CREE INC
Form 10-Q
January 21, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)
[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 28, 2014
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 14, 2015, was 111,630,099.

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

	December 28, 2014 (unaudited)	June 29, 2014
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$199,960	$286,824
Short-term investments	629,965	875,642
Total cash, cash equivalents and short-term investments	829,925	1,162,466
Accounts receivable, net	218,960	225,160
Inventories	332,548	284,780
Deferred income taxes	30,150	29,414
Prepaid expenses and other current assets	76,312	72,071
Total current assets	1,487,895	1,773,891
Property and equipment, net	652,852	605,713
Goodwill	616,345	616,345
Intangible assets, net	327,725	336,423
Other long-term investments	79,089	—
Other assets	11,527	11,997
Total assets	$3,175,433	$3,344,369
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable, trade	$158,600	$202,294
Accrued salaries and wages	48,028	50,527
Income taxes payable	528	14,848
Other current liabilities	37,788	38,986
Total current liabilities	244,944	306,655
Long-term liabilities:		
Long-term debt	150,000	—
Deferred income taxes	14,277	12,173
Other long-term liabilities	26,668	35,395
Total long-term liabilities	190,945	47,568
Commitments and contingencies (Note 11)		
Shareholders’ equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 28, 2014 and June 29, 2014; none issued and outstanding	—	—
Common stock, par value $0.00125; 200,000 shares authorized at December 28, 2014 and June 29, 2014; 111,626 and 120,114 shares issued and outstanding at December 28, 2014 and June 29, 2014, respectively	138	149
Additional paid-in-capital	2,239,689	2,190,011
Accumulated other comprehensive income, net of taxes	8,192	11,405
Retained earnings	491,525	788,581
Total shareholders’ equity	2,739,544	2,990,146
Total liabilities and shareholders’ equity	$3,175,433	$3,344,369

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

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CREE, INC.
(UNAUDITED)
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(In thousands, except per share amounts)			
Revenue, net	$413,157	$415,086	$840,829	$806,092
Cost of revenue, net	276,378	259,308	568,230	499,557
Gross profit	136,779	155,778	272,599	306,535
Operating expenses:				
Research and development	46,989	44,436	93,714	86,179
Sales, general and administrative	72,375	67,943	142,067	132,221
Amortization or impairment of acquisition-related intangibles	6,495	7,256	12,994	14,543
Loss on disposal or impairment of long-lived assets	735	760	2,182	1,417
Total operating expenses	126,594	120,395	250,957	234,360
Operating income	10,185	35,383	21,642	72,175
Non-operating income, net	1,728	3,403	4,632	6,221
Income before income taxes	11,913	38,786	26,274	78,396
Income tax (benefit) expense	(238)	3,105	2,993	12,218
Net income	$12,151	$35,681	$23,281	$66,178
Earnings per share:				
Basic	$0.11	$0.30	$0.20	$0.55
Diluted	$0.10	$0.29	$0.20	$0.54
Weighted average shares used in per share calculation:				
Basic	115,264	120,932	117,435	120,248
Diluted	115,845	123,204	118,599	122,821

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

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

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
	(In thousands)			
Net income	$12,151	$35,681	$23,281	$66,178
Other comprehensive income:				
Currency translation (loss) gain	(735)	(125)	(1,902)	135
Net unrealized (loss) gain on available-for-sale securities, net of tax benefit (expense) of $489, ($283), $827 and ($1,065), respectively	(800)	447	(1,311)	1,710
Other comprehensive (loss) income	(1,535)	322	(3,213)	1,845
Comprehensive income	$10,616	$36,003	$20,068	$68,023

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

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

	Six Months Ended December 28, 2014	December 29, 2013
	(In thousands)	
Cash flows from operating activities:		
Net income	$23,281	$66,178
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	87,143	79,611
Stock-based compensation	33,196	30,250
Excess tax benefit from stock-based payment arrangements	(1,651)	(14,853)
Loss on disposal or impairment of long-lived assets	2,182	1,417
Amortization of premium/discount on investments	3,537	5,043
Gain on equity method investment	(679)	—
Foreign exchange loss on equity method investment	2,156	—
Changes in operating assets and liabilities:		
Accounts receivable, net	5,571	(21,029)
Inventories	(47,702)	(36,632)
Prepaid expenses and other assets	(5,457)	(6,148)
Accounts payable, trade	(44,784)	40,501
Accrued salaries and wages and other liabilities	(28,741)	23,649
Net cash provided by operating activities	28,052	167,987
Cash flows from investing activities:		
Purchases of property and equipment	(113,375)	(83,450)
Purchases of short-term investments	(195,892)	(346,799)
Proceeds from maturities of short-term investments	240,463	251,020
Proceeds from sale of property and equipment	60	94
Proceeds from sale of short-term investments	192,153	12,295
Purchases of patent and licensing rights	(9,604)	(10,046)
Purchase of other long-term investments	(80,566)	—
Net cash provided by (used in) investing activities	33,239	(176,886)
Cash flows from financing activities:		
Proceeds from long-term debt borrowings	265,000	—
Payments on long-term debt borrowings	(115,000)	—
Net proceeds from issuance of common stock	21,089	73,079
Excess tax benefit from stock-based payment arrangements	1,651	14,853
Repurchases of common stock	(320,349)	(107)
Net cash (used in) provided by financing activities	(147,609)	87,825
Effects of foreign exchange changes on cash and cash equivalents	(546)	393
Net (decrease) increase in cash and cash equivalents	(86,864)	79,319
Cash and cash equivalents:		
Beginning of period	286,824	190,069
End of period	$199,960	$269,388

