

CREE INC  
Form 10-Q  
April 25, 2018  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 25, 2018

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 27703  
Durham, North Carolina  
(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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   
Accelerated filer

Non-accelerated filer   
Smaller reporting company

(Do

not

check

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 [  ]

The number of shares outstanding of the registrant's common stock, par value \$0.00125 per share, as of April 20, 2018, was 100,509,216.

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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## CREE, INC.

## UNAUDITED CONSOLIDATED BALANCE SHEETS

	March 25, 2018	June 25, 2017
	(In thousands, except par value)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$101,226	\$132,597
Short-term investments	300,239	478,341
Total cash, cash equivalents and short-term investments	401,465	610,938
Accounts receivable, net	143,337	148,392
Income tax receivable	7,674	8,040
Inventories	309,858	284,385
Prepaid expenses	22,597	23,305
Other current assets	17,666	23,390
Current assets held for sale	6,913	2,180
Total current assets	909,510	1,100,630
Property and equipment, net	641,400	581,263
Goodwill	617,651	618,828
Intangible assets, net	400,836	274,315
Other long-term investments	60,419	50,366
Deferred income taxes	10,527	11,763
Other assets	12,295	12,702
Total assets	\$2,652,638	\$2,649,867
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable, trade	\$156,558	\$133,185
Accrued salaries and wages	50,821	41,860
Other current liabilities	35,921	36,978
Total current liabilities	243,300	212,023
Long-term liabilities:		
Long-term debt	316,000	145,000
Deferred income taxes	—	49,860
Other long-term liabilities	26,467	20,179
Total long-term liabilities	342,467	215,039
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, par value \$0.01; 3,000 shares authorized at March 25, 2018 and June 25, 2017; none issued and outstanding	—	—
Common stock, par value \$0.00125; 200,000 shares authorized at March 25, 2018 and June 25, 2017; 100,487 issued and outstanding at March 25, 2018 and 97,674 shares issued and outstanding at June 25, 2017	124	121
Additional paid-in-capital	2,509,296	2,419,517
Accumulated other comprehensive income, net of taxes	1,946	5,909
Accumulated deficit	(449,454)	(202,742)
Total shareholders' equity	2,061,912	2,222,805

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Noncontrolling interest	4,959	—
Total liabilities and equity	\$2,652,638	\$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 LOSS

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
	(In thousands, except per share amounts)			
Revenue, net	\$355,958	\$341,505	\$1,084,226	\$1,114,064
Cost of revenue, net	256,902	255,429	792,235	777,490
Gross profit	99,056	86,076	291,991	336,574
Operating expenses:				
Research and development	40,239	41,451	121,874	119,292
Sales, general and administrative	70,256	68,165	201,296	213,136
Amortization or impairment of acquisition-related intangibles	7,453	8,362	21,037	20,707
Loss on disposal or impairment of long-lived assets	1,716	500	8,803	1,541
Goodwill impairment charges	247,455	—	247,455	—
Wolfspeed transaction termination fee	—	(12,500 )	—	(12,500 )
Total operating expenses	367,119	105,978	600,465	342,176
Operating loss	(268,063 )	(19,902 )	(308,474 )	(5,602 )
Non-operating (expense) income, net	(9,651 )	9,865	16,011	4,946
Loss before income taxes	(277,714 )	(10,037 )	(292,463 )	(656 )
Income tax (benefit) expense	(37,181 )	88,976	(45,810 )	91,574
Net loss	(\$240,533)	(\$99,013 )	(\$246,653 )	(\$92,230 )
Net income attributable to noncontrolling interest	44	—	59	—
Net loss attributable to controlling interest	(\$240,577)	(\$99,013 )	(\$246,712 )	(\$92,230 )
Loss per share:				
Basic	(\$2.40 )	(\$1.02 )	(\$2.49 )	(\$0.93 )
Diluted	(\$2.40 )	(\$1.02 )	(\$2.49 )	(\$0.93 )
Weighted average shares used in per share calculation:				
Basic	100,140	97,346	99,046	98,791
Diluted	100,140	97,346	99,046	98,791

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

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CREE, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
	(In thousands)			
Net loss	(\$240,577)	(\$99,013)	(\$246,712)	(\$92,230)
Other comprehensive gain (loss):				
Currency translation (loss) gain	(788)	550	(2,006)	(765)
Net unrealized gain (loss) on available-for-sale securities, net of tax benefit of \$0 and \$1,948, \$0 and (\$4,723) respectively	2,269	(608)	5,969	(4,723)
Other comprehensive gain (loss):	1,481	(58)	3,963	(5,488)
Comprehensive loss	(\$239,096)	(\$99,071)	(\$242,749)	(\$97,718)

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



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CREE, INC.

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	March 25, 2018	March 26, 2017
	(In thousands)	
Cash flows from operating activities:		
Net loss	(\$246,653)	(\$92,230)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	113,244	113,459
Stock-based compensation	33,319	38,417
Excess tax benefit from stock-based payment arrangements	—	(1)
Goodwill impairment charges	247,455	—
Loss on disposal or impairment of long-lived assets	8,803	1,345
Amortization of premium/discount on investments	3,943	4,150
Gain on equity investment	(7,510)	(144)
Foreign exchange gain on equity investment	(2,543)	(2,436)
Deferred income taxes	(49,875)	71,342
Changes in operating assets and liabilities:		
Accounts receivable, net	5,728	16,080
Inventories	(4,640)	12,064
Prepaid expenses and other assets	2,041	11,478
Accounts payable, trade	15,328	(10,891)
Accrued salaries and wages and other liabilities	6,783	521
Net cash provided by operating activities	125,423	163,154
Cash flows from investing activities:		
Purchases of property and equipment	(128,433)	(56,895)
Purchases of patent and licensing rights	(7,913)	(8,876)
Proceeds from sale of property and equipment	538	1,111
Purchases of short-term investments	(174,623)	(169,414)
Proceeds from maturities of short-term investments	166,771	112,307
Proceeds from sale of short-term investments	176,981	13,613
Purchase of acquired business, net of cash acquired	(427,120)	—
Net cash used in investing activities	(393,799)	(108,154)
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	555,000	373,000
Payments on long-term debt borrowings	(384,000)	(380,000)
Net proceeds from issuance of common stock	62,240	10,160
Excess tax benefit from stock-based payment arrangements	—	1
Repurchases of common stock	—	(104,014)
Net cash provided by (used in) financing activities	236,290	(103,628)
Effects of foreign exchange changes on cash and cash equivalents	715	(432)
Net decrease in cash and cash equivalents	(31,371)	(49,060)
Cash and cash equivalents:		
Beginning of period	132,597	166,154
End of period	\$101,226	\$117,094
Supplemental disclosure of cash flow information:		

Significant non-cash transactions:

Accrued property and equipment	\$19,275	\$7,243
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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 wide bandgap semiconductor products for power and radio-frequency (RF) applications, lighting-class light emitting diode (LED) products, and lighting products. The Company's products are targeted for applications such as transportation, electronic signs and signals, power supplies, inverters, wireless systems, indoor and outdoor lighting, and video displays.

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

The Company's LED Products segment's 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 Lighting Products segment's 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 majority of the Company's products are manufactured at its production facilities located in North Carolina, Wisconsin, California 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, Arizona, 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:

•Wolfspeed

•LED Products

•Lighting Products

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

Basis of Presentation

The consolidated balance sheet at March 25, 2018, the consolidated statements of loss for the three and nine months ended March 25, 2018 and March 26, 2017, the consolidated statements of comprehensive loss for the three and nine months ended March 25, 2018 and March 26, 2017, and the consolidated statements of cash flows for the nine months ended March 25, 2018 and March 26, 2017 (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 loss and cash flows at March 25, 2018, 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 nine months ended March 25, 2018 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 nine months ended March 25, 2018, 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

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negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to continue to perform Step 1 of the goodwill impairment test. The Company early adopted this standard in the third quarter of fiscal year ending June 24, 2018.

