

Fabrinet  
Form 10-Q  
November 09, 2011  
[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
September 30, 2011 For the quarterly period ended September 30, 2011

OR

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
Commission File Number: 001-34775

**FABRINET**

(Exact name of registrant as specified in its charter)

Edgar Filing: Fabrinet - Form 10-Q

|  |  |
|--|--|
| <b>Cayman Islands</b><br>(State or other jurisdiction of<br>incorporation or organization)   | <b>Not Applicable</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>Walker House</b><br><b>87 Mary Street</b><br><b>George Town</b><br><b>Grand Cayman</b><br><b>Cayman Islands</b><br>(Address of principal executive offices) | <b>KY1-9005</b><br>(Zip Code)                                    |
| <b>+66 2-524-9600</b><br>(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 (the Exchange Act ) 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 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

As of October 28, 2011, the registrant had 34,394,252 ordinary shares, \$0.01 par value, outstanding.

---

**Table of Contents**

**FABRINET**

**FORM 10-Q**

**QUARTER ENDED SEPTEMBER 30, 2011**

**Table of Contents**

|   | <b>Page No.</b> |
|---|-----------------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>   | 3               |
| <b><u>Item 1. Financial Statements</u></b>  | 3               |
| <u>Unaudited Condensed Consolidated Balance Sheets as of September 30, 2011 and June 24, 2011</u>                                     | 3               |
| <u>Unaudited Condensed Consolidated Statements of Operations for the three months ended September 30, 2011 and September 24, 2010</u> | 4               |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended September 30, 2011 and September 24, 2010</u> | 5               |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>   | 6               |
| <b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>                           | 21              |
| <b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>  | 31              |
| <b><u>Item 4. Controls and Procedures</u></b>   | 32              |
| <b><u>PART II. OTHER INFORMATION</u></b>  | 33              |
| <b><u>Item 1. Legal Proceedings</u></b>   | 33              |
| <b><u>Item 1A. Risk Factors</u></b>   | 33              |
| <b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>   | 49              |
| <b><u>Item 6. Exhibits</u></b>  | 49              |
| <b><u>Signature</u></b>   | 50              |
| <b><u>Exhibit Index</u></b>   | 51              |

**Table of Contents****PART I: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****FABRINET****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands of U.S. dollars, except share data)

|  | September 30, 2011 | June 24, 2011     |
|--|--------------------|-------------------|
| <b>Assets</b>  |                    |                   |
| Current assets                                       |                    |                   |
| Cash and cash equivalents                            | \$ 132,349         | \$ 127,282        |
| Trade accounts receivable, net                       | 122,433            | 117,705           |
| Inventories, net                                     | 106,552            | 106,467           |
| Investment in leases                                 | 1,795              | 448               |
| Deferred tax assets                                  | 1,471              | 1,308             |
| Prepaid expenses and other current assets            | 2,983              | 4,466             |
| <b>Total current assets</b>                          | <b>367,583</b>     | <b>357,676</b>    |
| Non-current assets                                   |                    |                   |
| Property, plant and equipment, net                   | 82,786             | 75,410            |
| Intangibles, net                                     | 649                | 892               |
| Investment in leases                                 | 1,928              | 1,163             |
| Deferred tax assets                                  | 2,060              | 1,953             |
| Deposits and other non-current assets                | 667                | 681               |
| <b>Total non-current assets</b>                      | <b>88,090</b>      | <b>80,099</b>     |
| <b>Total assets</b>                                  | <b>\$ 455,673</b>  | <b>\$ 437,775</b> |
| <b>Liabilities and Shareholders' Equity</b>          |                    |                   |
| Current liabilities                                  |                    |                   |
| Long-term loans from banks, current portion          | \$ 4,898           | \$ 4,398          |
| Trade accounts payable                               | 85,791             | 92,563            |
| Construction payable                                 | 5,266              | 2,475             |
| Income tax payable                                   | 2,515              | 1,858             |
| Deferred tax liability                               | 1,125              | 1,056             |
| Accrued payroll, profit sharing and related expenses | 7,374              | 7,677             |
| Accrued expenses                                     | 5,116              | 3,986             |
| Other payables                                       | 4,158              | 3,796             |
| <b>Total current liabilities</b>                     | <b>116,243</b>     | <b>117,809</b>    |
| Non-current liabilities                              |                    |                   |
| Long-term loans from banks, non-current portion      | 14,562             | 11,979            |
| Severance liabilities                                | 4,615              | 4,478             |
| Other non-current liabilities                        | 2,023              | 1,982             |
| <b>Total non-current liabilities</b>                 | <b>21,200</b>      | <b>18,439</b>     |
| <b>Total liabilities</b>                             | <b>137,443</b>     | <b>136,248</b>    |

## Edgar Filing: Fabrinet - Form 10-Q

|  |                   |                   |
|--|-------------------|-------------------|
| <b>Commitments and contingencies (Note 13)</b>   |                   |                   |
| <b>Shareholders' equity</b>  |                   |                   |
| Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of September 30, 2011 and June 24, 2011)  |                   |                   |
| Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 34,238,964 shares and 34,207,579 shares issued and outstanding as of September 30, 2011 and June 24, 2011, respectively) | 342               | 342               |
| Additional paid-in capital   | 60,864            | 59,816            |
| Retained earnings  | 257,024           | 241,369           |
| <b>Total shareholders' equity</b>  | <b>318,230</b>    | <b>301,527</b>    |
| <b>Total Liabilities and Shareholders' equity</b>  | <b>\$ 455,673</b> | <b>\$ 437,775</b> |

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

**Table of Contents****FABRINET****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(in thousands of U.S. dollars, except share data)

|   | <b>Three Months Ended</b>     |                               |
|---|-------------------------------|-------------------------------|
|   | <b>September 30,<br/>2011</b> | <b>September 24,<br/>2010</b> |
| Revenues  | \$ 186,347                    | \$ 173,740                    |
| Cost of revenues  | (163,463)                     | (151,964)                     |
| Gross profit  | 22,884                        | 21,776                        |
| Selling, general and administrative expenses  | (6,638)                       | (4,827)                       |
| Operating income  | 16,246                        | 16,949                        |
| Interest income   | 195                           | 98                            |
| Interest expense  | (74)                          | (111)                         |
| Foreign exchange loss, net  | (187)                         | (378)                         |
| Other income  | 97                            | 4                             |
| Income before income taxes  | 16,277                        | 16,562                        |
| Income taxes  | (622)                         | (1,357)                       |
| Net income  | \$ 15,655                     | \$ 15,205                     |
| <b>Earnings per share</b>   |                               |                               |
| Basic   | \$ 0.46                       | \$ 0.45                       |
| Diluted   | 0.45                          | 0.44                          |
| <b>Weighted average number of ordinary shares outstanding</b> (thousands of shares) |                               |                               |
| Basic   | 34,223                        | 33,761                        |
| Diluted   | 34,502                        | 34,351                        |

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

**Table of Contents****FABRINET****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands of U.S. dollars)

|  | <b>Three Months Ended</b> |                           |
|--|---------------------------|---------------------------|
|  | <b>September 30, 2011</b> | <b>September 24, 2010</b> |
| <b>Cash flows from operating activities</b>                                      |                           |                           |
| Net income for the period  | \$ 15,655                 | \$ 15,205                 |
| Adjustments to reconcile net income to net cash provided by operating activities |                           |                           |
| Depreciation and impairment losses   | 2,497                     | 2,102                     |
| Amortization of intangibles  | 102                       | 130                       |
| Gain on disposal of property, plant and equipment                                | (4)                       | (21)                      |
| Allowance for doubtful accounts and warranties                                   | 15                        | 16                        |
| Unrealized loss (gain) on exchange rate and fair value of derivative             | 576                       | (510)                     |
| Share-based compensation   | 988                       | 228                       |
| Deferred income tax  | (201)                     | (173)                     |
| Provision for uncertain tax position and severance liabilities, net of payments  | 188                       | 574                       |
| Inventory obsolescence   | 9                         | 153                       |
| Changes in operating assets and liabilities                                      |                           |                           |
| Trade accounts receivable  | (4,743)                   | (8,650)                   |
| Inventories  | (94)                      | (15,138)                  |
| Other current assets and non-current assets                                      | 1,493                     | (2,111)                   |
| Trade accounts payable   | (6,772)                   | 5,468                     |
| Income tax payable   | 657                       | 896                       |
| Other current liabilities and non-current liabilities                            | (524)                     | (72)                      |
| Net cash provided by (used in) operating activities                              | 9,842                     | (1,903)                   |
| <b>Cash flows from investing activities</b>                                      |                           |                           |
| Purchase of property, plant and equipment  | (5,862)                   | (7,245)                   |
| Purchase of intangibles  | (15)                      | (7)                       |
| Purchase of assets for lease under direct financing leases                       | (2,824)                   | (90)                      |
| Proceeds from direct financing leases  | 713                       | 6                         |
| Proceeds from disposals of property, plant and equipment                         | 5                         | 22                        |
| Net cash used in investing activities  | (7,983)                   | (7,314)                   |
| <b>Cash flows from financing activities</b>                                      |                           |                           |
| Receipts of long-term loans from banks   | 4,000                     |                           |
| Repayments of long-term loans from banks   | (917)                     | (1,417)                   |
| Proceeds from initial public offering, net                                       |                           | 26,319                    |
| Proceeds from issue of ordinary shares under employee share option plan          | 60                        | 28                        |
| Net cash provided by financing activities  | 3,143                     | 24,930                    |
| <b>Net increase in cash and cash equivalents</b>                                 | <b>5,002</b>              | <b>15,713</b>             |
| <b>Movement in cash and cash equivalents</b>                                     |                           |                           |
| Cash and cash equivalents at beginning of period                                 | 127,282                   | 84,942                    |
| Increase in cash and cash equivalents  | 5,002                     | 15,713                    |
| Effect of exchange rate on cash and cash equivalents                             | 65                        | 435                       |
| <b>Cash and cash equivalents at end of period</b>                                | <b>\$ 132,349</b>         | <b>\$ 101,090</b>         |

## Edgar Filing: Fabrinet - Form 10-Q

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



---

**Table of Contents**

**FABRINET**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Business and organization**

**General**

Fabrinet ( Fabrinet or the Company ) was incorporated on August 12, 1999, and commenced operations on January 1, 2000. The Company is an exempted company incorporated with limited liability, and is domiciled in the Cayman Islands, British West Indies. Fabrinet and its direct and indirect subsidiaries are referred to as the Group .

The Group provides precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (OEMs) of complex products, such as optical communication components, modules and sub-systems, industrial lasers and sensors. The Group offers a broad range of advanced optical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, integration and full product assembly and test. The Group focuses primarily on the production of low-volume, high-mix products.

The Company has the following direct and indirect subsidiaries:

Fabrinet Co., Ltd., ( Fabrinet Thailand ) incorporated in Thailand on September 27, 1999;

Fabrinet USA, Inc., incorporated in the U.S. in the State of California on October 12, 1999;

FBN New Jersey Manufacturing, Inc., incorporated in the U.S. in the State of Delaware on May 11, 2005;

Fabrinet China Holdings, incorporated in Mauritius and CASIX Inc., incorporated in the People s Republic of China, which were both acquired on May 29, 2005;

Fabrinet Pte. Ltd., incorporated in Singapore on November 14, 2007; and

Fabrinet AB, incorporated in Sweden on September 29, 2010.

Asia Pacific Growth Fund III, L.P. held 26.4% and 26.5% of the Company s share capital (fully diluted) as of September 30, 2011 and June 24, 2011, respectively.

**2. Accounting policies**

***Basis of presentation***

The condensed consolidated financial statements of Fabrinet included herein have been prepared on a basis consistent with the June 24, 2011 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These condensed consolidated financial statements should be read in conjunction with the June 24, 2011 audited consolidated financial statements and notes thereto. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America ( U.S.

## Edgar Filing: Fabrinet - Form 10-Q

GAAP ). Fabrinet's results of operations for the three months ended September 30, 2011 and September 24, 2010 are not necessarily indicative of future operating results.

---

## **Table of Contents**

The preparation of the Group's condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amount of total revenues and expense during the year. The Group bases estimates on historical experience and various assumptions about the future that are believed to be reasonable based on available information. The Group's reported financial position or results of operations may be materially different under different conditions or when using different estimates and assumptions, particularly with respect to significant accounting policies, which are discussed below. Significant assumptions are used in accounting for business combinations, share-based compensation, allowance for doubtful accounts, income taxes and inventory obsolescence, among others. Due to the inherent uncertainty involved in making estimates, actual results reported in future periods may be different from these estimates. In the event that estimates or assumptions prove to differ from actual results, adjustments are made in subsequent periods to reflect more current information.

### ***Fiscal years***

The Company utilizes a 52-53 week fiscal year ending on the Friday closest to June 30. The three months ended September 30, 2011 and September 24, 2010 consisted of 14 weeks and 13 weeks, respectively. Fiscal year 2012 will be comprised of 53 weeks and will end on June 29, 2012.

### ***Concentration of credit risk***

Financial instruments that potentially subject the Group to concentrations of credit risk consist of cash and cash equivalents and accounts receivable.

As of September 30, 2011, the Group's cash and cash equivalents were held in deposits and highly liquid products with maturities of three months or less with banks with credit ratings of A minus or above. The Group had four customers and five customers that each contributed to 10% or more of its total accounts receivable as of September 30, 2011 and June 24, 2011, respectively.

Accounts receivable include amounts due from companies that are monitored by the Group for credit worthiness. Management has implemented a program to closely monitor near term cash collection and credit exposures and believes no material loss will be incurred.

