CREE INC
Form 10-Q
January 19, 2012
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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 25, 2011
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 11, 2012, was 116,099,017.

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

	December 25, 2011 (unaudited)	June 26, 2011
	(Thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$171,651	$390,598
Short-term investments	515,595	695,199
Total cash, cash equivalents, and short-term investments	687,246	1,085,797
Accounts receivable, net	156,385	118,469
Income tax receivable	1,829	6,796
Inventories	187,373	176,482
Deferred income taxes	18,907	17,857
Prepaid expenses and other current assets	52,806	51,494
Total current assets	1,104,546	1,456,895
Property and equipment, net	605,504	555,929
Intangible assets, net	385,484	102,860
Goodwill	617,936	326,178
Other assets	5,990	4,860
Total assets	$2,719,460	$2,446,722
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable, trade	$81,493	$76,593
Accrued salaries and wages	25,957	18,491
Income taxes payable	2,209	15,493
Other current liabilities	39,505	29,739
Total current liabilities	149,164	140,316
Long-term liabilities:		
Deferred income taxes	21,902	21,902
Other long-term liabilities	26,121	22,940
Total long-term liabilities	48,023	44,842
Commitments and contingencies (Note 11)		
Shareholders’ equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 25, 2011 and June 26, 2011; none issued and outstanding	—	—
Common stock, par value $0.00125; 200,000 shares authorized at December 25, 2011 and June 26, 2011; 116,097 and 109,607 shares issued and outstanding at December 25, 2011 and June 26, 2011, respectively	144	136
Additional paid-in-capital	1,831,909	1,593,530
Accumulated other comprehensive income, net of taxes	10,516	13,091
Retained earnings	679,704	654,807
Total shareholders’ equity	2,522,273	2,261,564
Total liabilities and shareholders’ equity	$2,719,460	$2,446,722

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 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
	(Thousands, except per share amounts)			
Revenue, net	$304,118	$256,983	$573,098	$525,420
Cost of revenue, net	199,000	135,837	369,952	273,745
Gross profit	105,118	121,146	203,146	251,675
Operating expenses:				
Research and development	35,886	29,233	70,288	53,965
Sales, general and administrative	49,176	33,366	94,715	62,568
Amortization of acquisition related intangibles	7,367	2,706	11,292	5,412
Loss on disposal or impairment of long-lived assets	497	429	1,272	901
Total operating expenses	92,926	65,734	177,567	122,846
Operating income	12,192	55,412	25,579	128,829
Non-operating income:				
Other non-operating (loss) income, net	(111)	63	863	1
Interest income, net	1,800	2,170	3,769	4,186
Income from operations before income taxes	13,881	57,645	30,211	133,016
Income tax expense	1,803	7,870	5,314	25,205
Net income	$12,078	$49,775	$24,897	$107,811
Earnings per share:				
Basic net income per share	$0.10	$0.46	$0.22	$1.00
Diluted net income per share	$0.10	$0.45	$0.22	$0.98
Shares used in per share calculation:				
Basic	115,536	108,364	113,701	108,032
Diluted	115,883	109,976	114,239	109,817

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

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

	Six Months Ended	
	December 25, 2011	December 26, 2010
Cash flows from operating activities:		
Net income	$24,897	$107,811
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	68,303	50,318
Stock-based compensation	22,635	17,981
Excess tax benefit from share-based payment arrangements	(201)	(9,277)
Loss on disposal or impairment of long-lived assets	1,272	901
Amortization of premium/discount on investments	4,017	7,617
Changes in operating assets and liabilities:		
Accounts receivable	(12,973)	(16,928)
Inventories	28,572	(32,871)
Prepaid expenses and other assets	8,755	1,991
Accounts payable, trade	(14,923)	22,516
Accrued salaries and wages and other liabilities	(8,117)	(4,303)
Net cash provided by operating activities	122,237	145,756
Cash flows from investing activities:		
Purchases of property and equipment	(53,038)	(126,387)
Purchases of investments	(145,802)	(194,872)
Proceeds from maturities of investments	66,040	147,502
Proceeds from sale of property and equipment	2	1
Proceeds from sale of available-for-sale investments	252,152	61,833
Purchase of Ruud Lighting, net of cash acquired	(456,008)	—
Purchases of patent and licensing rights	(8,043)	(5,199)
Net cash used in investing activities	(344,697)	(117,122)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	2,648	29,977
Excess tax benefit from share-based payment arrangements	201	9,277
Net cash provided by financing activities	2,849	39,254
Effects of foreign exchange changes on cash and cash equivalents	664	238
Net (decrease) increase in cash and cash equivalents	(218,947)	68,126
Cash and cash equivalents:		
Beginning of period	390,598	397,431
End of period	$171,651	$465,557

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 Changes in Significant Accounting Policies
Overview

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

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

The Company's LED products consist of LED components, LED chips, and SiC wafers. As the Company develops and improves its LED technology and the market continues to focus on energy efficiency, the Company believes the potential market for LED lighting will continue to expand. The Company's success in selling LED products depends upon its ability to drive adoption and offer innovative products and solutions that enable its customers to succeed in the market. By driving adoption, the Company believes it can influence the growth of the market and open more opportunities for LEDs.

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

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

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

The Company currently operates its business as one reportable segment.
Basis of Presentation
The consolidated balance sheet at December 25, 2011 and the consolidated statements of income for the three and six months ended December 25, 2011 and December 26, 2010, and the consolidated statements of cash flows for the six months ended December 25, 2011 and December 26, 2010 (“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 25, 2011, and for all periods presented, have been made. The consolidated balance sheet at June 26, 2011 has been derived from the audited financial statements as of that date.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted. It is suggested that these financial statements 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 26, 2011 (“fiscal 2011”). The results of operations for the period ended December 25, 2011 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 24, 2012 (“fiscal 2012”). Certain fiscal 2011 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2012 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders’ equity.

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Recently Adopted Accounting Pronouncements

Fair Value Disclosures

In January 2010, the Financial Accounting Standards Board (the "FASB") issued amended standards requiring additional fair value disclosures. The amended standards require disclosures of transfers in and out of Levels 1 and 2 of the fair value hierarchy, as well as requiring gross basis disclosures for purchases, sales, issuances and settlements within the Level 3 reconciliation. Additionally, the update clarifies the requirement to determine the level of disaggregation for fair value measurement disclosures and to disclose valuation techniques and inputs used for both recurring and nonrecurring fair value measurements in either Level 2 or Level 3. The Company adopted the new guidance in the third quarter of fiscal 2010, except for the disclosures related to purchases, sales, issuance and settlements, which was effective for the Company beginning in the first quarter of fiscal 2012. Because these new standards are related primarily to disclosures, their adoption has not had a significant impact on the Company's consolidated financial statements.

Goodwill Impairment Testing

On September 15, 2011, the FASB issued updated guidance concerning the testing of goodwill for impairment. This guidance modifies goodwill impairment testing by allowing the inclusion of qualitative factors in the assessment of whether a two-step goodwill impairment test is necessary. Thus, entities are no longer required to calculate the fair value of a reporting unit unless they conclude through an assessment of qualitative factors that it is more likely than not that the unit's carrying value is greater than its fair value. When an entity's qualitative assessment reveals that goodwill impairment is more likely than not, the entity must perform the two-step goodwill impairment test. This guidance became effective for the Company in the second quarter of fiscal 2012. The Company's adoption of this guidance has not had a significant impact on its consolidated financial statements.

Recently Issued Accounting Pronouncements

Presentation of Comprehensive Income

In June 2010, the FASB issued new guidance concerning the presentation of total comprehensive income and its components. Under this guidance an entity has the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in single continuous statement of comprehensive income or in two separate but consecutive statements. This guidance, as amended in December 2011, will become effective for the Company beginning in the third quarter of fiscal 2012. The Company's adoption of the new accounting guidance is not expected to have a significant impact on its consolidated financial statements.

Note 2. Acquisitions

Acquisition of Ruud Lighting, Inc.

On August 17, 2011, the Company entered into a Stock Purchase Agreement with all of the shareholders of Ruud Lighting, Inc. ("Ruud Lighting"). Pursuant to the terms of the Stock Purchase Agreement and concurrently with the execution of the Stock Purchase Agreement, the Company acquired all of the outstanding share capital of Ruud Lighting in exchange for consideration consisting of 6.1 million shares of the Company's common stock and $372.2 million cash, subject to certain post-closing adjustments. Prior to the Company completing its acquisition of Ruud Lighting, Ruud Lighting completed the re-acquisition of its e-conolight business by purchasing all of the membership interests of E-conolight LLC ("E-conolight"). Ruud Lighting previously sold its e-conolight business in March 2010 and had been providing operational services to E-conolight since that date. In connection with the stock purchase transaction with Ruud Lighting, the Company funded Ruud Lighting's re-acquisition of E-conolight and paid off Ruud Lighting's outstanding debt in the aggregate amount of approximately $85.0 million. The acquisition allows the Company to expand its product portfolio into outdoor LED lighting.

The acquisitions of Ruud Lighting and E-conolight have been accounted for as business combinations in accordance with ASC 805 Business Combinations and, as such, the Ruud Lighting and E-conolight assets acquired and liabilities assumed have been recorded at their respective fair values. The determination of fair value for the identifiable tangible and intangible assets acquired and liabilities assumed requires extensive use of estimates and judgments. Significant estimates and assumptions include, but are not limited to: estimating future cash flows and determining the appropriate discount rate.

