

CREE INC
Form 10-Q
October 18, 2017
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark One)

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

For the quarterly period ended September 24, 2017

or

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

For the transition period from _____ to _____
Commission file number 0-21154

CREE, INC.

(Exact name of registrant as specified in its charter)

North Carolina 56-1572719
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

4600 Silicon Drive 27703
Durham, North Carolina
(Address of principal executive offices) (Zip Code)
(919) 407-5300
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer", "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer
Accelerated filer
 Non-accelerated
Smaller reporting company
filer
 (Do
not
check

if
a
smaller
reporting
company)

Emerging growth company []

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Securities Act. []

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes [] No []

Table of Contents

The number of shares outstanding of the registrant's common stock, par value \$0.00125 per share, as of October 13, 2017, was 98,135,192.

Table of Contents

CREE, INC.
 FORM 10-Q
 For the Quarterly Period Ended September 24, 2017
 INDEX

Description	Page No.
<u>PART I - FINANCIAL INFORMATION</u>	
Item 1. <u>Financial Statements</u>	<u>3</u>
<u>Unaudited Consolidated Balance Sheets as of September 24, 2017 and June 25, 2017</u>	<u>3</u>
<u>Unaudited Consolidated Statements of (Loss) Income for the three months ended September 24, 2017 and September 25, 2016</u>	<u>4</u>
<u>Unaudited Consolidated Statements of Comprehensive (Loss) Income for the three months ended September 24, 2017 and September 25, 2016</u>	<u>5</u>
<u>Unaudited Consolidated Statements of Cash Flows for the three months ended September 24, 2017 and September 25, 2016</u>	<u>6</u>
<u>Notes to Unaudited Consolidated Financial Statements</u>	<u>7</u>
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>20</u>
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>31</u>
Item 4. <u>Controls and Procedures</u>	<u>31</u>
<u>PART II – OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	<u>31</u>
Item 1A. <u>Risk Factors</u>	<u>32</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>45</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>45</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>45</u>
Item 5. <u>Other Information</u>	<u>45</u>
Item 6. <u>Exhibits</u>	<u>46</u>
<u>SIGNATURE</u>	<u>47</u>

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CREE, INC.

UNAUDITED CONSOLIDATED BALANCE SHEETS

	September 24, 2017	June 25, 2017
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$152,058	\$132,597
Short-term investments	472,796	478,341
Total cash, cash equivalents and short-term investments	624,854	610,938
Accounts receivable, net	154,854	148,392
Income tax receivable	7,639	8,040
Inventories, net	277,944	284,385
Prepaid expenses	23,572	23,305
Other current assets	15,352	23,390
Current assets held for sale	2,254	2,180
Total current assets	1,106,469	1,100,630
Property and equipment, net	594,698	581,263
Goodwill	618,828	618,828
Intangible assets, net	267,066	274,315
Other long-term investments	47,298	50,366
Deferred income taxes	11,137	11,763
Other assets	12,491	12,702
Total assets	\$2,657,987	\$2,649,867
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	\$146,578	\$133,185
Accrued salaries and wages	39,766	41,860
Other current liabilities	43,024	36,978
Total current liabilities	229,368	212,023
Long-term liabilities:		
Long-term debt	141,000	145,000
Deferred income taxes	52,895	49,860
Other long-term liabilities	18,743	20,179
Total long-term liabilities	212,638	215,039
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, par value \$0.01; 3,000 shares authorized at September 24, 2017 and June 25, 2017; none issued and outstanding	—	—
Common stock, par value \$0.00125; 200,000 shares authorized at September 24, 2017 and June 25, 2017; 98,045 issued and 98,039 outstanding at September 24, 2017 and 97,674 shares issued and outstanding at June 25, 2017	121	121
Additional paid-in-capital	2,426,063	2,419,517
Accumulated other comprehensive income, net of taxes	7,512	5,909
Accumulated deficit	(222,599)	(202,742)
Total shareholders' equity	2,211,097	2,222,805

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Noncontrolling interest	4,884	—
Total liabilities and equity	\$2,657,987	\$2,649,867

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

3

Table of Contents

CREE, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF (LOSS) INCOME

	Three Months Ended	
	September 24, 2017	September 25, 2016
	(In thousands, except per share amounts)	
Revenue, net	\$360,398	\$371,231
Cost of revenue, net	260,066	261,302
Gross profit	100,332	109,929
Operating expenses:		
Research and development	41,859	39,948
Sales, general and administrative	62,964	68,458
Amortization or impairment of acquisition-related intangibles	6,792	6,408
Loss on disposal or impairment of long-lived assets	2,825	324
Total operating expenses	114,440	115,138
Operating loss	(14,108)	(5,209)
Non-operating expense, net	(1,068)	(158)
Loss before income taxes	(15,176)	(5,367)
Income tax expense (benefit)	4,697	(5,933)
Net (loss) income	(\$19,873)	\$566
Net loss attributable to noncontrolling interest	(16)	—
Net (loss) income attributable to controlling interest	(\$19,857)	\$566
(Loss) earnings per share:		
Basic	(\$0.20)	\$0.01
Diluted	(\$0.20)	\$0.01
Weighted average shares used in per share calculation:		
Basic	97,811	100,559
Diluted	97,811	100,559

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

Table of Contents

CREE, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME

	Three Months Ended	
	September 30,	September 25,
	2017	2016
	(In thousands)	
Net (loss) income	(\$19,857)	\$566
Other comprehensive (loss) income:		
Currency translation gain	1,642	29
Net unrealized loss on available-for-sale securities, net of tax benefit of \$0 and \$199, respectively	(39)	(320)
Other comprehensive (loss) income	1,603	(291)
Comprehensive (loss) income	(\$18,254)	\$275
The accompanying notes are an integral part of the consolidated financial statements.		

Table of Contents

CREE, INC.

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	September 30, 2017	September 25, 2016
	(In thousands)	
Cash flows from operating activities:		
Net (loss) income	(\$19,873)	\$566
Adjustments to reconcile net (loss) income to net cash provided by operating activities:		
Depreciation and amortization	37,400	35,939
Stock-based compensation	10,135	14,650
Excess tax benefit from stock-based payment arrangements	—	(12)
Loss on disposal or impairment of long-lived assets	2,824	325
Amortization of premium/discount on investments	1,310	1,382
Loss on equity investment	3,267	2,487
Foreign exchange gain on equity investment	(199)	(1,373)
Deferred income taxes	3,133	54
Changes in operating assets and liabilities:		
Accounts receivable, net	(5,996)	(9,227)
Inventories	6,960	(10,808)
Prepaid expenses and other assets	9,323	(1,922)
Accounts payable, trade	6,442	(2,111)
Accrued salaries and wages and other liabilities	(603)	(11,852)
Net cash provided by operating activities	54,123	18,098
Cash flows from investing activities:		
Purchases of property and equipment	(36,450)	(19,337)
Purchases of patent and licensing rights	(2,476)	(2,252)
Proceeds from sale of property and equipment	327	165
Purchases of short-term investments	(117,607)	(106,749)
Proceeds from maturities of short-term investments	119,928	77,645
Proceeds from sale of short-term investments	1,974	5,148
Net cash used in investing activities	(34,304)	(45,380)
Cash flows from financing activities:		
Proceeds from issuing shares to non-controlling interest	4,900	—
Payment of acquisition-related contingent consideration	(1,850)	(2,775)
Proceeds from long-term debt borrowings	95,000	110,000
Payments on long-term debt borrowings	(99,000)	(83,000)
Net proceeds from issuance of common stock	119	406
Excess tax benefit from stock-based payment arrangements	—	12
Repurchases of common stock	—	(35,663)
Net cash used in financing activities	(831)	(11,020)
Effects of foreign exchange changes on cash and cash equivalents	473	(11)
Net increase (decrease) in cash and cash equivalents	19,461	(38,313)
Cash and cash equivalents:		
Beginning of period	132,597	166,154
End of period	\$152,058	\$127,841
Supplemental disclosure of cash flow information:		
Significant non-cash transactions:		
Accrued property and equipment	\$18,909	\$3,103

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

6

Table of Contents

CREE, INC.

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Basis of Presentation and New Accounting Standards

Overview

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

The Company's lighting products primarily consist of LED lighting systems and lamps. The Company designs, manufactures and sells lighting fixtures and lamps for the commercial, industrial and consumer markets.

The Company's LED products consist of LED chips and LED components. The Company's LED products enable its customers to develop and market LED-based products for lighting, video screens, automotive and other industrial applications.

The Company's Wolfspeed business consists of silicon carbide (SiC) materials, power devices and RF devices based on wide bandgap semiconductor materials such as SiC and gallium nitride (GaN). The Company's materials products and power devices are used in solar, electric vehicles, motor drives, power supplies and transportation applications.

The Company's RF devices are used in military communications, radar, satellite and telecommunication applications.

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

Cree, Inc. is a North Carolina corporation established in 1987 and is headquartered in Durham, North Carolina.

The Company's three reportable segments are:

• Lighting Products

• LED Products

• Wolfspeed

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

Basis of Presentation

The consolidated balance sheet at September 24, 2017, the consolidated statements of (loss) income for the three months ended September 24, 2017 and September 25, 2016, the consolidated statements of comprehensive (loss) income for the three months ended September 24, 2017 and September 25, 2016, and the consolidated statements of cash flows for the three months ended September 24, 2017 and September 25, 2016 (collectively, the consolidated financial statements) have been prepared by the Company and have not been audited. In the opinion of management, all normal and recurring adjustments necessary to fairly state the consolidated financial position, results of operations, comprehensive income and cash flows at September 24, 2017, and for all periods presented, have been made. All intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 25, 2017 has been derived from the audited financial statements as of that date.

These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for annual financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 25, 2017 (fiscal 2017). The results of operations for the three months ended September 24, 2017 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 24, 2018 (fiscal 2018).