### ***Recent accounting pronouncements***

In September 2011, the FASB issued the Accounting Standards Update No. 2011-08 Intangibles-Goodwill and Other (Topic 350) Testing Goodwill for Impairment. The amendments in this Update are intended to reduce complexity and costs by allowing an entity the option to make a qualitative evaluation about the likelihood of goodwill impairment to determine whether it should calculate the fair value of a reporting unit. The amendments also improve previous guidance by expanding upon the examples of events and circumstances that an entity should consider between annual impairment tests in determining whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. Also, the amendments improve the examples of events and circumstances that an entity having a reporting unit with a zero or negative carrying amount should consider in determining whether to measure an impairment loss, if any, under the second step of the goodwill impairment test. This guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted. The Company will adopt this guidance in the third quarter of fiscal year 2012, and is currently evaluating the impact, if any, the guidance will have on its unaudited condensed consolidated financial statements.

In June 2011, the FASB issued the Accounting Standards Update No. 2011-05 Comprehensive Income (Topic 220) Presentation of Comprehensive Income. Under the amendments to Topic 220, Comprehensive Income, 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. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. In a single continuous statement, the entity is required to present the components of net income and total net income, the components of other comprehensive income and a total for other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, an entity is required to present components of net income and total net income in the statement of net income. The statement of other comprehensive income should immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. Regardless of whether an entity chooses to present comprehensive income in a single continuous statement or in two separate but consecutive statements, the entity is required to present on the face of the financial statements reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. This guidance is effective for fiscal years, and interim periods within those years,

## Edgar Filing: Fabrinet - Form 10-Q

beginning after December 15, 2011. Early adoption is permitted. The Company will adopt this guidance in the first quarter of fiscal year 2013, and is currently evaluating the impact, if any, the guidance will have on its unaudited condensed consolidated financial statements.

**Table of Contents**

In May 2011, the FASB issued the Accounting Standards Update No. 2011-04 Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments in this Update result in common fair value measurement and disclosure requirements in U.S. GAAP and IFRSs. Consequently, the amendments change the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the Board does not intend for the amendments in this Update to result in a change in the application of the requirements in Topic 820. Some of the amendments clarify the Board's intent about the application of existing fair value measurement requirements. Other amendments change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements. This guidance is effective during interim or annual periods beginning after December 15, 2011. Early application is not permitted. The Company will adopt this guidance in the third quarter of fiscal year 2012, and is currently evaluating the impact, if any, the guidance will have on its unaudited condensed consolidated financial statements.

In April 2011, the FASB issued the Accounting Standards Update No. 2011-03 Transfers and Servicing (Topic 860) Reconsideration of Effective Control for Repurchase Agreements. The amendments in this Update remove from the assessment of effective control (1) the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee, and (2) the collateral maintenance implementation guidance related to that criterion. Other criteria applicable to the assessment of effective control are not changed by the amendments in this Update. Those criteria indicate that the transferor is deemed to have maintained effective control over the financial assets transferred (and thus must account for the transaction as a secured borrowing) for agreements that both entitle and obligate the transferor to repurchase or redeem the financial assets before their maturity if all of the following conditions are met: 1. The financial assets to be repurchased or redeemed are the same or *substantially the same* as those transferred. 2. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price. 3. The agreement is entered into contemporaneously with, or in contemplation of, the transfer. This guidance is effective for the first interim or annual period beginning on or after December 15, 2011. Early adoption is not permitted. The Company will adopt this guidance in the third quarter of fiscal year 2012, and is currently evaluating the impact, if any, the guidance will have on its unaudited condensed consolidated financial statements.

**3. Earnings per ordinary share**

Basic earnings per ordinary share are computed by dividing reported net income by the weighted average number of ordinary shares outstanding during each period.

|  | Three Months Ended    |                       |
|--|-----------------------|-----------------------|
|  | September 30,<br>2011 | September 24,<br>2010 |
| Net income attributable to shareholders                                      | \$ 15,655             | \$ 15,205             |
| Weighted average number of ordinary shares outstanding (thousands of shares) | 34,223                | 33,761                |
| Basic earnings per ordinary share (in dollars)                               | \$ 0.46               | \$ 0.45               |

**Table of Contents**

Diluted earnings per ordinary share are computed by dividing reported net income by the weighted average number of ordinary shares and dilutive ordinary equivalent shares outstanding during each period. Dilutive ordinary equivalent shares consist of share options and restricted shares. Diluted earnings per ordinary share is calculated as follows:

|  | Three Months Ended    |                       |
|--|-----------------------|-----------------------|
|  | September 30,<br>2011 | September 24,<br>2010 |
| Net income used to determine diluted earnings per ordinary share   | \$ 15,655             | \$ 15,205             |
| Weighted average number of ordinary shares outstanding (thousands of shares)                               | 34,223                | 33,761                |
| Adjustment for incremental shares arising from the assumed exercise of share options (thousands of shares) | 279                   | 590                   |
| Weighted average number of ordinary shares for diluted earnings per ordinary share (thousands of shares)   | 34,502                | 34,351                |
| Diluted earnings per ordinary share (in dollars)   | \$ 0.45               | \$ 0.44               |

**4. Fair value**

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A fair value hierarchy is established which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company utilizes the market approach to measure fair value for its financial assets and liabilities. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

The following table sets forth the Company's applicable liabilities measured at fair value on a recurring basis as of September 30, 2011:

|  | Fair Value Measurements at Reporting Date Using  |   |   |                  |
|--|--|---|---|------------------|
|  | Quoted<br>Prices<br>in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) | Total<br>Balance |
| <b>Liabilities</b>                       |  |   |   |                  |
| Derivative liabilities                   | \$   | \$ 1,603  | \$  | \$ 1,603         |
| Total liabilities measured at fair value | \$   | \$ 1,603  | \$  | \$ 1,603         |



**Table of Contents**

The above derivative liabilities are classified in accrued expenses on the condensed consolidated balance sheet.

The following table sets forth the Company's applicable liabilities measured at fair value on a recurring basis as of June 24, 2011:

|  | Fair Value Measurements at Reporting Date Using  |   |   | Total<br>Balance |
|--|--|---|---|------------------|
|  | Quoted<br>Prices<br>in<br>Active<br>Markets for<br>Identical<br>Assets<br>(Level<br>1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs (Level 3) |                  |
| <b>Liabilities</b>                       |  |   |   |                  |
| Derivative liabilities                   | \$   | \$ 966  | \$  | \$ 966           |
| Total liabilities measured at fair value | \$   | \$ 966  | \$  | \$ 966           |

The above derivative liabilities are classified in accrued expenses on the condensed consolidated balance sheet.

**5. Allowance for doubtful accounts**

The activities and balances for allowance for doubtful accounts for the three months ended September 30, 2011 and September 24, 2010 were as follows:

|                                 | Balance at<br>beginning of<br>period | Charged to<br>Expenses/<br>(Credited to Income)<br>for the three<br>months | Balance at<br>end of period |
|---------------------------------|--------------------------------------|--|-----------------------------|
| Period ended September 30, 2011 | \$ 79                                | \$ 15  | \$ 94                       |
| Period ended September 24, 2010 | \$ 41                                | \$ (5)   | \$ 36                       |

**6. Inventories**

|                                    | September 30,<br>2011 | June 24,<br>2011 |
|------------------------------------|-----------------------|------------------|
| Raw materials                      | \$ 44,505             | \$ 47,172        |
| Work in progress                   | 46,269                | 46,190           |
| Finished goods                     | 8,752                 | 9,651            |
| Goods in transit                   | 9,237                 | 5,656            |
|                                    | 108,763               | 108,669          |
| <u>Less</u> Inventory obsolescence | (2,211)               | (2,202)          |
| Inventories, net                   | \$ 106,552            | \$ 106,467       |





**Table of Contents****7. Investment in leases**

Investment in direct financing leases primarily consists of manufacturing equipment. The following lists the components of the Company's investment in direct financing leases as of September 30, 2011 and June 24, 2011:

|   | September 30,<br>2011 | June 24,<br>2011 |
|---|-----------------------|------------------|
| Total minimum lease payments receivable       | \$ 4,527              | \$ 2,026         |
| Estimated residual values of leased equipment |                       |                  |
| Investment in direct financing leases         | 4,527                 | 2,026            |
| Less: unearned income                         | (804)                 | (415)            |
| Net investment in direct financing leases     | \$ 3,723              | \$ 1,611         |

As of September 30, 2011, the future minimum lease payments to be received are as follows at the end of each fiscal year in June:

|   |          |
|---|----------|
| 2012                                    | \$ 1,672 |
| 2013                                    | 526      |
| 2014                                    | 599      |
| 2015                                    | 691      |
| 2016                                    | 235      |
| Total minimum lease payments receivable | \$ 3,723 |

**8. Intangibles**

The following tables present details of the Group's intangibles:

|                   | Gross Carrying<br>Amount | September 30, 2011<br>Accumulated<br>Amortization | Net    |
|-------------------|--------------------------|---|--------|
| Software          | \$ 3,453                 | \$ (2,804)  | \$ 649 |
| Total intangibles | \$ 3,453                 | \$ (2,804)  | \$ 649 |

|                   | Gross Carrying<br>Amount | June 24, 2011<br>Accumulated<br>Amortization | Net    |
|-------------------|--------------------------|--|--------|
| Software          | \$ 3,594                 | \$ (2,702)                                   | \$ 892 |
| Total intangibles | \$ 3,594                 | \$ (2,702)                                   | \$ 892 |

**Table of Contents**

The Group recorded amortization expense relating to intangibles of \$102 and \$130 for the three months ended September 30, 2011 and September 24, 2010, respectively.

Based on the carrying amount of intangibles as of September 30, 2011, and assuming no future impairment of the underlying assets, the estimated future amortization at the end of each fiscal year in June is as follows:

|                           |               |
|---------------------------|---------------|
| 2012                      | \$ 279        |
| 2013                      | 131           |
| 2014                      | 112           |
| 2015                      | 84            |
| 2016                      | 41            |
| Thereafter                | 2             |
| <b>Total amortization</b> | <b>\$ 649</b> |

**9. Borrowings**

Bank borrowings and long-term debt was comprised of the following:

|                            | September 30,<br>2011 | June 24,<br>2011 |
|----------------------------|-----------------------|------------------|
| Short-term bank borrowings | \$                    | \$               |
| Long-term loans from banks | 19,460                | 16,377           |
| <b>Total borrowings</b>    | <b>\$ 19,460</b>      | <b>\$ 16,377</b> |

*Long-term loans from banks consisted of:*

|                     |          |          |
|---------------------|----------|----------|
| Current portion     | \$ 4,898 | \$ 4,398 |
| Non-current portion | 14,562   | 11,979   |

At September 30, 2011 and June 24, 2011, the Group had outstanding borrowings under long-term loan agreements with banks totaling \$19,460 and \$16,377, respectively, which consisted of:

| Contract No. | Amount             |                  | Interest rate per annum (%) | Conditions   | Repayment term               |
|--------------|--------------------|------------------|-----------------------------|--|------------------------------|
|              | September 30, 2011 | June 24, 2011    |                             |  |                              |
| 1            | \$ 6,000           | \$ 2,000         | LIBOR + 2.8% per annum      | Repayable in quarterly installments within 6 years   | June 2012 -<br>March 2017    |
| 2            | 12,830             | 13,747           | SIBOR + 1.5% per annum      | Repayable in quarterly installments within 8 years   | May 2009 -<br>February 2015  |
| 3            | 630                | 630              | SIBOR + 1.5% per annum      | Repayable in semi-annual installments within 7 years | June 2005 -<br>November 2011 |
| <b>Total</b> | <b>\$ 19,460</b>   | <b>\$ 16,377</b> |                             |  |                              |

## Edgar Filing: Fabrinet - Form 10-Q

Certain of the long-term loans are secured by certain property, plant and equipment. The carrying amount of assets secured and pledged as collateral was \$34,553 and \$34,946 as of September 30, 2011 and June 24, 2011, respectively. The carrying amounts of borrowings approximate their fair value.

Interest expense relating to a long-term loan from a bank for the development of a new factory site, Pinehurst Building 6, of \$22 was capitalized in construction in progress for the three months ended September 30, 2011.

**Table of Contents**

The long-term loans prescribe maximum ratios of debt to equity and minimum levels of debt service coverage ratios. As of September 30, 2011 and June 24, 2011, the Group was in compliance with its long-term loan agreements. In addition to financial ratios, certain of the Group's packing credits and long-term loans include customary events of default. There is no requirement for the Group to maintain a lock-box arrangement under these agreements. As such, the non-current portions of the long-term loans are classified as non-current liabilities in the condensed consolidated balance sheet.

The movements of long-term loans were as follows for the periods ended:

|                                    | September 30,<br>2011 | September 24,<br>2010 |
|------------------------------------|-----------------------|-----------------------|
| Opening net book amount            | \$ 16,377             | \$ 20,385             |
| Additional loans during the period | 4,000                 |                       |
| Repayment during the period        | (917)                 | (1,417)               |
| Closing net book amount            | \$ 19,460             | \$ 18,968             |

As of September 30, 2011, future maturities of long-term debt were as follows at the end of each fiscal year below:

|              |                  |
|--------------|------------------|
| 2012         | \$ 3,681         |
| 2013         | 4,868            |
| 2014         | 4,868            |
| 2015         | 3,943            |
| 2016         | 1,200            |
| Thereafter   | 900              |
| <b>Total</b> | <b>\$ 19,460</b> |

**Credit facilities:**

Undrawn available credit facilities at September 30, 2011 and June 24, 2011 totaled:

|                  | September 30,<br>2011 | June 24,<br>2011 |
|------------------|-----------------------|------------------|
| Bank borrowings: |                       |                  |
| Short-term loans | \$ 50,354             | \$ 50,450        |
| Long-term loans  | 24,000                | 28,000           |

**10. Income tax**

The Group has implemented FASB ASC Topic 740, *Income Taxes* ( FASB ASC 740 ). As of September 30, 2011, the liability for uncertain tax positions including accrued interest and penalties increased to \$1,754 (June 24, 2011: \$1,703). The Group does not expect any material changes to the estimated amount of liability associated with its uncertain tax positions within the next 12 months.

