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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FORM 10-Q
For the Quarterly Period Ended December 28, 2014
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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 December 28, 2014			December 29, 2013			Six Months Ended 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 28, 2014 from 45.4% for the three months ended December 29, 2013 and decreased to 39.0% for the six months ended December 28, 2014 from 46.0% for the six months ended December 29, 2013. LED Products gross profit and gross margin decreases were due to lower units sold and lower pricing, as a result of weaker global demand for the three and six months ended December 28, 2014 as compared to the three and six months ended December 29, 2013.

Lighting Products Segment Gross Profit and Gross Margin

Lighting Products gross profit increased 34% to $64.7 million for the three months ended December 28, 2014 from $48.4 million for the three months ended December 29, 2013 and increased 36% to $120.3 million for the six months ended December 28, 2014 from $88.2 million for the six months ended December 29, 2013. Lighting Products gross margin increased to 28.1% for the three months ended December 28, 2014 from 27.9% for the three months ended December 29, 2013 and decreased to 26.5% for the six months ended December 28, 2014 from 27.4% for the six months ended December 29, 2013. Lighting Products gross profit increased for the three and six months ended December 28, 2014 as compared to the three and six months ended December 29, 2013 due to growth in LED lighting products sales. Lighting Products gross margin decreased for the six months ended December 28, 2014 as compared to the six months ended December 29, 2013 due to changes in product mix driven primarily by higher sales of LED bulbs, which have lower gross margins.

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Power and RF Products Segment Gross Profit and Gross Margin

Power and RF Products gross profit increased 13% to $17.3 million for the three months ended December 28, 2014 from $15.3 million for the three months ended December 29, 2013 and increased 22% to $35.1 million for the six months ended December 28, 2014 from $28.8 million for the six months ended December 29, 2013. Power and RF Products gross margin decreased to 55.5% for the three months ended December 28, 2014 from 58.0% for the three months ended December 29, 2013 and increased to 56.5% for the six months ended December 28, 2014 from 55.9% for the six months ended December 29, 2013. Power and RF Products gross profit increases were due primarily to higher revenue. Power and RF Products gross margin decreased for the three months ended December 28, 2014 as compared to the three months ended December 29, 2013 due primarily to product mix. Power and RF Products gross margin increased for the six months ended December 28, 2014 as compared to the six months ended December 29, 2013 due primarily to changes in product mix and increased factory utilization.

Unallocated Costs

Unallocated costs were $4.6 million and $5.6 million for the three months ended December 28, 2014 and December 29, 2013, respectively. For the six months ended December 28, 2014 and December 29, 2013, unallocated costs were $9.9 million and $9.8 million, respectively. These costs consisted primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under our 401(k) plan. These costs were not allocated to the reportable segments' gross profit because our CODM does not review them regularly when evaluating segment performance and allocating resources. The decrease of $1.0 million for the three months ended December 28, 2014 as compared to the three months ended December 29, 2013 was primarily attributable to lower incentive compensation, partially offset by higher stock-based compensation.

Research and Development

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

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Research and development	$46,989	$44,436	$2,553	6 %	$93,714	$86,179	$7,535	9 %
Percent of revenue	11 %	11 %			11 %	11 %		

Research and development expenses for the three months ended December 28, 2014 increased 6% to $47.0 million from $44.4 million for the three months ended December 29, 2013. For the six months ended December 28, 2014, research and development expenses increased 9% to $93.7 million from $86.2 million for the six months ended December 29, 2013. These increases were primarily due to increased spending on research and development activities focused on new higher performance and lower cost products in all our product lines. Our research and development expenses vary significantly from quarter to quarter based on a number of factors, including the timing of new product introductions and the number and nature of our ongoing research and development activities. We anticipate that in general our research and development expenses will continue to increase over time to support future growth.