Based on the updating of the Company's long range business strategy that was announced February 26, 2018, the Company determined there was a triggering event and performed an impairment test in connection with the preparation of its financial statements for the period ended March 25, 2018. The Company derived the Lighting Products reporting unit's fair value through a combination of the market approach (a guideline transaction method) and the income approach (a discounted cash flow analysis). The Company utilized a discount rate from the capital asset pricing model for the discounted cash flow analysis.

From this testing, the Company concluded that the carrying value of the Lighting Products reporting unit exceeded its fair value, resulting in a goodwill impairment of \$247.5 million. As of March 25, 2018, there was \$347.0 million, \$180.3 million and \$90.3 million of goodwill remaining related to the Wolfspeed, LED Products, and Lighting Products reporting units, respectively.

#### 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 nine months ended March 25, 2018, the noncontrolling interest increased by \$59 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

##### Infineon Technologies AG Radio Frequency Power Business

On March 6, 2018, the Company acquired certain assets of the Infineon Technologies AG (Infineon) Radio Frequency Power Business (RF Power), pursuant to an asset purchase agreement with Infineon in exchange for a base purchase price of \$429 million, subject to certain adjustments. As part of the agreement, the Company paid \$427 million of cash on the purchase date and has agreed to purchase certain additional non-U.S. property and equipment related to the RF Power business from Infineon for approximately \$2.2 million, with this additional purchase expected to close during the fourth quarter of fiscal 2018. The acquisition allows the Company to expand its product portfolio into the wireless market.

The acquisition of the RF Power business from Infineon was accounted for as a business combination. The purchase price for this acquisition is preliminary and subject to change. The areas of the purchase price that are not yet finalized are primarily related to intangible assets, property and equipment, other long-term liabilities, amortization and depreciation lives. The purchase price has been preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair values as follows (in thousands):





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## Assets:

Inventories	\$24,931
Property and equipment	10,504
Intangible assets	149,000
Goodwill	246,278
Total Assets	430,713

## Liabilities assumed:

Accounts payable	(39 )
Accrued expenses and liabilities	(3,264 )
Other long-term liabilities	(290 )
Total liabilities assumed	(3,593 )
Net assets acquired	\$427,120

As noted above, the valuation of acquired intangible assets is preliminary as of March 25, 2018. Similarly, the amortization periods are preliminary until the valuation is finalized. The preliminary amortization periods for intangible assets acquired are as follows (in thousands, except for years):

	Asset Amount	Estimated Life in Years
Lease agreement	1,000	10
Customer relationships	92,000	15
Developed technology	44,000	14
Non-compete agreements	12,000	4
Total identifiable intangible assets	\$149,000	

Goodwill largely consists of the manufacturing and other synergies of the combined companies, and the value of the assembled workforce. For tax purposes, in accordance with IRC Section 197, \$246 million of goodwill will be amortized over 15 years.

The assets, liabilities, and operating results of the RF Power business have been included in the Company's consolidated financial statements from the date of acquisition. Additionally, the RF Power business's results from operations are reported as part of the Company's Wolfspeed segment. The results of the RF Power business reflected in the Company's Consolidated Statements of Loss for the three months ended March 25, 2018 from the date of acquisition (March 6, 2018) are as follows (in thousands):

Amount
Revenue \$4,191
Net loss (2,325 )

The Company incurred total transaction costs related to the acquisition of approximately \$3.1 million which were expensed in the third quarter of fiscal 2018 in accordance with U.S. GAAP.

## Pro Forma Financial Information

The following supplemental pro forma information (in thousands, except per share data) presents the consolidated financial results as if the RF Power transaction had occurred at the beginning of the 2017 fiscal year:

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Revenue	\$370,939	\$365,771	\$1,149,681	\$1,202,199
Net loss	(237,189)	(101,142)	(247,614)	(97,542 )
Earnings per share, basic	\$(2.37)	\$(1.04 )	\$(2.50)	\$(0.99 )
Earnings per share, diluted	\$(2.37)	\$(1.04 )	\$(2.50)	\$(0.99 )



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These amounts have been calculated after applying the Company's accounting policies and adjusting the results of the RF Power business to give effect to events and transactions that are directly attributable to the RF Power business transactions, including the elimination of sales by the Company to the RF Power business prior to acquisition, additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property and equipment and intangible assets had been applied at the beginning of the 2017 fiscal year, together with the consequential tax effects. Excluded from the pro forma net income and the earnings per share amounts for the three and nine months ended March 25, 2018 are one-time acquisition costs and foreign currency gains attributable to the RF Power business of \$3.1 million and \$1.9 million, respectively. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made at the beginning of the 2017 fiscal year, nor is it indicative of any future results.

Arkansas Power Electronics International, Inc.

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

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

	March 25, June 25,	
	2018	2017
Billed trade receivables	\$204,675	\$205,516
Unbilled contract receivables	1,078	912
	205,753	206,428
Allowance for sales returns, discounts and other incentives	(53,635 )	(49,425 )
Allowance for bad debts	(8,781 )	(8,611 )
Accounts receivable, net	\$143,337	\$148,392

##### Inventories

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

	March 25, June 25,	
	2018	2017
Raw material	\$90,455	\$73,410
Work-in-progress	109,457	100,402
Finished goods	109,946	110,573
Inventories	\$309,858	\$284,385

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## Other Current Liabilities

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

	March 25, June 25,	
	2018	2017
Accrued taxes	\$8,368	\$11,148
Accrued professional fees	5,991	5,545
Accrued warranty	12,391	13,631
Accrued other	9,171	6,654
Other current liabilities	\$35,921	\$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):

	March 25, June 25,	
	2018	2017
Currency translation gain	\$6,478	\$4,471
Net unrealized (loss) gain on available-for-sale securities	(4,532 )	1,438
Accumulated other comprehensive income, net of taxes	\$1,946	\$5,909

## Non-Operating (Expense) Income, net

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

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Foreign currency gain, net	\$3,641	\$2,434	\$4,869	\$1,939
(Loss) gain on sale of investments, net	(133 )	1	(85 )	13
(Loss) gain on equity investment, net	(13,968)	6,443	7,510	160
Interest income, net	743	927	3,360	2,714
Other, net	66	60	357	120
Non-operating (expense) income, net	(\$9,651)	\$9,865	\$16,011	\$4,946

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The change in (loss) gain on equity investment, net 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 Loss
	Three Months Ended		Nine Months Ended		
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017	
Net unrealized gain on available-for-sale securities, net of taxes	(\$133)	\$1	(\$85)	\$13	Non-operating (expense) income, net
	(133 )	1	(85 )	13	Loss before income taxes
	—	—	—	—	Income tax (benefit) expense
	(\$133)	\$1	(\$85)	\$13	

## 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.

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

	March 25, 2018				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
Municipal bonds	\$110,504	\$6	(\$1,122)	)	\$109,388
Corporate bonds	68,238	36	(978)	)	67,296
U.S. agency securities	3,921	—	(28)	)	3,893
Non-U.S. certificates of deposit	117,566	—	—		117,566
Commercial paper	2,096	—	—		2,096
Total short-term investments	\$302,325	\$42	(\$2,128)	)	\$300,239

	June 25, 2017				Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses		
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

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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):

	March 25, 2018					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	\$98,251	(\$988 )	\$3,666	(\$87 )	\$101,917	(\$1,075 )
Corporate bonds	56,160	(967 )	1,493	(58 )	57,653	(1,025 )
U.S. agency securities	8,515	(28 )	—	—	8,515	(28 )
Total	\$162,926	(\$1,983 )	\$5,159	(\$145 )	\$168,085	(\$2,128 )
Number of securities with an unrealized loss		134		6		140

	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

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains and losses from the sale of investments are included in Non-operating (expense) income, net in the consolidated statements of 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 March 25, 2018 and June 25, 2017.

