CREE INC
Form 10-Q
January 24, 2018
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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 24, 2017
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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer”, “accelerated filer,” “smaller reporting company,” and "emerging growth 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)
Emerging growth company [ ]

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

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

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The number of shares outstanding of the registrant’s common stock, par value $0.00125 per share, as of January 19, 2018, was 99,960,179.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CREE, INC.

UNAUDITED CONSOLIDATED BALANCE SHEETS

	December 24, 2017	June 25, 2017
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$169,688	$132,597
Short-term investments	480,221	478,341
Total cash, cash equivalents and short-term investments	649,909	610,938
Accounts receivable, net	153,014	148,392
Income tax receivable	2,809	8,040
Inventories, net	273,211	284,385
Prepaid expenses	22,933	23,305
Other current assets	19,450	23,390
Current assets held for sale	6,913	2,180
Total current assets	1,128,239	1,100,630
Property and equipment, net	612,131	581,263
Goodwill	618,828	618,828
Intangible assets, net	259,607	274,315
Other long-term investments	72,517	50,366
Deferred income taxes	10,399	11,763
Other assets	12,564	12,702
Total assets	$2,714,285	$2,649,867
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$158,291	$133,185
Accrued salaries and wages	46,906	41,860
Other current liabilities	40,525	36,978
Total current liabilities	245,722	212,023
Long-term liabilities:		
Long-term debt	124,000	145,000
Deferred income taxes	37,404	49,860
Other long-term liabilities	24,147	20,179
Total long-term liabilities	185,551	215,039
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 24, 2017 and June 25, 2017; none issued and outstanding	—	—
Common stock, par value $0.00125; 200,000 shares authorized at December 24, 2017 and June 25, 2017; 99,888 issued and outstanding at December 24, 2017 and 97,674 shares issued and outstanding at June 25, 2017	123	121
Additional paid-in-capital	2,483,424	2,419,517
Accumulated other comprehensive income, net of taxes	3,427	5,909
Accumulated deficit	(208,878)	(202,742)
Total shareholders' equity	2,278,096	2,222,805

Noncontrolling interest	4,916	—
Total liabilities and equity	$2,714,285	$2,649,867

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

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

	Three Months Ended		Six Months Ended	
	December 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
	(In thousands, except per share amounts)			
Revenue, net	$367,870	$401,326	$728,268	$772,559
Cost of revenue, net	275,267	260,759	535,333	522,061
Gross profit	92,603	140,567	192,935	250,498
Operating expenses:				
Research and development	39,776	37,893	81,635	77,841
Sales, general and administrative	68,076	76,513	131,040	144,971
Amortization or impairment of acquisition-related intangibles	6,792	5,937	13,584	12,345
Loss on disposal or impairment of long-lived assets	4,262	717	7,087	1,041
Total operating expenses	118,906	121,060	233,346	236,198
Operating (loss) income	(26,303)	19,507	(40,411)	14,300
Non-operating income (expense), net	26,729	(4,760)	25,662	(4,919)
Income (loss) before income taxes	426	14,747	(14,749)	9,381
Income tax (benefit) expense	(13,326)	8,531	(8,629)	2,598
Net income (loss)	$13,752	$6,216	($6,120)	$6,783
Net income attributable to noncontrolling interest	31	—	16	—
Net income (loss) attributable to controlling interest	$13,721	$6,216	($6,136)	$6,783
Earnings (loss) per share:				
Basic	$0.14	$0.06	($0.06)	$0.07
Diluted	$0.14	$0.06	($0.06)	$0.07
Weighted average shares used in per share calculation:				
Basic	99,184	98,467	98,499	99,513
Diluted	100,763	98,730	98,499	99,994

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

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

	Three Months Ended		Six Months Ended	
	December 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
	(In thousands)			
Net income (loss)	$13,721	$6,216	($6,136)	$6,783
Other comprehensive loss:				
Currency translation (loss) gain	(424)	(1,343)	1,218	(1,314)
Net unrealized loss on available-for-sale securities, net of tax benefit of $0 and $2,357 and $0 and $2,556 respectively	(3,660)	(3,795)	(3,700)	(4,115)
Other comprehensive loss:	(4,084)	(5,138)	(2,482)	(5,429)
Comprehensive income (loss)	$9,637	$1,078	($8,618)	$1,354

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

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CREE, INC.
UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended	
	December 24, 2017	December 25, 2016
	(In thousands)	
Cash flows from operating activities:		
Net income (loss)	($6,120)	$6,783
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	74,634	62,574
Stock-based compensation	22,162	26,856
Excess tax benefit from stock-based payment arrangements	—	(1)
Loss on disposal or impairment of long-lived assets	7,087	845
Amortization of premium/discount on investments	2,631	2,749
(Gain) loss on equity investment	(21,479)	6,298
Foreign exchange gain on equity investment	(672)	(434)
Deferred income taxes	(11,801)	44
Changes in operating assets and liabilities:		
Accounts receivable, net	(4,203)	13,647
Inventories	11,339	1,290
Prepaid expenses and other assets	5,014	2,735
Accounts payable, trade	17,925	(13,834)
Accrued salaries and wages and other liabilities	9,295	10,164
Net cash provided by operating activities	105,812	119,716
Cash flows from investing activities:		
Purchases of property and equipment	(85,222)	(35,211)
Purchases of patent and licensing rights	(4,932)	(5,836)
Proceeds from sale of property and equipment	380	236
Purchases of short-term investments	(158,327)	(125,022)
Proceeds from maturities of short-term investments	138,435	93,312
Proceeds from sale of short-term investments	11,938	7,619
Net cash used in investing activities	(97,728)	(64,902)
Cash flows from financing activities:		
Proceeds from issuing shares to noncontrolling interest	4,900	—
Payment of acquisition-related contingent consideration	(1,850)	(2,775)
Proceeds from long-term debt borrowings	160,000	245,000
Payments on long-term debt borrowings	(181,000)	(235,000)
Net proceeds from issuance of common stock	46,550	8,021
Excess tax benefit from stock-based payment arrangements	—	1
Repurchases of common stock	—	(98,431)
Net cash provided by (used in) financing activities	28,600	(83,184)
Effects of foreign exchange changes on cash and cash equivalents	407	(691)
Net increase (decrease) in cash and cash equivalents	37,091	(29,061)
Cash and cash equivalents:		
Beginning of period	132,597	166,154
End of period	$169,688	$137,093
Supplemental disclosure of cash flow information:		
Significant non-cash transactions:		
Accrued property and equipment	$19,039	$8,240

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

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CREE, INC.
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation and New Accounting Standards

Overview

Cree, Inc. (the Company) is an 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 lamps. 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 chips and LED components. The Company's LED products enable its customers to develop and market LED-based products for lighting, video screens, automotive and other industrial applications.

The Company’s Wolfspeed business consists of 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 materials products and power devices are used in solar, electric vehicles, motor drives, power supplies and transportation applications. The Company’s RF devices are used in military communications, radar, satellite and telecommunication applications.

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, Arkansas, 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 three reportable segments are:

- Lighting Products
- LED Products
- Wolfspeed

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

Basis of Presentation

The consolidated balance sheet at December 24, 2017, the consolidated statements of income (loss) for the three and six months ended December 24, 2017 and December 25, 2016, the consolidated statements of comprehensive income (loss) for the three and six months ended December 24, 2017 and December 25, 2016, and the consolidated statements of cash flows for the six months ended December 24, 2017 and December 25, 2016 (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 24, 2017, and for all periods presented, have been made. All intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 25, 2017 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 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 25, 2017 (fiscal 2017). The results of operations for the three and six months ended December 24, 2017 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 24, 2018 (fiscal 2018).