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

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

Note 1 – Basis of Presentation and New Accounting Standards
Overview
Cree, Inc. (the Company) is a leading innovator of lighting-class light emitting diode (LED) products, lighting products and semiconductor products for power and radio-frequency (RF) applications. The Company's products are targeted for applications such as indoor and outdoor lighting, video displays, transportation, electronic signs and signals, power supplies, inverters and wireless systems.
The Company's LED products consist of LED components, LED chips and silicon carbide (SiC) materials. The Company's success in selling LED products depends upon its ability to offer innovative products and to enable its customers to develop and market LED-based products that successfully compete against other LED-based products and drive LED adoption against traditional lighting products.
The Company's lighting products primarily consist of LED lighting systems and bulbs. The Company designs, manufactures and sells lighting fixtures and lamps for the commercial, industrial and consumer markets.
In addition, the Company develops, manufactures and sells power and RF devices. The Company's power products are made from SiC and provide increased efficiency, faster switching speeds and reduced system size and weight over comparable silicon-based power devices. The Company's RF devices are made from gallium nitride (GaN) and provide improved efficiency, bandwidth and frequency of operation as compared to silicon or gallium arsenide (GaAs).
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, India 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:
- LED Products
- Lighting Products
- Power and RF Products

For financial results by reportable segment, please refer to Note 12, "Reportable Segments."
Basis of Presentation
The consolidated balance sheet at December 28, 2014, the consolidated statements of income for the three and six months ended December 28, 2014 and December 29, 2013, the consolidated statements of comprehensive income for the three and six months ended December 28, 2014 and December 29, 2013, and the consolidated statements of cash flows for the six months ended December 28, 2014 and December 29, 2013 (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 28, 2014, and for all periods presented, have been made. All intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 29, 2014 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 29, 2014 (fiscal 2014). The results of operations for the three and six months ended December 28, 2014 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 28, 2015 (fiscal 2015).

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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 2014 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2015 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders’ equity.

New Accounting Standards

Revenue from Contracts with Customers

In May 2014, the FASB issued Accounting Standards Update (ASU) No. 2014-09: Revenue from Contracts with Customers (Topic 606). The ASU establishes a principles-based approach for accounting for revenue arising from contracts with customers and supersedes existing revenue recognition guidance. The ASU provides that an entity should apply a five-step approach for recognizing revenue, including (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. Also, the entity must provide various disclosures concerning the nature, amount and timing of revenue and cash flows arising from contracts with customers. The effective date will be the first quarter of the Company's fiscal year ending June 24, 2018, using one of two retrospective application methods. The Company is currently analyzing the impact of this new accounting guidance.

Note 2 – Financial Statement Details

Accounts Receivable, net

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

	December 28, 2014	June 29, 2014
Billed trade receivables	$256,350	$255,374
Unbilled contract receivables	2,131	1,557
	258,481	256,931
Allowance for sales returns, discounts and other incentives	(35,869)	(29,010)
Allowance for bad debts	(3,652)	(2,761)
Accounts receivable, net	$218,960	$225,160

Inventories

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

	December 28, 2014	June 29, 2014
Raw material	$98,177	$95,594
Work-in-progress	114,378	92,889
Finished goods	119,993	96,297
Inventories	$332,548	$284,780

Other Current Liabilities

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

	December 28, 2014	June 29, 2014
Accrued taxes	$18,148	$19,835
Accrued professional fees	6,281	5,373
Accrued warranty	6,945	5,842
Accrued other	6,414	7,936
Other current liabilities	$37,788	$38,986

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Accumulated Other Comprehensive Income, net of taxes

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

	December 28, 2014	June 29, 2014
Currency translation gain	$6,647	$8,549
Net unrealized gain on available-for-sale securities	1,545	2,856
Accumulated other comprehensive income, net of taxes	$8,192	$11,405

Non-Operating Income, net

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

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Foreign currency (loss) gain, net	($2,365)	$213	($2,596)	$477
Gain on sale of investments, net	774	—	776	10
Gain on equity method investment	679	—	679	—
Interest income, net	2,586	2,806	5,618	5,147
Other, net	54	384	155	587
Non-operating income, net	$1,728	$3,403	$4,632	$6,221

