CREE INC
Form 10-Q
January 25, 2017
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 25, 2016
or
[   ] 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 0-21154
CREE, INC.
(Exact name of registrant as specified in its charter)

North Carolina	56-1572719
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

4600 Silicon Drive Durham, North Carolina	27703
(Address of principal executive offices)	(Zip Code)

(919) 407-5300
(Registrant’s telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [   ]

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes [X] No [   ]
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [X]
Accelerated filer [   ]
Non-accelerated filer [   ] (Do not check
Smaller reporting company [   ]

if
a
smaller
reporting
company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No[X]
The number of shares outstanding of the registrant's common stock, par value $0.00125 per share, as of January 20, 2017, was 97,404,938.

Table of Contents

CREE, INC.
FORM 10-Q
For the Quarterly Period Ended December 25, 2016
INDEX

2

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
CREE, INC.
UNAUDITED CONSOLIDATED BALANCE SHEETS

	December 25, 2016	June 26, 2016
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$137,093	$166,154
Short-term investments	454,021	439,151
Total cash, cash equivalents and short-term investments	591,114	605,305
Accounts receivable, net	121,759	138,772
Income tax receivable	3,245	6,304
Inventories	281,677	281,671
Prepaid expenses	22,017	25,728
Other current assets	45,024	44,501
Current assets held for sale	434,859	54,426
Total current assets	1,499,695	1,156,707
Property and equipment, net	360,171	387,167
Goodwill	518,059	518,059
Intangible assets, net	246,246	259,400
Other long-term investments	34,315	40,179
Deferred income taxes	41,019	38,564
Long-term assets held for sale	—	356,735
Other assets	8,165	9,249
Total assets	$2,707,670	$2,766,060
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$109,306	$122,808
Accrued salaries and wages	41,955	40,128
Other current liabilities	42,107	45,101
Current liabilities held for sale	21,281	14,962
Total current liabilities	214,649	222,999
Long-term liabilities:		
Long-term debt	170,000	160,000
Deferred income taxes	945	943
Long-term liabilities held for sale	—	1,850
Other long-term liabilities	22,057	12,444
Total long-term liabilities	193,002	175,237
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 25, 2016 and June 26, 2016; none issued and outstanding	—	—
Common stock, par value $0.00125; 200,000 shares authorized at December 25, 2016 and June 26, 2016; 97,399 and 100,829 shares issued and outstanding at December 25, 2016 and June 26, 2016, respectively	121	125
Additional paid-in-capital	2,388,855	2,359,584

Accumulated other comprehensive income, net of taxes	3,299	8,728
Accumulated deficit	(92,256)	(613)
Total shareholders' equity	2,300,019	2,367,824
Total liabilities and shareholders' equity	$2,707,670	$2,766,060

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

Table of Contents

CREE, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
	(In thousands, except per share amounts)			
Revenue, net	$346,962	$393,758	$668,291	$775,307
Cost of revenue, net	236,071	282,624	471,059	556,981
Gross profit	110,891	111,134	197,232	218,326
Operating expenses:				
Research and development	28,070	31,563	56,601	64,294
Sales, general and administrative	67,671	67,877	129,042	138,049
Amortization or impairment of acquisition-related intangibles	5,937	6,468	12,203	12,937
Loss on disposal or impairment of long-lived assets	530	2,015	846	11,580
Total operating expenses	102,208	107,923	198,692	226,860
Operating income (loss)	8,683	3,211	(1,460)	(8,534)
Non-operating (expense) income, net	(4,754)	8,016	(4,912)	(14,787)
Income (loss) from continuing operations before income taxes	3,929	11,227	(6,372)	(23,321)
Income tax expense (benefit)	5,036	1,815	(2,407)	(6,997)
(Loss) income from continuing operations	(1,107)	9,412	(3,965)	(16,324)
Income from discontinued operations, net of tax	7,326	4,030	10,750	5,277
Net income (loss)	$6,219	$13,442	$6,785	($11,047)
Earnings (loss) per share-basic				
Continuing operations	($0.01)	$0.09	($0.04)	($0.16)
Discontinued operations	0.07	0.04	0.11	0.05
Earnings (loss) per share-basic	$0.06	$0.13	$0.07	($0.11)
Earnings (loss) per share-diluted				
Continuing operations	($0.01)	$0.09	($0.04)	($0.16)
Discontinued operations	0.07	0.04	0.11	0.05
Earnings (loss) per share-diluted	$0.06	$0.13	$0.07	($0.11)
Weighted average shares used in per share calculation:				
Basic	98,467	102,391	99,513	102,932
Diluted	98,467	102,521	99,513	102,932

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

CREE, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
	(In thousands)			
Net income (loss)	$6,219	$13,442	$6,785	($11,047)
Other comprehensive loss:				
Currency translation loss	(1,343)	(430)	(1,314)	(789)
Net unrealized (loss) gain on available-for-sale securities, net of tax benefit (expense) of $2,357 and $113, $2,556 and ($376), respectively	(3,795)	(180)	(4,115)	612
Other comprehensive loss	(5,138)	(610)	(5,429)	(177)
Comprehensive income (loss)	$1,081	$12,832	$1,356	($11,224)

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

Table of Contents

CREE, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended	
	December 25, 2016	December 27, 2015
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	$6,785	($11,047)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	62,574	81,746
Stock-based compensation	26,856	29,462
Excess tax benefit from stock-based payment arrangements	(1)	(12)
Loss on disposal or impairment of long-lived assets	845	16,587
Amortization of premium/discount on investments	2,749	2,747
Loss on equity investment	6,298	12,922
Foreign exchange (gain) loss on equity investment	(434)	2,800
Deferred income taxes	44	60
Changes in operating assets and liabilities:		
Accounts receivable, net	13,647	3,883
Inventories	1,290	379
Prepaid expenses and other assets	2,735	12,025
Accounts payable, trade	(13,836)	(8,788)
Accrued salaries and wages and other liabilities	10,164	(18,968)
Net cash provided by operating activities	119,716	123,796
Cash flows from investing activities:		
Purchases of property and equipment	(35,211)	(81,804)
Purchases of patent and licensing rights	(5,836)	(7,628)
Proceeds from sale of property and equipment	236	2,376
Purchases of short-term investments	(125,022)	(169,197)
Proceeds from maturities of short-term investments	93,312	194,406
Proceeds from sale of short-term investments	7,619	19,352
Purchase of acquired business, net of cash acquired	(2,775)	(12,513)
Net cash used in investing activities	(67,677)	(55,008)
Cash flows from financing activities:		
Proceeds from long-term debt borrowings	245,000	368,000
Payments on long-term debt borrowings	(235,000)	(363,000)
Net proceeds from issuance of common stock	8,021	9,939
Excess tax benefit from stock-based payment arrangements	1	12
Repurchases of common stock	(98,431)	(131,749)
Net cash used in financing activities	(80,409)	(116,798)
Effects of foreign exchange changes on cash and cash equivalents	(691)	(1,114)
Net decrease in cash and cash equivalents	(29,061)	(49,124)
Cash and cash equivalents:		
Beginning of period	166,154	139,710
End of period	$137,093	$90,586
Supplemental disclosure of cash flow information:		
Significant non-cash transactions:		
Accrued property and equipment	$8,240	$7,681

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

Table of Contents

CREE, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation and New Accounting Standards

Overview

Cree, Inc. (the Company) is a leading innovator of lighting-class light emitting diode (LED) products, lighting products and wide bandgap semiconductor products for power and radio-frequency (RF) applications. The Company's products are targeted for applications such as indoor and outdoor lighting, video displays, transportation, electronic signs and signals, power supplies, inverters and wireless systems.

The Company's lighting products primarily consist of LED lighting systems and bulbs. The Company designs, manufactures and sells lighting fixtures and lamps for the commercial, industrial and consumer markets.

The Company's LED products consist of LED components and LED chips. The Company's LED products enable its customers to develop and market LED-based products for lighting, video screens and other industrial applications.

In addition, the Company develops, manufactures and sells silicon carbide (SiC) materials, power devices and RF devices based on wide bandgap semiconductor materials such as SiC and gallium nitride (GaN). The Company's SiC materials products are sold to customers developing power and RF products as well as gemstones. These SiC materials products had previously been included within the LED Products segment. The Company's power products are made from SiC and provide increased efficiency, faster switching speeds and reduced system size and weight over comparable silicon-based power devices. The Company's RF devices are made from GaN and provide improved efficiency, bandwidth and frequency of operation as compared to silicon or gallium arsenide (GaAs). Collectively, the Company refers to these product lines as the Wolfspeed business. As discussed more fully below in Note 2, “Discontinued Operations,” on July 13, 2016, the Company executed a definitive agreement to sell its Wolfspeed business to Infineon Technologies AG (Infineon). As a result, the Company has classified the results of the Wolfspeed business as discontinued operations in its consolidated statements of income (loss) for all periods presented. Additionally, the related assets and liabilities associated with the discontinued operations are classified as held for sale in the consolidated balance sheets. Unless otherwise noted, discussion within these notes to the consolidated financial statements relates to the Company's continuing operations.

The majority of the Company's products are manufactured at its production facilities located in North Carolina, Wisconsin and China. The Company also uses contract manufacturers for certain products and aspects of product fabrication, assembly and packaging. The Company operates research and development facilities in North Carolina, California, Wisconsin, India, Italy and China (including Hong Kong).

Cree, Inc. is a North Carolina corporation established in 1987 and is headquartered in Durham, North Carolina.

The Company's two reportable segments are:

- Lighting Products
- LED Products

For financial results by reportable segment, please refer to Note 14, "Reportable Segments."

Basis of Presentation

The consolidated balance sheet at December 25, 2016, the consolidated statements of income (loss) for the three and six months ended December 25, 2016 and December 27, 2015, the consolidated statements of comprehensive income (loss) for the three and six months ended December 25, 2016 and December 27, 2015, and the consolidated statements of cash flows for the six months ended December 25, 2016 and December 27, 2015 (collectively, the consolidated financial statements) have been prepared by the Company and have not been audited. In the opinion of management, all normal and recurring adjustments necessary to fairly state the consolidated financial position, results of operations, comprehensive income and cash flows at December 25, 2016, and for all periods presented, have been made. All intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 26, 2016 has been derived from the audited financial statements as of that date.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for annual financial statements. These financial

Table of Contents

statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 26, 2016 (fiscal 2016). The results of operations for the three and six months ended December 25, 2016 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 25, 2017 (fiscal 2017).

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities. Actual amounts could differ materially from those estimates.

Certain fiscal 2016 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2017 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders’ equity.

Revision of Prior Period Financial Statements

During the third quarter of fiscal 2016, the Company identified errors in its previously reported financial statements in which amortization expense was understated as certain patents were being amortized over a life longer than the life of the underlying patent right.

The Company assessed the materiality of these errors on prior periods’ financial statements in accordance with the United States Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 99, Materiality, codified in the Accounting Standards Codification (ASC) 250, Presentation of Financial Statements, and concluded that they were not material individually or in the aggregate to any prior annual or interim periods. However, through the second quarter of fiscal 2016 the aggregate amount of the prior period errors of $6.8 million before income taxes would have been material to the Company's interim Consolidated Statements of Income (Loss) for the third quarter of fiscal 2016. Consequently, in accordance with ASC 250, the Company corrected these errors, and other immaterial errors, for all prior periods presented by revising the consolidated financial statements and other financial information included herein.

Table of Contents

The following table summarizes the effects of the revision on the consolidated statements of income (loss) (in thousands):

	Three Months Ended December 27, 2015			Six Months Ended December 27, 2015		
	As Reported	Revision Adjustments	As Revised	As Reported	Revision Adjustments	As Revised
Cost of revenue, net	$281,992	$632	$282,624	$555,248	$1,733	$556,981
Gross profit	111,766	(632)	111,134	220,059	(1,733)	218,326
Operating income (loss)	3,843	(632)	3,211	(6,801)	(1,733)	(8,534)
Income (loss) from continuing operations before income taxes	11,859	(632)	11,227	(21,588)	(1,733)	(23,321)
Income tax expense (benefit)	1,985	(170)	1,815	(6,543)	(454)	(6,997)
(Loss) income from continuing operations	9,874	(462)	9,412	(15,045)	(1,279)	(16,324)
Income (loss) from discontinued operations, net of tax	4,084	(54)	4,030	5,380	(103)	5,277
Net income (loss)	$13,958	($516)	$13,442	($9,665)	($1,382)	($11,047)
Earnings (loss) per share-basic						
Continuing operations	$0.10	($0.01)	$0.09	($0.14)	($0.02)	($0.16)
Discontinued operations	0.04	—	0.04	0.05	—	0.05
Earnings (loss) per share-basic	$0.14	($0.01)	$0.13	($0.09)	($0.02)	($0.11)
Earnings (loss) per share-diluted						
Continuing operations	$0.10	($0.01)	$0.09	($0.14)	($0.02)	($0.16)
Discontinued operations	0.04	—	0.04	0.05	—	0.05
Earnings (loss) per share-diluted	$0.14	($0.01)	$0.13	($0.09)	($0.02)	($0.11)

The revision had no net impact on the Company’s net cash provided by operating activities.

Recently Issued Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09: Revenue from Contracts with Customers (Topic 606). The FASB has subsequently issued multiple ASUs which amend and clarify the guidance in Topic 606. The ASU establishes a principles-based approach for accounting for revenue arising from contracts with customers and supersedes existing revenue recognition guidance. The ASU provides that an entity should apply a five-step approach for recognizing revenue, including (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. Also, the entity must provide various disclosures concerning the nature, amount and timing of revenue and cash flows arising from contracts with customers. The effective date will be the first quarter of the Company's fiscal year ending June 30, 2019, using one of two retrospective application methods. The Company is currently analyzing the impact of this new pronouncement.

Table of Contents

Leases
In February 2016, the FASB issued ASU No. 2016-02: Leases (Topic 842). The ASU requires that a lessee recognize in its statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. For income statement purposes, leases are still required to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. The effective date will be the first quarter of the Company's fiscal year ending June 28, 2020, using a modified retrospective approach. The Company is currently analyzing the impact of this new pronouncement.
Stock Compensation
In March 2016, the FASB issued ASU No. 2016-09: Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU simplifies the current stock compensation guidance for tax consequences. The ASU requires an entity to recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in its income statement. The ASU also eliminates the requirement to defer recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable. For cash flows statement purposes, excess tax benefits should be classified as an operating activity and cash payments made to taxing authorities on the employee’s behalf for withheld shares should be classified as financing activity. The ASU is effective for public companies for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The Company is currently analyzing the impact of this new pronouncement.
Note 2 – Discontinued Operations

On July 13, 2016, the Company executed an Asset Purchase Agreement (the APA) with Infineon. The transaction, which was approved by both the Company’s Board of Directors and Infineon’s Supervisory Board, is currently pending customary closing conditions and governmental approvals. The Company targets closing the transaction within its third quarter of fiscal year 2017.

Pursuant to the APA, the Company will sell to Infineon, and Infineon will (i) purchase from the Company (a) the assets comprising the Company’s power and RF product lines (formerly the Company's Power and RF Products segment), including manufacturing facilities and equipment, inventory, intellectual property rights, contracts, real estate, and the outstanding equity interests of Cree Fayetteville, Inc, one of the Company’s wholly-owned subsidiaries, and (b) certain related portions of the Company’s SiC materials and gemstones business previously included within the LED Products segment and (ii) assume certain liabilities related to the Wolfspeed business. The Company will retain certain liabilities associated with the Wolfspeed business arising prior to the closing of the transaction. Infineon is expected to hire most of the Company’s approximately 594 Wolfspeed employees either at the closing of the transaction or following a transition period.

The purchase price for the Wolfspeed business will be $850 million in cash, which is subject to certain adjustments. In connection with the transaction, the Company and Infineon will also enter into certain ancillary and related agreements, including (i) an intellectual property assignment and license agreement, which will assign to Infineon certain intellectual property owned by the Company and license to Infineon certain additional intellectual property owned by the Company, (ii) a transition services agreement, which is designed to ensure a smooth transition of the Wolfspeed business to Infineon, and (iii) a wafer supply agreement, pursuant to which the Company will supply Infineon with SiC wafers and SiC boules for a transitional period of time.