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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 2017 amounts related to the Wolfspeed business in the accompanying consolidated financial statements have been reclassified to continuing operations to conform to the fiscal 2018 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

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 Company's evaluation of ASU 2014-09 is ongoing and not complete; however, the Company anticipates the primary changes to revenue recognition to be related to certain patent license arrangements. The FASB has issued and may issue in the future, interpretive guidance, which may cause our evaluation to change. The effective date will be the first quarter of the Company's fiscal year ending June 30, 2019 and the Company currently expects to use the modified retrospective method.

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 grants an entity the right to withhold up to the employee's maximum statutory tax rate in the applicable jurisdiction without triggering liability accounting. The effective date was the first quarter of the Company's fiscal year ending June 24, 2018.
The Company's adoption of this ASU did not have a material impact on its consolidated financial statements. All excess tax benefits and deficiencies in the current and future periods will be recognized as income tax expense in the Company's income statement in the reporting period in which they occur. This could result in increased volatility in the Company's effective tax rate. For the six months ended December 24, 2017, the Company did not recognize a discrete event related to the excess tax benefits from stock-based compensation due to a full U.S. valuation allowance on the impact. The Company plans to continue its existing practice of estimating expected forfeitures in determining compensation cost.

Goodwill Impairment Testing

In January 2017, the FASB issued ASU No. 2017-04: Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU simplifies the manner in which an entity is required to test for goodwill impairment by eliminating Step 2 from the goodwill impairment test. Additionally, the ASU removes the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to continue to perform Step 1 of

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the goodwill impairment test. The effective date will be the first quarter of the Company's fiscal year ending June 27, 2021. The Company’s adoption of this guidance is not expected to have a significant impact on its consolidated financial statements.

Note 2 – Joint Venture

Effective July 17, 2017, the Company entered into a Shareholders Agreement with San’an Optoelectronics Co., Ltd. (San’an) and Cree Venture LED Company Limited (Cree Venture LED) pursuant to which the Company and San’an funded their contributions to Cree Venture LED and agreed upon the management and operation of Cree Venture LED. The Company contributed $5.1 million of cash for a 51% ownership interest and San’an contributed $4.9 million of cash for a 49% ownership interest. Cree Venture LED has a five-member board of directors, three of which were designated by the Company and two of which were designated by San’an. As a result of the Company's majority voting interest, the Company consolidates the operations of Cree Venture LED and reports its revenue and gross profit within the Company's LED Products segment. The Company classifies the 49% ownership interest held by San'an as "Noncontrolling interest" on the consolidated balance sheet. During the six months ended December 24, 2017, the noncontrolling interest increased by $16 thousand for its share of net income from Cree Venture LED. There were no other changes in the noncontrolling interest.

In connection with forming Cree Venture LED and entering into the Shareholders Agreement, Cree Venture LED and San’an also entered into a manufacturing agreement pursuant to which San'an will supply Cree Venture LED with mid-power LED products, and the Company and Cree Venture LED entered into a sales agency agreement pursuant to which the Company will be the independent sales representative of Cree Venture LED in the exclusive markets, among certain other ancillary agreements related to the transaction. Cree Venture LED will produce and deliver to market high performing, mid-power lighting class LEDs in an exclusive arrangement to serve the expanding markets of North and South America, Europe and Japan, and serve China and the rest of the world on a non-exclusive basis. Cree Venture LED recorded its first sales to customers during the first quarter of fiscal 2018.

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 were achieved over the subsequent two years, additional cash payments totaling up to $4.6 million were to 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 final payment of $1.9 million was made in July 2017 based on achievement of the second year goals. 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 are reported as part of the Company's Wolfspeed segment.

Note 4 – Financial Statement Details

Accounts Receivable, net

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

	December 24, 2017	June 25, 2017
Billed trade receivables	$214,266	$205,516
Unbilled contract receivables	987	912
	215,253	206,428
Allowance for sales returns, discounts and other incentives	(53,528)	(49,425)
Allowance for bad debts	(8,711)	(8,611)
Accounts receivable, net	$153,014	$148,392

Inventories

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

	December 24, 2017	June 25, 2017
Raw material	$84,429	$73,410
Work-in-progress	89,501	100,402
Finished goods	99,281	110,573
Inventories, net	$273,211	$284,385

Other Current Liabilities

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

	December 24, 2017	June 25, 2017
Accrued taxes	$13,181	$11,148
Accrued professional fees	4,713	5,545
Accrued warranty	15,151	13,631
Accrued other	7,480	6,654
Other current liabilities	$40,525	$36,978

Accumulated Other Comprehensive Income, net of taxes

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

	December 24, 2017	June 25, 2017
Currency translation gain	$5,689	$4,471
Net unrealized (loss) gain on available-for-sale securities	(2,262)	1,438
Accumulated other comprehensive income, net of taxes	$3,427	$5,909

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Non-Operating Income (Expense), net

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

	Three Months Ended		Six Months Ended	
	December 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
Foreign currency gain (loss), net	$462	($1,856)	$1,228	($495)
Gain on sale of investments, net	1	—	47	12
Gain (loss) on equity investment, net	24,746	(3,796)	21,479	(6,283)
Interest income, net	1,467	900	2,617	1,787
Other, net	53	(8)	291	60
Non-operating income (expense), net	$26,729	($4,760)	$25,662	($4,919)

The change in Gain (loss) on equity investment is due to the increase in the Lextar Electronics Corporation (Lextar) stock price.

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 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016	
Net unrealized gain on available-for-sale securities, net of taxes	$1	$—	$47	$12	Non-operating income (expense), net
	1	—	47	12	Income (loss) before income taxes
	—	—	—	5	Income tax (benefit) expense
	$1	$—	$47	$7	

Note 5 – Investments

Investments consist of municipal bonds, corporate bonds, U.S. agency securities, 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.

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

	December 24, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$178,985	$815	($1,025)	$178,775
Corporate bonds	172,410	1,161	(761)	172,810
U.S. agency securities	3,921	—	(7)	3,914
Non-U.S. certificates of deposit	122,634	—	—	122,634
Commercial paper	2,088	—	—	2,088
Total short-term investments	$480,038	$1,976	($1,793)	$480,221

	June 25, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$177,890	$2,219	($68)	$180,041
Corporate bonds	175,991	1,925	(195)	177,721
U.S. agency securities	—	—	—	—
Non-U.S. certificates of deposit	120,379	—	—	120,379
Commercial paper	200	—	—	200
Total short-term investments	$474,460	$4,144	($263)	$478,341

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 24, 2017					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$115,005	($897)	$7,821	($90)	$122,826	($987)
Corporate bonds	100,236	(563)	12,808	(237)	113,044	(800)
U.S. agency securities	3,914	(7)	—	—	3,914	(7)
Total	$219,155	($1,467)	$20,629	($327)	$239,784	($1,794)
Number of securities with an unrealized loss		148		23		171

	June 25, 2017					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$26,816	($68)	$—	$—	$26,816	($68)
Corporate bonds	57,404	(195)	—	—	57,404	(195)
U.S. agency securities	—	—	—	—	—	—
Total	$84,220	($263)	$—	$—	$84,220	($263)
Number of securities with an unrealized loss		67		—		67

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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 income (expense), 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 24, 2017 and June 25, 2017.

