things, injunctive relief preventing the parties from consummating the Merger, damages to be awarded to the plaintiff and any class if the Merger is consummated, and litigation costs, including attorneys' fees. The defendants intend to defend the Karri Lawsuit vigorously.

ITEM 4. MINE SAFETY DISCLOSURES

None.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market Information for Common Stock and Stockholders

From August 4, 2015, our common stock has traded on the NASDAQ Stock Market under the symbol "LITE". The following table sets forth the range of high and low closing prices of our common stock per the NASDAQ Global Select Market for the periods indicated:

	High	Low
Fiscal 2018 Quarter Ended:		
June 30, 2018	$64.50	$50.20
March 31, 2018	$73.20	$42.60
December 30, 2017	$64.75	$46.40
September 30, 2017	$67.95	$50.80
Fiscal 2017 Quarter Ended:		
July 1, 2017	$65.10	$42.75
April 1, 2017	$54.70	$34.40
December 31, 2016	$44.50	$33.60
October 1, 2016	$41.99	$23.30

According to records of our transfer agent, we had 2,530 stockholders of record as of August 23, 2018 and we believe there is a substantially greater number of beneficial holders.

Dividends

Our subsidiary, Lumentum Inc., issued $35.8 million in Series A Preferred Stock to Viavi, which was sold to Amada following the Separation. Holders of Series A Preferred Stock, in preference to holders of Lumentum Inc.'s common stock or any other class or series of its outstanding capital stock ranking in any such event junior to the Series A Preferred Stock, are entitled to receive, when and as declared by the board of directors, quarterly cumulative cash dividends at the annual rate of 2.5% of the Issuance Value per share on each outstanding share of Series A Preferred Stock. The accrued dividends are payable on March 31, June 30, September 30 and December 31 of each year commencing on September 30, 2015. During fiscal 2018, Lumentum Inc. paid $0.7 million in dividends to the holders of Series A Preferred Stock.

Stock Performance Graph

This performance graph shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the Exchange Act), or incorporated by reference into any filing of Lumentum Holdings Inc. under the Securities Act of 1933, as amended, or the Exchange Act, except as shall be expressly set forth by specific reference in such filing.

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The following graph compares the cumulative total return of our common stock with the total return for the NASDAQ Composite Index (the "IXIC") and the NASDAQ 100 Technology Sector Index (the "NDXT") from August 4, 2015 through June 30, 2018. The stock price performance on the following graph is not necessarily indicative of future stock price performance.

Recent Sale of Unregistered Equity Securities

None.

Issuer Purchases of Equity Securities

None.

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ITEM 6. SELECTED FINANCIAL DATA

This table sets forth selected financial data of Lumentum (in millions, except share and per share amounts) for the periods indicated. This data should be read in conjunction with the discussion in “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in Item 7 of this Annual Report and our audited consolidated financial statements included in Item 8 of this Annual Report. The selected data in this section are not intended to replace the Consolidated Financial Statements included in this Annual Report.

Our historical consolidated financial statements include allocations of expenses arising from shared services and infrastructure provided by Viavi to us, including costs of information technology, human resources, accounting, legal, real estate and facilities, corporate marketing, insurance, treasury and other corporate and infrastructure services. There were no allocations of expenses from Viavi for the fiscal years ended June 30, 2018 or July 1, 2017. The financial information included here may not necessarily reflect our financial position and results of operations or what our financial position and results of operations would have been had we been an independent, publicly-traded company during the entirety of the periods presented or be indicative of our future performance as an independent company.

	Years Ended				
	June 30, 2018	July 1, 2017 (4)	July 2, 2016	June 27, 2015 (1)	June 28, 2014 (2)
Consolidated Statements of Operations Data:					
Net revenue	$1,247.7	$1,001.6	$903.0	$837.1	$817.9
Gross profit	432.1	318.1	277.3	257.9	256.6
Income (loss) from operations	139.9	47.6	11.5	(23.4)	8.7
Net (loss) income	248.1	(102.5)	9.3	(3.4)	10.7
Cumulative dividends on Series A Preferred Stock	(0.9)	(0.9)	(0.8)	—	—
Accretion of Series A Preferred Stock	—	—	(11.7)	—	—
Earnings allocated to Series A Preferred Stock	(5.7)	—	—	—	—
Net income (loss) attributable to common stockholders	$241.5	$(103.4)	$(3.2)	$(3.4)	$10.7
Net income (loss) per share attributable to common stockholders(3):					
Basic	$3.88	$(1.71)	$(0.05)	$(0.06)	$0.18
Diluted	$3.82	$(1.71)	$(0.05)	$(0.06)	$0.18
Shares used to compute net income (loss) per share attributable to common stockholders(3):					
Basic	62.3	60.6	59.1	58.8	58.8
Diluted	63.3	60.6	59.1	58.8	58.8

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	Balance as of				
	June 30, 2018	July 1, 2017 (4)	July 2, 2016	June 27, 2015 (1)	June 28, 2014 (2)
Consolidated Balance Sheet Data:					
Cash and cash equivalents	$397.3	$272.9	$157.1	$14.5	$19.9
Total assets	1,581.5	1,232.9	726.3	512.6	492.1
Convertible notes	334.2	317.5	—	—	—
Derivative liability	52.4	51.6	10.3	—	—
Other non-current liabilities	19.0	25.0	9.1	9.8	19.6
Total redeemable convertible preferred stock	35.8	35.8	35.8	—	—
Total stockholders' equity	926.1	618.8	497.4	380.6	335.6

(1) During the third quarter of fiscal 2015, we settled an audit in a non-U.S. jurisdiction which resulted in the recognition of a $21.8 million tax benefit. In addition, we recognized $14.1 million of additional deferred tax assets which were fully offset by a corresponding increase in the deferred tax valuation allowance.

(2) During the third quarter of fiscal 2014, we acquired Time-Bandwidth in a transaction accounted for in accordance with the authoritative guidance on business combinations. The Consolidated Statement of Operations for fiscal 2014 included the results of operations from Time-Bandwidth subsequent to the date of acquisition, and the Consolidated Balance Sheets as of June 28, 2014 included Time-Bandwidth's financial position.

(3) On August 1, 2015, JDSU distributed 47.1 million shares, or 80.1% of the outstanding shares of Lumentum common stock to existing holders of JDSU common stock. JDSU was renamed Viavi and at the time of distribution, retained 11.7 million shares, or 19.9% of Lumentum's outstanding shares. Basic and diluted net income (loss) per share for all periods through June 27, 2015 is calculated using the shares of Lumentum common stock outstanding on August 1, 2015. Refer to "Note 4. Earnings Per Share" in the Notes to Consolidated Financial Statements.

(4) During the third quarter of fiscal 2017, we completed the acquisition of a privately held company in accordance with the authoritative guidance on business combinations. Results of operations and financial position of the business acquired have been included in our consolidated financial statements subsequent to the date of acquisition.

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Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion in conjunction with the audited consolidated financial statements and the corresponding notes included elsewhere in this Annual Report. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. The matters discussed in these forward-looking statements are subject to risk, uncertainties and other factors that could cause actual results to differ materially from those made, projected or implied in the forward-looking statements. Please see "Risk Factors" and "Forward-Looking Statements" for a discussion of the uncertainties, risks and assumptions associated with these statements.

Overview

We are an industry leading provider of optical and photonic products defined by revenue and market share addressing a range of end-market applications including optical communications and commercial lasers. We have two operating segments: OpComms and Lasers. The two operating segments were primarily determined based on how the Chief Operating Decision Maker ("CODM") views and evaluates our operations. Operating results are regularly reviewed by the CODM to make decisions about resources to be allocated to the segments and to assess their performance. Other factors, including market separation and customer specific applications, go-to-market channels, products and manufacturing, are considered in determining the formation of these operating segments.

We see the world as becoming more reliant on ever-increasing amounts of data flowing through optical networks and data centers, which demand new networks and data centers to be built to satisfy this insatiable demand for data. As higher levels of precision, new materials, factory and energy efficiency are being demanded by manufacturers, suppliers of manufacturing tools globally are turning more and more to laser based approaches, including the types of lasers Lumentum supplies. Laser based 3D sensing is a rapidly developing market. The technology enables computer vision applications that enhance security, safety, and new functionality in the electronic devices that people rely on every day. We believe the global markets in which Lumentum participates have fundamentally robust, long-term trends that increase the need for our photonics products and technologies.

During fiscal 2018, we made good progress on our key strategic objectives that accelerated growth, margin expansion, and customer and end-market diversification. We ramped new major product lines in 3D sensing for mobile devices and engaged numerous customers globally, which we believe will facilitate future product and customer expansion.

OpComms

Our OpComms products address the following markets: Telecom, Datacom and Consumer and Industrial.

Our OpComms products include a wide range of components, modules and subsystems to support and maintain customers including carrier networks for access (local), metro (intracity), long-haul (city-to-city and worldwide) and, submarine (undersea). Additionally, our products address enterprise, cloud, and data center applications, including SANs, LANs, and WANs. These products enable the transmission and transport of video, audio and text data over high-capacity fiber-optic cables. We maintain leading positions in these fast growing OpComms markets through our extensive product portfolio, including ROADMs, tunable 10-gigabit small form-factor pluggable transceivers and tunable small form-factor pluggable transceivers. Our 10G, 40G legacy transceivers and a growing portfolio of 100G pluggable transceivers support LAN/SAN/WAN needs and the cloud for customers building enterprise and hyperscale data center networks. Additionally, we are engaging customers in the sale of laser chips for use in the manufacture of high-speed transceivers.

In the Consumer and Industrial market, our OpComms products include laser light sources, which are integrated into 3D sensing platforms being used in applications for mobile devices, gaming, computers, and other consumer electronics devices. New emerging applications include virtual and augmented reality, as well as automotive and industrial segments. Our products include VCSELs and edge emitting lasers which are used in 3D sensing depth imaging systems. These systems simplify the way people interact with technology by enabling the use of natural user interfaces. Systems are used for biometric identification, surveillance, and process efficiency, among numerous other application spaces. Emerging applications for this technology include various mobile device applications, autonomous vehicles, self-navigating robotics and drones in industrial applications and 3D capture of objects coupled with 3D printing. In addition, our industrial diode lasers are used primarily as pump sources for pulsed and CW Fiber Lasers.

Our OpComms customers include Accelink, Alphabet (formerly Google), Apple, Arista, Arris, Ciena, Cisco Systems, Coriant, ECI, Facebook, FiberHome, Fujitsu, HiSilicon, Huawei Marine, Huawei Technologies, Infinera, Microsoft, NEC, Nokia Networks (including Alcatel-Lucent International), O-Net, Oplink, Padtec, TE Subcom, and Yahoo.

Lasers

Our Lasers products serve our customers in markets and applications such as sheet metal processing, general manufacturing, biotechnology, graphics and imaging, remote sensing, and precision machining such as drilling in printed circuit boards, wafer singulation, glass cutting and solar cell scribing.

Our Lasers products are used in a variety of OEM applications including diode-pumped solid-state, fiber, diode, direct-diode and gas lasers such as argon-ion and helium-neon lasers. Fiber lasers provide kW-class output powers combined with excellent beam quality and are used in sheet metal processing and metal welding applications. Diode-pumped solid-state lasers provide excellent beam quality, low noise and exceptional reliability and are used in biotechnology, graphics and imaging, remote sensing, materials processing and precision machining applications. Diode and direct-diode lasers address a wide variety of applications, including laser pumping, thermal exposure, illumination, ophthalmology, image recording, printing, plastic welding and selective soldering. Gas lasers such as argon-ion and helium-neon lasers provide a stable, low-cost and reliable solution over a wide range of operating conditions, making them well suited for complex, high-resolution OEM applications such as flow cytometry, DNA sequencing, graphics and imaging and semiconductor inspection.

We also provide high-powered and ultrafast lasers for the industrial and scientific markets. Manufacturers use high-power, ultrafast lasers to create micro parts for consumer electronics and to process semiconductor, LED, and other types of chips. Use of ultrafast lasers for micromachining applications is being driven primarily by the increasing use of consumer electronics and connected devices globally.

Our Lasers customers include Amada, ASML Holding, Beckman Coulter, Becton, Dickinson and Company, DISCO, Electro Scientific Industries, EO Technics, Han’s Laser Technology, and KLA-Tencor.

Acquisition of Oclaro

On March 11, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Oclaro, Inc. (“Oclaro”), Prota Merger Sub, Inc., and Prota Merger, LLC, pursuant to which we will acquire Oclaro and Oclaro will become a wholly-owned subsidiary of Lumentum. In accordance with the terms of the Merger Agreement, each issued and outstanding share of Oclaro common stock will be exchanged for $5.60 in cash and 0.0636 of a share of Lumentum common stock, subject to the conditions and restrictions set forth in the Merger Agreement. The total transaction consideration was approximately $1.8 billion as of the date of the Merger Agreement. Oclaro stockholders will own approximately 16% of the combined company following the closing. Oclaro’s stockholders approved the Merger Agreement on July 10, 2018 and we have received approval for the transaction under the Hart-Scott Rodino Act in the United States. We are in the process of obtaining antitrust approval in China. The Merger Agreement contains certain termination rights for both Lumentum and Oclaro. The Merger Agreement further provides that upon termination of the Merger Agreement under specified circumstances relating to failure to obtain regulatory approvals, Lumentum may be required to pay Oclaro a termination fee of $80 million.

As of August 23, 2018, the total transaction consideration was expected to be approximately $1.7 billion, which would be funded by a combination of $700 million in Lumentum common stock, $500 million in new debt, and the remaining amount from the cash balances of the combined company.