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The total purchase price for this acquisition is as follows (in thousands):

Cash consideration paid to stockholders	$372,235
Fair value of common stock issued by the Company (1)	211,040
Fair value of debt paid on behalf of stockholders	84,991
Total purchase price	$668,266

(1) Represents 6,074,833 shares of the Company's common stock at $34.74 per share, the closing share price on August 17, 2011. The shares are subject to certain transfer restrictions under the Stock Purchase Agreement that will generally lapse with respect to 25% of the shares held (i) at the completion of the consecutive six-month period following the date of the closing of the transaction; and, (ii) at the completion of each of the following three successive six-month periods, such that all restrictions will lapse by the second anniversary of the closing.

The Company incurred total transaction costs related to the acquisition of approximately $3.6 million, of which, $3.1 million were expensed in the first quarter of fiscal 2012 in accordance with U.S. GAAP.

The purchase price for this acquisition has been preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair values as follows (in thousands):

	August 17, 2011 (As initially reported)	Measurement Period Adjustments	August 17, 2011 (As adjusted)
Tangible assets:			
Cash and cash equivalents	$3,081	$—	$3,081
Accounts receivable	25,698	(375)	25,323
Inventories	39,330	(461)	38,869
Property and equipment	45,946	(233)	45,713
Other assets	4,727	217	4,944
Total tangible assets	$118,782	$(852)	$117,930
Intangible assets:			
Developed technology	$96,300	$—	$96,300
Customer relationships	84,820	—	84,820
Trade names	82,950	—	82,950
In-process research & development	15,050	—	15,050
Non-compete agreements	9,800	—	9,800
Goodwill	287,431	4,326	291,757
Total intangible assets	$576,351	$4,326	$580,677
Liabilities assumed:			
Accounts payable	$12,943	$—	$12,943
Accrued expenses and liabilities	10,116	451	10,567
Warranty liabilities	2,600	3,023	5,623
Other long-term liabilities	1,208	—	1,208
Total liabilities assumed	$26,867	$3,474	$30,341
Net assets acquired	$668,266	$—	$668,266

The above estimated fair values of assets acquired and liabilities assumed are based on the information that was available through the balance sheet date and are provisional. The Company believes that this information provides a reasonable basis for estimating the fair values but is waiting for certain additional information necessary to finalize those amounts, which includes certain post-closing working capital and related adjustments, certain litigation, potential uncertain tax positions, certain foreign taxes payable, certain product warranties and certain reviews at the foreign subsidiary locations. Thus, the provisional measurements of fair value reflected are subject to change.

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Acquired finished goods and work-in-process inventory was valued at its estimated selling price less the sum of costs of disposal and a reasonable profit allowance for the Company's selling effort and, with respect to work-in-process inventory, estimated costs to complete. This resulted in a fair value adjustment that increased finished goods inventory approximately $1.5 million. Raw material inventory has been valued at current replacement cost, resulting in a write down of approximately $0.7 million. As the Company sells the acquired inventory, its costs of revenue will reflect the increased valuation of the inventory, which will reduce the Company's gross margins until such inventory is sold.

The identifiable intangible assets acquired as a result of the acquisition will be amortized over their respective estimated useful lives as follows (in thousands, except for years):

	Asset Amount	Estimated Life in Years
Developed technology	$96,300	7 to 10
Customer relationships	84,820	7 to 20
Trade names (indefinite lived)	82,880	-
Trade names (definite lived)	70	3
In-process research and development (1)	15,050	6 to 7
Non-compete agreements	9,800	5
Total identifiable intangible assets	$288,920	

(1) Initially, in-process research and development ("IPR&D") is classified as indefinite-lived assets until completion or abandonment. Therefore, amortization of IPR&D does not begin until the technological and market risk(s) no longer exist. During the interim, IPR&D intangibles are subject to annual testing for impairment or when there are indicators of impairment.

The fair value of the developed technology, IPR&D and customer relationship assets were estimated using an income approach. Under this method, an intangible asset's fair value is equal to the present value of the incremental after-tax cash flows (excess earnings) attributable solely to the intangible asset over its remaining useful life. To calculate fair value, the Company used cash flows discounted at rates considered appropriate given the inherent risks associated with each type of asset. The Company believes that the level and timing of cash flows appropriately reflect market participant assumptions. The fair value of the Ruud Lighting and e-conolight trade names were estimated using an income approach, specifically known as the relief from royalty method. The relief from royalty method is based on a hypothetical royalty stream that would be paid if the Company did not own the Ruud Lighting “BetaLED” brand and had to license the Ruud Lighting and e-conolight trade names. The Company derived the hypothetical royalty income from the projected revenues of Ruud Lighting and e-conolight products. Cash flows were assumed to extend through the remaining economic useful life of each class of intangible asset.

Goodwill largely consists of geographic expansion of product sales, manufacturing and other synergies of the combined companies, and the value of the assembled workforce.

As a result of the Company's U.S. tax election under Internal Revenue Code section 338(h)(10), the acquisition did not result in the recording of an opening net deferred tax position as the deferred tax asset resulting from excess tax deductible goodwill equally offsets the deferred tax liability resulting from excess book over tax basis in the underlying assets acquired.

The assets, liabilities, and operating results of Ruud Lighting have been included in the Company's consolidated financial statements from the date of acquisition. The results of Ruud Lighting reflected in the Company's Consolidated Statements of Income from the date of acquisition (August 17, 2011) to December 25, 2011 are as follows (in thousands, except per share data):

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

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Amortization expense related to identifiable intangible assets associated with the Ruud Lighting acquisition, included in the table above, was $5.2 million and $6.9 million for the three and six months ended December 25, 2011, respectively.
The following supplemental pro forma information (in thousands, except per share data) presents the financial results as if the Ruud Lighting transaction had occurred at the beginning of the 2011 fiscal year for the six months ended December 25, 2011 and the three and six months ended December 26, 2010. Financial results for the three months ended December 25, 2011, which are included in the Consolidated Statements of Income, are actual results and therefore have not been presented in the table below.

	Three Months Ended	Six Months Ended	
	December 26, 2010	December 25, 2011	December 26, 2010
Revenue	$313,220	$603,430	$623,516
Operating Income	55,625	23,872	124,048
Net income	50,290	23,117	105,433
Earnings per share, basic	$0.44	$0.20	$0.92
Earnings per share, diluted	$0.43	$0.20	$0.91

The total revenue for Ruud Lighting included in the pro forma table above was $60.1 million for the three months ended December 26, 2010. The total revenue for Ruud Lighting included in the pro forma table above was $115.0 million and $107.4 million for the six months ended December 25, 2011 and December 26, 2010, respectively. These amounts have been calculated after applying the Company’s accounting policies and adjusting the results of Ruud Lighting to give effect to events that are directly attributable to the Ruud Lighting transactions, including the elimination of sales to Ruud Lighting prior to acquisition, additional depreciation and amortization that would have been charged assuming the fair value adjustments primarily to property and equipment and intangible assets, had been applied at the beginning of the 2011 fiscal year, together with the consequential tax effects. Excluded from the pro forma net income and the earnings per share amounts for the six months ended December 25, 2011 are one-time acquisition costs of $3.1 million attributable to the Ruud Lighting transaction. This supplemental pro forma information has been prepared for comparative purposes and does not purport to be indicative of what would have occurred had the acquisition been made at the beginning of the 2011 fiscal year, nor is it indicative of any future results.

Acquisition of LED Lighting Fixtures, Inc.
On February 29, 2008 the Company acquired LED Lighting Fixtures, Inc. (“LLF”) through a wholly owned subsidiary that merged into Cree, Inc. on June 27, 2010. The Company acquired all of the outstanding share capital of LLF in exchange for total upfront consideration of $80.8 million, consisting of (1) $16.5 million in cash, (2) approximately 1.9 million shares of the Company’s common stock valued at $58.8 million, and (3) the assumption of fully vested LLF employee stock options valued at $4.5 million. The Company incurred transaction costs of approximately $1.0 million consisting primarily of professional fees incurred relating to attorneys, accountants and valuation advisors. Under the acquisition terms, additional consideration of up to $26.4 million would become payable to the former shareholders of LLF if defined product development targets and key employee retention measures were achieved over the three calendar years following the acquisition.
LLF met the conditions necessary for the earn-out payment for the calendar years ended December 31, 2008, 2009 and 2010. As a result, the Company made a cash payment in the amount of $4.4 million to the former shareholders of LLF in the third quarter of fiscal 2009, a cash payment in the amount of $8.8 million to the former shareholders of LLF in the third quarter of fiscal 2010, and a final cash payment in the amount of $13.2 million to the former shareholders of LLF in the third quarter of fiscal 2011. These incremental payments were treated as additional purchase price and resulted in an increase to goodwill in the Company’s consolidated financial statements.

The assets, liabilities, and operating results of LLF have been included in the Company's consolidated financial statements from the date of acquisition and are reflected in all periods presented in the accompanying financial statements.