The APA contains customary representations, warranties and covenants, including covenants to cooperate in seeking regulatory approvals, as well as the Company’s agreement to not compete with the Wolfspeed business for five years following the closing of the transaction and to indemnify Infineon for certain damages that Infineon may suffer following the closing of the transaction.

Infineon's obligation to purchase the Wolfspeed business is subject to the satisfaction or waiver of a number of conditions set forth in the APA, including regulatory approval under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 and certain similar non-U.S. regulations, the approval of the Committee on Foreign Investment in the United States and other customary closing conditions. The APA provides for customary termination rights of the parties and also provides that in the event the APA is terminated for certain specified regulatory-related circumstances, Infineon may be required to pay the Company a termination fee ranging from $12.5 million to $42.5 million.

The Company has classified the results of the Wolfspeed business as discontinued operations in the Company’s consolidated statements of income (loss) for all periods presented. The Company ceased recording depreciation and amortization of long-lived assets of the Wolfspeed business upon classification as discontinued operations in July 2016. Additionally, the related assets and liabilities associated with the discontinued operations are classified as held for sale in the consolidated balance sheets. The assets

Table of Contents

and liabilities held for sale as of December 25, 2016 are classified as current in the consolidated balance sheet as the Company expects the transaction to close within one year.

Table of Contents

The following table presents the financial results of the Wolfspeed business as income from discontinued operations, net of income taxes in the Company's consolidated statements of income (loss) (in thousands):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
Revenue, net	$54,363	$42,048	$104,265	$85,987
Cost of revenue, net	24,688	18,723	51,002	39,271
Gross profit	29,675	23,325	53,263	46,716
Total operating expenses	18,854	17,812	37,509	39,325
Income from discontinued operations before income taxes	10,821	5,513	15,754	7,391
Income tax expense	3,495	1,483	5,004	2,114
Income from discontinued operations, net of income taxes	$7,326	$4,030	$10,750	$5,277

The following table presents the assets and liabilities related to the Wolfspeed business held for sale (in thousands):

	December 25, 2016	June 26, 2016
Assets Held For Sale		
Accounts receivable, net	$30,020	$26,839
Prepaid and other Current Assets	2,130	1,369
Inventories	19,435	21,871
Property and equipment, net	235,319	214,936
Intangible assets, net	45,273	43,409
Goodwill	100,769	100,769
Total Assets Held for Sale*	$432,946	$409,193
Liabilities Held for Sale		
Accounts payable	$12,813	$9,477
Accrued salaries and wages	5,473	4,514
Other accrued liabilities	2,995	971
Other long term liabilities	—	1,850
Total Liabilities Held for Sale*	$21,281	$16,812

*Amounts in the June 26, 2016 column are classified as current and long-term in the consolidated balance sheet.

The following table presents the cash flow of the Wolfspeed business (in thousands):

	Six Months Ended	
	December 25, 2016	December 27, 2015
Net cash provided by discontinued operating activities	$17,314	$21,146
Net cash used in discontinued investing activities	22,699	68,221

Table of Contents

Note 3 – Acquisition

On July 8, 2015, the Company closed on the acquisition of Arkansas Power Electronics International, Inc. (APEI), a global leader in power modules and power electronics applications, pursuant to a merger agreement with APEI and certain shareholders of APEI, whereby the Company acquired all of the outstanding share capital of APEI in exchange for a base purchase price of $13.8 million, subject to certain adjustments. In addition, if certain goals are achieved over the subsequent two years, additional cash payments totaling up to $4.6 million may be made to the former APEI shareholders. Payments totaling $2.8 million were made to the former APEI shareholders in July 2016 based on achievement of the first year goals. The Company expects that the second year goals will also be achieved. In connection with this acquisition, APEI became a wholly owned subsidiary of the Company, renamed Cree Fayetteville, Inc. (Cree Fayetteville). Cree Fayetteville is not considered a significant subsidiary of the Company and its results from operations were reported as part of the Company's former Power and RF Products segment prior to the classification of the Wolfspeed business as discontinued operations and is discussed more fully in Note 2, "Discontinued Operations."

The total purchase price for this acquisition was as follows (in thousands):

Cash consideration paid to shareholders	$13,797
Post-closing adjustments	181
Contingent consideration	4,625
Total purchase price	$18,603

The purchase price for this acquisition has been allocated to the assets acquired and liabilities assumed based on their estimated fair values as follows (in thousands):

Tangible assets:	
Cash and cash equivalents	$1,284
Accounts receivable	1,006
Inventories	143
Property and equipment	935
Other assets	270
Total tangible assets	3,638
Intangible assets:	
Patents	40
Customer relationships	4,500
Developed technology	11,403
In-process research and development	7,565
Non-compete agreements	231
Goodwill	2,483
Total intangible assets	26,222
Liabilities assumed:	
Accounts payable	55
Accrued expenses and liabilities	1,911
Other long-term liabilities	9,291
Total liabilities assumed	11,257
Net assets acquired	$18,603

Table of Contents

Prior to the classification of the Wolfspeed business as discontinued operations, the identifiable intangible assets acquired as a result of the acquisition were being amortized over their respective estimated useful lives as follows (in thousands, except for years):

	Asset Amount	Estimated Life in Years
Patents	$40	20
Customer relationships	4,500	4
Developed technology	11,403	10
In-process research and development[1]	7,565	7
Non-compete agreements	231	3
Total identifiable intangible assets	$23,739	

(1) In-process research and development (IPR&D) is initially classified as indefinite-lived assets and tested for impairment at least annually or when indications of potential impairment exist. The IPR&D was completed in January 2016.

Goodwill largely consists of expansion of product offerings of power modules and power electronics applications, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

The assets, liabilities, and operating results of APEI have been included in the Company's consolidated financial statements from the date of acquisition and are not significant to the Company as a whole.

Note 4 – Financial Statement Details

Accounts Receivable, net

The following table summarizes the components of accounts receivable, net (in thousands):

	December 25, 2016	June 26, 2016
Billed trade receivables	$173,645	$188,672
Unbilled contract receivables	182	59
	173,827	188,731
Allowance for sales returns, discounts and other incentives	(46,235)	(44,543)
Allowance for bad debts	(5,833)	(5,416)
Accounts receivable, net	$121,759	$138,772

Inventories

The following table summarizes the components of inventories (in thousands):

	December 25, 2016	June 26, 2016
Raw material	$69,219	$79,957
Work-in-progress	80,635	84,459
Finished goods	131,823	117,255
Inventories	$281,677	$281,671

Table of Contents

Other Current Liabilities

The following table summarizes the components of other current liabilities (in thousands):

	December 25, 2016	June 26, 2016
Accrued taxes	$12,033	$12,023
Accrued professional fees	9,569	7,959
Accrued warranty	15,045	20,102
Accrued other	5,460	5,017
Other current liabilities	$42,107	$45,101

Accumulated Other Comprehensive Income, net of taxes

The following table summarizes the components of accumulated other comprehensive income, net of taxes (in thousands):

	December 25, 2016	June 26, 2016
Currency translation gain	$3,310	$4,624
Net unrealized (loss) gain on available-for-sale securities	(11)	4,104
Accumulated other comprehensive income, net of taxes	$3,299	$8,728

Non-Operating Expense, net

The following table summarizes the components of non-operating (expense) income, net (in thousands):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
Foreign currency loss, net	($1,856)	($385)	($495)	($4,679)
Gain on sale of investments, net	—	14	12	16
(Loss) gain on equity investment	(3,796)	7,026	(6,283)	(12,922)
Interest income, net	900	1,220	1,787	2,517
Other, net	(2)	141	67	281
Non-operating (expense) income, net	($4,754)	$8,016	($4,912)	($14,787)

Table of Contents

Reclassifications Out of Accumulated Other Comprehensive Income, net of taxes

The following table summarizes the amounts reclassified out of accumulated other comprehensive income, net of taxes (in thousands):

Accumulated Other Comprehensive Income Component	Amount Reclassified Out of Accumulated Other Comprehensive Income				Affected Line Item in the Consolidated Statements of Income (Loss)
	Three Months Ended		Six Months Ended		
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015	
Net unrealized gain on available-for-sale securities, net of taxes	$—	$14	$12	$16	Non-operating (expense) income, net
	—	14	12	16	Income (loss) from continuing operations before income taxes
	—	2	5	5	Income tax expense (benefit)
	$—	$12	$7	$11	(Loss) income from continuing operations

Note 5 – Investments

Investments consist of municipal bonds, corporate bonds, commercial paper and certificates of deposit. All short-term investments are classified as available-for-sale. Other long-term investments consist of the Company's ownership interest in Lextar Electronics Corporation.

The following tables summarize short-term investments (in thousands):

	December 25, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$186,214	$583	($767)	$186,030
Corporate bonds	165,016	874	(813)	165,077
Non-U.S. certificates of deposit	89,901	—	—	89,901
U.S. certificates of deposit	9,150	—	—	9,150
Commercial paper	3,863	—	—	3,863
Total short-term investments	$454,144	$1,457	($1,580)	$454,021

	June 26, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$186,893	$3,562	($15)	$190,440
Corporate bonds	165,766	3,074	(73)	168,767
Non-U.S. certificates of deposit	73,127	—	—	73,127
U.S. certificates of deposit	3,500	—	—	3,500
Commercial paper	3,317	—	—	3,317
Total short-term investments	$432,603	$6,636	($88)	$439,151

Table of Contents

The following tables present the gross unrealized losses and estimated fair value of the Company's short-term investments, aggregated by investment type and the length of time that individual securities have been in a continuous unrealized loss position (in thousands, except numbers of securities):

	December 25, 2016					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$106,408	($767)	$—	$—	$106,408	($767)
Corporate bonds	80,976	(808)	2,495	(5)	83,471	(813)
Total	$187,384	($1,575)	$2,495	($5)	$189,879	($1,580)
Number of securities with an unrealized loss		131		1		132

	June 26, 2016					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$2,936	($9)	$3,535	($6)	$6,471	($15)
Corporate bonds	27,578	(73)	—	—	27,578	(73)
Total	$30,514	($82)	$3,535	($6)	$34,049	($88)
Number of securities with an unrealized loss		22		3		25

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains and losses from the sale of investments are included in Non-operating (expense) income, net in the consolidated statements of income (loss) and unrealized gains and losses are included as a separate component of equity, net of tax, unless the loss is determined to be other-than-temporary.

The Company evaluates its investments for possible impairment or a decline in fair value below cost basis that is deemed to be other-than-temporary on a periodic basis. It considers such factors as the length of time and extent to which the fair value has been below the cost basis, the financial condition of the investee, and its ability and intent to hold the investment for a period of time that may be sufficient for an anticipated full recovery in market value. Accordingly, the Company considered declines in its investments to be temporary in nature, and did not consider its securities to be impaired as of December 25, 2016 and June 26, 2016.

The contractual maturities of short-term investments as of December 25, 2016 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	$44,551	$112,725	$28,755	$—	$186,031
Corporate bonds	32,559	96,042	36,476	—	165,077
Non-U.S. certificates of deposit	89,901	—	—	—	89,901
U.S. certificates of deposit	6,150	3,000	—	—	9,150
Commercial paper	3,862	—	—	—	3,862
Total short-term investments	$177,023	$211,767	$65,231	$—	$454,021

Table of Contents

Note 6 – Fair Value of Financial Instruments

Under U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., the exit price) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches, including quoted market prices and discounted cash flows. U.S. GAAP also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are obtained from independent sources and can be validated by a third party, whereas unobservable inputs reflect assumptions regarding what a third party would use in pricing an asset or liability. The fair value hierarchy is categorized into three levels based on the reliability of inputs as follows:

- Level 1 - Valuations based on quoted prices in active markets for identical instruments that the Company is able to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.
- Level 2 - Valuations based on quoted prices in active markets for instruments that are similar, or quoted prices in markets that are not active for identical or similar instruments, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.
- Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The financial assets for which the Company performs recurring fair value remeasurements are cash equivalents, short-term investments and long-term investments. As of December 25, 2016, financial assets utilizing Level 1 inputs included money market funds, and financial assets utilizing Level 2 inputs included municipal bonds, corporate bonds, certificates of deposit, and common stock of non-U.S. corporations. Level 2 assets are valued based on quoted prices in active markets for instruments that are similar or using a third-party pricing service's consensus price, which is a weighted average price based on multiple sources. These sources determine prices utilizing market income models which factor in, where applicable, transactions of similar assets in active markets, transactions of identical assets in infrequent markets, interest rates, bond or credit default swap spreads and volatility. The Company did not have any financial assets requiring the use of Level 3 inputs as of December 25, 2016. There were no transfers between Level 1 and Level 2 during the six months ended December 25, 2016.

Table of Contents

The following table sets forth financial instruments carried at fair value within the U.S. GAAP hierarchy (in thousands):

	December 25, 2016				June 26, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
U.S. agency securities	$—	$—	$—	$—	$—	$—	$—	$—
Non-U.S. certificates of deposit	—	—	—	—	—	137	—	137
Money market funds	466	—	—	466	576	—	—	576
Total cash equivalents	466	—	—	466	576	137	—	713
Short-term investments:								
Municipal bonds	—	186,030	—	186,030	—	190,440	—	190,440
Corporate bonds	—	165,077	—	165,077	—	168,767	—	168,767
U.S. certificates of deposit	—	9,150	—	9,150	—	3,500	—	3,500
Commercial paper	—	3,862	—	3,862	—	3,317	—	3,317
Non-U.S. certificates of deposit	—	89,901	—	89,901	—	73,127	—	73,127
Total short-term investments	—	454,020	—	454,020	—	439,151	—	439,151
Other long-term investments:								
Common stock of non-U.S. corporations	—	34,315	—	34,315	—	40,179	—	40,179
Total other long-term investments	—	34,315	—	34,315	—	40,179	—	40,179
Total assets	$466	$488,335	$—	$488,801	$576	$479,467	$—	$480,043

Note 7– Intangible Assets

Intangible Assets, net

The following table presents the components of intangible assets, net (in thousands):

	December 25, 2016			June 26, 2016		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets with finite lives:						
Customer relationships	$136,920	($79,869)	$57,051	$136,920	($77,313)	$59,607
Developed technology	162,760	(119,525)	43,235	162,760	(110,204)	52,556
Non-compete agreements	10,244	(10,244)	—	10,244	(9,917)	327
Trade names, finite-lived	520	(520)	—	520	(520)	—
Patent and licensing rights	107,656	(41,376)	66,280	105,035	(37,805)	67,230
Total intangible assets with finite lives	418,100	(251,534)	166,566	415,479	(235,759)	179,720
Trade names, indefinite-lived	79,680	—	79,680	79,680	—	79,680
Total intangible assets	$497,780	($251,534)	$246,246	$495,159	($235,759)	$259,400

For the three and six months ended December 25, 2016, total amortization of finite-lived intangible assets was $8.5 million and $16.6 million, respectively. For the three and six months ended December 27, 2015, total amortization of finite-lived intangible assets was $8.4 million and $17.0 million, respectively.

Table of Contents

Total future amortization expense of finite-lived intangible assets is estimated to be as follows (in thousands):

Fiscal Year Ending	
June 25, 2017 (remainder of fiscal 2017)	$16,103
June 24, 2018	31,466
June 30, 2019	18,826
June 28, 2020	14,809
June 27, 2021	13,556
Thereafter	71,806
Total future amortization expense	$166,566

Note 8 – Long-term Debt

As of December 25, 2016, the Company had a $500 million secured revolving line of credit under which the Company can borrow, repay and reborrow loans from time to time prior to its scheduled maturity date of January 9, 2020. The Company classifies balances outstanding under its line of credit as long-term debt in the consolidated balance sheets. At December 25, 2016, the Company had $170 million outstanding under the line of credit and $330 million available for borrowing. For the three and six months ended December 25, 2016, the average interest rate was 1.41% for each period. For the three and six months ended December 25, 2016 the average commitment fee percentage was 0.09%. The Company was in compliance with all covenants in the line of credit at December 25, 2016.