Separation from JDSU

Lumentum Holdings Inc. was incorporated in Delaware as a wholly owned subsidiary of JDS Uniphase Corporation (“JDSU”) on February 10, 2015 and is comprised of the former communications and commercial optical products (“CCOP”) segment and the WaveReady product lines of JDSU. On August 1, 2015, we became an independent publicly-traded company through the distribution by JDSU to its stockholders of 80.1% of our outstanding common stock (the “Separation”). Each JDSU stockholder of record as of the close of business on July 27, 2015 received one share of Lumentum common stock for every five shares of JDSU common stock held on the record date. JDSU was renamed Viavi in connection with the Separation and retained ownership of 19.9% of Lumentum’s outstanding shares. Since the Separation, Viavi has sold a significant portion of its shares and is no longer a significant shareholder of Lumentum.

On July 31, 2015, prior to the Separation, Viavi transferred substantially all of the assets and liabilities and operations of the CCOP segment and WaveReady product lines to Lumentum. Our financial statements for periods prior to the Separation were prepared on a stand-alone basis and were derived from Viavi’s consolidated financial statements and accounting records. For the period from June 28, 2015 to August 1, 2015, expenses were allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services provided to or benefits received by us.

The consolidated financial statements include certain assets and liabilities that were historically held at the Viavi level but which were transferred to us in the Separation. Viavi’s debt and related interest expense were not attributed or allocated to us for the periods presented since we are not the legal obligor of the debt and Viavi's borrowings were not directly attributable to us. Certain intercompany transactions between us and Viavi were considered to be effectively settled in the consolidated financial statements at the time the transactions were recorded. The total net effect of the settlement of these intercompany transactions is reflected in our consolidated statements of cash flows as a financing activity and on the consolidated balance sheets as Viavi net investment.

The consolidated statements of operations include our direct expenses for cost of sales, R&D, sales and marketing, and administration as well as allocations of expenses arising from shared services and infrastructure provided by Viavi to us through the Separation. These allocated expenses include costs of information technology, human resources, accounting, legal, real estate and facilities, corporate marketing, insurance, treasury and other corporate and infrastructure services. In addition, other costs allocated to us include restructuring and stock-based compensation related to Viavi's corporate and shared services employees as well as other public company costs. These expenses were allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services provided to or benefits received by our business. The allocation methods include revenue, headcount, square footage, actual consumption and usage of services and others.

There were no allocations of expenses from Viavi for the fiscal years ended June 30, 2018 or July 1, 2017. Refer to "Note 3. Related Party Transactions" in the Notes to Consolidated Financial Statements for allocations during the fiscal year ended July 2, 2016.

Critical Accounting Policies and Estimates

The preparation of the consolidated financial statements in accordance with U.S. generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact us in the future, actual results may be different from the estimates. Our critical accounting policies are those that affect our financial statements materially and involve difficult, subjective or complex judgments by management. Those policies are short-term investments, impairment of marketable and non-marketable securities, inventory valuation, goodwill and intangibles, long-lived asset valuation, pension benefits, revenue recognition, stock-based compensation, income taxes, restructuring, derivative liabilities, business combinations, and warranty.

Our consolidated financial statements are prepared in accordance with GAAP as set forth in the Financial Accounting Standards Board's Accounting Standards Codification ("ASC"), and we consider the various staff accounting bulletins and other applicable guidance issued by the United States Securities and Exchange Commission ("SEC"). GAAP, as set forth within the ASC, requires us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are differences between these estimates, judgments or assumptions and actual results, our financial statements will be affected. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

- Inventory Valuation
- Revenue Recognition
- Income Taxes
- Long-lived Asset Valuation
- Warranty
- Derivative Liability
- Business Combinations
- Goodwill

On March 11, 2018, we entered into an Agreement and Plan of Merger with Oclaro, Prota Merger Sub, Inc., and Prota Merger, LLC, which was unanimously approved by the boards of directors of both Lumentum and Oclaro. The transaction is subject to customary closing conditions and is expected to close in the second half of calendar 2018. We added Business Combinations and Goodwill to our critical accounting policies and estimates in the third quarter of fiscal 2018.

Inventory Valuation

Inventory is valued at standard cost, which approximates actual cost computed on a first-in, first-out basis, not in excess of net realizable value. We assess the value of our inventory on a quarterly basis and write down those inventories which are obsolete or in excess of our forecasted usage to the lower of their cost or estimated net realizable value. Our estimates of realizable value are based upon our analysis and assumptions including, but not limited to, forecasted sales levels and historical usage by product, expected product lifecycle, product development plans and future demand requirements. Our product line management personnel play a key role in our excess review process by providing updated sales forecasts, managing product transitions and working with manufacturing to minimize excess inventory. If actual market conditions are less favorable than our forecasts or actual demand from our customers is lower than our estimates, we may be required to record additional inventory write-downs. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower cost of sales and higher income from operations than expected in that period.

Revenue Recognition

During the periods presented, we recognized revenue when all four revenue recognition criteria have been met: (i) persuasive evidence of an arrangement exists, (ii) the product has been delivered or the service has been rendered, (iii) the price is fixed or determinable and (iv) collection is reasonably assured. Revenue from product sales is recorded when all of the foregoing conditions are met and risk of loss and title passes to the customer. Our products typically include a warranty and the estimated cost of product warranty claims, based on historical experience, is recorded at the time the sale is recognized. Sales to customers are generally not subject to price protection or return rights. The majority of our sales are made to OEMs, distributors, resellers and end-users.

We record as a reduction to revenues reserves for sales returns based upon historical experience rates and for any specific known customer amounts. We also provide certain distributors and OEMs with volume-pricing discounts, such as rebates and incentives, which are recorded as a reduction to revenues at the time of sale. Historically these volume discounts have not been significant. For revenue recognition changes related to implementation of ASU 2014-09, refer to “Note 2. Recent Accounting Pronouncements”.

Income Taxes

In accordance with the authoritative guidance on accounting for income taxes, we recognize income taxes using an asset and liability approach. This approach requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. The measurement of current and deferred taxes is based on provisions of the enacted tax law, and the effects of future changes in tax laws or rates are not anticipated.

The authoritative guidance provides for recognition of deferred tax assets if the realization of such deferred tax assets is more likely than not to occur based on an evaluation of both positive and negative evidence and the relative weight of the evidence. We consider future growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate, historical earnings, taxable income in prior years, if carryback is permitted under the law, and prudent and feasible tax planning strategies in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets valuation allowance would be charged to earnings in the period in which we make such a determination, or goodwill would be adjusted at our final determination of the valuation allowance related to an acquisition within the measurement period. If we later determine that it is more likely than not that the net deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance as an adjustment to earnings at such time.

We are subject to income tax audits by the respective tax authorities of the jurisdictions in which we operate. The determination of our income tax liabilities in each of these jurisdictions requires the interpretation and application of complex, and sometimes uncertain, tax laws and regulations. The authoritative guidance on accounting for income taxes prescribes both recognition and measurement criteria that must be met for the benefit of a tax position to be recognized in the financial statements. If a tax position taken, or expected to be taken, in a tax return does not meet such recognition or measurement criteria, an unrecognized tax benefit liability is recorded. If we ultimately determine that an unrecognized tax benefit liability is no longer necessary, we reverse the liability and recognize a tax benefit in the period in which it is determined that the unrecognized tax benefit liability is no longer necessary.

The recognition and measurement of current taxes payable or refundable and deferred tax assets and liabilities requires that we make certain estimates and judgments. Changes to these estimates or a change in judgment may have a material impact on our tax provision in a future period.

Long-lived Asset Valuation

We test long-lived assets for recoverability, at the asset group level, when events or changes in circumstances indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to: significant decreases in the market price of the asset, significant adverse changes in the business climate or legal factors, accumulation of

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costs significantly in excess of the amount originally expected for the acquisition or construction of the asset, current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset, or current expectation that the asset will more likely than not be sold or disposed significantly before the end of its estimated useful life.

Recoverability is assessed based on the difference between the carrying amount of the asset and the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

Warranty

We provide reserves for the estimated costs of product warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our historical experience of known product failure rates, use of materials to repair or replace defective products and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise.

Derivative Liability

The Series A Preferred Stock issued by our subsidiary Lumentum Inc. is redeemable at the option of the holder after five years and classified as non-controlling interest redeemable convertible preferred stock in our consolidated balance sheet and is measured at its redemption value. The Series A Preferred Stock conversion feature is bifurcated from the Series A Preferred Stock and accounted for separately as a derivative liability. In March 2017, we issued $450.0 million in aggregate principal amount of 0.25% Convertible Senior Notes due in March 2024 (the “2024 Notes”), unless earlier repurchased by us or converted pursuant to their terms. Prior to the Tax Matters Agreement settlement condition (“TMA settlement condition”), because we could only settle the 2024 Notes in cash, we determined that the conversion feature met the definition of a derivative liability. We separated the derivative liability from the host debt instrument based on the fair value of the derivative liability. On June 29, 2017, we met the requirements to account for the conversion option of the 2024 Notes as equity and the conversion option is no longer marked to market. On a quarterly basis, the derivative liability for the Series A Preferred Stock is marked to market based on the fair value of the conversion feature, with the resulting income or loss recorded as unrealized loss on the derivative liabilities on our consolidated statements of operations. The determination of fair value includes various inputs, including volatility and interest rate assumptions. However, the change in the fair value of our common stock has the largest impact to the fair value of the derivatives. During fiscal 2018, 2017, and 2016, we recognized unrealized loss on derivative liabilities of $0.8 million, $104.2 million, and $0.6 million, respectively.

Business Combinations

In accordance with the guidance for business combinations, we determine whether a transaction or other event is a business combination, which requires that the assets acquired and liabilities assumed constitute a business. Each business combination is then accounted for by applying the acquisition method. If the assets acquired are not a business, we account for the transaction or other event as an asset acquisition. Under both methods, we recognize the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired entity. We capitalize acquisition-related costs and fees associated with asset acquisitions and immediately expense acquisition-related costs and fees associated with business combinations.

We allocate the fair value of purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, we make significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer relationships and acquired developed technology and discount rates. Our estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ materially from estimates. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed. Any change in facts and circumstances that existed as of the acquisition date and impacts our preliminary estimates is recorded to goodwill if identified within the measurement period. Subsequent to the measurement period or our final determination of fair value of assets and liabilities whichever is earlier the adjustments will affect our earnings.

In addition, we estimate the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expense. If our estimates of the economic lives change, depreciation or amortization expenses could be accelerated or slowed.

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Goodwill

Goodwill represents the excess of the purchase price of an acquired business over the fair value of the identifiable assets acquired and liabilities assumed. We test for impairment of goodwill on an annual basis in the fourth quarter and at any other time when events occur or circumstances indicate that the carrying amount of goodwill may not be recoverable.

An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines that as a result of the qualitative assessment that it is more likely than not (i.e., greater than 50% likelihood) that the fair value of a reporting unit is less than its carrying amount, then the quantitative test is required. Otherwise, no further testing is required. The two-step quantitative goodwill impairment test requires us to estimate the fair value of our reporting units. If the carrying value of a reporting unit exceeds its fair value, the goodwill of that reporting unit is potentially impaired and we proceed to step two of the impairment analysis. In step two of the analysis, we measure and record an impairment loss equal to the excess of the carrying value of the reporting unit's goodwill over its implied fair value, if any.

Application of the goodwill impairment test requires judgments, including: identification of the reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, a qualitative assessment to determine whether there are any impairment indicators, and determining the fair value of each reporting unit. We estimate the fair value of a reporting unit using market approach, income approach or a combination of market and income approach. Significant estimates in the market approach include: identifying similar companies with comparable business factors such as size, growth, profitability, risk and return on investment, and assessing comparable revenue and operating income multiples in estimating the fair value of the reporting unit. Significant estimates in the income approach include: future cash flows, discount rates.

We base our estimates on historical experience and on various assumptions about the future that we believe are reasonable based on available information. Unanticipated events and circumstances may occur that affect the accuracy of our assumptions, estimates and judgments. For example, if the price of our common stock were to significantly decrease combined with other adverse changes in market conditions, thus indicating that the underlying fair value of our reporting units may have decreased, we might be required to reassess the value of our goodwill in the period such circumstances were identified.

Based on the impairment analysis performed in the fourth quarter of each year presented, the fair value of our reporting unit substantially exceeded the carrying value; as such, our annual qualitative assessment did not indicate that a more detailed quantitative analysis was necessary.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result. Our senior management has reviewed our critical accounting policies and related disclosures with the Audit Committee of our board of directors.

Recently Issued Accounting Pronouncements

Refer to "Note 2. Recent Accounting Pronouncements" in the Notes to Consolidated Financial Statements.

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RESULTS OF OPERATIONS

The results of operations for the periods presented are not necessarily indicative of results to be expected for future periods. The following table summarizes selected Consolidated Statements of Operations items as a percentage of net revenue:

	Years Ended June 30, 2018	July 1, 2017	July 2, 2016
Segment net revenue:			
OpComms	84.9 %	85.6 %	84.3 %
Lasers	15.1	14.4	15.7
Net revenue	100.0	100.0	100.0
Cost of sales	65.1	67.6	68.5
Amortization of acquired developed technologies	0.3	0.6	0.8
Gross profit	34.6	31.8	30.7
Operating expenses:			
Research and development	12.6	14.8	15.6
Selling, general and administrative	10.3	11.0	13.0
Restructuring and related charges	0.6	1.2	0.8
Total operating expenses	23.4	27.0	29.4
Income from operations	11.2	4.8	1.3
Unrealized loss on derivative liabilities	(0.1)	(10.4)	(0.1)
Interest and other income (expense), net	(0.8)	(0.3)	(0.1)
Income (loss) before income taxes	10.4	(6.0)	1.1
Provision for (benefit from) income taxes	(9.5)	4.3	0.1
Net income (loss)	19.9 %	(10.2)%	1.0 %

Financial Data for Fiscal 2018, 2017 and 2016

The following table summarizes selected Consolidated Statements of Operations items (in millions, except for percentages):

	2018	2017	Change	Percentage Change	2017	2016	Change	Percentage Change
Segment net revenue:								
OpComms	$1,059.2	$857.8	$201.4	23.5 %	$857.8	$761.3	$96.5	12.7 %
Lasers	188.5	143.8	44.7	31.1	143.8	141.7	2.1	1.5
Net revenue	$1,247.7	$1,001.6	$246.1	24.6 %	$1,001.6	$903.0	$98.6	10.9 %
Gross profit	$432.1	$318.1	$114.0	35.8 %	$318.1	$277.3	$40.8	14.7 %
Gross margin	34.6 %	31.8 %			31.8 %	30.7 %		
Research and development	$156.8	$148.3	$8.5	5.7 %	$148.3	$141.1	$7.2	5.1 %
Percentage of net revenue	12.6 %	14.8 %			14.8 %	15.6 %		
Selling, general and administrative	$128.2	$110.2	$18.0	16.3 %	$110.2	$117.3	$(7.1)	(6.1)%
Percentage of net revenue	10.3 %	11.0 %			11.0 %	13.0 %		
Restructuring and related charges	$7.2	$12.0	$(4.8)	(40.0)%	$12.0	$7.4	$4.6	62.2 %
Percentage of net revenue	0.6 %	1.2 %			1.2 %	0.8 %		

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Net Revenue

Net revenue increased by $246.1 million, or 24.6% during fiscal 2018 compared to fiscal 2017. This increase was primarily due to record revenues in 3D sensing, TrueFlex® ROADMs, commercial lasers, and industrial diode lasers.