Reclassifications Out of Accumulated Other Comprehensive Income, net of taxes

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

Accumulated Other Comprehensive Income Component	Amount Reclassified Out of Accumulated Other Comprehensive Income				Affected Line Item in the Consolidated Statements of Income
	Three Months Ended		Six Months Ended		
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013	
Net unrealized gain on available-for-sale securities, net of taxes	$774	$—	$776	$10	Non-operating income, net
	774	—	776	10	Income before income taxes
	(15)	—	88	2	Income tax (benefit) expense
	$789	$—	$688	$8	Net income

Note 3 – Investments

Investments consisted primarily of municipal bonds, corporate bonds, U.S. agency securities, non-U.S. certificates of deposit and non-U.S. government securities. All short-term investments are classified as available-for-sale. Other long-term investments consist of the Company's approximately 13% common stock ownership interest in Lextar Electronics Corporation, which was completed in December 2014. This investment is accounted for under the equity method utilizing the fair value option.

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

	December 28, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$183,806	$1,504	($154)	$185,156
Corporate bonds	160,346	1,537	(377)	161,506
U.S. agency securities	—	—	—	—
Non-U.S. certificates of deposit	283,303	—	—	283,303
Non-U.S. government securities	—	—	—	—
Total short-term investments	$627,455	$3,041	($531)	$629,965

	June 29, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$291,869	$2,323	($12)	$294,180
Corporate bonds	200,177	2,283	(114)	202,346
U.S. agency securities	18,994	141	—	19,135
Non-U.S. certificates of deposit	352,928	—	—	352,928
Non-U.S. government securities	7,025	28	—	7,053
Total short-term investments	$870,993	$4,775	($126)	$875,642

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

	December 28, 2014					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$35,417	($154)	$—	$—	$35,417	($154)
Corporate bonds	58,229	(341)	2,212	(36)	60,441	(377)
Total	$93,646	($495)	$2,212	($36)	$95,858	($531)
Number of securities with an unrealized loss		47		1		48

	June 29, 2014					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$7,906	($8)	$1,520	($4)	$9,426	($12)
Corporate bonds	15,696	(31)	13,049	(83)	28,745	(114)
Total	$23,602	($39)	$14,569	($87)	$38,171	($126)
Number of securities with an unrealized loss		13		7		20

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains and losses from the sale of investments are included in Non-operating income, net in the Consolidated Statements of Income 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.

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The Company evaluates its investments for possible impairment or a decline in fair value below cost basis that is deemed to be other-than-temporary on a periodic basis. It considers such factors as the length of time and extent to which the fair value has been below the cost basis, the financial condition of the investee, and its ability and intent to hold the investment for a period of time that may be sufficient for an anticipated full recovery in market value. Accordingly, the Company considered declines in its investments to be temporary in nature, and did not consider its securities to be impaired as of December 28, 2014 and June 29, 2014.

The contractual maturities of short-term investments as of December 28, 2014 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	$23,593	$127,148	$34,415	$—	$185,156
Corporate bonds	22,435	106,525	32,546	—	161,506
Non-U.S. certificates of deposit	283,303	—	—	—	283,303
Total short-term investments	$329,331	$233,673	$66,961	$—	$629,965

Note 4 – Fair Value of Financial Instruments

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

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

The financial assets for which the Company performs recurring fair value remeasurements are cash equivalents, short-term investments and long-term investments. As of December 28, 2014, financial assets utilizing Level 1 inputs included money market funds, and financial assets utilizing Level 2 inputs included municipal bonds, corporate bonds, U.S. agency securities, non-U.S. certificates of deposit, non-U.S. government securities and common stock of non-U.S. corporations. Level 2 assets are valued using a third-party pricing service's consensus price, which is a weighted average price based on multiple sources. These sources determine prices utilizing market income models which factor in, where applicable, transactions of similar assets in active markets, transactions of identical assets in infrequent markets, interest rates, bond or credit default swap spreads and volatility. The Company did not have any financial assets requiring the use of Level 3 inputs as of December 28, 2014. There were no transfers between Level 1 and Level 2 during the six months ended December 28, 2014.

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

	December 28, 2014				June 29, 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Non-U.S. certificates of deposit	$—	$156	$—	$156	$—	$—	$—	$—
Money market funds	4,455	—	—	4,455	40,031	—	—	40,031
Total cash equivalents	4,455	156	—	4,611	40,031	—	—	40,031
Short-term investments:								
Municipal bonds	—	185,156	—	185,156	—	294,180	—	294,180
Corporate bonds	—	161,506	—	161,506	—	202,346	—	202,346
U.S. agency securities	—	—	—	—	—	19,135	—	19,135
Non-U.S. certificates of deposit	—	283,303	—	283,303	—	352,928	—	352,928
Non-U.S. government securities	—	—	—	—	—	7,053	—	7,053
Total short-term investments	—	629,965	—	629,965	—	875,642	—	875,642
Other long-term investments:								
Common stock of non-U.S. corporations	—	79,089	—	79,089	—	—	—	—
Total other long-term investments	—	79,089	—	79,089	—	—	—	—
Total assets	$4,455	$709,210	$—	$713,665	$40,031	$875,642	$—	$915,673