Note 9 – Shareholders' Equity

As of December 25, 2016, pursuant to an approval by the Board of Directors, the Company is authorized to repurchase shares of its common stock having an aggregate purchase price not exceeding $300 million for all purchases from August 24, 2016 through the expiration of the program on June 25, 2017. During the six months ended December 25, 2016, the Company repurchased 4.2 million shares of common stock for $98.5 million under the stock repurchase program.

Note 10– Earnings (Loss) Per Share

The following table presents the computation of basic earnings (loss) per share (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
(Loss) income from continuing operations	($1,107)	$9,412	($3,965)	($16,324)
Income from discontinued operations, net of tax	7,326	4,030	10,750	5,277
Net income (loss)	$6,219	$13,442	$6,785	$ (11,047)
Weighted average common shares	98,467	102,391	99,513	102,932
Basic (loss) income per share from continuing operations	($0.01)	$0.09	($0.04)	($0.16)
Basic earnings per share from discontinued operations	0.07	0.04	$0.11	0.05
Earnings (loss) per share-basic	$0.06	$0.13	$0.07	($0.11)

Table of Contents

The following computation reconciles the differences between the basic and diluted earnings (loss) per share presentations (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
(Loss) income from continuing operations	($1,107)	$9,412	($3,965)	($16,324)
Income from discontinued operations, net of tax	7,326	4,030	10,750	5,277
Net income (loss)	$6,219	$13,442	$6,785	($11,047)
Weighted average common shares - basic	98,467	102,391	99,513	102,932
Dilutive effect of stock options, nonvested shares and Employee Stock Purchase Plan purchase rights	—	130	—	—
Weighted average common shares - diluted	98,467	102,521	99,513	102,932
Diluted (loss) earnings per share from continuing operations	($0.01)	$0.09	($0.04)	($0.16)
Diluted earnings per share from discontinued operations	0.07	0.04	0.11	0.05
Earnings (loss) per share-diluted	$0.06	$0.13	$0.07	($0.11)

Potential common shares that would have the effect of increasing diluted earnings per share or decreasing diluted loss per share are considered to be anti-dilutive and as such, these shares are not included in calculating diluted earnings per share. For the three and six months ended December 25, 2016, there were 12.1 million and 11.7 million, respectively, of potential common shares not included in the calculation of diluted earnings (loss) per share because their effect was anti-dilutive. For the three and six months ended December 27, 2015, there were 12.2 million and 11.5 million, respectively, of potential common shares not included in the calculation of diluted earnings (loss) per share because their effect was anti-dilutive.

Note 11 – Stock-Based Compensation

Overview of Employee Stock-Based Compensation Plans

The Company currently has one equity-based compensation plan, the 2013 Long-Term Incentive Compensation Plan (2013 LTIP), from which stock-based compensation awards can be granted to employees and directors. The 2013 LTIP provides for awards in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units and other awards. The Company has other equity-based compensation plans that have been terminated so that no future grants can be made under those plans, but under which stock options, restricted stock and restricted stock units are currently outstanding.

The Company's stock-based awards can be either service-based or performance-based. Performance-based conditions are generally tied to future financial and/or operating performance of the Company. The compensation expense with respect to performance-based grants is recognized if the Company believes it is probable that the performance condition will be achieved. The Company reassesses the probability of the achievement of the performance condition at each reporting period, and adjusts the compensation expense for subsequent changes in the estimate or actual outcome. As with non-performance based awards, compensation expense is recognized over the vesting period. The vesting period runs from the date of grant to the expected date that the performance objective is likely to be achieved.

The Company also has an Employee Stock Purchase Plan (ESPP) that provides employees with the opportunity to purchase common stock at a discount. The ESPP limits employee contributions to 15% of each employee's compensation (as defined in the plan) and allows employees to purchase shares at a 15% discount to the fair market value of common stock on the purchase date two times per year. The ESPP provides for a twelve-month participation period, divided into two equal six-month purchase periods, and also provides for a look-back feature. At the end of each six-month period in April and October, participants purchase the Company's common stock through the ESPP at a 15% discount to the fair market value of the common stock on the first day of the twelve-month participation period or the purchase date, whichever is lower. The plan also provides for an automatic reset feature to start participants on a new twelve-month participation period if the fair market value of common stock declines during the first six-month purchase period.

Table of Contents

Stock Option Awards

The following table summarizes stock option awards outstanding as of December 25, 2016 and changes during the six months then ended (numbers of shares in thousands):

	Number of Shares	Weighted Average Exercise Price
Outstanding at June 26, 2016	11,247	$40.42
Granted	1,705	$24.42
Exercised	(39)	$25.88
Forfeited or expired	(1,162)	$37.24
Outstanding at December 25, 2016	11,751	$38.46

Restricted Stock Awards and Units

A summary of nonvested restricted stock awards (RSAs) and restricted stock unit awards (RSUs) outstanding as of December 25, 2016, and changes during the six months then ended is as follows (numbers of awards and units in thousands):

	Number of RSAs/RSUs	Weighted Average Grant-Date Fair Value
Nonvested at June 26, 2016	1,631	31.66
Granted	1,282	$24.04
Vested	(554)	$34.23
Forfeited	(96)	$29.94
Nonvested at December 25, 2016	2,263	$26.79

Stock-Based Compensation Valuation and Expense

The Company accounts for its employee stock-based compensation plans using the fair value method. The fair value method requires the Company to estimate the grant-date fair value of its stock-based awards and amortize this fair value to compensation expense over the requisite service period or vesting term.

The Company uses the Black-Scholes option-pricing model to estimate the fair value of the Company’s stock option and ESPP awards. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company’s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, the risk-free interest rate and expected dividends. Due to the inherent limitations of option-valuation models, future events that are unpredictable and the estimation process utilized in determining the valuation of the stock-based awards, the ultimate value realized by award holders may vary significantly from the amounts expensed in the Company’s financial statements.

For RSAs and RSUs, the grant-date fair value is based upon the market price of the Company’s common stock on the date of the grant. This fair value is then amortized to compensation expense over the requisite service period or vesting term.

Stock-based compensation expense is recognized net of estimated forfeitures such that expense is recognized only for those stock-based awards that are expected to vest. A forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates.

Table of Contents

Total stock-based compensation expense was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
Income Statement Classification:				
Cost of revenue, net	$2,564	$2,714	$5,343	$5,335
Research and development	1,907	2,428	4,513	5,192
Sales, general and administrative	6,184	7,140	13,819	14,988
Income from discontinued operations, net of tax	1,551	2,108	3,181	3,947
Total stock-based compensation expense	$12,206	$14,390	$26,856	$29,462

Note 12 – Income Taxes

The variation between the Company's effective income tax rate and the U.S. statutory rate of 35% is due to the impact of the Company’s pre-tax income or loss relative to favorable tax rate impacts associated predominantly with the Company’s: (i) projected income for the full year derived from international locations with lower tax rates than the U.S. and (ii) projected tax credits generated. Tax credits and other deductions have the impact of increasing the tax rate above the statutory rate of 35% in periods in which the Company reports pre-tax losses as they provide a benefit that is recoverable in future periods.

U.S. GAAP requires a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates that it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount that is cumulatively more than 50% likely to be realized upon ultimate settlement.

As of June 26, 2016, the Company's liability for unrecognized tax benefits was $17.7 million. During the six months ended December 25, 2016, the Company did not record any material movement in its unrecognized tax benefits. As a result, the total liability for unrecognized tax benefits as of December 25, 2016 was $17.7 million. If any portion of this $17.7 million is recognized, the Company will then include that portion in the computation of its effective tax rate. Although the ultimate timing of the resolution and/or closure of audits is highly uncertain, the Company believes it is reasonably possible that $4.3 million of gross unrecognized tax benefits will change in the next 12 months as a result of audit closures and statute requirements.

The Company files U.S. federal, U.S. state and foreign tax returns. For U.S. federal purposes, the Company is generally no longer subject to tax examinations for fiscal years prior to 2013. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2012. For foreign purposes, the Company is generally no longer subject to tax examinations for tax periods 2006 and prior. Certain carryforward tax attributes generated in prior years remain subject to examination, adjustment and recapture. On January 20, 2017, the Company settled an ongoing audit by the Italian Revenue Agency for the fiscal year ended June 30, 2013. The Company will release the associated unrecognized tax benefit in the third quarter of fiscal 2017, with a resulting immaterial impact on tax expense.

During the fourth quarter of fiscal 2016, the Company concluded it is likely that sufficient future taxable income needed to fully utilize net operating loss carryovers in Luxembourg will not be generated due to additional losses on the Company’s equity investment held there. As a result, the Company recorded a $9.5 million valuation allowance against the related deferred tax asset, representing the $32.4 million net operating loss carryover net of tax. During the six months ended December 25, 2016, the Company recorded an additional $2.8 million valuation allowance against the loss carryover deferred tax asset as a result of the $9.7 million year-to-date loss in Luxembourg.

Table of Contents

Note 13 – Commitments and Contingencies

Warranties

The following table summarizes the changes in the Company's product warranty liabilities (in thousands):

Balance at June 26, 2016	$21,426
Warranties accrued in current period	19,896
Expenditures	(13,032)
Balance at December 25, 2016	$28,290

Product warranties are estimated and recognized at the time the Company recognizes revenue. The warranty periods range from 90 days to 10 years. The Company accrues warranty liabilities at the time of sale, based on historical and projected incident rates and expected future warranty costs. The Company accrues estimated costs related to product recalls based on a formal campaign soliciting repair or return of that product when they are deemed probable and reasonably estimable. The warranty reserves, which are primarily related to Lighting Products, are evaluated quarterly based on various factors including historical warranty claims, assumptions about the frequency of warranty claims, and assumptions about the frequency of product failures derived from quality testing, field monitoring and the Company's reliability estimates. As of December 25, 2016, $13.2 million of the Company's product warranty liabilities were classified as long-term.

The Company has voluntarily recalled its linear LED T8 replacement lamps due to the hazard of overheating and melting. The Company expects the majority of the costs of the recall to be recoverable from insurance proceeds resulting in an immaterial impact to the Company’s financial results.

Litigation

The Company is currently a party to various legal proceedings. While management presently believes that the ultimate outcome of such proceedings, individually and in the aggregate, will not materially harm the Company’s financial position, cash flows, or overall trends in results of operations, legal proceedings are subject to inherent uncertainties, and unfavorable rulings could occur. An unfavorable ruling could include money damages or, in matters for which injunctive relief or other conduct remedies may be sought, an injunction prohibiting the Company from selling one or more products at all or in particular ways. Were unfavorable final outcomes to occur, there exists the possibility of a material adverse impact on the Company’s business, results of operation, financial position and overall trends. The outcomes in these matters are not reasonably estimable.

Note 14 – Reportable Segments

The Company's operating and reportable segments are:

- Lighting Products
- LED Products

As discussed more fully in Note 2, “Discontinued Operations,” on July 13, 2016, the Company executed a definitive agreement to sell the Wolfspeed business to Infineon. As a result, the Company has classified the results of the Wolfspeed business as discontinued operations in its consolidated statements of income (loss) for all periods presented. For comparative purposes, the prior segment results have been recast to conform to the current segment presentation.

Reportable Segments Description

The Company's Lighting Products segment primarily consists of LED lighting systems and bulbs. The Company's LED Products segment includes LED chips and LED components.

Financial Results by Reportable Segment

The table below reflects the results of the Company's reportable segments as reviewed by the Chief Operating Decision Maker (CODM) for the three and six months ended December 25, 2016 and December 27, 2015. The Company's CODM is the Chief Executive Officer. The Company used the same accounting policies to derive the segment results reported below as those used in the Company's consolidated financial statements.

The Company's CODM does not review inter-segment transactions when evaluating segment performance and allocating resources to each segment, and inter-segment transactions are not included in the segment revenue presented in the table below. As such, total segment revenue in the table below is equal to the Company's consolidated revenue.

Table of Contents

The Company's CODM reviews gross profit as the lowest and only level of segment profit. As such, all items below gross profit in the consolidated statements of income (loss) must be included to reconcile the consolidated gross profit presented in the table below to the Company's consolidated loss from continuing operations before income taxes.
In order to determine gross profit for each reportable segment, the Company allocates direct costs and indirect costs to each segment's cost of revenue. The Company allocates indirect costs, such as employee benefits for manufacturing employees, shared facilities services, information technology, purchasing, and customer service, when the costs are identifiable and beneficial to the reportable segment. The Company allocates these indirect costs based on a reasonable measure of utilization that considers the specific facts and circumstances of the costs being allocated. Unallocated costs in the table below consisted primarily of manufacturing employees’ stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under the Company’s 401(k) plan. These costs were not allocated to the reportable segments’ gross profit because the Company’s CODM does not review them regularly when evaluating segment performance and allocating resources.
Revenue, gross profit and gross margin for each of the Company's segments were as follows (in thousands, except percentages):

	Three Months Ended		Six Months Ended	
	December 25, 2016	December 27, 2015	December 25, 2016	December 27, 2015
Revenue:				
Lighting Products revenue	$208,924	$254,970	$392,760	$503,001
LED Products revenue	138,038	138,788	275,531	272,306
Total revenue	$346,962	$393,758	$668,291	$775,307
Gross Profit and Gross Margin:				
Lighting Products gross profit	$74,770	$72,642	$124,060	$141,723
Lighting Products gross margin	35.8 %	28.5 %	31.6 %	28.2 %
LED Products gross profit	40,314	42,931	82,084	84,800
LED Products gross margin	29.2 %	30.9 %	29.8 %	31.1 %
Total segment gross profit	115,084	115,573	206,144	226,523
Unallocated costs	(4,193)	(4,439)	(8,912)	(8,197)
Consolidated gross profit	$110,891	$111,134	$197,232	$218,326
Consolidated gross margin	32.0 %	28.2 %	29.5 %	28.2 %

The total revenue and Lighting Products segment revenue and gross profit for the three months ended December 25, 2016 include a benefit from the confidential Feit Electric Company Inc. license agreement which provided a patent license issuance fee to the Company. The gross profit benefit within the quarter was partially offset by additional lighting reserves related primarily to third party supplied drivers for commercial lighting products that were identified as defective within the fiscal second quarter. Excluding the impact of the license agreement, the Company’s total revenue would have been approximately in the middle of the Company’s revenue targets for the quarter, which were $310 million to $330 million.

Assets by Reportable Segment
Inventories are the only assets reviewed by the Company's CODM when evaluating segment performance and allocating resources to the segments. The CODM reviews all of the Company's assets other than inventories on a consolidated basis.
Unallocated inventories in the table below were not allocated to the reportable segments because the Company’s CODM does not review them when evaluating performance and allocating resources to each segment. Unallocated inventories consisted primarily of manufacturing employees’ stock-based compensation, profit sharing and quarterly or annual incentive compensation and matching contributions under the Company’s 401(k) plan.

25

Table of Contents

Inventories for each of the Company's segments were as follows (in thousands):

	December 25, 2016	June 26, 2016
Lighting Products	$170,326	$172,261
LED Products	107,522	104,544
Total segment inventories	277,848	276,805
Unallocated inventories	3,829	4,866
Consolidated inventories	$281,677	$281,671

Table of Contents

Note 15 - Costs Associated with LED Business Restructuring

In June 2015, the Company’s Board of Directors approved a plan to restructure the LED Products business. The restructuring reduced excess capacity and overhead in order to improve the cost structure moving forward. The primary components of the restructuring include the planned sale or abandonment of certain manufacturing equipment, facility consolidation and the elimination of certain positions. The restructuring activity ended in the second quarter of fiscal 2016.