The contractual maturities of short-term investments as of March 25, 2018 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	\$—	\$109,388	\$—	\$—	\$109,388
Corporate bonds	4,161	55,705	7,430	—	67,296
U.S. agency securities	—	3,893	—	—	3,893
Non-U.S. certificates of deposit	112,842	4,724	—	—	117,566
Commercial paper	2,096	—	—	—	2,096
Total short-term investments	\$119,099	\$173,710	\$7,430	\$—	\$300,239

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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 March 25, 2018, financial assets utilizing Level 1 inputs included money market funds and U.S. agency securities, 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 March 25, 2018. There were no transfers between Level 1 and Level 2 during the nine months ended March 25, 2018.

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

	March 25, 2018				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
U.S. agency securities	1,000	6,368	—	7,368	—	—	—	—
Non-U.S. certificates of deposit	—	—	—	—	—	736	—	736
Commercial Paper	—	999	—	999	—	—	—	—
Money market funds	2,054	—	—	2,054	1,184	—	—	1,184
Total cash equivalents	3,054	7,367	—	10,421	1,184	2,538	—	3,722
Short-term investments:								
Municipal bonds	—	109,388	—	109,388	—	180,041	—	180,041
Corporate bonds	—	67,296	—	67,296	—	177,721	—	177,721
U.S. agency securities	3,893	—	—	3,893	—	—	—	—
Commercial paper	—	2,096	—	2,096	—	200	—	200
Non-U.S. certificates of deposit	—	117,566	—	117,566	—	120,379	—	120,379
Total short-term investments	3,893	296,346	—	300,239	—	478,341	—	478,341
Other long-term investments:								
Common stock of non-U.S. corporations	—	60,419	—	60,419	—	50,366	—	50,366
Total other long-term investments	—	60,419	—	60,419	—	50,366	—	50,366
Total assets	\$6,947	\$364,132	\$—	\$371,079	\$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):

	March 25, 2018			June 25, 2017		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets with finite lives:						
Customer relationships	\$233,420	(\$89,679 )	\$143,741	\$141,420	(\$84,673 )	\$56,747
Developed technology	226,728	(148,569 )	78,159	181,728	(132,747 )	48,981
Non-compete agreements	22,475	(10,617 )	11,858	10,475	(10,398 )	77
Trade names, finite-lived	520	(520 )	—	520	(520 )	—
Patent and licensing rights	158,054	(70,656 )	87,398	151,985	(63,155 )	88,830
Total intangible assets with finite lives	641,197	(320,041 )	321,156	486,128	(291,493 )	194,635
Trade names, indefinite-lived	79,680	—	79,680	79,680	—	79,680
Total intangible assets	\$720,877	(\$320,041 )	\$400,836	\$565,808	(\$291,493 )	\$274,315

For the three and nine months ended March 25, 2018, total amortization of finite-lived intangible assets was \$10.6 million and \$30.4 million, respectively. For the three and nine months ended March 26, 2017, total amortization of finite-lived intangible assets was \$13.0 million and \$29.9 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)	\$13,588
June 30, 2019	38,032
June 28, 2020	32,591
June 27, 2021	31,153
June 26, 2022	27,831
Thereafter	177,961
Total future amortization expense	\$321,156

Goodwill by reportable segment as March 25, 2018 was as follows (in thousands):

	Wolfspeed	LED Products	Lighting Products	Consolidated Total
Balance at June 25, 2017	\$100,769	\$180,278	\$337,781	\$618,828
Acquisition	246,278	—	—	246,278
Goodwill impairment charges	—	—	(247,455)	(247,455)
Balance at March 25, 2018	\$347,047	\$180,278	\$90,326	\$617,651

The goodwill impairment charges in the Lighting Products segment resulted from updating the Company's long range business strategy as described in Note 1.

#### Note 8 – Long-term Debt

As of March 25, 2018, 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 March 25, 2018, the Company had \$316 million outstanding under the line of credit and \$184 million available for borrowing. For the three and nine months ended March 25, 2018, the average interest rate was 2.19% and 1.93% for each period, respectively. For the three and nine months ended March 25, 2018 the average commitment fee percentage was 0.10%. The Company was in compliance with all covenants in the line of credit at March 25, 2018.

#### Note 9 – Shareholders' Equity

As of March 25, 2018, 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 nine months ended March 25, 2018, the Company repurchased no shares of common stock under the stock repurchase program.

#### Note 10 – Loss Per Share

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

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Net loss	(\$240,577)	(\$99,013)	(\$246,712)	(\$92,230)
Weighted average common shares	100,140	97,346	99,046	98,791
Basic loss per share	(\$2.40)	(\$1.02)	(\$2.49)	(\$0.93)

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

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Net loss	(\$240,577)	(\$99,013)	(\$246,712)	(\$92,230)
Weighted average common shares - basic	100,140	97,346	99,046	98,791
Dilutive effect of stock options, nonvested shares and Employee Stock Purchase Plan purchase rights	—	—	—	—
Weighted average common shares - diluted	100,140	97,346	99,046	98,791
Diluted loss per share	(\$2.40 )	(\$1.02 )	(\$2.49 )	(\$0.93 )

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 nine months ended March 25, 2018, there were 3.8 million and 4.4 million, respectively, of potential common shares not included in the calculation of diluted loss per share because their effect was anti-dilutive. For the three and nine months ended March 26, 2017, there were 11.3 million and 11.5 million, respectively, of potential common shares not included in the calculation of diluted 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 March 25, 2018 and changes during the nine 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	(1,988 )	\$27.97
Forfeited or expired	(1,548 )	\$49.13
Outstanding at March 25, 2018	7,121	\$38.69

## Restricted Stock Awards and Units

A summary of nonvested restricted stock awards (RSAs) and restricted stock unit awards (RSUs) outstanding as of March 25, 2018, and changes during the nine 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	2,305	\$26.47
Vested	(677 )	\$29.24
Forfeited	(532 )	\$24.57
Nonvested at March 25, 2018	3,508	\$26.41

## 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 March 25, 2018		Nine Months Ended March 25, 2018	
Income Statement Classification:				
Cost of revenue, net	\$1,729	\$2,229	\$5,402	\$8,012
Research and development	2,374	2,542	6,830	8,468
Sales, general and administrative	7,056	6,790	21,087	21,937
Total stock-based compensation expense	\$11,159	\$11,561	\$33,319	\$38,417

## Note 12 – Income Taxes

In general, 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 Company has included preliminary estimates for the impact of the Tax Legislation in our unaudited financial statements within this Quarterly Report. These preliminary estimates may be impacted by a number of additional considerations, including, but not limited to, the issuance of authoritative guidance and 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.

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. As of March 25, 2018, the Company estimates the deemed repatriation will result in \$14.1 million of additional U.S. income tax, a decrease of \$1.6 million from the estimate as of December 24, 2017. There is no impact to the Company's effective income tax rate as a result of the change in estimated deemed repatriation tax as the Company continues to expect to fully offset the additional tax through the utilization of tax credits. This preliminary estimate was impacted by the issuance of authoritative guidance and the Company's actual earnings for the three months ended March 25, 2018.

As of March 25, 2018, the Company has approximately \$215.4 million of undistributed earnings for certain non-U.S. subsidiaries, a decrease from the prior quarter primarily due to distribution of foreign earnings. During the three months ended March 25, 2018, the Company reevaluated its assertion to reinvest a portion of its undistributed foreign earnings in foreign operations indefinitely considering the acquisition of the RF Power assets. For the three months ended March 25, 2018, the Company has determined that \$184.6 million of the \$215.4 million of undistributed foreign earnings are expected to be repatriated in the foreseeable future. For the three months ended March 25, 2018, the Company recorded a \$1.3 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 March 25, 2018, the Company has not provided income taxes on the remaining undistributed foreign earnings of \$30.9 million 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 \$1.5 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 the acquisition of the RF Power assets 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

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the nine months ended March 25, 2018, the Company decreased the U.S. valuation allowance by \$7.0 million due to the impact of the Tax Legislation offset by the creation of U.S. deferred tax assets upon the impairment of goodwill. As of June 25, 2017, the Luxembourg valuation allowance was \$5.8 million. During the nine months ended March 25, 2018, the Company reduced this valuation allowance by \$1.1 million due to year-to-date income in Luxembourg. 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 nine months ended March 25, 2018, 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, and a \$0.3 million decrease due to expiration of statute of limitations. As a result, the total liability for unrecognized tax benefits as of March 25, 2018 was \$8.9 million. If any portion of this \$8.9 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 \$0.8 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 2015. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2014. 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	19,753
Expenditures	(13,071 )
Balance at March 25, 2018	\$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 March 25, 2018, \$22.2 million of the Company's product warranty liabilities were classified as long-term.

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

##### Litigation

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

the possibility of a material adverse impact on the Company's business, results of operation, financial position and overall trends. The outcomes in these matters are not reasonably estimable.

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Note 14 – Reportable Segments

The Company's operating and reportable segments are:

•Wolfspeed

•LED Products

•Lighting Products

Reportable Segments Description

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

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 nine months ended March 25, 2018. 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 loss must be included to reconcile the consolidated gross profit presented in the table below to the Company's consolidated 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, quarterly or annual incentive plans, matching contributions under the Company's 401(k) plan, and acquisition related costs. 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 nine months ended March 26, 2017, 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 nine months ended March 26, 2017 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		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Revenue:				
Wolfspeed revenue	\$81,902	\$56,133	\$218,628	\$160,401
LED Products revenue	143,298	131,327	440,500	406,858
Lighting Products revenue	130,758	154,045	425,098	546,805
Total revenue	\$355,958	\$341,505	\$1,084,226	\$1,114,064
Gross Profit and Gross Margin:				
Wolfspeed gross profit	\$39,285	\$26,396	\$105,816	\$74,737
Wolfspeed gross margin	48.0 %	47.0 %	48.4 %	46.6 %
LED Products gross profit	37,764	32,385	115,180	115,499
LED Products gross margin	26.4 %	24.7 %	26.1 %	28.4 %
Lighting Products gross profit	24,956	35,355	79,803	159,415
Lighting Products gross margin	19.1 %	23.0 %	18.8 %	29.2 %
Total segment gross profit	102,005	94,136	300,799	349,651
Unallocated costs	(2,949 )	(3,459 )	(8,808 )	(13,077 )
Depreciation and amortization adjustment	—	(4,601 )	—	—
Consolidated gross profit	\$99,056	\$86,076	\$291,991	\$336,574
Consolidated gross margin	27.8 %	25.2 %	26.9 %	30.2 %

## 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, quarterly or annual incentive compensation, matching contributions under the Company's 401(k) plan, and acquisition related costs.

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

	March 25, 2018	June 25, 2017
Wolfspeed	\$56,261	\$26,453
LED Products	102,078	108,297
Lighting Products	147,131	145,710
Total segment inventories	305,470	280,460
Unallocated inventories	4,388	3,925
Consolidated inventories	\$309,858	\$284,385

## Note 15 – Subsequent Event

In April 2018, the Company approved a plan to restructure the Lighting Products business. The restructuring is expected to reduce excess capacity and overhead in order to improve the cost structure moving forward. The primary components of the restructuring include the planned sale or abandonment of certain manufacturing equipment, facility consolidation and the elimination of certain positions. The estimated cost of the restructuring is \$7 million.



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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,” “expect,” “intend” and other similar expressions constitute forward-looking statements. These forward-looking statements are subject to business, economic and other risks and uncertainties, both known and unknown, and actual results may differ materially from those contained in the forward-looking statements. Any forward-looking statements we make are as of the date made, and except as required under the U.S. federal securities laws and the rules and regulations of the Securities and Exchange Commission (the SEC), we have no duty to update them if our views later change. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this Quarterly Report. Examples of risks and uncertainties that could cause actual results to differ materially from historical performance and any forward-looking statements include, but are not limited to, those described in “Risk Factors” in Part II, Item 1A of this Quarterly Report.

Executive Summary

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 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 wide bandgap semiconductor products for power and radio-frequency (RF) applications, lighting-class light emitting diode (LED) products, and lighting products. Our products are targeted for applications such as transportation, electronic signs and signals, power supplies, inverters, wireless systems, indoor and outdoor lighting, and video displays.

Our Wolfspeed segment's products consists of silicon carbide (SiC) and gallium nitride (GaN) materials, power devices and RF devices based on silicon (Si) and 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.

Our LED Products segment’s 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 Lighting Products segment’s 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.

The majority of our products are manufactured at our production facilities located in North Carolina, Wisconsin, California, 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, Arizona, 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:

Wolfspeed  
LED Products  
Lighting Products

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

### Industry Dynamics and Trends

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

Overall Demand for Products and Applications using SiC power devices, GaN and Si RF devices, and LEDs. Our potential for growth depends significantly on the adoption of SiC and GaN materials and device products in the power and RF markets, the continued use of Si devices in the RF telecommunications market, the continued adoption of LEDs, 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 in the power, RF, LED and lighting 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.

Technological Innovation and Advancement. Innovations and advancements in power, RF, LEDs and lighting 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.

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.

### Overview of the Nine Months Ended March 25, 2018

The following is a summary of our financial results for the nine months ended March 25, 2018:

- Revenue decreased to \$1.08 billion for the nine months ended March 25, 2018 from \$1.11 billion for the nine months ended March 26, 2017.

Gross profit decreased to \$292 million for the nine months ended March 25, 2018 from \$337 million for the nine months ended March 26, 2017. Gross margin was 27% for the nine months ended March 25, 2018 and 30% for the nine months ended March 26, 2017.

Operating loss was \$308 million for the nine months ended March 25, 2018, which includes impairment charges of \$247 million attributable to our Lighting Products segment, compared to operating loss of \$6 million for the nine months ended March 26, 2017. Net loss per diluted share was \$2.49 for the nine months ended March 25, 2018 compared to net loss per diluted share of \$0.93 for the nine months ended March 26, 2017.

Cash, cash equivalents and short-term investments were \$401 million at March 25, 2018 and \$611 million at June 25, 2017. Cash provided by operating activities was \$125 million for the nine months ended March 25, 2018 compared to \$163 million for the nine months ended March 26, 2017.

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Inventories increased to \$310 million at March 25, 2018 compared to \$284 million at June 25, 2017.

Purchases of property and equipment were \$128 million for the nine months ended March 25, 2018 compared to \$57 million for the nine months ended March 26, 2017.

Business Outlook

We are uniquely positioned as an innovator in all three business segments. The strength of our balance sheet and operating cash flow provides us the ability to invest in our businesses, as we did with the recent acquisition of the assets related to the RF Power business of Infineon Technologies AG (Infineon) to grow our Wolfspeed segment as discussed in Note 3, "Acquisition" to our unaudited financial statements in Part I, Item 1 of this Quarterly Report.

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

- Wolfspeed - invest in the business to expand the scale, further develop the technologies, and accelerate the growth opportunities of SiC materials, SiC power devices and modules, and GaN and Si RF devices.

- LED Products - focus our efforts where our best-in-class technology and application-optimized solutions are differentiated and valued while using Cree Venture LED Company Limited (Cree Venture LED) to access the broader mid-power LED markets.

- Lighting Products - grow revenue and margins by improving product quality, investing in our channel relationships, improving execution, and delivering innovative lighting solutions focused on higher specification and smart intelligent features.

- Improve the customer experience and service levels in all of our businesses.

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## Results of Operations

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

	Three Months Ended				Nine Months Ended			
	March 25, 2018		March 26, 2017		March 25, 2018		March 26, 2017	
	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue
Revenue, net	\$355,958	100 %	\$341,505	100 %	\$1,084,226	100 %	\$1,114,064	100 %
Cost of revenue, net	256,902	72 %	255,429	75 %	792,235	73 %	777,490	70 %
Gross profit	99,056	28 %	86,076	25 %	291,991	27 %	336,574	30 %
Research and development	40,239	11 %	41,451	12 %	121,874	11 %	119,292	11 %
Sales, general and administrative	70,256	20 %	68,165	20 %	201,296	19 %	213,136	19 %
Amortization or impairment of acquisition-related intangibles	7,453	2 %	8,362	2 %	21,037	2 %	20,707	2 %
Loss on disposal or impairment of long-lived assets	1,716	— %	500	— %	8,803	1 %	1,541	— %
Goodwill impairment charges	247,455	70 %	—	— %	247,455	23 %	—	— %
Wolfspeed transaction termination fee	—	— %	(12,500 )	(4 )%	—	— %	(12,500 )	(1 )%
Operating loss	(268,063 )	(75 )%	(19,902 )	(6 )%	(308,474 )	(28 )%	(5,602 )	(1 )%
Non-operating (expense) income, net	(9,651 )	(3 )%	9,865	3 %	16,011	1 %	4,946	— %
Loss before income taxes	(277,714 )	(78 )%	(10,037 )	(3 )%	(292,463 )	(27 )%	(656 )	— %
Income tax (benefit) expense	(37,181 )	(10 )%	88,976	26 %	(45,810 )	(4 )%	91,574	8 %
Net loss	(240,533 )	(68 )%	(\$99,013 )	(29 )%	(\$246,653 )	(23 )%	(\$92,230 )	(8 )%
Net income attributable to noncontrolling interest	44	— %	—	— %	59	— %	—	— %
Net loss attributable to controlling interest	(\$240,577)	(68 )%	(\$99,013 )	(29 )%	(\$246,712 )	(23 )%	(\$92,230 )	(8 )%
Basic loss per share	(\$2.40 )		(\$1.02 )		(\$2.49 )		(\$0.93 )	
Diluted loss per share	(\$2.40 )		(\$1.02 )		(\$2.49 )		(\$0.93 )	



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## Revenue

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

	Three Months Ended			Nine Months Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Wolfspeed revenue	\$81,902	\$56,133	\$25,769	\$218,628	\$160,401	\$58,227
Percent of revenue	23 %	16 %	46 %	20 %	14 %	36 %
LED Products revenue	143,298	131,327	11,971	440,500	406,858	33,642
Percent of revenue	40 %	39 %	9 %	41 %	37 %	8 %
Lighting Products revenue	130,758	154,045	(23,287)	425,098	546,805	(121,707)
Percent of revenue	37 %	45 %	(15)%	39 %	49 %	(22)%
Total revenue	\$355,958	\$341,505	\$14,453	\$1,084,226	\$1,114,064	(\$29,838)

Our consolidated revenue increased 4% to \$356.0 million for the three months ended March 25, 2018 from \$341.5 million for the three months ended March 26, 2017. This increase was driven by the 46% and 9% increase in Wolfspeed and LED Products revenue, respectively, which was partially offset by the 15% reduction in Lighting Products revenue.

For the nine months ended March 25, 2018, our consolidated revenue decreased 3% to \$1.08 billion from \$1.11 billion for the nine months ended March 26, 2017. This decrease was driven by the 22% decrease in Lighting Products revenue, which was partially offset by the 36% and 8% increase in Wolfspeed and LED Products revenue, respectively.

**Wolfspeed Segment Revenue**

Wolfspeed revenue represented approximately 23% and 16% of our total revenue for the three months ended March 25, 2018 and March 26, 2017, respectively.

Wolfspeed revenue increased 46% to \$81.9 million for the three months ended March 25, 2018 from \$56.1 million for the three months ended March 26, 2017. The increase in revenue for the three months ended March 25, 2018 as compared to the three months ended March 26, 2017 was due primarily to incremental revenue from the RF Power business acquisition, a 20% increase in the number of units sold as well as a 23% increase in average selling prices (ASP). The increase in ASP was due to a greater mix of higher priced wafer and device products.

Wolfspeed revenue represented approximately 20% and 14% of our total revenue for the nine months ended March 25, 2018 and March 26, 2017, respectively.

Wolfspeed revenue increased 36% to \$218.6 million for the nine months ended March 25, 2018 from \$160.4 million for the nine months ended March 26, 2017. The increase in revenue for the nine months ended March 25, 2018 as compared to the nine months ended March 26, 2017 was due primarily to incremental revenue from the RF Power business acquisition, a 19% increase in the number of units sold as well as a 20% increase in ASP. The increase in ASP was due to a greater mix of higher priced wafer and device products.

**LED Products Segment Revenue**

LED Products revenue represented 40% and 39% of our total revenue for the three months ended March 25, 2018 and March 26, 2017, respectively.

LED Products revenue increased 9% to \$143.3 million for the three months ended March 25, 2018 from \$131.3 million for the three months ended March 26, 2017. The increase in revenue for the three months ended March 25, 2018 compared to the three months ended March 26, 2017 was due primarily to a 5% increase in the number of units sold as well as a 5% increase in ASP. The increase in revenue is due to strong demand in general lighting, specialty lighting, after-market automotive, and video screen applications as well as mid-power applications through Cree Venture LED, Cree's joint venture with San'an Optoelectronics Co., Ltd..

LED Products revenue represented 41% and 37% of our total revenue for the nine months ended March 25, 2018 and March 26, 2017, respectively.



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LED Products revenue increased 8% to \$440.5 million for the nine months ended March 25, 2018 from \$406.9 million for the nine months ended March 26, 2017. The increase in revenue for the nine months ended March 25, 2018 compared to the nine months ended March 26, 2017 was due primarily to a 16% increase in the number of units sold, partially offset by a 6% decrease in ASP.

**Lighting Products Segment Revenue**

Lighting Products revenue represented approximately 37% and 45% of our total revenue for the three months ended March 25, 2018 and March 26, 2017, respectively.

Lighting Products revenue decreased 15% to \$130.8 million for the three months ended March 25, 2018 from \$154.0 million for the three months ended March 26, 2017. The decrease in revenue for the three months ended March 25, 2018 compared to the three months ended March 26, 2017 was due to an 18% decrease in the number of overall units sold, which was partially offset by a 2% 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.

Lighting Products revenue represented approximately 39% and 49% of our total revenue for the nine months ended March 25, 2018 and March 26, 2017, respectively.

Lighting Products revenue decreased 22% to \$425.1 million for the nine months ended March 25, 2018 from \$546.8 million for the nine months ended March 26, 2017. The decrease in revenue for the nine months ended March 25, 2018 compared to the nine months ended March 26, 2017 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 35% decrease in the number of overall units sold, which was partially offset by a 24% 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.

**Gross Profit and Gross Margin**

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

	Three Months Ended			Nine Months Ended			Change		Change	
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change				
Wolfspeed gross profit	\$39,285	\$26,396	\$12,889	49 %	\$105,816	\$74,737	\$31,079	42 %		
Wolfspeed gross margin	48.0 %	47.0 %			48.4 %	46.6 %				
LED Products gross profit	37,764	32,385	5,379	17 %	115,180	115,499	(319 )	— %		
LED Products gross margin	26.4 %	24.7 %			26.1 %	28.4 %				
Lighting Products gross profit	24,956	35,355	(10,399 )	(29 )%	79,803	159,415	(79,612 )	(50)%		
Lighting Products gross margin	19.1 %	23.0 %			18.8 %	29.2 %				
Unallocated costs	(2,949 )	(3,459 )	510	15 %	(8,808 )	(13,077 )	4,269	33 %		
Depreciation and amortization adjustment	—	(4,601 )	4,601	100 %	—	—	—	— %		
Consolidated gross profit	\$99,056	\$86,076	\$12,980	15 %	\$291,991	\$336,574	(\$44,583)	(13)%		
Consolidated gross margin	27.8 %	25.2 %			26.9 %	30.2 %				

Our consolidated gross profit increased 15% to \$99.1 million for the three months ended March 25, 2018 from \$86.1 million for the three months ended March 26, 2017. Our consolidated gross margin increased to 27.8% for the three months ended March 25, 2018 from 25.2% for the three months ended March 26, 2017.

Our consolidated gross profit decreased 13% to \$292.0 million for the nine months ended March 25, 2018 from \$337 million for the nine months ended March 26, 2017. Our consolidated gross margin decreased to 26.9% for the nine months ended March 25, 2018 from 30.2% for the nine months ended March 26, 2017.

Table of Contents**Wolfspeed Segment Gross Profit and Gross Margin**

Wolfspeed gross profit increased 49% to \$39.3 million for the three months ended March 25, 2018 from \$26.4 million for the three months ended March 26, 2017. Wolfspeed gross margin increased to 48.0% for the three months ended March 25, 2018 from 47.0% for the three months ended March 26, 2017. 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 42% to \$105.8 million for the nine months ended March 25, 2018 from \$74.7 million for the nine months ended March 26, 2017. Wolfspeed gross margin increased to 48.4% for the nine months ended March 25, 2018 from 46.6% for the nine months ended March 26, 2017. The increase in gross profit and margin is primarily due to the factors listed above.

**LED Products Segment Gross Profit and Gross Margin**

LED Products gross profit increased 17% to \$37.8 million for the three months ended March 25, 2018 from \$32.4 million for the three months ended March 26, 2017. LED Products gross margin increased to 26.4% for the three months ended March 25, 2018 from 24.7% for the three months ended March 26, 2017. The increases in gross profit and margin are primarily due to higher revenue, better factory loading and more favorable product mix.

LED Products gross profit was relatively constant at \$115.2 million for the nine months ended March 25, 2018 from \$115.5 million for the nine months ended March 26, 2017. LED Products gross margin decreased to 26.1% for the nine months ended March 25, 2018 from 28.4% for the nine months ended March 26, 2017. The decreases in gross profit and margin are due primarily to costs associated with expanding our wafer factory and a less favorable mix of LED products sold.

**Lighting Products Segment Gross Profit and Gross Margin**

Lighting Products gross profit decreased 29% to \$25.0 million for the three months ended March 25, 2018 from \$35.4 million for the three months ended March 26, 2017. Lighting Products gross margin decreased to 19.1% for the three months ended March 25, 2018 from 23.0% for the three months ended March 26, 2017. The decrease in Lighting Products gross profit and gross margin for the three months ended March 25, 2018 was primarily due to lower commercial lighting fixture sales, lower commercial factory utilization and higher commercial lighting product warranty reserves.

Lighting Products gross profit decreased 50% to \$79.8 million for the nine months ended March 25, 2018 from \$159.4 million for the nine months ended March 26, 2017. Lighting Products gross margin decreased to 18.8% for the nine months ended March 25, 2018 from 29.2% for the nine months ended March 26, 2017. The decrease in Lighting Products gross profit and gross margin for the nine months ended March 25, 2018 was primarily due to the absence of the significant patent license issuance fee discussed above, lower commercial lighting fixture sales, lower commercial factory utilization, and higher commercial lighting product warranty reserves.

**Unallocated Costs**

Unallocated costs were \$2.9 million and \$3.5 million for the three months ended March 25, 2018 and March 26, 2017, respectively. Unallocated costs were \$8.8 million and \$13.1 million for the nine months ended March 25, 2018 and March 26, 2017, respectively. These costs consisted primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans, matching contributions under our 401(k) plan, and acquisition related costs. 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 March 25, 2018 as compared to the three months ended March 26, 2017 was primarily attributable to lower stock-based and incentive compensation. The decrease for the nine months ended March 25, 2018 as compared to the nine months ended March 26, 2017 was primarily attributable to lower stock-based and incentive compensation.

**Depreciation and Amortization Adjustment**

The depreciation and amortization adjustment was \$4.6 million and \$0 for the three and nine months ended March 26, 2017, respectively. The depreciation and amortization adjustment impacting cost of revenue for the three months ended March 26, 2017, represents the depreciation and amortization that would have been recognized in prior periods had the Wolfspeed assets been continuously classified as held and used from July 16, 2016 through March 26, 2017. These costs were not allocated to the reportable segments' gross profit for the three months ended March 26, 2017

because they represent an adjustment which does not provide comparability to the corresponding prior period and therefore were not reviewed by our Chief Operating Decision Maker (CODM) when evaluating segment performance and allocating resources. These costs were allocated to the Wolfspeed segment's gross profit for the nine months ended March 26, 2017 because they provide comparability to the corresponding prior period and were reviewed by our CODM when evaluating segment performance and allocating resources.

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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			Nine Months Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Research and development	\$40,239	\$41,451	(\$1,212) (3)%	\$121,874	\$119,292	\$2,582 2%
Percent of revenue	11	% 12	%	11	% 11	%

Research and development expenses for the three months ended March 25, 2018 decreased 3% to \$40 million from \$41 million for the three months ended March 26, 2017. This decrease was primarily due to the absence of an adjustment for depreciation and amortization that would have been recognized had the Wolfspeed assets been continuously classified as held and used. 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 nine months ended March 25, 2018, research and development expenses increased 2% to \$122 million from \$119 million for the nine months ended March 26, 2017. The increase was 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			Nine Months Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Sales, general and administrative	\$70,256	\$68,165	\$2,091 3%	\$201,296	\$213,136	(\$11,840) (6)%
Percent of revenue	20	% 20	%	19	% 19	%

Sales, general and administrative expenses of \$70.3 million for the three months ended March 25, 2018 increased 3% from \$68.2 million for the three months ended March 26, 2017. The increase for the three months ended March 25, 2018 was primarily due to legal fees associated with the acquisition of the Infineon RF Power business.

For the nine months ended March 25, 2018, sales, general and administrative expenses decreased 6% to \$201.3 million from \$213.1 million for the nine months ended March 26, 2017. The decrease for the nine months ended March 25, 2018 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			Nine Months		
	Ended			Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Customer relationships	\$1,889	\$2,074	(\$185) (9 )%	\$5,006	\$4,677	\$329 7 %
Developed technology	5,383	5,467	(84 ) (2 )%	15,811	14,835	976 7 %
In-process research and development	—	766	(766 ) (100)%	—	811	(811 ) (100)%
Non-compete agreements	181	55	126 229 %	220	384	(164 ) (43 )%
Trade names, finite-lived	—	—	— — %	—	—	— — %
Total amortization	\$7,453	\$8,362	(\$909) (11 )%	\$21,037	\$20,707	\$330 2 %

Amortization of acquisition-related intangibles was \$7.5 million for the three months ended March 25, 2018 compared to \$8.4 million for the three months ended March 26, 2017.

Amortization of acquisition-related intangibles was \$21.0 million for the nine months ended March 25, 2018 compared to \$20.7 million for the nine months ended March 26, 2017.

## Impairment of Goodwill

Based on the updating of our long range business strategy that was announced February 26, 2018, we determined there was a triggering event and performed an impairment test in connection with the preparation of our financial statements for the period ended March 25, 2018. As a result of this evaluation, we determined the remaining carrying value for the Lighting Products segment exceeded the fair value and recorded total non-cash goodwill impairment charges of \$247.46 million attributable to our Lighting Products segment. The impairment charge resulted from the inability to meet forecasted results, and our new business strategy.

## 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			Nine Months		
	Ended			Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Loss on disposal or impairment of long-lived assets	\$1,716	\$500	\$1,216 243%	\$8,803	\$1,541	\$7,262 471%

We recognized a net loss of \$1.7 million and a net loss of \$0.5 million on the disposal of long-lived assets for the three months ended March 25, 2018 and March 26, 2017, respectively. The increase in net loss for the three months ended March 25, 2018 as compared to the three months ended March 26, 2017 was primarily due to demolition and move costs associated with our current Wolfspeed manufacturing capacity expansion and closure of certain manufacturing facilities.

For the nine months ended March 25, 2018, we recognized a net loss on the disposal of long-lived assets of \$8.8 million compared to a net loss of \$1.5 million for the nine months ended March 26, 2017. The increase in net loss for the nine months ended March 25, 2018 as compared to the nine months ended March 26, 2017 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.

## Non-Operating (Expense) Income, net

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





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	Three Months			Nine Months				
	Ended March 25, 2018	March 26, 2017	Change	Ended March 25, 2018	March 26, 2017	Change		
(Loss) gain on sale of investments, net	(\$133 )	\$1	(\$134 )	(13,400)%	(\$85 )	\$13	(\$98 )	(754 )%
(Loss) gain on equity investment, net	(13,968)	6,443	(20,411 )	(317 )%	7,510	160	7,350	4,594 %
Foreign currency gain, net	3,641	2,434	1,207	50 %	4,869	1,939	2,930	151 %
Interest income, net	743	927	(184 )	(20 )%	3,360	2,714	646	24 %
Other, net	66	60	6	10 %	357	120	237	198 %
Non-operating (expense) income, net	(\$9,651)	\$9,865	(\$19,516)	(198 )%	\$16,011	\$4,946	\$11,065	224 %

(Loss) gain on sale of investments, net. Loss on sale of investments, net was \$133 thousand for the three months ended March 25, 2018 compared to a \$1 thousand gain for the three months ended March 26, 2017. For the nine months ended March 25, 2018 loss on sale of investments, net was \$85 thousand compared to a gain of \$13 thousand for the nine months ended March 26, 2017.

(Loss) gain on equity investment, net. Loss on equity investment in Lextar Electronics Corporation (Lextar), which we account for utilizing the fair value option, was \$14.0 million for the three months ended March 25, 2018 compared to a gain on equity investment of \$6.4 million for the three months ended March 26, 2017. The gain on equity investment was \$7.5 million for the nine months ended March 25, 2018 compared to \$0.2 million for the nine months ended March 26, 2017. Lextar's stock is publicly traded on the Taiwan Stock Exchange and its share price increased from 18.40 New Taiwanese Dollars (TWD) at June 25, 2017 to 26.15 TWD at December 24, 2017 and decreased to 21.25 TWD at March 25, 2018. 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, net. Foreign currency gain, 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 March 25, 2018 was primarily due to the Euro hedge related to the Infineon RF Power business purchase and a favorable fluctuation in the exchange rates between both the Chinese Yuan, Euro, TWD and the United States Dollar offset by an unfavorable fluctuation between the Canadian Dollar and the United States Dollar. The foreign currency gain for the three months ended March 26, 2017 was primarily due to favorable fluctuations in the exchange rate between the TWD and the United States Dollar related to our Lextar investment, partially offset by unfavorable fluctuations in the exchange rate between the Chinese Yuan and the United States Dollar.

The foreign currency gain for the nine months ended March 25, 2018 was primarily due to the Euro hedge related to the Infineon RF Power business purchase and a favorable fluctuations in the exchange rates between both the Chinese Yuan, the Euro, the Canadian Dollar and the United States Dollar. The foreign currency gain for the nine months ended March 26, 2017 was primarily due to favorable fluctuations in the exchange rate between the TWD and the United States Dollar related to our Lextar investment, partially offset by unfavorable fluctuations in the exchange rate between the Chinese Yuan and the United States Dollar.

Interest income, net. Interest income, net was \$0.7 million for the three months ended March 25, 2018 compared to \$0.9 million for the three months ended March 26, 2017. For the nine months ended March 25, 2018, interest income, net was \$3.4 million compared to \$2.7 million for the nine months ended March 26, 2017. The decrease in interest income, net for the three months ended March 25, 2018 was primarily due to higher interest expense due to the higher borrowing on our line of credit as compared to the three months ended March 26, 2017. The higher borrowing relates to the purchase of the Infineon RF Power business. The increase in interest income, net for the nine months ended March 25, 2018 was 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 for the nine months ended March 26, 2017.

Other, net. Other, net income was \$66 thousand for the three months ended March 25, 2018 compared to income of \$60 thousand for the three months ended March 26, 2017. For the nine months ended March 25, 2018, other, net was income of \$357 thousand compared to income of \$120 thousand for the nine months ended March 26, 2017.

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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			Nine Months Ended		
	March 25, 2018	March 26, 2017	Change	March 25, 2018	March 26, 2017	Change
Income tax (benefit) expense	(\$37,181)	\$88,976	(\$126,157) (142)%	(\$45,810)	\$91,574	(\$137,384) (150)%
Effective tax rate	13.4	% (886.5)	%	15.7	% (13,959.5)	%

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. 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 \$37.2 million for an effective tax rate of 13.4% for the three months ended March 25, 2018 as compared to income tax expense of \$89.0 million for an effective tax rate of (886.5)% for the three months ended March 26, 2017. For the nine months ended March 25, 2018 we recognized income tax benefit of \$45.8 million for an effective tax rate of 15.7% compared to an income tax expense of \$91.6 million for an effective rate of (13,959.5)% for the nine months ended March 26, 2017. The change in our effective tax rate for the three and nine months ended March 25, 2018 was primarily attributable to the tax benefit of remeasuring our U.S. deferred taxes as a result of the Tax Legislation and the establishment of a valuation allowance against our U.S. deferred tax assets during the three months ended March 26, 2017.

## Liquidity and Capital Resources

## Overview

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

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

necessary or appropriate, make selective acquisitions or other strategic investments to strengthen our product portfolio, secure key intellectual properties or expand our production capacity.

From time to time, we evaluate strategic opportunities, including potential acquisitions, joint ventures, divestitures or investments in complementary businesses, and we anticipate continuing to make such evaluations. We may also access capital markets through

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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		
	March 25, 2018	June 25, 2017	Change
Days of sales outstanding <sup>(a)</sup>	36	37	(1 )
Days of supply in inventory <sup>(b)</sup>	109	98	11
Days in accounts payable <sup>(c)</sup>	(55)	(46)	(9 )
Cash conversion cycle	90	89	1

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.

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.

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 increase in our cash conversion cycle was primarily driven by an increase in days in inventory.

As of March 25, 2018, we had unrealized losses on our investments of \$2.1 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at March 25, 2018 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 March 25, 2018.

**Cash Flows**

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

	Nine Months Ended			Change
	March 25, 2018	March 26, 2017		
Net cash provided by operating activities	\$125,423	\$163,154	(\$37,731)	(23 )%
Net cash used in investing activities	(393,799 )	(108,154 )	(285,645)	(264)%
Net cash provided by (used in) financing activities	236,290	(103,628 )	339,918	328 %
Effects of foreign exchange changes on cash and cash equivalents	715	(432 )	1,147	266 %
Net decrease in cash and cash equivalents	(\$31,371 )	(\$49,060 )	\$17,689	36 %

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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 \$125.4 million for the nine months ended March 25, 2018 from \$163.2 million for the nine months ended March 26, 2017. 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 \$393.8 million for the nine months ended March 25, 2018 and net cash used in investing activities was \$108.2 million for the nine months ended March 26, 2017. The increase in cash used for investing activities was due to the \$427.1 million net purchase of the Infineon RF Power business during the three months ended March 25, 2018 and \$70.6 million increase in our capital spending primarily related to the wafer factory expansion for the nine months ended March 25, 2018 compared to the nine months ended March 26, 2017, which was partially offset by net proceeds of short-term investments increasing \$212.6 million for the nine months ended March 25, 2018 compared to the nine months ended March 26, 2017.

For fiscal 2018, we target approximately \$190 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 financing activities was \$236.3 million for the nine months ended March 25, 2018 compared to net cash used by financing activities of \$103.6 million used for the nine months ended March 26, 2017. For the nine months ended March 25, 2018, our financing activities primarily consisted of net draw on our line of credit of \$171.0 million for the Infineon RF Power acquisition and payment of acquisition-related contingent consideration of \$1.9 million in connection with our acquisition of Arkansas Power Electronics International, Inc., offset by proceeds of \$62.2 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. For the nine months ended March 26, 2017, our financing activities primarily consisted of the repurchase of common stock worth approximately \$104.0 million, a payment of acquisition-related contingent consideration of \$2.8 million, partially offset by net borrowing on our line of credit of \$7.0 million, and proceeds of \$10.2 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 March 25, 2018, 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 “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 third 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;
- integrate the personnel, operations, customers, and suppliers from our recent acquisition of the Infineon RF Power business;
- 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;

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- manage organizational complexity and communication;
- 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 calendar 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.

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

From time to time, we evaluate strategic opportunities available to us for product, technology or business transactions, such as business acquisitions, investments, joint ventures, divestitures, or spin-offs. For example, during the first quarter of fiscal 2018 we formed Cree Venture LED, a joint venture between San'an and us to produce and supply to customers high-performance mid-power LED components, and in the third quarter of fiscal 2018, we acquired the Infineon RF Power business. If we choose to enter into such transactions, we face certain risks including:

- the failure of an acquired business, investee or joint venture to meet our performance and financial expectations;
- identification of additional liabilities relating to an acquired business;
- loss of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers' existing product lines;
- that we are not able to enter into acceptable contractual arrangements with the significant customers of an acquired business;
- difficulty integrating an acquired business's operations, personnel and financial and operating systems into our current business;
- that we are not able to develop and expand customer bases and accurately anticipate demand from end customers, which can result in increased inventory and reduced orders as we experience wide fluctuations in supply and demand;

diversion of management attention;

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- difficulty separating the operations, personnel and financial and operating systems of a spin-off or divestiture from our current business;
- the possibility we are unable to complete the transaction and expend substantial resources without achieving the desired benefit;
- the inability to obtain required regulatory agency approvals;
  - reliance on a transaction counterparty for transition services for an extended period of time, which may result in additional expenses and delay the integration of the acquired business and realization of the desired benefit of the transaction. For example, Infineon has agreed to continue to operate the RF Power business on our behalf for a short transition period, including continuing to employ the approximately 260 RF Power business employees to whom we have agreed to extend an offer of employment during such period;
- uncertainty of the financial markets or circumstances that cause conditions that are less favorable and/or different than expected; and
- expenses incurred to complete a transaction may be significantly higher than anticipated.

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

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 power, RF, and LED 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.

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

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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. For example, during the third quarter of fiscal 2018, we incurred impairment charges of \$247.5 million in relation to the goodwill in our Lighting Products segment. 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.

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

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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. Similarly, we have the ability to add, consolidate, or remove distributors.

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.

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 calendar 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 semiconductor market, we compete with companies that have greater market share, name recognition and/or technical resources than we do. Competitors continue to offer new products with aggressive pricing, additional features and improved performance. 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. Competitive pricing

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pressures remain a challenge and continue to accelerate the rate of decline in our sales prices, particularly in our LED Products and Wolfsped 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 power, RF, LEDs and lighting products that meet the evolving needs of our customers will be critical to our success. Competitors may also try to align with some of our strategic customers. This could lead to lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Any of these developments could have an adverse effect on our business, results of operations or financial condition. Global economic conditions could materially adversely impact demand for our products and services.

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

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

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

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

• protection of intellectual property and trade secrets;

• tariffs, customs, trade sanctions, trade embargoes and other barriers to importing/exporting materials and products in a cost-effective and timely manner, or changes in applicable tariffs or custom rules;

• the burden of complying with and changes in U.S. or international taxation policies;

• timing and availability of export licenses;

• rising labor costs;

• disruptions in or inadequate infrastructure of the countries where we operate;

• difficulties in collecting accounts receivable;

• difficulties in staffing and managing international operations; and

• the burden of complying with foreign and international laws and treaties.

For example, the proposed tariffs by the United States on Chinese goods and any corresponding Chinese tariffs in response may negatively impact demand for our products. In some instances, we have received and may continue to receive incentives from foreign governments to encourage our investment in certain countries, regions or areas outside of the United States. In particular,



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we have received and may continue to receive such incentives in connection with our operations in Asia, as Asian national and local governments seek to encourage the development of the technology industry. Government incentives may include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to us due to our foreign operations. Any of these incentives could be reduced or eliminated by governmental authorities at any time or as a result of our inability to maintain minimum operations necessary to earn the incentives. Any reduction or elimination of incentives currently provided for our operations could adversely affect our business and results of operations. These same governments also may provide increased incentives to or require production processes that favor local companies, which could further negatively impact our business and results of operations. Changes in regulatory, geopolitical, social, economic, or monetary policies and other factors, if any, may have a material adverse effect on our business in the future, or may require us to exit a particular market or significantly modify our current business practices. Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could also result in an adverse effect on our business and results of operations.

We are subject to risks related to international sales and purchases.

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

Our international sales and purchases are subject to numerous U.S. and foreign laws and regulations, including, without limitation, tariffs, trade sanctions, trade barriers, trade embargoes, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. For example, the U.S. Government's recent export ban on Chinese technology company ZTE will reduce company revenue and profit at least in the near term. We are in process of assessing the potential longer term impact to our company. Additionally, like many global manufacturers, we are monitoring the Office of United States Trade Representative's (USTR) Notice and Request for Public Comment published in April 2018 in order to fully understand the potential impact on our customers, our suppliers and our business and to determine our response within the USTR's published timeframe. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and, in the extreme case, we could be suspended or debarred from government contracts or have our export privileges suspended, which could have a material adverse effect on our business.

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

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

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

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

previously agreed upon specifications or made other modifications we do not specify, which impacted our cost of revenue.

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

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

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