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Sales, General and Administrative

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Sales, general and administrative	$72,375	$67,943	$4,432	7 %	$142,067	$132,221	$9,846	7 %
Percent of revenue	18 %	16 %			17 %	16 %		

Sales, general and administrative expenses for the three months ended December 28, 2014 increased 7% to $72.4 million from $67.9 million for the three months ended December 29, 2013. For the six months ended December 28, 2014, sales, general and administrative expenses increased 7% to $142.1 million from $132.2 million for the six months ended December 29, 2013. These increases were primarily due to an increase in spending on sales and marketing for lighting products, including commissions and advertising, as we continue to expand our direct sales resources and channels and invest in building and promoting the Cree brand.

Amortization or Impairment of Acquisition-Related Intangibles

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Customer relationships	$1,345	$1,840	($495)	(27)%	$2,689	$3,679	($990)	(27)%
Developed technology	4,660	4,920	(260)	(5)%	9,321	9,872	(551)	(6)%
Non-compete agreements	490	490	—	— %	980	980	—	— %
Trade names, finite-lived	—	6	(6)	(100)%	4	12	(8)	(67)%
Total amortization	$6,495	$7,256	($761)	(10)%	$12,994	$14,543	($1,549)	(11)%

Loss on Disposal or Impairment of Long-Lived Assets

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

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Loss on disposal or impairment of long-lived assets	$735	$760	($25)	(3)%	$2,182	$1,417	$765	54 %

We recognized a net loss of $0.7 million and $0.8 million on the disposal of long-lived assets for the three months ended December 28, 2014 and the three months ended December 29, 2013, respectively. For the six months ended December 28, 2014, we recognized a net loss of $2.2 million compared to a net loss of $1.4 million for the six months ended December 29, 2013. These net losses were primarily the result of disposals of equipment due to changes in various manufacturing processes, the abandonment of certain patent assets as a result of technological obsolescence and dispositions of building improvements as we expand our manufacturing facilities to support future growth.

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Non-Operating Income, net

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Foreign currency (loss) gain, net	($2,365)	$213	($2,578)	(1,210)%	($2,596)	$477	($3,073)	(644)%
Gain on sale of investments, net	774	—	774	—	776	10	766	7,660 %
Gain on equity method investment	679	—	679	—	679	—	679	—
Interest income, net	2,586	2,806	(220)	(8)%	5,618	5,147	471	9 %
Other, net	54	384	(330)	(86)%	155	587	(432)	(74)%
Non-operating income, net	$1,728	$3,403	($1,675)	(49)%	$4,632	$6,221	($1,589)	(26)%

Foreign currency (loss) gain, net. Foreign currency (loss) gain, net consisted primarily of remeasurement adjustments resulting from our investment in Lextar Electronics Corporation (Lextar) and consolidating our international subsidiaries. The foreign currency loss for the three and six months ended December 28, 2014 was primarily due to fluctuations in the exchange rate between the New Taiwan Dollar and the United States Dollar related to the Lextar investment. The foreign currency gains for the three and six months ended December 29, 2013 were primarily due to fluctuations in the exchange rate between the Chinese Yuan and the United States Dollar.

Gain on sale of investments, net. Gain on sale of investments, net was $774 thousand for the three months ended December 28, 2014 compared to zero for the three months ended December 29, 2013. For the six months ended December 28, 2014, gain on sale of investments, net was $776 thousand compared to $10 thousand for the six months ended December 29, 2013. Gain on sale of investments, net was higher for the three and six months ended December 28, 2014 primarily due to gains realized on sales of investments liquidated in order to fund the repurchase of our common stock.

Gain on equity method investment. Gain on equity method investment was $0.7 million for the three and six months ended December 28, 2014 due to our investment in Lextar.

Interest income, net. Interest income, net was $2.6 million for the three months ended December 28, 2014 compared to $2.8 million for the three months ended December 29, 2013. For the six months ended December 28, 2014, interest income, net was $5.6 million compared to $5.1 million for the six months ended December 29, 2013. The decrease in interest income, net for the three months ended December 28, 2014 was primarily due to lower invested balances and higher interest expense, partially offset by higher investment yields as compared to the three months ended December 29, 2013. The increase in interest income, net for the six months ended December 28, 2014 was primarily due to earning higher investment yields, partially offset by lower invested balances and higher interest expense as compared to the six months ended December 29, 2013.