The Company incurred a total of $102.4 million, of which $4.9 million related to discontinued operations, pursuant to this restructuring plan. See Note 18, "Costs Associated with LED Business Restructuring" in Part II, Item 8 of the Company's Annual Report on Form 10K for the fiscal year ended June 26, 2016 for additional information. The following table summarizes the actual charges incurred for the three months and six months ended December 27, 2015 (in thousands):

Capacity and Overhead Cost Reductions	Amounts incurred during the three months ended December 27, 2015	Amounts incurred for the six months ended December 27, 2015	Affected Line Item in the Consolidated Statements of Income (Loss)
Loss on disposal or impairment of long-lived assets	$1,641	$10,646	Loss on disposal or impairment of long-lived assets
Loss on disposal or impairment of long-lived assets	—	4,873	Income from discontinued operations, net of tax
Severance expense	(36)	264	Sales, general and administrative expenses
Lease termination and facility consolidation costs	1,198	2,933	Sales, general and administrative expenses
Total restructuring charges	$2,803	$18,716	

Table of Contents

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Information set forth in this Quarterly Report on Form 10-Q contains various “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All information contained in this report relative to future markets for our products and trends in and anticipated levels of revenue, gross margins and expenses, as well as other statements containing words such as “believe,” “project,” “may,” “will,” “anticipate,” “target,” “plan,” “estimate,” “expe “intend” and other similar expressions constitute forward-looking statements. These forward-looking statements are subject to business, economic and other risks and uncertainties, both known and unknown, and actual results may differ materially from those contained in the forward-looking statements. Any forward-looking statements we make are as of the date made, and except as required under the U.S. federal securities laws and the rules and regulations of the Securities and Exchange Commission (the SEC), we have no duty to update them if our views later change. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this Quarterly Report. Examples of risks and uncertainties that could cause actual results to differ materially from historical performance and any forward-looking statements include, but are not limited to, those described in “Risk Factors” in Part II, Item 1A of this Quarterly Report.

Executive Summary

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 26, 2016. Historical results and percentage relationships among any amounts in the financial statements are not necessarily indicative of trends in operating results for any future periods.

Overview

Cree, Inc. (Cree, we, our, or us) is a leading innovator of lighting-class light emitting diode (LED) products, lighting products and wide bandgap semiconductor products for power and radio-frequency (RF) applications. Our products are targeted for applications such as indoor and outdoor lighting, video displays, transportation, electronic signs and signals, power supplies, inverters and wireless systems.

Our lighting products primarily consist of LED lighting systems and bulbs. We design, manufacture and sell lighting fixtures and lamps for the commercial, industrial and consumer markets.

Our LED products consist of LED components and LED chips. Our LED products enable our customers to develop and market LED-based products for lighting, video screens and other industrial applications.

In addition, we develop, manufacture and sell silicon carbide (SiC) materials, power devices and RF devices based on wide bandgap semiconductor materials such as SiC and gallium nitride (GaN). Our SiC materials products are sold to customers developing power and RF products as well as gemstones. These SiC materials products had previously been included within our LED Products segment. Our power products are made from SiC and provide increased efficiency, faster switching speeds and reduced system size and weight over comparable silicon-based power devices. Our RF devices are made from GaN and provide improved efficiency, bandwidth and frequency of operation as compared to silicon or gallium arsenide (GaAs). Collectively, we refer to these product lines as the Wolfspeed business. As discussed more fully in Note 2, “Discontinued Operations,” in our consolidated financial statements included in Item 1 of this Quarterly Report, on July 13, 2016, we executed a definitive agreement to sell the Wolfspeed business to Infineon Technologies AG (Infineon). As a result, we have classified the results of the Wolfspeed business as discontinued operations in our consolidated statements of income (loss) for all periods presented. Additionally, the related assets and liabilities associated with the discontinued operations are classified as held for sale in the consolidated balance sheets. Unless otherwise noted, discussion within this Management's Discussion and Analysis relates to our continuing operations.

The majority of our products are manufactured at our production facilities located in North Carolina, Wisconsin, and China. We also use contract manufacturers for certain products and aspects of product fabrication, assembly and

packaging. We operate research and development facilities in North Carolina, California, Wisconsin, India, Italy and China (including Hong Kong).
Cree, Inc. is a North Carolina corporation established in 1987, and our headquarters are in Durham, North Carolina.
For further information about our consolidated revenue and earnings, please see our consolidated financial statements included in Item 1 of this Quarterly Report.

Table of Contents

Reportable Segments

Our two reportable segments are:

- Lighting Products
- LED Products

For further information about our reportable segments, please refer to Note 14, "Reportable Segments," in our consolidated financial statements included in Item 1 of this Quarterly Report.

Industry Dynamics and Trends

There are a number of industry factors that affect our business which include, among others:

- Overall Demand for Products and Applications using LEDs. Our potential for growth depends significantly on the continued adoption of LEDs within the general lighting market and our ability to affect this rate of adoption. Demand also fluctuates based on various market cycles, a continuously evolving LED industry supply chain, and evolving competitive dynamics in the market. These uncertainties make demand difficult to forecast for us and our customers.
- Intense and Constantly Evolving Competitive Environment. Competition in the LED and lighting industries is intense. Many companies have made significant investments in LED development and production equipment. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share, increase the utilization of their production capacity and open new applications to LED-based solutions. To remain competitive, market participants must continuously increase product performance and reduce costs. To address these competitive pressures, we have invested in research and development activities to support new product development and to deliver higher levels of performance and lower costs to differentiate our products in the market.
- Lighting Sales Channel Development. Commercial lighting is usually sold through lighting agents and distributors in the North American lighting market. The lighting agents typically have exclusive sales rights for a defined territory and are typically aligned with one large lighting company for a large percentage of their product sales. The size, quality and capability of the lighting agent has a significant effect on winning new projects and sales in a given geographic market. While these agents or distributors can sell other lighting products, the large traditional lighting companies have taken steps to prevent their channel partners from selling competing product lines. We are constantly working to improve the capabilities of our existing channel partners as well as develop new partners to improve our sales effectiveness in each geographic market.
- Technological Innovation and Advancement. Innovations and advancements in LEDs and lighting continue to expand the potential commercial application for our products. However, new technologies or standards could emerge or improvements could be made in existing technologies that could reduce or limit the demand for our products in certain markets.
- Intellectual Property Issues. Market participants rely on patented and non-patented proprietary information relating to product development, manufacturing capabilities and other core competencies of their business. Protection of intellectual property is critical. Therefore, steps such as additional patent applications, confidentiality and non-disclosure agreements, as well as other security measures are generally taken. To enforce or protect intellectual property rights, litigation or threatened litigation is common.

Overview of the Six Months Ended December 25, 2016

The following is a summary of our financial results for the six months ended December 25, 2016:

- Revenue decreased to $668 million for the six months ended December 25, 2016 from $775 million for the six months ended December 27, 2015.
- Gross profit decreased to $197 million for the six months ended December 25, 2016 from $218 million for the six months ended December 27, 2015. Gross margin increased to 30% for the six months ended December 25, 2016 from 28% for the six months ended December 27, 2015.
- Operating loss was $1 million for the six months ended December 25, 2016 compared to operating loss of $9 million for the six months ended December 27, 2015. Net income per diluted share was $0.07 for the six months ended December 25, 2016 compared to net loss per diluted share of $0.11 for the six months ended December 27, 2015.

Table of Contents

- Cash, cash equivalents and short-term investments were $0.6 billion at December 25, 2016 and June 26, 2016. Cash provided by operating activities was $120 million for the six months ended December 25, 2016 compared to $124 million for the six months ended December 27, 2015.
- Inventories were $282 million at December 25, 2016 and June 26, 2016.
- Purchases of property and equipment were $35 million for the six months ended December 25, 2016 compared to $82 million for the six months ended December 27, 2015.

Business Outlook

We announced Cree 3.0 during fiscal 2016 and updated our strategy to become a more focused LED lighting technology company. As part of this strategy, we outlined a plan to separate the Wolfspeed business through an initial public offering (IPO). The decision to sell the Wolfspeed business to Infineon, instead of continuing down the IPO path, speeds our transition to an LED lighting company while providing significant resources to accelerate our growth. Divesting the Wolfspeed business is expected to reduce short-term profits, but at the same time increase free cash flow. We believe this transaction will increase management focus on the core growth business and provide capital to support our mission to build a more valuable company.

We project that the markets for commercial LED lighting products will expand in fiscal 2017, while the consumer LED bulb and LED components market will remain highly competitive.

We are focused on the following goals to further support our transition to a more focused LED lighting company:

- Complete the sale of our Wolfspeed business to Infineon.
- Grow company revenue.
  - Grow commercial lighting revenue with the market, potentially adding to that growth through product line expansion and/or strategic acquisitions, and maintain consumer lighting revenue in a similar range while transitioning to a new generation LED bulb family.
  - Maintain LED revenue in a similar range through new product design wins to offset the competitive environment.
- Improve operating margin.
  - Increase lighting margins through a combination of lower costs and higher value new products.
  - Maintain LED margins in a similar range by reducing product costs and increasing performance levels.
  - Manage company operating expenses to grow slower than revenue.
- Continue to innovate in all of our businesses to differentiate our products in the market.
- Improve the customer experience and service levels in all of our businesses.

Table of Contents

Results of Operations

The following table sets forth certain consolidated statement of income (loss) data for the periods indicated (in thousands, except per share amounts and percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016		December 27, 2015		December 25, 2016		December 27, 2015	
		% of Revenue		% of Revenue		% of Revenue		% of Revenue
Revenue, net	$346,962	100 %	$393,758	100 %	$668,291	100 %	$775,307	100 %
Cost of revenue, net	236,071	68 %	282,624	72 %	471,059	70 %	556,981	72 %
Gross profit	110,891	32 %	111,134	28 %	197,232	30 %	218,326	28 %
Research and development	28,070	8 %	31,563	8 %	56,601	8 %	64,294	8 %
Sales, general and administrative	67,671	20 %	67,877	17 %	129,042	19 %	138,049	18 %
Amortization or impairment of acquisition-related intangibles	5,937	2 %	6,468	2 %	12,203	2 %	12,937	2 %
Loss on disposal or impairment of long-lived assets	530	— %	2,015	1 %	846	— %	11,580	1 %
Operating income (loss)	8,683	3 %	3,211	1 %	(1,460)	— %	(8,534)	(1)%
Non-operating (expense) income, net	(4,754)	(1)%	8,016	2 %	(4,912)	(1)%	(14,787)	(2)%
Income (loss) from continuing operations before income taxes	3,929	1 %	11,227	3 %	(6,372)	(1)%	(23,321)	(3)%
Income tax expense (benefit)	5,036	1 %	1,815	— %	(2,407)	— %	(6,997)	(1)%
(Loss) income from continuing operations	($1,107)	— %	$9,412	2 %	($3,965)	(1)%	($16,324)	(2)%
Income from discontinued operations, net of tax	7,326	2 %	4,030	1 %	10,750	2 %	5,277	1 %
Net income (loss)	$6,219	2 %	$13,442	3 %	$6,785	1 %	($11,047)	(1)%
Earnings (loss) per share-basic								
Continuing operations	($0.01)		$0.09		($0.04)		($0.16)	
Discontinued operations	0.07		0.04		$0.11		$0.05	
Earnings (loss) per share-basic	$0.06		$0.13		$0.07		($0.11)	
Earnings (loss) per share-diluted								
Continuing operations	($0.01)		$0.09		($0.04)		($0.16)	
Discontinued operations	0.07		0.04		0.11		0.05	
Earnings (loss) per share-diluted	$0.06		$0.13		$0.07		($0.11)	

LED Business Restructuring

In June 2015, our Board of Directors approved a plan to restructure the LED Products business. The restructuring reduced excess capacity and overhead in order to improve the cost structure moving forward. The primary components of the restructuring include the planned sale or abandonment of certain manufacturing equipment, facility consolidation and the elimination of certain positions. The restructuring activity ended in the second quarter of fiscal 2016.

Table of Contents

We incurred a total of $102.4 million, of which $4.9 million related to discontinued operations, pursuant to this restructuring plan. The following table summarizes the actual charges incurred for the three and six months ended December 27, 2015 (in thousands):

Capacity and Overhead Cost Reductions	Amounts incurred during the three months ended December 27, 2015	Amounts incurred for the six months ended December 27, 2015	Affected Line Item in the Consolidated Statements of Income (Loss)
Loss on disposal or impairment of long-lived assets	$1,641	$10,646	Loss on disposal or impairment of long-lived assets
Loss on disposal or impairment of long-lived assets	—	4,873	Income from discontinued operations, net of tax
Severance expense	(36)	264	Sales, general and administrative expenses
Lease termination and facility consolidation costs	1,198	2,933	Sales, general and administrative expenses
Total restructuring charges	$2,803	$18,716	

Revenue

Revenue was comprised of the following (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Lighting Products revenue	$208,924	$254,970	($46,046)	(18)%	$392,760	$503,001	($110,241)	(22)%
Percent of revenue	60%	65%			59%	74%		
LED Products revenue	138,038	138,788	(750)	(1)%	275,531	272,306	3,225	1%
Percent of revenue	40%	35%			41%	35%		
Total revenue	$346,962	$393,758	($46,796)	(12)%	$668,291	$775,307	($107,016)	(14)%

Our consolidated revenue decreased 12% to $347.0 million for the three months ended December 25, 2016 from $393.8 million for the three months ended December 27, 2015. This decrease was driven primarily by the 18% reduction in Lighting Products revenue. For the six months ended December 25, 2016, our consolidated revenue decreased 14% to $668.3 million from $775.3 million for the six months ended December 27, 2015. This decrease was driven by the 22% decrease in Lighting Products revenue partially offset by the 1% increase in LED Products revenue.

Our total revenue and Lighting Products segment revenue and gross profit for the three months ended December 25, 2016 include a benefit from the confidential license agreement discussed in Note 14, "Reportable Segments." Excluding the impact of the confidential agreement, our total revenue would have been in the middle of our revenue targets for the quarter.

Lighting Products Segment Revenue

Lighting Products revenue represented approximately 60% and 65% of our total revenue for the three months ended December 25, 2016 and December 27, 2015, respectively.

Lighting Products revenue decreased 18% to $208.9 million for the three months ended December 25, 2016 from $255.0 million for the three months ended December 27, 2015 and decreased 22% to $392.8 million for the six months ended December 25, 2016 from $503.0 million for the six months ended December 27, 2015. These decreases were due to a combination of a reduction in units sold and a decrease in Average Selling Price (ASP), partially offset by incremental revenue associated with a patent license issuance fee in connection with the new patent license agreement discussed above.

Total units sold decreased 27% and ASP decreased 4% for the three months ended December 25, 2016 compared to the three months ended December 27, 2015. Total units sold decreased 15% and ASP decreased 16% for the six months ended December 25, 2016 compared to the six month ended December 27, 2015. The decreases in units sold were due to lower sales of both commercial lighting fixtures and consumer bulbs. The decreases in ASP were due to lower consumer bulb sale prices year over year that were partially offset by an increase in commercial lighting fixtures ASPs.

LED Products Segment Revenue

LED Products revenue represented 40% and 35% of our total revenue for the three months ended December 25, 2016 and December 27, 2015, respectively.

LED Products revenue decreased 1% to $138.0 million for the three months ended December 25, 2016 from $138.8 million for the three months ended December 27, 2015 and increased 1% to $275.5 million for the six months ended December 25, 2016 from $272.3 million for the six months ended December 27, 2015. The decrease in revenue for the three months ended December 25, 2016 compared to the three months ended December 27, 2015 was due to an 11% decrease in ASP partially offset by an 11% increase in the number of units sold. The increase in revenue for the six months ended December 25, 2016 compared to the six months ended December 27, 2015 was due to a 4% increase in units sold partially offset by a 1% decrease in ASP. The decreases in ASP for the respective periods were due to competitive pricing pressures and a more favorable mix of LED products sold.

Gross Profit and Gross Margin

Gross profit and gross margin were as follows (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Lighting Products gross profit	$74,770	$72,642	$2,128	3 %	$124,060	$141,723	($17,663)	(12)%
Lighting Products gross margin	35.8 %	28.5 %			31.6%	28.2 %		
LED Products gross profit	40,314	42,931	(2,617)	(6)%	82,084	84,800	(2,716)	(3)%
LED Products gross margin	29.2 %	30.9 %			29.8%	31.1 %		
Unallocated costs	(4,193)	(4,439)	246	(6)%	(8,912)	(8,197)	(715)	9 %
Consolidated gross profit	$110,891	$111,134	($243)	—%	$197,232	$218,326	($21,094)	(10)%
Consolidated gross margin	32.0 %	28.2 %			29.5%	28.2 %		

Our consolidated gross profit decreased slightly to $110.9 million for the three months ended December 25, 2016 as compared with $111.1 million for the three months ended December 27, 2015. Our consolidated gross margin increased to 32.0% for the three months ended December 25, 2016 from 28.2% for the three months ended December 27, 2015. Our consolidated gross profit decreased 10% to $197.2 million for the six months ended December 25, 2016 from $218.3 million for the six months ended December 27, 2015. Our consolidated gross margin increased to 29.5% for the six months ended December 25, 2016 from 28.2% for the six months ended December 27, 2015.