The Group files several income tax returns in the U.S. and foreign tax jurisdictions. The tax years from 2007 to 2011 remain open to examination by U.S. and state tax authorities, and the tax years from 2007 to 2011 remain open to examination by the foreign tax authorities.

The Group's income tax is recognized based on the best estimate of the expected annual income tax rate for the full financial year of each entity in the Group. The effective tax rate for the Group for the three months ended September 30, 2011 and September 24, 2010 was 4% and 8% of net income, respectively. The decrease in effective tax rate during the three months ended September 30, 2011 as compared to the three months

## Edgar Filing: Fabrinet - Form 10-Q

ended September 24, 2010 was due to the fact that during the three months ended September 24, 2010, the Group recognized uncertainty income tax provision and income tax assessment of \$213 and \$137, respectively for fiscal 2010 of a subsidiary located in New Jersey.

**Table of Contents****11. Share-based compensation***Share-based compensation*

FASB ASC Topic 718, *Compensation-Stock Compensation* ( FASB ASC 718 ) requires companies to recognize the cost of employee service received in exchange for awards of equity instruments, based on the grant date fair value of those awards, in the financial statements. In determining the grant date fair value of those awards, the Group is required to make estimates of the fair value of the Group's ordinary shares, expected dividends to be issued, expected volatility of the Group's shares, expected forfeitures of the awards, risk free interest rates for the expected term of the awards, expected terms of the awards, and the vesting period of the respective awards. FASB ASC 718 requires forfeitures to be estimated at the time of grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates.

The effect of recording share-based compensation expense for the three months ended September 30, 2011 and September 24, 2010 was as follows:

|   | <b>Three Months Ended</b>     |                               |
|---|-------------------------------|-------------------------------|
|   | <b>September 30,<br/>2011</b> | <b>September 24,<br/>2010</b> |
| <b>Share-based compensation expense by type of award:</b> |                               |                               |
| Share options   | \$ 870                        | \$ 165                        |
| Restricted shares   | \$ 118                        | 63                            |
| <br>  |                               |                               |
| Total share-based compensation expense                    | \$ 988                        | \$ 228                        |
| <br>  |                               |                               |
| <b>Tax effect on share-based compensation expense</b>     |                               |                               |
| <br>  |                               |                               |
| Net effect on share-based compensation expense            | \$ 988                        | \$ 228                        |

Share-based compensation expense was recorded in the condensed consolidated statements of operations as follows: cost of revenues of \$445 and \$92 for the three months ended September 30, 2011 and September 24, 2010, respectively, and SG&A expenses of \$543 and \$136 for the three months ended September 30, 2011 and September 24, 2010, respectively. The Group did not capitalize any share-based compensation expense as part of any asset costs during the three months ended September 30, 2011 and September 24, 2010.

*Share-based award activity*

Share options have been granted to directors and employees. As of September 30, 2011, there were 387,227 share options outstanding under the Amended and Restated 1999 Share Option Plan (the "1999 Plan"), and no more option grants may be made under the 1999 Plan.

On March 12, 2010, the Company's shareholders adopted the 2010 Performance Incentive Plan (the "2010 Plan"), and on December 20, 2010, the Company's shareholders adopted an amendment to the 2010 Plan to increase the number of ordinary shares authorized for issuance under the 2010 Plan. A total of 2,000,000 ordinary shares are authorized for issuance under the 2010 Plan, plus any shares subject to share options under the 1999 Plan outstanding as of June 24, 2010, that expire, are canceled or terminate after the effective date of such date. As of September 30, 2011, there were an aggregate of 1,134,626 share options outstanding, 25,900 restricted shares outstanding and 823,018 ordinary shares available for future grant under the 2010 Plan.

*Share options*

The Company's board of directors has the authority to determine the type of option and the number of shares subject to the option. Options generally vest and become exercisable over four years and expire, if not exercised, within 7 years of the grant date. In the case of a grantee's first grant, 25 percent of the underlying shares subject to option vest 12 months after the grant date and 1/48 of the underlying shares vest monthly over each of the subsequent 36 months. In the case of any additional grants to a grantee, 1/48 of the underlying shares subject to option vest monthly over four years, commencing one month after the grant date.





**Table of Contents**

The following summarizes share option activities under the 1999 Plan:

|  | Number of shares underlying options<br>Three Months Ended |                       | Weighted-average exercise price<br>per share<br>Three Months Ended |                       |
|--|---|-----------------------|--|-----------------------|
|  | September 30,<br>2011                                     | September 24,<br>2010 | September 30,<br>2011  | September 24,<br>2010 |
| Shares underlying options outstanding at beginning of the period | 423,205   | 858,005               | \$ 4.34  | \$ 3.66               |
| Granted  |   |                       |  |                       |
| Exercised  | (31,385)  | (12,900)              | 1.92   | 2.15                  |
| Forfeited  | (4,593)   | (1,350)               | 6.01   | 5.00                  |
| Expired  |   | (5,900)               |  | 2.78                  |
| Shares underlying options outstanding at end of the period       | 387,227   | 837,855               | 4.52   | 3.69                  |
| Shares underlying options exercisable at end of the period       | 282,312   | 606,538               | \$ 4.08  | \$ 3.03               |

The following summarizes information for share options outstanding as of September 30, 2011 under the 1999 Plan:

|                     | Number of shares underlying options | Exercise price | Weighted average remaining contractual life (years) | Aggregate intrinsic value |
|---------------------|-------------------------------------|----------------|---|---------------------------|
|                     | 28,212                              | \$ 1.75        | 0.53  |                           |
|                     | 2,500                               | 2.00           | 1.00  |                           |
|                     | 4,925                               | 2.25           | 1.37  |                           |
|                     | 4,100                               | 2.75           | 1.92  |                           |
|                     | 1,600                               | 3.00           | 1.94  |                           |
|                     | 120,021                             | 3.50           | 2.25  |                           |
|                     | 14,750                              | 4.25           | 2.92  |                           |
|                     | 10,161                              | 4.75           | 3.17  |                           |
|                     | 11,156                              | 5.00           | 3.38  |                           |
|                     | 5,480                               | 5.25           | 3.60  |                           |
|                     | 41,750                              | 5.50           | 3.91  |                           |
|                     | 138,372                             | 5.75           | 5.07  |                           |
|                     | 4,200                               | 6.25           | 5.60  |                           |
| Options outstanding | 387,227                             |                | 3.43  | \$ 5,493                  |
| Options exercisable | 282,312                             |                | 2.89  | \$ 4,128                  |

As of September 30, 2011, \$147 of estimated share-based compensation expense related to share options under the 1999 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 2.01 years.

**Table of Contents**

The following summarizes share option activities under the 2010 Plan:

|  | Number of shares<br>underlying options<br>Three Months Ended |                       | Weighted-average exercise price<br>per share<br>Three Months Ended |                       |
|--|--|-----------------------|--|-----------------------|
|  | September 30,<br>2011  | September 24,<br>2010 | September 30,<br>2011  | September 24,<br>2010 |
| Shares underlying options outstanding at beginning of the period | 925,921  |                       | \$ 17.37   | \$                    |
| Granted  | 221,163  | 40,000                | 15.16  | 13.77                 |
| Exercised  |  |                       |  |                       |
| Forfeited  | (12,458)   |                       | 16.70  |                       |
| Expired  |  |                       |  |                       |
| Shares underlying options outstanding at end of the period       | 1,134,626  | 40,000                | 16.95  | 13.77                 |
| Shares underlying options exercisable at end of the period       | 174,001  |                       | \$ 16.86   | \$                    |

The following summarizes information for share options outstanding as of September 30, 2011 under the 2010 Plan:

|                     | Number of<br>shares<br>underlying<br>options | Exercise<br>price | Weighted average<br>remaining<br>contractual<br>life<br>(years) | Aggregate<br>intrinsic<br>value |
|---------------------|--|-------------------|---|---------------------------------|
|                     | 40,000                                       | \$ 13.77          | 5.90  |                                 |
|                     | 764,098                                      | 16.83             | 6.04  |                                 |
|                     | 30,000                                       | 15.05             | 6.10  |                                 |
|                     | 35,544                                       | 25.50             | 6.29  |                                 |
|                     | 24,800                                       | 26.16             | 6.35  |                                 |
|                     | 20,000                                       | 23.62             | 6.60  |                                 |
|                     | 220,184                                      | 15.16             | 6.88  |                                 |
| Options outstanding | 1,134,626                                    |                   | 6.23  | \$ 2,515                        |
| Options exercisable | 174,001                                      |                   | 6.05  | \$ 354                          |

As of September 30, 2011, \$3,377 of estimated share-based compensation expense related to share options under the 2010 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 3.34 years.

**Restricted shares**

Restricted shares are one type of share-based awards that can be granted under the 2010 Plan. Restricted shares granted to non-employee directors generally cliff vest 100% on the last business day prior to the Company's next annual shareholder meeting, which is typically approximately 1 year from the date of grant.

**Table of Contents**

The following summarizes restricted share activities under the 2010 Plan:

|   | Number of shares<br>underlying options<br>Three Months Ended |                       | Weighted-average grant date<br>fair value per share<br>Three Months Ended |                       |
|---|--|-----------------------|---|-----------------------|
|   | September 30,<br>2011  | September 24,<br>2010 | September 30,<br>2011   | September 24,<br>2010 |
| Unvested balance at beginning of the period | 25,900   |                       | \$ 21.62  | \$                    |
| Granted                                     |  | 16,806                |   | 13.77                 |
| Issued                                      |  |                       |   |                       |
| Vested                                      |  |                       |   |                       |
| Forfeited                                   |  |                       |   |                       |
| Unvested balance at end of the period       | 25,900   | 16,806                | \$ 21.62  | \$ 13.77              |

As of September 30, 2011, \$79 of estimated share-based compensation expense related to restricted shares under the 2010 Plan remains to be recorded. That cost is expected to be recorded over an estimated amortization period of 0.19 years.

**12. Shareholders equity****Share capital**

In February 2010, the Company's shareholders approved a change in the Company's authorized share capital to US\$5,050,000 divided into 500,000,000 ordinary shares, par value of \$0.01 per ordinary share, and 5,000,000 preferred shares, par value of \$0.01 per preferred share. The Company amended and restated its memorandum and articles of association in March 2010 to reflect this change.

For the three months ended September 30, 2011, the Company issued 31,385 ordinary shares upon exercise of options, for consideration of a weighted average exercise price of \$1.92 per share. All such issued shares are fully paid.

For the three months ended September 24, 2010, the Company issued 12,900 ordinary shares upon exercise of options, for consideration of a weighted average exercise price of \$2.15 per share. All such issued shares are fully paid.

**13. Commitments and contingencies****Bank guarantees**

At September 30, 2011 and June 24, 2011, there were outstanding bank guarantees given by banks on behalf of Fabrinet Thailand for electricity usage and other normal business amounting to \$674 and \$686, respectively.

**Operating lease commitments**

The Group leases a portion of its capital equipment, and certain land and buildings for its facilities in Thailand, China and New Jersey, under operating lease arrangements that expire in various calendar years through 2015. Rental expense under these operating leases amounted to \$497 and \$460 for the three months ended September 30, 2011 and September 24, 2010, respectively.

**Table of Contents**

As of September 30, 2011, the future minimum lease payments due under non-cancelable leases were as follows at the end of each fiscal year below:

|  |              |
|--|--------------|
| 2012                                       | \$ 1,413     |
| 2013                                       | 1,884        |
| 2014                                       | 1,103        |
| 2015                                       | 59           |
| 2016                                       | 14           |
| <br>Total minimum operating lease payments | <br>\$ 4,473 |

**Purchase obligations**

Purchase obligations represent legally-binding commitments to purchase inventory and other commitments made in the normal course of business to meet operational requirements. Although open purchase orders are considered enforceable and legally binding, the terms generally give the Group the option to cancel, reschedule and/or adjust its requirements based on its business needs prior to the delivery of goods or performance of services. Obligations to purchase inventory and other commitments are generally expected to be fulfilled within one year.

As of September 30, 2011, there was an outstanding commitment to third parties relating to the development of a new factory site, Pinehurst Building 6, of \$18,282.

**Indemnification of directors and officers**

Cayman Islands law does not limit the extent to which a company's memorandum and articles of association may provide for indemnification of directors and officers, except to the extent any such provision may be held by the Cayman Islands courts to be contrary to public policy, such as to provide indemnification against civil fraud or the consequences of committing a crime. The Company's amended and restated memorandum and articles of association provide for indemnification of directors and officers for actions, costs, charges, losses, damages and expenses incurred in their capacities as such, except that such indemnification does not extend to any matter in respect of any fraud or dishonesty that may attach to any of them.

On February 9, 2010, shareholders of the Company approved a form of indemnification agreement for directors and officers of the Company. The Company subsequently entered into indemnification agreements with each of its directors and executive officers, pursuant to which, the Company agreed to indemnify its directors and officers against certain liabilities and expenses incurred by such persons in connection with claims by reason of their being such a director or officer. The Company has a director and officer liability insurance policy that may enable it to recover a portion of any future amounts paid under the indemnification agreements.

**14. Business segments and geographic information**

The Group evaluates its reportable segments in accordance with FASB ASC Topic 280, *Segment Reporting*. Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision making group, in deciding how to allocate resources and in assessing performance. The Group's chief operating decision maker is Fabrinet's board of directors. As of September 30, 2011, the Group operated and internally managed a single operating segment. Accordingly, the Group does not accumulate discrete information with respect to separate product lines and does not have separate reportable segments.

**Table of Contents**

The Group operates primarily in three geographic regions: North America, Asia-Pacific and Europe. The following table presents total revenues by geographic regions:

|               | <b>Three Months Ended</b>     |                               |
|---------------|-------------------------------|-------------------------------|
|               | <b>September 30,<br/>2011</b> | <b>September 24,<br/>2010</b> |
| North America | \$ 91,042                     | \$ 74,583                     |
| Asia-Pacific  | 59,304                        | 66,921                        |
| Europe        | 36,001                        | 32,236                        |
|               | \$ 186,347                    | \$ 173,740                    |

Total revenues are attributed to a particular geographic area based on the bill-to location of the customer. As of September 30, 2011, the Group had approximately \$142 of long-lived assets based in North America, with the substantial remainder of assets based in Asia-Pacific.

