

CREE INC
Form 10-Q
October 17, 2012
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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 23, 2012

or

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

For the transition period from _____ to _____

Commission file number 0-21154

CREE, INC.

(Exact name of registrant as specified in its charter)

North Carolina
(State or other jurisdiction of incorporation or organization)

56-1572719

(I.R.S. Employer Identification No.)

4600 Silicon Drive
Durham, North Carolina
(Address of principal executive offices)
(919) 407-5300

27703

(Zip Code)

(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, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the registrant's common stock, par value \$0.00125 per share, as of October 10, 2012, was 116,283,450.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CREE, INC.

CONSOLIDATED BALANCE SHEETS

	September 23, 2012 (unaudited) (Thousands, except par value)	June 24, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 163,852	\$ 178,885
Short-term investments	652,432	565,628
Total cash, cash equivalents, and short-term investments	816,284	744,513
Accounts receivable, net	162,287	152,258
Inventories	179,678	188,849
Deferred income taxes	21,773	21,744
Prepaid expenses and other current assets	60,223	56,917
Total current assets	1,240,245	1,164,281
Property and equipment, net	566,138	582,461
Intangible assets, net	371,994	376,075
Goodwill	616,345	616,345
Other assets	7,920	8,336
Total assets	\$ 2,802,642	\$ 2,747,498
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	\$ 87,520	\$ 78,873
Accrued salaries and wages	37,361	29,837
Income taxes payable	9,647	3,834
Other current liabilities	40,425	36,633
Total current liabilities	174,953	149,177
Long-term liabilities:		
Deferred income taxes	15,719	15,609
Other long-term liabilities	19,995	22,695
Total long-term liabilities	35,714	38,304
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock, par value \$0.01; 3000 shares authorized at September 23, 2012 and June 24, 2012; none issued and outstanding	—	—
Common stock, par value \$0.00125; 200,000 shares authorized at September 23, 2012 and June 24, 2012; 116,280 and 115,906 shares issued and outstanding at September 23, 2012 and June 24, 2012, respectively	144	144
Additional paid-in-capital	1,876,622	1,861,502
Accumulated other comprehensive income, net of taxes	11,848	11,133
Retained earnings	703,361	687,238
Total shareholders' equity	2,591,975	2,560,017
Total liabilities and shareholders' equity	\$ 2,802,642	\$ 2,747,498

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

CREE, INC.

(UNAUDITED)

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended	
	September 23, 2012	September 25, 2011
	(Thousands, except per share amounts)	
Revenue, net	\$315,753	\$268,980
Cost of revenue, net	199,704	170,952
Gross profit	116,049	98,028
Operating expenses:		
Research and development	37,547	34,402
Sales, general and administrative	52,645	45,539
Amortization of acquisition-related intangibles	7,670	3,925
Loss on disposal or impairment of long-lived assets	898	775
Total operating expenses	98,760	84,641
Operating income	17,289	13,387
Non-operating income:		
Other non-operating income, net	1,593	974
Interest income, net	1,792	1,969
Income from operations before income taxes	20,674	16,330
Income tax expense	4,551	3,511
Net income	\$16,123	\$12,819
Earnings per share:		
Basic net income per share	\$0.14	\$0.11
Diluted net income per share	\$0.14	\$0.11
Shares used in per share calculation:		
Basic	115,539	111,866
Diluted	115,960	112,543

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

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

	Three Months Ended	
	September 23, 2012	September 25, 2011
	(In thousands)	
Net income	\$16,123	\$12,819
Other comprehensive income:		
Currency translation gain, net of tax expense of \$110 and \$197, respectively	182	323
Net unrealized gain (loss) on available-for-sale securities, net of tax (expense) benefit of (\$323) and \$661, respectively	533	(1,092)
Other comprehensive income	715	(769)
Comprehensive income	\$16,838	\$12,050