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Note 3. Financial Statement Details
Accounts Receivable, net
The following is a summary of the components of accounts receivable, net (in thousands):

	December 25, 2011	June 26, 2011
Billed trade receivables	$170,929	$137,799
Unbilled contract receivables	1,623	1,038
	172,552	138,837
Allowance for sales returns, discounts, and other incentives	(14,739)	(19,615)
Allowance for bad debts	(1,428)	(753)
Total accounts receivable, net	$156,385	$118,469

Inventories
The following is a summary of the components of inventories (in thousands):

	December 25, 2011	June 26, 2011
Raw material	$56,318	$38,781
Work-in-progress	70,296	74,816
Finished goods	60,759	62,885
Total inventories	$187,373	$176,482

Revenues, net
Revenues were comprised of the following product groups (in thousands, except percentages):

	Three Months Ended		Six Months Ended	
	December 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
LED products	$194,162	$209,984	$390,940	$438,749
Percent of revenue	64 %	81 %	68 %	83 %
Lighting products	$95,736	$19,715	$147,409	$35,316
Percent of revenue	31 %	8 %	26 %	7 %
Power and RF products	$14,220	$27,284	$34,749	$51,355
Percent of revenue	5 %	11 %	6 %	10 %
Total revenue	$304,118	$256,983	$573,098	$525,420

Note 4. Investments
Short-term investments consist of high grade municipal and corporate bonds and other debt securities. The Company classifies its marketable securities as available-for-sale. This is based upon management’s determination that the underlying cash invested in these securities is available for operations as necessary.

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The following table provides a summary of marketable investments by type (in thousands):

	December 25, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$196,688	$2,657	$(4)	$ 199,341
Corporate bonds	168,732	1,374	(614)	169,492
Certificates of deposit	68,002	5	(3)	68,004
Municipal variable rate demand notes	2,795	—	—	2,795
Commercial paper	2,149	—	—	2,149
U.S. agency securities	72,446	476	(119)	72,803
Non-U.S. government securities	1,013	—	(2)	1,011
Total	$511,825	$4,512	$(742)	$ 515,595

	June 26, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	$391,465	$3,943	$(10)	$ 395,398
Corporate bonds	207,241	2,312	(115)	209,438
Certificates of deposit	10,003	12	—	10,015
Municipal variable rate demand notes	295	—	—	295
Commercial paper	4,999	—	—	4,999
U.S. agency securities	67,244	807	(2)	68,049
Non-U.S. government securities	6,986	19	—	7,005
Total	$688,233	$7,093	$(127)	$ 695,199

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

	December 25, 2011					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$11,984	$(4)	$—	$—	$11,984	$(4)
Corporate bonds	39,280	(614)	—	—	39,280	(614)
Certificates of deposit	2,998	(3)	—	—	2,998	(3)
U.S. agency securities	28,816	(119)	—	—	28,816	(119)
Non-U.S. government securities	1,012	(2)	—	—	1,012	(2)
Total	$84,090	$(742)	$—	$—	$84,090	$(742)
Number of securities with an unrealized loss		38		—		38

	June 26, 2011					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	$14,348	$(10)	$—	$—	$14,348	$(10)
Corporate bonds	20,484	(115)	—	—	20,484	(115)
U.S. agency securities	6,518	(2)	—	—	6,518	(2)
Total	$41,350	$(127)	$—	$—	$41,350	$(127)
Number of securities with an unrealized loss		20		—		20

The contractual maturities of marketable investments at December 25, 2011 were as follows (in thousands):

	December 25, 2011				
	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	$89,687	$109,654	$—	$—	$199,341
Corporate bonds	64,957	104,535	—	—	169,492
Certificates of deposit	63,001	5,003	—	—	68,004
Municipal variable rate demand notes	—	—	—	2,795	2,795
Commercial paper	2,149	—	—	—	2,149
U.S. agency securities	10,235	62,568	—	—	72,803
Non-U.S. government securities	—	1,011	—	—	1,011
Total	$230,029	$282,771	$—	$2,795	$515,595

Note 5. Fair Value of Financial Instruments

Under U.S. GAAP, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (i.e., “the exit price”) in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various valuation approaches, including quoted market prices and discounted cash flows. U.S. GAAP also establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available.

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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 broken down into three levels based on the reliability of inputs as follows:

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

The financial assets for which the Company performs recurring fair value remeasurements are cash equivalents and short-term investments. As of December 25, 2011, financial assets utilizing Level 1 inputs included money market funds and investments traded on active securities exchanges. Financial assets utilizing Level 2 inputs included certificates of deposit, corporate bonds, commercial paper, municipal bonds and variable rate demand notes, and U.S. agency securities and non-U.S. government securities. Level 2 assets are valued using a third-party pricing services consensus price which is a weighted average price based on multiple sources. These sources determine prices utilizing market income models which factor in, where applicable, transactions of similar assets in active markets, transactions of identical assets in infrequent markets, interest rates, bond or credit default swap spreads and volatility. The Company does not have any significant financial assets requiring the use of Level 3 inputs. There were no transfers between Level 1 and Level 2 during the six months ended December 25, 2011.
The following table sets forth financial instruments carried at fair value within the U.S. GAAP hierarchy and using the lowest level of input (in thousands):

	December 25, 2011				June 26, 2011			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents								
Money market funds	$5,711	$—	$—	$5,711	$7,386	$—	$—	$7,386
Total cash equivalents	5,711	—	—	5,711	7,386	—	—	7,386
Short-term investments								
Municipal bonds	—	199,341	—	199,341	—	395,398	—	395,398
Corporate bonds	—	169,492	—	169,492	—	209,438	—	209,438
Municipal variable rate demand notes	—	2,795	—	2,795	—	295	—	295
Certificates of deposit	—	68,004	—	68,004	—	10,015	—	10,015
Commercial paper	—	2,149	—	2,149	—	4,999	—	4,999
U.S. agency securities	—	72,803	—	72,803	—	68,049	—	68,049
Non-U.S. government securities	—	1,011	—	1,011	—	7,005	—	7,005
Total short-term investments	—	515,595	—	515,595	—	695,199	—	695,199
Total assets	$5,711	$515,595	$—	$521,306	$7,386	$695,199	$—	$702,585

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains from the sale of investments for the six months ended December 25, 2011 of approximately $1.0 million are included in "Other non-operating (loss) income, net" and unrealized gains and losses are included as a separate component of equity, net of tax, unless the loss is determined to be "other-than-temporary."
The Company evaluates its investments for possible impairment or a decline in fair value below cost basis that is deemed to be "other-than-temporary" on a periodic basis. It considers such factors as the length of time and extent to

which fair value has been below cost basis, the financial condition of the investee, and its ability and intent to hold the investment for a period of time that may be sufficient for an anticipated recovery in market value.

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Note 6. Intangible Assets

Intangible Assets, net

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

	December 25, 2011	June 26, 2011
Customer relationships	$137,440	$52,620
Developed technology	148,160	51,860
In-process research and development	15,050	—
Non-compete agreements	9,800	—
Patent and license rights	174,454	83,884
	$484,904	$188,364
Accumulated amortization	(99,420)	(85,504)
Intangible assets, net	$385,484	$102,860

Total amortization expense, including the amortization of acquisition related intangibles, patents and license rights, recognized during the three and six months ended December 25, 2011 was $8.8 and $14.1 million, respectively. For the three and six months ended December 26, 2010, total amortization expense, including amortization of acquisition related intangibles, patents and license rights was $3.8 and $7.6 million, respectively.

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

Fiscal Year Ending	
June 24, 2012	$31,452
June 30, 2013	33,955
June 29, 2014	31,802
June 28, 2015	28,715
June 26, 2016	28,533

Goodwill

Goodwill increased by $291.8 million during the six months ended December 25, 2011 due to the acquisition of Ruud Lighting. Refer to “Note 2. Acquisitions” for the calculation of total goodwill recognized on the purchase.

Note 7. Shareholders’ Equity

In connection with the acquisition of Ruud Lighting, the Company issued 6.1 million shares of common stock valued at approximately $211.0 million. The shares are subject to certain transfer restrictions under the Stock Purchase Agreement that will generally lapse with respect to 25% of the shares held (i) at the completion of the consecutive six-month period following the date of the closing of the transaction; and, (ii) at the completion of each of the following three successive six-month periods, such that all restrictions will lapse by the second anniversary of the closing.

As of December 25, 2011, the Company is authorized to repurchase shares of its common stock having an aggregate purchase price not exceeding $200.0 million for all purchases from June 16, 2011 through the expiration of the program, as authorized by the Board of Directors and extended through June 24, 2012. During the six months ended December 25, 2011, the Company did not repurchase any shares under the repurchase program.

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The following presents a summary of activity in comprehensive income, net (in thousands):

	Three Months Ended		Six Months Ended	
	December 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
Net income	$12,078	$49,775	$24,897	$107,811
Other comprehensive income:				
Net unrealized loss on available-for-sale securities, net of tax benefit of $544, $1,177, $1,206 and $611 respectively	(899)	(1,945)	(1,991)	(1,010)
Currency Translation Loss	(1,103)	—	(583)	—
Comprehensive income	$10,076	$47,830	$22,323	$106,801

For the six months ended December 25, 2011 approximately $1.0 million of unrealized gains were reclassified out of accumulated other comprehensive income into earnings for the period, and are included in "Other non-operating (loss) income, net" in the Consolidated Statements of Income.