**15. Subsequent events**

The Company suspended production in all of its manufacturing facilities in Thailand during the week of October 17, 2011 due to severe flooding in Thailand. On October 22, 2011, the flood waters breached the Company's flood barriers and infiltrated the offices and manufacturing floor space at its Chokchai campus in Pathum Thani, Thailand. The manufacturing buildings at Chokchai, known as Buildings 1 and 2, filled with water to a level that ultimately reached a height of five feet, a situation that persists as of the date of this filing. To date, the flooding has not breached the Company's flood barriers at its Pinehurst campus, located approximately 7 miles north of Chokchai. However, production at the Pinehurst campus buildings, known as Buildings 3, 4 and 5, was suspended in its entirety for almost three weeks due to the impacted local transportation and utilities that continue to affect arterial and access roads to the Company's factories and some employee residences. While the Company began production at Pinehurst on a limited scale on November 7, 2011, depending on the flood waters, the Company could be required to cease those limited operations at any time and could be required to do so for an extended period of time. The Company may also be constrained in scaling from limited operations to full operations at Pinehurst. Because of these uncertainties, the Company is not yet able to estimate when it will be able to recommence full operations.

The Chokchai site accounted for 29% of the Group's revenue during the fiscal quarter ended September 30, 2011, while the Pinehurst site accounted for 67% of the Group's revenue during that fiscal quarter. Production at the Chokchai facility will not resume during the fiscal quarter ending December 30, 2011. Efforts at the Chokchai facility are now focused on recovery and salvaging of inventory, equipment and other assets. The Company may never resume production at its Chokchai facilities but rather divert its Chokchai production capacity to Buildings 3, 4 and 5 at Pinehurst as well as Building 6 at Pinehurst once it is completed. The Company has temporarily leased two warehouses in Thailand in safer areas where it is storing recovered equipment, inventory and other assets. At these sites, the Company and its customers are assessing damage to equipment and inventory and determining functionality and what assets are salvageable. The Company has also established on-site temporary housing for its employees and is presently sheltering approximately 700 people, for whom the Company has arranged food service, bathroom and laundry facilities.

The Company is evaluating the flooding situation in Thailand on an ongoing basis. At this time, the Company does not know when it will recommence operations at its Chokchai site. The Company is evaluating its options as to how and when it can safely begin working on water removal and transfer any salvageable equipment, inventory and assets to Pinehurst. The Company does not have back-up or alternative manufacturing capabilities outside of Thailand to which it could transfer any of its Thai manufacturing operations.

The flooding of the Company's facilities in Thailand, combined with the flood damage to its supply chain, will have a significant impact on the Group's overall operations, financial results and its ability to meet customer demand for the fiscal quarter ending December 30, 2011 and possibly beyond. Because of the flooding and suspension of operations, the Group expects that its revenues will be substantially lower for the fiscal quarter ending December 30, 2011 in comparison to the fiscal quarter ended September 30, 2011, and the Group will suffer a net loss, whether or not the Company is able to resume operations at its Pinehurst facilities before the end of the December quarter. In addition, while the Group's operations in Thailand remain suspended in whole or in part, its costs will be impacted negatively by significant under-utilization of its assets and infrastructure, costs it will incur in restoring supply and costs to expedite the immediate availability of the Company's production for its customers. The Group also expects to incur significant charges and expenses related to the flooding of its operations, including such items as fixed asset impairments, inventory write-downs, purchase order cancellations for excess materials that cannot be used near term and service

## Edgar Filing: Fabrinet - Form 10-Q

charges for reclaim and recovery work. The Group is unable to reasonably estimate the amount or timing of these charges and expenses for the fiscal quarter ending December 30, 2011 at this time.

**Table of Contents**

The Group maintains insurance coverage that provides for reimbursement from losses resulting from flood damage. The Group's property and casualty insurance covers loss or damage to the Group's property and third-party property over which the Group has custody and control, as well as losses associated with business interruption. The Group maintains approximately \$120 million in coverage for equipment across its manufacturing campuses and another approximately \$120 million in coverage for inventory. These amounts include coverage for customer-owned assets that are under the Group's care, custody and control. The Group also maintains an additional approximately \$45 million in coverage against building damage and approximately \$47 million in business interruption loss. The Company is currently working with its insurance carriers to determine the amounts that may be recoverable under these policies. Because the Company and the insurance carriers will not be able to make a final assessment of the extent of loss and determine the amount of insurance coverage under the Group's policies until the flood waters recede (which could take several weeks), the Group has not made any adjustments to its financial statements for the three months ended September 30, 2011.

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or to our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Forward-looking statements include, but are not limited to, statements about:*

our goals and strategies;

our and our customers' estimates regarding future revenues, operating results, expenses, capital requirements and liquidity and our needs for additional financing;

our future capital expenditures;

expansion of our manufacturing capacity;

the growth rates of our existing markets and potential new markets;

our and our customers' and our suppliers' ability to respond successfully to technological or industry developments;

our suppliers' estimates regarding future costs;

our ability to increase our penetration of existing markets and penetrate new markets;

our plans to diversify our sources of revenues;

trends in the optical communications, industrial lasers and sensors markets, including trends to outsource the production of components used in those markets;

our ability to attract and retain a qualified management team and other qualified personnel and advisors;

the impact of the flooding in Thailand on the industry and our business in the three months ending December 30, 2011 and beyond, including the availability of components from our suppliers, our planned operations recovery efforts and the expected costs and expenses that we will incur in connection with these efforts, and our ability to complete recovery efforts and recommence normal operations in our Thailand facilities;



## Edgar Filing: Fabrinet - Form 10-Q

the impact of the flooding in Thailand on the industry and our business in the December quarter and beyond, including the availability of components from our suppliers, expectations about our customers, our ability to recover from our insurers, our planned operations recovery efforts and the expected costs and expenses that we will incur in connection with these efforts, and our ability to complete recovery efforts and recommence normal operations in our Thailand facilities;

expectations regarding the impact of the Thailand flooding on our revenues, gross margin, results of operations and liquidity in the quarter ending December 30, 2011 and possibly beyond;

expectations regarding the impact of the Thailand flooding on our revenues, gross margin and results of operations in the three months ending December 30, 2011 and possibly beyond; and

competition in our existing and new markets.

*These forward-looking statements are subject to certain risks and uncertainties that could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Quarterly Report on Form 10-Q and, in particular, the risks discussed under the heading "Risk Factors" in Item 1A of this Quarterly Report on Form 10-Q and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.*

### **Overview**

We provide precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (OEMs) of complex products such as optical communication components, modules and sub-systems, industrial lasers and sensors. We offer a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, final assembly and test. We focus primarily on low-volume production of a wide variety of high complexity products, which we refer to as "low-volume, high-mix". Based on our experience with, and feedback from, customers, we believe we are a global leader in providing these services to the optical communications market.

---

## **Table of Contents**

Our customer base includes companies in complex industries that require advanced precision manufacturing capabilities, such as optical communications, industrial lasers and sensors. The products that we manufacture for our OEM customers include: selective switching products; tunable transponders and transceivers; active optical cables; solid state, diode-pumped, gas and fiber lasers; and sensors. In many cases, we are the sole outsourced manufacturing partner used by our customers for the products that we produce for them.

We also design and fabricate application-specific crystals, prisms, mirrors, laser components, substrates and other custom and standard borosilicate, clear fused quartz, and synthetic fused silica glass products. We incorporate our customized optics and glass into many of the products we manufacture for our OEM customers, and we also sell customized optics and glass in the merchant market.

We began operations in January 2000 through the acquisition of a precision mechanical and electro-mechanical manufacturing site in Thailand from Seagate Technology, or Seagate. We have been consistently profitable since our inception, achieving 47 consecutive quarters of profitable operations.

### **Thailand Flooding**

We suspended production in all of our manufacturing facilities in Thailand during the week of October 17, 2011 due to severe flooding in Thailand. On October 22, 2011, the flood waters breached our flood barriers and infiltrated the offices and manufacturing floor space at our Chokchai campus in Pathum Thani, Thailand. The manufacturing buildings at Chokchai, known as Buildings 1 and 2, filled with water to a level that ultimately reached a height of five feet, a situation that persists as of the date of this filing. To date, the flooding has not breached our flood barriers at our Pinehurst campus, located approximately 7 miles north of Chokchai. However, production at the Pinehurst campus buildings, known as Buildings 3, 4 and 5, was suspended in its entirety for almost three weeks due to the impacted local transportation and utilities that continue to affect arterial and access roads to our factories and some employee residences. While we began production at Pinehurst on a limited scale on November 7, 2011, depending on the flood waters, we could be required to cease those limited operations at any time and could be required to do so for an extended period of time. We may also be constrained in scaling from limited operations to full operations at Pinehurst. Because of these uncertainties, we are not yet able to estimate when we will be able to recommence full operations.

The Chokchai site accounted for 29% of our revenue during the fiscal quarter ended September 30, 2011, while the Pinehurst site accounted for 67% of our revenue during that fiscal quarter. Production at the Chokchai facility will not resume during the fiscal quarter ending December 30, 2011. Efforts at the Chokchai facility are now focused on recovery and salvaging of inventory, equipment and other assets. We may never resume production at our Chokchai facilities but rather divert our Chokchai production capacity to Buildings 3, 4 and 5 at Pinehurst as well as Building 6 at Pinehurst once it is completed. We have temporarily leased two warehouses in Thailand in safer areas where we are storing recovered equipment, inventory and other assets. At these sites, we and our customers are assessing damage to equipment and inventory and determining functionality and what assets are salvageable. We have also established on-site temporary housing for our employees and are presently sheltering approximately 700 people, for whom we have arranged food service, bathroom and laundry facilities.

We are evaluating the flooding situation in Thailand on an ongoing basis. At this time, we do not know when we will recommence operations at our Chokchai site. We are evaluating our options as to how and when we can safely begin working on water removal and transfer any salvageable equipment, inventory and assets to Pinehurst. We do not have back-up or alternative manufacturing capabilities outside of Thailand to which we could transfer any of our Thai manufacturing operations.

The flooding of our facilities in Thailand, combined with the flood damage to our supply chain, will have a significant impact on our overall operations, financial results and our ability to meet customer demand for the fiscal quarter ending December 30, 2011 and possibly beyond. Because of the flooding and suspension of operations, we expect that our revenues will be substantially lower for the fiscal quarter ending December 30, 2011 in comparison to the fiscal quarter ended September 30, 2011. If Pinehurst generates no further revenues during the quarter ending December 30, 2011, our total revenues for the quarter would be approximately \$28 million, representing primarily revenues generated before production shutdown at our Thailand facilities, together with revenues from our Casix and Vitrocom businesses throughout the quarter. We do expect our revenues to be in excess of that minimum, though at this time, we are unable to determine to what level. In addition, while our operations in Thailand remain suspended in whole or in part, our costs will be impacted negatively by significant under-utilization of our assets and infrastructure, costs we will incur in restoring supply and costs to expedite the immediate availability of our production for our customers. We also expect to incur significant charges and expenses related to the flooding of our operations, including such items as fixed asset impairments, inventory write-downs, purchase order cancellations for excess materials that cannot be used near term and service charges for reclaim and recovery work. We are unable to reasonably estimate the amount or timing of these charges and expenses for the fiscal quarter ending December 30, 2011 at this time. Because of this reduced revenue and these significant charges and expenses related to the flooding, we expect to suffer a net loss for the quarter ending December 30, 2011, whether or not we are able to resume operations at our Pinehurst facilities before the end of the December quarter.



**Table of Contents**

We maintain insurance coverage that provides for reimbursement from losses resulting from flood damage. Our property and casualty insurance covers loss or damage to our property and third-party property over which we have custody and control, as well as losses associated with business interruption. We maintain approximately \$120 million in coverage for equipment across our manufacturing campuses and another approximately \$120 million in coverage for inventory. These amounts include coverage for customer-owned assets that are under our care, custody and control. We also maintain an additional approximately \$45 million in coverage against building damage and approximately \$47 million in business interruption loss. We are currently working with our insurance carriers to determine the amounts that may be recoverable under these policies. Because we and the insurance carriers will not be able to make a final assessment of the extent of loss and determine the amount of insurance coverage under our policies until the flood waters recede (which could take several weeks), we have not made any adjustments to our financial statements for the three months ended September 30, 2011.

**Revenues**

Our total revenues increased by \$12.6 million, or 7.3%, to \$186.3 million for the three months ended September 30, 2011, as compared to \$173.7 million for the three months ended September 24, 2010. We generated substantially all of our total revenues during the three months ended September 30, 2011 from the optical communications, industrial lasers and sensors markets. Our revenues from products for markets other than the optical communications market have continued to increase. Our revenues from lasers, sensors and other markets as a percentage of total revenues increased from 21.4% for the three months ended September 24, 2010, to 26.2% for the three months ended September 30, 2011. We expect that industrial lasers and sensors will continue to represent an increasing portion of our revenues in the future. Because our share of the available business in the industrial lasers and sensors end-markets is presently small, we hope to grow our business in those end-markets in excess of industry growth forecasts.

We believe our ability to expand our relationships with existing customers and attract new customers is due to a number of factors, including our broad range of complex engineering and manufacturing service offerings, flexible low-cost manufacturing platform, process optimization capabilities, advanced supply chain management, excellent customer service and experienced management team. We expect the prices we charge for the products we manufacture for our customers to decrease over time due in part to competitive market forces. However, we believe we will be able to maintain favorable pricing for our services due to our ability to reduce cycle time, adjust our product mix by focusing on more complicated products, improve yields, and reduce material costs for the products we manufacture. We believe these capabilities have enabled us to help our OEM customers reduce their manufacturing costs while maintaining or improving the design, quality, reliability and delivery times for their products.