Note 5 – Intangible Assets

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

	December 28, 2014			June 29, 2014		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets with finite lives:						
Customer relationships	$137,440	($69,659)	$67,781	$137,440	($66,970)	$70,470
Developed technology	162,760	(82,242)	80,518	162,760	(72,921)	89,839
Non-compete agreements	10,244	(6,977)	3,267	10,244	(5,997)	4,247
Trade names, finite-lived	520	(520)	—	520	(516)	4
Patent and licensing rights	143,342	(46,863)	96,479	134,607	(42,424)	92,183
Total intangible assets with finite lives	454,306	(206,261)	248,045	445,571	(188,828)	256,743
Trade names, indefinite-lived	79,680		79,680	79,680		79,680
Total intangible assets	$533,986	($206,261)	$327,725	$525,251	($188,828)	$336,423

For the three and six months ended December 28, 2014, total amortization of finite-lived intangible assets was $9.0 million and $17.9 million, respectively. For the three and six months ended December 29, 2013, total amortization of finite-lived intangible assets was $9.4 million and $18.8 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 28, 2015 (remainder of fiscal 2015)	$17,562
June 26, 2016	34,921
June 25, 2017	32,910
June 24, 2018	31,718
June 30, 2019	19,150
Thereafter	111,784
Total future amortization expense	$248,045

Note 6 – Long-term Debt

As of December 28, 2014, the Company had a $150 million unsecured revolving line of credit under which the Company could borrow, repay and reborrow loans from time to time prior to its scheduled maturity date of August 12, 2017. This line of credit was repaid on January 9, 2015 when the Company entered into a new $500 million credit agreement with Wells Fargo Bank, National Association (Wells Fargo Bank) and a syndication of financial institutions. See Note 13, “Subsequent Event” for a description of the new credit agreement.

The Company classifies balances outstanding under its line of credit as Long-term debt in the Consolidated Balance Sheets. At December 28, 2014, the Company had $150 million outstanding under the line of credit and nothing available for borrowing. The average interest rate was 0.86% for the three and six months ended December 28, 2014. The average commitment fee percentage was 0.08% for the three and six months ended December 28, 2014. The Company was in compliance with all covenants in the line of credit at December 28, 2014.

Note 7 – Shareholders’ Equity

As of December 28, 2014, pursuant to an approval by the Board of Directors to an increase in the amount of the stock repurchase program, the Company is authorized to repurchase shares of its common stock having an aggregate purchase price not exceeding $550 million for all purchases from June 30, 2014 through the expiration of the program on June 28, 2015. During the six months ended December 28, 2014, the Company repurchased 9.3 million shares of common stock for $320.3 million under the stock repurchase program.

Note 8 – Earnings Per Share

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

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Net income	$12,151	$35,681	$23,281	$66,178
Weighted average common shares	115,264	120,932	117,435	120,248
Basic earnings per share	$0.11	$0.30	$0.20	$0.55

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

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Net income	$12,151	$35,681	$23,281	$66,178
Weighted average common shares - basic	115,264	120,932	117,435	120,248
Dilutive effect of stock options, nonvested shares and Employee Stock Purchase Plan purchase rights	581	2,272	1,164	2,573
Weighted average common shares - diluted	115,845	123,204	118,599	122,821
Diluted earnings per share	$0.10	$0.29	$0.20	$0.54

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be anti-dilutive and as such, these shares are not included in calculating diluted earnings per share. For the three and six months ended December 28, 2014, there were 8.6 million and 6.5 million, respectively, of potential common shares not included in the calculation of diluted earnings per share because their effect was anti-dilutive. For the three and six months ended December 29, 2013, there were 3.1 million and 2.1 million, respectively, of potential common shares not included in the calculation of diluted earnings per share because their effect was anti-dilutive.

Note 9 – 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 options, restricted stock and restricted stock units are currently outstanding.

Prior to fiscal 2013, the Company's stock-based awards had been service-based only. Beginning in fiscal 2013, the Company began issuing grants of awards that also contain performance-based conditions. 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 originally allowed 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 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 in April and October, employees participating in the plan 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 amendment 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 option activity as of December 28, 2014 and changes during the six months then ended (numbers of shares in thousands):

	Number of Shares	Weighted Average Exercise Price
Outstanding at June 29, 2014	8,922	$41.85
Granted	3,294	$44.93
Exercised	(477)	$29.15
Forfeited or expired	(362)	$47.99
Outstanding at December 28, 2014	11,377	$43.08

Restricted Stock Awards and Units

A summary of nonvested restricted stock awards (RSAs) and restricted stock unit awards (RSUs) outstanding as of December 28, 2014, and changes during the six months then ended is as follows (numbers of awards and units in thousands):

	Number of RSAs/RSUs	Weighted Average Grant-Date Fair Value
Nonvested at June 29, 2014	860	$46.81
Granted	433	$44.94
Vested	(347)	$46.15
Forfeited	(38)	$48.62
Nonvested at December 28, 2014	908	$46.09

Stock-Based Compensation Valuation and Expense

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

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

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

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

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

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Income Statement Classification:				
Cost of revenue, net	$3,448	$2,849	$6,353	$5,228
Research and development	4,112	3,829	8,583	7,541
Sales, general and administrative	8,876	8,994	18,260	17,481
Total stock-based compensation expense	$16,436	$15,672	$33,196	$30,250

Note 10 – Income Taxes

The variation between the Company's effective income tax rate and the U.S. statutory rate of 35% 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. A change in the mix of pretax income of the Company's various tax jurisdictions can have a material impact on the Company's periodic effective tax rate.