The contractual maturities of short-term investments as of December 24, 2017 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	$1,526	$130,557	$35,186	$11,506	$178,775
Corporate bonds	4,759	97,126	62,274	8,651	172,810
U.S. agency securities	—	3,914	—	—	3,914
Non-U.S. certificates of deposit	114,911	7,723	—	—	122,634
Commercial paper	2,088	—	—	—	2,088
Total short-term investments	$123,284	$239,320	$97,460	$20,157	$480,221

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 24, 2017, financial assets utilizing Level 1 inputs included money market funds and certificates of deposit, and financial assets utilizing Level 2 inputs included municipal bonds, corporate bonds, U.S. agency securities, certificates of deposit, commercial paper 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 24, 2017. There were no transfers between Level 1 and Level 2 during the six months ended December 24, 2017.

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

	December 24, 2017				June 25, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Municipal bonds	$—	$—	$—	$—	$—	$1,802	$—	$1,802
Non-U.S. certificates of deposit	—	85,259	—	85,259	—	736	—	736
Money market funds	1,191	—	—	1,191	1,184	—	—	1,184
Total cash equivalents	1,191	85,259	—	86,450	1,184	2,538	—	3,722
Short-term investments:								
Municipal bonds	—	178,775	—	178,775	—	180,041	—	180,041
Corporate bonds	—	172,810	—	172,810	—	177,721	—	177,721
U.S. agency securities	3,914	—	—	3,914	—	—	—	—
Commercial paper	—	2,088	—	2,088	—	200	—	200
Non-U.S. certificates of deposit	—	122,634	—	122,634	—	120,379	—	120,379
Total short-term investments	3,914	476,307	—	480,221	—	478,341	—	478,341
Other long-term investments:								
Common stock of non-U.S. corporations	—	72,517	—	72,517	—	50,366	—	50,366
Total other long-term investments	—	72,517	—	72,517	—	50,366	—	50,366
Total assets	$5,105	$634,083	$—	$639,188	$1,184	$531,245	$—	$532,429

Note 7– Intangible Assets

Intangible Assets, net

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

	December 24, 2017			June 25, 2017		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets with finite lives:						
Customer relationships	$141,420	($87,790)	$53,630	$141,420	($84,673)	$56,747
Developed technology	181,728	(143,179)	38,549	181,728	(132,747)	48,981
Non-compete agreements	10,475	(10,436)	39	10,475	(10,398)	77
Trade names, finite-lived	520	(520)	—	520	(520)	—
Patent and licensing rights	155,523	(67,814)	87,709	151,985	(63,155)	88,830
Total intangible assets with finite lives	489,666	(309,739)	179,927	486,128	(291,493)	194,635
Trade names, indefinite-lived	79,680	—	79,680	79,680	—	79,680
Total intangible assets	$569,346	($309,739)	$259,607	$565,808	($291,493)	$274,315

For the three and six months ended December 24, 2017, total amortization of finite-lived intangible assets was $9.9 million and $19.8 million, respectively. For the three and six months ended December 25, 2016, total amortization of finite-lived intangible assets was $9.0 million and $18.4 million, respectively.

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

Fiscal Year Ending	
June 24, 2018 (remainder of fiscal 2018)	$13,925
June 30, 2019	25,459
June 28, 2020	20,042
June 27, 2021	18,631
June 26, 2022	16,307
Thereafter	85,563
Total future amortization expense	$179,927

Note 8 – Long-term Debt

As of December 24, 2017, 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, 2022. The Company classifies balances outstanding under its line of credit as long-term debt in the consolidated balance sheets. At December 24, 2017, the Company had $124 million outstanding under the line of credit and $376 million available for borrowing. For the three and six months ended December 24, 2017, the average interest rate was 1.75% and 1.76% for each period, respectively. For the three and six months ended December 24, 2017 the average commitment fee percentage was 0.10%. The Company was in compliance with all covenants in the line of credit at December 24, 2017.

Note 9 – Shareholders' Equity

As of December 24, 2017, 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 $200 million for all purchases from June 26, 2017 through the expiration of the program on June 24, 2018. During the six months ended December 24, 2017, the Company repurchased no shares of common stock 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 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
Net income (loss)	$13,721	$6,216	($6,136)	$6,783
Weighted average common shares	99,184	98,467	98,499	99,513
Basic earnings (loss) per share	$0.14	$0.06	($0.06)	$0.07

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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 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
Net income (loss)	$13,721	$6,216	($6,136)	$6,783
Weighted average common shares - basic	99,184	98,467	98,499	99,513
Dilutive effect of stock options, nonvested shares and Employee Stock Purchase Plan purchase rights	1,579	263	—	481
Weighted average common shares - diluted	100,763	98,730	98,499	99,994
Diluted earnings (loss) per share	$0.14	$0.06	($0.06)	$0.07

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 24, 2017, there were 4.1 million and 5.8 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 25, 2016, there were 12.1 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.

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Stock Option Awards

The following table summarizes stock option awards outstanding as of December 24, 2017 and changes during the six months then ended (numbers of shares in thousands):

	Number of Shares	Weighted Average Exercise Price
Outstanding at June 25, 2017	10,604	$38.27
Granted	53	$24.66
Exercised	(1,448)	$27.56
Forfeited or expired	(1,371)	$49.48
Outstanding at December 24, 2017	7,838	$38.20

Restricted Stock Awards and Units

A summary of nonvested restricted stock awards (RSAs) and restricted stock unit awards (RSUs) outstanding as of December 24, 2017, 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 25, 2017	2,412	$26.74
Granted	2,211	$25.91
Vested	(584)	$29.44
Forfeited	(478)	$24.52
Nonvested at December 24, 2017	3,561	$26.08

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.

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

	Three Months Ended		Six Months Ended	
	December 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
Income Statement Classification:				
Cost of revenue, net	$1,898	$2,978	$3,673	$5,783
Research and development	1,999	2,486	4,456	5,925
Sales, general and administrative	8,129	6,742	14,031	15,148
Total stock-based compensation expense	$12,026	$12,206	$22,160	$26,856

Note 12 – Income Taxes

The variation between the Company's effective income tax rate and the U.S. statutory rate of 28.3% is primarily due to: (i) changes in the Company’s valuation allowances against deferred tax assets in the U.S. and Luxembourg, (ii) projected income for the full year derived from international locations with lower tax rates than the U.S. and (iii) projected tax credits generated.

The Tax Cuts and Jobs Act of 2017 (Tax Legislation), enacted on December 22, 2017, contains significant changes to U.S. tax law, including lowering the U.S. corporate income tax rate to 21%, implementing a territorial tax system, and imposing a one-time tax on deemed repatriated earnings of foreign subsidiaries.

The Tax Legislation reduces the U.S. statutory tax rate from 35% to 21%, effective January 1, 2018. U.S. tax law requires that taxpayers with a fiscal year that begins before and ends after the effective date of a rate change calculate a blended tax rate based on the pro rata number of days in the fiscal year before and after the effective date. As a result, for the fiscal year ending June 24, 2018, the Company’s statutory income tax rate will be 28.3%. For the fiscal year ending June 30, 2019, the Company’s statutory income tax rate will be 21%. During the three months ended December 24, 2017, the Company recorded an $18.8 million discrete tax benefit representing the benefit of remeasuring its U.S. deferred tax liabilities at the lower 21% statutory tax rate.