Table of Contents

Lighting Products Segment Gross Profit and Gross Margin

Lighting Products gross profit increased 3% to $74.8 million for the three months ended December 25, 2016 from $72.6 million for the three months ended December 27, 2015 and decreased 12% to $124.1 million for the six months ended December 25, 2016 from $141.7 million for the six months ended December 27, 2015. Lighting Products gross margin increased to 35.8% for the three months ended December 25, 2016 from 28.5% for the three months ended December 25, 2015 and increased to 31.6% for the six months ended December 25, 2016 from 28.2% for the six months ended December 25, 2015. The increase in Lighting Products gross profit for the three months ended December 25, 2016 was due to the patent license issuance fee associated with the new patent license agreement discussed above, partially offset by lower commercial lighting fixture sales and incrementally higher commercial lighting product warranty reserves. The decrease in the Lighting Products gross profit for the six months ended December 25, 2016 was due to lower commercial lighting fixture sales and incrementally higher commercial lighting product warranty reserves, partially offset by the patent license issuance fee revenue. The increases in Lighting Products gross margin for the three and six months ended December 25, 2016 was primarily due to the patent license issuance fee revenue, partially offset by the incremental commercial product warranty reserves.

LED Products Segment Gross Profit and Gross Margin

LED Products gross profit decreased 6% to $40.3 million for the three months ended December 25, 2016 from $42.9 million for the three months ended December 27, 2015 and decreased 3% to $82.1 million for the six months ended December 25, 2016 from $84.8 million for the six months ended December 27, 2015. LED Products gross margin decreased to 29.2% for the three months ended December 25, 2016 from 30.9% for the three months ended December 27, 2015 and decreased to 29.8% for the six months ended December 25, 2016 from 31.1% for the six months ended December 27, 2015. The decreases in LED Products gross profit and gross margin are due to lower pricing resulting from the increased global competition for LED products and a less favorable mix of LED products sold.

Unallocated Costs

Unallocated costs were $4.2 million and $4.4 million for the three months ended December 25, 2016 and December 27, 2015, respectively. For the six months ended December 25, 2016 and December 27, 2015, unallocated costs were $8.9 million and $8.2 million, respectively. These costs consisted primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under our 401(k) plan. These costs were not allocated to the reportable segments' gross profit because our Chief Operating Decision Maker does not review them regularly when evaluating segment performance and allocating resources. The decrease for the three months ended December 25, 2016 as compared to the three months ended December 27, 2015 was primarily attributable to lower incentive and stock-based compensation. The increase for the six months ended December 25, 2016 as compared to the six months ended December 27, 2015 was primarily attributable to higher incentive compensation.

Research and Development

Research and development expenses include costs associated with the development of new products, enhancements of existing products and general technology research. These costs consisted primarily of employee salaries and related compensation costs, occupancy costs, consulting costs and the cost of development equipment and supplies.

The following table sets forth our research and development expenses in dollars and as a percentage of revenue (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Research and development	$28,070	$31,563	($3,493)	(11)%	$56,601	$64,294	($7,693)	(12)%
Percent of revenue	8 %	8 %			8 %	8 %		

Research and development expenses for the three months ended December 25, 2016 decreased 11% to $28.1 million from $31.6 million for the three months ended December 27, 2015. For the six months ended December 25, 2016, research and development expenses decreased 12% to $56.6 million from $64.3 million for the six months ended

December 27, 2015. These decreases were primarily due to cost management and the nature of current research and development projects. Our research and development expenses vary significantly from quarter to quarter based on a number of factors, including the timing of new product introductions and the number and nature of our ongoing research and development activities.

Table of Contents

Sales, General and Administrative

Sales, general and administrative expenses were comprised primarily of costs associated with our sales and marketing personnel and our executive and administrative personnel (for example, finance, human resources, information technology and legal) and consisted of salaries and related compensation costs; consulting and other professional services (such as litigation and other outside legal counsel fees, audit and other compliance costs); marketing and advertising expenses; facilities and insurance costs; and travel and other costs. The following table sets forth our sales, general and administrative expenses in dollars and as a percentage of revenue (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Sales, general and administrative	$67,671	$67,877	($206)	—%	$129,042	$138,049	($9,007)	(7)%
Percent of revenue	20 %	17 %			19 %	18 %		

Sales, general and administrative expenses of $67.7 million for the three months ended December 25, 2016 were similar to the $67.9 million for the three months ended December 27, 2015. For the six months ended December 25, 2016, sales, general and administrative expenses decreased 7% to $129.0 million from $138.0 million for the six months ended December 27, 2015. The decrease for the six months ended December 25, 2016 was primarily due to lower variable sales expense resulting from the decrease in lighting revenue, a decrease in litigation spending and lower brand spending.

Amortization or Impairment of Acquisition-Related Intangibles

As a result of our acquisitions, we have recognized various amortizable intangible assets, including customer relationships, developed technology, non-compete agreements and trade names. Amortization of intangible assets related to our acquisitions was as follows (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Customer relationships	$1,277	$1,318	($41)	(3)%	$2,556	$2,636	($80)	(3)%
Developed technology	4,660	4,660	—	—%	9,321	9,321	—	—%
Non-compete agreements	—	490	(490)	(100)%	326	980	(654)	(67)%
Total amortization	$5,937	$6,468	($531)	(8)%	$12,203	$12,937	($734)	(6)%

Amortization of acquisition-related intangibles was $5.9 million for the three months ended December 25, 2016 compared to $6.5 million for the three months ended December 27, 2015 and $12.2 million for the six months ended December 25, 2016 compared to the $12.9 million for the six months ended December 27, 2015.

(Gain) Loss on Disposal or Impairment of Long-Lived Assets

We operate a capital intensive business. As such, we dispose of a certain level of our equipment in the normal course of business as our production processes change due to production improvement initiatives or product mix changes. Due to the risk of technological obsolescence or changes in our production process, we regularly review our equipment and capitalized patent costs for possible impairment.

Table of Contents

The following table sets forth our (gain) loss on disposal or impairment of long-lived assets (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Loss on disposal or impairment of long-lived assets	$530	$2,015	($1,485)	(74)%	$846	$11,580	($10,734)	(93)%

We recognized a net loss of $0.5 million and a net loss of $2.0 million on the disposal of long-lived assets for the three months ended December 25, 2016 and December 27, 2015, respectively. For the six months ended December 25, 2016, we recognized a net loss of $0.8 million compared to a net loss of $11.6 million for the six months ended December 27, 2015. The decreases were primarily due to the planned sale or abandonment of certain long-lived assets to reduce excess manufacturing capacity pursuant to our LED business restructuring discussed above, which was completed in the second quarter of fiscal 2016.

Non-Operating (Expense) Income, net

The following table sets forth our non-operating expense, net (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Gain on sale of investments, net	$—	$14	($14)	(100)%	$12	$16	($4)	(25)%
(Loss) gain on equity investment	(3,796)	7,026	(10,822)	(154)%	(6,283)	(12,922)	6,639	(51)%
Foreign currency loss, net	(1,856)	(385)	(1,471)	382 %	(495)	(4,679)	4,184	(89)%
Interest income, net	900	1,220	(320)	(26)%	1,787	2,517	(730)	(29)%
Other, net	(2)	141	(143)	(101)%	67	281	(214)	(76)%
Non-operating (expense) income, net	($4,754)	$8,016	($12,770)	(159)%	($4,912)	($14,787)	$9,875	(67)%

Gain on sale of investments, net. Gain on sale of investments, net was $0 for the three months ended December 25, 2016 compared to $14 thousand for the three months ended December 27, 2015. For the six months ended December 25, 2016, gain on sale of investments, net was $12 thousand compared to $16 thousand for the six months ended December 27, 2015.

(Loss) gain on equity investment. Loss on our equity investment in Lextar Electronics Corporation (Lextar), which we account for utilizing the fair value option, was $3.8 million for the three months ended December 25, 2016 compared to a gain on equity investment of $7.0 million for the three months ended December 27, 2015. The loss on equity investment was $6.3 million for the six months ended December 25, 2016 compared to a loss of $12.9 million for the six months ended December 27, 2015. Lextar's stock is publicly traded on the Taiwan Stock Exchange and its share price declined from 15.70 New Taiwanese Dollars (TWD) at June 26, 2016 to 14.75 TWD at September 25, 2016 and further declined to 13.30 TWD at December 25, 2016. This volatile stock price trend may continue in the future given the risks inherent in Lextar's business and trends affecting the Taiwan and global equity markets. Any future stock price changes will be recorded as further gains or losses on equity investment based on the increase or decrease, respectively, in the fair value of the investment during the applicable fiscal period. Further losses could have a material adverse effect on our results of operations.

Foreign currency loss, net. Foreign currency loss, net consisted primarily of remeasurement adjustments resulting from our investment in Lextar and consolidating our international subsidiaries. The foreign currency loss for the three months ended December 25, 2016 was primarily due to unfavorable fluctuation in the exchange rate between the TWD and the United States Dollar related to our Lextar investment as well as unfavorable fluctuations in the exchange rates between both the Chinese Yuan and the Euro and the United States Dollar. The foreign currency loss for the six months ended December 25, 2016 was primarily due to unfavorable fluctuations in the exchange rates between both the Chinese Yuan and the Euro relative to the United States Dollar, partially offset by a favorable fluctuation in the exchange rate between the TWD and the United States Dollar. The foreign currency loss for the three months ended December 27, 2015 was primarily due to the unfavorable fluctuation in the exchange

Table of Contents

rate between the TWD and the United States Dollar related to our investment in Lextar. The foreign currency loss for the six months ended December 27, 2015 was primarily due to unfavorable fluctuations in each of the TWD, Chinese Yuan and the Euro relative to the United States Dollar.

Interest income, net. Interest income, net was $0.9 million for the three months ended December 25, 2016 compared to $1.2 million for the three months ended December 27, 2015. For the six months ended December 25, 2016, interest income, net was $1.8 million compared to $2.5 million for the six months ended December 27, 2015. The decrease in interest income, net for the three and six months ended December 25, 2016 was primarily due to lower invested balances and higher interest expense due to higher average borrowings associated with our line of credit as compared to the three and six months ended December 27, 2015.

Other, net. Other, net was income of $2 thousand for the three months ended December 25, 2016 and expense of $141 thousand for the three months ended December 27, 2015. For the six months ended December 25, 2016, other, net was expense of $67 thousand compared to expense of $281 thousand for the six months ended December 27, 2015.

Income Tax Expense (Benefit)

The following table sets forth our income tax expense (benefit) in dollars and our effective tax rate (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2016	December 27, 2015	Change		December 25, 2016	December 27, 2015	Change	
Income tax expense (benefit)	$5,036	$1,815	$3,221	177%	($2,407)	($6,997)	$4,590	(66)%
Effective tax rate	128.2 %	16.2 %			37.8 %	30.0 %		

The variation between our effective income tax rate and the U.S. statutory rate of 35% is due to the impact of our pre-tax income or loss relative to favorable tax rate impacts associated predominantly with our: (i) projected income for the full year derived from international locations with lower tax rates than the U.S. and (ii) projected tax credits generated. Tax credits and other deductions have the impact of increasing the tax rate above the statutory rate of 35% in periods in which we report pre-tax losses as they provide a benefit recoverable in future periods.

We recognized an income tax expense of $5.0 million for an effective tax rate of 128.2% for the three months ended December 25, 2016 as compared to income tax expense of $1.8 million for an effective tax rate of 16.2% for the three months ended December 27, 2015. For the six months ended December 25, 2016, we recognized income tax benefit of $2.4 million for an effective tax rate of 37.8% compared to an income tax benefit of $7.0 million for an effective tax rate of 30.0% for the six months ended December 27, 2015. The increase in our effective tax rate for the three months ended December 25, 2016 was primarily due to an increase in the valuation allowance for additional losses on the Company’s equity investment held in Luxembourg. The increase in our effective tax rate for the six months ended December 25, 2016 was primarily due to the increased impact of tax credits and other deductions relative to the smaller pretax loss.

Discontinued Operations

As discussed above, we have classified the results of the Wolfspeed business as discontinued operations in our consolidated statements of income (loss) for all periods presented. We ceased recording depreciation and amortization of long-lived assets of the Wolfspeed business upon classification as discontinued operations in July 2016.

Income from discontinued operations, net of tax, was $7.3 million for the three months ended December 25, 2016 compared to $4.0 million for the three months ended December 27, 2015. The increase in income for the three months ended December 25, 2016 was due to the favorable impact of higher year-over-year revenue and the impact associated with the cessation of depreciation and amortization of long-lived assets upon our classification of the Wolfspeed business as discontinued operations in July 2016, partially offset by transaction related costs incurred in fiscal 2017 in conjunction with the pending sale of the Wolfspeed business to Infineon. For the six months ended December 25, 2016, income from discontinued operations, net of tax was $10.8 million compared to $5.3 million for the six months ended December 27, 2015. The increase in income for the six months ended December 25, 2016 was due to the favorable impact of higher year-over-year revenue, the impact associated with the cessation of depreciation and amortization of long-lived assets upon our classification of the Wolfspeed business as discontinued operations and the reduction in expenses in fiscal 2017 as compared to fiscal 2016 resulting from the prior year impairment of long-lived assets pursuant to the restructuring plan discussed above, partially offset by transaction related costs incurred in fiscal 2017 in conjunction with the pending sale of the Wolfspeed business.

Table of Contents

Liquidity and Capital Resources

Overview

We require cash to fund our operating expenses and working capital requirements, including outlays for research and development, capital expenditures, strategic acquisitions and investments. Our principal sources of liquidity are cash on hand, marketable securities, cash generated from operations and availability under our line of credit. Our ability to generate cash from operations has been one of our fundamental strengths and has provided us with substantial flexibility in meeting our operating, financing and investing needs. We have a $500 million line of credit as discussed in Note 8, “Long-term Debt,” in our consolidated financial statements included in Part I, Item 1 of this Quarterly Report. The purpose of this facility is to provide short term flexibility to optimize returns on our cash and investment portfolio while funding share repurchases, capital expenditures and other general business needs.

Based on past performance and current expectations, we believe our current working capital, availability under our line of credit and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for at least the next 12 months. We may use a portion of our available cash and cash equivalents, line of credit or funds underlying our marketable securities to repurchase shares of our common stock pursuant to repurchase programs authorized by our Board of Directors. With our strong working capital position, we believe that we have the ability to continue to invest in further development of our products and, when necessary or appropriate, make selective acquisitions or other strategic investments to strengthen our product portfolio, secure key intellectual properties or expand our production capacity.

From time to time, we evaluate strategic opportunities, including potential acquisitions, divestitures or investments in complementary businesses, and we anticipate continuing to make such evaluations. We may also access capital markets through the issuance of debt or additional shares of common stock in connection with the acquisition of complementary businesses or other significant assets or for other strategic opportunities. As discussed more fully above in “Business Outlook” and in Note 2, “Discontinued Operations,” in our consolidated financial statements in Part I, Item 1 of this Quarterly Report, on July 13, 2016, we executed a definitive agreement to sell the Wolfspeed business to Infineon. We anticipate using the proceeds from this transaction, combined with our expected improved free cash flow following the closing of the transaction, to fund potential acquisitions as well as to support additional share repurchases.

Liquidity

Our liquidity and capital resources primarily depend on our cash flows from operations and our working capital. The significant components of our working capital are liquid assets such as cash and cash equivalents, short-term investments, accounts receivable and inventories reduced by trade accounts payable.