Other, net. Other, net was $0.1 million for the three months ended December 28, 2014 compared to $0.4 million for the three months ended December 29, 2013. For the six months ended December 28, 2014, other, net was $0.2 million compared to $0.6 million for the six months ended December 29, 2013.

Income Tax (Benefit) Expense

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

	Three Months Ended				Six Months Ended			
	December 28, 2014	December 29, 2013	Change		December 28, 2014	December 29, 2013	Change	
Income tax (benefit) expense	($238)	$3,105	($3,343)	(108)%	$2,993	$12,218	($9,225)	(76)%
Effective tax rate	(2.0)%	8.0 %			11.4 %	15.6 %		

The variation between our effective income tax rate and the U.S. statutory rate of 35 percent is due to a percentage of our 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 our various tax jurisdictions can have a material impact on our periodic effective tax rate.

We recognized income tax benefit of $0.2 million for an effective tax rate of (2.0)% for the three months ended December 28, 2014 as compared to income tax expense of $3.1 million for an effective tax rate of 8.0% for the three months ended December 29, 2013. For the six months ended December 28, 2014, we recognized income tax expense of $3.0 million for an effective tax rate of 11.4% compared to $12.2 million for an effective tax rate of 15.6% for the six months ended December 29, 2013. The decreases in our effective tax rate for the three and six months ended December 28, 2014 were primarily due to the tax benefit of the retroactive reinstatement and extension of the research and development credit recognized in the second quarter of fiscal 2015 and lower pretax income relative to our energy and state tax credits.

Liquidity and Capital Resources

Overview

We require cash to fund our operating expenses and working capital requirements, including outlays for research and development, capital expenditures, strategic acquisitions and investments. Our principal sources of liquidity are cash on hand, marketable securities, cash generated from operations and availability under our line of credit. Our ability to generate cash from operations has been one of our fundamental strengths and has provided us with substantial flexibility in meeting our operating, financing and investing needs. We have subsequently repaid our $150 million line of credit in full in connection with entering into a new $500 million line of credit as discussed in Note 6, "Long-term Debt," and Note 13, "Subsequent Event," in our consolidated financial statements included in Part I, Item 1 of this Quarterly Report. The purpose of this new facility is to provide short term flexibility to optimize returns on our cash and investment portfolio while funding share repurchases, capital expenditures and other general business needs.

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

From time to time, we evaluate strategic opportunities, including potential acquisitions, divestitures or investments in complementary businesses, and we anticipate continuing to make such evaluations. We may also access capital markets through the issuance of debt or additional shares of common stock in connection with the acquisition of complementary businesses or other significant assets or for other strategic opportunities.

Liquidity

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

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

	Three Months Ended		
	December 28, 2014	June 29, 2014	Change
Days of sales outstanding[(a)]	48	46	2
Days of supply in inventory[(b)]	108	94	14
Days in accounts payable[(c)]	(52)	(66)	14
Cash conversion cycle	104	74	30

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

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

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

The increase in the cash conversion cycle was primarily driven by an increase in days of supply in inventory and a decrease in days in accounts payable.

As of December 28, 2014, we had unrealized losses on our investments of $0.5 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at December 28, 2014 were in such position due to interest rate changes, sector credit rating changes or company-specific rating changes. As we intend and believe that we have the ability to hold such investments for a period of time that will be sufficient for anticipated recovery in market value, we currently expect to receive the full principal or recover our cost basis in these securities. The declines in value of the securities in our portfolio are considered to be temporary in nature and, accordingly, we do not believe these securities are impaired as of December 28, 2014.

Cash Flows

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

	Six Months Ended			
	December 28, 2014	December 29, 2013	Change	
Net cash provided by operating activities	$28,052	$167,987	($139,935)	(83)%
Net cash provided by (used in) investing activities	33,239	(176,886)	210,125	(119)%
Net cash (used in) provided by financing activities	(147,609)	87,825	(235,434)	(268)%
Effects of foreign exchange changes on cash and cash equivalents	(546)	393	(939)	(239)%
Net (decrease) increase in cash and cash equivalents	($86,864)	$79,319	($166,183)	

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

Cash Flows from Operating Activities

Net cash provided by operating activities decreased to $28.1 million for the six months ended December 28, 2014 from $168.0 million for the six months ended December 29, 2013. This decrease was primarily due to a decrease in net income and an increase in our working capital.