Table of Contents

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosure of contingent assets and liabilities. Actual amounts could differ materially from those estimates. Certain fiscal 2017 amounts related to the Wolfspeed business in the accompanying consolidated financial statements have been reclassified to continuing operations to conform to the fiscal 2018 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

Recently Issued Accounting Pronouncements

Revenue from Contracts with Customers

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09: Revenue from Contracts with Customers (Topic 606). The FASB has subsequently issued multiple ASUs which amend and clarify the guidance in Topic 606. The ASU establishes a principles-based approach for accounting for revenue arising from contracts with customers and supersedes existing revenue recognition guidance. The ASU provides that an entity should apply a five-step approach for recognizing revenue, including (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the entity satisfies a performance obligation. Also, the entity must provide various disclosures concerning the nature, amount and timing of revenue and cash flows arising from contracts with customers. The Company's evaluation of ASU 2014-09 is ongoing and not complete; however, the Company anticipates the primary changes to revenue recognition to be related to certain patent license arrangements. The FASB has issued and may issue in the future, interpretive guidance, which may cause our evaluation to change. The effective date will be the first quarter of the Company's fiscal year ending June 30, 2019 and the Company currently expects to use the modified retrospective method.

Leases

In February 2016, the FASB issued ASU No. 2016-02: Leases (Topic 842). The ASU requires that a lessee recognize in its statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. The asset will be based on the liability, subject to adjustment, such as for initial direct costs. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. For income statement purposes, leases are still required to be classified as either operating or finance. Operating leases will result in straight-line expense while finance leases will result in a front-loaded expense pattern. The effective date will be the first quarter of the Company's fiscal year ending June 28, 2020, using a modified retrospective approach. The Company is currently analyzing the impact of this new pronouncement.

Stock Compensation

In March 2016, the FASB issued ASU No. 2016-09: Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU simplifies the current stock compensation guidance for tax consequences. The ASU requires an entity to recognize all excess tax benefits and tax deficiencies as income tax expense or benefit in its income statement. The ASU also eliminates the requirement to defer recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable. For cash flows statement purposes, excess tax benefits should be classified as an operating activity and cash payments made to taxing authorities on the employee's behalf for withheld shares should be classified as financing activity. The ASU grants an entity the right to withhold up to the employee's maximum statutory tax rate in the applicable jurisdiction without triggering liability accounting. The effective date was the first quarter of the Company's fiscal year ending June 24, 2018.

The Company's adoption of this ASU did not have a material impact on its consolidated financial statements. All excess tax benefits and deficiencies in the current and future periods will be recognized as income tax expense in the Company's income statement in the reporting period in which they occur. This could result in increased volatility in the Company's effective tax rate. For the three months ended September 24, 2017, the Company did not recognize a discrete event related to the excess tax benefits from stock-based compensation due to a full U.S. valuation allowance on the impact. The Company plans to continue its existing practice of estimating expected forfeitures in determining compensation cost.

Goodwill Impairment Testing

In January 2017, the FASB issued ASU No. 2017-04: Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU simplifies the manner in which an entity is required to test for goodwill impairment by eliminating Step 2 from the goodwill impairment test. Additionally, the ASU removes the requirement for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails such qualitative test, to continue to perform Step 1 of

8

Table of Contents

the goodwill impairment test. The effective date will be the first quarter of the Company's fiscal year ending June 27, 2021. The Company's adoption of this guidance is not expected to have a significant impact on its consolidated financial statements.

Note 2 – Joint Venture

Effective July 17, 2017, we entered into a Shareholders Agreement with San'an Optoelectronics Co., Ltd. (San'an) and Cree Venture LED Company Limited. (Cree Venture LED) pursuant to which we and San'an funded our contributions to Cree Venture LED and agreed upon the management and operation of Cree Venture LED. We contributed \$5.1 million of cash for a 51% ownership interest and San'an contributed \$4.9 million of cash for a 49% ownership interest. Cree Venture LED has a five-member board of directors, three of which were designated by Cree and two of which were designated by San'an. As a result of our majority voting interest, we consolidate the operations of Cree Venture LED and report its revenue and gross profit within our LED Products segment. We classify the 49% ownership interest held by San'an as "Noncontrolling interest" on the consolidated balance sheet.

In connection with forming Cree Venture LED and entering into the Shareholders Agreement, Cree Venture LED and San'an also entered into a manufacturing agreement pursuant to which San'an will supply Cree Venture LED with mid-power LED products, and we and Cree Venture LED entered into a sales agency agreement pursuant to which we will be the independent sales representative of Cree Venture LED in the exclusive markets, among certain other ancillary agreements related to the transaction.

Cree Venture LED will produce and deliver to market high performing, mid-power lighting class LEDs in an exclusive arrangement to serve the expanding markets of North and South America, Europe and Japan, and serve China and the rest of the world on a non-exclusive basis. Cree Venture LED recorded its first sales to customers during the first quarter of fiscal 2018.

Note 3 – Acquisition

On July 8, 2015, the Company closed on the acquisition of Arkansas Power Electronics International, Inc. (APEI), a global leader in power modules and power electronics applications, pursuant to a merger agreement with APEI and certain shareholders of APEI, whereby the Company acquired all of the outstanding share capital of APEI in exchange for a base purchase price of \$13.8 million, subject to certain adjustments. In addition, if certain goals were achieved over the subsequent two years, additional cash payments totaling up to \$4.6 million were to be made to the former APEI shareholders. Payments totaling \$2.8 million were made to the former APEI shareholders in July 2016 based on achievement of the first year goals. The final payment of \$1.9 million was made in July 2017 based on achievement of the second year goals. In connection with this acquisition, APEI became a wholly owned subsidiary of the Company, renamed Cree Fayetteville, Inc. (Cree Fayetteville). Cree Fayetteville is not considered a significant subsidiary of the Company and its results from operations are reported as part of the Company's Wolfspeed segment.

Note 4 – Financial Statement Details

Accounts Receivable, net

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

	September 24, June 25,	
	2017	2017
Billed trade receivables	\$213,345	\$205,516
Unbilled contract receivables	1,294	912
	214,639	206,428
Allowance for sales returns, discounts and other incentives	(51,076)	(49,425)
Allowance for bad debts	(8,709)	(8,611)
Accounts receivable, net	\$154,854	\$148,392

Inventories

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

Table of Contents

	September 24, 2017	June 25, 2017
Raw material	\$77,097	\$73,410
Work-in-progress	95,720	100,402
Finished goods	105,127	110,573
Inventories	\$277,944	\$284,385

Other Current Liabilities

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

	September 24, 2017	June 25, 2017
Accrued taxes	\$12,561	\$11,148
Accrued professional fees	6,625	5,545
Accrued warranty	16,627	13,631
Accrued other	7,211	6,654
Other current liabilities	\$43,024	\$36,978

Accumulated Other Comprehensive Income, net of taxes

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

	September 24, 2017	June 25, 2017
Currency translation gain	\$6,114	\$4,471
Net unrealized gain on available-for-sale securities	1,398	1,438
Accumulated other comprehensive income, net of taxes	\$7,512	\$5,909

Non-Operating Expense, net

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

	Three Months Ended	
	September 24, 2017	September 25, 2016
Foreign currency gain, net	\$767	\$1,361
Gain on sale of investments, net	45	12
Loss on equity investment	(3,267)	(2,487)
Interest income, net	1,151	887
Other, net	236	69
Non-operating expense, net	(\$1,068)	(\$158)

Table of Contents

Reclassifications Out of Accumulated Other Comprehensive Income, net of taxes

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

Accumulated Other Comprehensive Income Component	Amount Reclassified Out of Accumulated Other Comprehensive Income		Affected Line Item in the Consolidated Statements of (Loss) Income
	Three Months Ended September 24, 2017	Three Months Ended September 25, 2016	
Net unrealized gain on available-for-sale securities, net of taxes	\$45	\$12	Non-operating expense, net
	45	12	(Loss) income before income taxes
	—	9	Income tax expense (benefit)
	\$45	\$3	

Note 5 – Investments

Investments consist of municipal bonds, corporate bonds, commercial paper and certificates of deposit. All short-term investments are classified as available-for-sale. Other long-term investments consist of the Company's ownership interest in Lextar Electronics Corporation.

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

	September 24, 2017		Gross Unrealized Losses	Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains		
Municipal bonds	\$183,070	\$2,247	(\$77)	\$185,240
Corporate bonds	171,326	1,830	(189)	172,967
Non-U.S. certificates of deposit	112,478	31	—	112,509
Commercial paper	2,080	—	—	2,080
Total short-term investments	\$468,954	\$4,108	(\$266)	\$472,796

	June 25, 2017		Gross Unrealized Losses	Estimated Fair Value
	Amortized Cost	Gross Unrealized Gains		
Municipal bonds	\$177,890	\$2,219	(\$68)	\$180,041
Corporate bonds	175,991	1,925	(195)	177,721
Non-U.S. certificates of deposit	120,379	—	—	120,379
Commercial paper	200	—	—	200
Total short-term investments	\$474,460	\$4,144	(\$263)	\$478,341

Table of Contents

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

	September 24, 2017					
	Less than 12		Greater than 12		Total	
	Months		Months			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	\$22,844	(\$40)	\$3,795	(\$22)	\$26,639	(\$62)
Corporate bonds	45,214	(159)	5,572	(45)	50,786	(204)
Total	\$68,058	(\$199)	\$9,367	(\$67)	\$77,425	(\$266)
Number of securities with an unrealized loss	53		11		64	

	June 25, 2017					
	Less than 12		Greater than 12		Total	
	Months		Months			
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	\$26,816	(\$68)	\$—	\$—	\$26,816	(\$68)
Corporate bonds	57,404	(195)	—	—	57,404	(195)
Total	\$84,220	(\$263)	\$—	\$—	\$84,220	(\$263)
Number of securities with an unrealized loss	67		—		67	

The Company utilizes specific identification in computing realized gains and losses on the sale of investments.

Realized gains and losses from the sale of investments are included in Non-operating expense, net in the consolidated statements of (loss) income and unrealized gains and losses are included as a separate component of equity, net of tax, unless the loss is determined to be other-than-temporary.

The Company evaluates its investments for possible impairment or a decline in fair value below cost basis that is deemed to be other-than-temporary on a periodic basis. It considers such factors as the length of time and extent to which the fair value has been below the cost basis, the financial condition of the investee, and its ability and intent to hold the investment for a period of time that may be sufficient for an anticipated full recovery in market value.

Accordingly, the Company considered declines in its investments to be temporary in nature, and did not consider its securities to be impaired as of September 24, 2017 and June 25, 2017.