OpComms net revenue increased $201.4 million, or 23.5%, during fiscal 2018 compared to fiscal 2017, driven by increased sales of Consumer and Industrial products of $386.7 million, primarily in 3D sensing for mobile devices and engage numerous customers globally, partially offset by decreased sales of Telecom and Datacom products.

Lasers net revenue increased $44.7 million, or 31.1%, in fiscal 2018 compared to fiscal 2017, primarily due to increased sales of our kilowatt class fiber lasers. Growth was driven by strong demand from customers in both the micro and macro material processing markets.

Net revenue increased by $98.6 million, or 10.9%, during fiscal 2017 compared to fiscal 2016. This increase was primarily due to an increase in net revenue from our OpComms segment. OpComms net revenue increased $96.5 million, or 12.7%, during fiscal 2017 compared to fiscal 2016, driven by increases from Telecom and 100G Datacom products. Lasers net revenue increased $2.1 million, or 1.5%, in fiscal 2017 compared to fiscal 2016.

During our fiscal 2018, 2017, and 2016, net revenue generated from a single end customer that represented 10% or greater of total net revenue is summarized as follows:

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
APPLE	30.0%	*	*
HUAWEI	11.0%	16.7%	17.1%
CIENA	11.0%	18.5%	17.1%
CISCO	*	12.4%	13.0%

*Represents less than 10% of total net revenue

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Revenue by Region

We operate in three geographic regions: Americas, Asia-Pacific and EMEA. Net revenue is assigned to the geographic region and country where our product is initially shipped. For example, certain customers may request shipment of our product to a contract manufacturer in one country, however, the location of the end customers may differ. The following table presents net revenue by the three geographic regions we operate in and net revenue from countries that represented 10% or more of our total net revenue (in millions, except for percentages):

	Years Ended					
	June 30, 2018		July 1, 2017		July 2, 2016	
Net revenue:						
Americas:						
United States	$115.1	9.2 %	$147.9	14.8%	$162.3	18.0%
Mexico	145.8	11.7	185.1	18.5	112.9	12.5
Other Americas	7.0	0.6	9.2	0.9	19.6	2.2
Total Americas	$267.9	21.5%	$342.2	34.2%	$294.8	32.7%
Asia-Pacific:						
Hong Kong	$183.0	14.7%	$226.7	22.6%	$214.0	23.7%
Japan	194.7	15.6	99.2	9.9	92.9	10.3
South Korea	146.1	11.7	4.9	0.5	3.8	0.4
Other Asia-Pacific	354.2	28.3	220.5	22.0	174.0	19.2
Total Asia-Pacific	$878.0	70.3%	$551.3	55.0%	$484.7	53.6%
EMEA	$101.8	8.2 %	$108.1	10.8%	$123.5	13.7%
Total net revenue	$1,247.7		$1,001.6		$903.0	

During fiscal 2018, 2017 and 2016, net revenue from customers outside the United States, based on customer shipping location, represented 90.8%, 85.2% and 82.0% of net revenue, respectively.

Our net revenue is primarily denominated in U.S. dollars, including our net revenue from customers outside the United States as presented above. We expect revenue from customers outside of the United States to continue to be an important part of our overall net revenue and an increasing focus for net revenue growth opportunities. However, regulatory and enforcement actions by U.S. and other governmental agencies, as well as changes in tax and trade policies and tariffs, may impact net revenue from customers outside the United States in future periods.

Gross Margin and Segment Gross Margin

The following table summarizes segment gross margin for fiscal 2018, 2017 and 2016 (in millions, except for percentages):

	Gross Profit			Gross Margin		
	2018	2017	2016	2018	2017	2016
OpComms	$402.3	$287.3	$236.3	38.0%	33.5%	31.0%
Lasers	82.8	59.9	61.4	43.9%	41.7%	43.3%
Segment total	$485.1	$347.2	$297.7	38.9%	34.7%	33.0%
Unallocated corporate items [(1)]	(53.0)	(29.1)	(20.4)			
Total	$432.1	$318.1	$277.3	34.6%	31.8%	30.7%

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(1) The unallocated corporate items for the years presented include the effects of amortization of acquired developed technologies, share-based compensation and certain other charges. We do not allocate these items to the gross margin for each segment because management does not include such information in measuring the performance of the operating segments.

The increase in unallocated corporate items during fiscal 2018 compared to fiscal 2017, primarily relates to set-up costs of our facility in Thailand, including costs of transferring the manufacturing of product lines to Thailand of $27.0 million in our fiscal 2018 compared to $1.8 million in fiscal 2017. The increase in unallocated corporate items during fiscal 2017 compared to fiscal 2016, primarily relates to inventory write-downs due to canceled programs not allocated to the segments of $7.9 million incurred in fiscal 2017.

Gross Margin

Gross margin in fiscal 2018 increased to 34.6% from 31.8% in fiscal 2017. The increase was primarily due to increased sales in our 3D sensing and lasers products, which have higher gross margins than the average for the Company. The increase was partially offset by underutilized capacity costs due to the decline in Telecom and Datacom demand, higher write-downs of excess and obsolete inventory of $1.2 million, as well as set-up costs of our facility in Thailand, including costs of transferring product lines to Thailand of $27.0 million in our fiscal 2018 compared to $1.8 million in fiscal 2017.

Gross margin in fiscal 2017 increased to 31.8% from 30.7% in fiscal 2016. This increase was primarily due to an increase in OpComms gross margins, partially offset by a decrease in Lasers gross margins.

We sell products in certain markets that are consolidating, undergoing product, architectural and business model transitions, have high customer concentrations, are highly competitive, are price sensitive and/or are affected by customer seasonal and mix variant buying patterns. We expect these factors to continue to result in variability of our gross margin.

Segment Gross Margin

OpComms

OpComms gross margin in fiscal 2018 increased to 38.0% from 33.5% in fiscal 2017. This increase was primarily due to increased sales of our 3D sensing products, which have higher gross margins than the average for the segment. The increase was partially offset by underutilized capacity costs due to the decline in Telecom and Datacom demand.

OpComms gross margin in fiscal 2017 increased to 33.5% from 31.0% in fiscal 2016. This increase was primarily due to higher revenue volume and product mix.

Lasers

Lasers gross margin in fiscal 2018 increased to 43.9% from 41.7% in fiscal 2017. This increase was primarily due to increased sales of solid state lasers products, which have higher gross margins than the average for the segment.

Lasers gross margin in fiscal 2017 decreased to 41.7% from 43.3% in fiscal 2016. This decrease was primarily due to higher manufacturing and warranty costs.

Research and Development

R&D expense increased by $8.5 million, or 5.7%, in fiscal 2018 compared to fiscal 2017. The increase in R&D expense was primarily due to the increase in stock-based compensation of $2.6 million and payroll related expense of $4.1 million, which includes an increase in variable incentive compensation of $2.9 million.

R&D expense increased by $7.2 million, or 5.1%, in fiscal 2017 compared to fiscal 2016. The increase in R&D expense was primarily due to the increase in the payroll related expense of $8.6 million, which includes an increase of stock-based compensation of $2.6 million. This was partially offset by higher partner reimbursements for development expense.

We believe that continuing our investments in R&D is critical to attaining our strategic objectives. We plan to continue to invest in R&D and new products that we believe will further differentiate us in the marketplace and expect our investment to increase in absolute dollars in future quarters.

Selling, General and Administrative

SG&A expense increased $18.0 million, or 16.3%, in fiscal 2018 compared to fiscal 2017. The increase was primarily attributable to increases in stock based compensation of $6.4 million and payroll related expense of $10.5 million, which includes

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an increase in variable incentive compensation of $3.8 million. We also incurred $4.8 million of costs related to the planned acquisition of Oclaro during our fiscal 2018.

SG&A expense decreased $7.1 million, or 6.1%, in fiscal 2017 compared to fiscal 2016. The decrease was primarily a result of reduced separation related charges and restructuring expenses of $13.6 million. This decrease was partially offset by an increase in payroll related expense of $7.8 million and an increase in stock-based compensation of $1.8 million.

We expect to experience in the future certain non-core expenses, such as mergers and acquisition-related expenses and litigation expenses, which will likely increase our SG&A expenses and potentially impact our profitability expectations in any particular quarter.

Restructuring and Related Charges

We have reduced costs through targeted restructuring efforts intended to consolidate our operations, rationalize the manufacturing of our products and align our business in response to market conditions. Refer to "Note 14. Restructuring and Related Charges" in the Notes to Consolidated Financial Statements.

During fiscal 2018, we recorded $7.2 million in restructuring and related charges in the consolidated statements of operations.

- During the fourth quarter of fiscal 2018, we initiated a new restructuring plan in order to realign the organization and enable further investment in key priority areas. As a result, a restructuring charge of $3.4 million was recorded for severance costs and employee benefits. In total, 52 employees in manufacturing, R&D and SG&A functions were terminated in connection with this new restructuring plan.
- We also incurred restructuring and related charges of $3.8 million from restructuring plans approved prior to fiscal 2016 primarily related to the shut down of our manufacturing facility in Bloomfield, Connecticut as a result of the transfer of certain production processes into existing sites in the United States or to contract manufacturers.

During fiscal 2017, we recorded $12.0 million in restructuring and related charges. Of the $12.0 million charge recorded during fiscal 2017, $2.1 million related to severance, retention and employee benefits.

During fiscal 2016, we recorded $7.7 million in restructuring and related charges.

- During the fourth quarter of fiscal 2016, management approved a plan to optimize operations and gain efficiencies throughout the organization. As a result, a restructuring charge of $0.7 million was recorded for severance and employee benefits during fiscal 2016. In total, 18 employees in manufacturing, R&D and SG&A functions were terminated in connection with this restructuring plan. Payments related to the remaining severance and benefits accrual have been paid in full.
- We also incurred restructuring and related charges of $7.0 million from restructuring plans approved prior to fiscal 2016 primarily related to manufacturing transfer costs for transfer of certain production processes into existing sites in the United States or to contract manufacturers.

Interest and Other Income (Expense), Net

The components of interest and other income (expense), net are as follows (in millions):

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Interest expense	$(18.2)	$(5.5)	$(0.1)
Foreign exchange gains (losses), net	(0.3)	0.6	(0.9)
Interest income	8.5	1.1	—
Other income (expense), net	0.3	0.6	(0.2)
Interest and other income (expense), net	$(9.7)	$(3.2)	$(1.2)

During fiscal 2018, interest and other income (expense), net increased by $6.5 million compared to fiscal 2017, driven by amortization of the debt discount on the 2024 Notes of $16.7 million in our fiscal 2018 compared to $5.1 million in fiscal 2017, partially offset by interest income on the short-term investments and cash equivalents of $8.5 million in our fiscal 2018 compared to $1.1 million in fiscal 2017. Refer to "Note 11. Convertible Senior Notes"

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Interest and other income (expense), net was $(3.2) million in fiscal 2017 as compared to $(1.2) million in fiscal 2016. The $2.0 million change was primarily due to amortization of the debt discount on the 2024 Notes in fiscal 2017 of $5.1 million offset by interest income on the short-term investments and cash equivalents of $1.1 million.

Unrealized Gain (Loss) on Derivative Liabilities

Unrealized loss on Series A Preferred Stock derivative liability amounted to $0.8 million, $41.3 million, and $0.6 million for the fiscal years 2018, 2017, and 2016, respectively. The change is primarily related to the change in the price of our underlying common stock and is reflected in the consolidated statements of operations as "Unrealized gain (loss) on derivative liabilities". For further discussion of our derivative liability, see "Note 12. Derivative Liability" in the Notes to Consolidated Financial Statements.

Unrealized loss on the derivate liability from the 2024 Notes in the amount of $62.9 million is also included in the "Unrealized gain (loss) on derivative liabilities" of our consolidated statements of operations for the year ended July 1, 2017. On June 29, 2017, we met the requirements to account for the conversion option of the 2024 Notes as equity and the conversion option is no longer marked to market. Refer to "Note 11. Convertible Senior Notes" in the Notes to Consolidated Financial Statements.

Provision for (Benefit from) Income Taxes (in millions)

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Provision for (benefit from) income taxes	$(118.7)	$42.7	$ 0.4

We recorded a provision (benefit) for income taxes of $(118.7) million, $42.7 million, and $0.4 million in fiscal 2018, 2017, and 2016, respectively.

Our provision for income taxes for fiscal 2018 differed from the tax provision based on the U.S. statutory federal income tax rate of approximately 28% as a result of $207.2 million of income tax benefit related to the release of valuation allowance against our U.S. federal and certain state deferred tax assets, partially offset by $80.5 million of income tax expense related to the remeasurement of our net deferred tax assets as a result of reduction in the U.S. federal corporate tax rate. Our provision for income taxes was also impacted by the benefit our foreign income being taxed at lower rates than the U.S. statutory rate, as well as the benefit of research and development tax credits.