Note 8. Earnings Per Share

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

	Three Months Ended		Six Months Ended	
	December 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
Basic:				
Net income	$12,078	$49,775	$24,897	$107,811
Weighted average common shares	115,536	108,364	113,701	108,032
Basic earnings per share	$0.10	$0.46	$0.22	$1.00

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

	Three Months Ended		Six Months Ended	
	December 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
Diluted:				
Net income	$12,078	$49,775	$24,897	$107,811
Weighted average common shares - basic	115,536	108,364	113,701	108,032
Dilutive effect of stock options, unvested shares and ESPP purchase rights	347	1,612	538	1,785
Weighted average common shares - diluted	115,883	109,976	114,239	109,817
Diluted earnings per share	$0.10	$0.45	$0.22	$0.98

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be antidilutive. In accordance with U.S. GAAP, these shares were not included in calculating diluted earnings per share. For the three and six months ended December 25, 2011, there were 8.1 and 6.6 million shares, respectively, not included in calculating diluted earnings per share because their effect was antidilutive. For three and six months ended December 26, 2010, there were 2.3 and 1.6 million shares, respectively, not included in calculating diluted earnings per share because their effect was antidilutive.

Note 9. Stock-Based Compensation

The Company currently has one equity-based compensation plan from which stock-based compensation awards can be granted to employees and directors. In addition, the Company has plans that have been terminated as to future grants, but under which options are currently outstanding. The Company also has an Employee Stock Purchase Plan ("ESPP") that provides employees with the opportunity to purchase the Company’s common stock at a discount. The

ESPP was amended in the second quarter of fiscal 2012 to increase the six-month participation period to a twelve-month participation period, divided into two equal six-month purchase periods and provide for a look-back feature. At the end of each six-month period, employees purchase the

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Company's common stock through the ESPP at 15% less than the fair market value of the common stock on the first day of the twelve-month participation period or the purchase date, whichever is lower. The plan amendment also provides for an automatic reset feature to start participants on a new twelve-month participation period if the share value declines during the first six-month purchase period.

Stock Option Awards

The following table summarizes outstanding option awards as of December 25, 2011, and changes during the six months then ended (shares in thousands):

	Number of Shares	Weighted-Average Exercise Price
Outstanding at June 26, 2011	6,467	$39.56
Granted	2,920	30.74
Exercised	(112)	23.64
Forfeited or expired	(311)	39.83
Outstanding at December 25, 2011	8,964	$36.88

Restricted Stock and Stock Unit Awards

A summary of nonvested shares of restricted stock and stock unit awards outstanding under the Company's 2004 Long-Term Incentive Compensation Plan as of December 25, 2011, and changes during the six months then ended, follows (shares in thousands):

	Number of Shares/Units	Weighted-Average Grant-Date Fair Value
Nonvested at June 26, 2011	509	$40.87
Granted	227	30.97
Vested	(177)	38.29
Forfeited	(28)	35.37
Nonvested at December 25, 2011	531	$37.79

Stock-Based Compensation Valuation and Expense

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

To estimate the fair value of the Company's stock option awards the Company currently uses the Black-Scholes option-pricing model. 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, risk-free interest rate and expected dividends. Due to the inherent limitations of option-valuation models available today, including future events that are unpredictable and the estimation process utilized in determining the valuation of the stock-based awards, the ultimate value realized by award holders may vary significantly from the amounts expensed in the Company's financial statements.

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

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Stock-based compensation expense is recorded net of estimated forfeitures such that expense is recorded 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.Total stock-based compensation expense was as follows (in thousands):

Income Statement Classification	Three Months Ended		Six Months Ended	
	December 25, 2011	December 26, 2010	December 25, 2011	December 26, 2010
Cost of goods sold	$1,615	$1,351	$3,329	$2,483
Research and development	2,603	2,183	5,031	3,998
Sales, general and administrative	6,977	6,443	14,275	11,500
Total operating expenses	9,580	8,626	19,306	15,498
Total	$11,195	$9,977	$22,635	$17,981

Note 10. Income Taxes

The variation between the Company’s effective income tax rate and the U.S. statutory rate of 35 percent is primarily due to the consolidation of its foreign operations, which are subject to income taxes at lower statutory rates. A change in the mix of pretax income from these various tax jurisdictions can have a significant impact on the Company’s periodic effective tax rate.

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

At June 26, 2011, the Company had recorded $7.0 million of unrecognized tax benefits. During the six months ended December 25, 2011, there were no changes to that amount of recognized tax benefits. As a result, the total amount of unrecognized tax benefits as of December 25, 2011 is $7.0 million. If any portion of this $7.0 million is recognized, the Company will then include that portion in the computation of its effective tax rate. Although the ultimate timing of the resolution and/or closure of audits is highly uncertain, the Company believes it is reasonably possible that approximately $2.6 million of gross unrecognized tax benefits will change in the next 12 months.

The Company’s policy is to include interest and penalties related to unrecognized tax benefits within the income tax expense line item in the consolidated statements of income. As of December 25, 2011, the Company had accrued $58 thousand of interest and penalties.

The Company files U.S. federal, U.S. state, and foreign tax returns. For U.S. federal purposes, the Company is generally no longer subject to tax examinations for fiscal years ended June 29, 2008 and prior. For foreign purposes, the Company is generally no longer subject to examination for tax periods 2001 and prior. Certain carryforward tax attributes generated in prior years remain subject to examination and adjustment. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2008. The Company is currently under examination by the Internal Revenue Service for fiscal 2009. The Company is also currently under inquiry by the Hong Kong Inland Revenue Department for fiscal 2008 and fiscal 2010.

Note 11. Commitments and Contingencies

Warranties

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

Balance at September 25, 2011	$3,860
Measurement period acquisition related warranty (See Note 2)	3,023
Warranties accrued in current period	323
Changes in estimates for pre-existing warranties	(400)
Expenditures	(958)

Balance at December 25, 2011	$5,848

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Product warranties are provided for at the time the Company recognizes revenue. The warranty periods range from ninety days to ten years. The Company estimates these warranty liabilities as a percentage of revenue, based on historical knowledge of warranty costs and expected future warranty costs. If actual product failure rates materially differ from these estimates, revisions to the estimated warranty liability would be required. The Company evaluates its warranty reserve on a quarterly basis.

Litigation

The Company is a party to various legal proceedings. Information regarding material legal proceedings is contained in our Annual Report on Form 10-K for the year ended June 26, 2011, and updates to that disclosure, including with respect to the proceedings discussed below, are contained in our Quarterly Report on Form 10-Q for the quarter ended September 25, 2011. The following is provided as an update to the Company's legal proceedings as contained in those reports. Unless otherwise indicated, the potential losses for claims against the Company in these matters are not reasonably estimable.

Dow Corning Litigation
As previously reported, Dow Corning Compound Semiconductor Solutions, LLC filed a complaint against the Company in the U.S. District Court for the Eastern District of Michigan on September 27, 2011. The complaint, as subsequently amended, seeks a declaratory judgment that the plaintiff does not infringe three U.S. patents owned by the Company relating to high quality silicon carbide materials and that the patents are invalid. The Company has moved the court to dismiss the action for lack of subject matter jurisdiction on the grounds that at the time the complaint was filed there was no substantial or immediate controversy between the parties regarding the patents-in-suit.

Osram Sylvania and Lighting Science Group Litigation
As previously reported, Ruud Lighting, Inc. filed a complaint for patent infringement against Osram Sylvania, Inc. in the U.S. District Court for the Eastern District of Wisconsin on April 2, 2010 and Lighting Science Group Corporation intervened as a co-defendant in the action. In November 2011, the action was voluntarily dismissed without prejudice pursuant to a joint stipulation of the parties.

Cooper Lighting Litigation
As previously reported, Illumination Management Solutions, Inc., a subsidiary of Cooper Lighting, LLC, filed a complaint for patent infringement against Ruud Lighting in the U.S. District Court for the Eastern District of Texas on June 7, 2010. The action was later transferred to the U.S. District Court for the Eastern District of Wisconsin. As amended in January 2012, the complaint alleges that Ruud Lighting is infringing two U.S. patents owned by Illumination Management Solutions, No. 7,674,018 and No. 7,993,036, each entitled "LED Device for Wide Beam Generation." It also alleges that Ruud Lighting and its then president, Alan Ruud, who served on the plaintiff's board of directors in 2006 and 2007 when Ruud Lighting was a shareholder of the plaintiff, conspired to misuse confidential information obtained from the plaintiff to file patent applications and to obtain patents assigned to Ruud Lighting. The complaint seeks injunctive relief, damages and ownership of any interest in the patent applications and patents alleged to have been wrongfully filed and obtained.