The contractual maturities of short-term investments as of September 24, 2017 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	\$45,350	\$116,758	\$23,132	\$—	\$185,240
Corporate bonds	33,399	107,050	32,518	—	172,967
Non-U.S. certificates of deposit	107,788	4,721	—	—	112,509
Commercial paper	2,080	—	—	—	2,080
Total short-term investments	\$188,617	\$228,529	\$55,650	\$—	\$472,796

Table of Contents

Note 6 – Fair Value of Financial Instruments

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

Level 1 - Valuations based on quoted prices in active markets for identical instruments that the Company is able to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 - Valuations based on quoted prices in active markets for instruments that are similar, or quoted prices in markets that are not active for identical or similar instruments, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 - Valuations based on inputs that are unobservable and significant to the overall fair value measurement.

The financial assets for which the Company performs recurring fair value remeasurements are cash equivalents, short-term investments and long-term investments. As of September 24, 2017, financial assets utilizing Level 1 inputs included money market funds and certificates of deposit, and financial assets utilizing Level 2 inputs included municipal bonds, corporate bonds, certificates of deposit, commercial paper and common stock of non-U.S. corporations. Level 2 assets are valued based on quoted prices in active markets for instruments that are similar or using a third-party pricing service's consensus price, which is a weighted average price based on multiple sources. These sources determine prices utilizing market income models which factor in, where applicable, transactions of similar assets in active markets, transactions of identical assets in infrequent markets, interest rates, bond or credit default swap spreads and volatility. The Company did not have any financial assets requiring the use of Level 3 inputs as of September 24, 2017. There were no transfers between Level 1 and Level 2 during the three months ended September 24, 2017.

Table of Contents

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

	September 24, 2017				June 25, 2017			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Municipal bonds	\$—	\$—	\$—	\$—	\$—	\$1,802	\$—	\$1,802
Non-U.S. certificates of deposit	—	86,161	—	86,161	—	736	—	736
Money market funds	861	—	—	861	1,184	—	—	1,184
Total cash equivalents	861	86,161	—	87,022	1,184	2,538	—	3,722
Short-term investments:								
Municipal bonds	—	185,240	—	185,240	—	180,041	—	180,041
Corporate bonds	—	172,967	—	172,967	—	177,721	—	177,721
Commercial paper	—	2,080	—	2,080	—	200	—	200
Non-U.S. certificates of deposit	—	112,509	—	112,509	—	120,379	—	120,379
Total short-term investments	—	472,796	—	472,796	—	478,341	—	478,341
Other long-term investments:								
Common stock of non-U.S. corporations	—	47,298	—	47,298	—	50,366	—	50,366
Total other long-term investments	—	47,298	—	47,298	—	50,366	—	50,366
Total assets	\$861	\$606,255	\$—	\$607,116	\$1,184	\$531,245	\$—	\$532,429

Note 7— Intangible Assets

Intangible Assets, net

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

	September 24, 2017			June 25, 2017		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Intangible assets with finite lives:						
Customer relationships	\$141,420	(\$86,232)	\$55,188	\$141,420	(\$84,673)	\$56,747
Developed technology	181,728	(137,963)	43,765	181,728	(132,747)	48,981
Non-compete agreements	10,475	(10,417)	58	10,475	(10,398)	77
Trade names, finite-lived	520	(520)	—	520	(520)	—
Patent and licensing rights	153,893	(65,518)	88,375	151,985	(63,155)	88,830
Total intangible assets with finite lives	488,036	(300,650)	187,386	486,128	(291,493)	194,635
Trade names, indefinite-lived	79,680	—	79,680	79,680	—	79,680
Total intangible assets	\$567,716	(\$300,650)	\$267,066	\$565,808	(\$291,493)	\$274,315

For the three months ended September 24, 2017, total amortization of finite-lived intangible assets was \$9.9 million.

For the three months ended September 25, 2016, total amortization of finite-lived intangible assets was \$9.4 million.

Table of Contents

Total future amortization expense of finite-lived intangible assets is estimated to be as follows (in thousands):

Fiscal Year Ending	
June 24, 2018 (remainder of fiscal 2018)	\$28,618
June 30, 2019	25,225
June 28, 2020	19,821
June 27, 2021	18,444
June 26, 2022	16,323
Thereafter	78,955
Total future amortization expense	\$187,386

Note 8 – Long-term Debt

As of September 24, 2017, the Company had a \$500 million secured revolving line of credit under which the Company can borrow, repay and reborrow loans from time to time prior to its scheduled maturity date of January 9, 2020.

The Company classifies balances outstanding under its line of credit as long-term debt in the consolidated balance sheets. At September 24, 2017, the Company had \$141 million outstanding under the line of credit and \$359 million available for borrowing. For the three months ended September 24, 2017, the average interest rate was 1.78%. For the three months ended September 24, 2017 the average commitment fee percentage was 0.09%. The Company was in compliance with all covenants in the line of credit at September 24, 2017.

Note 9 – Shareholders' Equity

As of September 24, 2017, pursuant to an approval by the Board of Directors, the Company is authorized to repurchase shares of its common stock having an aggregate purchase price not exceeding \$200 million for all purchases from June 26, 2017 through the expiration of the program on June 24, 2018. During the three months ended September 24, 2017, the Company repurchased no shares of common stock under the stock repurchase program.

Note 10– (Loss) Earnings Per Share

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

	Three Months Ended	
	September 24, 2017	September 25, 2016
Net (loss) income	(\$19,857)	\$566
Weighted average common shares	97,811	100,559
Basic (loss) earnings per share	(\$0.20)	\$0.01

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

	Three Months Ended	
	September 24, 2017	September 25, 2016
Net (loss) income	(\$19,857)	\$566
Weighted average common shares - basic	97,811	100,559
Dilutive effect of stock options, nonvested shares and Employee Stock Purchase Plan purchase rights	—	—
Weighted average common shares - diluted	97,811	100,559
Diluted (loss) earnings per share	(\$0.20)	\$0.01

Table of Contents

Potential common shares that would have the effect of increasing diluted earnings per share or decreasing diluted loss per share are considered to be anti-dilutive and as such, these shares are not included in calculating diluted earnings per share. For the three months ended September 24, 2017, there were 10.1 million of potential common shares not included in the calculation of diluted (loss) earnings per share because their effect was anti-dilutive. For the three months ended September 25, 2016, there were 11.4 million of potential common shares not included in the calculation of diluted (loss) earnings per share because their effect was anti-dilutive.

Note 11 – Stock-Based Compensation

Overview of Employee Stock-Based Compensation Plans

The Company currently has one equity-based compensation plan, the 2013 Long-Term Incentive Compensation Plan (2013 LTIP), from which stock-based compensation awards can be granted to employees and directors. The 2013 LTIP provides for awards in the form of incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units and other awards. The Company has other equity-based compensation plans that have been terminated so that no future grants can be made under those plans, but under which stock options, restricted stock and restricted stock units are currently outstanding.

The Company's stock-based awards can be either service-based or performance-based. Performance-based conditions are generally tied to future financial and/or operating performance of the Company. The compensation expense with respect to performance-based grants is recognized if the Company believes it is probable that the performance condition will be achieved. The Company reassesses the probability of the achievement of the performance condition at each reporting period, and adjusts the compensation expense for subsequent changes in the estimate or actual outcome. As with non-performance based awards, compensation expense is recognized over the vesting period. The vesting period runs from the date of grant to the expected date that the performance objective is likely to be achieved. The Company also has an Employee Stock Purchase Plan (ESPP) that provides employees with the opportunity to purchase common stock at a discount. The ESPP limits employee contributions to 15% of each employee's compensation (as defined in the plan) and allows employees to purchase shares at a 15% discount to the fair market value of common stock on the purchase date two times per year. The ESPP provides for a twelve-month participation period, divided into two equal six-month purchase periods, and also provides for a look-back feature. At the end of each six-month period in April and October, participants purchase the Company's common stock through the ESPP at a 15% discount to the fair market value of the common stock on the first day of the twelve-month participation period or the purchase date, whichever is lower. The plan also provides for an automatic reset feature to start participants on a new twelve-month participation period if the fair market value of common stock declines during the first six-month purchase period.

Table of Contents

Stock Option Awards

The following table summarizes stock option awards outstanding as of September 24, 2017 and changes during the three months then ended (numbers of shares in thousands):

	Number of Shares	Weighted Average Exercise Price
Outstanding at June 25, 2017	10,604	\$38.27
Granted	53	\$24.66
Exercised	(5)	\$25.13
Forfeited or expired	(1,133)	\$50.88
Outstanding at September 24, 2017	9,519	\$36.70

Restricted Stock Awards and Units

A summary of nonvested restricted stock awards (RSAs) and restricted stock unit awards (RSUs) outstanding as of September 24, 2017, and changes during the three months then ended is as follows (numbers of awards and units in thousands):

	Number of RSAs/RSUs	Weighted Average Grant-Date Fair Value
Nonvested at June 25, 2017	2,412	\$26.74
Granted	1,705	\$24.44
Vested	(523)	\$29.91
Forfeited	(191)	\$25.20
Nonvested at September 24, 2017	3,403	\$25.18

Stock-Based Compensation Valuation and Expense

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

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

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

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

Table of Contents

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

	Three Months Ended	
	September 24,	September 25,
	2017	2016
Income Statement Classification:		
Cost of revenue, net	\$1,775	\$2,805
Research and development	2,457	3,439
Sales, general and administrative	5,903	8,406
Total stock-based compensation expense	\$10,135	\$14,650

Note 12 – Income Taxes

The variation between the Company's effective income tax rate and the U.S. statutory rate of 35% is primarily due to: (i) changes in the Company's valuation allowances against deferred tax assets in the U.S. and Luxembourg, (ii) projected income for the full year derived from international locations with lower tax rates than the U.S. and (iii) projected tax credits generated.

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

As of June 25, 2017, the Company's liability for unrecognized tax benefits was \$13.3 million. During the three months ended September 24, 2017, the Company did not record any material movement in its unrecognized tax benefits. As a result, the total liability for unrecognized tax benefits as of September 24, 2017 was \$13.3 million. If any portion of this \$13.3 million is recognized, the Company will then include that portion in the computation of its effective tax rate. Although the ultimate timing of the resolution and/or closure of audits is highly uncertain, the Company believes it is reasonably possible that \$0.2 million of gross unrecognized tax benefits will change in the next 12 months as a result of statute requirements.