**Revenues by Geography**

We generate revenues from three geographic regions: North America, Asia-Pacific and Europe. Revenues are attributed to a particular geographic area based on the bill-to location of our customers, notwithstanding that our customers may ultimately ship their products to end customers in a different geographic region. Virtually all of our revenues are derived from our manufacturing facilities in Asia-Pacific.

The percentage of our revenues generated from the bill-to location outside of North America has decreased from 57.1% in the three months ended September 24, 2010 to 51.1% in the three months ended September 30, 2011, primarily as a result of decreasing sales in Asia-Pacific. We expect that an increasing portion of our revenues will come from the bill-to location outside of North America in the future.

The following table presents total revenues, by percentage, by geographic regions:

|               | Three Months Ended    |                       |
|---------------|-----------------------|-----------------------|
|               | September 30,<br>2011 | September 24,<br>2010 |
| North America | 48.9%                 | 42.9%                 |
| Asia-Pacific  | 31.8                  | 38.5                  |
| Europe        | 19.3                  | 18.6                  |
|               | 100.0%                | 100.0%                |

---

## **Table of Contents**

### ***Our Contracts***

We enter into supply agreements with our customers that generally have an initial term of up to three years. Although there are no minimum purchase requirements in our supply agreements, our customers do provide us with rolling forecasts of their demand requirements. Our supply agreements generally include provisions for pricing and periodic review of pricing, consignment of our customer's unique production equipment to us and sharing benefits from cost-savings derived from our efforts. We are generally required to purchase materials, which may include long lead-time materials, to meet the stated demands of our customers. After procuring materials, we manufacture products for our customers based on purchase orders that contain terms regarding product quantities, delivery locations and delivery dates. Our customers generally are obligated to purchase finished goods that we have manufactured according to their demand requirements. Materials that are not consumed by our customers within a specified period of time or are no longer required due to a product's cancellation or end-of-life are typically designated as excess or obsolete inventory under our contracts. Once materials are designated as either excess or obsolete inventory, our customers are typically required to purchase such inventory from us even if they have chosen to cancel production of the related products.

### **Cost of Revenues**

The key components of our cost of revenues are material costs, employee costs, and infrastructure-related costs. Material costs generally represent the majority of our cost of revenues. Several of the materials we require to manufacture products for our customers are customized for their products and, in many instances, sourced from a single supplier, or in some cases our own subsidiaries. Shortages from sole-source suppliers due to yield loss, quality concerns and capacity constraints, among other factors, may increase our expenses and negatively impact our gross profit margin or total revenues in a given quarter. Material costs include scrap material. Historically, our rate of scrap diminishes during a product's life cycle due to process, fixturing and test improvement and optimization.

A second significant element of cost of revenues is employee costs, including: indirect employee costs related to design, configuration and optimization of manufacturing processes for our customers, quality testing, materials testing and other engineering services; and direct costs related to our manufacturing employees. Direct employee costs include employee salaries, insurance and benefits, merit-based bonuses, recruitment, training and retention. Historically, our employee costs have increased primarily due to increases in the number of employees necessary to support our growth and, to a lesser extent, costs to recruit, train and retain employees. Salary levels in Thailand and the PRC, the fluctuation of the Thai baht and RMB against our functional currency, the U.S. dollar, and our ability to retain our employees significantly impact our cost of revenues. We expect our employee costs to increase as we continue to increase our headcount to service additional business and as wages continue to increase in Thailand and the PRC. Wage increases may impact our ability to sustain our competitive advantage and may reduce our profit margin. We seek to mitigate these cost increases through improvements in employee productivity, employee retention and asset utilization.

Our infrastructure costs are comprised of depreciation, utilities, and facilities management and overhead costs. Most of our facility leases are long-term agreements. Our depreciation costs are comprised of buildings and fixed assets, primarily at our Pinehurst Campus in Thailand, and capital equipment located at each of our manufacturing locations.

In fiscal 2011, the compensation committee of our board of directors approved an executive incentive plan with quantitative objectives, based on achieving certain revenue and earnings per share milestones for the fiscal year, and qualitative objectives. Bonuses under the executive incentive plan were paid after the end of fiscal 2011. During the three months ended September 30, 2011 and September 24, 2010, charges included in cost of revenues for merit-based bonus distributions to employees under these plans were \$0.6 million and \$0.3 million, respectively.

Share-based compensation expense included in the cost of revenues was \$0.4 million and \$0.1 million for the three months ended September 30, 2011 and September 24, 2010, respectively.

Other than incremental costs associated with growing our business generally, we do not expect to incur material incremental costs of revenue as a result of our planned expansion into new geographic markets, our continued diversification into the industrial lasers and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities.

### **Selling, General and Administrative Expenses**

Our selling, general and administrative expenses, or SG&A expenses, primarily consist of corporate employee costs for sales and marketing, general and administrative and other support personnel, including amounts previously paid under our Employee Profit Sharing Plan, research and development expenses related to the design of customized optics and glass, travel expenses, legal and other professional fees, share-based compensation expense, and other general expenses not related to cost of revenues. In fiscal 2012, we expect our SG&A expenses to increase as

## Edgar Filing: Fabrinet - Form 10-Q

we continue to respond to the requirements of being a public company, including increased expenses associated with: preparing and filing required reports under the U.S. securities laws; comprehensively documenting and assessing our system of internal controls and maintaining our disclosure controls and procedures as a result of the requirements of the Sarbanes-Oxley Act; competitively compensating our board of directors; and insuring against additional risks associated with being a public company.

---

**Table of Contents**

Charges included in SG&A expenses for merit-based bonus compensation distributed to employees and senior staff were \$0.6 million and \$0.3 million during the three months ended September 30, 2011 and September 24, 2010, respectively.

Other than incremental costs associated with growing our business generally and increased costs associated with being a public company, we do not expect to incur material incremental SG&A expenses as a result of our planned expansion into new geographic markets, our continued diversification into the industrial lasers and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities.

**Additional Financial Disclosures**

***Foreign Exchange***

As a result of our international operations, we are exposed to foreign exchange risk arising from various currency exposures primarily with respect to the Thai baht. Although a majority of our total revenues is denominated in U.S. dollars, a substantial portion of our payroll as well as certain other operating expenses are incurred and paid in Thai baht. The exchange rates between the Thai baht and the U.S. dollar have fluctuated substantially in recent years and may continue to fluctuate substantially in the future. We report our financial results in U.S. dollars and our results of operations have been and may continue to be negatively impacted due to Thai baht appreciation against the U.S. dollar. Smaller portions of our expenses are incurred in a variety of other currencies, including RMB, Canadian dollars, Euros and Japanese yen, the appreciation of which may also negatively impact our financial results.

In addition, we are exposed to foreign exchange risk in connection with the transaction we entered into with TMB Bank Public Company Limited (the Bank) in May 2011, containing a credit facility and cross currency swap arrangement, for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency interest rate swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. As of September 30, 2011, we had drawn down an aggregate of \$6.0 million. The remainder of the term loan is scheduled to be drawn down according to the following schedule: (1) \$12.0 million on December 15, 2011 and (2) \$12.0 million on March 15, 2012. Borrowings under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. Under the terms of the cross currency swap arrangement, amounts drawn in Thai baht are to be immediately converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of 3-month U.S. LIBOR plus 2.8% per annum. Until we take the final drawdown under the credit facility, we will be required to recognize any fair market value gains and losses on the cross currency interest rate swap arrangement as we utilize the credit facility.

In order to manage the risks arising from fluctuations in currency exchange rates, we use derivative financial instruments. We may enter into short-term forward foreign currency contracts to help manage currency exposures associated with certain assets and liabilities, primarily short-term obligations. The forward exchange contracts have generally ranged from one to three months in original maturity, and no forward exchange contract has had an original maturity greater than one year. All foreign currency exchange contracts are recognized on the balance sheet at fair value. As we do not apply hedge accounting to these instruments, the derivatives are recorded at fair value through earnings. The gains and losses on our forward contracts generally offset losses and gains on the assets, liabilities and transactions economically hedged and, accordingly, generally do not subject us to the risk of significant accounting losses.

**Table of Contents**

As of September 30, 2011 and June 24, 2011, we had outstanding foreign currency assets and liabilities in Thai baht and RMB as follows:

|   | September 30, 2011 |        |       | June 24, 2011 |        |       |
|---|--------------------|--------|-------|---------------|--------|-------|
|   | Currency           | \$     | %     | Currency      | \$     | %     |
| <b>(in thousands, except percentages)</b> |                    |        |       |               |        |       |
| <b>Assets</b>                             |                    |        |       |               |        |       |
| Thai baht                                 | 602,757            | 19,338 | 59.3  | 425,872       | 13,904 | 50.9  |
| RMB                                       | 84,399             | 13,281 | 40.7  | 85,478        | 13,411 | 49.1  |
|   |                    | 32,619 | 100.0 |               | 27,315 | 100.0 |
| <b>Liabilities</b>                        |                    |        |       |               |        |       |
| Thai baht                                 | 844,837            | 27,104 | 85.3  | 669,367       | 21,853 | 79.6  |
| RMB                                       | 29,684             | 4,671  | 14.7  | 36,303        | 5,607  | 20.4  |
|   |                    | 31,775 | 100.0 |               | 27,460 | 100.0 |

The Thai baht assets represent cash and cash equivalents, accounts receivable, deposits and other current assets. The Thai baht liabilities represent trade accounts payable, accrued expenses and other payables. We manage our exposure to fluctuations in foreign exchange rates by the use of foreign currency contracts and offsetting assets and liabilities denominated in the same currency in accordance with management's policy. As of September 30, 2011, there was \$30 million in selling forward contracts outstanding on the Thai baht payables and an undrawn committed loan in Thai baht equivalent to \$24 million. As of June 24, 2011, there was \$30 million in selling forward contracts outstanding on the Thai baht payables and an undrawn committed loan in Thai baht equivalent to \$28 million.

The RMB assets represent cash and cash equivalents, accounts receivable and other current assets. The RMB liabilities represent trade accounts payable, accrued expenses and other payables. As of September 30, 2011 and June 24, 2011, there was none and \$4.0 million, respectively, in selling RMB to U.S. dollar forward contracts.

**Currency Regulation and Dividend Distribution**

Foreign exchange regulation in the PRC is primarily governed by the following rules:

Foreign Currency Administration Rules, as amended on August 5, 2008, or the Exchange Rules;

Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules; and

Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, as promulgated by the State Administration of Foreign Exchange, or SAFE, on August 29, 2008, or Circular 142.

Under the Exchange Rules, RMB is freely convertible into foreign currencies for current account items, including the distribution of dividends, interest payments, trade and service-related foreign exchange transactions. However, conversion of RMB for capital account items, such as direct investments, loans, security investments and repatriation of investments, is still subject to the approval of SAFE.

Under the Administration Rules, foreign-invested enterprises may only buy, sell or remit foreign currencies at banks authorized to conduct foreign exchange business after providing valid commercial documents and relevant supporting documents and, in the case of capital account item transactions, obtaining approval from SAFE. Capital investments by foreign-invested enterprises outside of the PRC are also subject to limitations, which include approvals by the Ministry of Commerce, SAFE and the State Development and Reform Commission.





---

## **Table of Contents**

Circular 142 regulates the conversion by a foreign-invested company of foreign currency into RMB by restricting how the converted RMB may be used. Circular 142 requires that the registered capital of a foreign-invested enterprise settled in RMB converted from foreign currencies may only be used for purposes within the business scope approved by the applicable governmental authority and may not be used for equity investments within the PRC. In addition, SAFE strengthened its oversight of the flow and use of the registered capital of foreign-invested enterprises settled in RMB converted from foreign currencies. The use of such RMB capital may not be changed without SAFE's approval and may not be used to repay RMB loans if the proceeds of such loans have not been used.

On January 5, 2007, SAFE promulgated the Detailed Rules for Implementing the Measures for the Administration on Individual Foreign Exchange, or the Implementation Rules. Under the Implementation Rules, PRC citizens who are granted share options by an overseas publicly-listed company are required, through a PRC agent or PRC subsidiary of such overseas publicly-listed company, to register with SAFE and complete certain other procedures.

In addition, the General Administration of Taxation has issued circulars concerning employee share options. Under these circulars, our employees working in the PRC who exercise share options will be subject to PRC individual income tax. Our PRC subsidiary has obligations to file documents related to employee share options with relevant tax authorities and withhold individual income taxes of those employees who exercise their share options.

In addition, our transfer of funds to our subsidiaries in Thailand and the PRC are each subject to approval by governmental authorities in case of an increase in registered capital, or subject to registration with governmental authorities in case of a shareholder loan. These limitations on the flow of funds between us and our subsidiaries could restrict our ability to act in response to changing market conditions.

### ***Income Tax***

Our effective tax rate is a function of the mix of tax rates in the various jurisdictions in which we do business. We are domiciled in the Cayman Islands. Under the current laws of the Cayman Islands, we are not subject to tax on income or capital gains in the Cayman Islands. We have received this undertaking for a 20-year period ending August 24, 2019, and after the expiration date, we can make a request for renewal with the office of the Clerk of the Cabinet for another twenty years.

Throughout the period of our operations in Thailand, we have generally received income tax and other incentives from the Thailand Board of Investment. While we did not receive any income tax incentive in our operations in Thailand for fiscal 2010, we began receiving a new tax exemption in July 2010 for a five-year period for income generated from new products manufactured at our Pinehurst Building 5. We do not currently qualify for any available tax incentives at our Fuzhou, PRC facility under the laws of the PRC.

### **Critical Accounting Policies and Use of Estimates**

We prepare our condensed consolidated financial statements in conformity with U.S. GAAP, which requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent liabilities on the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the financial reporting period. We continually evaluate these estimates and assumptions based on the most recently available information, our own historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Because the use of estimates is an integral component of the financial reporting process, actual results could differ from those estimates. Some of our accounting policies require higher degrees of judgment than others in their application. We consider the policies discussed below to be critical to an understanding of our condensed consolidated financial statements as their application places the most significant demands on our management's judgment.