Cash Flows from Investing Activities

Our investing activities primarily relate to transactions within our short-term investments, purchases of property and equipment and payments for patents and licensing rights. Net cash provided by investing activities was $33.2 million for the six months ended December 28, 2014 compared to net cash used in investing activities of $176.9 million for the six months ended December 29, 2013. Net proceeds from the sale of short-term investments increased $320.2 million for the six months ended December 28, 2014 compared to the six months ended December 29, 2013. This was partially offset by a $29.9 million increase in our capital spending to support our future growth and the $80.6 million investment in Lextar.

We continue to actively manage our capital spending. For fiscal 2015, we target approximately $200.0 million of capital investment which is primarily related to infrastructure projects to support our longer term growth and strategic priorities.

Cash Flows from Financing Activities

Net cash used in financing activities was $147.6 million for the six months ended December 28, 2014 and net cash provided by financing activities was $87.8 million for the six months ended December 29, 2013. For the six months ended December 28, 2014, our financing activities primarily consisted of the repurchase of common stock worth approximately $320.3 million, partially offset by net borrowings on our then outstanding line of credit of $150.0 million, and proceeds of $22.7 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises. For the six months ended December 29, 2013, our financing activities primarily consisted of proceeds of $87.9 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises.

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Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use any other forms of off-balance sheet arrangements. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of December 28, 2014, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases primarily for certain of our U.S. and international facilities in the normal course of business. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 29, 2014, in the section entitled “Contractual Obligations” for the future minimum lease payments due under our operating leases as of June 29, 2014. There have been no significant changes to the contractual obligations discussed therein, except for our line of credit as discussed in Note 6, "Long-term Debt," and Note 13, "Subsequent Event," in our consolidated financial statements included in Part I, Item 1 of this Quarterly Report.

Critical Accounting Policies and Estimates

For information about our critical accounting policies and estimates, see the “Critical Accounting Policies and Estimates” section of “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended June 29, 2014.

New Accounting Standards

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about our market risks, see “Part II. Item 7A. Quantitative and Qualitative Disclosures About Market Risk” of our Annual Report on Form 10-K for the fiscal year ended June 29, 2014. There have been no material changes to the amounts presented therein, except as noted below.

As of December 28, 2014, we maintained an unsecured revolving line of credit under which we could borrow, repay and reborrow loans from time to time prior to its scheduled maturity date of August 12, 2017. At December 28, 2014, we had $150 million outstanding under the line of credit. If interest rates were to increase by 100 basis points, the annual interest incurred under our then existing line of credit would have increased by $1.5 million. We have subsequently repaid this line of credit in full in connection with entering into a new line of credit as discussed in Note 6, “Long-term Debt,” and Note 13, “Subsequent Event,” in our consolidated financial statements included in Part I, Item 1 of this Quarterly Report.

Item 4. Controls and Procedures

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

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. There have been no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the second quarter of fiscal 2015 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this item is set forth under Note 11, “Commitments and Contingencies,” to our unaudited financial statements in Part I, Item 1 of this Quarterly Report and is incorporated herein by reference.

Item 1A. Risk Factors

Described below are various risks and uncertainties that may affect our business. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in “Part I, Item IA. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended June 29, 2014 and any subsequent periodic reports. If any of the risks described below actually occurs, our business, financial condition or results of operations could be materially and adversely affected.

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

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

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

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

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

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

We have experienced these conditions in our business in the past and may experience such conditions in the future, which could have a material negative impact on our business, results of operations or financial condition.