The Company files U.S. federal, U.S. state and foreign tax returns. For U.S. federal purposes, the Company is generally no longer subject to tax examinations for fiscal years prior to 2014. For U.S. state tax returns, the Company is generally no longer subject to tax examinations for fiscal years prior to 2013. For foreign purposes, the Company is generally no longer subject to tax examinations for tax periods 2007 and prior. Certain carryforward tax attributes generated in prior years remain subject to examination, adjustment and recapture.

The Company assesses all available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilize the existing deferred tax assets by jurisdiction. The Company has concluded that it is necessary to recognize a full valuation allowance against its U.S. and Luxembourg deferred tax assets.

Note 13 – Commitments and Contingencies

Warranties

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

Balance at June 25, 2017	\$27,919
Warranties accrued in current period	7,142
Expenditures	(4,890)
Balance at September 24, 2017	\$30,171

Product warranties are estimated and recognized at the time the Company recognizes revenue. The warranty periods range from 90 days to 10 years. The Company accrues warranty liabilities at the time of sale, based on historical and projected incident rates and expected future warranty costs. The Company accrues estimated costs related to product recalls based on a formal campaign soliciting repair or return of that product when they are deemed probable and reasonably estimable. The warranty reserves, which are primarily related to Lighting Products, are evaluated quarterly based on various factors including historical warranty claims, assumptions about the frequency of warranty claims, and assumptions about the frequency of product failures derived from quality testing, field monitoring and the Company's reliability estimates. As of September 24, 2017, \$13.5 million of the Company's product warranty

liabilities were classified as long-term.

18

Table of Contents

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

Litigation

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

Note 14 – Reportable Segments

The Company's operating and reportable segments are:

• Lighting Products

• LED Products

• Wolfspeed

Reportable Segments Description

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

Financial Results by Reportable Segment

The table below reflects the results of the Company's reportable segments as reviewed by the Chief Operating Decision Maker (CODM) for the three months ended September 24, 2017. The Company's CODM is the Chief Executive Officer. The Company used the same accounting policies to derive the segment results reported below as those used in the Company's consolidated financial statements.

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

The Company's CODM reviews gross profit as the lowest and only level of segment profit. As such, all items below gross profit in the consolidated statements of (loss) income must be included to reconcile the consolidated gross profit presented in the table below to the Company's consolidated loss from continuing operations before income taxes. In order to determine gross profit for each reportable segment, the Company allocates direct costs and indirect costs to each segment's cost of revenue. The Company allocates indirect costs, such as employee benefits for manufacturing employees, shared facilities services, information technology, purchasing, and customer service, when the costs are identifiable and beneficial to the reportable segment. The Company allocates these indirect costs based on a reasonable measure of utilization that considers the specific facts and circumstances of the costs being allocated. Unallocated costs in the table below consisted primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under the Company's 401(k) plan. These costs were not allocated to the reportable segments' gross profit because the Company's CODM does not review them regularly when evaluating segment performance and allocating resources.

Table of Contents

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

	Three Months Ended	
	September 24, 2017	September 25, 2016
Revenue:		
Lighting Products revenue	\$149,724	\$183,836
LED Products revenue	144,520	137,493
Wolfspeed revenue	66,154	49,902
Total revenue	\$360,398	\$371,231

Gross Profit and Gross Margin:

Lighting Products gross profit	\$31,883	\$49,290		
Lighting Products gross margin	21.3	% 26.8	%	
LED Products gross profit	38,810	41,770		
LED Products gross margin	26.9	% 30.4	%	
Wolfspeed gross profit	32,398	23,460		
Wolfspeed gross margin	49.0	% 47.0	%	
Total segment gross profit	103,091	114,520		
Unallocated costs	(2,759)	(4,591)		
Consolidated gross profit	\$100,332	\$109,929		
Consolidated gross margin	27.8	% 29.6	%	

Assets by Reportable Segment

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

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

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

	September 24, June 25, 2017 2017	
	Lighting Products	\$141,544
LED Products	105,799	108,297
Wolfspeed	26,172	26,453
Total segment inventories	273,515	280,460
Unallocated inventories	4,429	3,925
Consolidated inventories	\$277,944	\$284,385

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

Information set forth in this Quarterly Report on Form 10-Q contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All information contained in this report relative to future markets for our products and trends in and anticipated levels of revenue, gross margins and expenses, as well as other statements containing words such as "believe," "project," "may," "will," "anticipate," "target," "plan," "estimate," "expect," "intend" and other similar expressions constitute forward-looking statements. These forward-looking statements are subject to business, economic and other risks and uncertainties, both known and unknown, and actual results may differ materially from those contained in the forward-looking statements. Any forward-looking statements we make

are as of the date made, and except as required under the U.S. federal

20

Table of Contents

securities laws and the rules and regulations of the Securities and Exchange Commission (the SEC), we have no duty to update them if our views later change. These forward-looking statements should not be relied upon as representing our views as of any date subsequent to the date of this Quarterly Report. Examples of risks and uncertainties that could cause actual results to differ materially from historical performance and any forward-looking statements include, but are not limited to, those described in "Risk Factors" in Part II, Item 1A of this Quarterly Report.

Executive Summary

The following discussion is designed to provide a better understanding of our unaudited consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance and a summary of our operating results. The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included in Part I, Item 1 of this Quarterly Report on Form 10-Q, and the consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the fiscal year ended June 25, 2017. Historical results and percentage relationships among any amounts in the financial statements are not necessarily indicative of trends in operating results for any future periods.

Overview

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

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

Our LED products consist of LED chips and LED components. Our LED products enable our customers to develop and market LED-based products for lighting, video screens, automotive and other industrial applications.

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

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 products and aspects of product fabrication, assembly and packaging. We operate research and development facilities in North Carolina, Arkansas, California, Wisconsin, India, Italy and China (including Hong Kong).

Cree, Inc. is a North Carolina corporation established in 1987, and our headquarters are in Durham, North Carolina. For further information about our consolidated revenue and earnings, please see our consolidated financial statements included in Item 1 of this Quarterly Report.

Reportable Segments

Our three reportable segments are:

• Lighting Products

• LED Products

• Wolfspeed

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

Table of Contents

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, SiC power devices and GaN RF devices. Our potential for growth depends significantly on the continued adoption of LEDs, the adoption of SiC and GaN materials and device products in the power and RF markets, and our ability to win new designs for these applications. Demand also fluctuates based on various market cycles, continuously evolving industry supply chains, and evolving competitive dynamics in each of the respective markets. These uncertainties make demand difficult to forecast for us and our customers.

Intense and Constantly Evolving Competitive Environment. Competition in the industries we serve is intense. Many companies have made significant investments in product development and production equipment. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share, increase the utilization of their production capacity and open new applications to the LED, lighting, power and RF markets we serve. To remain competitive, market participants must continuously increase product performance, reduce costs and develop improved ways to serve their customers. To address these competitive pressures, we have invested in research and development activities to support new product development, lower product costs and deliver higher levels of performance to differentiate our products in the market. In addition, we invest in systems, people and new processes to improve our ability to deliver a better overall experience for our customers.

Lighting Sales Channel Development. Commercial lighting is usually sold through lighting agents and distributors in the North American lighting market. The lighting agents typically have exclusive sales rights for a defined territory and are typically aligned with one large lighting company for a large percentage of their product sales. The size, quality and capability of the lighting agent has a significant effect on winning new projects and sales in a given geographic market. While these agents sell other lighting products, the large traditional lighting companies have taken steps to prevent their channel partners from selling competing product lines. We are constantly working to improve the capabilities of our existing channel partners and increase our share of their sales as well as develop new partners to improve our sales effectiveness in each geographic market.

Technological Innovation and Advancement. Innovations and advancements in LEDs, lighting and power and RF technologies continue to expand the potential commercial application for our products. However, new technologies or standards could emerge or improvements could be made in existing technologies that could reduce or limit the demand for our products in certain markets.

Intellectual Property Issues. Market participants rely on patented and non-patented proprietary information relating to product development, manufacturing capabilities and other core competencies of their business. Protection of intellectual property is critical. Therefore, steps such as additional patent applications, confidentiality and non-disclosure agreements, as well as other security measures are generally taken. To enforce or protect intellectual property rights, litigation or threatened litigation is common.

Overview of the Three Months Ended September 24, 2017

The following is a summary of our financial results for the three months ended September 24, 2017:

- Revenue decreased to \$360 million for the three months ended September 24, 2017 from \$371 million for the three months ended September 25, 2016.
- Gross profit decreased to \$100 million for the three months ended September 24, 2017 from \$110 million for the three months ended September 25, 2016. Gross margin was 28% for the three months ended September 24, 2017 and 30% for the three months ended September 25, 2016.
- Operating loss was \$14 million for the three months ended September 24, 2017 and \$5 million for the three months ended September 25, 2016. Net loss per diluted share was \$0.20 for the three months ended September 24, 2017 compared to net earnings per diluted share of \$0.01 for the three months ended September 25, 2016.
- Cash, cash equivalents and short-term investments were \$0.6 billion at September 24, 2017 and \$0.6 billion at June 25, 2017. Cash provided by operating activities was \$54 million for the three months ended September 24, 2017 compared to \$18 million for the three months ended September 25, 2016.
- Inventories decreased to \$278 million at September 24, 2017 compared to \$284 million at June 25, 2017.

Purchases of property and equipment were \$36 million for the three months ended September 24, 2017 compared to \$19 million for the three months ended September 25, 2016.

Table of Contents

Business Outlook

We continue to focus on growing the Wolfspeed business, as our customers have further realized the value of our technology. The strength of our balance sheet and improving operating cash flow provides us the ability to invest in Wolfspeed, while continuing to pursue our LED and Lighting growth plans.

We are uniquely positioned as a market leading innovator in all three business segments and target growth in all three businesses over the next several years. These businesses are in different phases of their growth plans and generally operate on different market cycles. This is targeted to provide better business diversity and less cyclical results over time.

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

- Invest in the Wolfspeed business to increase capacity and further develop the technology to support longer term growth opportunities in SiC materials, SiC power devices and modules, and GaN RF devices.

- Grow Lighting Products revenue and improve margins by investing in our channel relationships, improving execution, and continuing to deliver innovative lighting solutions.

- Grow the LED Products business by expanding our product offering with new products that leverage our market leadership to serve a larger share of existing customers' LED demand, while also opening new applications for our technology.