The Tax Legislation also implements a territorial tax system. Under the territorial tax system, in general, the Company’s foreign earnings will no longer be subject to tax in the U.S. As part of transitioning to the territorial tax system the Tax Legislation includes a mandatory deemed repatriation of all undistributed foreign earnings that are subject to a U.S. income tax. The Company estimates that the deemed repatriation will result in $15.7 million of additional U.S. income tax which the Company expects to fully offset through the utilization of tax credits. This preliminary estimate may be impacted by a number of additional considerations, including, but not limited to, the issuance of final regulations, the Company's ongoing analysis of the new law and the Company's actual earnings for the fiscal year ending June 24, 2018.

As of December 24, 2017, the Company has approximately $280.3 million of undistributed earnings for certain non-U.S. subsidiaries. These undistributed earnings are subject to the one-time deemed repatriation tax, but could be subject to additional foreign and state income taxes if they are repatriated. The Company has historically asserted its intent to reinvest these earnings in foreign operations indefinitely. The Company has reevaluated its historical assertion considering the enactment of the Tax Legislation and determined that $220.8 million of the undistributed foreign earnings are expected to be repatriated in the foreseeable future. During the three months ended December 24, 2017, the Company recorded a $3.0 million discrete tax expense representing the deferred tax liability for foreign income taxes expected to be withheld upon repatriation of the foreign earnings. As of December 24, 2017, the Company has not provided income taxes on the remaining undistributed foreign earnings as the Company continues to maintain its intention to reinvest these earnings in foreign operations indefinitely. If, at a later date, these earnings were repatriated to the U.S., the Company would be required to pay approximately $3.0 million in taxes on these amounts.

The Company assesses all available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilize the existing deferred tax assets by jurisdiction. The Company has concluded that it is necessary to recognize a full valuation allowance against its U.S. and Luxembourg deferred tax assets. The Company reassessed the need for a full valuation allowance against its U.S. deferred tax assets due to the Tax Legislation and concluded that a full valuation allowance is still necessary. As of June 25, 2017, the U.S. valuation allowance was $101.8

million. During the six months ended December 24, 2017, the Company reduced the U.S. valuation allowance by $20.0 million as a result of remeasuring its U.S. deferred tax assets at the 21% statutory rate and, as a result, the U.S. valuation allowance is $81.8 million as of December 24, 2017. As of June 25, 2017, the Luxembourg valuation allowance was $5.8 million. During the six months ended December 24, 2017, the Company reduced this valuation allowance by $4.8 million as a result of the $18.4 million year-to-date income in Luxembourg.

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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 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 25, 2017, the Company's liability for unrecognized tax benefits was $13.3 million. During the six months ended December 24, 2017, the Company recorded a $4.7 million decrease to the liability for unrecognized tax benefits due to the U.S. statutory rate reduction. In addition, there was a $0.6 million increase in the unrecognized tax benefits due to uncertainty regarding state depreciation deductions. As a result, the total liability for unrecognized tax benefits as of December 24, 2017 was $9.2 million. If any portion of this $9.2 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 $0.4 million of gross unrecognized tax benefits will change in the next 12 months as a result of 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 2014. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2013. For foreign purposes, the Company is generally no longer subject to tax examinations for tax periods prior to 2007. Certain carryforward tax attributes generated in prior years remain subject to examination, adjustment and recapture.

Note 13 – Commitments and Contingencies

Warranties

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

Balance at June 25, 2017	$27,919
Warranties accrued in current period	15,853
Expenditures	(9,171)
Balance at December 24, 2017	$34,601

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 24, 2017, $19.5 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
- Wolfspeed

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Reportable Segments Description

The Company's Lighting Products segment primarily consists of LED lighting systems and lamps. The Company's LED Products segment includes LED chips and LED components. The Company's Wolfspeed segment includes power devices, RF devices, and SiC materials.

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 24, 2017. 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.

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 income (loss) 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.

For the three and six months ended December 25, 2016, the Wolfspeed segment was presented as discontinued operations. The depreciation and amortization adjustment in the table below represents the depreciation and amortization that would have been recognized had the Wolfspeed assets been continuously classified as held and used. These costs were allocated to the Wolfspeed segment's gross profit for the three and six months ended December 25, 2016 because they represent an adjustment which provides comparability to the current period.

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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 24, 2017	December 25, 2016	December 24, 2017	December 25, 2016
Revenue:				
Lighting Products revenue	$144,616	$208,924	$294,340	$392,760
LED Products revenue	152,682	138,038	297,202	275,531
Wolfspeed revenue	70,572	54,364	136,726	104,268
Total revenue	$367,870	$401,326	$728,268	$772,559
Gross Profit and Gross Margin:				
Lighting Products gross profit	$22,964	$74,770	$54,847	$124,060
Lighting Products gross margin	15.9 %	35.8 %	18.6 %	31.6 %
LED Products gross profit	38,606	40,314	77,416	82,084
LED Products gross margin	25.3 %	29.2 %	26.0 %	29.8 %
Wolfspeed gross profit	34,133	25,911	66,531	49,371
Wolfspeed gross margin	48.4 %	47.7 %	48.7 %	47.4 %
Total segment gross profit	95,703	140,995	198,794	255,515
Unallocated costs	(3,100)	(4,859)	(5,859)	(9,618)
Depreciation and amortization adjustment	—	4,431	—	4,601
Consolidated gross profit	$92,603	$140,567	$192,935	$250,498
Consolidated gross margin	25.2 %	35.0 %	26.5 %	32.4 %

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.

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

	December 24, 2017	June 25, 2017
Lighting Products	$140,657	$145,710
LED Products	100,411	108,297
Wolfspeed	28,047	26,453
Total segment inventories, net	269,115	280,460
Unallocated inventories	4,096	3,925
Consolidated inventories, net	$273,211	$284,385

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-

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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 25, 2017. 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 an 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 lamps. We design, manufacture and sell lighting fixtures and lamps for the commercial, industrial and consumer markets.

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

Our Wolfspeed business consists of silicon carbide (SiC) and gallium nitride (GaN) materials, power devices and RF devices based on wide bandgap semiconductor materials. Our materials products and power devices are used in solar, electric vehicles, motor drives, power supplies and transportation applications. Our materials products and RF devices are used in military communications, radar, satellite and telecommunication applications.

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, Arkansas, 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.

Reportable Segments

Our three reportable segments are:

- Lighting Products
- LED Products
- Wolfspeed

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.

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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, SiC power devices and GaN RF devices. Our potential for growth depends significantly on the continued adoption of LEDs, the adoption of SiC and GaN materials and device products in the power and RF markets, and our ability to win new designs for these applications. Demand also fluctuates based on various market cycles, continuously evolving industry supply chains, and evolving competitive dynamics in each of the respective markets. These uncertainties make demand difficult to forecast for us and our customers.
- Intense and Constantly Evolving Competitive Environment. Competition in the industries we serve is intense. Many companies have made significant investments in product 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 the LED, lighting, power and RF markets we serve. To remain competitive, market participants must continuously increase product performance, reduce costs and develop improved ways to serve their customers. To address these competitive pressures, we have invested in research and development activities to support new product development, lower product costs and deliver higher levels of performance to differentiate our products in the market. In addition, we invest in systems, people and new processes to improve our ability to deliver a better overall experience for our customers.
- 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 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 and increase our share of their sales as well as develop new partners to improve our sales effectiveness in each geographic market.
- Technological Innovation and Advancement. Innovations and advancements in LEDs, lighting and power and RF technologies 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 24, 2017

The following is a summary of our financial results for the six months ended December 24, 2017:

- Revenue decreased to $728 million for the six months ended December 24, 2017 from $773 million for the six months ended December 25, 2016.
- Gross profit decreased to $193 million for the six months ended December 24, 2017 from $250 million for the six months ended December 25, 2016. Gross margin was 26% for the six months ended December 24, 2017 and 32% for the six months ended December 25, 2016.
- Operating loss was $40 million for the six months ended December 24, 2017 compared to operating income of $14 million for the six months ended December 25, 2016. Net loss per diluted share was $(0.06) for the six months ended December 24, 2017 compared to net earnings per diluted share of $0.07 for the six months ended December 25, 2016.
- Cash, cash equivalents and short-term investments were $650 million at December 24, 2017 and $611 million at June 25, 2017. Cash provided by operating activities was $106 million for the six months ended December 24, 2017 compared to $120 million for the six months ended December 25, 2016.
- Inventories decreased to $273 million at December 24, 2017 compared to $284 million at June 25, 2017.