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended June 24, 2011. There were no material changes to our critical accounting policies during the three months ended September 30, 2011.

**Table of Contents****Results of Operations**

The following table sets forth a summary of our unaudited condensed consolidated statements of operations. We believe that period-to-period comparisons of operating results should not be relied upon as indicative of future performance. Where necessary, comparative figures have been adjusted to conform with changes in presentation in the current year.

|  | <b>Three Months Ended</b> |                           |
|--|---------------------------|---------------------------|
|  | <b>September 30, 2011</b> | <b>September 24, 2010</b> |
|  | <b>(in thousands)</b>     |                           |
| Revenues                                     | \$ 186,347                | \$ 173,740                |
| Cost of revenues                             | (163,463)                 | (151,964)                 |
| <b>Gross profit</b>                          | <b>22,884</b>             | <b>21,776</b>             |
| Selling, general and administrative expenses | (6,638)                   | (4,827)                   |
| <b>Operating income</b>                      | <b>16,246</b>             | <b>16,949</b>             |
| Interest income                              | 195                       | 98                        |
| Interest expense                             | (74)                      | (111)                     |
| Foreign exchange loss, net                   | (187)                     | (378)                     |
| Other income                                 | 97                        | 4                         |
| <br>   |                           |                           |
| Income before income taxes                   | 16,277                    | 16,562                    |
| Income tax                                   | (622)                     | (1,357)                   |
| <br>   |                           |                           |
| Net income                                   | \$ 15,655                 | \$ 15,205                 |

The following table sets forth a summary of our unaudited condensed consolidated statements of operations as a percentage of total revenues for the periods indicated.

|  | <b>Three Months Ended</b> |                           |
|--|---------------------------|---------------------------|
|  | <b>September 30, 2011</b> | <b>September 24, 2010</b> |
| Revenues                                     | 100.0%                    | 100.0%                    |
| Cost of revenues                             | (87.7)                    | (87.5)                    |
| <b>Gross profit</b>                          | <b>12.3</b>               | <b>12.5</b>               |
| Selling, general and administrative expenses | (3.6)                     | (2.8)                     |
| <b>Operating income</b>                      | <b>8.7</b>                | <b>9.7</b>                |
| Interest income                              | 0.1                       | 0.1                       |
| Interest expense                             | (0.1)                     | (0.1)                     |
| Foreign exchange loss, net                   | (0.1)                     | (0.2)                     |
| Other income                                 | 0.1                       | 0.1                       |
| <br>   |                           |                           |
| Income before income taxes                   | 8.7                       | 9.6                       |
| Income tax                                   | (0.3)                     | (0.8)                     |
| <br>   |                           |                           |
| Net income                                   | 8.4%                      | 8.8%                      |

The following table sets forth our revenues by end market for the periods indicated.

## Edgar Filing: Fabrinet - Form 10-Q

|                            | Three Months Ended |                    |
|----------------------------|--------------------|--------------------|
|                            | September 30, 2011 | September 24, 2010 |
|                            | (in thousands)     |                    |
| Optical communications     | \$ 137,491         | \$ 136,613         |
| Lasers, sensors, and other | 48,856             | 37,127             |
| <b>Total</b>               | <b>\$ 186,347</b>  | <b>\$ 173,740</b>  |

We operate and internally manage a single operating segment. As such, discrete information with respect to separate product lines and segments is not accumulated.

---

**Table of Contents*****Comparison of Three Months Ended September 30, 2011 to Three Months Ended September 24, 2010***

*Total revenues.* Our total revenues increased by \$12.6 million, or 7.3%, to \$186.3 million for the three months ended September 30, 2011, as compared to \$173.7 million for the three months ended September 24, 2010. This increase was the result of a \$0.9 million increase in our revenues from optical communications products as a result of a recovery in demand for optical communications products following the recent global economic slowdown and a \$11.7 million increase in our revenues from non-optical communications products, primarily reflecting the growth of our programs for industrial lasers and sensors customers. Revenues from optical communications products represented 73.8% of our total revenues for the three months ended September 30, 2011, as compared to 78.6% for the three months ended September 24, 2010.

*Cost of revenues.* Our cost of revenues increased by \$11.5 million, or 7.6%, to \$163.5 million, or 87.7% of total revenues, for the three months ended September 30, 2011, as compared to \$152.0 million, or 87.5% of total revenues, for the three months ended September 24, 2010. The increase in absolute dollars was primarily due to higher volumes of materials used in our production during the three months ended September 30, 2011. Cost of revenues also included share-based compensation expense of \$0.4 million for the three months ended September 30, 2011, as compared to \$0.1 million for the three months ended September 24, 2010.

*Gross profit.* Our gross profit increased by \$1.1 million, or 5.1%, to \$22.9 million, or 12.3% of total revenues, for the three months ended September 30, 2011, as compared to \$21.8 million, or 12.5% of total revenues, for the three months ended September 24, 2010.

*SG&A expenses.* Our SG&A expenses increased by \$1.8 million, or 37.5%, to \$6.6 million, or 3.6% of total revenues, for the three months ended September 30, 2011, as compared to \$4.8 million, or 2.8% of total revenues, for the three months ended September 24, 2010. Our SG&A expenses increased in absolute dollars during the three months ended September 30, 2011 as compared to the three months ended September 24, 2010 due primarily to an increase in business development and research and development spending. We also recorded share-based compensation charges of \$0.5 million for the three months ended September 30, 2011, as compared to \$0.1 million for the three months ended September 24, 2010.

*Operating income.* Our operating income decreased by \$0.7 million to \$16.2 million, or 8.7% of total revenues, for the three months ended September 30, 2011.

*Interest income.* Our interest income increased by \$0.1 million to \$0.2 million for the three months ended September 30, 2011, due to increases in cash and cash equivalent balances.

*Interest expense.* Our interest expense decreased by \$37,000 to \$74,000 for the three months ended September 30, 2011, as compared to \$111,000 for the three months ended September 24, 2010. The decrease was due to decreases in our long-term loan interest rates and decrease in our long-term loan balances due to scheduled repayments.

*Income before income taxes.* We recorded income before income tax expenses of \$16.3 million for the three months ended September 30, 2011, as compared to \$16.6 million for the three months ended September 24, 2010.

*Provision for income tax.* Our provision for income tax reflects an effective tax rate of 3.8% for the three months ended September 30, 2011, as compared to an effective tax rate of 8.2% for the three months ended September 24, 2010. The decrease in effective tax rate during the three months ended September 30, 2011 as compared to the three months ended September 24, 2010 was due to the fact that during the three months ended September 24, 2010, we recognized uncertainty income tax provision and income tax assessment of \$213 and \$137, respectively for fiscal 2010 of a subsidiary located in New Jersey.

*Net income.* Our net income increased to \$15.7 million, or 8.4% of total revenues, for the three months ended September 30, 2011, as compared to \$15.2 million, or 8.8% of total revenues, for the three months ended September 24, 2010, an increase of \$0.5 million, or 3.0%.

**Liquidity and Capital Resources*****Cash Flows and Working Capital***

To date, we have primarily financed our operations through the sale of ordinary shares to investors in March 2000, the sale of our ordinary shares in our initial public offering in June 2010, and through cash flow from operations and commercial loans. As of September 30, 2011, we had approximately \$132.3 million in cash and cash equivalents and approximately \$19.5 million of outstanding debt. As of September 24, 2010, we had approximately \$101.1 million in cash and cash equivalents and approximately \$19.0 million of outstanding debt.



**Table of Contents**

Our cash and cash equivalents primarily consist of cash on hand, demand deposits and liquid investments with original maturities of three months or less which are placed with banks and other financial institutions. For the three months ended September 30, 2011 and September 24, 2011, the weighted average interest rate on our cash and cash equivalents was 0.7% and 0.5%, respectively.

We expect that our cash position will be materially and adversely impacted by the suspension of our operations in Thailand, by increases in expenditures related to recovery from the flooding of our facilities and lost revenue. We expect our cash flow for the quarter ending December 30, 2011, and possibly beyond, to be negative. The extent of such negative cash flow will depend in part on the amount and timing of any insurance recoveries. We expect to incur significant charges and expenses related to the flooding, and some of these will be cash charges and expenses. We anticipate that we will need to repair and replace equipment and inventory that has been submerged as a result of the flooding, and our capital expenditures to do so are expected to be significantly in excess what we had originally budgeted for fiscal 2012, subject to any insurance recoveries we may receive. We also expect a significant reduction in revenues for the quarter ending December 30, 2011 and possibly beyond, both because of customer orders that we cannot fulfill and because some customers may cease doing business with us entirely, even after we are able to recommence our manufacturing operations. Notwithstanding the foregoing, we believe our current cash, cash equivalents and cash generated from operations, combined with proceeds that we receive from insurance recoveries, will be sufficient to meet our working capital and capital expenditure needs for the next 12 months. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

In June 2010, we entered into an agreement to purchase land in Thailand for the construction of Pinehurst Building 6. The land purchase was completed in August 2010, and, due to the flooding in Thailand, we expect to complete construction of Building 6 in the fourth quarter of our fiscal year 2012. Once we complete construction of Building 6 and can operate it at or near full capacity, we believe that our manufacturing capacity at Pinehurst will be sufficient to meet anticipated production requirements for the remainder of fiscal 2012. Until that time, our limited manufacturing capacity will be materially constrained. We maintain a long-term credit facility that will come due within the next 2 months and a long-term credit facility that will come due within the next 41 months, both of which are associated with prior construction of production facilities at our Pinehurst campus in Thailand. In the three months ended September 30, 2011, we drew down an aggregate of \$6.0 million under another long-term credit facility to support construction of Building 6. This loan will come due within the next 66 months. We anticipate that our internally generated working capital, along with our cash and cash equivalents and the proceeds from insurance recoveries, will be adequate to repay these obligations.

The following table shows our net cash provided by (used in) operating activities, net cash used in investing activities and net cash provided by financing activities for the periods indicated:

| (in thousands of U.S. dollars)                      | Three Months Ended |                                   |
|---|--------------------|-----------------------------------|
|   | September 30, 2011 | September 24, 2010<br>(unaudited) |
| Net cash provided by (used in) operating activities | \$ 9,842           | \$ (1,903)                        |
| Net cash used in investing activities               | (7,983)            | (7,314)                           |
| Net cash provided by financing activities           | 3,143              | 24,930                            |
| Net increase in cash and cash equivalents           | 5,002              | 15,713                            |
| Cash and cash equivalents, beginning of period      | 127,282            | 84,942                            |
| Cash and cash equivalents, end of period            | 132,349            | 101,090                           |

*Operating Activities*

Net cash provided by operating activities increased by \$11.7 million, or 617.2%, to \$9.8 million for the three months ended September 30, 2011, as compared to net cash used in operating activities of \$1.9 million for the three months ended September 24, 2010. The increase in net cash from operations for the three months ended September 30, 2011 as compared to the three months ended September 24, 2010 was primarily due to an increase in cash collection from accounts receivable and an increase in turnover of inventories into cash, partially offset by an increase in payments of accounts payable.

---

## **Table of Contents**

### *Investing Activities*

Net cash used in investing activities increased by \$0.7 million, or 9.1%, to \$8.0 million for the three months ended September 30, 2011, as compared to \$7.3 million for the three months ended September 24, 2010. The increase in net cash used in investing activities was primarily related to additional payments for construction in progress for Pinehurst Building 6 and new equipment purchases.

### *Financing Activities*

Net cash provided by financing activities decreased by \$21.8 million, or 87.4%, to \$3.1 million for the three months ended September 30, 2011, as compared to net cash provided by financing activities of \$24.9 million for the three months ended September 24, 2010. This decrease in net cash provided by financing activities was primarily due to the proceeds from our initial public offering of \$26.3 million during the three months ended September 24, 2010.

### **Off-Balance Sheet Commitments and Arrangements**

We have not entered into any financial guarantees or other commitments to guarantee the payment obligations of any third parties. In addition, we have not entered into any derivative contracts that are not reflected in our condensed consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We also do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

### **Recent Accounting Pronouncements**

See Note 2 of Notes to Unaudited Condensed Consolidated Financial Statements for recent accounting pronouncements that could have an effect on us.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

### *Interest Rate Risk*

We had cash and cash equivalents totaling \$132.3 million and \$127.3 million as of September 30, 2011 and June 24, 2011, respectively. Our exposure to interest rate risk primarily relates to the interest income generated by excess cash invested in highly liquid investments with maturities of three months or less from the original dates of purchase. The cash and cash equivalents are held for working capital purposes. We have not used derivative financial instruments in our investment portfolio. We have not been exposed nor do we anticipate being exposed to material risks due to changes in market interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates had declined by 10 basis points during the three months ended September 30, 2011 and the fiscal year ended June 24, 2011, our interest income would have decreased by approximately \$29,000 and \$88,000, respectively, assuming consistent investment levels.

Interest rate risk also refers to our exposure to movements in interest rates associated with our interest bearing liabilities. The interest bearing liabilities are denominated in U.S. dollars and the interest expense is based on the Singapore Inter-Bank Offered Rate, or SIBOR, and the London Inter-Bank Offered Rate, or LIBOR, plus an additional margin, depending on the lending institution. If the SIBOR and the LIBOR had increased by 100 basis points during the three months ended September 30, 2011 and the fiscal year ended June 24, 2011, our interest expense would have increased by approximately \$49,000 and \$0.2 million, respectively, assuming consistent borrowing levels.

### *Foreign Currency Risk*

As a result of our foreign operations, we have significant expenses, assets and liabilities that are denominated in foreign currencies. Substantially all of our employees and most of our facilities are located in Thailand and the PRC. Therefore, a substantial portion of our payroll as well as certain other operating expenses are paid in Thai baht or RMB. The significant majority of our revenues are denominated in U.S. dollars because our customer contracts generally provide that our customers will pay us in U.S. dollars.