As also previously reported, Ruud Lighting is a defendant in an action commenced by Illumination Management Solutions in the U.S. District Court for the Central District of California on June 8, 2010 and later transferred to the U.S. District Court for the Eastern District of Wisconsin. As amended in December 2011, the complaint names as defendants Ruud Lighting and two of its employees, Alan Ruud and Christopher Ruud, and asserts that the defendants engaged in wrongful acts arising out of the relationship between the plaintiff and Ruud Lighting in 2006 and 2007 when Ruud Lighting was a shareholder of the plaintiff and Alan Ruud served on the plaintiff's board of directors. The complaint alleges that the defendants breached fiduciary duties and otherwise acted improperly by pursuing a plan to compete with the plaintiff and that the defendants misused trade secrets and other information obtained from the plaintiff as fiduciaries and subject to a non-disclosure agreement. These allegedly wrongful acts included filing patent applications and obtaining patents assigned to Ruud Lighting on inventions claimed by the plaintiff. The complaint also alleges that Ruud Lighting: (a) marketed its LED products without reference to certain optical technology claimed by the plaintiff, thereby breaching a marketing agreement with the plaintiff and engaging in unfair competition and false advertising; (b) breached the marketing agreement by failing to give the plaintiff a right of first refusal to integrate the plaintiff's optical technology into Ruud Lighting LED products; and (c) committed fraud by entering into the marketing agreement without any intention to perform it. The complaint further alleges that the plaintiff is entitled to a correction of the inventors named in one or more patents to add a founder of the plaintiff as an inventor. The complaint seeks to recover damages, all profits and other gains realized by defendants as a result of the acts complained of, attorneys' fees, ownership of any interest in the patent applications and patents alleged to have been wrongfully filed and obtained, and correction of the named inventors on one or more patents.

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

Information set forth in this Quarterly Report on Form 10-Q contains various “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). All information contained in this report relative to future markets for our products and trends in and anticipated levels of revenue, gross margins and expenses, as well as other statements containing words such as “believe,” “project,” “may,” “will,” “anticipate,” “target,” “plan,” “estimate,” “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 we have no duty to update them if our views later change. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this Quarterly Report. Examples of risks and uncertainties that could cause actual results to differ materially from historical performance and any forward-looking statements include, but are not limited to, those described in “Risk Factors” in Part II, Item 1A of this Quarterly Report.

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended June 26, 2011. 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 general illumination, video displays, automotive, electronic signs and signals, power supplies and solar inverters.

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

Our LED products consist of LED components, LED chips, and SiC wafers. As we develop and improve our LED technology and the market continues to focus on energy efficiency, we believe the potential market for LED lighting will continue to expand. Our success in selling LED products depends upon our ability to drive adoption and offer innovative products and solutions that enable our customers to succeed in the market. By driving adoption we believe we can influence the growth of the market and open more opportunities for LEDs.

Our lighting products consist of both LED and traditional lighting systems. We design, manufacture and sell lighting systems for indoor and outdoor applications, with our primary focus on LED lighting systems for the commercial and industrial markets. We also use our LED systems expertise to accelerate LED adoption and expand the market for our LED components.

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

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 our products fabrication, packaging and assembly. We operate research and development facilities in North Carolina, California, Wisconsin and China.

We currently operate our business as one reportable segment.

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Industry Dynamics and Trends

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

- Overall Demand for Products and Applications using LEDs. Our potential for growth depends significantly on the adoption of LEDs within the general lighting market and our ability to affect this rate of adoption. Although LED lighting has grown in recent years, adoption of LEDs for general lighting is relatively new and faces

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significant challenges before widespread adoption. Demand also fluctuates based on various market cycles, a continuously evolving LED industry supply chain, and demand dynamics in the market. These uncertainties make demand difficult to forecast for us and our customers.

- Intense and Constantly Evolving Competitive Environment. Competition in the industry is intense and new companies have entered and are entering the LED market, with many companies making significant investments in LED production equipment. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share and to increase the utilization of their production capacity. Currently, many LED suppliers are reporting excess or underutilized factory capacity which generally leads to a more aggressive pricing environment. To remain competitive, market participants must continuously increase product performance and reduce costs to offset lower average sales prices. To address this pricing pressure, we have invested in cost reduction activities including lower cost product designs, yield and productivity improvements, and the development of 150mm wafer production, which is intended to reduce our costs of producing LED chips. The effectiveness of these activities will vary based on overall factory utilization rates, which are driven primarily by market demand.
- Technological Innovation and Advancement. Innovations and advancements in LED technology continue to expand the potential commercial application of LEDs particularly in the general illumination market. However, new technologies or standards could emerge, or improvements could be made in existing technologies, that reduce or limit the demand for LEDs in certain markets.
- Regulatory Actions Concerning Energy Efficiency. Many countries have already instituted or have announced plans to institute government regulations and programs designed to encourage or mandate increased energy efficiency, even in some cases banning forms of incandescent lighting, which are advancing the adoption of more energy efficient lighting solutions such as LEDs. While this trend is generally positive, there have been some political efforts in the United States to change or limit the effectiveness of these new regulations.
- Intellectual Property Issues. Market participants rely on patented and non-patented proprietary information relating to product development, manufacturing capabilities and other core competencies of their business. Protection of intellectual property is critical. Therefore, steps such as additional patent applications, confidentiality and non-disclosure agreements, as well as other security measures are generally taken. To enforce or protect intellectual property rights, litigation or threatened litigation commonly occurs.

Highlights of the Second Quarter Fiscal 2012

The following is a summary of our financial results for the three months ended December 25, 2011:

- Our year over year revenues increased to $304.1 million from $257.0 million.
- Operating income was $12.2 million in the second quarter of fiscal 2012 compared to $55.4 million in the second quarter of fiscal 2011. Net income per diluted share was $0.10 compared to $0.45 for the second quarter of fiscal 2011;
- Inventory decreased to $187.4 million at December 25, 2011 compared to $203.6 million at September 25, 2011;
- We spent $53.0 million on capital expenditures during the six months ended December 25, 2011 compared to $126.4 million during the six months ended December 26, 2010; and
- Combined cash, cash equivalents and marketable investments increased to $687.2 million at December 25, 2011 compared to $632.2 million at September 25, 2011.

Business Outlook

We project that the markets for our products will remain highly competitive during the remainder of fiscal 2012. We anticipate focusing on the following key areas in response to this competitive environment:

- Build on our market leadership and drive adoption of LED lighting. We are focused on developing innovative new LED lighting systems to drive adoption, and new LED components that enable our customers to deliver a more competitive payback versus traditional lighting. In August 2011, we acquired Ruud Lighting, a leading innovator of LED lighting products, which we believe gives us a stronger product portfolio to drive LED adoption and expand the market for LED lighting. We plan to continue to invest in both our LED lighting and LED component product lines to increase performance, enable lower lighting system costs with shorter paybacks and find new ways to drive the market and o

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bsolete old, energy-wasting lighting technology.

- Accelerate cost reductions and drive operational improvements to increase the profitability of our business. We target lower LED costs from new lower cost product designs, yield and productivity improvements and the conversion

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to 150mm wafers. In the near term, cost reductions may be offset by the aggressive pricing environment and low factory utilization. It will take time and increased volume to fully realize the benefit of many of these improvements. We are also delaying the rate of conversion to 150mm wafer production to take advantage of existing 100mm capacity to optimize the current factory to deliver the lowest cost in the near term. We are continuing work to enable the full conversion as business needs warrant over the next three to six quarters. We plan to lower LED lighting system costs with new product designs that are under development and we target improved operating leverage over time from higher revenues across our LED lighting systems and component product lines.

- Expand the power and RF product line beyond niche applications. SiC power devices can deliver better performance and increased payback against silicon (Si) based power devices in applications where efficiency and reliability is an important criteria. We target continued investment in R&D for new diode and switch products focused on more mainstream and higher volume power switching applications. We are managing the product line through a slowdown in solar inverter demand. We target the combination of new products, improved market demand and expanded sales coverage to drive growth in the product line.

Results of Operations

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

	Three Months Ended December 25, 2011		December 26, 2010		Six Months Ended December 25, 2011		December 26, 2010	
(in thousands, except per share amounts and percentages)	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue
Revenue, net	$304,118	100 %	$256,983	100 %	$573,098	100 %	$525,420	100 %
Cost of revenue, net	199,000	65 %	135,837	53 %	369,952	65 %	273,745	52 %
Gross profit	105,118	35 %	121,146	47 %	203,146	35 %	251,675	48 %
Research and development	35,886	12 %	29,233	11 %	70,288	12 %	53,965	10 %
Sales, general and administrative	49,176	16 %	33,366	13 %	94,715	17 %	62,568	12 %
Amortization of acquisition related intangibles	7,367	2 %	2,706	1 %	11,292	2 %	5,412	1 %
Loss on disposal or impairment of long-lived assets	497	— %	429	— %	1,272	— %	901	— %
Operating income	12,192	4 %	55,412	22 %	25,579	4 %	128,829	25 %
Other non-operating (loss) income, net	(111)	— %	63	— %	863	— %	1	— %
Interest income, net	1,800	1 %	2,170	1 %	3,769	1 %	4,186	1 %
Income from operations before income taxes	13,881	5 %	57,645	22 %	30,211	5 %	133,016	25 %
Income tax expense	1,803	1 %	7,870	3 %	5,314	1 %	25,205	5 %
Net income	12,078	4 %	49,775	19 %	24,897	4 %	107,811	21 %
Diluted earnings per share	$0.10		$0.45		$0.22		$0.98	

Revenues

Our revenues are presented below in the following categories: LED products, lighting products and power and RF products, which represents a change from our prior presentation. Revenues for the three and six months ended December 25, 2011 and December 26, 2010 were comprised of the following (in thousands, except percentages):

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	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
LED products	$194,162	$209,984	$(15,822)	(8)%	$390,940	$438,749	$(47,809)	(11)%
Percent of revenues	64%	81%			68%	83%		
Lighting products	95,736	19,715	76,021	386%	147,409	35,316	112,093	317%
Percent of revenues	31%	8%			26%	7%		
Power and RF products	14,220	27,284	(13,064)	(48)%	34,749	51,355	(16,606)	(32)%
Percent of revenues	5%	11%			6%	10%		
Total revenues	$304,118	$256,983	$47,135	18%	$573,098	$525,420	$47,678	9%

LED Products

We derive the largest portion of our revenue from the sale of our LED products which comprised approximately 64% and 81% of our total revenues for the second quarter of fiscal 2012 and fiscal 2011, respectively.