The research and development credit, which had previously expired on December 31, 2013, was reinstated as part of the Tax Increase Prevention Act of 2014, enacted on December 19, 2014. This legislation retroactively reinstated and extended the credit from the previous expiration date through December 31, 2014. The Company recognized a $1.9 million benefit for this credit in the three months ended December 28, 2014.

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

As of June 29, 2014, the Company's liability for unrecognized tax benefits was $18.4 million. During the six months ended December 28, 2014, there was a $0.2 million decrease to the amount of unrecognized tax benefits following statute expirations. As a result, the total liability for unrecognized tax benefits as of December 28, 2014 was $18.2 million. If any portion of this $18.2 million is recognized, the Company will then include that portion in the computation of its effective tax rate. Although the ultimate timing of the resolution and/or closure of audits is highly uncertain, the Company believes it is reasonably possible that an immaterial amount of gross unrecognized tax benefits will change in the next 12 months.

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 2012. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2010. For foreign purposes, the Company is generally no longer subject to tax examinations for tax periods 2004 and prior. Certain carryforward tax attributes generated in prior years remain subject to examination and adjustment. During the second quarter of fiscal 2015, the Company settled its examination with the French Tax Administration for the fiscal year ended June 26, 2011 (fiscal 2011) through the fiscal year ended June 29, 2014 (fiscal 2014), resulting in no additional tax expense.

Note 11 – Commitments and Contingencies

Warranties

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

Balance at June 29, 2014	$6,822	
Warranties accrued in current period	4,086	
Expenditures	(3,086	)
Balance at December 28, 2014	$7,822	

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 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,

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and assumptions about the frequency of product failures derived from quality testing, field monitoring and the Company's reliability estimates. As of December 28, 2014, $0.9 million of the Company's product warranty liabilities were classified as long-term.

Litigation

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

Note 12 – Reportable Segments

The Company's operating and reportable segments are:

- LED Products
- Lighting Products
- Power and RF Products

Reportable Segments Description

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

Financial Results by Reportable Segment

The table below reflects the results of the Company's reportable segments as reviewed by the Chief Operating Decision Maker (CODM) for the three and six months ended December 28, 2014 and December 29, 2013. The Company's CODM is the Chief Executive Officer. The Company used the same accounting policies to derive the segment results reported below as those used in the Company's consolidated financial statements.

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

The Company's CODM reviews gross profit as the lowest and only level of segment profit. As such, all items below gross profit in the Consolidated Statements of Income must be included to reconcile the consolidated gross profit presented in the table below to the Company's consolidated income 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, profit sharing and quarterly or annual incentive compensation and matching contributions under the Company’s 401(k) plan. These costs were not allocated to the reportable segments’ gross profit because the Company’s CODM does not review them regularly when evaluating segment performance and allocating resources.

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Revenue, gross profit and gross margin for each of the Company's segments were as follows (in thousands, except percentages):

	Three Months Ended		Six Months Ended	
	December 28, 2014	December 29, 2013	December 28, 2014	December 29, 2013
Revenue:				
LED Products revenue	$151,877	$215,022	$325,467	$433,045
Lighting Products revenue	230,168	173,656	453,254	321,574
Power and RF Products revenue	31,112	26,408	62,108	51,473
Total revenue	$413,157	$415,086	$840,829	$806,092
Gross Profit and Gross Margin:				
LED Products gross profit	$59,424	$97,644	$127,048	$199,297
LED Products gross margin	39.1 %	45.4 %	39.0 %	46.0 %
Lighting Products gross profit	64,701	48,426	120,293	88,244
Lighting Products gross margin	28.1 %	27.9 %	26.5 %	27.4 %
Power and RF Products gross profit	17,260	15,321	35,117	28,777
Power and RF Products gross margin	55.5 %	58.0 %	56.5 %	55.9 %
Total segment gross profit	141,385	161,391	282,458	316,318
Unallocated costs	(4,606)	(5,613)	(9,859)	(9,783)
Consolidated gross profit	$136,779	$155,778	$272,599	$306,535
Consolidated gross margin	33.1 %	37.5 %	32.4 %	38.0 %

Assets by Reportable Segment

Inventories are the only assets reviewed by the Company's CODM when evaluating segment performance and allocating resources to the segments. The CODM reviews all of the Company's assets other than inventories on a consolidated basis.