## **Table of Contents**

As a consequence, our gross profit margins, operating results, profitability and cash flows are adversely impacted when the dollar depreciates relative to the Thai baht or the RMB. We have a particularly significant currency rate exposure to changes in the exchange rate between the Thai baht and the U.S. dollar. We must translate foreign currency-denominated results of operations, assets and liabilities for our foreign subsidiaries to U.S. dollars in our condensed consolidated financial statements. Consequently, increases and decreases in the value of the U.S. dollar compared to such foreign currencies will affect our reported results of operations and the value of our assets and liabilities on our condensed consolidated balance sheets, even if our results of operations or the value of those assets and liabilities has not changed in its original currency. These transactions could significantly affect the comparability of our results between financial periods or result in significant changes to the carrying value of our assets, liabilities and shareholders' equity.

In addition, we are exposed to foreign exchange risk in connection with the transaction we entered into with TMB Bank Public Company Limited (the Bank) in May 2011, containing a credit facility and cross currency swap arrangement, for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. As of September 30, 2011, we had drawn down an aggregate of \$6.0 million. The remainder of the term loan is scheduled to be drawn down according to the following schedule: (1) \$12.0 million on December 15, 2011 and (2) \$12.0 million on March 15, 2012. Borrowings under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. Under the terms of the cross currency interest rate swap arrangement, amounts drawn in Thai baht are to be immediately converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of 3-month U.S. LIBOR plus 2.8% per annum. Until we take the final drawdown under the credit facility, we will be required to recognize any fair market value gains and losses on the cross currency interest rate swap arrangement as we utilize the credit facility.

We attempt to hedge against these exchange rate risks by entering into hedging contracts that are typically one to three months in duration, leaving us exposed to longer term changes in exchange rates. We realized foreign currency losses of \$0.2 million during the three months ended September 30, 2011 and foreign currency losses of \$0.4 million during the three months ended September 24, 2010. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to incur foreign currency translation adjustments and may incur foreign currency exchange losses. For example, a 10% weakening in the U.S. dollar against the Thai baht and the RMB as of September 30, 2011 and June 24, 2011 would have resulted in a decrease in our net dollar position of approximately \$0.09 million and \$0.02 million, respectively. We cannot give any assurance as to the effect that future changes in foreign currency rates will have on our condensed consolidated financial position, operating results or cash flows.

### ***Credit Risk***

Credit risk refers to our exposures to financial institutions, suppliers and customers that have in the past and may in the future experience financial difficulty, particularly in light of recent conditions in the credit markets and the global economy. As of September 30, 2011, our cash and cash equivalents were held in deposits and highly liquid investment products with maturities of three months or less with a small number of banks and other financial institutions having credit ratings of A minus or above as determined by Fitch Ratings. We generally monitor the financial performance of our suppliers and customers, as well as other factors that may affect their access to capital and liquidity. Presently, we believe that we will not incur material losses due to our exposures to such credit risk.

## **ITEM 4. CONTROLS AND PROCEDURES**

### ***Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our chief executive officer and chief financial officer concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.



---

## **Table of Contents**

### ***Changes in Internal Control over Financial Reporting***

There were no changes in our internal control over financial reporting during our the three months ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II: OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

From time to time, we may be involved in litigation relating to claims arising in the ordinary course of our business. There are currently no material claims or actions pending or threatened against us.

### **ITEM 1A. RISK FACTORS**

*Investing in our common stock involves a high degree of risk. You should carefully consider the following risks and all other information contained in this Quarterly Report on Form 10-Q, including our consolidated financial statements and the related notes, before investing in our common stock. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties that we are unaware of, or that we currently believe are not material, also may become important factors that affect us. If any of the following risks materialize, our business, financial condition and results of operations could be materially harmed. In that case, the trading price of our common stock could decline, and you may lose some or all of your investment.*

#### **Risks Related to Our Business**

***Recent severe flooding in Thailand resulted in the suspension of all production in our facilities in Thailand, which will have a material and adverse effect on our business, financial condition and results of operations in the near-term and potentially beyond.***

The recent severe flooding in Thailand, and the suspension of production in all of our Thailand manufacturing facilities, will adversely affect our business, results of operations and financial condition in the near-term and potentially beyond. Material risks and uncertainties we face as a result of flooding in Thailand include, but are not limited to, the following:

*Recommencement of Operations.* Our ability, and the time required, to recommence full operations following the flooding of our Thailand facilities will be affected by the time necessary for the flood waters to recede, the extent of damage to our facilities and equipment caused by the floods, the time required to repair or replace damaged equipment and complete customer qualification of any replaced equipment, the ability for our employees to return to work, and our ability to access freight lanes and transportation routes. Production will not recommence at our Chokchai facilities for the remainder of the quarter ending December 30, 2011, and likely for significantly longer. It is possible that we may never again manufacture at our Chokchai campus but, instead, divert manufacturing to the existing Buildings 3, 4 and 5 at our Pinehurst campus, and our newest Building 6 at Pinehurst, upon completion. Completion of construction of Building 6 at Pinehurst has been delayed as a result of the flooding in Thailand. Even after we complete construction of Building 6, it may take two and a half months or longer after completion before we can manufacture at full capacity at that new site. In addition, while we began limited operations at our Pinehurst facilities on November 7, 2011, depending on the flood waters, we could be required to cease those limited operations at any time and could be required to do so for an extended period of time. We may also be constrained in scaling from limited operations to full operations at Pinehurst. Because of these uncertainties, we are not yet able to estimate when we will be able to recommence full operations.

Our business operations in Thailand typically generate over 90% of our overall revenue in a given quarter. We do not have significant manufacturing operations outside of Thailand to which we would otherwise be able to transfer people, equipment, inventory and our production capacity. Until we are able to recommence production at normal capacity in Thailand, our costs will be materially and adversely impacted by significant under-utilization of our assets and infrastructure, our operations will be constrained, and our business, financial condition and results of operations will be materially and adversely affected. Even after we recover from the recent flooding and resume normal operations, we cannot assure you that future flooding in Thailand will be less severe or have less of an impact on our business, financial condition and results of operations than the most recent flooding.

*Thai Government Actions.* Several billion cubic meters of water remain in Northern Thailand and are steadily making their way south. Even though the flooding season has ended, the Thai government must still manage these vast quantities of water and route them as safely as possible south through the country and out to the Gulf of Thailand. To do so, the government may divert significant amounts of this water on paths that run near or through our Pinehurst or Chokchai facilities, which would have a material adverse effect on our business, financial condition and results of operations.

## Edgar Filing: Fabrinet - Form 10-Q

*Customers.* Our Chokchai and Pinehurst facilities service all of our major customers. Because of the suspension of our operations in Thailand, it is possible that some customers will take their business elsewhere, either to our competitors or in house. A number of customers have already removed from our facilities their equipment that had been consigned to our factories for purposes of fulfilling

---

**Table of Contents**

customer orders. Even after we return to normal operations in Thailand, given the qualification process that an alternative manufacturer would have to undertake, once a customer leaves us for a competitor and qualifies operations for manufacturing with that competitor, it will become more difficult and costly for that customer to later return to us. Given the flooding in Thailand, some customers may choose not to reengage with us simply because of the fear of future flooding in Thailand. Other customers may be so reliant on us for their manufacturing capabilities that the suspension of our operations could materially and adversely affect their own businesses and potentially lead to customer bankruptcies or liquidations. Customer bankruptcies or liquidations would mean less revenue for us and could also require that we write off any accounts receivable and inventory associated with those customers. We may also have disputes with our customers regarding who bears the responsibility for losses of equipment, inventory, business and profits as a result of the flooding. Other customers may simply walk away from their obligations to us pay us for equipment, inventory and finished goods for which we feel that they have a contractual obligation to us. The recent flooding may also make it more difficult for us to win business from new customers even after we resume normal operations. These consequences will materially and adversely affect our business, financial condition and results of operations.

*Suppliers.* Even after we are able to bring our manufacturing capacity in Thailand up to normal levels, our suppliers may not be able to supply us with materials in sufficient volumes and in a timely enough manner for us to satisfy our customers' demands. A number of our suppliers are located in Thailand. These Thai-based suppliers may be materially and adversely impacted by the flooding and may be impacted far longer than we are. Some of these suppliers could be required to file for bankruptcy or otherwise liquidate as a result of the effects of the flooding on their businesses. In addition, our suppliers located outside of Thailand rely on Thai infrastructure and logistics to deliver their goods to our factories in Thailand. To the extent that Thai infrastructure and logistics remain materially and adversely affected longer than our manufacturing facilities, it will continue to be difficult for us to obtain necessary volumes of materials in a timely manner, which will materially and adversely impact our business and customer relations, and operations will be substantially constrained.

*Recovery and Related Charges and Expenses.* We expect to incur significant charges and expenses related to the recovery from the flooding of our Thailand facilities and its impact on our operations, including items such as fixed asset impairments, inventory write-downs, charges related to cancellation of purchase orders for excess materials and charges for restoration and recovery work. The amount of these charges and expenses cannot currently be estimated and depends on a number of factors, including our ability to remove water from our facilities, the extent of damage to our facilities, existing inventories and equipment caused by the flooding, the time and effort required to restore or replace damaged equipment, our ability to replace existing but damaged equipment, and the time required to recommence production at normal capacity. In the event that we move our manufacturing capacity from Chokchai to Buildings 3, 4 and 5 at Pinehurst and, when completed, Building 6, we also expect to incur significant expenses in connection with such a move. We expect to incur a significant amount of these various flood-related charges and expenses during our second fiscal quarter ending December 30, 2011. However, the ultimate timing of the incurrence of these charges and expenses depends on the time required to complete our recovery efforts and recommence production at normal capacity.

*Insurance.* We maintain insurance coverage that provides for reimbursement from losses resulting from flood damage. The magnitude of the flood damage we will incur depends on a number of factors, including those described above, and currently cannot be estimated. Our property and casualty insurance covers loss or damage to our property and third-party property over which we have custody and control as well as losses associated with business interruption and building damage. We cannot yet estimate the amount or timing of any proceeds that we ultimately receive under our insurance policies, and there may therefore be a substantial delay between our incurrence of losses and our recovery under our insurance policies, which would adversely affect our cash flows. We cannot assure you that our insurance policies cover the business interruption losses we incur in connection with the flooding of our Thailand facilities. There is also a risk that our insurance claims may exceed our insurance caps. We expect that the insurance claims process will also require a significant amount of time from management in terms of assessing the extent of damage, working with insurance carriers to determine the scope of coverage, making all appropriate claims in a timely manner and potentially disputing claim denials or coverage limits for which we do not agree with our carriers. There is a risk that our flood insurance premiums may rise significantly in the future or that insurers may cease writing policies for flood insurance in Thailand.

*Restoration or Replacement of Equipment.* The equipment we use at our facilities in Thailand is highly sophisticated and complex. Our ability to repair any damage to this equipment as a result of the flooding of our Thailand facilities will depend on our ability to source and install replacement parts for the equipment. If we are unable to successfully do so or if the extent of damage to any of our equipment is too extensive to repair, we may need to replace the equipment. We cannot assure that replacement equipment will be available on acceptable terms or at all. In addition, extended lead-time requirements for replacing some of the equipment used in our Thailand facilities may adversely affect our ability to recommence full operations on a timely basis after other recovery efforts have been completed.

*Operating Model.* Given the increased costs and substantially reduced revenue in the near-term and possibly beyond, we may have to undertake a significant restructuring of our organization in order to align our cost structure with our post-flooding operating model. Because the extent of the loss, the amount of costs and charges that we will incur and the amount of lost revenue are currently unknown, we cannot yet estimate the extent or timing of such a restructuring but anticipate that such a restructuring will occur over the next several quarters.



---

**Table of Contents**

We have depended, and expect to continue to depend, upon a relatively small number of customers for a significant percentage of our total revenues. During the three months ended September 30, 2011 and September 24, 2010, we had four customers that each contributed 10% or more of our total revenues. These customers together accounted for 57% and 57% of our total revenues, respectively, during the periods. Dependence on a limited number of customers means that a reduction in orders from, a loss of, or other adverse actions by any one of these customers could have an adverse effect on our business, operating results and share price. For example, on July 1, 2011, Oclaro, Inc. delivered a notice of termination to us under our volume supply agreement, stating that they are currently in discussions with multiple third party manufacturers, including Fabrinet, for one or more of such third party manufacturers to manufacture those products that are currently being manufactured by Fabrinet under our supply agreement. Pursuant to the notice of termination, our supply agreement will terminate on December 31, 2011. From July 8, 2011, following Oclaro's announcement of the termination of our volume supply agreement, through July 14, 2011, our share price on the NYSE declined approximately 22%.

Further, our customer concentration increases the concentration of our accounts receivable and our exposure to payment default by any of our key customers. Many of our existing and potential customers have substantial debt burdens, have experienced financial distress or have static or declining revenues. Certain of our customers have gone out of business, been acquired, or announced their withdrawal from segments of the optics market. We generate significant accounts payable and inventory for the services that we provide to our customers, which could expose us to substantial and potentially unrecoverable costs if we do not receive payment from our customers.

Reliance on a small number of customers gives those customers substantial purchasing power and leverage in negotiating contracts with us. In addition, although we enter into master supply agreements with our customers, the level of business to be transacted under those agreements is not guaranteed. Instead, we are awarded business under those agreements on a project-by-project basis. Some of our customers have at times significantly reduced or delayed the volume of manufacturing services that they order from us. If we are unable to maintain our relationships with our existing significant customers, our business, financial condition and operating results could be harmed.