- Purchases of property and equipment were $85 million for the six months ended December 24, 2017 compared to $35 million for the six months ended December 25, 2016.

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Business Outlook

We continue to focus on growing the Wolfspeed business, as our customers have further realized the value of our technology. The strength of our balance sheet and operating cash flow provides us the ability to invest in Wolfspeed, while continuing to pursue our LED and Lighting growth plans.

We are uniquely positioned as an innovator in all three business segments and target growth in all three businesses over the next several years. These businesses are in different phases of their growth plans and generally operate on different market cycles. This is targeted to provide better business diversity and less cyclical results over time.

We are focused on the following priorities to support our goals of delivering higher revenue and profits over time:

- Invest in the Wolfspeed business to increase capacity and further develop the technology to support longer term growth opportunities in SiC materials, SiC power devices and modules, and GaN RF devices.
- Grow Lighting Products revenue and improve margins by investing in our channel relationships, improving execution, and continuing to deliver innovative lighting solutions.
- Grow the LED Products business by expanding our product offering with new products that leverage our market leadership to serve a larger share of existing customers' LED demand, while also opening new applications for our technology.
- Improve the customer experience and service levels in all of our businesses.

Results of Operations

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

	Three Months Ended				Six Months Ended			
	December 24, 2017		December 25, 2016		December 24, 2017		December 25, 2016	
	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue
Revenue, net	$367,870	100 %	$401,326	100 %	$728,268	100 %	$772,559	100 %
Cost of revenue, net	275,267	75 %	260,759	65 %	535,333	74 %	522,061	68 %
Gross profit	92,603	25 %	140,567	35 %	192,935	26 %	250,498	32 %
Research and development	39,776	11 %	37,893	9 %	81,635	11 %	77,841	10 %
Sales, general and administrative	68,076	19 %	76,513	19 %	131,040	18 %	144,971	19 %
Amortization or impairment of acquisition-related intangibles	6,792	2 %	5,937	1 %	13,584	2 %	12,345	2 %
Loss on disposal or impairment of long-lived assets	4,262	1 %	717	— %	7,087	1 %	1,041	— %
Operating (loss) income	(26,303)	(7)%	19,507	5 %	(40,411)	(6)%	14,300	2 %
Non-operating income (expense), net	26,729	7 %	(4,760)	(1)%	25,662	4 %	(4,919)	(1)%
Income (loss) before income taxes	426	— %	14,747	4 %	(14,749)	(2)%	9,381	1 %
Income tax (benefit) expense	(13,326)	(4)%	8,531	2 %	(8,629)	(1)%	2,598	— %
Net income (loss)	13,752	4 %	$6,216	2 %	($6,120)	(1)%	$6,783	1 %
Net income attributable to noncontrolling interest	31	— %	—	— %	16	— %	—	— %
Net income (loss) attributable to controlling interest	$13,721	4 %	$6,216	2 %	($6,136)	(1)%	$6,783	1 %
Basic earnings (loss) per share	$0.14		$0.06		($0.06)		$0.07	
Diluted earnings (loss) per share	$0.14		$0.06		($0.06)		$0.07	

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Revenue

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

	Three Months Ended				Six Months Ended			
	December 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Lighting Products revenue	$144,616	$208,924	($64,308)	(31)%	$294,340	$392,760	($98,420)	(25)%
Percent of revenue	39 %	52 %			40 %	51 %		
LED Products revenue	152,682	138,038	14,644	11 %	297,202	275,531	21,671	8 %
Percent of revenue	42 %	34 %			41 %	36 %		
Wolfspeed revenue	70,572	54,364	16,208	30 %	136,726	104,268	32,458	31 %
Percent of revenue	19 %	14 %			19 %	13 %		
Total revenue	$367,870	$401,326	($33,456)	(8)%	$728,268	$772,559	($44,291)	(6)%

Our consolidated revenue decreased 8% to $367.9 million for the three months ended December 24, 2017 from $401.3 million for the three months ended December 25, 2016. This decrease was driven by the 31% reduction in Lighting Products revenue, which was partially offset by the 30% and 11% increase in Wolfspeed and LED Products revenue, respectively.

For the six months ended December 24, 2017, our consolidated revenue decreased 6% to $728.3 million from $772.6 million for the six months ended December 25, 2016. This decrease was driven by the 25% decrease in Lighting Products revenue, which was partially offset by the 31% and 8% increase in Wolfspeed and LED Products revenue, respectively.

Lighting Products Segment Revenue

Lighting Products revenue represented approximately 39% and 52% of our total revenue for the three months ended December 24, 2017 and December 25, 2016, respectively.

Lighting Products revenue decreased 31% to $144.6 million for the three months ended December 24, 2017 from $208.9 million for the three months ended December 25, 2016. The decrease in revenue for the three months ended December 24, 2017 compared to the three months ended December 25, 2016 was due to the absence of the significant patent license issuance fee we received as part of the confidential Feit Electric Company Inc. license agreement in the fiscal quarter ended December 25, 2016, and a 28% decrease in the number of overall units sold, which were partially offset by a 10% increase in average selling prices (ASP). The decrease in units sold for the period was primarily due to the current weakness in the North American commercial lighting market, lingering effects related to quality holds which have lowered project win rates, and reduced consumer sales due to lower demand.

Lighting Products revenue represented approximately 40% and 51% of our total revenue for the six months ended December 24, 2017 and December 25, 2016, respectively.

Lighting Products revenue decreased 25% to $294.3 million for the six months ended December 24, 2017 from $392.8 million for the six months ended December 25, 2016. The decrease in revenue for the six months ended December 24, 2017 compared to the six months ended December 25, 2016 was due to the absence of the significant patent license issuance fee we received as part of the confidential Feit Electric Company Inc. license agreement in the fiscal quarter ended December 25, 2016, and a 41% decrease in the number of overall units sold, which was partially offset by a 39% increase in ASP. The decrease in units sold for the period was primarily due to the current weakness in the North American commercial lighting market, lingering effects related to quality holds which have lowered project win rates, and reduced consumer sales due to lower demand.

LED Products Segment Revenue

LED Products revenue represented 42% and 34% of our total revenue for the three months ended December 24, 2017 and December 25, 2016, respectively.