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

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

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

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

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

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

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 rapidly in recent years, adoption of LEDs for general lighting is relatively new, still limited and faces significant challenges before widespread adoption. In order to manage our growth and business strategy effectively in light of uncertainty related to the pace of adoption, we must continue to:

- maintain, expand and purchase adequate manufacturing facilities and equipment to meet customer demand;
- manage an increasingly complex supply chain that has the ability to scale to maintain a sufficient supply of raw materials and deliver on time to our manufacturing facilities or our third party manufacturing facilities;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- manage organizational complexity and communication;
- expand the skills and capabilities of our current management team;
- add experienced senior level managers; and
- attract and retain qualified employees.

While we intend to focus on managing our costs and expenses, over the long term we expect to invest substantially to support our growth and may have additional unexpected costs. For example, we are in the process of expanding our facilities in North Carolina, to support our targeted longer term growth. Such investments take time to become fully operational, and we may not be able to expand quickly enough to exploit targeted market opportunities. There are also inherent execution risks in starting up a new factory or expanding production capacity that could increase costs and reduce our operating results, including design and construction cost overruns, poor production process yields and reduced quality control during the start-up phase. We are also increasingly dependent on information technology to enable us to improve the effectiveness of our operations and to maintain financial accuracy and efficiency. For example, we are in the process of implementing a new information technology platform at our Racine operations. If we do not allocate and effectively manage the resources necessary to build, implement, upgrade, integrate and sustain the proper technology infrastructure, we could be subject to transaction errors, processing inefficiencies, loss of customers, business disruptions or loss of or damage to intellectual property through security breach.

In connection with our efforts to cost-effectively manage our growth, we have increasingly relied on contractors for production capacity, logistics support and certain administrative functions including hosting of certain information technology software applications. If these service providers do not perform effectively, we may not be able to achieve the expected cost savings and may incur additional costs to correct errors or fulfill customer demand. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies, the loss of or damage to intellectual property through security breach, or an impact on employee morale. Our operations may also be negatively impacted if any of these service providers do not have the financial capability to meet our growing needs.

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

The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture and sell LED chips and LED components. In the lighting market, we compete with companies that manufacture and sell traditional and LED lighting products, many of which have larger and more established sales channels. Competitors continue to offer new products with aggressive pricing and improved performance. Competitive pricing pressures may change and could accelerate the rate of decline of our average sales prices.

With the growth potential for LEDs, we will continue to face increased competition in the future. If the investment in new capacity exceeds the growth in demand, the LED market is likely to become more competitive with additional pricing pressures. Additionally, new technologies could emerge or improvements could be made in existing technologies that may also reduce the demand for LEDs in certain markets. There are also new technologies, such as organic LEDs (OLEDs), which could potentially have the same impact on LED demand for backlighting, which could impact the overall LED market.

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

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

As customer demand for our products changes, we must be able to ramp up or adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase our production capacity at our targeted rate or if there are unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets.

Conversely, due to the proportionately high fixed cost nature of our business (such as facility costs), if demand does not increase at the rate forecasted, we may not be able to scale our manufacturing expenses or overhead costs to correspond to the demand. This could result in lower margins and adversely impact our business and results of operations. Additionally, if product demand decreases or we fail to forecast demand accurately, we may be required to recognize impairments on our long-lived assets or recognize excess inventory write-off charges. We have in the past and may in the future be required to recognize excess capacity charges, which would have a negative impact on our results of operations.

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

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

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

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

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

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

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

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

We receive a significant amount of our revenue from a limited number of customers, including distributors and retailers, two of which represented greater than 10% of our consolidated revenue in fiscal 2014. Most of our customer orders are made on a purchase order basis, which does not generally require any long-term customer commitments. Therefore, these customers may alter their purchasing behavior with little or no notice to us for various reasons, including developing, or, in the case of our distributors, their customers developing, their own product solutions; choosing to purchase product from our competitors; incorrectly forecasting end market demand for their products; or experiencing a reduction in their market share in the markets for which they purchase our products. In the case of retailers, these customers may alter their promotional pricing; increase promotion of competitors' products over our products; or reduce their inventory levels; all of which could negatively impact our financial condition and results of operations. If our customers alter their purchasing behavior, if our customers’ purchasing behavior does not match our expectations or if we encounter any problems collecting amounts due from them, our financial condition and results of operations could be negatively impacted.