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

Results of Operations

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

	Three Months Ended			
	September 24, 2017		September 25, 2016	
	Dollars	% of Revenue	Dollars	% of Revenue
Revenue, net	\$360,398	100 %	\$371,231	100 %
Cost of revenue, net	260,066	72 %	261,302	70 %
Gross profit	100,332	28 %	109,929	30 %
Research and development	41,859	12 %	39,948	11 %
Sales, general and administrative	62,964	17 %	68,458	18 %
Amortization or impairment of acquisition-related intangibles	6,792	2 %	6,408	2 %
Loss on disposal or impairment of long-lived assets	2,825	1 %	324	— %
Operating loss	(14,108)	(4)%	(5,209)	(1)%
Non-operating expense, net	(1,068)	— %	(158)	— %
Loss before income taxes	(15,176)	(4)%	(5,367)	(1)%
Income tax expense (benefit)	4,697	1 %	(5,933)	(2)%
Net (loss) income	(19,873)	(6)%	\$566	— %
Net loss attributable to noncontrolling interest	(16)	— %	—	— %
Net (loss) income attributable to controlling interest	(\$19,857)	(6)%	\$566	— %
Basic (loss) earnings per share	(\$0.20)		\$0.01	
Diluted (loss) earnings per share	(\$0.20)		\$0.01	

Table of Contents

Revenue

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

	Three Months Ended		Change	
	September 24, 2017	September 25, 2016		
Lighting Products revenue	\$149,724	\$183,836	(\$34,112)	(19)%
Percent of revenue	42	% 50	%	
LED Products revenue	144,520	137,493	7,027	5 %
Percent of revenue	40	% 37	%	
Wolfsped revenue	66,154	49,902	16,252	33 %
Percent of revenue	18	% 13	%	
Total revenue	\$360,398	\$371,231	(\$10,833)	(3)%

Our consolidated revenue decreased 3% to \$360.4 million for the three months ended September 24, 2017 from \$371.2 million for the three months ended September 25, 2016. This decrease was driven by the 19% reduction in Lighting Products revenue, which was partially offset by the 33% and 5% increase in Wolfsped and LED Products revenue, respectively.

Lighting Products Segment Revenue

Lighting Products revenue represented approximately 42% and 50% of our total revenue for the three months ended September 24, 2017 and September 25, 2016, respectively.

Lighting Products revenue decreased 19% to \$149.7 million for the three months ended September 24, 2017 from \$183.8 million for the three months ended September 25, 2016. The decrease in revenue for the three months ended September 24, 2017 compared to the three months ended September 25, 2016 was due to a 52% decrease in the number of overall units sold, which was partially offset by a 68% increase in average selling prices (ASP). The decrease in units sold for the period was due to weakness in the North American commercial market, the lingering effects related primarily to driver quality holds which have lowered project win rates and lower consumer sales due to lower demand.

LED Products Segment Revenue

LED Products revenue represented 40% and 37% of our total revenue for the three months ended September 24, 2017 and September 25, 2016, respectively.

LED Products revenue increased 5% to \$144.5 million for the three months ended September 24, 2017 from \$137.5 million for the three months ended September 25, 2016. The increase in revenue for the three months ended September 24, 2017 compared to the three months ended September 25, 2016 was due primarily to a 17% increase in the number of units sold partially offset by a 11% decrease in ASP. The decrease in ASP for the respective period was due primarily to competitive pricing pressures.

Wolfsped Segment Revenue

Wolfsped revenue represented approximately 18% and 13% of our total revenue for the three months ended September 24, 2017 and September 25, 2016, respectively.

Wolfsped revenue increased 33% to \$66.2 million for the three months ended September 24, 2017 from \$49.9 million for the three months ended September 25, 2016. The increase in revenue for the three months ended September 24, 2017 as compared to the three months ended September 25, 2016 was due to a 17% increase in the number of units sold as well as a 22% increase in ASP. The increase in ASP was due to a greater mix of higher priced products.

Table of Contents

Gross Profit and Gross Margin

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

	Three Months Ended			Change
	September 24, 2017	September 25, 2016		
Lighting Products gross profit	\$31,883	\$49,290	(\$17,407)	(35)%
Lighting Products gross margin	21	% 27	%	
LED Products gross profit	38,810	41,770	(2,960)	(7)%
LED Products gross margin	27	% 30	%	
Wolfspeed gross profit	32,398	23,460	8,938	38 %
Wolfspeed gross margin	49	% 47	%	
Unallocated costs	(2,759)	(4,591)	1,832	(40)%
Consolidated gross profit	\$100,332	\$109,929	(\$9,597)	(9)%
Consolidated gross margin	28	% 30	%	

Our consolidated gross profit decreased 9% to \$100.3 million for the three months ended September 24, 2017 from \$109.9 million for the three months ended September 25, 2016. Our consolidated gross margin decreased to 27.8% for the three months ended September 24, 2017 from 29.6% for the three months ended September 25, 2016.

Lighting Products Segment Gross Profit and Gross Margin

Lighting Products gross profit decreased 35% to \$31.9 million for the three months ended September 24, 2017 from \$49.3 million for the three months ended September 25, 2016. Lighting Products gross margin decreased to 21.3% for the three months ended September 24, 2017 from 26.8% for the three months ended September 25, 2016. The decrease in Lighting Products gross profit and gross margin for the three months ended September 24, 2017 was primarily due to lower commercial lighting fixture sales, lower commercial factory utilization and higher commercial lighting product warranty reserves.

LED Products Segment Gross Profit and Gross Margin

LED Products gross profit decreased 7% to \$38.8 million for the three months ended September 24, 2017 from \$41.8 million for the three months ended September 25, 2016. LED Products gross margin decreased to 26.9% for the three months ended September 24, 2017 from 30.4% for the three months ended September 25, 2016. The decreases in gross profit and gross margin are due primarily to lower pricing resulting from the global competition for LED products and a less favorable mix of LED products sold.

Wolfspeed Segment Gross Profit and Gross Margin

Wolfspeed gross profit increased 38% to \$32.4 million for the three months ended September 24, 2017 from \$23.5 million for the three months ended September 25, 2016. Wolfspeed gross margin increased to 49.0% for the three months ended September 24, 2017 from 47.0% for the three months ended September 25, 2016. The increases in gross profit and gross margin are primarily due to a more favorable product sales mix, higher factory utilization and improved production yields.

Unallocated Costs

Unallocated costs were \$2.8 million and \$4.6 million for the three months ended September 24, 2017 and September 25, 2016, respectively. These costs consisted primarily of manufacturing employees' stock-based compensation, expenses for profit sharing and quarterly or annual incentive plans and matching contributions under our 401(k) plan. These costs were not allocated to the reportable segments' gross profit because our Chief Operating Decision Maker does not review them regularly when evaluating segment performance and allocating resources. The decrease for the three months ended September 24, 2017 as compared to the three months ended September 25, 2016 was primarily attributable to lower stock-based and incentive compensation.

Table of Contents

Research and Development

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

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

	Three Months Ended			Change
	September 24, 2017	September 25, 2016		
Research and development	\$41,859	\$39,948	\$1,911	5%
Percent of revenue	12	% 11	%	

Research and development expenses for the three months ended September 24, 2017 increased 5% to \$41.9 million from \$39.9 million for the three months ended September 25, 2016. These increases were primarily due to an increase in Wolfspeed research and development, to accelerate 150mm development along with next generation power and RF device research and development. Our research and development expenses vary significantly from quarter to quarter based on a number of factors, including the timing of new product introductions and the number and nature of our ongoing research and development activities.

Sales, General and Administrative

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

	Three Months Ended			Change
	September 24, 2017	September 25, 2016		
Sales, general and administrative	\$62,964	\$68,458	(\$5,494)	(8)%
Percent of revenue	17	% 18	%	

Sales, general and administrative expenses of \$63.0 million for the three months ended September 24, 2017 decreased 8% from \$68.5 million for the three months ended September 25, 2016. The decrease for the three months ended September 24, 2017 was primarily due to lower variable commercial lighting sales expense resulting from the decrease in lighting revenue, lower stock compensation expense and the non-recurrence of fiscal 2017 costs associated with the former Wolfspeed transaction.

Amortization or Impairment of Acquisition-Related Intangibles

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

	Three Months Ended			Change
	September 24, 2017	September 25, 2016		
Customer relationships	\$1,558	\$1,324	\$234	18 %
Developed technology	5,214	4,845	369	8 %
Non-compete agreements	20	239	(219)	(92)%
Total amortization	\$6,792	\$6,408	\$384	6 %

Amortization of acquisition-related intangibles was \$6.8 million for the three months ended September 24, 2017 compared to \$6.4 million for the three months ended September 25, 2016.

Table of Contents

Loss on Disposal or Impairment of Long-Lived Assets

We operate a capital-intensive business. As such, we dispose of a certain level of our equipment in the normal course of business as our production processes change due to production improvement initiatives or product mix changes. Due to the risk of technological obsolescence or changes in our production process, we regularly review our equipment and capitalized patent costs for possible impairment. The following table sets forth our loss on disposal or impairment of long-lived assets (in thousands, except percentages):

	Three Months Ended		Change
	September 24, 2017	September 25, 2016	
Loss on disposal or impairment of long-lived assets	\$2,825	\$324	\$2,501 772 %

We recognized a net loss of \$2.8 million and a net loss of \$0.3 million on the disposal of long-lived assets for the three months ended September 24, 2017 and September 25, 2016, respectively. The increase in net loss for the three months ended September 24, 2017 as compared to the three months ended September 25, 2016 was primarily due to demolition and move costs associated with our current Wolfspeed manufacturing capacity expansion.

Non-Operating Expense, net

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

	Three Months Ended		Change
	September 24, 2017	September 25, 2016	
Gain on sale of investments, net	\$45	\$12	\$33 275 %
Loss on equity investment	(3,267)	(2,487)	(780) 31 %
Foreign currency gain, net	767	1,361	(594) (44)%
Interest income, net	1,151	887	264 30 %
Other, net	236	69	167 242 %
Non-operating expense, net	(\$1,068)	(\$158)	(\$910) 576 %

Gain on sale of investments, net. Gain on sale of investments, net was \$45 thousand for the three months ended September 24, 2017 compared to \$12 thousand for the three months ended September 25, 2016.