The following table presents the components of our cash conversion cycle:

	Three Months Ended		
	December 25, 2016	June 26, 2016	Change
Days of sales outstanding[(a)]	32	37	(5)
Days of supply in inventory[(b)]	107	101	6
Days in accounts payable[(c)]	(42)	(44)	2
Cash conversion cycle	97	94	3

a) Days of sales outstanding (DSO) measures the average collection period of our receivables. DSO is based on the ending net trade receivables and the revenue, net for the quarter then ended. DSO is calculated by dividing ending accounts receivable, net of applicable allowances and reserves, by the average net revenue per day for the respective 90 day period.

b) Days of supply in inventory (DSI) measures the average number of days from procurement to sale of our product. DSI is based on ending inventory and cost of revenue, net for the quarter then ended. DSI is calculated by dividing ending inventory by average cost of revenue, net per day for the respective 90 day period.

c) Days in accounts payable (DPO) measures the average number of days our payables remain outstanding before payment. DPO is based on ending accounts payable and cost of revenue, net for the quarter then ended. DPO is calculated by dividing ending accounts payable by the average cost of revenue, net per day for the respective 90 day period.

Table of Contents

The increase in our cash conversion cycle was driven by an increase in days of supply in inventory and a decrease in days in accounts payable, partially offset by a decrease in days of sales outstanding.

As of December 25, 2016, we had unrealized losses on our investments of $1.6 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at December 25, 2016 were in such position due to interest rate changes, sector credit rating changes or company-specific rating changes. As we intend and believe that we have the ability to hold such investments for a period of time that will be sufficient for anticipated recovery in market value, we currently expect to receive the full principal or recover our cost basis in these securities. The declines in value of the securities in our portfolio are considered to be temporary in nature and, accordingly, we do not believe these securities are impaired as of December 25, 2016.

Cash Flows

In summary, our cash flows were as follows (in thousands, except percentages):

	Six Months Ended			
	December 25, 2016	December 27, 2015	Change	
Net cash provided by operating activities	$119,716	$123,796	($4,080)	(3)%
Net cash used in investing activities	(67,677)	(55,008)	(12,669)	23 %
Net cash used in financing activities	(80,409)	(116,798)	36,389	(31)%
Effects of foreign exchange changes on cash and cash equivalents	(691)	(1,114)	423	(38)%
Net decrease in cash and cash equivalents	($29,061)	($49,124)	$20,063	

The following is a discussion of our primary sources and uses of cash in our operating, investing and financing activities.

Cash Flows from Operating Activities

Net cash provided by operating activities decreased to $119.7 million for the six months ended December 25, 2016 from $123.8 million for the six months ended December 27, 2015. This decrease was primarily due to a decrease in pre-tax income year over year.

Cash Flows from Investing Activities

Our investing activities primarily relate to transactions within our short-term investments, purchases of property and equipment and payments for patents and licensing rights. Net cash used in investing activities was $67.7 million for the six months ended December 25, 2016 and net cash used in investing activities was $55.0 million for the six months ended December 27, 2015. Net purchases of short-term investments increased $68.7 million for the six months ended December 25, 2016 compared to the six months ended December 27, 2015. This was partially offset by a $48.4 million decrease in our capital spending for the six months ended December 25, 2016 compared to the six months ended December 27, 2015. The six months ended December 25, 2016 included $2.8 million in net spend relative to the Arkansas Power Electronics International, Inc. (APEI) acquisition while the six months ended December 27, 2015 included $12.5 million.

For fiscal 2017, we target approximately $55 million of capital investment for our LED Products and Lighting Products businesses, which is primarily related to infrastructure projects to support our longer term growth and strategic priorities. Additionally, we have spent $20 million for capital investment year to date for our Wolfspeed business which we have agreed to sell to Infineon.

Cash Flows from Financing Activities

Net cash used in financing activities was $80.4 million for the six months ended December 25, 2016 compared to $116.8 million for the six months ended December 27, 2015. For the six months ended December 25, 2016, our financing activities primarily consisted of the repurchase of common stock worth approximately $98.4 million, partially offset by net borrowing on our line of credit of $10.0 million and proceeds of $8.0 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises. For the six months ended December 27, 2015, our financing activities primarily consisted of the repurchase of common stock worth approximately $131.7 million, partially offset by net borrowings on our line of credit of $5.0 million, and proceeds of $10.0 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises.

Table of Contents

Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use any other forms of off-balance sheet arrangements. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of December 25, 2016, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases primarily for certain of our U.S. and international facilities in the normal course of business. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 26, 2016, in the section entitled "Contractual Obligations" for the future minimum lease payments due under our operating leases as of June 26, 2016. There have been no significant changes to the contractual obligations discussed therein.

Critical Accounting Policies and Estimates

For information about our critical accounting policies and estimates, see the "Critical Accounting Policies and Estimates" section of "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended June 26, 2016.

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including the expected dates of adoption and the estimated effects, if any, on our consolidated financial statements, see Note 1, "Basis of Presentation and New Accounting Standards," to our unaudited consolidated financial statements in Part I, Item 1 of this Quarterly Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about our market risks, see "Part II. Item 7A. Quantitative and Qualitative Disclosures About Market Risk" of our Annual Report on Form 10-K for the fiscal year ended June 26, 2016. There have been no material changes to the amounts presented therein.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Form 10-Q, our disclosure controls and procedures are effective in that they provide reasonable assurances that the information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required by the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. There have been no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the second quarter of fiscal 2017 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this item is set forth under Note 13, "Commitments and Contingencies," to our unaudited financial statements in Part I, Item 1 of this Quarterly Report and is incorporated herein by reference.

Table of Contents

Item 1A. Risk Factors

Described below are various risks and uncertainties that may affect our business. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in "Part I, Item 1A. Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended June 26, 2016. If any of the risks described below actually occurs, our business, financial condition or results of operations could be materially and adversely affected.

Our operating results are substantially dependent on the acceptance of new products.

Our future success may depend on our ability to deliver new, higher performing and lower cost solutions for existing and new markets and for customers to accept those solutions. We must introduce new products in a timely and cost-effective manner, and we must secure production orders for those products from our customers. The development of new products is a highly complex process, and we have in some instances experienced delays in completing the development and introduction of new products which impacted our results for our fiscal 2016 third quarter and beyond. Our research and development efforts are aimed at solving increasingly complex problems, and we do not expect that all of our projects will be successful. The successful development, introduction and acceptance of new products depend on a number of factors, including the following:

- achievement of technology breakthroughs required to make commercially viable products;
- the accuracy of our predictions for market requirements;
- our ability to predict, influence and/or react to evolving standards;
- acceptance of our new product designs;
- acceptance of new technology in certain markets;
- the availability of qualified research and development personnel;
- our timely completion of product designs and development;
- our ability to develop repeatable processes to manufacture new products in sufficient quantities, with the desired specifications and at competitive costs;
- our ability to effectively transfer products and technology from development to manufacturing;
- our customers’ ability to develop competitive products incorporating our products; and
- market acceptance of our products and our customers’ products.

If any of these or other similar factors becomes problematic, we may not be able to deliver and introduce new products in a timely or cost-effective manner.

We operate in industries that are subject to significant fluctuation in supply and demand and ultimately pricing that affects our revenue and profitability.

The LED lighting industry is in the relatively early stages of adoption and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life-cycles and fluctuations in product supply and demand. The LED industry has experienced significant fluctuations, often in connection with, or in anticipation of, product cycles and changes in general economic conditions. As the markets for our products mature, additional fluctuations may result from variability and consolidations within the industry’s customer base. These fluctuations have been characterized by lower product demand, production overcapacity, higher inventory levels and increased pricing pressure. These fluctuations have also been characterized by higher demand for key components and equipment used in, or in the manufacture of, our products resulting in longer lead times, supply delays and production disruptions.

We have experienced these conditions in our business and may experience such conditions in the future, which could have a material negative impact on our business, results of operations or financial condition. For example, in the fourth quarter of fiscal 2015, we commenced a restructuring plan for our LED business that reduced excess capacity and overhead as well as increased reserves as the result of a more aggressive pricing environment. The restructuring activity ended in the second quarter of fiscal 2016.

Table of Contents

In addition, as we diversify our product offerings and as pricing differences in the average selling prices among our product lines widen, a change in the mix of sales among our product lines may increase volatility in our revenue and gross margin from period to period.

We face significant challenges managing our growth as the market adopts LEDs for general lighting and other applications.

Our potential for growth depends significantly on the adoption of LEDs within the general lighting market and for other applications, and our ability to affect this rate of adoption. In order to manage our growth and business strategy effectively relative to the uncertain pace of adoption, we must continue to:

- expand the capability of information systems to support a more complex business;
- maintain, expand and purchase adequate manufacturing facilities and equipment, as well as secure sufficient third-party manufacturing resources, to meet customer demand;
- manage an increasingly complex supply chain that has the ability to supply an increasing number of raw materials, subsystems and finished products with the required specifications and quality, and deliver on time to our manufacturing facilities, our third party manufacturing facilities, or our logistics operations;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- manage organizational complexity and communication;
- expand the skills and capabilities of our current management team;
- add experienced senior level managers;
- attract and retain qualified employees; and
- adequately maintain and adjust the operational and financial controls that support our business.

We are also increasingly dependent on information technology to enable us to improve the effectiveness of our operations and to maintain financial accuracy and efficiency. For example, the implementation of a new information technology platform at our Racine operations in our 2016 fiscal third quarter led to service interruptions that resulted in lower commercial lighting orders and revenues during that quarter and beyond. Allocation and effective management of the resources necessary to successfully implement, integrate, train personnel and sustain this new platform will remain critical to ensure that we are not subject to transaction errors, processing inefficiencies, loss of customers, business disruptions or loss of or damage to intellectual property through security breach in the near term. Additionally, we face these same risks if we fail to allocate and effectively manage the resources necessary to build, implement, upgrade, integrate and sustain appropriate technology infrastructure over the longer term.

While we intend to focus on managing our costs and expenses, over the long term we expect to invest to support our growth and may have additional unexpected costs. Such investments take time to become fully operational, and we may not be able to expand quickly enough to exploit targeted market opportunities. In connection with our efforts to cost-effectively manage our growth, we have increasingly relied on contractors for production capacity, logistics support and certain administrative functions including hosting of certain information technology software applications. If our contract manufacturers, original design manufacturers (ODMs) or other service providers do not perform effectively, we may not be able to achieve the expected cost savings and may incur additional costs to correct errors or fulfill customer demand. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies, the loss of or damage to intellectual property through security breach, or an impact on employee morale. Our operations may also be negatively impacted if any of these contract manufacturers, ODMs or other service providers do not have the financial capability to meet our growing needs. There are also inherent execution risks in starting up a new factory or expanding production capacity, whether one of our own factories or that of our contract manufacturers or ODMs, or moving production to different contract manufacturers or ODMs, that could increase costs and reduce our operating results, including design and construction cost overruns, poor production process yields and reduced quality control.

Table of Contents

We are subject to a number of risks associated with the proposed sale of the Wolfspeed business, and these risks could adversely impact our operations, financial condition and business.

On July 13, 2016, we executed an Asset Purchase Agreement (the APA) with Infineon to sell the Wolfspeed business. We are subject to a number of risks associated with this transaction, including risks associated with:

- the failure to obtain, on a timely basis or at all, the regulatory approvals required to complete the transaction without the imposition of conditions that may cause the parties to abandon the transaction, or the failure to satisfy, on a timely basis or at all, the other closing conditions set forth in the APA;
- the disruption to and uncertainty in our business and our relationships with our customers, including attempts by our customers to renegotiate their relationships with us or decisions by our customers to defer or delay purchases from us;
- the diversion of our management's attention away from the operation of the businesses we are retaining;
- difficulties in hiring, retaining and motivating key personnel during this process or as a result of uncertainties generated by this process or any developments or actions relating to it;
- our incurrence of significant transaction costs in connection with the transaction, regardless of whether it is completed;
- the restrictions on and obligations with respect to our business set forth in the APA and, following closing, the transition services agreement and the wafer supply agreement;
- the separation of the Wolfspeed business from the businesses we are retaining and the operation of our retained businesses without the Wolfspeed business;
- any required payments of indemnification obligations under the APA for retained liabilities and breaches of representations, warranties or covenants;
- fluctuations in our market value, including the depreciation in our market value if the transaction is not completed or the failure of the transaction, even if completed, to increase our market value; and
- failure to realize the full purchase price anticipated under the APA.

As a result of these risks, we may be unable to complete the transaction or realize the anticipated benefits of the transaction, including the total amount of cash we expect to realize. Our failure to complete the transaction or realize the anticipated benefits of the transaction would adversely impact our operations, financial condition and business and could limit our ability to pursue strategic transactions or engage in stock repurchases.

If we are unable to effectively develop, manage and expand our sales channels for our products, our operating results may suffer.

We have expanded into business channels that are different from those in which we have historically operated as we grow our business and sell more lighting and LED products. Lighting sales agents have in the past and may in the future choose to drop our product lines from their portfolio to avoid losing access to our competitors' lighting products, resulting in a disruption in the project pipeline and lower than targeted sales for our lighting products. Lighting sales agents have the ability to shift business to different suppliers within their product portfolio based on a number of factors, including customer service and new product availability. We sell a portion of our lighting products through retailers who may alter their promotional pricing or inventory strategies, which could impact our targeted sales of these products. If we are unable to effectively penetrate these channels or develop alternate channels to ensure our products are reaching the intended customer base, our financial results may be adversely impacted. In addition, if we successfully penetrate or develop these channels, we cannot guarantee that customers will accept our products or that we will be able to manufacture and deliver them in the timeline established by our customers.

We sell a substantial portion of our products to distributors. We rely on distributors to develop and expand their customer base as well as anticipate demand from their customers. If they are not successful, our growth and profitability may be adversely impacted. Distributors must balance the need to have enough products in stock in order to meet their customers' needs against their internal target inventory levels and the risk of potential inventory obsolescence. The risks of inventory obsolescence are especially relevant to technological products. The distributors' internal target inventory levels vary depending on market cycles and a number of factors within each distributor over which we have very little, if any, control. Distributors also have the ability to shift business to different manufacturers within their product portfolio based on a number of factors, including new product availability and performance.

Table of Contents

We typically recognize revenue on products sold to distributors when the item is shipped and title passes to the distributor (sell-in method). Certain distributors have limited rights to return inventory under stock rotation programs and have limited price protection rights for which we make estimates. We evaluate inventory levels in the distribution channel, current economic trends and other related factors in order to account for these factors in our judgments and estimates. As inventory levels and product return trends change, we may have to revise our estimates and incur additional costs, and our gross margins and operating results could be adversely impacted.

The markets in which we operate are highly competitive and have evolving technical requirements.

The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture and sell LED chips and LED components. In the lighting market, we compete with companies that manufacture and sell traditional and LED lighting products, many of which have larger and more established sales channels. Competitors continue to offer new products with aggressive pricing, additional features and improved performance. Competitive pricing pressures remain a challenge and continue to accelerate the rate of decline of our sales prices, particularly in our LED Products segment. Aggressive pricing actions by our competitors in our lighting business could reduce margins if we are not able to reduce costs at an equal or greater rate than the sales price decline. With the growth potential for LEDs, we will continue to face increased competition in the future across our businesses. If the investment in capacity exceeds the growth in demand, such as exists in the current LED market, the LED market is likely to become more competitive with additional pricing pressures. Additionally, new technologies could emerge or improvements could be made in existing technologies that may also reduce the demand for lighting and LEDs in certain markets. There are also new technologies, such as organic LEDs (OLEDs), which could potentially reduce LED demand for backlighting, potentially impacting the overall LED market.

As competition increases, we need to continue to develop new products that meet or exceed the needs of our customers. Therefore, our ability to continually produce more efficient, higher brightness and lower cost LEDs and lighting products that meet the evolving needs of our customers will be critical to our success. Competitors may also try to align with some of our strategic customers. This could lead to lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Any of these developments could have an adverse effect on our business, results of operations or financial condition.

Our results of operations, financial condition and business could be harmed if we are unable to balance customer demand and capacity.

As customer demand for our products changes, we must be able to adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase or decrease our production capacity at our targeted rate or if there are unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets. In addition, as we introduce new products and change product generations, we must balance the production and inventory of prior generation products with the production and inventory of new generation products, whether manufactured by us or our contract manufacturers, to maintain a product mix that will satisfy customer demand and mitigate the risk of incurring cost write-downs on the previous generation products, related raw materials and tooling.