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

The manufacture of our products involves highly complex processes. Our customers specify quality, performance and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment. Even if our products meet standard specifications, our customers may attempt to use our products in applications for which they were not designed or in products that were not designed or manufactured properly, resulting in product failures and creating customer satisfaction issues.

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

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

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

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

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

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

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

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

- variability in our process repeatability and control;
- contamination of the manufacturing environment;
- equipment failure, power outages, information or other system failures or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts, other raw materials and other bill of materials items;
- inventory shrinkage or human errors;

- defects in production processes (including system assembly) either within our facilities or at our suppliers; and
- any transitions or changes in our production process, planned or unplanned.

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

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

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

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

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

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

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about global economic conditions could result in customers postponing purchases of our products and services in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values and other macroeconomic factors, which could have a material negative effect on demand for our products and services and, accordingly, on our business, results of operations or financial condition.

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

From time to time, we evaluate strategic opportunities available to us for product, technology or business transactions, such as business acquisitions, divestitures or investments. If we choose to enter into such transactions, we face certain risks, such as the failure of an acquired business or an investee to meet our performance expectations, diversion of management attention, identification of additional liabilities relating to the acquired business, loss of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers' existing product lines, and difficulty integrating an acquired business's operations, personnel and financial and operating systems into our current business.

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

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

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

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

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

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

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

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

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

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

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

Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could also result in an adverse effect on our business and results of operations.

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

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

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

Litigation could adversely affect our operating results and financial condition.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Our international sales and purchases are subject to numerous U.S. and foreign laws and regulations, including, without limitation, tariffs, trade sanctions, trade barriers, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and, in the extreme case, we could be suspended or debarred from government contracts or have our export privileges suspended, which could have a material adverse effect on our business.
International sales and purchases are also subject to a variety of other risks, including risks arising from currency fluctuations, collection issues and taxes. Our international sales are subject to variability as our selling prices become less competitive in countries with currencies that are declining in value against the U.S. Dollar and more competitive in countries with currencies that are increasing in value against the U.S. Dollar. In addition, our international purchases can become more expensive if the U.S. Dollar weakens against the foreign currencies in which we are billed.
We have entered and may in the future enter into foreign currency derivative financial instruments in an effort to manage or hedge some of our foreign exchange rate risk. We may not be able to engage in hedging transactions in the future, and, even if we do, foreign currency fluctuations may still have a material adverse effect on our results of operations.
Our business may be adversely affected by uncertainties in the global financial markets and our or our customers' or suppliers' ability to access the capital markets.
Global financial markets continue to reflect uncertainty about a sustained global economic recovery. Given these uncertainties, there could be future disruptions in the global economy, financial markets and consumer confidence. If economic conditions deteriorate unexpectedly, our business and results of operations could be materially and adversely affected. For example, our customers, including our distributors and their customers, may experience difficulty obtaining the working capital and other financing necessary to support historical or projected purchasing patterns, which could negatively affect our results of operations.
Although we believe we have adequate liquidity and capital resources to fund our operations internally and under our existing line of credit, our inability to access the capital markets on favorable terms in the future, or at all, may adversely affect our financial performance. The inability to obtain adequate financing from debt or capital sources in the future could force us to self-fund strategic initiatives or even forego certain opportunities, which in turn could potentially harm our performance.
Changes in our effective tax rate may affect our results.
Our future effective tax rates may be affected by a number of factors including:
- the jurisdiction in which profits are determined to be earned and taxed;
- changes in government administrations, such as the Presidency and Congress of the U.S. as well as in the states and countries in which we operate;
- changes in tax laws or interpretation of such tax laws and changes in generally accepted accounting principles;
- the resolution of issues arising from tax audits with various authorities;
- changes in the valuation of our deferred tax assets and liabilities;
- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes, including impairment of goodwill in connection with acquisitions;
- changes in available tax credits;
- the recognition and measurement of uncertain tax positions;
- the lack of sufficient excess tax benefits (credits) in our additional paid-in-capital pool in situations where our realized tax deductions for certain stock-based compensation awards (such as non-qualified stock options and restricted stock) are less than those originally anticipated; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes or any changes in legislation that may result in these earnings being taxed within the U.S., regardless of our decision regarding repatriation of funds.