Our provision for income taxes for fiscal 2017 differed from the tax provision based on the then-U.S. statutory federal income tax rate of 35% primarily as a result of $36.5 million of income tax expense related to the non-deductible unrealized losses associated with the embedded derivatives for the Series A Preferred Stock and the 2024 Notes, as well as $8.4 million of unrecognized tax benefits, $4.9 million of non-deductible stock-based compensation, and $21.5 million of changes in the valuation allowance against our deferred tax assets. Our provision for income taxes was also impacted by the benefit of our foreign income being taxed at lower rates than the U.S. statutory rate, as well as the income tax benefit of research and development tax credits.

Our effective tax rate of 4.1% in fiscal 2016 differed from the then-U.S. statutory federal income tax rate of 35%, primarily due to changes in the valuation allowance against our deferred tax assets, offset by the benefit of our foreign income being taxed at different rates than the U.S. statutory rates.

As of June 30, 2018, we had net deferred tax assets of $125.3 million, which were mainly comprised of goodwill and intangible assets related to tax assets established in the spin-off from JDSU.

During fiscal 2018, our subsidiary in Thailand operated under a tax holiday. The tax holiday will expire in fiscal 2025 unless extension is granted by the Thailand government and we continue to meet the requirements thereunder. If we do not meet the tax holiday requirements or we decide not to extend the tax holiday, income earned in Thailand will be subject to higher statutory income tax rate, which may cause our effective tax rate to increase.

For further discussion of our income tax provision, see "Note 15. Income Taxes" in the Notes to Consolidated Financial Statements.

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Contractual Obligations

The following table summarizes our contractual obligations as of June 30, 2018, and the effect such obligations are expected to have on our liquidity and cash flow over the next five years (in millions):

	Payments due by period				
	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Contractual Obligations					
Asset retirement obligations	$2.7	$—	$1.0	$ 0.4	$1.3
Purchase obligations (1)	173.5	165.5	7.9	—	0.1
Operating lease obligations (1)	30.8	11.6	11.6	5.8	1.8
Capital lease obligation (1)	9.4	9.0	0.4	—	—
Pension plan contributions (2)	0.5	0.5	—	—	—
0.25% Convertible Senior Notes due 2024	450.0	—	—	—	450.0
Interest on 2024 Notes (3)	6.7	1.1	2.2	2.2	1.2
Acquisition contingencies (4)	3.0	—	3.0	—	—
Total	$676.6	$187.7	$26.1	$ 8.4	$454.4

(1) Refer to “Note 18. Commitments and Contingencies” in the Notes to Consolidated Financial Statements.

(2) Represents planned contributions to our pension plan. Although additional future contributions will be required, the amount and timing of these contributions will be affected by actuarial assumptions, the actual rate of returns on plan assets, the level of market interest rates, legislative changes, and the amount of voluntary contributions to the plan. Any contributions for the following fiscal year and later will depend on the value of the plan assets in the future and thus are uncertain. As such, we have not included any amounts beyond 1 year in the table above. Refer to “Note 17. Employee Benefit Plans” in the Notes to Consolidated Financial Statements.

(3) Includes interest on our 0.25% Convertible Senior Notes due 2024 through March 2024 as we have the right to redeem the 2024 Notes in whole or in part at any time on or after March 15, 2024. Refer to “Note 11. Convertible Senior Notes” in the Notes to Consolidated Financial Statements.

(4) Refer to “Note 9. Fair Value Measurements” in the Notes to Consolidated Financial Statements.

Purchase obligations represent legally-binding commitments to purchase inventory and other commitments made in the normal course of business to meet operational requirements.

As of June 30, 2018, asset retirement obligations presented in the preceding table are included in other non-current liabilities on our consolidated balance sheet. As of June 30, 2018, our other non-current liabilities also include $6.1 million of unrecognized tax benefit for uncertain tax positions. We are unable to reliably estimate the timing of future payments related to uncertain tax positions and therefore have excluded them from the preceding table.

In addition to the obligations discussed above, at the time of the closing of the Oclaro acquisition, which is expected in the next fiscal year, we will be required to pay cash consideration as described further in “Acquisitions” below. We also expect to incur indebtedness in an aggregate principal amount of approximately $500 million pursuant to a senior secured term loan facility entered into in connection with the closing of the Oclaro acquisition.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as such term is defined in rules promulgated by the SEC, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to investors.

Acquisitions

As part of our strategy, we are committed to the ongoing evaluation of strategic opportunities and, where appropriate, the acquisition of additional products, technologies or businesses that are complementary to, or broaden the markets for, our products.

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We believe we have strengthened our business model by expanding our addressable markets, customer base and expertise, diversifying our product portfolio, and fortifying our core businesses through acquisitions as well as through organic initiatives.

On March 11, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Oclaro, Inc. (“Oclaro”), Prota Merger Sub, Inc., and Prota Merger, LLC, pursuant to which we will acquire Oclaro and Oclaro will become a wholly-owned subsidiary of Lumentum. In accordance with the terms of the Merger Agreement, each issued and outstanding share of Oclaro common stock will be exchanged for $5.60 in cash and 0.0636 of a share of Lumentum common stock, subject to the conditions and restrictions set forth in the Merger Agreement. The total transaction consideration was approximately $1.8 billion as of the date of the Merger Agreement. Oclaro stockholders will own approximately 16% of the combined company following the closing. Oclaro’s stockholders approved the Merger Agreement on July 10, 2018 and we have received approval for the transaction under the Hart-Scott Rodino Act in the United States. We are in the process of obtaining antitrust approval in China. The Merger Agreement contains certain termination rights for both Lumentum and Oclaro. The Merger Agreement further provides that upon termination of the Merger Agreement under specified circumstances relating to failure to obtain regulatory approvals, Lumentum may be required to pay Oclaro a termination fee of $80 million.

As of August 23, 2018, the total transaction consideration was expected to be approximately $1.7 billion, which would be funded by a combination of $700 million in Lumentum common stock, $500 million in new debt, and the remaining amount from the cash balances of the combined company.

In February 2017, we completed the acquisition of a privately held company to enhance our manufacturing and vertical integration capabilities. We acquired all of the outstanding shares of the company for a total purchase consideration of $8.7 million. In connection with the acquisition, we paid upfront cash consideration of $5.1 million, incurred liabilities of $2.7 million contingent upon the achievement of certain production targets being achieved within 36 months following the acquisition date, and retained $0.9 million of the purchase price as security for the seller’s indemnification obligations, which was fully paid to the seller subsequent to the year ended June 30, 2018.

Pension Benefits

As a result of acquiring Time-Bandwidth in January 2014, we have a pension plan for our employees in Switzerland. This plan is open to new participants and additional service costs are being accrued. The Switzerland plan is partially funded. As of June 30, 2018, our pension plan was under funded by $3.5 million since the projected benefit obligation (“PBO”) exceeded the fair value of the plan assets.

We expect to contribute $0.5 million to the Switzerland plan during fiscal 2019.

A key actuarial assumption in calculating the net periodic cost and the PBO is the discount rate. Changes in the discount rate impact the interest cost component of the net periodic benefit cost calculation and PBO due to the fact that the PBO is calculated on a net present value basis. Decreases in the discount rate will generally increase pre-tax cost, recognized expense and the PBO. Increases in the discount rate tend to have the opposite effect. We estimate a 50 basis point decrease or increase in the discount rate would cause a corresponding increase or decrease, respectively, in the PBO of $1.3 million or $(1.1) million, based upon data as of June 30, 2018.

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Financial Condition

Liquidity and Capital Resources

As of June 30, 2018 and July 1, 2017, our cash and cash equivalents of $397.3 million and $272.9 million, respectively, were held predominantly in the United States. The total amount of cash outside the United States as of June 30, 2018 was $37.8 million, which was primarily held in Cayman Islands, Hong Kong, British Virgin Islands, Netherlands, Thailand, and Japan. Although the cash currently held in the United States as well as the cash generated in the United States from future operations is expected to cover our normal operating requirements, a substantial amount of additional cash could be required for other purposes, such as capital expenditures to support our business and growth, including costs associated with increasing internal manufacturing capabilities, such as our new Thailand facility, strategic transactions and partnerships, and acquisitions. Our intent is to indefinitely reinvest funds held outside the United States, except for the funds held in the Cayman Islands and Hong Kong, and our current plans do not demonstrate a need to repatriate them to fund our domestic operations. However, if in the future, we encounter a significant need for liquidity domestically or at a particular location that we cannot fulfill through borrowings, equity offerings, or other internal or external sources, or the cost to bring back the money is insignificant from a tax perspective, we may determine that cash repatriations are necessary or desirable. Repatriation could result in additional material taxes. These factors may cause us to have an overall tax rate higher than other companies or higher than our tax rates have been in the past. If conditions warrant, we may seek to obtain additional financing through debt or equity sources. To the extent we issue additional shares, our existing stockholders may be diluted. However, any such financing may not be available on terms favorable to us, or may not be available at all.

Fiscal 2018

As of June 30, 2018, our consolidated balance of cash and cash equivalents increased by $124.4 million, to $397.3 million from $272.9 million as of July 1, 2017. The increase in cash and cash equivalents was mainly due to cash provided by operating activities of $247.5 million during fiscal 2018 offset by purchases of short-term investments, net of sales of $33.8 million and capital expenditures of $93.2 million.

Cash provided by operating activities was $247.5 million for the year ended June 30, 2018, primarily resulting from $248.1 million of net income and $18.5 million of non-cash items (such as depreciation, stock-based compensation, amortization of intangibles, amortization of discount on the 2024 Notes, net of the release of the valuation allowance), offset by $19.1 million of changes in our operating assets and liabilities. Changes in our operating assets and liabilities related primarily to an increase in accounts receivable of $30.8 million, offset by an increase in accrued expenses and other current and non-current liabilities of $11.9 million.

Cash used in investing activities of $127.0 million for the year ended June 30, 2018, was primarily attributable to capital expenditures of $93.2 million and purchases of short-term investments, net of sales of $33.8 million.

Cash provided by financing activities was $3.8 million for the year ended June 30, 2018, resulting primarily from the issuance of common stock under the 2015 Employee Stock Purchase Plan of $9.2 million offset by repayment of capital lease obligation of $6.4 million.

Fiscal 2017

As of July 1, 2017, our consolidated balance of cash and cash equivalents increased by $115.8 million, to $272.9 million from $157.1 million as of July 2, 2016. The increase in cash and cash equivalents was mainly due to proceeds from the issuance of the 2024 Notes during fiscal 2017, offset by the purchases of short-term investments and property, plant and equipment.

Cash provided by operating activities was $85.0 million for the year ended July 1, 2017, primarily resulting from $102.5 million of net loss and $199.4 million of non-cash items such as depreciation, stock-based compensation, amortization of intangibles and unrealized loss on derivative liabilities, the impact of which was offset by changes in excess tax benefit associated with stock-based compensation. In addition, changes in our operating assets and liabilities of $11.9 million related primarily to an increase in inventories of $41.7 million and a decrease in accounts payable of $16.9 million related to non-cash items such as $10.0 million unpaid property, plant and equipment, offset by a decrease in income taxes, net of $42.7 million.

Cash used in investing activities was mainly for capital expenditures and purchases of short-term investments, net of sales of $138.1 million and $282.5 million, respectively, for the year ended July 1, 2017. Changes in investing cash

flow in fiscal 2017 also related to the acquisition of a business for $5.1 million.
Cash provided by financing activities was $456.7 million for the year ended July 1, 2017, resulting primarily from proceeds of $442.3 million from the issuance of the 2024 Notes.

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Fiscal 2016

As of July 2, 2016, our consolidated balance of cash and cash equivalents and short-term investments was $157.1 million, an increase of $142.3 million, or 961.5%, as compared to $14.8 million as of June 27, 2015.

Cash provided by operating activities was $86.6 million, primarily resulting from $9.3 million of net income, which included $80.7 million of non-cash items such as depreciation, stock-based compensation, derivative liability, amortization of intangibles and disposal of property, plant and equipment, offset by changes in operating assets and liabilities of $3.4 million. Changes in our operating assets and liabilities related primarily to an increase in accounts payable of $28.9 million, an increase in accounts receivable of $21.8 million, an increase in prepayments, other current and non-currents assets of $12.7 million, an increase in accrued payroll and related expenses of $9.2 million, a decrease in deferred taxes, net of $1.7 million, a decrease in income taxes payable of $1.7 million, an increase in inventories of $3.1 million and a decrease in accrued expenses and other current and non-current liabilities of $0.5 million.

Cash used in investing activities included $82.0 million of cash used for capital expenditures, primarily to expand our manufacturing capacity.

Cash provided by financing activities was $136.4 million, resulting primarily from net transfers from Viavi of $134.2 million at the Separation date.

Liquidity and Capital Resources Requirements

We believe that our cash and cash equivalents as of June 30, 2018, and cash flows from our operating activities will be sufficient to meet our liquidity and capital spending requirements for at least the next 12 months. However, if market conditions are favorable, we may evaluate alternatives to opportunistically pursue additional financing.

There are a number of factors that could positively or negatively impact our liquidity position, including:

- global economic conditions which affect demand for our products and services and impact the financial stability of our suppliers and customers;
- changes in accounts receivable, inventory or other operating assets and liabilities, which affect our working capital;
- increase in capital expenditures to support our business and growth;
- the tendency of customers to delay payments or to negotiate favorable payment terms to manage their own liquidity positions;
- timing of payments to our suppliers;
- factoring or sale of accounts receivable;
- volatility in fixed income and credit, which impact the liquidity and valuation of our investment portfolios;
- volatility in foreign exchange markets, which impacts our financial results;
- possible investments or acquisitions of complementary businesses, products or technologies, or other strategic transactions or partnerships;
- issuance of debt or equity securities, or other financing transactions, including bank debt;
- potential funding of pension liabilities either voluntarily or as required by law or regulation; and
- settlement of any conversion or redemption of the 2024 Notes in cash.