Loss on equity investment. Loss on our equity investment in Lextar Electronics Corporation (Lextar), which we account for utilizing the fair value option, was \$3.3 million for the three months ended September 24, 2017 compared to a loss on equity investment of \$2.5 million for the three months ended September 25, 2016. Lextar's stock is publicly traded on the Taiwan Stock Exchange and its share price declined from 18.40 New Taiwanese Dollars (TWD) at June 25, 2017 to 17.20 TWD at September 24, 2017. This volatile stock price trend may continue in the future given the risks inherent in Lextar's business and trends affecting the Taiwan and global equity markets. Any future stock price changes will be recorded as further gains or losses on equity investment based on the increase or decrease, respectively, in the fair value of the investment during the applicable fiscal period. Further losses could have a material adverse effect on our results of operations.

Foreign currency gain, net. Foreign currency gain, net consisted primarily of remeasurement adjustments resulting from our investment in Lextar and consolidating our international subsidiaries. The foreign currency gain for the three months ended September 24, 2017 was primarily due to favorable fluctuations in the exchange rates between both the Chinese Yuan and the Euro and the United States Dollar. The foreign currency gain for the three months ended September 25, 2016 was primarily due to favorable fluctuation in the exchange rate between the TWD and the United States Dollar related to our Lextar investment.

Interest income, net. Interest income, net was \$1.2 million for the three months ended September 24, 2017 compared to \$0.9 million for the three months ended September 25, 2016. The increase in interest income, net for the three months ended September 24, 2017 was primarily due to higher invested balances in China and Hong Kong which was offset with a higher interest expense due to higher borrowing rates associated with our line of credit as compared to the three months ended September 25, 2016.

Other, net. Other, net was income of \$0.2 million for the three months ended September 24, 2017 compared to income of \$0.1 million for the three months ended September 25, 2016.

Table of Contents

Income Tax Expense (Benefit)

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

	Three Months Ended		
	September 24, 2017	September 25, 2016	Change
Income tax expense (benefit)	\$4,697	(\$5,933)	\$10,630 (179)%
Effective tax rate	(31.0)%	110.5%	

The variation between our effective income tax rate and the U.S. statutory rate of 35% is due to: (i) changes in our valuation allowances against deferred tax assets in the U.S. and Luxembourg, (ii) projected income for the full year derived from international locations with lower tax rates than the U.S., and (iii) projected tax credits generated.

We recognized an income tax expense of \$4.7 million for an effective tax rate of (31.0)% for the three months ended September 24, 2017 as compared to income tax benefit of \$5.9 million for an effective tax rate of 110.5% for the three months ended September 25, 2016. The decrease in our effective tax rate for the three months ended September 24, 2017 was primarily due to the change in the valuation allowance against our U.S. deferred tax assets.

Liquidity and Capital Resources

Overview

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

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

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

Liquidity

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

Table of Contents

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

	Three Months Ended		
	September 24, 2017	June 25, 2017	Change
Days of sales outstanding ^(a)	39	37	2
Days of supply in inventory ^(b)	96	98	(2)
Days in accounts payable ^(c)	(51)	(46)	(5)
Cash conversion cycle	84	89	(5)

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

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

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

The decrease in our cash conversion cycle was primarily driven by an increase in days in accounts payable.

As of September 24, 2017, we had unrealized losses on our investments of \$0.3 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at September 24, 2017 were in such position due to interest rate changes, sector credit rating changes or company-specific rating changes. As we intend and believe that we have the ability to hold such investments for a period of time that will be sufficient for anticipated recovery in market value, we currently expect to receive the full principal or recover our cost basis in these securities. The declines in value of the securities in our portfolio are considered to be temporary in nature and, accordingly, we do not believe these securities are impaired as of September 24, 2017.

Cash Flows

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

	Three Months Ended			Change	
	September 24, 2017	September 25, 2016			
Net cash provided by operating activities	\$54,123	\$18,098	\$36,025	199	%
Net cash used in investing activities	(34,304)	(45,380)	11,076	(24)	%
Net cash used in financing activities	(831)	(11,020)	10,189	(92)	%
Effects of foreign exchange changes on cash and cash equivalents	473	(11)	484	(4,400)	%
Net increase (decrease) in cash and cash equivalents	\$19,461	(\$38,313)	\$57,774		

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

Table of Contents

Cash Flows from Operating Activities

Net cash provided by operating activities increased to \$54.1 million for the three months ended September 24, 2017 from \$18.1 million for the three months ended September 25, 2016. This increase was primarily due to cash generated from working capital.

Cash Flows from Investing Activities

Our investing activities primarily relate to transactions within our short-term investments, purchases of property and equipment and payments for patents and licensing rights. Net cash used in investing activities was \$34.3 million for the three months ended September 24, 2017 and net cash used in investing activities was \$45.4 million for the three months ended September 25, 2016. Net purchases of short-term investments decreased \$28.3 million for the three months ended September 24, 2017 compared to the three months ended September 25, 2016. This was partially offset by a \$17.3 million increase in our capital spending for the three months ended September 24, 2017 compared to the three months ended September 25, 2016.

For fiscal 2018, we target approximately \$220.0 million of capital investment, which is primarily related to infrastructure projects to support our longer-term growth and strategic priorities.

Cash Flows from Financing Activities

Net cash used in financing activities was \$0.8 million for the three months ended September 24, 2017 compared to \$11.0 million for the three months ended September 25, 2016. For the three months ended September 24, 2017, our financing activities primarily consisted of net repayment on our line of credit of \$4.0 million and payment of acquisition-related contingent consideration of \$1.9 million, partially offset by proceeds of \$0.1 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit from those exercises and proceeds of \$4.9 million from issuing shares related to Cree Venture LED. For the three months ended September 25, 2016, our financing activities primarily consisted of the repurchase of common stock worth approximately \$35.7 million, partially offset by net borrowing on our line of credit of \$27.0 million, and proceeds of \$0.4 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit from those exercises.

Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use any other forms of off-balance sheet arrangements. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of September 24, 2017, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases primarily for certain of our U.S. and international facilities in the normal course of business. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 25, 2017, in the section entitled “Contractual Obligations” for the future minimum lease payments due under our operating leases as of June 25, 2017. There have been no significant changes to the contractual obligations discussed therein.

Critical Accounting Policies and Estimates

For information about our critical accounting policies and estimates, see the “Critical Accounting Policies and Estimates” section of “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for the fiscal year ended June 25, 2017.

Recent Accounting Pronouncements

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

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about our market risks, see “Part II. Item 7A. Quantitative and Qualitative Disclosures About Market Risk” of our Annual Report on Form 10-K for the fiscal year ended June 25, 2017. There have been no material changes to the amounts presented therein.

Item 4. Controls and Procedures

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

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. There have been no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the first quarter of fiscal 2018 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this item is set forth under Note 13, “Commitments and Contingencies,” to our unaudited financial statements in Part I, Item 1 of this Quarterly Report and is incorporated herein by reference.

Table of Contents

Item 1A. Risk Factors

Described below are various risks and uncertainties that may affect our business. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in "Part I, Item 1A. Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended June 25, 2017. If any of the risks described below actually occurs, our business, financial condition or results of operations could be materially and adversely affected.

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

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

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

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

We face significant challenges managing our growth strategy.

Our potential for growth depends significantly on the adoption of our products within the markets we serve and for other applications, and our ability to affect this rate of adoption. In order to manage our growth and business strategy effectively relative to the uncertain pace of adoption, we must continue to:

- maintain, expand, construct and purchase adequate manufacturing facilities and equipment, as well as secure sufficient third-party manufacturing resources, to meet customer demand;
- manage an increasingly complex supply chain that has the ability to supply an increasing number of raw materials, subsystems and finished products with the required specifications and quality, and deliver on time to our manufacturing facilities, our third party manufacturing facilities, or our logistics operations;
- expand the capability of information systems to support a more complex business;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- manage organizational complexity and communication;

Table of Contents

- expand the skills and capabilities of our current management team;
- add experienced senior level managers and executives;
- attract and retain qualified employees; and
- adequately maintain and adjust the operational and financial controls that support our business.

While we intend to continue to focus on managing our costs and expenses, in the short term and in the long term we expect to invest to support our growth and may have additional unexpected costs. Such investments take time to become fully operational, and we may not be able to expand quickly enough to exploit targeted market opportunities. For example, during fiscal 2018 we target converting the majority of our Wolfspeed power production from 100mm to 150mm substrates. If we are unable to make this transition in a timely or cost-effective manner, our results could be negatively impacted. In connection with our efforts to cost-effectively manage our growth, we have increasingly relied on contractors for production capacity, logistics support and certain administrative functions including hosting of certain information technology software applications. If our contract manufacturers, original design manufacturers (ODMs) or other service providers do not perform effectively, we may not be able to achieve the expected cost savings and may incur additional costs to correct errors or fulfill customer demand. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies, the loss of or damage to intellectual property through security breach, or an impact on employee morale. Our operations may also be negatively impacted if any of these contract manufacturers, ODMs or other service providers do not have the financial capability to meet our growing needs. There are also inherent execution risks in starting up a new factory or expanding production capacity, whether one of our own factories or that of our contract manufacturers or ODMs, or moving production to different contract manufacturers or ODMs, that could increase costs and reduce our operating results, including design and construction cost overruns, poor production process yields and reduced quality control.

We are also increasingly dependent on information technology to enable us to improve the effectiveness of our operations and to maintain financial accuracy and efficiency. Allocation and effective management of the resources necessary to successfully implement, integrate, train personnel and sustain our IT platforms will remain critical to ensure that we are not subject to transaction errors, processing inefficiencies, loss of customers, business disruptions or loss of or damage to intellectual property through a security breach in the near term. Additionally, we face these same risks if we fail to allocate and effectively manage the resources necessary to build, implement, upgrade, integrate and sustain appropriate technology infrastructure over the longer term.

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

The industries we serve are in different stages of adoption and are characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life-cycles in the case of the LED industry and fluctuations in product supply and demand. The LED, power and RF industries have experienced significant fluctuations, often in connection with, or in anticipation of, product cycles and changes in general economic conditions. The semiconductor industry is characterized by rapid technological change, high capital expenditures, short product life cycles and continuous advancements in process technologies and manufacturing facilities. As the markets for our products mature, additional fluctuations may result from variability and consolidations within the industry's customer base. These fluctuations have been characterized by lower product demand, production overcapacity, higher inventory levels and increased pricing pressure. These fluctuations have also been characterized by higher demand for key components and equipment used in, or in the manufacture of, our products resulting in longer lead times, supply delays and production disruptions. We have experienced these conditions in our business and may experience such conditions in the future, which could have a material negative impact on our business, results of operations or financial condition.