Revenue from LED products decreased approximately 8% to $194.2 million in the second quarter of fiscal 2012 from $210.0 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, revenue from our LED products decreased approximately 11% to $390.9 million from $438.7 million for the six months ended December 26, 2010. These decreases were primarily due to generally weaker demand and downward pricing pressure. Although the blended average selling price (ASP) for our LED chips decreased, the ASP for our LED products overall increased by 22.4% in the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011. This increase was primarily due to a higher product mix of LED components, which have a higher ASP.

Lighting Products

Revenues from lighting products comprised approximately 31% and 8% of our total revenues for the second quarter of fiscal 2012 and fiscal 2011, respectively.

Revenue from lighting products increased approximately 386% to $95.7 million in the second quarter of fiscal 2012 from $19.7 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, revenue from our lighting products increased approximately 317% to $147.4 million from $35.3 million for the six months ended December 26, 2010. These increases were due to an increase in the sales of our existing products and sales of product offerings acquired from Ruud Lighting. The ASP for our lighting products increased by 24.9% in the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011.

Power and RF Products

Revenues from power and RF products comprised approximately 5% and 11% of our total revenues for the second quarter of fiscal 2012 and fiscal 2011, respectively.

Revenue from power and RF decreased approximately 48% to $14.2 million in the second quarter of fiscal 2012 from $27.3 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, revenue from our power and RF products decreased approximately 32% to $34.7 million from $51.4 million for the six months ended December 26, 2010. The decreases in our power and RF products revenue were primarily due to a lower demand in the solar inverter markets and the delay of RF orders related to military programs. The ASP for our power and RF products decreased by 7.6% in the second quarter of fiscal 2012 compared to the second quarter of fiscal 2011.

Gross Profit

Cost of revenue includes materials, labor and overhead costs incurred internally or paid to contract manufacturers to produce our products. Gross profit in dollars and gross margin were as follows (in thousands, except percentages):

	Three Months Ended		Change	Six Months Ended		Change

	December 25, 2011	December 26, 2010			December 25, 2011	December 26, 2010		
Total gross profit	$105,118	$121,146	$(16,028)	(13)%	$203,146	$251,675	$(48,529)	(19)%
Gross margin	35%	47%			35%	48%		

Gross profit in the second quarter of fiscal 2012 decreased approximately 13% to $105.1 million from $121.1 million in the

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second quarter of fiscal 2011. For the six months ended December 25, 2011, gross profit decreased approximately 19% to $203.1 million from $251.7 million for the six months ended December 26, 2010. Additionally, for the second quarter of fiscal

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2012 our gross margin decreased to 35% from 47% in the second quarter of fiscal 2011. For the six months ended December 25, 2011, our gross margin decreased to 35% from 48% for the six months ended December 26, 2010. Factors contributing to the decrease in gross profit and gross margin were an aggressive pricing environment for LED chips and components and overall lower factory utilization.

Research and Development

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

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

	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
Research and development	$35,886	$29,233	$6,653	23 %	$70,288	$53,965	$16,323	30 %
Percent of revenues	12 %	11 %			12 %	10 %		

Research and development expenses in the second quarter of fiscal 2012 increased 23% to $35.9 million from $29.2 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, research and development expenses increased 30% to $70.3 million from $54.0 million for the six months ended December 26, 2010. These increases were primarily due to increased spending on research and development activities focused on new LED chips, LED components, LED lighting products, power products and the incremental research and development expense incurred from the acquisition of Ruud Lighting. Our research and development expenses vary significantly from quarter to quarter based on a number of factors, including: the timing of new product introductions, timing of expenditures and the number and nature of our ongoing research and development activities. However, we anticipate that in general our research and development expenses will continue to increase over time to support future growth.

Sales, General and Administrative

Sales, general and administrative expenses are composed primarily of costs associated with our sales and marketing personnel and our executive and administrative personnel (for example, legal, finance, information technology and human resources personnel) and consist of 1) salaries and related compensation costs, 2) consulting and other professional services (such as litigation and other outside legal counsel fees, audit and other compliance costs), 3) facilities and insurance costs, and 4) travel and other costs. The following table sets forth our sales, general and administrative expenses in dollars and as a percentage of revenues (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
Sales, general and administrative	$49,176	$33,366	$15,810	47 %	$94,715	$62,568	$32,147	51 %
Percent of revenues	16 %	13 %			17 %	12 %		

Sales, general and administrative expenses in the second quarter of fiscal 2012 increased 47% to $49.2 million from $33.4 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, sales, general and administrative expenses increased 51% to $94.7 million from $62.6 million for the six months ended December 26,

2010. The increase in the second quarter of fiscal 2012 from fiscal 2011 is primarily due to an increase in spending on sales and marketing for lighting products as we continue to expand our direct sales resources and channels and invest in building and promoting the Cree brand, as well as the incremental sales, general and administrative expenses associated with Ruud Lighting. Additionally, we incurred increased legal costs associated with patent litigation and transaction costs associated with the acquisition of Ruud Lighting.

Amortization of Acquisition Related Intangibles

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As a result of our acquisitions, we have recorded various intangible assets that require amortization, including customer relationships and developed technologies. During fiscal 2007, we acquired INTRINSIC Semiconductor Corporation and

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COTCO Luminant Device Limited (now Cree Hong Kong Limited) (COTCO), resulting in $63.7 million of amortizable intangible assets principally composed of customer relationships and developed technology. In fiscal 2008, we acquired LLF, resulting in an additional $41.2 million of amortizable intangible assets. These intangible assets are principally composed of developed technology that specifically relates to technologies underlying the development of LED lighting products for the general illumination market. During fiscal 2012, we acquired Ruud Lighting, resulting in $206.0 million of amortizable intangible assets consisting of developed technology, customer relationships, trade names, in-process research and development, and non-compete agreements. Amortization of intangible assets related to our acquisitions is as follows (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
INTRINSIC	$186	$ 186	$—	— %	$372	$ 372	$—	— %
COTCO	1,264	1,734	(470)	(27)%	2,528	3,468	(940)	(27)%
LLF	750	786	(36)	(5)%	1,500	1,572	(72)	(5)%
Ruud Lighting	5,167	—	5,167	100 %	6,892	—	6,892	100 %
Total	$7,367	$ 2,706	$4,661	172 %	$11,292	$ 5,412	$5,880	109 %

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 for possible impairments in value. 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 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
Loss on disposal or impairment of long-lived assets, net	$497	$ 429	$68	16 %	$1,272	$ 901	$371	41 %

We recorded a net loss of $0.5 million on the disposal of long-lived assets in the second quarter of fiscal 2012 compared to a net loss of $0.4 million in the second quarter of fiscal 2011. For the six months ended December 25, 2011, we recorded a loss of $1.3 million compared to $0.9 million for the six months ended December 26, 2010. These net losses resulted from the disposal of equipment due to manufacturing process changes and the impairment of certain capitalized patent costs.

Non-Operating Income

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

	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
Other non-operating (loss) income, net	$(111)	$ 63	$(174)	(276)%	$863	$ 1	$862	86,200 %
Interest income, net	1,800	2,170	(370)	(17)%	3,769	4,186	(417)	(10)%
Total	$1,689	$ 2,233	$(544)	(24)%	$4,632	$ 4,187	$445	11 %

We have no debt or lines of credit with activity and we are in a net interest income position. We have historically invested portions of our available cash in fixed interest rate securities such as high-grade corporate debt, commercial paper, government securities, municipal bonds, and other fixed interest rate investments. The primary objective of our investment policy is preservation of principal.

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Other non-operating (loss) income, net, is comprised primarily of gains on sales of investments and foreign exchange gains and losses. The decrease for the three months ended December 25, 2011 compared to the three months ended December

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26, 2010 is due to foreign exchange losses. The increase for the six months ended December 25, 2011 compared to the six months ended December 26, 2010 is primarily from gains on sales of investments liquidated in order to fund our acquisition of Ruud Lighting.

Income Tax Expense

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

	Three Months Ended				Six Months Ended			
	December 25, 2011	December 26, 2010	Change		December 25, 2011	December 26, 2010	Change	
Income tax expense	$1,803	$7,870	$(6,067)	(77)%	$5,314	$25,205	$(19,891)	(79)%
Effective Tax Rate	13.0%	13.7%			17.6%	18.9%		

The variation between our effective tax rate and the U.S. statutory rate of 35% is primarily due to the consolidation of our foreign operations, which are subject to income taxes at lower statutory rates. A change in the mix of pretax income from these various tax jurisdictions can have a material impact on our periodic effective tax rate.

We recorded income tax expense of $1.8 million for an effective tax rate of 13.0% in the second quarter of fiscal 2012 as compared to income tax expense of $7.9 million for an effective tax rate of 13.7% in the second quarter of fiscal 2011. For the six months ended December 25, 2011, we recorded income tax expense of $5.3 million for an effective tax rate of 17.6% compared to income tax expense of $25.2 million for an effective tax rate of 18.9% for the six months ended December 26, 2010. The decrease in our effective tax rate for the six month comparable period is primarily due to the increased impact of tax credits relative to lower year over year pre-tax income.