Unallocated inventories in the table below were not allocated to the reportable segments because the Company’s CODM does not review them when evaluating performance and allocating resources to each segment. Unallocated inventories consisted primarily of manufacturing employees’ stock-based compensation, profit sharing and quarterly or annual incentive compensation and matching contributions under the Company’s 401(k) plan.

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

	December 28, 2014	June 29, 2014
LED Products	$135,456	$123,249
Lighting Products	181,848	148,757
Power and RF Products	10,190	8,019
Total segment inventories	327,494	280,025
Unallocated inventories	5,054	4,755
Consolidated inventories	$332,548	$284,780

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Note 13 – Subsequent Event

Credit Agreement with Wells Fargo Bank

On January 9, 2015, the Company entered into a new credit agreement (New Credit Agreement) with Wells Fargo Bank as administrative agent and lender, E-conolight LLC, a domestic subsidiary of the Company, as guarantor, and the other lenders party thereto.

The New Credit Agreement provides for a $500 million revolving line of credit, under which the Company may borrow, repay and reborrow loans from time to time prior to its scheduled maturity date of January 9, 2020 (Maturity Date). The obligations of the Company under the New Credit Agreement are collateralized by 65% of the equity interests of the first-tier foreign subsidiaries of the Company. Proceeds of the initial loans made under the New Credit Agreement were used to repay amounts outstanding under the Company's previous credit agreement with Wells Fargo Bank, and proceeds of any additional loans may be used for working capital, capital expenditures, acquisitions and other general corporate purposes. The Company may prepay the loans under the New Credit Agreement in whole or in part at any time without premium or penalty, subject to customary breakage costs. The Company's existing and future material domestic subsidiaries are required to guarantee its obligations under the New Credit Agreement.

The loans bear interest, at the Company's option, at either a London Interbank Offered Rate (LIBOR) rate for a period of one, two, three or six months as elected by the Company (or twelve months if elected by the Company and agreed by all relevant lenders) and as determined in accordance with the New Credit Agreement, plus a spread of 0.80% to 1.50% (depending on a ratio of funded debt to Earnings Before Interest Taxes Depreciation and Amortization (EBITDA) as determined in accordance with the New Credit Agreement), or at a base rate equal to the prime rate announced by the administrative agent from time to time (or, if higher either the Federal Funds Rate plus 0.50% or the one month LIBOR rate plus 1.0%), plus a spread of 0.0% to 0.50% (depending on a ratio of funded debt to EBITDA as determined in accordance with the New Credit Agreement). Principal, together with all accrued and unpaid interest, is due and payable on the Maturity Date. The default rate under the New Credit Agreement is an additional 2.0% per annum over the otherwise applicable rate.

The Company is also obligated to pay a quarterly fee, payable in arrears, based on the daily unused amount of the line of credit at a rate of 0.09% to 0.20%, with such rate determined based on the ratio described above.

The New Credit Agreement contains customary affirmative and negative covenants, including the required compliance with financial covenants described below, as well as customary events of default. The New Credit Agreement requires the Company to maintain a ratio of consolidated funded indebtedness to EBITDA equal to or less than 3.00 to 1.00, and a ratio of consolidated EBITDA to interest expense greater than or equal to 3.00 to 1.00, in each case determined in accordance with the New Credit Agreement.

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

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

Executive Summary

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual

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Report on Form 10-K for the fiscal year ended June 29, 2014. 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.

Our LED products consist of LED components, LED chips and silicon carbide (SiC) materials. Our success in selling LED products depends upon our ability to offer innovative products and to enable our customers to develop and market LED-based products that successfully compete against other LED-based products and drive LED adoption against traditional lighting products.

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

In addition, we develop, manufacture and sell power and RF devices. Our power products are made from SiC and provide increased efficiency, faster switching speeds and reduced system size and weight over comparable silicon-based power devices. Our RF devices are made from gallium nitride (GaN) and provide improved efficiency, bandwidth and frequency of operation as compared to silicon or gallium arsenide (GaAs).

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 (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:

- LED Products
- Lighting Products
- Power and RF Products

For further information about our reportable segments, please refer to Note 12, "Reportable Segments," in our consolidated financial statements included in Item 1 of this Quarterly Report.

Industry Dynamics and Trends

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

- Overall Demand for Products and Applications using LEDs. Our potential for growth depends significantly on the adoption of LEDs within the general lighting market and our ability to affect this rate of adoption. Although the market for LED lighting has grown in recent years, adoption of LEDs for general lighting is still relatively low and faces 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. Traditional lighting companies have taken steps to try and limit access to their sales channels, including lighting agents and distributors. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share, increase the utilization of their production capacity and open new applications to LED-based solutions. To remain competitive, market participants must continuously increase product performance and reduce costs. To address these competitive pressures, we have invested in research and development activities to support new product development and to deliver higher levels of performance and lower costs to

differentiate our products in the market.