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Any significant increase or decrease in our future effective tax rates could impact net income for future periods. In addition, the determination of our income tax provision requires complex estimations, significant judgments and significant knowledge and experience concerning the applicable tax laws. To the extent our income tax liability materially differs from our income tax provisions due to factors, including the above, which were not anticipated at the time we estimated our tax provision, our net income or cash flows could be affected.

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

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

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

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

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

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

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

Catastrophic events may disrupt our business.

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

Our stock price may be volatile.

Historically, our common stock has experienced substantial price volatility, particularly as a result of significant fluctuations in our revenue, earnings and margins over the past few years, and variations between our actual financial results and the published expectations of analysts. For example, the closing price per share of our common stock on the NASDAQ Global Select Market ranged from a low of $27.28 to a high of $67.33 during the 12 months ended December 28, 2014. If our future operating results or margins are below the expectations of stock market analysts or our investors, our stock price will likely decline.

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

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

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

From time to time, we have also made investments in public and private companies that engage in complementary businesses. For example, we recently made an investment in Lextar Electronics Corporation (Lextar), a public company in Taiwan. An investment in another company is subject to the risks inherent in the business of the company in which we have invested and to trends affecting the equity markets as a whole. Investments in publicly held companies are subject to market risks and, like our investment in Lextar, may not be liquidated easily. As a result we may not be able to reduce the size of our position or liquidate our investments when we deem appropriate to limit our downside risk. Should the value of any such investments we hold decline, the related write-down in value could have a material adverse effect on our financial condition and results of operations.

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC established new annual disclosure and reporting requirements for those companies who may use “conflict” minerals mined from the DRC and adjoining countries in their products. These requirements required us to undertake due diligence efforts beginning in the 2013 calendar year, with initial disclosures regarding our diligence to the SEC filed in June 2014. These requirements could affect the sourcing and availability of certain minerals used in the manufacture of our products. As a result, we may not be able to obtain the relevant minerals at competitive prices and there will likely be additional costs associated with complying with the due diligence procedures as required by the SEC. In addition, because our supply chain is complex, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins of all minerals used in our products through the due diligence procedures that we implement, and we may incur additional costs as a result of changes to product, processes or sources of supply as a consequence of these requirements.

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

Sale of Unregistered Securities

There were no unregistered securities sold during the second quarter of fiscal 2015.

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Stock Repurchase Program

The following table summarizes stock repurchase activity for the second quarter of fiscal 2015 (in thousands, except price per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs[1]
Shares repurchased under our Stock Repurchase Program				
September 29, 2014 to October 26, 2014	—	$—	1,202	$495,651
October 27, 2014 to November 23, 2014	6,967	$32.45	8,169	$269,585
November 24, 2014 to December 28, 2014	1,151	$34.87	9,320	$229,465
Total	8,118	$32.79		

(1) On October 27, 2014, our Board of Directors approved an increase in the amount of our stock repurchase program. Pursuant to the program, we are now authorized to repurchase shares of our common stock having an aggregate purchase price not exceeding $550 million for all purchases from June 30, 2014 through the new expiration of the program on June 28, 2015.

Since the inception of our stock repurchase program in January 2001 through December 28, 2014, we have repurchased 21.7 million shares of our common stock at an average price of $28.78 per share with an aggregate value of $625.6 million. The repurchase program can be implemented through open market or privately negotiated transactions at the discretion of our management.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

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Item 6. Exhibits

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

Exhibit No.	Description
10.1	2013 Long-Term Incentive Compensation Plan, as amended (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, dated October 28, 2014, filed with the Securities and Exchange Commission on October 28, 2014)
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Cree Inc.’s Quarterly Report on Form 10-Q for the fiscal quarter ended December 28, 2014 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Comprehensive Income; (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements

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SIGNATURE

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

CREE, INC.

January 21, 2015

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

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