LED Products revenue increased 11% to $152.7 million for the three months ended December 24, 2017 from $138.0 million for the three months ended December 25, 2016. The increase in revenue for the three months ended December 24, 2017 compared to the three months ended December 25, 2016 was due primarily to a 26% increase in the number of units sold, partially offset by a 12% decrease in ASP. The increase in revenue is due to strong demand

in general lighting, specialty lighting, after-market automotive, and video screen applications.
LED Products revenue represented 41% and 36% of our total revenue for the six months ended December 24, 2017 and December 25, 2016, respectively.

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LED Products revenue increased 8% to $297.2 million for the six months ended December 24, 2017 from $275.5 million for the six months ended December 25, 2016. The increase in revenue for the six months ended December 24, 2017 compared to the six months ended December 25, 2016 was due primarily to a 22% increase in the number of units sold, partially offset by a 12% decrease in ASP.

Wolfspeed Segment Revenue

Wolfspeed revenue represented approximately 19% and 14% of our total revenue for the three months ended December 24, 2017 and December 25, 2016, respectively.

Wolfspeed revenue increased 30% to $70.6 million for the three months ended December 24, 2017 from $54.4 million for the three months ended December 25, 2016. The increase in revenue for the three months ended December 24, 2017 as compared to the three months ended December 25, 2016 was due to a 21% increase in the number of units sold as well as an 8% increase in ASP. The increase in ASP was due to a greater mix of higher priced wafer and device products.

Wolfspeed revenue represented approximately 19% and 13% of our total revenue for the six months ended December 24, 2017 and December 25, 2016, respectively.

Wolfspeed revenue increased 31% to $136.7 million for the six months ended December 24, 2017 from $104.3 million for the six months ended December 25, 2016. The increase in revenue for the six months ended December 24, 2017 as compared to the six months ended December 25, 2016 was due to a 19% increase in the number of units sold as well as an 11% increase in ASP. The increase in ASP was due to a greater mix of higher priced wafer and device products.

Gross Profit and Gross Margin

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

	Three Months Ended				Six Months Ended			
	December 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Lighting Products gross profit	$22,964	$74,770	($51,806)	(69)%	$54,847	$124,060	($69,213)	(56)%
Lighting Products gross margin	15.9%	35.8%			18.6%	31.6%		
LED Products gross profit	38,606	40,314	(1,708)	(4)%	77,416	82,084	(4,668)	(6)%
LED Products gross margin	25.3%	29.2%			26.0%	29.8%		
Wolfspeed gross profit	34,133	25,911	8,222	32%	66,531	49,371	17,160	35%
Wolfspeed gross margin	48.4%	47.7%			48.7%	47.4%		
Unallocated costs	(3,100)	(4,859)	1,759	(36)%	(5,859)	(9,618)	3,759	(39)%
Depreciation and amortization adjustment	—	4,431	(4,431)	(100)%	—	4,601	(4,601)	(100)%
Consolidated gross profit	$92,603	$140,567	($47,964)	(34)%	$192,935	$250,498	($57,563)	(23)%
Consolidated gross margin	25.2%	35.0%			26.5%	32.4%		

Our consolidated gross profit decreased 34% to $92.6 million for the three months ended December 24, 2017 from $140.6 million for the three months ended December 25, 2016. Our consolidated gross margin decreased to 25.2% for the three months ended December 24, 2017 from 35.0% for the three months ended December 25, 2016.

Our consolidated gross profit decreased 23% to $193 million for the six months ended December 24, 2017 from $250.5 million for the six months ended December 25, 2016. Our consolidated gross margin decreased to 26.5% for the six months ended December 24, 2017 from 32.4% for the six months ended December 25, 2016.

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Lighting Products Segment Gross Profit and Gross Margin

Lighting Products gross profit decreased 69% to $23.0 million for the three months ended December 24, 2017 from $74.8 million for the three months ended December 25, 2016. Lighting Products gross margin decreased to 15.9% for the three months ended December 24, 2017 from 35.8% for the three months ended December 25, 2016. The decrease in Lighting Products gross profit and gross margin for the three months ended December 24, 2017 was primarily due to the absence of the significant patent license issuance fee associated with the new patent license agreement discussed above, lower commercial lighting fixture sales, lower commercial factory utilization and higher commercial lighting product warranty reserves.

Lighting Products gross profit decreased 56% to $54.8 million for the six months ended December 24, 2017 from $124.1 million for the six months ended December 25, 2016. Lighting Products gross margin decreased to 18.6% for the six months ended December 24, 2017 from 31.6% for the six months ended December 25, 2016. The decrease in Lighting Products gross profit and gross margin for the six months ended December 24, 2017 was primarily due to the same factors listed above.

LED Products Segment Gross Profit and Gross Margin

LED Products gross profit decreased 4% to $38.6 million for the three months ended December 24, 2017 from $40.3 million for the three months ended December 25, 2016. LED Products gross margin decreased to 25.3% for the three months ended December 24, 2017 from 29.2% for the three months ended December 25, 2016. The decreases in gross profit and gross margin are due primarily to costs associated with expanding our wafer factory, a less favorable mix of LED products sold, and lower pricing resulting from the global competition for LED products.

LED Products gross profit decreased 6% to $77.4 million for the six months ended December 24, 2017 from $82.1 million for the six months ended December 25, 2016. LED Products gross margin decreased to 26.0% for the six months ended December 24, 2017 from 29.8% for the six months ended December 25, 2016. The decreases in gross profit and gross margin are due primarily to the same factors listed above.

Wolfspeed Segment Gross Profit and Gross Margin

Wolfspeed gross profit increased 32% to $34.1 million for the three months ended December 24, 2017 from $25.9 million for the three months ended December 25, 2016. Wolfspeed gross margin increased to 48.4% for the three months ended December 24, 2017 from 47.7% for the three months ended December 25, 2016. The increase in gross profit and margin is primarily due to a more favorable product mix, higher factory utilization and improved production yields.

Wolfspeed gross profit increased 35% to $66.5 million for the six months ended December 24, 2017 from $49.4 million for the six months ended December 25, 2016. Wolfspeed gross margin increased to 48.7% for the six months ended December 24, 2017 from 47.4% for the six months ended December 25, 2016. The increase in gross profit and margin is primarily due to the factors listed above.

Unallocated Costs

Unallocated costs were $3.1 million and $4.9 million for the three months ended December 24, 2017 and December 25, 2016, respectively. Unallocated costs were $5.9 million and $9.6 million for the six months ended December 24, 2017 and December 25, 2016, 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 24, 2017 as compared to the three months ended December 25, 2016 was primarily attributable to lower stock-based and incentive compensation. The decrease for the six months ended December 24, 2017 as compared to the six months ended December 25, 2016 was primarily attributable to lower stock-based and incentive compensation.

Depreciation and Amortization Adjustment

The depreciation and amortization adjustment was $4.4 million and $4.6 million for the three and six months ended December 25, 2016, respectively. The depreciation and amortization adjustment impacting cost of revenue for the three and six months ended December 25, 2016, represents the depreciation and amortization that would have been recognized had the Wolfspeed assets been continuously classified as held and used from July 16, 2016 through

December 25, 2016. These costs were allocated to the Wolfspeed segment's gross profit for the three and six months ended December 25, 2016 because they represent an adjustment which provides comparability to the current period.

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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 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Research and development	$39,776	$37,893	$1,883	5%	$81,635	$77,841	$3,794	5%
Percent of revenue	11 %	9 %			11 %	10 %		

Research and development expenses for the three months ended December 24, 2017 increased 5% to $39.8 million from $37.9 million for the three months ended December 25, 2016. These increases were primarily due to an increase in Wolfspeed research and development to accelerate 150mm development along with next generation power and RF device research and development. 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.