In March 2018, we entered into the Merger Agreement with Oclaro. Pursuant to the terms of the Merger Agreement, each issued and outstanding share of Oclaro common stock will be exchanged for $5.60 in cash and 0.0636 of a share of Lumentum common stock, subject to the conditions and restrictions set forth in the Merger Agreement. In connection with the acquisition of Oclaro, we have entered into a commitment letter with Deutsche Bank, pursuant to which, subject to the terms and conditions set forth therein, Deutsche Bank has committed to provide a senior secured term loan facility in an aggregate principal amount of $550 million, with a provision for additional senior secured term loans in an aggregate principal amount not to exceed $250 million. As of August 23, 2018, the total transaction consideration was expected to be approximately $1.7 billion, which would be funded by a combination of $700 million in Lumentum common stock, $500 million in new debt, and the remaining amount from the cash balances of the combined company.

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ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Exchange Risk

We conduct our business and sell our products to customers primarily in Asia, Europe, and North America. Due to the impact of changes in foreign currency exchange rates between the U.S. Dollar and foreign currencies, for the fiscal years ended June 30, 2018, July 1, 2017, and July 2, 2016, we recorded unrealized gain (loss) of $0.3 million, $0.6 million and $(0.9) million, respectively, in the interest and other income (expense), net in the Consolidated Statements of Operations included in this Annual Report.

Although we sell primarily in U.S. Dollar, we have foreign currency exchange risks related to our operating expenses denominated in currencies other than the U.S. Dollar, principally the Thai Baht, Taiwan Dollar, Canadian Dollar, Japanese Yen, Swiss Franc, Euro, and Chinese Yuan. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. In the event our foreign currency denominated assets, liabilities, sales or expenses increase, our operating results may be more greatly affected by fluctuations in the exchange rates of the currencies in which we do business.

Equity Price Risk

We are exposed to equity price risk related to the conversion options embedded in our Series A Preferred Stock and the 2024 Notes. Our Series A Preferred Stock is convertible, at the option of the holder, into shares of our common stock commencing on the second anniversary of the closing of the securities purchase (absent a change of control of us or similar event) using a conversion price of $24.63.

In March 2017, we issued the 2024 Notes in a private placement with an aggregate principal amount of $450 million. We carry the 2024 Notes at face value less amortized discount on the consolidated balance sheet. The 2024 Notes bear interest at a rate of 0.25% per year. Since the 2024 Notes bear interest at fixed rates, we have no financial statement risk associated with changes in interest rates. However, the potential value of the shares to be distributed to the holders of 2024 Notes changes when the market price of our stock fluctuates. The 2024 Notes will mature on March 15, 2024, unless earlier repurchased by us or converted pursuant to their terms, at a conversion price of approximately $60.62 per share.

The conversion feature is bifurcated from the Series A Preferred Stock and accounted for separately as a derivative liability. On a quarterly basis, the derivative liability is marked to market based on the fair values of the conversion feature, with the resulting income or loss recorded as unrealized gain (loss) on a derivative liability on our consolidated statements of operations. The determination of fair values includes various inputs, including volatility and interest rate assumptions (see “Note 12. Derivative Liability”). However, the change in the fair value of our common stock has the largest impact to the fair value of the derivative. Based on a hypothetical $10.00 per share increase or decrease in the fair value of our common stock, our net income would be reduced or increased by approximately ($14.5) million or $14.5 million, respectively, for the Series A Preferred Stock derivative.

Interest Rate Fluctuation Risk

As of June 30, 2018, we had cash, cash equivalents, and short-term investments of $711.5 million. Cash equivalents and short-term investments are primarily comprised of highly liquid investment grade fixed income securities. Our investment policy and strategy is focused on the preservation of capital and supporting our liquidity requirements. We do not enter into investments for trading or speculative purposes. As of June 30, 2018, the weighted-average duration of our investment portfolio was less than six months. Our fixed-income portfolio is subject to fluctuations in interest rates, which could affect our results of operations. Based on our investment portfolio balance as of June 30, 2018, a hypothetical increase or decrease in interest rates of 1% (100 basis points) would have resulted in a decrease or an increase in the fair value of our portfolio of approximately $2.5 million, and a hypothetical increase or decrease of 0.5% (50 basis points) would have resulted in a decrease or an increase in the fair value of our portfolio of approximately $1.2 million.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Lumentum Holdings Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Lumentum Holdings Inc. and subsidiaries (the "Company") as of June 30, 2018 and July 1, 2017, the related consolidated statements of operations, comprehensive income (loss), cash flows, and redeemable convertible preferred stock, stockholders' equity and invested equity for each of the two years in the period ended June 30, 2018, and the related notes and the schedule listed in the Index at Item 15 (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of June 30, 2018 and July 1, 2017, and the results of its operations and its cash flows for each of the two years in the period ended June 30, 2018, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of June 30, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 28, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
August 28, 2018

We have served as the Company's auditor since 2017.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Lumentum Holdings Inc.

In our opinion, the consolidated statements of operations, of comprehensive income (loss), of redeemable convertible preferred stock, stockholders’ equity, and invested equity and of cash flows for the year ended July 2, 2016 present fairly, in all material respects, the results of operations and cash flows of Lumentum Holdings Inc. and its subsidiaries for the year ended July 2, 2016, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule for the year ended July 2, 2016, appearing under Item 15(2), presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audit. We conducted our audit of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers LLP

San Jose, California
September 2, 2016

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LUMENTUM HOLDINGS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Net revenue	$1,247.7	$1,001.6	$903.0
Cost of sales	812.4	677.0	618.9
Amortization of acquired developed technologies	3.2	6.5	6.8
Gross profit	432.1	318.1	277.3
Operating expenses:			
Research and development	156.8	148.3	141.1
Selling, general and administrative	128.2	110.2	117.3
Restructuring and related charges	7.2	12.0	7.4
Total operating expenses	292.2	270.5	265.8
Income from operations	139.9	47.6	11.5
Unrealized loss on derivative liabilities	(0.8)	(104.2)	(0.6)
Interest and other income (expense), net	(9.7)	(3.2)	(1.2)
Income (loss) before income taxes	129.4	(59.8)	9.7
Provision for (benefit from) income taxes	(118.7)	42.7	0.4
Net income (loss)	248.1	(102.5)	9.3
Items reconciling net income (loss) to net income (loss) attributable to common stockholders:			
Cumulative dividends on Series A Preferred Stock	(0.9)	(0.9)	(0.8)
Accretion of Series A Preferred Stock	—	—	(11.7)
Earnings allocated to Series A Preferred Stock	(5.7)	—	—
Net income (loss) attributable to common stockholders - Basic	$241.5	$(103.4)	$(3.2)
Net income (loss) attributable to common stockholders - Diluted	$241.5	$(103.4)	$(3.2)
Net income (loss) per share attributable to common stockholders:			
Basic	$3.88	$(1.71)	$(0.05)
Diluted	$3.82	$(1.71)	$(0.05)
Shares used to compute net income (loss) per share attributable to common stockholders:			
Basic	62.3	60.6	59.1
Diluted	63.3	60.6	59.1

See accompanying notes to consolidated financial statements.

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LUMENTUM HOLDINGS INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in millions)

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Net income (loss)	$248.1	$(102.5)	$9.3
Other comprehensive income (loss), net of tax:			
Net change in cumulative translation adjustment	(0.2)	(1.2)	(2.0)
Net change in unrealized loss on available-for-sale securities	(1.6)	—	—
Net change in defined benefit obligation	0.8	(0.8)	(1.1)
Other comprehensive income (loss), net of tax	(1.0)	(2.0)	(3.1)
Comprehensive income (loss), net of tax	$247.1	$(104.5)	$6.2

See accompanying notes to consolidated financial statements.

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LUMENTUM HOLDINGS INC.
CONSOLIDATED BALANCE SHEETS
(in millions, except share and per share data)

	June 30, 2018	July 1, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$397.3	$272.9
Short-term investments	314.2	282.4
Accounts receivable, net	197.1	166.3
Inventories	153.6	145.2
Prepayments and other current assets	65.0	63.5
Total current assets	1,127.2	930.3
Property, plant and equipment, net	306.9	273.5
Goodwill and intangibles, net	18.3	21.5
Deferred income taxes	125.6	3.9
Other non-current assets	3.5	3.7
Total assets	$1,581.5	$1,232.9
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK, AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable	$126.5	$114.8
Accrued payroll and related expenses	31.5	27.5
Accrued expenses	33.9	19.3
Other current liabilities	22.1	22.6
Total current liabilities	214.0	184.2
Convertible notes	334.2	317.5
Derivative liability	52.4	51.6
Other non-current liabilities	19.0	25.0
Total liabilities	619.6	578.3
Commitments and contingencies (Note 18)		
Redeemable convertible preferred stock:		
Non-controlling interest redeemable convertible Series A Preferred Stock, $0.001 par value, 10,000,000 authorized shares; 35,805 shares issued and outstanding as of June 30, 2018 and July 1, 2017	35.8	35.8
Total redeemable convertible preferred stock	35.8	35.8
Stockholders’ equity:		
Common stock, $0.001 par value, 990,000,000 authorized shares, 62,790,087 and 61,476,103 shares issued and outstanding as of June 30, 2018 and July 1, 2017, respectively	0.1	0.1
Additional paid-in capital	753.2	694.5
Retained earnings (accumulated deficit)	166.4	(83.2)
Accumulated other comprehensive income	6.4	7.4
Total stockholders’ equity	926.1	618.8
Total liabilities, redeemable convertible preferred stock, and stockholders’ equity	$1,581.5	$1,232.9

See accompanying notes to consolidated financial statements.

LUMENTUM HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Years Ended June 30, 2018	July 1, 2017	July 2, 2016
OPERATING ACTIVITIES:			
Net income (loss)	$248.1	$(102.5)	$9.3
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation expense	74.0	54.2	47.4
Stock-based compensation	46.8	32.7	24.9
Unrealized loss on derivative liabilities	0.8	104.2	0.6
Amortization of acquired developed technologies and other intangibles	3.2	6.8	7.2
Loss on disposal of property, plant and equipment	0.6	0.2	0.6
Excess tax benefit associated with stock-based compensation	—	(3.8)	—
Amortization of discount on 0.25% Convertible Senior Notes due 2024	16.7	5.1	—
Release of valuation allowance, net	(124.0)	—	—
Other non-cash (income) expenses	0.4	—	—
Changes in operating assets and liabilities:			
Accounts receivable	(30.8)	4.2	(21.8)
Inventories	(7.7)	(41.7)	(3.1)
Prepayments and other current and non-currents assets	6.1	(7.4)	(12.7)
Income taxes, net	(7.3)	42.7	(3.4)
Accounts payable	4.8	(16.9)	28.9
Accrued payroll and related expenses	3.9	1.0	9.2
Accrued expenses and other current and non-current liabilities	11.9	6.2	(0.5)
Net cash provided by operating activities	247.5	85.0	86.6
INVESTING ACTIVITIES:			
Payments for acquisition of property, plant and equipment	(93.2)	(138.1)	(82.0)
Acquisition of business, net of cash acquired	—	(5.1)	—
Purchases of short-term investments	(634.3)	(290.7)	—
Proceeds from maturities and sales of short-term investments	600.5	8.2	—
Net cash used in investing activities	(127.0)	(425.7)	(82.0)
FINANCING ACTIVITIES:			
Net transfers from Viavi	—	—	134.2
Proceeds from the issuance of 0.25% Convertible Senior Notes due 2024, net of issuance costs	—	442.3	—
Excess tax benefit associated with stock-based compensation	—	3.8	—
Payment of dividends - Series A Preferred Stock	(0.7)	(0.9)	(0.5)
Payment of financing obligation related to acquisition	—	—	(2.3)
Proceeds from employee stock plans	9.2	8.1	3.1
Repayment of capital lease obligation	(6.4)	—	—
Proceeds from the exercise of stock options	1.7	3.4	1.9
Net cash provided by financing activities	3.8	456.7	136.4
Effect of exchange rates on cash and cash equivalents	0.1	(0.2)	1.6
Increase in cash and cash equivalents	124.4	115.8	142.6
Cash and cash equivalents at beginning of period	272.9	157.1	14.5
Cash and cash equivalents at end of period	$397.3	$272.9	$157.1
Supplemental disclosure of cash flow information:			

Cash paid for taxes	$12.7	$9.5	$2.7
Cash paid for interest	1.3	—	—
Unpaid property, plant and equipment in accounts payable and accrued expenses	17.2	18.4	13.1
Equipment acquired under capital lease	15.6	—	—
Accretion of Series A Preferred Stock	—	—	11.7

See accompanying notes to consolidated financial statements.