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- Technological Innovation and Advancement. Innovations and advancements in LED, power and RF technologies continue to expand the potential commercial application for our products, particularly in the general illumination, power electronics and wireless markets. 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.
- Regulatory Standards Concerning Energy Efficiency. Government agencies are involved in setting standards for energy efficient lighting, which can affect market acceptance and the availability of rebates from government agencies or third parties such as utilities. While this trend is generally positive, these regulations are affected by changing political priorities and evolving technical standards 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 is common.

Overview of the Six Months Ended December 28, 2014

The following is a summary of our financial results for the six months ended December 28, 2014:

- Revenue increased to $841 million for the six months ended December 28, 2014 from $806 million for the six months ended December 29, 2013.
- Gross profit decreased to $273 million for the six months ended December 28, 2014 from $307 million for the six months ended December 29, 2013. Gross margin declined to 32% for the six months ended December 28, 2014 from 38% for the six months ended December 29, 2013.
- Operating income decreased to $22 million for the six months ended December 28, 2014 from $72 million for the six months ended December 29, 2013. Net income per diluted share decreased to $0.20 for the six months ended December 28, 2014 from $0.54 for the six months ended December 29, 2013.
- Cash, cash equivalents and short-term investments decreased to $0.8 billion at December 28, 2014 compared to $1.2 billion at June 29, 2014. Cash provided by operating activities was $28 million for the six months ended December 28, 2014, compared to $168 million for the six months ended December 29, 2013.
- Inventories increased to $333 million at December 28, 2014 compared to $285 million at June 29, 2014.
- Purchases of property and equipment were $113 million for the six months ended December 28, 2014 compared to $83 million for the six months ended December 29, 2013.

Business Outlook

We project that the markets for our products will remain highly competitive during fiscal 2015. We anticipate focusing on the following key areas, among others, in response to this competitive environment:

- Build financial momentum. We target generating incremental operating margin over time through revenue growth and incremental operating leverage across the business. In fiscal 2015, we target revenue growth in Lighting Products and Power and RF Products, while LED Products revenue is currently targeted to be lower for the fiscal year. We have developed a new LED technology platform that is targeted to drive new design wins for our market leading high power LED products later in fiscal 2015. As a result, we currently target incremental operating leverage from higher revenues in the second half of fiscal 2015 as compared with the first half of fiscal 2015.

- Drive innovation to lower upfront customer cost and further improve payback. The LED lighting market has been enabled with tremendous innovation over the last decade with technology improvements in LEDs and LED lighting systems. We believe we can further accelerate LED lighting adoption by continuing to innovate in LEDs and LED lighting systems to lower the upfront cost and make the payback even more compelling. The approach also applies to our Power and RF product lines, where today our technology has tremendous technical benefits but a higher upfront cost. We are focused on developing the next generation devices that improve payback and expand the market for these products.

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- Drive LED lighting growth and build the Cree brand. We target growth in both the LED fixture and LED bulb product lines, driven by the new products we released over the last year and continued innovation in the year ahead. We plan to continue to drive awareness of the Cree brand and LED lighting in both the consumer and commercial markets.

- Expand our work with third party manufacturers to enable growth in LEDs and LED Lighting. We work with third party manufacturers for the production of LEDs and LED lighting products. Our internal team is focused primarily on the high-performance, high-power LEDs that differentiate Cree in the market. We work with external manufacturers on mid-power LEDs. As demand increases for LED lighting and LEDs, we plan to expand production at both our manufacturing partners and our own factories over time to support our targeted growth, optimize our factory utilization and focus our capital spending on higher value products.

Results of Operations

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

	Three Months Ended						Six Months Ended					
	December 28, 2014			December 29, 2013			December 28, 2014			December 29, 2013		
	Dollars	% of Revenue		Dollars	% of Revenue		Dollars	% of Revenue		Dollars	% of Revenue	
Revenue, net	$413,157	100	%	$415,086	100	%	$840,829	100	%	$806,092	100	%
Cost of revenue, net	276,378	67	%	259,308	62	%	568,230	68	%	499,557	62	%
Gross profit	136,779	33	%	155,778	38	%	272,599	32	%	306,535	38	%
Research and development	46,989	11	%	44,436	11	%	93,714	11	%	86,179	11	%
Sales, general and administrative	72,375	18	%	67,943	16	%	142,067	17	%	132,221	16	%
Amortization or impairment of acquisition-related intangibles	6,495	2	%	7,256	2	%	12,994	2	%	14,543	2	%
Loss on disposal or impairment of long-lived assets	735	—	%	760	—	%	2,182	—	%	1,417	—	%
Operating income	10,185	2	%	35,383	9	%	21,642	3	%	72,175	9	%
Non-operating income, net	1,728	—	%	3,403	1	%	4,632	1	%	6,221	1	%
Income before income taxes	11,913	3	%	38,786	9	%	26,274	3	%	78,396	10	%
Income tax (benefit) expense	(238)	—	%	3,105	1	%	2,993	—	%	12,218	2	%
Net income	$12,151	3	%	$35,681	9	%	$23,281	3	%	$66,178	8	%
Basic earnings per share	$0.11			$0.30			$0.20			$0.55		
Diluted earnings per share	$0.10			$0.29			$0.20			$0.54		