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 investments and cash generated from operations. 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 no debt or active lines of credit and have minimal lease commitments.

On August 17, 2011, we acquired all of the outstanding share capital of Ruud Lighting in exchange for consideration consisting of 6.1 million shares of our common stock and $372.2 million cash, subject to certain post-closing adjustments. Prior to the completion of our acquisition of Ruud Lighting, Ruud Lighting completed the re-acquisition of its e-conolight business by purchasing all of the membership interests of E-conolight, LLC. Ruud Lighting previously sold its e-conolight business in March 2010 and had been providing operational services to E-conolight since that date. In connection with the stock purchase transaction, we funded Ruud Lighting's re-acquisition of E-conolight and paid off Ruud Lighting's outstanding debt in the aggregate amount of approximately $85.0 million. The cash consideration and debt payoff were funded from cash on hand, which reduced our available cash to fund our operating expenses and working capital by approximately $457.2 million.

Based on past performance and current expectations, we believe our cash and cash equivalents, investments, cash generated from operations and our ability to access capital markets will satisfy our working capital needs, capital expenditures, investment requirements, stock repurchases, contractual obligations, commitments and other liquidity requirements associated with our operations through at least the next 12 months.

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 new debt or additional shares of common stock in connection with the acquisition of complementary businesses or other significant assets or for other strategic opportunities.

Financial Condition

Our liquidity and capital resources depend on our cash flows from operations and our working capital. Our working capital

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decreased to $955.4 million as of December 25, 2011 from $1,316.6 million at June 26, 2011, primarily due to cash used to fund our acquisition of Ruud Lighting in the first quarter of fiscal 2012. The following table presents the components of our cash conversion cycle for our second quarter of fiscal 2012 and fourth quarter of fiscal 2011:

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	December 25, 2011	June 26, 2011	Change			
Days of sales outstanding[a]	46	44	2		5	%
Days of supply in inventory[b]	85	106	(21	)	(20	)%
Days in accounts payable[c]	(37)	(46)	9		(20	)%
Cash conversion cycle	94	104	(10	)	(10	)%

(a) Days of sales outstanding (DSO) calculates the average collection period of our accounts receivable. DSO is based on the ending net trade receivables and the most recent quarterly revenue for each period. DSO is calculated by dividing accounts receivable, net of allowance for doubtful accounts and revenue reserves, by average net revenue for the current quarter (90 days).

(b) Days of supply in inventory (DSI) measures the average number of days from procurement to sale of our product. DSI is based on net ending inventory and the most recent quarterly cost of sales for each period. DSI is calculated by dividing net ending inventory by average cost of goods sold for the current quarter (90 days).

(c) Days in accounts payable (DPO) calculates the average number of days our payables remain outstanding before payment. DPO is based on ending accounts payable and most recent quarterly cost of sales for each period. DPO is calculated by dividing accounts payable by average cost of goods sold for the current quarter (90 days).

The decrease in the cash conversion cycle was primarily driven by a reduction in days supply in inventory which was the result of increased sales and better management of factory loading.

As of December 25, 2011, all of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at December 25, 2011 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. When evaluating our investments for possible impairment, we review factors such as the length of time and extent to which fair value has been below our cost basis, the financial condition of the entity in which the investment is made, and our ability and intent to hold the investment for a period of time that may be sufficient for anticipated recovery in market value. The declines in value of the securities in our portfolio are considered to be temporary in nature and we do not believe these securities are impaired as of December 25, 2011.

We believe our current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for the remainder of fiscal 2012. We have and may continue to use a portion of our available cash and cash equivalents, or funds underlying our marketable securities, to repurchase shares of our common stock. 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.

Cash Flows

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

	Six Months Ended							
	December 25, 2011		December 26, 2010		Change			
Cash provided by operating activities	$122,237		$145,756		$(23,519	)	(16	)%
Cash used in investing activities	(344,697	)	(117,122	)	(227,575	)	194	%
Cash provided by financing activities	2,849		39,254		(36,405	)	(93	)%

Effects of foreign exchange changes	664	238	426	179	%
Net (decrease) increase in cash and cash equivalents	$(218,947)	$68,126			

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

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Cash Flows from Operating Activities

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Net cash provided by operating activities was $122.2 million in the first six months of fiscal 2012 compared to $145.8 million for the first six months of fiscal 2011. This decrease was primarily driven by a year over year decline in our net income.

Cash Flows from Investing Activities

Our investing activities primarily relate to transactions within our investments, strategic acquisitions, purchase of property, plant and equipment and purchase of patent and license rights. Net cash used in investing activities was $344.7 million for the first six months of fiscal 2012 compared to $117.1 million for the first six months of fiscal 2011. This year over year increase to cash used in investing activities was primarily the result of the $457.2 million cash portion of the purchase price for our acquisition of Ruud Lighting in the first quarter of fiscal 2012, which was partially offset by a decrease in capital expenditures and an increase in our proceeds from the sale and maturity of investments, which were liquidated to pay for the Ruud Lighting acquisition.

We will continue to closely monitor our capital expenditures, while making strategic investments to develop our existing products, pursue strategic initiatives where appropriate, and invest in our manufacturing and information technology infrastructure to meet the needs of our business. We target committing capital of approximately $75 to $80 million in fiscal 2012 for capital expenditures.

Cash Flows from Financing Activities

Net cash provided by financing activities was $2.8 million for the first six months of fiscal 2012 compared to $39.3 million for the first six months of fiscal 2011. This change was primarily due to the lower issuance of shares related to option exercises.

Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use 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 25, 2011, 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 leases primarily for certain of our facilities in the normal course of business. These arrangements are often referred to as a form of off-balance-sheet financing. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 26, 2011, in the section entitled “Contractual Obligations” for the future minimum lease payments due under our operating leases as of June 26, 2011.

Critical Accounting Policies and Estimates

For information about our other 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 26, 2011.

Recent Accounting Pronouncements

See Note 1, "Basis of Presentation and Changes in Significant Accounting Policies," to our unaudited financial statements in Part I, Item 1 of this Quarterly Report for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about our market risks, see Item 7A of our Annual Report on Form 10-K for the fiscal year ended June 26, 2011.

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 the 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 are recorded, processed, summarized and reported within the time periods required by the United States Securities and Exchange Commission'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.

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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 2012 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 of Notes to Consolidated Financial Statements included 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 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 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.

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 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;
- maintain a sufficient supply of raw materials to support our growth;
- expand research and development, sales and marketing, technical support, distribution capabilities and administrative functions;
- 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, in November 2011, we broke ground on a 208,000 square foot expansion to our Wisconsin manufacturing facility to expand our capacity to manufacture and assemble LED lighting and we continue to expand our LED production facilities in China. However, 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. If we do not allocate and effectively manage the resources necessary to build, implement 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 or the loss of or damage to intellectual property through security breach, or impact 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.

We operate in an industry that is 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 industry has experienced significant fluctuations, often in connection with, or in anticipation of product cycles and changes in general economic conditions. These fluctuations have been characterized by lower product demand, production overcapacity, higher inventory levels and increased pricing pressure. We have experienced these conditions in our business in the past, are currently experiencing these conditions, and may experience such conditions in the future, which could

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have a material negative impact on our business and results of operations.

If we are unable to effectively develop, manage and expand our sales and distribution 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 LED lighting products and more LED components versus LED chips. For example, lighting sales agents may choose to drop our product lines from their portfolio to avoid losing access to our competitors' lighting products. If we are unable to effectively penetrate these channels or develop alternate channels to ensure our products are reaching the appropriate 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 true with 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 product 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 revise our estimates and our operating results could be impacted.

The markets in which we operate are highly competitive and have evolving technical requirements.
The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture or sell LED chips and LED components. In the lighting market we compete with companies that manufacture and sell traditional and LED lighting products. 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 may 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.

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. Additionally, we anticipate that increased competition will result in pressure to lower the selling prices of our products. Therefore, our ability to continually produce more efficient, higher brightness LEDs and lighting products that meet the evolving needs of our customers at lower costs will be critical to our success. Competitors may also try to align with some of our strategic customers. This could mean lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Any of these developments could have an adverse effect on our business, results of operations or financial condition.

We depend on a limited number of customers, including distributors, for a substantial portion of our revenues, 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 revenues from a limited number of customers, including distributors. 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 past 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. If our customers alter their past (or expected) purchasing behavior, or if we encounter any problems collecting amounts due from them, our financial condition and results of operations could be negatively impacted.

As a result of our continued expansion into new markets existing customers may reduce orders.

Through acquisitions and organic growth, including our recent acquisition of Ruud Lighting, we continue to expand into new markets. Many of our existing customers who purchase our LED chips and LED components develop and manufacture products using those chips and components that are offered into the same markets. As a result, some of our current customers perceive us as a competitor in these new markets. In response, our customers may reduce or discontinue their orders for our 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.

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. For example, in November of 2011, we broke ground on a 208,000 square foot expansion to our Wisconsin manufacturing facility to expand our capacity to manufacture and assemble LED lighting and we continue to expand our LED production facilities in China. 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 expansion costs), if demand does not increase at the rate forecasted, we may not be able to manage manufacturing expenses or overhead costs at the same rate as 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 record impairments on our long-lived assets or record excess inventory write off charges. We have in the past and may in the future be required to record excess capacity charges, which would have a negative impact on our results of operations.