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LUMENTUM HOLDINGS INC.
CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK, STOCKHOLDERS' EQUITY, AND INVESTED EQUITY
(in millions)

(in millions)	Non-Controlling Interest Redeemable Convertible Series A Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Viavi Net Investment	Total Invested Equity / Total Stockholders' Equity
	Shares	Amount	Shares	Amount					
Balance as of June 27, 2015	—	$ —	—	$ —	$ —	$ —	$ 12.5	$ 368.1	$ 380.6
Pre-Separation activity:									
Net income (loss)	—	—	—	—	—	—	—	(11.7)	(11.7)
Other comprehensive income (loss)	—	—	—	—	—	—	(4.7)	—	(4.7)
Transfers from Viavi	—	—	—	—	—	—	—	136.5	136.5
Total pre-Separation activity	—	—	—	—	—	—	(4.7)	124.8	120.1
Post-Separation activity:									
Issuance of common stock and reclassification of parent company investment in connection with the Separation	—	—	58.8	0.1	457.0	—	—	(457.1)	—
Issuance of redeemable convertible preferred stock, net of issuance costs of $2.0	—	33.8	—	—	—	—	—	(35.8)	(35.8)
Accretion of equity issuance costs	—	2.0	—	—	(2.0)	—	—	—	(2.0)
Recognition of the bifurcation of the preferred stock's derivative liability component	—	(9.7)	—	—	—	—	—	—	—
Recognition of the redemption value of the convertible preferred stock	—	9.7	—	—	(9.7)	—	—	—	(9.7)
Declared dividend for preferred stock	—	—	—	—	—	(0.8)	—	—	(0.8)
Other comprehensive income (loss)	—	—	—	—	—	—	1.6	—	1.6
Release of common stock shares upon vesting of restricted stock units	—	—	0.8	—	—	—	—	—	—
Shares withheld for the withholding on vesting of restricted stock units	—	—	(0.3)	—	(6.8)	—	—	—	(6.8)
Exercise of stock options	—	—	0.1	—	1.9	—	—	—	1.9
ESPP shares issued	—	—	0.2	—	3.1	—	—	—	3.1
Stock-based compensation	—	—	—	—	24.2	—	—	—	24.2
Net income (loss)	—	—	—	—	—	21.0	—	—	21.0
Total post-Separation activity	—	35.8	59.6	0.1	467.7	20.2	1.6	(492.9)	(3.3)
Balance as of July 2, 2016	—	35.8	59.6	0.1	467.7	20.2	9.4	—	497.4

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LUMENTUM HOLDINGS INC.
CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK, STOCKHOLDERS' EQUITY, AND INVESTED EQUITY
(in millions)

(in millions)	Non-Controlling Interest Redeemable Convertible Series A Preferred Stock		Common Stock		Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income/(Loss)	Viavi Net Investment	Total Invested Equity / Total Stockholders' Equity
	Shares	Amount	Shares	Amount					
Net income (loss)	—	—	—	—	—	(102.5)	—	—	(102.5)
Other comprehensive income (loss)	—	—	—	—	—	—	(2.0)	—	(2.0)
Declared dividend for preferred stock	—	—	—	—	—	(0.9)	—	—	(0.9)
Reclassification of 2024 Notes derivative liability in connection with cash settlement condition	—	—	—	—	192.8	—	—	—	192.8
Issuance of shares pursuant to equity plans, net of tax withholdings	—	—	1.6	—	(12.2)	—	—	—	(12.2)
ESPP shares issued	—	—	0.3	—	8.1	—	—	—	8.1
Stock-based compensation	—	—	—	—	34.3	—	—	—	34.3
Excess tax benefit associated with stock-based compensation	—	—	—	—	3.8	—	—	—	3.8
Balance as of July 1, 2017	—	35.8	61.5	0.1	694.5	(83.2)	7.4	—	618.8
Net income (loss)	—	—	—	—	—	248.1	—	—	248.1
Other comprehensive income (loss)	—	—	—	—	—	—	(1.0)	—	(1.0)
Declared dividend for preferred stock	—	—	—	—	—	(0.9)	—	—	(0.9)
Issuance of shares pursuant to equity plans, net of tax withholdings	—	—	1.1	—	1.7	—	—	—	1.7
ESPP shares issued	—	—	0.2	—	9.2	—	—	—	9.2
Stock-based compensation	—	—	—	—	47.6	—	—	—	47.6
Cumulative effect of stock compensation accounting change (Note 2)	—	—	—	—	0.2	2.4	—	—	2.6
Balance as of June 30, 2018	—	$ 35.8	62.8	$ 0.1	$ 753.2	$ 166.4	$ 6.4	$ —	$ 926.1

See accompanying notes to consolidated financial statements.

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LUMENTUM HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Description of Business and Summary of Significant Accounting Policies
Description of Business
Lumentum (we, us, our or the Company) is an industry-leading provider of optical and photonic products defined by revenue and market share addressing a range of end market applications including OpComms and Lasers for manufacturing, inspection and life-science applications. We seek to use our core optical and photonic technology and our volume manufacturing capability to expand into attractive emerging markets that benefit from advantages that optical or photonics-based solutions provide, including 3D sensing for consumer electronics and diode light sources for a variety of consumer and industrial applications. The majority of our customers tend to be OEMs that incorporate our products into their products which then address end-market applications. For example, we sell fiber optic components that Network Equipment Manufacturers ("NEMs") customers assemble into communications networking systems, which they sell to network service providers or enterprises with their own networks. Similarly, many of our customers for our Lasers products incorporate our products into tools they produce, which are used for manufacturing processes by their customers. For 3D sensing, we sell diode lasers to manufacturers of consumer electronics products for mobile, personal computing, and gaming who then integrate our devices within their products, for eventual resale to consumers and also into other industrial applications.
Basis of Presentation
On July 31, 2015, prior to the Separation, Viavi transferred substantially all of the assets and liabilities and operations of the CCOP segment and WaveReady product lines to Lumentum. Financial statements for periods prior to the Separation were prepared on a stand-alone basis and were derived from Viavi's consolidated financial statements and accounting records. The Company prepared consolidated financial statements for the period from June 28, 2015 to August 1, 2015 where expenses were allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services provided to, or benefits received by, us. From August 1, 2015 to July 2, 2016, the Company prepared consolidated financial statements as an independent stand-alone basis pursuant to the rules and regulations of the SEC and are in conformity with U.S. GAAP. In the opinion of management, these consolidated financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are necessary for a fair statement of the consolidated financial statements for the periods shown. The results of operations for such periods are not necessarily indicative of the results expected for the full year or for any future periods.
On August 1, 2015, Lumentum became an independent publicly-traded company through the distribution by JDS Uniphase ("JDSU") to its stockholders of 80.1% of our outstanding common stock (the "Separation"). Each JDSU stockholder of record as of the close of business on July 27, 2015 received one share of Lumentum common stock for every five shares of JDSU common stock held on the record date. JDSU was renamed Viavi and at the time of the distribution retained ownership of 19.9% of Lumentum's outstanding shares. Lumentum was incorporated in Delaware as a wholly owned subsidiary of Viavi on February 10, 2015 and is comprised of the former communications and commercial optical products ("CCOP") segment and WaveReady product lines of Viavi. Lumentum's Registration Statement on Form 10 was declared effective by the SEC on July 16, 2015. Lumentum's common stock began trading "regular-way" under the ticker "LITE" on the NASDAQ stock market on August 4, 2015.
See "Note 3. Related Party Transactions" in the Notes to Consolidated Financial Statements regarding the relationships we had with Viavi.
The preparation of the consolidated financial statements in accordance with GAAP in the United States requires management to make estimates and assumptions that affect the amounts reported in our consolidated financial statements and accompanying notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact the Company in the future, actual results may be different from the estimates. Our critical accounting policies are those that affect our financial statements materially and involve difficult, subjective or complex judgments by management. Those policies are inventory valuation, revenue recognition, accounting for income taxes, long-lived asset valuation, warranty, valuation of derivative liability, business combinations, and valuation of goodwill.

On March 11, 2018, we entered into an Agreement and Plan of Merger (the “Merger Agreement”) with Oclaro, Prota Merger Sub, Inc., and Prota Merger, LLC, pursuant to which we will acquire Oclaro and Oclaro will become a wholly-owned subsidiary of Lumentum. In accordance with the terms of the Merger Agreement, each issued and outstanding share of Oclaro common stock will be exchanged for $5.60 in cash and 0.0636 of a share of Lumentum common stock, subject to the conditions and restrictions set forth in the Merger Agreement. The total transaction consideration was approximately $1.8 billion as of the date of the Merger Agreement. Oclaro stockholders will own approximately 16% of the combined company following the closing. Oclaro’s stockholders approved the Merger Agreement on July 10, 2018 and we have received approval for the transaction under the Hart-Scott Rodino Act in the United States. We are in the process of obtaining antitrust approval in China. The Merger Agreement contains certain termination rights for both Lumentum and Oclaro. The Merger Agreement further provides that upon termination of the Merger Agreement under specified circumstances relating to failure to obtain regulatory approvals, Lumentum may be required to pay Oclaro a termination fee of $80 million.

As of August 23, 2018, the total transaction consideration was expected to be approximately $1.7 billion, which would be funded by a combination of $700 million in Lumentum common stock, $500 million in new debt, and the remaining amount from the cash balances of the combined company.

In connection with the Merger Agreement, Lumentum entered into a commitment letter, dated as of March 11, 2018, with Deutsche Bank Securities Inc. and Deutsche Bank AG New York, New York Branch (“Deutsche Bank”), pursuant to which, subject to the terms and conditions set forth therein, Deutsche Bank has committed to provide a senior secured term loan facility in an aggregate principal amount of up to $550 million, with a provision for additional senior secured term loans in an aggregate principal amount not to exceed $250 million.

The transaction is subject to customary closing conditions, including antitrust regulatory approval in China. The transaction is not subject to any financing condition. The transaction is expected to be completed in the second half of calendar 2018.

Fiscal Years

We utilize a 52-53 week fiscal year ending on the Saturday closest to June 30th. Our fiscal 2018 ended on June 30, 2018 and was a 52-week year. Our fiscal 2017 ended on July 1, 2017 and was a 53-week year. Our fiscal 2016 ended on July 2, 2016 and was a 52-week year.

Principles of Consolidation

These audited consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries.

All inter-company transactions and balances have been eliminated in consolidation. All material transactions between us and other businesses of Viavi prior to Separation were reflected as net transfers to and from Viavi as a component of financing activities in the consolidated statements of cash flows.

Certain prior period amounts have been reclassified to conform to the current year presentation on the notes to consolidated financial statements. The reclassification of the prior period amounts did not impact previously reported consolidated financial statements.

Summary of Significant Accounting Policies

Cash and Cash Equivalents

We consider highly-liquid fixed income securities with original maturities of three months or less at the time of purchase to be cash equivalents. As of fiscal year ended June 30, 2018, cash and cash equivalents mainly consist of commercial papers, U.S. Treasury securities, and U.S. Agency securities. As of fiscal year ended July 1, 2017, our cash and cash equivalents did not include any investments with original maturities of three months or less.

Short-term Investments

We classify our investments in debt as available-for-sale and record these investments at fair value. Investments with an original maturity of three months or less at the date of purchase are considered cash equivalents, while all other investments are classified as short-term based on management's intent and ability to use the funds in current operations. Unrealized gains and losses are reported as a component of other comprehensive loss. Realized gains and losses are determined based on the specific identification method, and are reflected as interest and other income (expense), net in our Consolidated Statements of Operations. We regularly review our investment portfolio to identify and evaluate investments that have indicators of possible impairment. Factors considered in determining whether a loss is other-than-temporary include, but are not limited to: the length of time and extent a security's fair value has been below its cost, the financial condition and near-term prospects of the investee, the credit quality of the security's issuer, likelihood of recovery and our intent and ability to hold the security for a period of time sufficient to allow for any anticipated recovery in value. For our debt instruments, we also evaluate whether we have the intent to sell the security or it is more likely than not that we will be required to sell the security before recovery of its cost basis.

Impairment of Marketable and Non-Marketable Securities

We periodically review our marketable and non-marketable securities for impairment. If we conclude that any of these investments are impaired, we determine whether such impairment is other-than-temporary. We consider factors such as the duration, severity and the reason for the decline in value, the potential recovery period and whether we intend to sell. For marketable debt securities, we also consider whether (i) it is more likely than not that we will be required to sell the debt securities before recovery of their amortized cost basis, and (ii) the amortized cost basis cannot be recovered as a result of credit losses. If any impairment is considered other-than-temporary, we will write-down the security to its fair value.

Fair Value of Financial Instruments

We define fair value as the price that would be received from selling an asset, or paid to transfer a liability, in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities which are required to be recorded at fair value, we consider the principal or most advantageous market in which to transact and the market-based risk. We apply fair value accounting for all financial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a recurring basis. The carrying amounts reported in the consolidated financial statements approximate the fair value for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities due to their short-term nature.

Basic and Diluted Net Income (Loss) per Common Share

Basic income (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the reporting period. The weighted average number of shares is calculated by taking the number of shares outstanding and weighting them by the amount of time that they were outstanding. Diluted earnings per share reflects the potential dilution that could occur if stock options, preferred stock, and other commitments to issue common stock were exercised or equity awards vest resulting in the issuance of common stock that could share in the earnings of the Company.

Diluted loss per share is the same as basic loss per share during periods where net losses are incurred since the inclusion of the potential common stock equivalents would be anti-dilutive as a result of the net loss.

Our Series A Preferred Stock is considered a participating security, which may participate in undistributed earnings with our common stock. The holders of our Preferred Stock would be entitled to share in dividends, on an as-converted basis, if the holders of our common stock were to receive dividends. We are required to use the two-class method when computing earnings per share as we have a security that qualifies as a participating security. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. In determining the amount of net earnings to allocate to common stockholders, earnings are allocated to both common and participating securities based on their respective weighted-average shares outstanding during the period. Diluted earnings per common share, when applicable, is computed using the more dilutive of the two-class method or the if-converted method. In periods of net loss, no effect is given to participating securities since they do not contractually participate in the losses of the Company.

In March 2017, we issued $450 million in aggregate principal amount of 0.25% Convertible Senior Notes due in 2024 (the “2024 Notes”). We have the ability and intent to settle the $450 million face value of the 2024 Notes in cash. Therefore, we use the treasury stock method for calculating the dilutive impact of the 2024 Notes. The 2024 Notes will have no impact to diluted earnings per share until the average price of our common stock exceeds the conversion price of $60.62. Refer to “Note 11. Convertible Senior Notes” for details.

The dilutive effect of securities from the 2015 Equity Incentive Plan is reflected in diluted earnings per share by application of the treasury stock method, which includes consideration of unamortized share-based compensation expense and the dilutive effect of in-the-money options and non-vested restricted stock units. Under the treasury stock method, the amount the employee must pay for exercising stock options and the amount of unamortized share-based compensation expense are collectively assumed to be used to repurchase hypothetical shares. An increase in the fair value of our common stock can result in a greater dilutive effect from potentially dilutive awards.