Due to the proportionately high fixed cost nature of our business (such as facility costs), if demand does not materialize at the rate forecasted, we may not be able to scale back our manufacturing expenses or overhead costs to correspond to the demand. This could result in lower margins and adversely impact our business and results of operations. Additionally, if product demand decreases or we fail to forecast demand accurately, our results may be adversely impacted due to higher costs resulting from lower factory utilization, causing higher fixed costs per unit produced. Further, we may be required to recognize impairments on our long-lived assets or recognize excess inventory write-off charges, as we did in the fourth quarter of fiscal 2015. We may in the future be required to recognize excess capacity charges, which would have a negative impact on our results of operations.

Table of Contents

In addition, our efforts to improve quoted delivery lead-time performance may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net revenue and operating results.

If our products fail to perform or fail to meet customer requirements or expectations, we could incur significant additional costs, including costs associated with the recall of those items.

The manufacture of our products involves highly complex processes. Our customers specify quality, performance and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment. For example, during the second quarter of fiscal 2017 we determined that the quality of several of our commercial lighting products were possibly impacted by third party supplied drivers that did not meet specifications. Therefore, we increased our product warranty reserves for potential future warranty claims. Even if our products meet standard specifications, our customers may attempt to use our products in applications for which they were not designed or in products that were not designed or manufactured properly, resulting in product failures and creating customer satisfaction issues.

We have experienced product quality, performance or reliability problems from time to time and defects or failures may occur in the future. If failures or defects occur, they could result in significant losses or product recalls due to:

- costs associated with the removal, collection and destruction of the product;
- payments made to replace product;
- costs associated with repairing the product;
- the write-down or destruction of existing inventory;
- insurance recoveries that fail to cover the full costs associated with product recalls;
- lost sales due to the unavailability of product for a period of time;
- delays, cancellations or rescheduling of orders for our products; or
- increased product returns.

A significant product recall could also result in adverse publicity, damage to our reputation and a loss of customer or consumer confidence in our products. We also may be the target of product liability lawsuits or regulatory proceedings by the Consumer Product Safety Commission (CPSC) and could suffer losses from a significant product liability judgment or adverse CPSC finding against us if the use of our products at issue is determined to have caused injury or contained a substantial product hazard.

We provide warranty periods ranging from 90 days to 10 years on our products. The standard warranty on nearly all of our new LED lighting products, which now represent the majority of our revenue, is 10 years. Although we believe our reserves are appropriate, we are making projections about the future reliability of new products and technologies, and we may experience increased variability in warranty claims. Increased warranty claims could result in significant losses due to a rise in warranty expense and costs associated with customer support.

Global economic conditions could materially adversely impact demand for our products and services.

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about global economic conditions could result in customers postponing purchases of our products and services in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values and other macroeconomic factors, which could have a material negative effect on demand for our products and services and, accordingly, on our business, results of operations or financial condition. For example, any economic and political uncertainty caused by the United Kingdom’s impending exit from the European Union may negatively impact demand for our products.

Additionally, our international sales are subject to variability as our selling prices become less competitive in countries with currencies that are declining in value against the U.S. Dollar and more competitive in countries with currencies that are increasing in value against the U.S. Dollar. In addition, our international purchases can become more expensive if the U.S. Dollar weakens against the foreign currencies in which we are billed.

Table of Contents

We rely on a number of key sole source and limited source suppliers and are subject to high price volatility on certain commodity inputs, variations in parts quality, and raw material consistency and availability.

We depend on a number of sole source and limited source suppliers for certain raw materials, components, services and equipment used in manufacturing our products, including key materials and equipment used in critical stages of our manufacturing processes. Although alternative sources generally exist for these items, qualification of many of these alternative sources could take up to six months or longer. Where possible, we attempt to identify and qualify alternative sources for our sole and limited source suppliers.

We generally purchase these sole or limited source items with purchase orders, and we have limited guaranteed supply arrangements with such suppliers. Some of our sources can have variations in attributes and availability which can affect our ability to produce products in sufficient volume or quality. We do not control the time and resources that these suppliers devote to our business, and we cannot be sure that these suppliers will perform their obligations to us. Additionally, general shortages in the marketplace of certain raw materials or key components may adversely impact our business. In the past, we have experienced decreases in our production yields when suppliers have varied from previously agreed upon specifications or made other modifications we do not specify, which impacted our cost of revenue.

Additionally, the inability of our suppliers to access capital efficiently could cause disruptions in their businesses, thereby negatively impacting ours. This risk may increase if an economic downturn negatively affects key suppliers or a significant number of our other suppliers. Any delay in product delivery or other interruption or variation in supply from these suppliers could prevent us from meeting commercial demand for our products. If we were to lose key suppliers, if our key suppliers were unable to support our demand for any reason or if we were unable to identify and qualify alternative suppliers, our manufacturing operations could be interrupted or hampered significantly.

We rely on arrangements with independent shipping companies for the delivery of our products from vendors and to customers both in the United States and abroad. The failure or inability of these shipping companies to deliver products or the unavailability of shipping or port services, even temporarily, could have a material adverse effect on our business. We may also be adversely affected by an increase in freight surcharges due to rising fuel costs and added security.

In our fabrication process we consume a number of precious metals and other commodities, which are subject to high price volatility. Our operating margins could be significantly affected if we are not able to pass along price increases to our customers. In addition, production could be disrupted by the unavailability of the resources used in production such as water, silicon, electricity and gases. Future environmental regulations could restrict supply or increase the cost of certain of those materials.

We depend on a limited number of customers, including distributors and retailers, for a substantial portion of our revenue, and the loss of, or a significant reduction in purchases by, one or more of these customers could adversely affect our operating results.

We receive a significant amount of our revenue from a limited number of customers, including distributors and retailers, one of which represented 10% of our consolidated revenue in fiscal 2016. Most of our customer orders are made on a purchase order basis, which does not generally require any long-term customer commitments. Therefore, these customers may alter their purchasing behavior with little or no notice to us for various reasons, including developing, or, in the case of our distributors, their customers developing, their own product solutions; choosing to purchase or distribute product from our competitors; incorrectly forecasting end market demand for their products; or experiencing a reduction in their market share in the markets for which they purchase our products. In the case of retailers, these customers may alter their promotional pricing; increase promotion of competitors' products over our products; or reduce their inventory levels; all of which could negatively impact our financial condition and results of operations. If our customers alter their purchasing behavior, if our customers’ purchasing behavior does not match our expectations or if we encounter any problems collecting amounts due from them, our financial condition and results of operations could be negatively impacted.

Our results may be negatively impacted if customers do not maintain their favorable perception of our brand and products.

We have a developing brand with increasing value. Maintaining and continually enhancing the value of this brand is critical to the success of our business. Brand value is based in large part on customer perceptions. Success in promoting and enhancing brand value depends in large part on our ability to provide high-quality products. Brand value could diminish significantly due to a number of factors, including adverse publicity about our products (whether valid or not), a failure to maintain the quality of our products (whether perceived or real), the failure of our products or Cree to deliver consistently positive consumer experiences, the products becoming unavailable to consumers or consumer perception that we have acted in an irresponsible manner. Damage to our brand, reputation or loss of customer confidence in our brand or products could result in decreased demand for our products and have a negative impact on our business, results of operations or financial condition.

Table of Contents

Variations in our production could impact our ability to reduce costs and could cause our margins to decline and our operating results to suffer.

All of our products are manufactured using technologies that are highly complex. The number of usable items, or yield, from our production processes may fluctuate as a result of many factors, including but not limited to the following:

- variability in our process repeatability and control;
- contamination of the manufacturing environment;
- equipment failure, power outages, fires, flooding, information or other system failures or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts, other raw materials and other bill of materials items;
- inventory shrinkage or human errors;
- defects in production processes (including system assembly) either within our facilities or at our suppliers; and
- any transitions or changes in our production process, planned or unplanned.

In the past, we have experienced difficulties in achieving acceptable yields on certain products, which has adversely affected our operating results. We may experience similar problems in the future, and we cannot predict when they may occur or their severity.

In some instances, we may offer products for future delivery at prices based on planned yield improvements or increased cost efficiencies from other production advances. Failure to achieve these planned improvements or advances could have a significant impact on our margins and operating results.

In addition, our ability to convert volume manufacturing to larger diameter substrates can be an important factor in providing a more cost effective manufacturing process. If we are unable to make this transition in a timely or cost effective manner, our results could be negatively impacted.

If we fail to evaluate and execute strategic opportunities successfully, our business may suffer.

In addition to the planned divestiture of the Wolfspeed business, from time to time, we evaluate strategic opportunities available to us for product, technology or business transactions, such as business acquisitions, investments, joint ventures, divestitures, or spin-offs. If we choose to enter into such transactions, we face certain risks including:

- the failure of an acquired business, investee or joint venture to meet our performance expectations;
- identification of additional liabilities relating to an acquired business;
- loss of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers’ existing product lines;
- difficulty integrating an acquired business's operations, personnel and financial and operating systems into our current business;
- diversion of management attention;
- difficulty separating the operations, personnel and financial and operating systems of a spin-off or divestiture from our current business;
- uncertainty of the financial markets or circumstances that cause conditions that are less favorable and/or different than expected; and
- expenses incurred to complete a transaction may be significantly higher than anticipated.

We may not be able to adequately address these risks or any other problems that arise from our prior or future acquisitions, investments, joint ventures, divestitures or spin-offs. Any failure to successfully evaluate strategic opportunities and address risks or other problems that arise related to any such business transaction could adversely affect our business, results of operations or financial condition.

As a result of our continued expansion into new markets, we may compete with existing customers who may reduce their orders.

Through acquisitions and organic growth, we continue to expand into new markets and new market segments. Many of our existing customers who purchase our LED products develop and manufacture products using those chips and components that are offered into the same lighting markets. As a result, some of our current customers perceive us as a competitor in these market segments. In response, our customers may reduce or discontinue their orders for our LED products. This reduction in or discontinuation of orders could occur faster than our sales growth in these new markets, which could adversely affect our business, results of operations or financial condition.

Our revenue is highly dependent on our customers' ability to produce, market and sell more integrated products.

Our revenue in our LED Products segment and the Wolfspeed business depends on getting our products designed into a larger number of our customers' products and in turn, our customers' ability to produce, market and sell their products. For example, we have current and prospective customers that create, or plan to create, lighting systems using our LED components. Even if our customers are able to develop and produce LED lighting products or products that incorporate our power and RF products, there can be no assurance that our customers will be successful in marketing and selling these products in the marketplace.

Our operations in foreign countries expose us to certain risks inherent in doing business internationally, which may adversely affect our business, results of operations or financial condition.

We have revenue, operations, manufacturing facilities and contract manufacturing arrangements in foreign countries that expose us to certain risks. For example, fluctuations in exchange rates may affect our revenue, expenses and results of operations as well as the value of our assets and liabilities as reflected in our financial statements. We are also subject to other types of risks, including the following:

- protection of intellectual property and trade secrets;
- tariffs, customs, trade sanctions, trade embargoes and other barriers to importing/exporting materials and products in a cost effective and timely manner, or changes in applicable tariffs or custom rules;
- the burden of complying with and changes in U.S. or international taxation policies;
- timing and availability of export licenses;
- rising labor costs;
- disruptions in or inadequate infrastructure of the countries where we operate;
- difficulties in collecting accounts receivable;
- difficulties in staffing and managing international operations; and
- the burden of complying with foreign and international laws and treaties.

In some instances, we have received and may continue to receive incentives from foreign governments to encourage our investment in certain countries, regions or areas outside of the United States. In particular, we have received and may continue to receive such incentives in connection with our operations in Asia, as Asian national and local governments seek to encourage the development of the technology industry. Government incentives may include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to us due to our foreign operations. Any of these incentives could be reduced or eliminated by governmental authorities at any time or as a result of our inability to maintain minimum operations necessary to earn the incentives. Any reduction or elimination of incentives currently provided for our operations could adversely affect our business and results of operations. These same governments also may provide increased incentives to or require production processes that favor local companies, which could further negatively impact our business and results of operations.

Table of Contents

Changes in regulatory, geopolitical, social, economic, or monetary policies and other factors, including those which may result from the new U.S presidential administration and the U.S Congress, if any, may have a material adverse effect on our business in the future, or may require us to exit a particular market or significantly modify our current business practices. Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could also result in an adverse effect on our business and results of operations. For example, the results of the United Kingdom's referendum on whether to remain a part of the European Union have created political and economic uncertainty not only in the United Kingdom, but in many European countries in which we do business. If the referendum is passed into law, there could be further uncertainty as the United Kingdom determines the future terms of its relationship with the European Union.

The adoption of or changes in government and/or industry policies, standards or regulations relating to the efficiency, performance, use or other aspects of our products could impact the demand for our products.

The adoption of or changes in government and/or industry policies, standards or regulations relating to the efficiency, performance or other aspects of our products may impact the demand for our products. Demand for our products may also be impacted by changes in government and/or industry policies, standards or regulations that discourage the use of certain traditional lighting technologies. These constraints may be eliminated or delayed by legislative action, which could have a negative impact on demand for our products. Our ability and the ability of our competitors to meet these new requirements could impact competitive dynamics in the market.

If governments, their agencies or utilities reduce their demand for our products or discontinue or curtail their funding, our business may suffer.

Changes in governmental budget priorities could adversely affect our business and results of operations. U.S. and foreign government agencies have purchased products directly from us and products from our customers, and U.S. government agencies have historically funded a portion of our research and development activities. When the government changes budget priorities, such as in times of war or financial crisis, or reallocates its research and development spending to areas unrelated to our business, our research and development funding and our product sales to government entities and government-funded customers are at risk. For example, demand and payment for our products and our customers' products may be affected by public sector budgetary cycles, funding authorizations or utility rebates. Funding reductions or delays could negatively impact demand for our products. If government or utility funding is discontinued or significantly reduced, our business and results of operations could be adversely affected.

We are exposed to fluctuations in the market value of our investment portfolio and in interest rates, and therefore, impairment of our investments or lower investment income could harm our earnings.

We are exposed to market value and inherent interest rate risk related to our investment portfolio. We have historically invested portions of our available cash in fixed interest rate securities such as high-grade corporate debt, commercial paper, municipal bonds, certificates of deposit, government securities and other fixed interest rate investments. The primary objective of our cash investment policy is preservation of principal. However, these investments are generally not Federal Deposit Insurance Corporation insured and may lose value and/or become illiquid regardless of their credit rating.

From time to time, we have also made investments in public and private companies that engage in complementary businesses. For example, during fiscal 2015 we made an investment in Lextar, a public company in Taiwan. An investment in another company is subject to the risks inherent in the business of that company and to trends affecting the equity markets as a whole. Investments in publicly held companies are subject to market risks and, like our investment in Lextar, may not be liquidated easily. As a result, we may not be able to reduce the size of our position or liquidate our investments when we deem appropriate to limit our downside risk. Should the value of any such investments we hold decline, the related write-down in value could have a material adverse effect on our financial condition and results of operations. For example, the value of our Lextar investment declined from the date of our investment in December 2014 through the end of the second quarter of fiscal 2017 with variability between quarters, and may continue to decline in the future. As required by Rule 3-09 of Regulation S-X, we filed Lextar's financial statements, prepared by Lextar and audited by its independent public accounting firm, as of and for the years ended December 31, 2015 and 2014 as an exhibit to our Annual Report on Form 10-K for the fiscal year ended June 26, 2016.

Table of Contents

In order to compete, we must attract, motivate and retain key employees, and our failure to do so could harm our results of operations.

Hiring and retaining qualified executives, scientists, engineers, technical staff and sales personnel is critical to our business, and competition for experienced employees in our industry can be intense. As a global company, this issue is not limited to the United States, but includes our other locations such as Europe and China. For example, there is substantial competition in China for qualified and capable personnel, particularly experienced engineers and technical personnel, which may make it difficult for us to recruit and retain qualified employees. Also, within Huizhou, China, there are other large companies building manufacturing plants that will likely compete for qualified employees. If we are unable to staff sufficient and adequate personnel at our China facilities, we may experience lower revenue or increased manufacturing costs, which would adversely affect our results of operations.