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

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 or divestitures. We acquired Ruud Lighting in August 2011 and LED Lighting Fixtures, Inc. (LLF) in February 2008. If we choose to enter into such transactions, we face certain risks, such as the failure of an acquired business to meet our performance expectations, diversion of management attention, identification of additional liabilities relating to the acquired business, retention of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers of existing product lines or otherwise, 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 recent or future acquisitions or divestitures. Any failure to successfully evaluate strategic opportunities and address risks or other problems that arise related to any such business transaction could adversely affect our business, results of operations or financial condition.

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

We are required under generally accepted accounting principles to review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our amortizable intangible assets or goodwill may not be recoverable include a decline in stock price and market capitalization and slower growth rates in our industry. We may be required to record a significant charge to earnings in our consolidated financial statements during the period in which any impairment of our amortizable intangible assets or goodwill is determined to exist. This could adversely impact our results of operations.

Our LED revenues are highly dependent on our customers' ability to produce, market and sell more integrated products using our LED products.
Our LED revenues depend 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. However, the traditional lighting industry is still developing technical expertise with LED related designs, which may limit the success of our customers' products. Even if our customers are able to develop and produce LED lighting 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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We also have current and prospective customers that create white LED components using our blue LEDs, in combination with phosphors. Sales of blue LED chips are highly dependent upon our customers' ability to procure efficient phosphors, develop high quality and highly efficient white LED components and gain access to the necessary intellectual property rights. Even if our customers are able to develop competitive white LED components using our blue LED chips, there can be no assurance that our customers will be successful in the marketplace.

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 or changes in government and/or industry policies, standards or regulations that discourage the use of certain traditional lighting technologies, could impact the demand for our LED 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 LED products. For example, in the second half of calendar year 2010 the Chinese government delayed purchases of LED street and tunnel lighting while developing new standards for the required performance for such lighting products in China. The process resulted in reduced demand for those lighting applications and continues to limit our ability to forecast demand for those applications in the short term.

Demand for our LED 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 regulated utilities discontinue or curtail their funding, or reduce their demand for our products, our business may suffer.

Changes in governmental budget priorities could adversely affect our business and results of operations. Historically, U.S. government agencies have funded a portion of our research and development activities. In addition, U.S. and foreign government agencies have purchased products directly from us and products from our customers. When the government changes budget priorities, such as in times of war or financial crisis, our research and development funding and our product sales 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. In particular, if U.S. government funding is discontinued or significantly reduced, our business and results of operations could be adversely affected.

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, system failures or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts and other raw materials, and other bill of materials items;
- production yield loss, inventory shrinkage or human errors;
- defects in production processes (including system assembly) either within our facilities or at our contractors; 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 allowing for 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 significantly affect our margins and operating results.

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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 single site for SiC wafer manufacturing. This 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 and their supply chain, which could cause delays in new orders, delays in completing sales or even order cancellations.

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 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 historically have 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 and introduction of these new products depends 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 beyond near term visibility;
- 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 expand direct customer sales and influence key distribution customers to adopt our products;
- our ability to develop repeatable processes to manufacture new products in sufficient quantities, with the desired specifications and at competitive costs for commercial sales;
- our ability to effectively transfer products and technology developed in one country to our manufacturing facilities in other countries;
- our customers' ability to develop competitive products incorporating our products; and
- acceptance of our customers' products by the market.

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

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 they were not designed for 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, we may need to recall our products. These recalls could result in significant losses due to:

- costs associated with the removal, collection and destruction of the product recalled;
- payments made to replace recalled product;
- a rise in warranty expense and costs associated with customer support;

- the write down or destruction of existing inventory subject to the recall;
- lost sales due to the unavailability of product for a period of time;
- delays, cancellations or rescheduling of orders for our products; or

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- increased product returns.

We also may be the target of product liability lawsuits, and could suffer losses from a significant product liability judgment against us if the use of our products at issue is determined to have caused injury. A significant product recall or product liability case could also result in adverse publicity, damage to our reputation, and a loss of customer confidence in our products.

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.

As a result of acquisitions and organic growth, 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 revenues, 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 and other barriers to importing/exporting materials and products in a cost effective and timely manner;
- timing and availability of export licenses;
- rising labor costs;
- disruptions in or inadequate infrastructure of the foreign countries where we operate;
- difficulties in accounts receivable collections;
- 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 been provided and may continue to receive competing 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.

Litigation could adversely affect our operating results and financial condition.

We are often involved in patent infringement litigation as described in Note 11, “Commitments and Contingencies,” to our consolidated financial statements included in Item 1 of this Quarterly Report and as described in more detail in Note 13, "Commitments and Contingencies" to our consolidated financial statements included in Item 8 of our Annual Report on Form 10-K for the fiscal year ended June 26, 2011 (as updated by our current and periodic reports filed with the Securities and Exchange Commission). 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. 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:

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- 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 take steps to seek to obtain a license or to avoid the infringement. However, we cannot predict whether a license will be available; 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 foreign patent authorities.

However, our existing patents are subject to expiration 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 subject to intellectual property 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 fraudulently induce employees to disclose sensitive information in order to gain access to our systems. 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.

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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 continue to experience difficulty obtaining the 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, 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.

We are subject to risks related to international sales and purchases.
We expect that revenue from international sales will continue to represent the majority of our total revenue. In fiscal 2011, approximately 76% of our revenue was derived from sales to non-U.S. customers, with approximately 36% of revenue from sales to customers in China. As such, a significant slowdown in these foreign economies 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 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 not entered into any foreign currency derivative financial instruments; however, we may choose to do so in the future in an effort to manage or hedge our foreign exchange rate risk.

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, including rare earth elements, 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, such as passive electrical components used in LED lighting applications, 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 that have impacted our cost of sales.

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, our key suppliers were

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unable to support our demand for any reason, or 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 in both the United States and abroad. The failure or inability of these shipping companies to deliver products, or the unavailability of their shipping 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.

New 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, the SEC is required to establish new annual disclosure and reporting requirements for those companies who use “conflict” minerals mined from the DRC and adjoining countries in their products. When these new requirements are implemented, they could affect the sourcing and availability of minerals used in the manufacture of our products. As a result, we cannot ensure that we will be able to obtain minerals at competitive prices and there may be additional costs associated with complying with the new due diligence procedures as required by the SEC. In addition, as 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.

Changes in our effective tax rate may have an adverse effect on our results.

Our future effective tax rates may be adversely 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 write-offs of acquired in-process research and development and 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 (APIC) 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.

For example, proposals have been made by various U.S. governmental bodies to change the U.S. tax laws that include, among other things, limiting U.S. tax deductions for expenses related to un-repatriated foreign-source income and modifying the U.S. foreign tax credit rules. Although the scope of the proposed changes is unclear, it is possible that these or other changes in U.S. tax laws could increase our U.S. income tax liability and adversely affect our profitability. At this time, we cannot determine the timing that the proposed changes, if enacted, would become effective.

Any significant increase in our future effective tax rates could adversely 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 and accruals 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 adversely affected.

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 $33.15 in fiscal 2011 to a high of $75.63 in the same fiscal year. If our future operating results or margins are below the expectations of stock market analysts or our investors, our stock price will likely decline.

Speculation 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.

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 attract qualified employees. If we are unable to staff sufficient and adequate personnel at our China facilities, we may experience lower revenues 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, which include non-qualified stock options and restricted stock. If the value of such stock awards does not appreciate, as measured by the performance of the price of our common stock, or if our share-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.

Our 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. For example, under the recently adopted greenhouse gas regulations in the U.S., most of our manufacturing facilities in the U.S. may be considered “major sources” under the Clean Air Act in 2011. This change could likely result in increased costs for our U.S. operations, such as increased control and remediation requirements, additional monitoring, recordkeeping and reporting costs.

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 regulations 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 our Management's Discussion and Analysis of Financial Condition and

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Results of Operations included in Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 26, 2011.) 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.

Likewise, our results may be impacted due to changes in the accounting rules to be applied, such as the increased use of fair value measurement rules, proposed changes in revenue recognition requirements, and the potential requirement that U.S. registrants prepare financial statements in accordance with International Financial Reporting Standards.

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, government securities and other fixed interest rate investments. The primary objective of our investment policy is preservation of principal. However, our investments are generally not FDIC insured and may lose value and/or become illiquid regardless of their rating.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. (Removed and Reserved)

Item 5. Other Information

Not applicable.

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	2004 Long-Term Incentive Compensation Plan, as amended (incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K, dated October 25, 2011, as filed with the Securities and Exchange Commission on October 27, 2011)
10.2	2005 Employee Stock Purchase Plan, as amended (incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K, dated October 25, 2011, as filed with the Securities and Exchange Commission on October 27, 2011)
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 25, 2011 formatted in XBRL (eXtensible Business Reporting Language) and furnished

electronically herewith: (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income; (iii) Consolidated Statements of Cash Flows; and (iv) Notes to Consolidated Financial Statements[(a)]

(a) Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files in Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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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 18, 2012

/s/ John T. Kurtzweil
John T. Kurtzweil
Executive Vice President, Chief Financial Officer and Treasurer
(Authorized Officer and Principal Financial and Chief Accounting Officer)

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