Anti-dilutive potential shares from 2015 Equity Incentive Plan are excluded from the calculation of diluted earnings per share if their exercise price exceeded the average market price during the period or the share-based awards were determined to be anti-dilutive based on applying the treasury stock method.

In periods when we have a net loss, all potentially dilutive securities are excluded from our calculation of earnings per share as their inclusion would have been anti-dilutive.

Inventory Valuation

Inventory is valued at standard cost, which approximates actual cost computed on a first-in, first-out basis, not in excess of net realizable value. We assess the value of our inventory on a quarterly basis and write down those inventories which are obsolete or in excess of our forecasted usage to the lower of their cost or estimated net realizable value. Our estimates of realizable value are based upon our analysis and assumptions including, but not limited to, forecasted sales levels and historical usage by product, expected product lifecycle, product development plans and future demand requirements. Our product line management personnel play a key role in our excess review process by providing updated sales forecasts, managing product transitions and working with manufacturing to minimize excess inventory. If actual market conditions are less favorable than our forecasts or actual demand from our customers is lower than our estimates, we may be required to record additional inventory write-downs. If actual market conditions are more favorable than anticipated, inventory previously written down may be sold, resulting in lower cost of sales and higher income from operations than expected in that period.

Revenue Recognition

During the periods presented, we recognized revenue when all four revenue recognition criteria have been met: (i) persuasive evidence of an arrangement exists, (ii) the product has been delivered or the service has been rendered, (iii) the price is fixed or determinable and (iv) collection is reasonably assured. Revenue from product sales is recorded when all of the foregoing conditions are met and risk of loss and title passes to the customer. Our products typically include a warranty and the estimated cost of product warranty claims, based on historical experience, is recorded at the time the sale is recognized. Sales to customers are generally not subject to price protection or return rights. The majority of our sales are made to OEMs, distributors, resellers and end-users.

We record as a reduction to revenues reserves for sales returns based upon historical experience rates and for any specific known customer amounts. We also provide certain distributors and OEMs with volume-pricing discounts, such as rebates and incentives, which are recorded as a reduction to revenues at the time of sale. Historically these volume discounts have not been significant. For revenue recognition changes related to implementation of ASU 2014-09, refer to “Note 2. Recent Accounting Pronouncements”.

Income Taxes

In accordance with the authoritative guidance on accounting for income taxes, we recognize income taxes using an asset and liability approach. This approach requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in our consolidated financial statements or tax returns. The measurement of current and deferred taxes is based on provisions of the enacted tax law, and the effects of future changes in tax laws or rates are not anticipated.

The authoritative guidance provides for recognition of deferred tax assets if the realization of such deferred tax assets is more likely than not to occur based on an evaluation of both positive and negative evidence and the relative weight of the evidence. We consider future growth, forecasted earnings, future taxable income, the mix of earnings in the jurisdictions in which we operate, historical earnings, taxable income in prior years, if carryback is permitted under the law, and prudent and feasible tax planning strategies in determining the need for a valuation allowance. In the event we were to determine that we would not be able to realize all or part of our net deferred tax assets in the future, an adjustment to the deferred tax assets valuation allowance would be charged to earnings in the period in which we make such a determination, or goodwill would be adjusted at our final determination of the valuation allowance related to an acquisition within the measurement period. If we later determine that it is more likely than not that the net deferred tax assets would be realized, we would reverse the applicable portion of the previously provided valuation allowance as an adjustment to earnings at such time.

We are subject to income tax audits by the respective tax authorities of the jurisdictions in which we operate. The determination of our income tax liabilities in each of these jurisdictions requires the interpretation and application of complex, and sometimes uncertain, tax laws and regulations. The authoritative guidance on accounting for income taxes prescribes both recognition and measurement criteria that must be met for the benefit of a tax position to be recognized in the financial statements. If a tax position taken, or expected to be taken, in a tax return does not meet such recognition or measurement criteria, an unrecognized tax benefit liability is recorded. If we ultimately determine that an unrecognized tax benefit liability is no longer necessary, we reverse the liability and recognize a tax benefit in the period in which it is determined that the unrecognized tax benefit liability is no longer necessary.

The recognition and measurement of current taxes payable or refundable and deferred tax assets and liabilities requires that we make certain estimates and judgments. Changes to these estimates or a change in judgment may have a material impact on our tax provision in a future period.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is computed by the straight-line method generally over the following estimated useful lives of the assets: 10 to 50 years for building and improvements, 3 to 5 years for machinery and equipment, and 2 to 5 years for furniture, fixtures, software and office equipment. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives of the assets or the term of the lease.

Goodwill

Goodwill represents the excess of the purchase price of an acquired business over the fair value of the identifiable assets acquired and liabilities assumed. We test for impairment of goodwill on an annual basis in the fourth quarter and at any other time when events occur or circumstances indicate that the carrying amount of goodwill may not be recoverable.

An entity has the option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. If an entity determines that as a result of the qualitative assessment that it is more likely than not (i.e., greater than 50% likelihood) that the fair value of a reporting unit is less than its carrying amount, then the quantitative test is required. Otherwise, no further testing is required. The two-step quantitative goodwill impairment test requires us to estimate the fair value of our reporting units. If the carrying value of a reporting unit exceeds its fair value, the goodwill of that reporting unit is potentially impaired and we proceed to step two of the impairment analysis. In step two of the analysis, we measure and record an impairment loss equal to the excess of the carrying value of the reporting unit's goodwill over its implied fair value, if any.

Application of the goodwill impairment test requires judgments, including: identification of the reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, a qualitative assessment to determine whether there are any impairment indicators, and determining the fair value of each reporting unit. We estimate the fair value of a reporting unit using market approach, income approach or a combination of market and income approach. Significant estimates in the market approach include: identifying similar companies with comparable business factors such as size, growth, profitability, risk and return on investment, and assessing comparable revenue and operating income multiples in estimating the fair value of the reporting unit. Significant estimates in the income approach include: future cash flows, discount rates.

We base our estimates on historical experience and on various assumptions about the future that we believe are reasonable based on available information. Unanticipated events and circumstances may occur that affect the accuracy of our assumptions, estimates and judgments. For example, if the price of our common stock were to significantly decrease combined with other adverse changes in market conditions, thus indicating that the underlying fair value of our reporting units may have decreased, we might be required to reassess the value of our goodwill in the period such circumstances were identified.

Based on the impairment analysis performed in the fourth quarter of each year presented, the fair value of our reporting unit substantially exceeded the carrying value; as such, our annual qualitative assessment did not indicate that a more detailed quantitative analysis was necessary.

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LUMENTUM HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Intangible Assets
Intangible assets consist primarily of intangible assets purchased through acquisitions. Purchased intangible assets primarily include acquired developed technologies (developed and core technology). Intangible assets are amortized using the straight-line method over the estimated economic useful lives of the assets, which is the period during which expected cash flows support the fair value of such intangible assets.
Long-lived Asset Valuation
We test long-lived assets for recoverability, at the asset group level, when events or changes in circumstances indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to: significant decreases in the market price of the asset, significant adverse changes in the business climate or legal factors, accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset, current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset, or current expectation that the asset will more likely than not be sold or disposed significantly before the end of its estimated useful life.
Recoverability is assessed based on the difference between the carrying amount of the asset and the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.
Pension Benefits
The funded status of our retirement-related benefit plan is measured as the difference between the fair value of plan assets and the benefit obligation at fiscal year end, the measurement date. The funded status of an underfunded benefit plan, of which the fair value of plan assets is less than the benefit obligation, is recognized as a non-current net pension liability in the consolidated balance sheets unless the fair value of plan assets is not sufficient to cover the expected payments to be made over the next year (or operating cycle, if longer) from the measurement date. For defined benefit pension plans, the benefit obligation is the projected benefit obligation (“PBO”) which represents the actuarial present value of benefits expected to be paid upon retirement.
Net periodic pension cost (income) (“NPPC”) is recorded in the consolidated statements of operations and includes service cost, interest cost, expected return on plan assets, amortization of prior service cost and (gains) losses previously recognized as a component of accumulated other comprehensive income. Service cost represents the actuarial present value of participant benefits attributed to services rendered by employees in the current year. Interest cost represents the time value of money cost associated with the passage of time. (Gains) losses arise as a result of differences between actual experience and assumptions or as a result of changes in actuarial assumptions. Prior service cost (credit) represents the cost of benefit improvements attributable to prior service granted in plan amendments. (Gains) losses and prior service cost (credit) that arise during the current year are first recognized as a component of accumulated other comprehensive income in the consolidated balances sheets, net of tax. Prior service cost is amortized as a component of NPPC over the average remaining service period of active plan participants starting at the date the plan amendment is adopted. Deferred actuarial (gains) losses are subsequently recognized as a component of NPPC if they exceed the greater of 10% of PBO or the fair value of plan assets, with the excess amortized over the average remaining service period of active plan participants.
The measurement of the benefit obligation and NPPC is based on our estimates and actuarial valuations, provided by third-party actuaries, which are approved by management. These valuations reflect the terms of the plans and use participant-specific information such as compensation, age and years of service, as well as certain assumptions, including estimates of discount rates, expected return on plan assets, rate of compensation increases, and mortality rates. We evaluate these assumptions annually at a minimum. In estimating the expected return on plan assets, we consider historical returns on plan assets, adjusted for forward-looking considerations, inflation assumptions and the impact of the active management of the plan’s invested assets.
Concentration of Credit and Other Risks
Financial instruments that potentially subject our business to concentration of credit risk consist primarily of cash and cash equivalents and trade receivables. We perform credit evaluations of our customers’ financial condition and

generally do not require collateral from our customers. These evaluations require significant judgment and are based on a variety of factors including, but not limited to, current economic trends, payment history, bad debt write-off experience, and financial review of the customer.

Although the Company deposits its cash with financial institutions that management believes are of high credit quality, its deposits, at times, may exceed federally insured limits. The Company’s investment portfolio consists of investment grade securities diversified amongst security types, industries, and issuers. The Company’s investment policy limits the amount of credit exposure in the investment portfolio to a maximum of 5% to any one issuer, except for Treasury and Government Agencies securities, and the Company believes no significant concentration risk exists with respect to these investments.

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. When we become aware that a specific customer is unable to meet their financial obligations, we record a specific allowance to reflect the level of credit risk in the customer's outstanding receivable balance. In addition, we record additional allowances based on certain percentages of aged receivable balances. These percentages take into account a variety of factors including, but not limited to, current economic trends, payment history and bad debt write-off experience. We classify bad debt expenses as selling, general and administrative ("SG&A") expense.

We have significant trade receivables concentrated in the telecommunications industry. While our allowance for doubtful accounts balance is based on historical loss experience along with anticipated economic trends, unanticipated financial instability in the telecommunications industry could lead to higher than anticipated losses.

During fiscal 2018, 2017 and 2016, several customers generated more than 10% of total net revenue. Refer to "Note 19. Operating Segments and Geographic Information" in the Notes to Consolidated Financial Statements.

As of June 30, 2018, two customers represented greater than 10% of total accounts receivable, net. As of July 1, 2017, one customer represented greater than 10% of total accounts receivable, net.

We rely on a limited number of suppliers for a number of key components contained in our products. We also rely on a limited number of significant independent contract manufacturers for the production of certain key components and subassemblies contained in our products.

We generally use a rolling twelve month forecast based on anticipated product orders, customer forecasts, product order history and backlog to determine our materials requirements. Lead times for the parts and components that we order vary significantly and depend on factors such as the specific supplier, contract terms and demand for a component at a given time. If the forecast does not meet or if it exceeds actual demand, we may have excess or shortfalls of some materials and components, as well as excess inventory purchase commitments. We could experience reduced or delayed product shipments or incur additional inventory write-downs and cancellation charges or penalties, which would increase costs and could have a material adverse impact on our results of operations.

Foreign Currency Translation

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment, where that local currency is the functional currency, are translated into U.S. dollars at exchange rates in effect at the balance sheet date, with the resulting translation adjustments directly recorded to a separate component of accumulated other comprehensive income, within the consolidated statements of redeemable convertible preferred stock, stockholders' equity, and invested equity. Income and expense accounts are translated at the average exchange rates during the year. Gains and losses from re-measurement of monetary assets and liabilities denominated in currencies other than the respective functional currencies are included in the consolidated statements of operations as a component of interest and other income (expense), net. Net gains or (losses) resulting from foreign currency transactions, including hedging gains and losses that were previously allocated to us by Viavi, are reported in interest and other income (expense), net and were $0.3 million, $0.6 million and $(0.9) million during fiscal 2018, 2017 and 2016, respectively. There were no allocations of expenses from Viavi for the fiscal 2018 and 2017. Refer to "Note 3. Related Party Transactions" in the Notes to Consolidated Financial Statements for allocations from Viavi during fiscal 2016.

Stock-based Compensation

Compensation expense related to stock-based transactions is measured and recognized in the financial statements based on fair value at the grant date.

Restricted stock units ("RSUs") are grants of shares of our common stock, the vesting of which is based on the requisite service requirement. Generally, our RSUs are subject to forfeiture and expected to vest over one to four years. For new-hire grants, RSUs generally vest ratably on an annual basis over four years. For annual refresh grants, RSUs generally vest ratably on an annual, or combination of annual and quarterly, basis over three years.

Restricted stock awards (“RSAs”) are grants of shares of our common stock that are subject to various restrictions, including restrictions on transferability and forfeiture provisions. RSAs are expected to vest over one to four years, and the shares acquired may not be transferred by the holder until the vesting conditions (if any) are satisfied.

Performance stock units (“PSUs”) are grants of shares of our common stock that vest upon the achievement of certain performance and service conditions. We account for the fair value of PSUs using the closing market price of our common stock on the date of grant. We begin recognizing compensation expense when we conclude that it is probable that the performance conditions will be achieved. We reassess the probability of vesting at each reporting period and adjust our compensation cost based on this probability assessment. Our PSUs are subject to risk of forfeiture until performance and service conditions are satisfied and generally vest over three years.