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

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

We have expanded into business channels that are different from those in which we have historically operated as we grow our business and sell more lighting, LED, power and RF products. Our sales agents have in the past and may in the future choose to drop our product lines from their portfolio to avoid losing access to our competitors' products, resulting in a disruption in the project pipeline and lower than targeted sales for our products. Our sales agents have the ability to shift business to different suppliers within their product portfolio based on a number of factors, including customer service and new product availability. We sell a portion of our lighting products through retailers who may alter their promotional pricing or inventory strategies, which

Table of Contents

could impact our targeted sales of these products. If we are unable to effectively penetrate these channels or develop alternate channels to ensure our products are reaching the intended customer base, our financial results may be adversely impacted. In addition, if we successfully penetrate or develop these channels, we cannot guarantee that customers will accept our products or that we will be able to manufacture and deliver them in the timeline established by our customers.

We sell a substantial portion of our products to distributors. We rely on distributors to develop and expand their customer base as well as anticipate demand from their customers. If they are not successful, our growth and profitability may be adversely impacted. Distributors must balance the need to have enough products in stock in order to meet their customers' needs against their internal target inventory levels and the risk of potential inventory obsolescence. The risks of inventory obsolescence are especially relevant to technological products. The distributors' internal target inventory levels vary depending on market cycles and a number of factors within each distributor over which we have very little, if any, control. Distributors also have the ability to shift business to different manufacturers within their product portfolio based on a number of factors, including new product availability and performance. We typically recognize revenue on products sold to distributors when the item is shipped and title passes to the distributor (sell-in method). Certain distributors have limited rights to return inventory under stock rotation programs and have limited price protection rights for which we make estimates. We evaluate inventory levels in the distribution channel, current economic trends and other related factors in order to account for these factors in our judgments and estimates. As inventory levels and product return trends change, we may have to revise our estimates and incur additional costs, and our gross margins and operating results could be adversely impacted.

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

As customer demand for our products changes, we must be able to adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase or decrease our production capacity at our targeted rate or if there are unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets. For example, our Wolfsped business is currently experiencing demand in excess of our production capacity, which is resulting in longer manufacturing lead times to customers as we manage our constrained capacity. While we began making significant investments in fiscal 2016 to expand our materials, power and RF device capacity and continue to do so, these investments take time to bring in, install and get fully qualified. As a result, we may be unable to build or qualify such new capacity on a timely basis to meet customer demand and customers may fulfill their orders with one of our competitors instead. In addition, as we introduce new products and change product generations, we must balance the production and inventory of prior generation products with the production and inventory of new generation products, whether manufactured by us or our contract manufacturers, to maintain a product mix that will satisfy customer demand and mitigate the risk of incurring cost write-downs on the previous generation products, related raw materials and tooling.

Due to the proportionately high fixed cost nature of our business (such as facility costs), if demand does not materialize at the rate forecasted, we may not be able to scale back our manufacturing expenses or overhead costs to correspond to the demand. This could result in lower margins and adversely impact our business and results of operations. Additionally, if product demand decreases or we fail to forecast demand accurately, our results may be adversely impacted due to higher costs resulting from lower factory utilization, causing higher fixed costs per unit produced. For example, in the third quarter of fiscal 2017 we had lower overall lighting demand which led to higher costs per unit produced from our Racine factory, thereby reducing gross margins for our Lighting Products segment. Further, we may be required to recognize impairments on our long-lived assets or recognize excess inventory write-off charges. We may in the future be required to recognize excess capacity charges, which would have a negative impact on our results of operations.

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

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

The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture and sell LED chips and LED components. In the lighting market, we compete with companies that manufacture and sell traditional and LED lighting products, many of which have larger and more established sales channels. In the semiconductor market, we compete with companies that have greater market share, name recognition and technical resources than we do. Competitors continue to offer new products with aggressive pricing, additional features and improved performance. Competitive pricing pressures remain a challenge and continue to accelerate the rate of decline in our sales prices, particularly in our LED Products and Wolfspeed

Table of Contents

segments. Aggressive pricing actions by our competitors in our businesses could reduce margins if we are not able to reduce costs at an equal or greater rate than the sales price decline.

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

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

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

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

- variability in our process repeatability and control;
- contamination of the manufacturing environment;
- equipment failure, power outages, fires, flooding, information or other system failures or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts, other raw materials and other bill of materials items;
- inventory shrinkage or human errors;
- defects in production processes (including system assembly) either within our facilities or at our suppliers; and
- any transitions or changes in our production process, planned or unplanned.

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

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

In addition, our ability to convert volume manufacturing to larger diameter substrates can be an important factor in providing a more cost-effective manufacturing process. During fiscal 2018, we target converting the majority of our Wolfsped power production from 100mm to 150mm substrates. If we are unable to make this transition in a timely or cost-effective manner, our results could be negatively impacted.

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

The manufacture of our products involves highly complex processes. Our customers specify quality, performance and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment and installation. For example, during the second and third quarters of fiscal 2017 we determined that the quality of several of our commercial lighting products were possibly impacted by third party supplied drivers that did not meet specifications. Therefore, we increased our product warranty reserves for potential future warranty claims. Even if our products meet standard specifications, our customers may attempt to use our products in applications for which they were not designed or in products that were not designed or manufactured properly,

resulting in product failures and creating customer satisfaction issues.

35

Table of Contents

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

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

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

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

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

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

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

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

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

In our fabrication process we consume a number of precious metals and other commodities, which are subject to high price volatility. Our operating margins could be significantly affected if we are not able to pass along price increases to our customers. In addition, production could be disrupted by the unavailability of the resources used in production

such as water, silicon, electricity and gases. Future environmental regulations could restrict supply or increase the cost of certain of those materials.

Table of Contents

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

We receive a significant amount of our revenue from a limited number of customers, including distributors and retailers, one of which represented 12% of our consolidated revenue in fiscal 2017. Most of our customer orders are made on a purchase order basis, which does not generally require any long-term customer commitments. Therefore, these customers may alter their purchasing behavior with little or no notice to us for various reasons, including developing, or, in the case of our distributors, their customers developing, their own product solutions; choosing to purchase or distribute product from our competitors; incorrectly forecasting end market demand for their products; or experiencing a reduction in their market share in the markets for which they purchase our products. In the case of retailers, these customers may alter their promotional pricing; increase promotion of competitors' products over our products; or reduce their inventory levels; all of which could negatively impact our financial condition and results of operations. If our customers alter their purchasing behavior, if our customers' purchasing behavior does not match our expectations or if we encounter any problems collecting amounts due from them, our financial condition and results of operations could be negatively impacted.

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

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

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

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

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

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

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

- the failure of an acquired business, investee or joint venture to meet our performance and financial expectations;
- identification of additional liabilities relating to an acquired business;

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loss of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers' existing product lines;
• difficulty integrating an acquired business's operations, personnel and financial and operating systems into our current business;
• diversion of management attention;

37

Table of Contents

- difficulty separating the operations, personnel and financial and operating systems of a spin-off or divestiture from our current business;
- the possibility we are unable to complete the transaction and expend substantial resources without achieving the desired benefit;
- the inability to obtain required regulatory agency approvals;
- uncertainty of the financial markets or circumstances that cause conditions that are less favorable and/or different than expected; and
- expenses incurred to complete a transaction may be significantly higher than anticipated.

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

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

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

Through acquisitions and organic growth, we continue to expand into new markets and new market segments. Many of our existing customers who purchase our LED products or Wolfspeed substrate materials develop and manufacture products using those wafers, chips and components that are offered into the same lighting, power and RF markets. As a result, some of our current customers perceive us as a competitor in these market segments. In response, our customers may reduce or discontinue their orders for our LED or Wolfspeed substrate materials 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 operations in foreign countries expose us to certain risks inherent in doing business internationally, which may adversely affect our business, results of operations or financial condition.

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

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

Table of Contents

In some instances, we have received and may continue to receive incentives from foreign governments to encourage our investment in certain countries, regions or areas outside of the United States. In particular, we have received and may continue to receive such incentives in connection with our operations in Asia, as Asian national and local governments seek to encourage the development of the technology industry. Government incentives may include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to us due to our foreign operations. Any of these incentives could be reduced or eliminated by governmental authorities at any time or as a result of our inability to maintain minimum operations necessary to earn the incentives. Any reduction or elimination of incentives currently provided for our operations could adversely affect our business and results of operations. These same governments also may provide increased incentives to or require production processes that favor local companies, which could further negatively impact our business and results of operations. Changes in regulatory, geopolitical, social, economic, or monetary policies and other factors, including those which may result from the new U.S presidential administration and the U.S Congress, if any, may have a material adverse effect on our business in the future, or may require us to exit a particular market or significantly modify our current business practices. Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could also result in an adverse effect on our business and results of operations. For example, the results of the United Kingdom's referendum on whether to remain a part of the European Union have created political and economic uncertainty not only in the United Kingdom, but in many European countries in which we do business. There could be further uncertainty as the United Kingdom negotiates the future terms of its relationship with the European Union following its withdrawal.

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, sales personnel and production 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 for qualified and capable personnel, particularly experienced engineers and technical personnel, which may make it difficult for us to recruit and retain qualified employees. If we are unable to staff sufficient and adequate personnel at our facilities, we may experience lower revenue or increased manufacturing costs, which would adversely affect our results of operations.

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

On May 19, 2017, we announced that we were accelerating the succession planning process for our chief executive officer and that Charles M. Swoboda would step down from his executive positions and as a member of the Board of Directors following a transition period. On September 25, 2017, we announced the appointment of Gregg Lowe as President and Chief Executive Officer and a member of our Board of Directors, effective September 27, 2017. Mr. Swoboda will remain on our Board of Directors until our Annual Meeting of Shareholders on October 24, 2017. Such a leadership transition can be inherently difficult to manage, and an inadequate transition may cause disruption to our business. If we do not successfully manage our CEO transition, it could be viewed negatively by our customers, suppliers, shareholders and other stakeholders and could have an adverse impact on our business.