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Revenue

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
LED Products revenue	$151,877	$215,022	($63,145)	(29)%	$325,467	$433,045	($107,578)	(25)%
Percent of revenue	37%	52%			39%	54%		
Lighting Products revenue	230,168	173,656	56,512	33%	453,254	321,574	131,680	41%
Percent of revenue	56%	42%			54%	40%		
Power and RF Products revenue	31,112	26,408	4,704	18%	62,108	51,473	10,635	21%
Percent of revenue	7%	6%			7%	6%		
Total revenue	$413,157	$415,086	($1,929)	—%	$840,829	$806,092	$34,737	4%

Our consolidated revenue decreased to $413.2 million for the three months ended December 28, 2014 from $415.1 million for the three months ended December 29, 2013. This decrease was driven by the 29% decrease in LED Products revenue that was mostly offset by the 33% increase in Lighting Products and the 18% increase in Power and RF Products revenue. For the six months ended December 28, 2014, our consolidated revenue increased 4% to $840.8 million from $806.1 million for the six months ended December 29, 2013. This increase was driven by the 41% increase in Lighting Products revenue and the 21% increase in Power and RF Products revenue, partially offset by the 25% decrease in LED Products revenue.

LED Products Segment Revenue

LED Products revenue represented 37% and 52% of our total revenue for the three months ended December 28, 2014 and December 29, 2013, respectively.

LED Products revenue decreased 29% to $151.9 million for the three months ended December 28, 2014 from $215.0 million for the three months ended December 29, 2013 and 25% to $325.5 million for the six months ended December 28, 2014 from $433.0 million for the six months ended December 29, 2013. These decreases were the result of an overall decrease in the number of units sold and lower pricing, due to weaker global demand for LED Products.

Lighting Products Segment Revenue

Lighting Products revenue represented approximately 56% and 42% of our total revenue for the three months ended December 28, 2014 and December 29, 2013, respectively.

Lighting Products revenue increased 33% to $230.2 million for the three months ended December 28, 2014 from $173.7 million for the three months ended December 29, 2013. This increase was the result of an overall increase in the number of units sold.

Lighting Products revenue increased 41% to $453.3 million for the six months ended December 28, 2014 from $321.6 million for the six months ended December 29, 2013. This increase was the result of an overall increase in the number of units sold, partially offset by a reduction in average selling prices (ASP) primarily due to a higher mix of lower priced LED bulb products.

Power and RF Products Segment Revenue

Power and RF Products revenue represented approximately 7% and 6% of our total revenue for the three months ended December 28, 2014 and December 29, 2013, respectively.

Power and RF Products revenue increased 18% to $31.1 million for the three months ended December 28, 2014 from $26.4 million for the three months ended December 29, 2013 and 21% to $62.1 million for the six months ended December 28, 2014 from $51.5 million for the six months ended December 29, 2013. These increases were primarily the result of an overall increase in the number of units sold.

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Gross Profit and Gross Margin

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
LED Products gross profit	$59,424	$97,644	($38,220)	(39)%	$127,048	$199,297	($72,249)	(36)%
LED Products gross margin	39.1%	45.4%			39.0%	46.0%		
Lighting Products gross profit	64,701	48,426	16,275	34%	120,293	88,244	32,049	36%
Lighting Products gross margin	28.1%	27.9%			26.5%	27.4%		
Power and RF Products gross profit	17,260	15,321	1,939	13%	35,117	28,777	6,340	22%
Power and RF Products gross margin	55.5%	58.0%			56.5%	55.9%		
Unallocated costs	(4,606)	(5,613)	1,007	(18)%	(9,859)	(9,783)	(76)	1%
Consolidated gross profit	$136,779	$155,778	($18,999)	(12)%	$272,599	$306,535	($33,936)	(11)%
Consolidated gross margin	33.1%	37.5%			32.4%	38.0%		

Our consolidated gross profit decreased 12% to $136.8 million for the three months ended December 28, 2014 from $155.8 million for the three months ended December 29, 2013. Our consolidated gross margin decreased to 33.1% for the three months ended December 28, 2014 from 37.5% for the three months ended December 29, 2013. Our consolidated gross profit decreased 11% to $272.6 million for the six months ended December 28, 2014 from $306.5 million for the six months ended December 29, 2013. Our consolidated gross margin decreased to 32.4% for the six months ended December 28, 2014 from 38.0% for the six months ended December 29, 2013.

LED Products Segment Gross Profit and Gross Margin

LED Products gross profit decreased 39% to $59.4 million for the three months ended December 28, 2014 from $97.6 million for the three months ended December 29, 2013 and decreased 36% to $127.0 million for the six months ended December 28, 2014 from $199.3 million for the six months ended December 29, 2013. LED Products gross margin decreased to 39.1% for the three months ended December