We estimate the fair value of the rights to acquire stock under our 2015 Employee Stock Purchase Plan (the “2015 Purchase Plan”) using the Black-Scholes option pricing formula. Our 2015 Purchase Plan provides for consecutive six-month offering periods. We recognize such compensation expense on a straight-line basis over the requisite service period. We calculate the volatility factor based on our historical stock prices.

Restructuring Accrual

Costs associated with restructuring activities are recognized when they are incurred. However, in the case of leases, the expense is estimated and accrued when the property is vacated. Given the significance of, and the timing of the execution of such activities, this process is complex and involves periodic reassessments of estimates made from the time the property was vacated, including evaluating real estate market conditions for expected vacancy periods and sub-lease income. We recognize a liability for post-employment benefits for workforce reductions related to restructuring activities when payment is probable and the amount is reasonably estimable. We continually evaluate the adequacy of the remaining liabilities under our restructuring initiatives. Although we believe that these estimates accurately reflect the costs of our restructuring plans, actual results may differ, thereby requiring us to record additional provisions or reverse a portion of such provisions. Refer to “Note 14. Restructuring and Related Charges” in the Notes to Consolidated Financial Statements.

Derivative Liability

The Series A Preferred Stock issued by our subsidiary Lumentum Inc. is redeemable at the option of the holder after five years and classified as non-controlling interest redeemable convertible preferred stock in our consolidated balance sheet and is measured at its redemption value. The Series A Preferred Stock conversion feature is bifurcated from the Series A Preferred Stock and accounted for separately as a derivative liability. In March 2017, we issued $450.0 million in aggregate principal amount of 2024 Notes, which are due in March 2024 unless earlier repurchased by us or converted pursuant to their terms. Prior to the Tax Matters Agreement settlement condition (“TMA settlement condition”), because we could only settle the 2024 Notes in cash, we determined that the conversion feature met the definition of a derivative liability. We separated the derivative liability from the host debt instrument based on the fair value of the derivative liability. On June 29, 2017, we met the requirements to account for the conversion option of the 2024 Notes as equity and the conversion option is no longer marked to market. On a quarterly basis, the derivative liability for the Series A Preferred Stock is marked to market based on the fair value of the conversion feature, with the resulting income or loss recorded as unrealized loss on the derivative liabilities on our consolidated statements of operations. The determination of fair value includes various inputs, including volatility and interest rate assumptions. However, the change in the fair value of our common stock has the largest impact to the fair value of the derivatives. During fiscal 2018, 2017, and 2016, we recognized unrealized loss on derivative liabilities of $0.8 million, $104.2 million, and $0.6 million, respectively.

Business Combinations

In accordance with the guidance for business combinations, we determine whether a transaction or other event is a business combination, which requires that the assets acquired and liabilities assumed constitute a business. Each business combination is then accounted for by applying the acquisition method. If the assets acquired are not a business, we account for the transaction or other event as an asset acquisition. Under both methods, we recognize the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired entity. We capitalize acquisition-related costs and fees associated with asset acquisitions and immediately expense acquisition-related costs and fees associated with business combinations.

We allocate the fair value of purchase consideration to the tangible assets acquired, liabilities assumed and intangible assets acquired based on their estimated fair values. The excess of the fair value of purchase consideration over the fair values of these identifiable assets and liabilities is recorded as goodwill. When determining the fair values of assets acquired and liabilities assumed, we make significant estimates and assumptions, especially with respect to intangible assets. Critical estimates in valuing certain intangible assets include, but are not limited to, future expected cash flows from customer relationships and acquired developed technology and discount rates. Our estimates of fair value are based upon assumptions believed to be reasonable, but which are inherently uncertain and unpredictable and, as a result, actual results may differ materially from estimates. Other estimates associated with the accounting for acquisitions may change as additional information becomes available regarding the assets acquired and liabilities assumed. Any change in facts and circumstances that existed as of the acquisition date and impacts our preliminary estimates is recorded to goodwill if identified within the measurement period. Subsequent to the measurement period or our final determination of fair value of assets and liabilities whichever is earlier the adjustments will affect our earnings.

In addition, we estimate the economic lives of certain acquired assets and these lives are used to calculate depreciation and amortization expense. If our estimates of the economic lives change, depreciation or amortization expenses could be accelerated or slowed.

Warranty

We provide reserves for the estimated costs of product warranties at the time revenue is recognized. We estimate the costs of our warranty obligations based on our historical experience of known product failure rates, use of materials to repair or replace defective products and service delivery costs incurred in correcting product failures. In addition, from time to time, specific warranty accruals may be made if unforeseen technical problems arise.

Shipping and Handling Costs

We record shipping and handling costs related to revenue transactions within cost of sales as a period cost for all periods presented.

Research and Development (“R&D”) Expense

Costs related to R&D, which primarily consists of labor and benefits, supplies, facilities, consulting and outside service fees, are charged to expense as incurred.

Loss Contingencies

We are subject to the possibility of various loss contingencies arising in the ordinary course of business. We consider the likelihood of loss or impairment of an asset or the incurrence of a liability, as well as our ability to reasonably estimate the amount of loss in determining loss contingencies. An estimated loss is accrued when it is probable that an asset has been impaired or a liability has been incurred and the amount of loss can be reasonably estimated. We regularly evaluate current information available to determine whether such accruals should be adjusted and whether new accruals are required.

Asset Retirement Obligations (“ARO”)

Our ARO are legal obligations associated with the retirement of long-lived assets pertaining to leasehold improvements. These liabilities are initially recorded at fair value and the related asset retirement costs are capitalized by increasing the carrying amount of the related assets by the same amount as the liability. Asset retirement costs are subsequently depreciated over the useful lives of the related assets. Subsequent to initial recognition, we record period-to-period changes in the ARO liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. We derecognize ARO liabilities when the related obligations are settled.

Note 2. Recent Accounting Pronouncements

Accounting Pronouncements Recently Adopted

Effective July 2, 2017, we adopted Accounting Standards Update (“ASU”) 2016-09, Stock Compensation ASU 718 - Improvements to Employee Share-Based Payment Accounting. As a result of the adoption, in the first quarter of fiscal year 2018, we recorded on a modified retrospective basis a $2.6 million cumulative-effect adjustment to retained earnings for the recognition of excess tax benefits generated by the settlement of share-based awards in prior periods. We elected to account for forfeitures of equity awards when they occur. The change was applied on a modified retrospective basis with a cumulative-effect adjustment of approximately $0.2 million to retained earnings in the fiscal first quarter of 2018.

All excess tax benefits and deficiencies are recognized in the income tax provision in the consolidated statements of operations prospectively, rather than in additional paid-in-capital in the consolidated balance sheets. In addition, the standard eliminates the requirement to defer recognition of excess tax benefits until they are realized through a reduction to income taxes payable. We present excess tax benefits as an operating activity in the consolidated statements of cash flows on a prospective basis.

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Accounting Pronouncements Not Yet Effective

In January 2017, the Financial Accounting Standards Board (“FASB”) issued ASU 2017-01, Business Combinations (Topic 805), which clarifies the definition of a business. For accounting and financial reporting purposes, businesses are generally comprised of three elements; inputs, processes, and outputs. Integrated sets of assets and activities capable of providing these three elements may not always be considered a business, and the lack of one of the three elements does not always disqualify the set from being a business. The issuance of ASU 2017-01 provides a clarifying screen to determine when a set of assets and activities is not a business. Primarily, the screen requires that when substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the set is not a business. The amendments contained in ASU 2017-01 are effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The accounting standard update will be effective for us beginning in the first quarter of fiscal 2019 and should be applied prospectively. The implementation of ASU 2017-01 will not have a material impact on our consolidated financial statements.

In January 2017, FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Accounting for Goodwill Impairment. ASU 2017-04 removes the requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. A goodwill impairment charge will be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. The amendments contained in ASU 2017-04 are effective for interim and annual periods beginning after December 15, 2019, with early adoption permitted, which should be applied prospectively. We plan to adopt the accounting standard update in our first quarter of fiscal 2020. We do not believe the implementation of ASU 2017-04 will have a material impact on our consolidated financial statements.

In October 2016, FASB issued ASU 2016-16, Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets other than Inventory. The new guidance removes the prohibition in ASC 740 against the immediate recognition of the current and deferred income tax effects of intra-entity transfers of assets other than inventory. The new guidance will be effective for us in our first quarter of fiscal 2019. We do not believe that the adoption of ASU 2016-16 will have a material impact on our financial statements.

In August 2016, FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies how companies present and classify certain cash receipts and cash payments in the statement of cash flows. The amendments contained in ASU 2016-15 are effective for interim and annual periods beginning after December 15, 2017. The accounting standard update will be effective for us in the first quarter of fiscal 2019 and will be applied prospectively. If we elect to settle the principal amounts of our 2024 Notes (refer to “Note 11. Convertible Senior Notes”) in cash, the payment will be bifurcated between (i) cash outflows for operating activities of $137.6 million for the portion related to accreted interest attributable to debt discount, and (ii) financing activities for the remainder of $312.4 million.

In February 2016, FASB issued ASU 2016-02, Leases. The new guidance generally requires an entity to recognize on its balance sheet operating and financing lease liabilities and corresponding right-of-use assets. The new guidance contained in ASU 2016-02 is effective for annual periods beginning after December 15, 2018, including interim periods within those periods, with early adoption permitted. The standard is effective for us in our first quarter of fiscal 2020 where we will be required to recognize and measure leases existing at, or entered into after, the beginning of the earliest comparative period presented using a modified retrospective approach, with an option to elect certain practical expedients. Based on our current lease portfolio, we estimate the value of leased assets and liabilities that may be recognized will be material. We are continuing to evaluate the impact of ASU 2016-02 which is subject to change.

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers (“ASU 2014-09”), which outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five-step process to achieve this core principle and, accordingly, we expect more judgment and estimates may be required within the revenue recognition process than is required under the previous revenue recognition standard, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. ASU 2014-09 is effective for us beginning on July 1, 2018. ASU 2014-09 permits two methods of adoption: retrospectively to each prior reporting period presented (the full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). We elected to adopt ASU 2014-09 using the modified retrospective method and will apply the standard to contracts that are not completed as of July 1, 2018.

We have completed our analysis of open revenue contracts as of July 1, 2018. Based on our assessment, the impact on revenue in our consolidated financial statements or disclosures is not material because under ASU 2014-09 we continue to recognize most revenue at the point-in-time when control transfers.

In the preparation for the adoption of ASU 2014-09, we have implemented internal controls to enable the preparation of financial information and related disclosures in accordance with this standard.

Note 3. Related Party Transactions

Transactions with Viavi

Since October 2017, all transactions with Viavi were no longer related party transactions, as Viavi held less than 5% of our total shares outstanding.

During the fiscal year ended July 1, 2017, we recognized revenue of $3.6 million from products sold to Viavi. During the fiscal year ended July 1, 2017, we recorded $0.5 million in research and development cost reimbursement and $0.7 million in sublease rental income. As of July 1, 2017, we had $0.1 million in trade accounts receivable due from Viavi and $0.5 million in other receivables from Viavi. As of July 1, 2017, we had $0.2 million in trade payables due to Viavi. During the fiscal year ended July 1, 2017, we recorded $0.6 million in other income, which resulted from a tax indemnification agreement between Lumentum and Viavi. As a result, we had $0.6 million in other non-current assets due from Viavi as of July 1, 2017.

During the fiscal year ended July 2, 2016, we recognized revenue of $3.3 million from products sold to Viavi. During the fiscal year ended July 2, 2016, we recorded $2.3 million in research and development cost reimbursement and $0.7 million in sublease rental income. As of July 2, 2016, we had $1.1 million in accounts receivable due from Viavi.

Allocated Costs

From June 28, 2015 to August 1, 2015, the Separation date, the consolidated statements of operations included our direct expenses for cost of sales, research and development, sales and marketing, and administration as well as allocations of expenses arising from shared services and infrastructure provided by Viavi to us. These allocated expenses include costs of information technology, human resources, accounting, legal, real estate and facilities, corporate marketing, insurance, treasury and other corporate and infrastructure services. In addition, other costs allocated to us include restructuring and stock-based compensation related to Viavi's corporate and shared services employees and are included in the table below. These expenses were allocated to us using estimates that we consider to be a reasonable reflection of the utilization of services or benefits received by our business. The allocation methods include revenue, headcount, square footage, actual consumption and usage of services and others.

There were no allocations of expenses from Viavi for the fiscal years ended June 30, 2018 or July 1, 2017. During the fiscal year ended July 2, 2016, allocated costs from Viavi included in the accompanying consolidated statements of operations were as follows (in millions):

	July 2, 2016
Selling, general and administrative	$11.7
Interest and other (income) expenses, net	(0.1)
Interest expense	0.1
Total allocated costs	$11.7

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LUMENTUM HOLDINGS INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Note 4. Earnings Per Share
The following table sets forth the computation of basic and diluted net income (loss) attributable to common stockholders per share (in millions, except per share data):

	Years Ended		
	June 30, 2018	July 1, 2017	July 2, 2016
Basic Earnings per Common Share			
Net income (loss)	$248.1	$(102.5)	$9.3
Less: Cumulative dividends on Series A Preferred Stock	(0.9)	(0.9)	(0.8)
Less: Earnings allocated to Series A Preferred Stock	(5.7)	—	—
Less: Accretion of Series A Preferred Stock	—	—	(11.7)
Net income (loss) attributable to common stockholders - Basic	$241.5	$(103.4)	$(3.2)
Weighted average common shares outstanding including Series A Preferred Stock	63.8	62.1	60.4
Less: Weighted average Series A Preferred Stock	(1.5)	(1.5)	(1.3)
Basic weighted average common shares outstanding	62.3	60.6	