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

The adoption of or changes in government and/or industry policies, standards or regulations relating to the efficiency, performance or other aspects of our products may impact the demand for our products. Demand for our products may also be impacted by changes in government and/or industry policies, standards or regulations that discourage the use of certain traditional lighting technologies. For example, efforts to eliminate or reduce Energy Star® standards could negatively impact our lighting and Wolfspeed power businesses. These constraints may be eliminated or delayed by legislative action, which could have a negative impact on demand for our products. Our ability and the ability of our competitors to meet these new requirements could impact competitive dynamics in the market.

Table of Contents

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

Changes in governmental budget priorities could adversely affect our business and results of operations. U.S. and foreign government agencies have purchased products directly from us and products from our customers, and U.S. government agencies have historically funded a portion of our research and development activities. When the government changes budget priorities, such as in times of war or financial crisis, or reallocates its research and development spending to areas unrelated to our business, our research and development funding and our product sales to government entities and government-funded customers are at risk. For example, demand and payment for our products and our customers' products may be affected by public sector budgetary cycles, funding authorizations or utility rebates. Funding reductions or delays could negatively impact demand for our products. If government or utility funding is discontinued or significantly reduced, our business and results of operations could be adversely affected. We are exposed to fluctuations in the market value of our investment portfolio and in interest rates, and therefore, impairment of our investments or lower investment income could harm our earnings.

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

From time to time, we have also made investments in public and private companies that engage in complementary businesses. For example, during fiscal 2015 we made an investment in Lextar Electronics Corporation (Lextar), a public company in Taiwan. An investment in another company is subject to the risks inherent in the business of that company and to trends affecting the equity markets as a whole. Investments in publicly held companies are subject to market risks and, like our investment in Lextar, may not be liquidated easily. As a result, we may not be able to reduce the size of our position or liquidate our investments when we deem appropriate to limit our downside risk. Should the value of any such investments we hold decline, the related write-down in value could have a material adverse effect on our financial condition and results of operations. For example, the value of our Lextar investment declined from the date of our investment in December 2014 through the end of the first quarter of fiscal 2018 with variability between quarters, and may continue to decline in the future. As required by Rule 3-09 of Regulation S-X, we filed Lextar's financial statements, prepared by Lextar and audited by its independent public accounting firm, as of and for the years ended December 31, 2015 and 2014 as an exhibit to our Annual Report on Form 10-K for the fiscal year ended June 25, 2017.

Litigation could adversely affect our operating results and financial condition.

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

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

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

pay substantial damages;

• indemnify our customers;
• stop the manufacture, use and sale of products found to be infringing;

40

Table of Contents

- incur asset impairment charges;
- discontinue the use of processes found to be infringing;
- expend significant resources to develop non-infringing products or processes; or
- obtain a license to use third party technology.

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

From time to time, we receive correspondence asserting that our products or processes are or may be infringing patents or other intellectual property rights of others. If we believe the assertions may have merit or in other appropriate circumstances, we may take steps to seek to obtain a license or to avoid the infringement. We cannot predict, however, whether a license will be available; that we would find the terms of any license offered acceptable; or that we would be able to develop an alternative solution. Failure to obtain a necessary license or develop an alternative solution could cause us to incur substantial liabilities and costs and to suspend the manufacture of affected products.

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

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

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

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

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

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

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

of operations.

41

Table of Contents

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

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

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

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

Our international sales and purchases are subject to numerous U.S. and foreign laws and regulations, including, without limitation, tariffs, trade sanctions, trade barriers, trade embargoes, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and, in the extreme case, we could be suspended or debarred from government contracts or have our export privileges suspended, which could have a material adverse effect on our business.

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

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. Given these uncertainties, there could be future disruptions in the global economy, financial markets and consumer confidence. If economic conditions deteriorate unexpectedly, our business and results of operations could be materially and adversely affected. For example, our customers, including our distributors and their customers, may experience difficulty obtaining the working capital and other financing necessary to support historical or projected purchasing patterns, which could negatively affect our results of operations.

Although we believe we have adequate liquidity and capital resources to fund our operations internally and under our existing line of credit, our inability to access the capital markets on favorable terms in the future, or at all, may adversely affect our financial performance. The inability to obtain adequate financing from debt or capital sources in the future could force us to self-fund strategic initiatives or even forego certain opportunities, which in turn could potentially harm our performance.

Changes in our effective tax rate may affect our results.

Our future effective tax rates may be affected by a number of factors including:

- the jurisdiction in which profits are determined to be earned and taxed;
- changes in government administrations, such as the new U.S. presidential administration and U.S. Congress, 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;

42

Table of Contents

changes in the valuation of our deferred tax assets and liabilities. For example, in the third quarter of fiscal 2017 we recognized a full valuation allowance against our U.S. deferred tax assets and other deferred charges primarily due to our three-year cumulative pre-tax loss position in the U.S. and the termination of the Wolfspeed sale transaction, which was anticipated to generate U.S. taxable income;

- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes, including impairment of goodwill in connection with acquisitions;
- changes in available tax credits;
- the recognition and measurement of uncertain tax positions;
- variations in realized tax deductions for certain stock-based compensation awards (such as non-qualified stock options and restricted stock) from 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.

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

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

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

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

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

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

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results (see “Critical Accounting Policies and Estimates” in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 25, 2017). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations or financial condition.

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

Table of Contents

Catastrophic events may disrupt our business.

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

Our stock price may be volatile.

Historically, our common stock has experienced substantial price volatility, particularly as a result of significant fluctuations in our revenue, earnings and margins over the past few years, and variations between our actual financial results and the published expectations of analysts. For example, the closing price per share of our common stock on the NASDAQ Global Select Market ranged from a low of \$21.12 to a high of \$28.83 during the 12 months ended September 24, 2017. 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 and opinions in the press or investment community about our strategic position, financial condition, results of operations or significant transactions can also cause changes in our stock price. In particular, speculation around our market opportunities for energy efficient lighting may have a dramatic effect on our stock price, especially as various government agencies announce their planned investments in energy efficient technology, including lighting. We have outstanding debt which could materially restrict our business and adversely affect our financial condition, liquidity and results of operations.

Our indebtedness consists of borrowings from our revolving line of credit. Our ability to pay interest and repay the principal for our indebtedness is dependent upon our ability to manage our business operations and generate sufficient cash flows to service such debt. There can be no assurance that we will be able to manage any of these risks successfully.

The level of outstanding debt under this line of credit may adversely affect our operating results and financial condition by, among other things:

- increasing our vulnerability to downturns in our business, to competitive pressures and to adverse general economic and industry conditions;
- requiring the dedication of an increased portion of our expected cash flows from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures, research and development and stock repurchases;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage compared to our peers that may have less indebtedness than we have by limiting our ability to borrow additional funds needed to operate and grow our business; and
- increasing our interest expense if interest rates increase.

Our line of credit requires us to maintain compliance with certain financial ratios. In addition, our line of credit contains certain restrictions that could limit our ability to, among other things: incur additional indebtedness, dispose of assets, create liens on assets, make acquisitions or engage in mergers or consolidations, and engage in certain transactions with our subsidiaries and affiliates. These restrictions could limit our ability to plan for or react to changing business conditions, or could otherwise restrict our business activities and plans.

Our ability to comply with our loan covenants may also be affected by events beyond our control and if any of these restrictions or terms is breached, it could lead to an event of default under our line of credit. A default, if not cured or waived, may permit acceleration of our indebtedness. In addition, our lenders could terminate their commitments to make further extensions of credit under our line of credit. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds to pay the accelerated indebtedness or that we will have the ability to refinance accelerated indebtedness on terms favorable to us or at all.

Table of Contents

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

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC established new annual disclosure and reporting requirements for those companies who may use “conflict” minerals mined from the DRC and adjoining countries in their products. Our most recent disclosure regarding our due diligence was filed in May 2017 for calendar year 2016. These requirements could affect the sourcing and availability of certain minerals used in the manufacture of our products. As a result, we may not be able to obtain the relevant minerals at competitive prices and there will likely be additional costs associated with complying with the due diligence procedures as required by the SEC. In addition, because our supply chain is complex, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins of all minerals used in our products through the due diligence procedures, and we may incur additional costs as a result of changes to product, processes or sources of supply as a consequence of these requirements.

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

There were no unregistered securities sold during the first quarter of fiscal 2017.

Stock Repurchase Program

On June 14, 2017, our Board of Directors approved the extension of our stock repurchase program through June 24, 2018. Pursuant to the program, we are authorized to repurchase shares of our common stock having an aggregate purchase price not exceeding \$200 million for all purchases from June 26, 2017 through the expiration of the program on June 24, 2018. During the three months ended September 24, 2017, the Company repurchased no shares of common stock under the stock repurchase program.

Since the inception of our stock repurchase program in January 2001 through September 24, 2017, we have repurchased 38.7 million shares of our common stock at an average price of \$28.66 per share with an aggregate value of \$1.1 billion. The repurchase program can be implemented through open market or privately negotiated transactions at the discretion of our management.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Table of Contents

Item 6. Exhibits

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

Exhibit Description

- 10.1 Notice of Grant to Charles M. Swoboda, dated August 28, 2017 (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, dated August 28, 2017, filed with the Securities and Exchange Commission on September 1, 2017)
- 10.2 Notice of Grant to Michael E. McDevitt, dated August 28, 2017 (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K, dated August 28, 2017, filed with the Securities and Exchange Commission on September 1, 2017)
- 10.3 Notice of Grant to Daniel J. Castillo, dated August 28, 2017 (incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K, dated August 28, 2017, filed with the Securities and Exchange Commission on September 1, 2017)
- 10.4 Notice of Grant to David T. Emerson, dated August 28, 2017 (incorporated by reference to Exhibit 10.4 of the Company's Current Report on Form 8-K, dated August 28, 2017, filed with the Securities and Exchange Commission on September 1, 2017)
- 10.5 Change in Control Agreement for Chief Executive Officer, dated September 22, 2017, between Cree, Inc. and Gregg A. Lowe (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K, dated September 27, 2017, filed with the Securities and Exchange Commission on September 28, 2017)
- 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 September 24, 2017 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income (Loss); (iii) Consolidated Statements of Comprehensive Income (Loss); (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements

Table of Contents

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.

October 18, 2017

/s/ MICHAEL E. MCDEVITT

Michael E. McDevitt

Executive Vice President and Chief Financial Officer

(Authorized Officer and Principal Financial and Chief Accounting Officer)