For the six months ended December 24, 2017, research and development expenses increased 5% to $82 million from $78 million for the six months ended December 25, 2016. These increases were primarily due to an increase in Wolfspeed research and development to accelerate 150mm development along with next generation power and RF device research and development. 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.

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 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Sales, general and administrative	$68,076	$76,513	($8,437)	(11)%	$131,040	$144,971	($13,931)	(10)%
Percent of revenue	19 %	19 %			18 %	19 %		

Sales, general and administrative expenses of $68.1 million for the three months ended December 24, 2017 decreased 11% from $76.5 million for the three months ended December 25, 2016. The decrease for the three months ended December 24, 2017 was primarily due to lower variable commercial lighting sales expense resulting from the lower lighting revenue and the fiscal 2017 transaction costs associated with the proposed sale of Wolfspeed to Infineon that did not occur.

For the six months ended December 24, 2017, sales, general and administrative expenses decreased 10% to $131.0 million from $145.0 million for the six months ended December 25, 2016. The decrease for the six months ended December 24, 2017 was primarily due to lower variable commercial lighting sales expense resulting from the decrease in lighting revenue, lower stock compensation expense and the fiscal 2017 transaction costs associated with the proposed sale of Wolfspeed to Infineon that did not occur.

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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 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Customer relationships	$1,558	$1,277	$281	22 %	$3,116	$2,602	$514	20 %
Developed technology	5,214	4,660	554	12 %	10,429	9,505	924	10 %
Non-compete agreements	20	—	20	100 %	39	(282)	321	(114)%
Trade names, finite-lived	—	—	—	— %	—	520	(520)	— %
Total amortization	$6,792	$5,937	$855	14 %	$13,584	$12,345	$1,239	10 %

Amortization of acquisition-related intangibles was $6.8 million for the three months ended December 24, 2017 compared to $5.9 million for the three months ended December 25, 2016.

Amortization of acquisition-related intangibles was $13.6 million for the six months ended December 24, 2017 compared to $12.3 million for the six months ended December 25, 2016.

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

	Three Months Ended				Six Months Ended			
	December 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Loss on disposal or impairment of long-lived assets	$4,262	$717	$3,545	494 %	$7,087	$1,041	$6,046	581 %

We recognized a net loss of $4.3 million and a net loss of $0.7 million on the disposal of long-lived assets for the three months ended December 24, 2017 and December 25, 2016, respectively. The increase in net loss for the three months ended December 24, 2017 as compared to the three months ended December 25, 2016 was primarily due to demolition and move costs associated with our current Wolfspeed manufacturing capacity expansion and a fair value market write-down of an aircraft being held for sale.

For the six months ended December 24, 2017, we recognized a net loss of $7.1 million compared to a net loss of $1.0 million for the six months ended December 25, 2016. The increase in net loss for the six months ended December 24, 2017 as compared to the six months ended December 25, 2016 was primarily due to demolition and move costs associated with our current Wolfspeed manufacturing capacity expansion and a fair value market write-down of the aircraft being held for sale.

Non-Operating Income (Expense), net

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

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	Three Months Ended				Six Months Ended			
	December 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Gain on sale of investments, net	$1	$—	$1	100%	$47	$12	$35	292%
Gain (loss) on equity investment, net	24,746	(3,796)	28,542	752%	21,479	(6,283)	27,762	442%
Foreign currency gain (loss), net	462	(1,856)	2,318	125%	1,228	(495)	1,723	348%
Interest income, net	1,467	900	567	63 %	2,617	1,787	830	46 %
Other, net	53	(8)	61	763%	291	60	231	385%
Non-operating income (expense), net	$26,729	($4,760)	$31,489	662%	$25,662	($4,919)	$30,581	622%

Gain on sale of investments, net. Gain on sale of investments, net was $1 thousand for the three months ended December 24, 2017 compared to $0 for the three months ended December 25, 2016. For the six months ended December 24, 2017 gain on sale of investments, net was $47 thousand compared to $12 thousand for the six months ended December 25, 2016.

Gain (loss) on equity investment, net. Gain on equity investment in Lextar Electronics Corporation (Lextar), which we account for utilizing the fair value option, was $24.7 million for the three months ended December 24, 2017 compared to a loss on equity investment of $3.8 million for the three months ended December 25, 2016. The gain on equity investment was $21.5 million for the six months ended December 24, 2017 compared to a loss of $6.3 million for the six months ended December 25, 2016. Lextar's stock is publicly traded on the Taiwan Stock Exchange and its share price declined from 18.40 New Taiwanese Dollars (TWD) at June 25, 2017 to 17.20 TWD at September 24, 2017 and increased to 26.15 TWD at December 24, 2017. 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 gain (loss), net. Foreign currency gain (loss), net consisted primarily of remeasurement adjustments resulting from our investment in Lextar and consolidating our international subsidiaries. The foreign currency gain for the three months ended December 24, 2017 was primarily due to a favorable fluctuation in the exchange rates between both the Chinese Yuan and and the United States Dollar offset by an unfavorable fluctuation between the Euro, the Canadian Dollar, and the United States Dollar. 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 gain for the six months ended December 24, 2017 was primarily due to favorable fluctuations in the exchange rates between both the Chinese Yuan, the Euro, the Canadian Dollar 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.

Interest income, net. Interest income, net was $1.5 million for the three months ended December 24, 2017 compared to $0.9 million for the three months ended December 25, 2016. For the six months ended December 24, 2017, interest income, net was $2.6 million compared to $1.8 million for the six months ended December 25, 2016. The increases in interest income, net for the three and six months ended December 24, 2017 were primarily due to higher invested balances in China and Hong Kong which was offset with a higher interest expense due to higher borrowing rates associated with our line of credit as compared to the three and six months ended December 25, 2016.

Other, net. Other, net income was $53 thousand for the three months ended December 24, 2017 compared to expense of $8 thousand for the three months ended December 25, 2016. For the six months ended December 24, 2017, other, net was income of $291 thousand compared to income of $60 thousand for the six months ended December 25, 2016.

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Income Tax (Benefit) Expense

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

	Three Months Ended				Six Months Ended			
	December 24, 2017	December 25, 2016	Change		December 24, 2017	December 25, 2016	Change	
Income tax (benefit) expense	($13,326)	$8,531	($21,857)	(256)%	($8,629)	$2,598	($11,227)	(432)%
Effective tax rate	(3,128.2)%	57.8 %			58.5 %	27.7 %		

In general, the variation between our effective income tax rate and the U.S. statutory rate of 28.3% (calculated as described in the following paragraph) is due to: (i) changes in our valuation allowances against deferred tax assets in the U.S. and Luxembourg, (ii) projected income for the full year derived from international locations with lower tax rates than the U.S., and (iii) projected tax credits generated.

The Tax Cuts and Jobs Act of 2017 (the Tax Legislation), enacted on December 22, 2017, contains significant changes to U.S. tax law, including lowering the U.S. corporate income tax rate to 21%, implementing a territorial tax system, and imposing a one-time tax on deemed repatriated earnings of foreign subsidiaries. U.S. tax law requires that taxpayers with a fiscal year that begins before the effective date of a rate change and ends after the effective date calculate a blended tax rate for the year based on the pro rata number of days in the year before and after the effective date. As a result, for the fiscal year ending June 24, 2018, our statutory income tax rate is expected to be 28.3%. For the fiscal year ending June 30, 2019, our U.S. statutory income tax rate is expected to be 21%. During the three months ended December 24, 2017, we recorded an $18.8 million discrete tax benefit representing the benefit of remeasuring our U.S. deferred tax liabilities that are expected to reverse in years after the reduction to the statutory tax rate.