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

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

	Three Months Ended	
	September 23, 2012	September 25, 2011
	(In thousands)	
Cash flows from operating activities:		
Net income	\$16,123	\$12,819
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	36,474	32,128
Stock-based compensation	12,485	11,440
Excess tax benefit from share-based payment arrangements	(42)	(261)
Loss on disposal or impairment of long-lived assets	898	775
Amortization of premium/discount on investments	2,264	1,922
Changes in operating assets and liabilities:		
Accounts receivable	(10,054)	(21,725)
Inventories	9,002	12,431
Prepaid expenses and other assets	(3,030)	1,811
Accounts payable, trade	9,680	(13,708)
Accrued salaries and wages and other liabilities	11,886	4,013
Net cash provided by operating activities	85,686	41,645
Cash flows from investing activities:		
Purchases of property and equipment	(12,597)	(33,962)
Purchases of investments	(179,601)	(80,874)
Proceeds from maturities of investments	78,504	42,590
Proceeds from sale of property and equipment	47	2
Proceeds from sale of available-for-sale investments	12,886	236,518
Purchase of Ruud Lighting, net of cash acquired	—	(456,008)
Purchases of patent and licensing rights	(5,548)	(4,159)
Net cash used in investing activities	(106,309)	(295,893)

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Cash flows from financing activities:

Net proceeds from issuance of common stock	5,286	2,094	
Excess tax benefit from share-based payment arrangements	42	261	
Net cash provided by financing activities	5,328	2,355	
Effects of foreign exchange changes on cash and cash equivalents	262	468	
Net decrease in cash and cash equivalents	(15,033) (251,425)
Cash and cash equivalents:			
Beginning of period	178,885	390,598	
End of period	\$163,852	\$139,173	

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

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

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

Overview

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

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

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

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

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

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

The Company currently operates its business as three reportable segments:

- LED Products
- Lighting Products
- Power and RF Products

Basis of Presentation

The consolidated balance sheet at September 23, 2012, the consolidated statements of income for the three months ended September 23, 2012 and September 25, 2011, the consolidated statements of comprehensive income for the three months ended September 23, 2012 and September 25, 2011, and the consolidated statements of cash flows for the three months ended September 23, 2012 and September 25, 2011 (collectively, the “consolidated financial statements”) have been prepared by the Company and have not been audited. In the opinion of management, all normal and recurring adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows at September 23, 2012, and for all periods presented, have been made. The consolidated balance sheet at June 24, 2012 has been derived from the audited financial statements as of that date.

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

omitted. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 24, 2012 ("fiscal 2012"). The results of operations for the three months ended September 23, 2012 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 30, 2013 ("fiscal 2013").

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual amounts could differ materially from those estimates. Certain fiscal 2012 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2013 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

Recently Adopted Accounting Pronouncements

Presentation of Comprehensive Income

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

Note 2. Acquisitions

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

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

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

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

The amounts of revenue and net income of Ruud Lighting in the Company's Consolidated Statements of Income from and including August 17, 2011 to September 25, 2011 are as follows (in thousands, except per share data):

	Amounts	
Revenue	\$22,343	
Loss from operations	(522))
Net loss	(664))

Basic net loss per share	\$ (0.01))
Diluted net loss per share	\$ (0.01))

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The following unaudited pro forma information presents a summary of the Company's consolidated results of operations as if the Ruud Lighting transaction occurred at the beginning of the fiscal year for the period presented (in thousands, except per share data):

	Three Months Ended September 25, 2011
Revenue	\$299,312
Income from operations	8,788
Net income	8,853
Earnings per share, basic	\$0.08
Earnings per share, diluted	\$0.08

The total revenue for Ruud Lighting included in the pro forma table above was \$53.8 million for the three months ended September 25, 2011.

Note 3. Financial Statement Details

Accounts Receivable, net

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

	September 23, 2012	June 24, 2012	
Billed trade receivables	\$184,504	\$173,145	
Unbilled contract receivables	1,561	1,576	
	186,065	174,721	
Allowance for sales returns, discounts, and other incentives	(21,921) (20,681)
Allowance for bad debts	(1,857) (1,782)
Total accounts receivable, net	\$162,287	\$152,258	

Inventories

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

	September 23, 2012	June 24, 2012
Raw material	\$55,826	\$57,618
Work-in-progress	68,126	74,241
Finished goods	55,726	56,990
Total inventories	\$179,678	\$188,849

Note 4. Investments

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

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

	September 23, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	\$237,007	\$1,936	\$(24) \$ 238,919
Corporate bonds	142,437	2,573	(7) 145,003

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Certificates of deposit	185,000	—	—	185,000
U.S. agency securities	72,759	515	(2)	