To help attract, motivate and retain key employees, we use benefits such as stock-based compensation awards. If the value of such awards does not appreciate, as measured by the performance of the price of our common stock or if our stock-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain and motivate employees could be weakened, which could harm our business and results of operations.

Litigation could adversely affect our operating results and financial condition.

We are often involved in litigation, primarily patent litigation. Defending against existing and potential litigation will likely require significant attention and resources and, regardless of the outcome, result in significant legal expenses, which could adversely affect our results unless covered by insurance or recovered from third parties. If our defenses are ultimately unsuccessful or if we are unable to achieve a favorable resolution, we could be liable for damage awards that could materially affect our results of operations and financial condition.

Where necessary, we may initiate litigation to enforce our patent or other intellectual property rights, which could adversely impact our relationship with certain customers. Any such litigation may require us to spend a substantial amount of time and money and could distract management from our day-to-day operations. Moreover, there is no assurance that we will be successful in any such litigation.

Our business may be impaired by claims that we, or our customers, infringe the intellectual property rights of others.

Vigorous protection and pursuit of intellectual property rights characterize our industry. These traits have resulted in significant and often protracted and expensive litigation. Litigation to determine the validity of patents or claims by third parties of infringement of patents or other intellectual property rights could result in significant legal expense and divert the efforts of our technical personnel and management, even if the litigation results in a determination favorable to us. In the event of an adverse result in such litigation, we could be required to:

- pay substantial damages;
- indemnify our customers;
- stop the manufacture, use and sale of products found to be infringing;
- incur asset impairment charges;
- discontinue the use of processes found to be infringing;
- expend significant resources to develop non-infringing products or processes; or
- obtain a license to use third party technology.

There can be no assurance that third parties will not attempt to assert infringement claims against us, or our customers, with respect to our products. In addition, our customers may face infringement claims directed to the customer’s products that incorporate our products, and an adverse result could impair the customer’s demand for our products. We have also promised certain of our customers that we will indemnify them in the event they are sued by our competitors for infringement claims directed to the products we supply. Under these indemnification obligations, we may be responsible for future payments to resolve infringement claims against them.

From time to time, we receive correspondence asserting that our products or processes are or may be infringing patents or other intellectual property rights of others. If we believe the assertions may have merit or in other appropriate circumstances, we may take steps to seek to obtain a license or to avoid the infringement. We cannot predict, however, whether a license will be available;

Table of Contents

that we would find the terms of any license offered acceptable; or that we would be able to develop an alternative solution. Failure to obtain a necessary license or develop an alternative solution could cause us to incur substantial liabilities and costs and to suspend the manufacture of affected products.

There are limitations on our ability to protect our intellectual property.

Our intellectual property position is based in part on patents owned by us and patents licensed to us. We intend to continue to file patent applications in the future, where appropriate, and to pursue such applications with U.S. and certain foreign patent authorities.

Our existing patents are subject to expiration and re-examination and we cannot be sure that additional patents will be issued on any new applications around the covered technology or that our existing or future patents will not be successfully contested by third parties. Also, since issuance of a valid patent does not prevent other companies from using alternative, non-infringing technology, we cannot be sure that any of our patents, or patents issued to others and licensed to us, will provide significant commercial protection, especially as new competitors enter the market.

We periodically discover products that are counterfeit reproductions of our products or that otherwise infringe on our intellectual property rights. The actions we take to establish and protect trademarks, patents and other intellectual property rights may not be adequate to prevent imitation of our products by others, and therefore, may adversely affect our sales and our brand and result in the shift of customer preference away from our products. Further, the actions we take to establish and protect trademarks, patents and other intellectual property rights could result in significant legal expense and divert the efforts of our technical personnel and management, even if the litigation or other action results in a determination favorable to us.

We also rely on trade secrets and other non-patented proprietary information relating to our product development and manufacturing activities. We try to protect this information through appropriate efforts to maintain its secrecy, including requiring employees and third parties to sign confidentiality agreements. We cannot be sure that these efforts will be successful or that the confidentiality agreements will not be breached. We also cannot be sure that we would have adequate remedies for any breach of such agreements or other misappropriation of our trade secrets, or that our trade secrets and proprietary know-how will not otherwise become known or be independently discovered by others.

We may be required to recognize a significant charge to earnings if our goodwill or other intangible assets become impaired.

Goodwill and purchased intangible assets with indefinite lives are not amortized, but are reviewed for impairment annually and more frequently when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We assess the recoverability of the unamortized balance of our finite-lived intangible assets when indicators of potential impairment are present. Factors that may indicate that the carrying value of our goodwill or other intangible assets may not be recoverable include a decline in our stock price and market capitalization and slower growth rates in our industry. The recognition of a significant charge to earnings in our consolidated financial statements resulting from any impairment of our goodwill or other intangible assets could adversely impact our results of operations.

We may be subject to confidential information theft or misuse, which could harm our business and results of operations.

We face attempts by others to gain unauthorized access to our information technology systems on which we maintain proprietary and other confidential information. Our security measures may be breached as the result of industrial or other espionage actions of outside parties, employee error, malfeasance or otherwise, and as a result, an unauthorized party may obtain access to our systems. Additionally, outside parties may attempt to access our confidential information through other means, for example by fraudulently inducing our employees to disclose confidential information. We actively seek to prevent, detect and investigate any unauthorized access, which sometimes occurs. We might be unaware of any such access or unable to determine its magnitude and effects. The theft and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an incident could adversely affect our competitive position and the value of our investment in research and development could be reduced. Our business could be subject to significant disruption and we could suffer monetary or other losses.

We are subject to risks related to international sales and purchases.
We expect that revenue from international sales will continue to represent a significant portion of our total revenue. As such, a significant slowdown or instability in relevant foreign economies, including economic instability in Europe, or lower investments in new infrastructure could have a negative impact on our sales. We also purchase a portion of the materials included in our products from overseas sources.

Table of Contents

Our international sales and purchases are subject to numerous U.S. and foreign laws and regulations, including, without limitation, tariffs, trade sanctions, trade barriers, trade embargoes, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and, in the extreme case, we could be suspended or debarred from government contracts or have our export privileges suspended, which could have a material adverse effect on our business.

International sales and purchases are also subject to a variety of other risks, including risks arising from currency fluctuations, collection issues and taxes. We have entered and may in the future enter into foreign currency derivative financial instruments in an effort to manage or hedge some of our foreign exchange rate risk. We may not be able to engage in hedging transactions in the future, and, even if we do, foreign currency fluctuations may still have a material adverse effect on our results of operations.

Our business may be adversely affected by uncertainties in the global financial markets and our or our customers' or suppliers' ability to access the capital markets.

Global financial markets continue to reflect uncertainty about a sustained global economic recovery. Given these uncertainties, there could be future disruptions in the global economy, financial markets and consumer confidence. If economic conditions deteriorate unexpectedly, our business and results of operations could be materially and adversely affected. For example, our customers, including our distributors and their customers, may experience difficulty obtaining the working capital and other financing necessary to support historical or projected purchasing patterns, which could negatively affect our results of operations.

Although we believe we have adequate liquidity and capital resources to fund our operations internally and under our existing line of credit, our inability to access the capital markets on favorable terms in the future, or at all, may adversely affect our financial performance. The inability to obtain adequate financing from debt or capital sources in the future could force us to self-fund strategic initiatives or even forego certain opportunities, which in turn could potentially harm our performance.

Changes in our effective tax rate may affect our results.

Our future effective tax rates may be affected by a number of factors including:

- the jurisdiction in which profits are determined to be earned and taxed;
- changes in government administrations, such as the new U.S. presidential administration and U.S. Congress, as well as in the states and countries in which we operate;
- changes in tax laws or interpretation of such tax laws and changes in generally accepted accounting principles;
- the resolution of issues arising from tax audits with various authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes, including impairment of goodwill in connection with acquisitions;
- changes in available tax credits;
- the recognition and measurement of uncertain tax positions;
- the lack of sufficient excess tax benefits (credits) in our additional paid-in-capital pool in situations where our realized tax deductions for certain stock-based compensation awards (such as non-qualified stock options and restricted stock) are less than those originally anticipated; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes or any changes in legislation that may result in these earnings being taxed within the U.S., regardless of our decision regarding repatriation of funds.

Any significant increase or decrease in our future effective tax rates could impact net income (loss) for future periods. In addition, the determination of our income tax provision requires complex estimations, significant judgments and significant knowledge and experience concerning the applicable tax laws. To the extent our income tax liability materially differs from our income tax

52

Table of Contents

provisions due to factors, including the above, which were not anticipated at the time we estimated our tax provision, our net income (loss) or cash flows could be affected.

Failure to comply with applicable environmental laws and regulations worldwide could harm our business and results of operations.

The manufacturing, assembling and testing of our products require the use of hazardous materials that are subject to a broad array of environmental, health and safety laws and regulations. Our failure to comply with any of these applicable laws or regulations could result in:

- regulatory penalties, fines, legal liabilities and the forfeiture of certain tax benefits;
- suspension of production;
- alteration of our fabrication, assembly and test processes; and
- curtailment of our operations or sales.

In addition, our failure to manage the use, transportation, emission, discharge, storage, recycling or disposal of hazardous materials could subject us to increased costs or future liabilities. Existing and future environmental laws and regulations could also require us to acquire pollution abatement or remediation equipment, modify our product designs or incur other expenses, such as permit costs, associated with such laws and regulations. Many new materials that we are evaluating for use in our operations may be subject to regulation under existing or future environmental laws and regulations that may restrict our use of one or more of such materials in our manufacturing, assembly and test processes or products. Any of these restrictions could harm our business and results of operations by increasing our expenses or requiring us to alter our manufacturing processes.

Our results could vary as a result of the methods, estimates and judgments that we use in applying our accounting policies, including changes in the accounting standards to be applied.

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results (see “Critical Accounting Policies and Estimates” in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2 of this Quarterly Report). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations or financial condition.

Likewise, our results may be impacted due to changes in the accounting standards to be applied, such as the increased use of fair value measurement standards and changes in revenue recognition requirements.

Catastrophic events may disrupt our business.

A disruption or failure of our systems or operations in the event of a natural disaster, health pandemic, such as an influenza outbreak within our workforce, or man-made catastrophic event could cause delays in completing sales, continuing production or performing other critical functions of our business, particularly if a catastrophic event occurred at our primary manufacturing locations or our subcontractors' locations. Any of these events could severely affect our ability to conduct normal business operations and, as a result, our operating results could be adversely affected. There may also be secondary impacts that are unforeseeable as well, such as impacts to our customers, which could cause delays in new orders, delays in completing sales or even order cancellations.

Our stock price may be volatile.

Historically, our common stock has experienced substantial price volatility, particularly as a result of significant fluctuations in our revenue, earnings and margins over the past few years, and variations between our actual financial results and the published expectations of analysts. For example, the closing price per share of our common stock on the NASDAQ Global Select Market ranged from a low of $21.12 to a high of $32.44 during the 12 months ended December 25, 2016. If our future operating results or margins are below the expectations of stock market analysts or our investors, our stock price will likely decline.

Speculation and opinions in the press or investment community about our strategic position, financial condition, results of operations or significant transactions can also cause changes in our stock price. In particular, speculation around our market opportunities for energy efficient lighting may have a dramatic effect on our stock price, especially as various government agencies announce their planned investments in energy efficient technology, including lighting.

53

Table of Contents

We have outstanding debt which could materially restrict our business and adversely affect our financial condition, liquidity and results of operations.

Our indebtedness consists of borrowings from our revolving line of credit. Our ability to pay interest and repay the principal for our indebtedness is dependent upon our ability to manage our business operations and generate sufficient cash flows to service such debt. There can be no assurance that we will be able to manage any of these risks successfully.

The level of outstanding debt under this line of credit may adversely affect our operating results and financial condition by, among other things:

- increasing our vulnerability to downturns in our business, to competitive pressures and to adverse general economic and industry conditions;
- requiring the dedication of an increased portion of our expected cash flows from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures, research and development and stock repurchases;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage compared to our peers that may have less indebtedness than we have by limiting our ability to borrow additional funds needed to operate and grow our business; and
- increasing our interest expense if interest rates increase.

Our line of credit requires us to maintain compliance with certain financial ratios. In addition, our line of credit contains certain restrictions that could limit our ability to, among other things: incur additional indebtedness, dispose of assets, create liens on assets, make acquisitions or engage in mergers or consolidations, and engage in certain transactions with our subsidiaries and affiliates. These restrictions could limit our ability to plan for or react to changing business conditions, or could otherwise restrict our business activities and plans.

Our ability to comply with our loan covenants may also be affected by events beyond our control and if any of these restrictions or terms is breached, it could lead to an event of default under our line of credit. A default, if not cured or waived, may permit acceleration of our indebtedness. In addition, our lenders could terminate their commitments to make further extensions of credit under our line of credit. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds to pay the accelerated indebtedness or that we will have the ability to refinance accelerated indebtedness on terms favorable to us or at all.

Regulations related to conflict-free minerals may force us to incur additional expenses.

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC established new annual disclosure and reporting requirements for those companies who may use “conflict” minerals mined from the DRC and adjoining countries in their products. Our most recent disclosure regarding our due diligence was filed in May 2016 for calendar year 2015. These requirements could affect the sourcing and availability of certain minerals used in the manufacture of our products. As a result, we may not be able to obtain the relevant minerals at competitive prices and there will likely be additional costs associated with complying with the due diligence procedures as required by the SEC. In addition, because our supply chain is complex, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins of all minerals used in our products through the due diligence procedures, and we may incur additional costs as a result of changes to product, processes or sources of supply as a consequence of these requirements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sale of Unregistered Securities

There were no unregistered securities sold during the second quarter of fiscal 2017.

Table of Contents

Stock Repurchase Program

The following table summarizes stock repurchase activity for the second quarter of fiscal 2017 (in thousands, except price per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs[1]
Shares repurchased under our Stock Repurchase Program				
September 26, 2016 to October 23, 2016	—	$—	1,471	$264,307
October 24, 2016 to November 20, 2016	2,375	$22.51	3,846	$210,830
November 21, 2016 to December 25, 2016	371	$25.22	4,217	$201,484
Total	2,746	$22.88		

(1) On August 24, 2016, our Board of Directors approved the extension of our stock repurchase program through June 25, 2017. Pursuant to the program, we are authorized to repurchase shares of our common stock having an aggregate purchase price not exceeding $300 million for all purchases from August 24, 2016 through the expiration of the program on June 25, 2017.

Since the inception of our stock repurchase program in January 2001 through December 25, 2016, we have repurchased 38.5 million shares of our common stock at an average price of $28.69 per share with an aggregate value of $1.1 billion. The repurchase program can be implemented through open market or privately negotiated transactions at the discretion of our management.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

The following exhibits are being filed herewith and are numbered in accordance with Item 601 of Regulation S-K:

Exhibit No.	Description
10.1	2013 Long-Term Incentive Compensation Plan, as amended (incorporated by reference to Exhibit 10.1 of the Company’s Current Report on Form 8-K, dated October 25, 2016, filed with the Securities and Exchange Commission on October 28, 2016)
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Cree, Inc.’s Quarterly Report on Form 10-Q for the fiscal quarter ended December 25, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income (Loss); (iii) Consolidated Statements of Comprehensive Income (Loss); (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CREE, INC.

January 25, 2017

/s/ MICHAEL E. MCDEVITT
Michael E. McDevitt
Executive Vice President and Chief Financial Officer
(Authorized Officer and Principal Financial and Chief Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit No.	Description
10.1	2013 Long-Term Incentive Compensation Plan, as amended (incorporated by reference to Exhibit 10.1 of the Company’s Current Report on Form 8-K, dated October 25, 2016, filed with the Securities and Exchange Commission on October 28, 2016)
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Cree, Inc.’s Quarterly Report on Form 10-Q for the fiscal quarter ended December 25, 2016 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income (Loss); (iii) Consolidated Statements of Comprehensive Income (Loss); (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements