CREE INC
Form 10-Q
January 23, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 30, 2012
or
[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 0-21154
CREE, INC.
(Exact name of registrant as specified in its charter)

North Carolina	56-1572719
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4600 Silicon Drive Durham, North Carolina	27703
(Address of principal executive offices)	(Zip Code)

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

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [ ] No[X]
The number of shares outstanding of the registrant's common stock, par value $0.00125 per share, as of January 16, 2013, was 116,649,539.

Table of Contents

CREE, INC.
FORM 10-Q
For the Quarterly Period Ended December 30, 2012
INDEX

Table of Contents

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

	December 30, 2012 (unaudited)	June 24, 2012
	(Thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$179,608	$178,885
Short-term investments	706,195	565,628
Total cash, cash equivalents, and short-term investments	885,803	744,513
Accounts receivable, net	144,552	152,258
Inventories	185,006	188,849
Deferred income taxes	21,931	21,744
Prepaid expenses and other current assets	61,117	56,917
Total current assets	1,298,409	1,164,281
Property and equipment, net	555,049	582,461
Intangible assets, net	366,520	376,075
Goodwill	616,345	616,345
Other assets	7,733	8,336
Total assets	$2,844,056	$2,747,498
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$94,487	$78,873
Accrued salaries and wages	39,907	29,837
Income taxes payable	8,904	3,834
Other current liabilities	32,655	36,633
Total current liabilities	175,953	149,177
Long-term liabilities:		
Deferred income taxes	15,733	15,609
Other long-term liabilities	16,762	22,695
Total long-term liabilities	32,495	38,304
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 30, 2012 and June 24, 2012; none issued and outstanding	—	—
Common stock, par value $0.00125; 200,000 shares authorized at December 30, 2012 and June 24, 2012; 116,650 and 115,906 shares issued and outstanding at December 30, 2012 and June 24, 2012, respectively	145	144
Additional paid-in-capital	1,900,500	1,861,502
Accumulated other comprehensive income, net of taxes	11,199	11,133
Retained earnings	723,764	687,238
Total shareholders' equity	2,635,608	2,560,017
Total liabilities and shareholders' equity	$2,844,056	$2,747,498

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

3

Table of Contents

CREE, INC.
(UNAUDITED)
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended		Six Months Ended	
	December 30, 2012	December 25, 2011	December 30, 2012	December 25, 2011
	(Thousands, except per share amounts)			
Revenue, net	$346,286	$304,118	$662,039	$573,098
Cost of revenue, net	212,810	199,000	412,514	369,952
Gross profit	133,476	105,118	249,525	203,146
Operating expenses:				
Research and development	39,941	35,886	77,488	70,288
Sales, general and administrative	60,100	49,176	112,745	94,715
Amortization of acquisition-related intangibles	7,719	7,367	15,389	11,292
Loss on disposal or impairment of long-lived assets	624	497	1,522	1,272
Total operating expenses	108,384	92,926	207,144	177,567
Operating income	25,092	12,192	42,381	25,579
Non-operating income:				
Other non-operating income (expense), net	535	(111)	2,128	863
Interest income, net	1,946	1,800	3,738	3,769
Income before income taxes	27,573	13,881	48,247	30,211
Income tax expense	7,170	1,803	11,721	5,314
Net income	$20,403	$12,078	$36,526	$24,897
Earnings per share:				
Basic	$0.18	$0.10	$0.32	$0.22
Diluted	$0.18	$0.10	$0.31	$0.22
Shares used in per share calculation:				
Basic	115,965	115,536	115,760	113,701
Diluted	116,410	115,883	116,249	114,239

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

Table of Contents

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

	Three Months Ended		Six Months Ended	
	December 30, 2012	December 25, 2011	December 30, 2012	December 25, 2011
	(In thousands)			
Net income	$20,403	$12,078	$36,526	$24,897
Other comprehensive income:				
Currency translation (loss) gain, net of tax benefit (expense) of $20, $418, ($91) and $221, respectively	(33)	(685)	149	(362)
Net unrealized (loss) on available-for-sale securities, net of tax benefit of $376, $544, $54 and $1,206, respectively	(617)	(899)	(83)	(1,991)
Other comprehensive (loss) income	(650)	(1,584)	66	(2,353)
Comprehensive income	$19,753	$10,494	$36,592	$22,544

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

Table of Contents

CREE, INC.
(UNAUDITED)
CONSOLIDATED STATEMENTS OF CASH FLOW

	Six Months Ended December 30, 2012	December 25, 2011
	(In thousands)	
Cash flows from operating activities:		
Net income	$36,526	$24,897
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	76,395	68,303
Stock-based compensation	27,029	22,635
Excess tax benefit from share-based payment arrangements	(117)	(201)
Loss on disposal or impairment of long-lived assets	1,522	1,272
Amortization of premium/discount on investments	4,744	4,017
Changes in operating assets and liabilities, net of effect of acquisition:		
Accounts receivable	7,683	(12,973)
Inventories	3,854	28,572
Prepaid expenses and other assets	(3,644)	8,755
Accounts payable, trade	14,581	(14,923)
Accrued salaries and wages and other liabilities	9,721	(8,117)
Net cash provided by operating activities	178,294	122,237
Cash flows from investing activities:		
Purchases of property and equipment	(30,430)	(53,038)
Purchases of investments	(364,027)	(145,802)
Proceeds from maturities of investments	194,754	66,040
Proceeds from sale of property and equipment	301	2
Proceeds from sale of available-for-sale investments	23,825	252,152
Purchase of acquired business, net of cash acquired	—	(456,008)
Purchases of patent and licensing rights	(10,021)	(8,043)
Net cash used in investing activities	(185,598)	(344,697)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	8,177	2,648
Excess tax benefit from share-based payment arrangements	117	201
Repurchases of common stock	(638)	—
Net cash provided by financing activities	7,656	2,849
Effects of foreign exchange changes on cash and cash equivalents	371	664
Net change in cash and cash equivalents	723	(218,947)
Cash and cash equivalents:		
Beginning of period	178,885	390,598
End of period	$179,608	$171,651

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

Table of Contents

CREE, INC.
(UNAUDITED)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Basis of Presentation and Changes in Significant Accounting Policies

Overview

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

The Company develops and manufactures semiconductor materials and devices primarily based on silicon carbide (SiC), gallium nitride (GaN) and related compounds. The physical and electronic properties of SiC and GaN offer technical advantages over traditional silicon, gallium arsenide (GaAs) and other materials used for electronic and opto-electronic applications.

The Company's LED products consist of LED components, LED chips, and SiC wafers. As LED technology improves, the Company believes the potential market for LED lighting will continue to expand. The Company's success in selling LED products depends upon the ability to offer innovative products and its ability to enable its customers to develop and market LED based products that successfully compete and drive LED adoption against traditional lighting products.

The Company's lighting products consist of both LED and traditional lighting systems. The Company designs, manufactures and sells lighting systems for indoor and outdoor applications, with a primary focus on LED lighting systems for the commercial and industrial markets. The Company also uses its LED systems expertise to accelerate LED lighting adoption and expand the market for its LED components.

In addition, the Company develops, manufactures and sells power and RF devices. The Company's power products are made from SiC and provide faster switching speeds than comparable silicon-based power devices for a given power level. The Company's RF devices are made from GaN and produce higher power densities as compared to silicon or gallium arsenide.

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

The Company currently operates its business as three reportable segments:

- LED Products
- Lighting Products
- Power and RF Products

Basis of Presentation

The consolidated balance sheet at December 30, 2012, the consolidated statements of income for the three and six months ended December 30, 2012 and December 25, 2011, the consolidated statements of comprehensive income for the three and six months ended December 30, 2012 and December 25, 2011, and the consolidated statements of cash flow for the six months ended December 30, 2012 and December 25, 2011 (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 present fairly the consolidated financial position, results of operations and cash flows at December 30, 2012, and for all periods presented, have been made. All significant intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 24, 2012 has been derived from the audited financial statements as of that date. The three and six month periods ended December 30, 2012 include one additional week as compared to the three and six month periods ended December 25, 2011.

Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted. 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 24, 2012 (“fiscal 2012”). The results of

Table of Contents

operations for the three and six months ended December 30, 2012 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 30, 2013 (“fiscal 2013”).

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, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual amounts could differ materially from those estimates.

Certain fiscal 2012 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2013 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders’ equity.

Recently Adopted Accounting Pronouncements

Presentation of Comprehensive Income

In June 2011, the Financial Accounting Standards Board ("FASB") issued new guidance concerning the presentation of total comprehensive income and its components. Under this guidance, an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance also requires an entity to present on the face of the financial statements reclassification adjustments from other comprehensive income to net income. In December 2011, the FASB issued an accounting standards update that deferred the presentation requirement for other comprehensive income reclassifications on the face of the financial statements. This guidance, as amended, became effective for the Company beginning in the first quarter of fiscal 2013. The Company's adoption of the new accounting guidance did not have a significant impact on the consolidated financial statements.

Note 2. Acquisitions

On August 17, 2011, the Company entered into a Stock Purchase Agreement with all of the shareholders of Ruud Lighting, Inc. ("Ruud Lighting"). Pursuant to the terms of the Stock Purchase Agreement and concurrently with the execution of the Stock Purchase Agreement, the Company acquired all of the outstanding share capital of Ruud Lighting in exchange for consideration consisting of 6.1 million shares of the Company's common stock valued at approximately $211.0 million and $372.2 million cash, subject to certain post-closing adjustments. The acquisition allowed the Company to expand its product portfolio into outdoor LED lighting.

Prior to the Company completing its acquisition of Ruud Lighting, Ruud Lighting completed the re-acquisition of its e-conolight business by purchasing all of the membership interests of E-conolight LLC ("E-conolight"). Ruud Lighting previously sold its e-conolight business in March 2010 and had been providing operational services to E-conolight since that date. In connection with the stock purchase transaction with Ruud Lighting, the Company funded Ruud Lighting's re-acquisition of E-conolight and repaid Ruud Lighting's outstanding debt in the aggregate amount of approximately $85.0 million.

Following the acquisition, the Company recorded certain post-closing purchase price adjustments resulting in a $2.3 million reduction to the purchase price and a total purchase price of approximately $666.0 million.

The Company incurred total transaction costs related to the acquisition of approximately $3.6 million, of which, $3.1 million were expensed in the first quarter of fiscal 2012, in accordance with U.S. GAAP. These transaction costs were included in "Sales, general and administrative" expense in the consolidated statements of income. Ruud Lighting is included in the Lighting Products segment.

Table of Contents

The amounts of revenue and net income of Ruud Lighting in the consolidated statements of income from and including August 17, 2011 to December 25, 2011 are as follows (in thousands, except per share data):

	Three Months Ended	Six Months Ended
	December 25, 2011	December 25, 2011
Revenue	$61,148	$83,491
Operating income	1,647	1,125
Net income	1,319	655
Basic net income per share	$0.01	$0.01
Diluted net income per share	$0.01	$0.01

The following unaudited pro forma information presents a summary of the Company's consolidated results of operations as if the Ruud Lighting acquisition occurred as of June 27, 2011 (in thousands, except per share data).

	Six Months Ended
	December 25, 2011
Revenue	$603,430
Operating income	23,872
Net income	23,117
Basic net income per share	$0.20
Diluted net income per share	$0.20

The total revenue for Ruud Lighting included in the pro forma table above was $115.0 million for the six month period from June 27, 2011 to December 25, 2011.

Note 3. Financial Statement Details

Accounts Receivable, net

The following table presents a summary of the components of accounts receivable, net (in thousands):

	December 30, 2012	June 24, 2012
Billed trade receivables	$170,544	$173,145
Unbilled contract receivables	1,876	1,576
	172,420	174,721
Allowance for sales returns, discounts, and other incentives	(25,668)	(20,681)
Allowance for bad debts	(2,200)	(1,782)
Total accounts receivable, net	$144,552	$152,258

Inventories

The following table presents a summary of the components of inventories (in thousands):

	December 30, 2012	June 24, 2012
Raw material	$56,925	$57,618
Work-in-progress	68,514	74,241
Finished goods	59,567	56,990
Total inventories	$185,006	$188,849

Table of Contents

Other current liabilities

The following table presents a summary of the components of other current liabilities (in thousands):

	December 30, 2012	June 24, 2012
Accrued taxes	$9,683	$11,615
Accrued professional fees	6,628	7,412
Accrued warranty	7,243	5,513
Accrued other	9,101	12,093
Total other current liabilities	$32,655	$36,633

Other non-operating income (expense), net

The following table presents a summary of the components of other non-operating income (expense), net (in thousands):

	Three Months Ended		Six Months Ended	
	12/30/2012	12/25/2011	12/30/2012	12/25/2011
Foreign currency gain (loss), net	$301	$(24)	$128	$21
Gain on sale of investments, net	8	1	36	997
Other, net	226	(88)	1,964	(155)
Total other non-operating income (expense), net	$535	$(111)	$2,128	$863

Note 4. Investments

Short-term investments consist of high grade municipal and corporate bonds and other debt securities. The Company classifies its marketable securities as available-for-sale based upon management's determination that the underlying cash invested in these securities is available for operations as necessary.

The following tables provide a summary of marketable investments by type (in thousands):

	December 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$236,819	$1,442	$(311)	$ 237,950
Corporate bonds	158,563	2,467	(49)	160,981
Certificates of deposit	225,000	—	—	225,000
U.S. agency securities	71,620	440	—	72,060
Non-U.S. government securities	10,172	32	—	10,204
Total	$702,174	$4,381	$(360)	$ 706,195

	June 24, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$209,626	$2,036	$(58)	$ 211,604
Corporate bonds	144,942	1,848	(123)	146,667
Certificates of deposit	130,000	—	—	130,000
U.S. agency securities	68,156	450	(7)	68,599
Non-U.S. government securities	8,746	15	(3)	8,758
Total	$561,470	$4,349	$(191)	$ 565,628

Table of Contents

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

	December 30, 2012					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$77,718	$(311)	$—	$—	$77,718	$(311)
Corporate bonds	21,128	(49)	—	—	21,128	(49)
Total	$98,846	$(360)	$—	$—	$98,846	$(360)
Number of securities with an unrealized loss		56		—		56

	June 24, 2012					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$30,102	$(58)	$—	$—	$30,102	$(58)
Corporate bonds	30,550	(123)	—	—	30,550	(123)
U.S. agency securities	3,014	(7)	—	—	3,014	(7)
Non-U.S. government securities	1,543	(3)	—	—	1,543	(3)
Total	$65,209	$(191)	$—	$—	$65,209	$(191)
Number of securities with an unrealized loss		33		—		33

The contractual maturities of marketable investments at December 30, 2012 were as follows (in thousands):

	December 30, 2012				
	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	$63,142	$174,808	$—	$—	$237,950
Corporate bonds	34,905	126,076	—	—	160,981
Certificates of deposit	225,000	—	—	—	225,000
U.S. agency securities	29,187	42,873	—	—	72,060
Non-U.S. government securities	2,523	7,681	—	—	10,204
Total	$354,757	$351,438	$—	$—	$706,195

Note 5. 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.

Table of Contents

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 and short-term investments. As of December 30, 2012, financial assets utilizing Level 1 inputs included money market funds. Financial assets utilizing Level 2 inputs included certificates of deposit, corporate bonds and municipal bonds, U.S. agency securities and non-U.S. government securities. Level 2 assets are valued using a third-party pricing services 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 does not have any financial assets requiring the use of Level 3 inputs. There were no transfers between Level 1 and Level 2 during the six months ended December 30, 2012.

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

	December 30, 2012				June 24, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Municipal bonds	$—	$—	$—	$—	$—	$3,000	$—	$3,000
Money market funds	4,425	—	—	4,425	31,318	—	—	31,318
Total cash equivalents	4,425	—	—	4,425	31,318	3,000	—	34,318
Short-term investments:								
Municipal bonds	—	237,950	—	237,950	—	211,604	—	211,604
Corporate bonds	—	160,981	—	160,981	—	146,667	—	146,667
Certificates of deposit	—	225,000	—	225,000	—	130,000	—	130,000
U.S. agency securities	—	72,060	—	72,060	—	68,599	—	68,599
Non-U.S. government securities	—	10,204	—	10,204	—	8,758	—	8,758
Total short-term investments	—	706,195	—	706,195	—	565,628	—	565,628
Total assets	$4,425	$706,195	$—	$710,620	$31,318	$568,628	$—	$599,946

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains from the sale of investments for the six months ended December 30, 2012 of approximately $36 thousand are included in "Other non-operating income (expense), net" 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 fair value has been below 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 recovery in market value.

Table of Contents

Note 6. Intangible Assets

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

	December 30, 2012			June 24, 2012		
	Gross	Accumulated amortization	Net	Gross	Accumulated amortization	Net
Intangible assets with finite lives:						
Customer relationships	$137,440	$(55,357)	$82,083	$137,440	$(51,103)	$86,337
Developed technology	162,760	(43,283)	119,477	160,360	(33,141)	127,219
Non-compete agreements	10,244	(3,057)	7,187	10,244	(2,077)	8,167
Trade names, finite-lived	520	(481)	39	520	(469)	51
Patent and license rights	106,399	(31,545)	74,854	97,812	(28,791)	69,021
Total intangible assets with finite lives	417,363	(133,723)	283,640	406,376	(115,581)	290,795
In-process research and development, indefinite-lived	—		—	2,400		2,400
Trade names, indefinite-lived	82,880		82,880	82,880		82,880
Total intangible assets	$500,243	$(133,723)	$366,520	$491,656	$(115,581)	$376,075

Total amortization expense, including the amortization of acquisition related intangibles, patents and license rights, recognized during the three and six months ended December 30, 2012 was $9.5 million and $18.7 million, respectively. For the three and six months ended December 25, 2011, total amortization expense, including the amortization of acquisition related intangibles, patents and license rights, was $8.8 million and $14.1 million, respectively.

Total annual amortization expense of intangible assets is estimated to be as follows (in thousands):

Fiscal Year Ending	
June 30, 2013 (remainder of fiscal 2013)	$18,784
June 29, 2014	35,539
June 28, 2015	32,572
June 26, 2016	32,296
June 25, 2017	30,335
Thereafter	134,114
Total	$283,640

Note 7. Shareholders' Equity

As of December 30, 2012, the Company is authorized by the Board of Directors to repurchase shares of its common stock having an aggregate purchase price not exceeding $200.0 million for all purchases from June 14, 2012 through the June 30, 2013 expiration of the program. During the six months ended December 30, 2012, there were no repurchases of common stock by the Company under the repurchase program.

Table of Contents

Note 8. Earnings Per Share

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

	Three Months Ended		Six Months Ended	
	December 30, 2012	December 25, 2011	December 30, 2012	December 25, 2011
Basic:				
Net income	$20,403	$12,078	$36,526	$24,897
Weighted average common shares - basic	115,965	115,536	115,760	113,701
Basic earnings per share	$0.18	$0.10	$0.32	$0.22

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

	Three Months Ended		Six Months Ended	
	December 30, 2012	December 25, 2011	December 30, 2012	December 25, 2011
Diluted:				
Net income	$20,403	$12,078	$36,526	$24,897
Weighted average common shares - basic	115,965	115,536	115,760	113,701
Dilutive effect of stock options, unvested shares and ESPP purchase rights	445	347	489	538
Weighted average common shares - diluted	116,410	115,883	116,249	114,239
Diluted earnings per share	$0.18	$0.10	$0.31	$0.22

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be antidilutive and as such, these shares are not included in calculating diluted earnings per share. For the three and six months ended December 30, 2012, there were 10.2 million and 9.1 million, respectively, of potential common shares not included in the calculation of diluted earnings per share because their effect was antidilutive. For the three and six months ended December 25, 2011, there were 8.1 million and 6.6 million, respectively, of potential common shares not included in the calculation of diluted earnings per share because their effect was antidilutive.

Note 9. Stock-Based Compensation

The Company currently has one equity-based compensation plan from which stock-based compensation awards can be granted to employees and directors. In addition, the Company has plans that have been terminated as to future grants, but under which options are currently outstanding.

During the first quarter of fiscal 2013, the Company initiated grants of performance-based stock option and stock unit awards. The compensation expense for an award with a performance condition is based on the probable outcome of that performance condition. Compensation expense is recognized if the Company believes it is probable that the performance condition will be achieved and is adjusted 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 the Company’s common stock at a discount. The ESPP was amended in the second quarter of fiscal 2012 to increase the six-month participation period to a twelve-month participation period, divided into two equal six-month purchase periods, and to provide for a look-back feature. At the end of each six-month period, employees purchase the Company's common stock through the ESPP at 15% less than 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 amendment also provides for an automatic reset feature to start participants on a new twelve-month participation period if the share value declines during the first six-month purchase period.

Table of Contents

Stock Option Awards

The following table summarizes outstanding option awards as of December 30, 2012, and changes during the six months then ended (shares in thousands):

	Number of Shares	Weighted-Average Exercise Price
Outstanding at June 24, 2012	8,800	$36.71
Granted	3,228	27.80
Exercised	(343)	23.83
Forfeited or expired	(275)	39.24
Outstanding at December 30, 2012	11,410	$34.51

Restricted Stock and Stock Unit Awards

A summary of nonvested shares of restricted stock and stock unit awards outstanding as of December 30, 2012, and changes during the six months then ended, follows (shares in thousands):

	Number of Shares/Units	Weighted-Average Grant-Date Fair Value
Nonvested at June 24, 2012	517	$37.41
Granted	350	28.11
Vested	(179)	34.98
Nonvested at December 30, 2012	688	$33.31

Stock-Based Compensation Valuation and Expense

The Company accounts for its employee stock-based compensation plan 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.

To estimate the fair value of the Company's stock option awards, the Company currently uses the Black-Scholes option-valuation model. The determination of the fair value of stock-based payment awards on the date of grant using an option-valuation 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, risk-free interest rate and expected dividends. Due to the inherent limitations of option-valuation models available today, including 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 restricted stock and stock unit awards, 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 reduced by estimated forfeitures such that expense is recognized only for those stock-based awards that are expected to vest. A forfeiture rate is estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates.

Table of Contents

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

Income Statement Classification	Three Months Ended December 30, 2012	Three Months Ended December 25, 2011	Six Months Ended December 30, 2012	Six Months Ended December 25, 2011
Cost of goods sold	$2,257	$1,615	$4,541	$3,329
Research and development	3,947	2,603	7,003	5,031
Sales, general and administrative	8,340	6,977	15,485	14,275
Total	$14,544	$11,195	$27,029	$22,635

Note 10. Income Taxes

The variation between the Company's effective income tax rate and the U.S. statutory rate of 35 percent is due to a percentage of the Company's projected income for the full year being derived from international locations with lower tax rates than the U.S. and the impact of tax credits available in the current year.

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

As of June 24, 2012, the Company's liability for unrecognized tax benefits was $4.4 million. During the six months ended December 30, 2012, there were no changes to the amount of unrecognized tax benefits. As a result, the total liability for unrecognized tax benefits as of December 30, 2012 was $4.4 million. If any portion of this $4.4 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 approximately $2.2 million of gross unrecognized tax benefits will change in the next 12 months as a result of pending audit settlements or 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 ended June 28, 2009 and prior. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2009. For foreign purposes, the Company is generally no longer subject to examination for tax periods 2002 and prior. Certain carryforward tax attributes generated in prior years remain subject to examination and adjustment. The Company is currently under inquiry by the Hong Kong Inland Revenue Department for the fiscal year ended June 29, 2008 through the fiscal year ended June 27, 2010. The Company is also currently under audit by the German Federal Central Tax Office for the fiscal year ended June 29, 2008 through the fiscal year ended June 27, 2010.

The American Taxpayer Relief Act of 2012 was enacted on January 2, 2013. Included within this legislation was an extension of the research and development credit which had previously expired on December 31, 2011. This legislation retroactively reinstates and extends the credit from the previous expiration date through December 31, 2013. As the legislation was not enacted until after the close of the second quarter of fiscal 2013, the income tax impact of the retroactive reinstatement and extension will not be recognized until the third quarter of fiscal 2013. If the tax impact of the research and development credit was recognized in the second quarter of fiscal 2013, it would represent a $1.5 million tax benefit.

Note 11. Commitments and Contingencies

Warranties

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

Balance at June 24, 2012	$5,513
Warranties accrued in current period	2,199
Changes in estimates for pre-existing warranties	1,056
Expenditures	(1,525)

Balance at December 30, 2012	$7,243

16

Table of Contents

Product warranties are estimated and recognized at the time the Company recognizes revenue. The warranty periods range from ninety days to ten years. The Company accrues warranty liabilities at the time of sale, based on historical and projected incident rates and expected future warranty costs. The warranty reserves, which are primarily related to Lighting products, are evaluated on a quarterly basis 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.

Litigation

The Company is a party to various legal proceedings, including those described in the Company's Annual Report on Form 10-K for fiscal 2012 and in the Company's Quarterly Report on Form 10-Q for the quarter ended September 23, 2012. The following is provided as an update to the Company's legal proceedings as contained in those reports. Unless otherwise indicated, the potential losses for claims against the Company in these matters are not reasonably estimable.

Cooper Lighting Litigation

Ruud Lighting, Inc. filed a complaint for patent infringement against Cooper Lighting, LLC in the U.S. District Court for the Eastern District of Wisconsin on April 2, 2010. The complaint as amended seeks injunctive relief and damages for infringement of two U.S. patents owned by Ruud Lighting: No. 7,686,469, entitled "LED Lighting Fixture"; and No. 7,891,835, entitled “Light-Directed Apparatus with Protected Reflector-Shield and Lighting Fixture Utilizing Same.” On May 23, 2012, Ruud Lighting filed a second complaint for patent infringement against Cooper Lighting in the U.S. District Court for the Eastern District of Wisconsin. The complaint seeks injunctive relief and damages for infringement of a third U.S. patent owned by Ruud Lighting, No. 7,952,262, entitled “Modular LED Unit Incorporating Interconnected Heat Sinks Configured To Mount and Hold Adjacent LED Modules." In each of these actions Cooper Lighting has filed an answer and counterclaims in which it denies any infringement and seeks a declaratory judgment that the asserted claims of the patents are invalid.

Cooper Lighting, LLC filed a complaint for patent infringement against Cree, Inc. and Ruud Lighting, Inc. in the U.S. District Court for the Northern District of Georgia on September 7, 2012. The complaint seeks injunctive relief and damages for infringement of one U.S. patent owned by Cooper Lighting, LLC: No. 8,210,722, entitled "LED Device for Wide Beam Generation." Cree has filed an answer in which it denies any infringement and asserts that the patent is invalid as well as other defenses.

Illumination Management Solutions, Inc., a subsidiary of Cooper Lighting, LLC, filed a complaint for patent infringement against Ruud Lighting in the U.S. District Court for the Eastern District of Texas on June 7, 2010. The action was later transferred to the U.S. District Court for the Eastern District of Wisconsin. As amended in January 2012, the complaint alleged that Ruud Lighting infringed two U.S. patents owned by Illumination Management Solutions, No. 7,674,018 and No. 7,993,036, each entitled "LED Device for Wide Beam Generation." It also alleged that Ruud Lighting and its then president, Alan Ruud, who served on the plaintiff's board of directors in 2006 and 2007 when Ruud Lighting was a shareholder of the plaintiff, conspired to misuse confidential information obtained from the plaintiff to file patent applications and to obtain patents assigned to Ruud Lighting. The complaint sought injunctive relief, damages and ownership of the patent applications and patents alleged to have been wrongfully filed and obtained. The court in October 2012 granted partial summary judgment in favor of Ruud Lighting, finding that most of the accused products did not infringe either of the asserted patents. The parties have moved the court to enter final judgment based on the court's summary judgment order and to dismiss the remaining claims and counterclaims without prejudice.

Ruud Lighting is a defendant in an action commenced by Illumination Management Solutions in the U.S. District Court for the Central District of California on June 8, 2010 and later transferred to the U.S. District Court for the Eastern District of Wisconsin. As amended in December 2012, the complaint names as defendants Ruud Lighting and two of its employees, Alan Ruud and Christopher Ruud, and asserts that the defendants engaged in wrongful acts arising out of the relationship between the plaintiff and Ruud Lighting in 2006 and 2007 when Ruud Lighting was a shareholder of the plaintiff and Alan Ruud served on the plaintiff's board of directors. The complaint alleges that the defendants breached fiduciary duties and otherwise acted improperly by pursuing a plan to compete with the plaintiff and that the defendants misused trade secrets and other information obtained from the plaintiff as fiduciaries and subject to a non-disclosure agreement. These allegedly wrongful acts included filing patent applications and obtaining patents assigned to Ruud Lighting on inventions claimed by the plaintiff. The complaint also alleges that Ruud Lighting: (a) marketed its LED products without reference to certain optical technology claimed by the plaintiff, thereby breaching a marketing agreement with the plaintiff and engaging in unfair competition and false advertising; (b) breached the marketing agreement by failing to give the plaintiff a right of first refusal to integrate the plaintiff's optical technology into Ruud Lighting LED products; and (c) committed fraud by entering into the marketing agreement without any intention to perform it. The complaint further alleges that the plaintiff is entitled to a correction of the inventors named in one or more patents to add a founder of the plaintiff as an inventor. The complaint seeks to recover damages, all profits and other gains realized by defendants as a result of the acts complained of, attorneys' fees, ownership of any interest in the patent applications and patents alleged to have been wrongfully filed and obtained, and correction of the named inventors on one or more patents. The plaintiff filed its amended complaint in December 2012 following a September 2012 order of the court that dismissed certain claims as preempted by the trade secret misappropriation claim. The plaintiff in January 2013 filed a motion seeking leave to file a further amended complaint that omits the previously asserted claims for trade secret misappropriation, fraud, unfair competition and false advertising.

Dynacraft Industries Litigation

On April 29, 2009, Dynacraft Industries Sdn. Bhd. commenced an action against the Company and Cree Malaysia Sdn. Bhd., a subsidiary of the Company, in Malaysia in a filing with the High Court of Malaysia at Pulau Pinang (Penang). The statement of claim alleged that the Cree defendants breached an agreement to purchase from Dynacraft certain real property in Malaysia for a contract price of 38 million Malaysia ringgit (approximately $12.4 million) and sought an award of damages in an unspecified amount. The Cree defendants filed defenses denying liability for damages. The case was tried before a judge and on November 28, 2012 all claims against the Cree defendants were dismissed. Dynacraft has filed a notice of appeal.

The Fox Group Litigation

The Fox Group, Inc. filed a complaint for patent infringement against the Company in the U.S. District Court for the Eastern District of Virginia on June 29, 2010. The complaint, which sought injunctive relief and damages, asserted that the Company was infringing two U.S. patents relating to high quality silicon carbide material: No. 6,534,026, entitled "Low Defect Density Silicon Carbide" (the "'026 patent"); and No. 6,562,130, entitled "Low Defect Axially Grown Single Crystal Silicon Carbide" (the "'130 patent"). The district court granted summary judgment in favor of the Company in August 2011. The court determined that the Company did not infringe the '026 patent and that the claims of the '130 patent asserted against the Company are invalid. The Fox Group appealed the decision to the U.S. Court of Appeals for the Federal Circuit and the decision was affirmed on November 28, 2012. The Fox Group has petitioned for a rehearing.

Note 12. Reportable Segments

The Company's three operating and reportable segments include:

- LED Products
- Lighting Products
- Power and RF Products

Reportable Segments Description

The Company's LED Products segment includes LED chips, LED components, and SiC wafers. The Company's Lighting Products segment consists of both LED and traditional lighting systems, with its primary focus on LED lighting. The Company's Power and RF Products segment includes power devices and RF devices.

Financial Results by Reportable Segment

The following table reflects the results of the Company's reportable segments as reviewed by the Chief Operating Decision Maker (CODM) for the three and six months ended December 30, 2012 and December 25, 2011. The Company's CODM is the Chief Executive Officer.

The Company uses substantially 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 revenue when evaluating segment performance and allocating resources to each segment. Thus, inter-segment revenue is not included in the segment revenues presented in the following table. 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 statement of income must be included to reconcile the consolidated gross profit presented in the following table to the Company's consolidated income before 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 sales. 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

Table of Contents

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 are not reviewed by the CODM when evaluating segment performance and allocating resources to each segment. These unallocated costs include variable compensation costs for manufacturing employees consisting primarily of stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans, matching contributions under the Company's 401(k) plan, and acquisition related costs.

	Three Months Ended		Six Months Ended	
	December 30, 2012	December 25, 2011	December 30, 2012	December 25, 2011
	(In thousands)			
Revenue				
LED Products	$200,962	$194,162	$388,509	$390,940
Lighting Products	122,714	95,736	230,787	147,409
Power and RF Products	22,610	14,220	42,743	34,749
Total Revenue	$346,286	$304,118	$662,039	$573,098
Gross Profit				
LED Products	$84,186	$70,302	$159,653	$148,062
Lighting Products	41,383	31,927	75,483	47,877
Power and RF Products	12,798	5,274	23,220	14,016
Total Segment Gross Profit	138,367	107,503	258,356	209,955
Unallocated Costs	(4,891)	(2,385)	(8,831)	(6,809)
Consolidated Gross Profit	$133,476	$105,118	$249,525	$203,146

Table of Contents

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

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

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 year ended June 24, 2012. Historical results and percentage relationships among any amounts in the financial statements are not necessarily indicative of trends in operating results for any future periods.

Overview

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

We develop and manufacture semiconductor materials and devices primarily based on silicon carbide (SiC), gallium nitride (GaN) and related compounds. In many cases the physical and electronic properties of SiC and GaN offer technical advantages over traditional silicon, gallium arsenide (GaAs) and other materials used for electronic and opto-electronic applications.

Our LED products consist of LED components, LED chips, and SiC wafers. As LED technology improves, we believe the potential market for LED lighting will continue to expand. Our success in selling LED products depends upon our ability to offer innovative products and our ability to enable our customers to develop and market LED based products that successfully compete and drive LED adoption against traditional lighting products.

Our lighting products consist of both LED and traditional lighting systems. We design, manufacture and sell lighting systems for indoor and outdoor applications, with our primary focus on LED lighting systems for the commercial and industrial markets.

In addition, we develop, manufacture and sell power and RF devices. Our power products are made from SiC and provide faster switching speeds than comparable silicon-based power devices for a given power level. Our RF devices are made from GaN and produce higher power densities as compared to silicon or gallium arsenide.

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

Reportable Segments

We have three reportable segments:

- LED Products
- Lighting Products

- Power and RF Products

20

Table of Contents

Reportable segments are components of an entity that have separate financial data that the entity's Chief Operating Decision Maker (CODM) regularly reviews when allocating resources and assessing performance. Our CODM is the Chief Executive Officer.

Industry Dynamics and Trends

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

- Overall Demand for Products and Applications using LEDs. Our potential for growth depends significantly on the adoption of LEDs within the general lighting market and our ability to affect this rate of adoption. Although LED lighting has grown in recent years, adoption of LEDs for general lighting is relatively new, still limited, and faces significant challenges before widespread adoption. Demand also fluctuates based on various market cycles, a continuously evolving LED industry supply chain, and demand dynamics in the market. These uncertainties make demand difficult to forecast for us and our customers.
- Intense and Constantly Evolving Competitive Environment. Competition in the LED and lighting industry is intense. Many companies have made significant investments in LED development and production equipment. Traditional lighting companies and new entrants are investing in LED based lighting products as LED adoption has gained momentum. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share, increase the utilization of their production capacity and open new applications to LED based solutions. To remain competitive, market participants must continuously increase product performance and reduce costs. To address these competitive pressures, we have invested in R&D activities to support new product development to deliver higher levels of performance and lower costs to differentiate our products in the market.
- Technological Innovation and Advancement. Innovations and advancements in LED technology continue to expand the potential commercial application of LEDs particularly in the general illumination market. However, new technologies or standards could emerge, or improvements could be made in existing technologies, that could reduce or limit the demand for LEDs in certain markets.
- Regulatory Actions Concerning Energy Efficiency. Many countries have already instituted or have announced plans to institute government regulations and programs designed to encourage or mandate increased energy efficiency, even in some cases banning forms of incandescent lighting, which are advancing the adoption of more energy efficient lighting solutions such as LEDs. While this trend is generally positive, these regulations are affected by changing political priorities which can modify or limit the effectiveness of these new regulations.
- 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 commonly occurs.

Financial Results of the Second Quarter Fiscal 2013

The following is a summary of our financial results for the three months ended December 30, 2012:

- Revenues increased to $346.3 million in the second quarter of fiscal 2013 from $315.8 million in the first quarter of fiscal 2013.
- Gross margins improved to 38.5% in the second quarter of fiscal 2013 from 36.8% in the first quarter of fiscal 2013.
- Operating income was $25.1 million in the second quarter of fiscal 2013 compared to $17.3 million in the first quarter of fiscal 2013. Net income per diluted share was $0.18 compared to $0.14 for the first quarter of fiscal 2013.
- Inventory increased to $185.0 million at December 30, 2012 compared to $179.7 million at September 23, 2012.
- We spent $17.8 million on purchases of property and equipment during the second quarter of fiscal 2013 compared to $12.6 million during the first quarter of fiscal 2013.
- Combined cash, cash equivalents and marketable investments increased to $885.8 million at December 30, 2012 compared to $816.3 million at September 23, 2012.

Table of Contents

Business Outlook

We project that the markets for our products will remain highly competitive during fiscal 2013. We are focusing on the following key areas, among others, in response to this competitive environment:

- Accelerate adoption of LED lighting. We continue to work to develop new LED lighting systems to increase the lumens per dollar, which brings LED lighting closer to price parity with conventional technology and reduces the payback time for the customer. We are focused on delivering best-in-class products for key lighting categories and expanding our sales channels to build the Cree brand and access more customers.
- Grow LED component sales through product innovation. We are working to leverage our SC^3 Technology™ next generation LED platform into a range of new LED component products that are targeted to deliver more lumens per dollar to the customer. We are also developing component and module products targeted to simplify our customers' product designs and reduce their time to market.
- Leverage technology leadership in Power and RF to open new applications for these products. In the power product line, we are working with our customers to combine our SiC MOSFET and Schottky diodes technology to enable power modules for solar, uninterruptable power supplies (UPS) and motor control applications. In the RF product line, we are developing GaN based products to access new applications.
- Translate product innovation into revenue and profit growth. We target incremental improvement from factory cost reductions, process improvements and lower cost new product designs.

Results of Operations

The following table sets forth certain consolidated statement of income data for the periods indicated:

	Three Months Ended						Six Months Ended					
	December 30, 2012			December 25, 2011			December 30, 2012			December 25, 2011		
(in thousands, except per share amounts and percentages)	Dollars	% of Revenue		Dollars	% of Revenue		Dollars	% of Revenue		Dollars	% of Revenue	
Revenue, net	$346,286	100	%	$304,118	100	%	$662,039	100	%	$573,098	100	%
Cost of revenue, net	212,810	61	%	199,000	65	%	412,514	62	%	369,952	65	%
Gross profit	133,476	39	%	105,118	35	%	249,525	38	%	203,146	35	%
Research and development	39,941	12	%	35,886	12	%	77,488	12	%	70,288	12	%
Sales, general and administrative	60,100	17	%	49,176	16	%	112,745	17	%	94,715	17	%
Amortization of acquisition-related intangibles	7,719	2	%	7,367	2	%	15,389	2	%	11,292	2	%
Loss on disposal or impairment of long-lived assets	624	—	%	497	—	%	1,522	—	%	1,272	—	%
Operating income	25,092	7	%	12,192	4	%	42,381	6	%	25,579	4	%
Other non-operating income (expense), net	535	—	%	(111)	—	%	2,128	—	%	863	—	%
Interest income, net	1,946	1	%	1,800	1	%	3,738	1	%	3,769	1	%
Income before income taxes	27,573	8	%	13,881	5	%	48,247	7	%	30,211	5	%
Income tax expense	7,170	2	%	1,803	1	%	11,721	2	%	5,314	1	%
Net income	20,403	6	%	12,078	4	%	36,526	6	%	24,897	4	%
Diluted earnings per share	$0.18			$0.10			$0.31			$0.22		

Our fiscal 2013 results include a nominal benefit of an additional week included in the three and six months periods ended December 30, 2012, as compared to the three and six month periods ended December 25, 2011.

Table of Contents

Revenues

Revenues for the three and six months ended December 30, 2012 and December 25, 2011 were comprised of the following (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 30, 2012	December 25, 2011	Change		December 30, 2012	December 25, 2011	Change	
LED Products	$200,962	$194,162	$6,800	4 %	$388,509	$390,940	$(2,431)	(1)%
Percent of revenue	58 %	64 %			59 %	68 %		
Lighting Products	122,714	95,736	26,978	28 %	230,787	147,409	83,378	57 %
Percent of revenue	35 %	31 %			35 %	26 %		
Power and RF Products	22,610	14,220	8,390	59 %	42,743	34,749	7,994	23 %
Percent of revenue	7 %	5 %			6 %	6 %		
Total revenue	$346,286	$304,118	$42,168	14 %	$662,039	$573,098	$88,941	16 %

Our consolidated revenue increased 14% to $346.3 million in the second quarter of fiscal 2013 from $304.1 million in the second quarter of fiscal 2012. This year-over-year increase is due primarily to higher sales across all three of our business segments, but driven primarily by strong sales in the Lighting Products segment. For the six months ended December 30, 2012, our consolidated revenue increased 16% to $662.0 million from $573.1 million for the six months ended December 25, 2011. This increase is due primarily to increased sales of our existing products as discussed above, and recognition of revenues from the Ruud Lighting acquisition for a full first quarter of fiscal year 2013.

LED Products Segment Revenue

LED Products revenue represents the largest portion of our revenue with approximately 58% and 64% of our total revenues for the second quarter of fiscal 2013 and fiscal 2012, respectively.

LED Products revenue increased approximately 4% to $201.0 million in the second quarter of fiscal 2013 from $194.2 million in the second quarter of fiscal 2012, and remained comparable on a year-to-date basis, decreasing approximately 1% to $388.5 million for the six months ended December 30, 2012 from $390.9 million for the six months ended December 25, 2011.

Changes in revenue are the result of an overall change in product mix. The average selling prices for our LED products decreased in fiscal 2013 compared to fiscal 2012, due primarily to market downward pricing pressure and sales of new lower cost products. The decline in selling prices was offset by the increase in the overall number of units sold, primarily from our newer products.

Lighting Products Segment Revenue

Lighting Products revenue represents approximately 35% and 31% of our total revenues for the second quarter of fiscal 2013 and fiscal 2012, respectively.

Lighting Products revenue increased on both quarter-to-date and year-to-date basis, improving by approximately 28% to $122.7 million in the second quarter of fiscal 2013 from $95.7 million in the second quarter of fiscal 2012, and approximately 57% to $230.8 million for the six months ended December 30, 2012 from $147.4 million for the six months ended December 25, 2011.

These increases were primarily due to higher sales of our indoor and outdoor LED lighting products, as well as recognizing a full quarter of sales in the first quarter of fiscal 2013 for products acquired from Ruud Lighting on a year-to-date basis. The volume of units sold increased in both quarter-to-date and year-to-date periods which was partially offset by a reduction in selling prices due to market downward pricing pressure and sales of new lower cost products.

Table of Contents

Power and RF Products Segment Revenue

Power and RF Products revenue represents approximately 7% and 5% of our total revenues for the second quarter of fiscal 2013 and fiscal 2012, respectively.

Power and RF Products revenue increased approximately 59% to $22.6 million in the second quarter of fiscal 2013 from $14.2 million in the second quarter of fiscal 2012, and approximately 23% to $42.7 million for the six months ended December 30, 2012 from $34.7 million for the six months ended December 25, 2011.

The increases in revenue are the result of higher sales of RF products in the second quarter of fiscal 2013 compared to the second quarter of fiscal 2012 when the Power and RF Products segment revenue was impacted by the delays for RF orders related to certain military programs and lower demand in the solar inverter market. The selling prices for our power and RF products decreased in the second quarter of fiscal 2013 compared to the second quarter of fiscal 2012 due to a change in product mix and targeted reductions in product pricing.

Unallocated Revenue

All of our revenue is allocated to our reportable segments. Our CODM does not review inter-segment revenue when evaluating performance and allocating resources to each segment, and inter-segment revenue is not included in the segment revenues presented above. As such, total segment revenue in the table above is equal to our consolidated revenue.

Gross Profit and Gross Margin

Gross profit and gross margin for the three and six months ended December 30, 2012 and December 25, 2011 were comprised of the following (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 30, 2012	December 25, 2011	Change		December 30, 2012	December 25, 2011	Change	
LED Products gross profit	$84,186	$ 70,302	$13,884	20 %	$159,653	$ 148,062	$11,591	8 %
LED Products gross margin	41.9 %	36.2 %			41.1 %	37.9 %		
Lighting Products gross profit	41,383	31,927	9,456	30 %	75,483	47,877	27,606	58 %
Lighting Products gross margin	33.7 %	33.3 %			32.7 %	32.5 %		
Power and RF Products gross profit	12,798	5,274	7,524	143 %	23,220	14,016	9,204	66 %
Power and RF Products gross margin	56.6 %	37.1 %			54.3 %	40.3 %		
Unallocated costs	(4,891)	(2,385)	(2,506)	105 %	(8,831)	(6,809)	(2,022)	30 %
Consolidated gross profit	$133,476	$ 105,118	$28,358	27 %	$249,525	$ 203,146	$46,379	23 %
Consolidated gross margin	39 %	35 %			38 %	35 %		

Our consolidated gross profit increased 27% to $133.5 million in the second quarter of fiscal 2013 from $105.1 million in the second quarter of fiscal 2012. Our consolidated gross margin increased to 39% in the second quarter of fiscal 2013 from 35% in the second quarter of fiscal 2012. These consolidated gross margin and gross profit increases were due to the increases realized by all our segments, as discussed further below. For the six months ended December 30, 2012, our consolidated gross profit increased 23% to $249.5 million from $203.1 million for the six months ended December 25, 2011. For the six months ended December 30, 2012, our consolidated gross margin increased to 38% from 35% for the six months ended December 25, 2011. These consolidated gross margin and profit increases were due to the increases realized by all our segments, as discussed further below.

LED Products Segment Gross Profit and Gross Margin

LED Products gross profit increased approximately 20% to $84.2 million in the second quarter of fiscal 2013 from $70.3 million in the second quarter of fiscal 2012 and LED Products gross margin increased to 41.9% in the second quarter of fiscal 2013 from 36.2% in the second quarter of fiscal 2012. For the six months ended December 30, 2012, LED Products gross profit increased approximately $11.6 million to $159.7 million from $148.1 million for the six months ended December 25, 2011, and increased to 41.1% for the six months ended December 30, 2012 from 37.9% for the six months ended December 25, 2011. LED Products gross profit and gross margin increased due to factory cost reductions, the introduction of new lower cost products and higher factory utilization. These benefits more than offset the decline in the average selling prices in fiscal 2013 as compared to fiscal 2012.

Table of Contents

Lighting Products Segment Gross Profit and Gross Margin

Lighting Products gross profit increased approximately 30% to $41.4 million in the second quarter of fiscal 2013 from $31.9 million in the second quarter of fiscal 2012, and increased approximately 58% to $75.5 million from $47.9 million for the six months ended December 25, 2011. Lighting Products gross margin increased to 33.7% in the second quarter of fiscal 2013 from 33.3% in the second quarter of fiscal 2012, and increased to 32.7% for the six months ended December 30, 2012 from 32.5% for the six months ended December 25, 2011. Lighting Products gross profit increased for both quarter-to-date and year-to-date due to higher overall revenues Gross margins increased, for both quarter-to-date and year-to-date periods, primarily due to higher overall revenues, product mix changes, factory cost reductions, the introduction of new lower cost products, higher factory utilization, and the inclusion of a full first quarter of Ruud Lighting sales in fiscal 2013.

Power and RF Products Segment Gross Profit and Gross Margin

Power and RF Products gross profit increased approximately 143% to $12.8 million in the second quarter of fiscal 2013 from $5.3 million in the second quarter of fiscal 2012, and increased approximately 66% to $23.2 million for the six months ended December 30, 2012 from $14.0 million for the six months ended December 25, 2011. Power and RF Products gross margin increased to 56.6% in the second quarter of fiscal 2013 from 37.1% in the second quarter of fiscal 2012, and increased to 54.3% for the six months ended December 30, 2012 from 40.3% for the six months ended December 25, 2011. These gross profit and gross margin increases are due primarily to higher revenues, factory cost reductions, increased factory utilization, and introduction of new lower cost products.

Unallocated Costs

Unallocated costs were $4.9 million and $2.4 million in the second quarter of fiscal 2013 and 2012, respectively. These costs consist primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under our 401(k) plan, and acquisition related costs. These costs are not allocated to the reportable segments' gross profit because our CODM does not review them regularly when evaluating segment performance and allocating resources. The increase of $2.5 million in the second quarter of fiscal 2013 is primarily attributable to higher incentive and stock-based compensation incurred as a result of improved business performance in fiscal 2013 as compared to fiscal 2012. For the six months ended December 30, 2012 and December 25, 2011, unallocated costs were $8.8 million and $6.8 million, respectively, increasing by $2.0 million for the reasons discussed above. For further information on the allocation of costs to segment gross profit, refer to Note 12, "Reportable Segments," in our consolidated financial statements included in Item 1 of this Quarterly Report.

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 consist primarily of employee salaries and related compensation costs, development materials, occupancy costs, consulting costs and the cost of development equipment and supplies.

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

	Three Months Ended				Six Months Ended			
	December 30, 2012	December 25, 2011	Change		December 30, 2012	December 25, 2011	Change	
Research and development	$39,941	$35,886	$4,055	11 %	$77,488	$70,288	$7,200	10 %
Percent of revenues	12 %	12 %			12 %	12 %		

Research and development expenses in the second quarter of fiscal 2013 increased 11% to $39.9 million from $35.9 million in the second quarter of fiscal