We have historically asserted our intent to indefinitely reinvest foreign earnings in foreign operations. As a result of the enactment of the Tax Legislation, we reevaluated our historic assertion and determined that $220.8 million of the undistributed foreign earnings are expected to be repatriated in the foreseeable future. During the three months ended December 24, 2017, we recorded a $3.0 million discrete tax expense representing the deferred tax liability for foreign income taxes that would be withheld upon repatriation of the foreign earnings. As of December 24, 2017, we have not provided income taxes on the remaining $59.4 million of undistributed earnings as we continue to maintain our intention to reinvest these earnings in foreign operations indefinitely. The Tax Legislation is discussed more fully in Note 12, “Income Taxes” to our unaudited financial statements in Part I, Item 1 of this Quarterly Report.

We recognized an income tax benefit of $13.3 million for an effective tax rate of (3,128.2)% for the three months ended December 24, 2017 as compared to income tax expense of $8.5 million for an effective tax rate of 57.8% for the three months ended December 25, 2016. For the six months ended December 24, 2017 we recognized income tax benefit of $8.6 million for an effective tax rate of 58.5% compared to an income tax expense of $2.6 million for an effective rate of 27.7% for the six months ended December 25, 2016. The change in our effective tax rate for the three and six months ended December 24, 2017 was primarily due to the tax benefit of remeasuring our U.S. deferred tax liabilities at the lower statutory tax rate.

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

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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, joint ventures, 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.

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 24, 2017	June 25, 2017	Change
Days of sales outstanding[a]	37	37	—
Days of supply in inventory[b]	89	98	(9)
Days in accounts payable[c]	(52)	(46)	(6)
Cash conversion cycle	74	89	(15)

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.

The decrease in our cash conversion cycle was primarily driven by an increase in days in accounts payable.

As of December 24, 2017, we had unrealized losses on our investments of $1.8 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at December 24, 2017 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 24, 2017.

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Cash Flows

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

	Six Months Ended			
	December 24, 2017	December 25, 2016	Change	
Net cash provided by operating activities	$105,812	$119,716	($13,904)	(12)%
Net cash used in investing activities	(97,728)	(64,902)	(32,826)	51 %
Net cash provided by (used in) financing activities	28,600	(83,184)	111,784	134 %
Effects of foreign exchange changes on cash and cash equivalents	407	(691)	1,098	159 %
Net increase (decrease) in cash and cash equivalents	$37,091	($29,061)	$66,152	228 %

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 $105.8 million for the six months ended December 24, 2017 from $119.7 million for the six months ended December 25, 2016. This decrease was primarily due to the absence of the significant patent license issuance fee previously mentioned, which was partially offset by greater cash generated from working capital.

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 $97.7 million for the six months ended December 24, 2017 and net cash used in investing activities was $64.9 million for the six months ended December 25, 2016. The increase in cash used for investing activities was due to a $49.1 million increase in our capital spending primarily related to the wafer factory expansion for the six months ended December 24, 2017 compared to the six months ended December 25, 2016, which was partially offset by net purchases of short-term investments decreasing $16.1 million for the six months ended December 24, 2017 compared to the six months ended December 25, 2016.

For fiscal 2018, we target approximately $220 million of capital investment, which is primarily related to infrastructure projects to support our longer-term growth and strategic priorities.

Cash Flows from Financing Activities

Net cash provided by (used in) financing activities was $28.6 million for the six months ended December 24, 2017 compared to $83.2 million used for the six months ended December 25, 2016. For the six months ended December 24, 2017, our financing activities primarily consisted of net repayment on our line of credit of $21.0 million and payment of acquisition-related contingent consideration of $1.9 million, offset by proceeds of $46.6 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit from those exercises and proceeds of $4.9 million from issuing shares related to Cree Venture LED Company, Ltd. (Cree Venture LED). For the six months ended December 25, 2016, our financing activities primarily consisted of the repurchase of common stock worth approximately $98.4 million, a payment of acquisition-related contingent consideration of $2.8 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 from those exercises.

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 24, 2017, 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 25, 2017, in the section entitled

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"Contractual Obligations" for the future minimum lease payments due under our operating leases as of June 25, 2017. 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 25, 2017.

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.

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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 25, 2017. 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 2018 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.

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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 25, 2017. 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/or 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 has impacted our results in the past. Our research and development efforts are aimed at solving increasingly complex problems, and we do not expect that all 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 and systems 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 increasingly complex 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 face significant challenges managing our growth strategy.

Our potential for growth depends significantly on the adoption of our products within the markets we serve 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:

- maintain, expand, construct 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 the capability of information systems to support a more complex business;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- manage organizational complexity and communication;

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- expand the skills and capabilities of our current management team;
- add experienced senior level managers and executives;
- attract and retain qualified employees; and
- adequately maintain and adjust the operational and financial controls that support our business.

While we intend to continue to focus on managing our costs and expenses, in the short term and in 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. For example, during fiscal 2018 we target converting the majority of our Wolfspeed power production from 100mm to 150mm substrates. If we are unable to make this transition in a timely or cost-effective manner, our results could be negatively impacted. 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.

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. Allocation and effective management of the resources necessary to successfully implement, integrate, train personnel and sustain our IT platforms 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 a 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.

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

The industries we serve are in different stages of adoption and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life-cycles in the case of the LED industry and fluctuations in product supply and demand. The LED, power and RF industries have experienced significant fluctuations, often in connection with, or in anticipation of, product cycles and changes in general economic conditions. The semiconductor industry is characterized by rapid technological change, high capital expenditures, short product life cycles and continuous advancements in process technologies and manufacturing facilities. 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.

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.

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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. For example, our Wolfspeed business is currently experiencing demand in excess of our production capacity, which is resulting in longer manufacturing lead times to customers as we manage our constrained capacity. While we began making significant investments in fiscal 2016 to expand our materials, power and RF device capacity and continue to do so, these investments take time to bring in, install and get fully qualified. As a result, we may be unable to build or qualify such new capacity on a timely basis to meet customer demand and customers may fulfill their orders with one of our competitors instead. 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. For example, in the third quarter of fiscal 2017 we had lower overall lighting demand which led to higher costs per unit produced from our Racine factory, thereby reducing gross margins for our Lighting Products segment. Further, we may be required to recognize impairments on our long-lived assets or recognize excess inventory write-off charges. We may in the future be required to recognize excess capacity charges, which would have a negative impact on our results of operations.

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 and installation. For example, during the second quarter of fiscal 2018 we determined that the quality of several of our commercial lighting products was possibly impacted by certain quality issues that could lower those products' reliability. 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.

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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. 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.

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

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.

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.

Additionally, our 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' products, resulting in a disruption in the project pipeline and lower than targeted sales for our products. Our 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.

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.

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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. During fiscal 2018, we target converting the majority of our Wolfspeed power production from 100mm to 150mm substrates. If we are unable to make this transition in a timely or cost-effective manner, our results could be negatively 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. In the semiconductor market, we compete with companies that have greater market share, name recognition and technical resources than we do. 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 in our sales prices, particularly in our LED Products and Wolfspeed segments. Aggressive pricing actions by our competitors in our businesses 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 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 and lower cost LEDs, lighting products and power and RF 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.
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 long