***Natural disasters, including the current flooding in Thailand, epidemics, acts of terrorism and other political and economic developments could harm our business, financial condition and operating results.***

Natural disasters, such as the current, severe flooding in Thailand, where most of our manufacturing operations are located, the May 2008 earthquake in Sichuan, China, and the March 2011 tsunami in Japan, could severely disrupt our manufacturing operations and increase our supply chain costs. These events, over which we have little or no control, could cause a decrease in demand for our services, make it difficult or impossible for us to manufacture and deliver products and for our suppliers to deliver components allowing us to manufacture those products, require large expenditures to repair or replace our facilities, or create delays and inefficiencies in our supply chain. For example, the current flooding situation in Thailand has forced us to temporarily shut down all of our manufacturing facilities in Thailand. This disruption is ongoing and will adversely affect our ability to meet our customers' demands during the three months ending December 30, 2011 and possibly beyond. In some countries in which we operate, including the PRC and Thailand, potential outbreaks of infectious diseases such as the H1N1 influenza virus, severe acute respiratory syndrome (SARS) or bird flu could disrupt our manufacturing operations, reduce demand for our customers' products and increase our supply chain costs. In addition, increased international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures, conflicts in the Middle East and Asia, strained international relations arising from these conflicts and the related decline in consumer confidence and economic weakness, may hinder our ability to do business. Any escalation in these events or similar future events may disrupt our operations and the operations of our customers and suppliers, and may affect the availability of materials needed for our manufacturing services. Such events may also disrupt the transportation of materials to our manufacturing facilities and finished products to our customers. These events have had, and may continue to have, an adverse impact on the U.S. and world economy in general, and customer confidence and spending in particular, which in turn could adversely affect our total revenues and operating results. The impact of these events on the volatility of the U.S. and world financial markets also could increase the volatility of the market price of our ordinary shares and may limit the capital resources available to us, our customers and our suppliers.

***We face significant competition in our business. If we are unable to compete successfully against our current and future competitors, our business, financial condition and operating results could be harmed.***

Our current and prospective customers tend to evaluate our capabilities against the merits of their internal manufacturing as well as the capabilities of third-party manufacturers. We believe the internal manufacturing capabilities of current and prospective customers are our primary competition. This competition is particularly strong when our customers have excess manufacturing capacity, as was the case when the markets that we serve experienced a downturn from 2001 through 2004 and again in 2008 and 2009, that resulted in underutilized capacity. Many of our potential customers continue to have excess manufacturing capacity at their facilities. If our customers choose to manufacture products internally rather than to outsource production to us, or choose to outsource to a third-party manufacturer, our business, financial condition and operating results could be harmed. For example, on July 1, 2011, Oclaro, Inc. delivered a notice of termination to us under our volume supply agreement, stating that they are currently in discussions with multiple third party manufacturers, including Fabrinet, for one or more of such third party manufacturers to manufacture those products that are currently being manufactured by Fabrinet under our supply

agreement.



---

**Table of Contents**

Competitors in the market for optical manufacturing services include Sanmina-SCI Corporation, Hon Hai Precision Industry Co. Ltd., Celestica Inc., Venture Corporation Limited and Oplink Communications, Inc. Our customized optics and glass operations face competition from companies such as Alps Electric Co., Ltd., Browave Corporation, Fujian Castech Crystals, Inc., Research Electro-Optic, Inc. and Photop Technologies, Inc. Other existing contract manufacturing companies, original design manufacturers or outsourced semiconductor assembly and test companies could also enter our target markets. In addition, we may face more competitors as we attempt to penetrate new markets.

Many of our customers and potential competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater resources than we have. These advantages may allow them to devote greater resources than we can to the development and promotion of service offerings that are similar or superior to our service offerings. These competitors may also engage in more extensive research and development, undertake more far-reaching marketing campaigns, adopt more aggressive pricing policies or offer services that achieve greater market acceptance than ours. These competitors may also compete with us by making more attractive offers to our existing and potential employees, suppliers and strategic partners. Further, consolidation in the optics industry could lead to larger and more geographically diverse competitors. New and increased competition could result in price reductions for our services, reduced gross profit margins or loss of market share. We may not be able to compete successfully against our current and future competitors, and the competitive pressures we face may harm our business, financial condition and operating results.

***Cancellations, delays or reductions of customer orders and the relatively short-term nature of the commitments of our customers could harm our business, financial condition and operating results.***

We do not typically obtain firm purchase orders or commitments from our customers that extend beyond 13 weeks. While we work closely with our customers to develop forecasts for periods of up to one year, these forecasts are not binding and may be unreliable. Customers may cancel their orders, change production quantities from forecasted volumes or delay production for a number of reasons beyond our control. Any material delay, cancellation or reduction of orders could cause our revenues to decline significantly and could cause us to hold excess materials. Many of our costs and operating expenses are fixed. As a result, a reduction in customer demand could decrease our gross profit and harm our business, financial condition and operating results.

In addition, we make significant decisions, including production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimate of our customers' requirements. The short-term nature of our customers' commitments and the possibility of rapid changes in demand for their products reduce our ability to accurately estimate the future requirements of our customers. Inability to forecast the level of customer orders with certainty makes it difficult to allocate resources to specific customers, order appropriate levels of materials and maximize the use of our manufacturing capacity. This could also lead to an inability to meet a spike in production demand, all of which could harm our business, financial condition and operating results.

***We are not fully insured against all potential losses. Natural disasters or other catastrophes could adversely affect our business, financial condition and results of operations.***

The occurrence of one or more natural disasters, such as tropical storms and floods, in Thailand where most of our manufacturing operations are located could adversely affect our operations and financial performance. Any losses that we would incur could have a material adverse effect on our business for an indeterminate period of time.

---

## **Table of Contents**

Even with insurance coverage, natural disasters or other catastrophic events, including acts of war, could cause us to suffer substantial losses in our operational capacity and could also lead to a loss of opportunity and to a potential adverse impact on our relationships with our existing customers resulting from our inability to produce products for them, for which we would not be compensated by existing insurance. This in turn could have a material adverse effect on our financial condition and results of operations.

***If the optical communications market does not expand as we expect, our business may not grow as fast as we expect, which could adversely impact our business, financial condition and operating results.***

Our future success as a provider of precision optical, electro-mechanical and electronic manufacturing services for the optical communications market depends on the continued growth of the optics industry and, in particular, the continued expansion of global information networks, particularly those directly or indirectly dependent upon a fiber optics infrastructure. As part of that growth, we are relying on increasing demand for voice, video, text and other data delivered over high-speed connections. Without network and bandwidth growth, the need for enhanced communications products would be jeopardized. Currently, demand for network services and for broadband access, in particular, is increasing but growth may be limited by several factors, including, among others: (i) relative strength or weakness of the global economy or certain countries or regions, (ii) an uncertain regulatory environment, and (iii) uncertainty regarding long-term sustainable business models as multiple industries, such as the cable, traditional telecommunications, wireless and satellite industries, offer competing content delivery solutions. The optical communications market also has experienced periods of overcapacity, some of which have occurred even during periods of relatively high network usage and bandwidth demands. If the factors described above were to slow, stop or reverse the expansion in the optical communications market, our business, financial condition and operating results would be negatively affected.

***Our quarterly revenues, gross profit margins and operating results have fluctuated significantly and may continue to do so in the future, which may cause the market price of our ordinary shares to decline or be volatile.***

Our quarterly revenues, gross profit margins, and operating results have fluctuated significantly and may continue to fluctuate significantly in the future. For example, between the three months ended September 25, 2009 and the three months ended June 25, 2010, our total revenues ranged from \$97.0 million to \$157.4 million, as compared to \$186.3 million for the three months ended September 30, 2011. Our gross profit margins and operating results experienced similar fluctuations during those periods. In addition, because of the recent flooding in Thailand, we expect our revenues from the fiscal quarter ending December 30, 2011 to be substantially lower than it has been in previous periods. Therefore, we believe that quarter-to-quarter comparisons of our operating results may not be useful in predicting our future operating results. You should not rely on our results for one quarter as any indication of our future performance. Quarterly variations in our operations could result in significant volatility in the market price of our ordinary shares.

***If we are unable to continue diversifying our precision optical and electro-mechanical manufacturing services across other markets within the optics industry, such as the semiconductor processing, biotechnology, metrology and material processing markets, our business may not grow as fast as we expect.***

We intend to continue diversifying across other markets within the optics industry, such as the semiconductor processing, biotechnology, metrology and material processing markets, to reduce our dependence on the optical communications market and to grow our business. Currently, the optical communications market contributes the majority of our revenues. There can be no assurance that our efforts to further expand and diversify into other markets within the optics industry will prove successful. In the event that the opportunities presented by these markets prove to be less than anticipated, if we are less successful than expected in diversifying into these markets, or if our margins in these markets prove to be less than expected, our growth may slow or stall, and we may incur costs that are not offset by revenues in these markets, all of which could harm our business, financial condition and operating results.

***Our exposure to financially troubled customers or suppliers could harm our business, financial condition and operating results.***

We provide manufacturing services to companies, and rely on suppliers, that have in the past and may in the future experience financial difficulty, particularly in light of recent conditions in the credit markets and the overall economy that affected access to capital and liquidity. As a result, we devote significant resources to monitor receivables and inventory balances with certain of our customers. If our customers experience financial difficulty, we could have difficulty recovering amounts owed to us from these customers, or demand for our services from these customers could decline. If our suppliers experience financial difficulty, we could have trouble sourcing materials necessary to fulfill production requirements and meet scheduled shipments. Any such financial difficulty could adversely affect our operating results and financial condition by resulting in a reduction in our revenues, a charge for inventory write-offs, a provision for doubtful accounts, and an increase in working capital requirements due to increases in days in inventory and in days in accounts receivable.



---

**Table of Contents**

***Fluctuations in foreign currency exchange rates and changes in governmental policies regarding foreign currencies could increase our operating costs, which would adversely affect our operating results.***

Volatility in the functional and non-functional currencies of our entities and the U.S. dollar could seriously harm our business, financial condition and operating results. The primary impact of currency exchange fluctuations is on our cash, receivables and payables of our operating entities. We may experience significant unexpected expenses from fluctuations in exchange rates.

Our customer contracts generally require that our customers pay us in U.S. dollars. However, the majority of our payroll and other operating expenses are paid in Thai baht. As a result of these arrangements, we have significant exposure to changes in the exchange rate between the Thai baht and the U.S. dollar, and our operating results are adversely impacted when the U.S. dollar depreciates relative to the Thai baht and other currencies. We have experienced such depreciation in the U.S. dollar as compared to the Thai baht, and our results have been adversely impacted by this fluctuation in exchange rates. For example, from September 25, 2009 to September 30, 2011, the U.S. dollar lost approximately 7.4% of its value against the Thai baht. We cannot guarantee that the depreciation of the U.S. dollar against the Thai baht will not continue. Further, while we attempt to hedge against certain exchange rate risks, we typically enter into hedging contracts with durations of one to three months, leaving us exposed to longer term changes in exchange rates.

Also, we have significant exposure to changes in the exchange rate between the RMB and the U.S. dollar. The expenses of our PRC subsidiary are denominated in RMB. Currently, RMB are convertible under current accounts, including trade- and service-related foreign exchange transactions, foreign debt service and payment of dividends. The PRC government may at its discretion restrict access in the future to foreign currencies for current account transactions. If this occurs, our PRC subsidiary may not be able to pay us dividends in U.S. dollars without prior approval from the PRC State Administration of Foreign Exchange. In addition, conversion of RMB for most capital account items, including direct investments, is still subject to government approval in the PRC. This restriction may limit our ability to invest the earnings of our PRC subsidiary.

Beginning in July 2005, the official exchange rate for the conversion of RMB into U.S. dollars was revalued and permitted to fluctuate within a band against a basket of foreign currencies. As a result, as of September 30, 2011, the U.S. dollar had depreciated approximately 6.5% against the RMB since September 25, 2009. There remains significant international pressure on the PRC government to adopt a substantially more liberalized currency policy. Any further and more significant appreciation in the value of the RMB against the U.S. dollar could negatively impact our operating results.

***We purchase some of the critical materials used in certain of our products from a single source or a limited number of suppliers. Supply shortages have in the past, and could in the future, impair the quality, reduce the availability or increase the cost of materials, which could harm our revenues, profitability and customer relations.***

We rely on a single source or a limited number of suppliers for critical materials used in a significant number of the products we manufacture. We generally purchase these single or limited source materials through standard purchase orders and do not maintain long-term supply agreements with our suppliers. We generally use a rolling 12 month forecast based on anticipated product orders, customer forecasts, product order history, backlog, and warranty and service demand to determine our materials requirements. Lead times for the parts and components that we order vary significantly and depend on factors such as manufacturing cycle times, manufacturing yields and the availability of raw materials used to produce the parts or components. Historically, we have experienced supply shortages resulting from various causes, including reduced yields by our suppliers, which prevented us from manufacturing products for our customers in a timely manner. Our revenues, profitability and customer relations could be harmed by a stoppage or delay of supply, a substitution of more expensive or less reliable parts, the receipt of defective parts or contaminated materials, an increase in the price of supplies, or an inability to obtain a reduction in price from our suppliers in response to competitive pressures.

We continue to undertake programs to strengthen our supply chain. Nevertheless, we are experiencing, and expect for the foreseeable future to continue to experience, strain on our supply chain and periodic supplier problems. We have incurred, and expect to continue to incur for the foreseeable future, costs to address these problems.

---

**Table of Contents**

***Managing our inventory is complex and may require write-downs due to excess or obsolete inventory, which could cause our operating results to decrease significantly in a given fiscal period.***

Managing our inventory is complex. We are generally required to procure material based upon the anticipated demand of our customers. The inaccuracy of these forecasts or estimates could result in excess supply or shortages of certain materials. Inventory that is not used or expected to be used as and when planned may become excess or obsolete. Generally, we are unable to use most of the materials purchased for one of our customers to manufacture products for any of our other customers. Additionally, we could experience reduced or delayed product shipments or incur additional inventory write-downs and cancellation charges or penalties, which would increase costs and could harm our business, financial condition and operating results. While our agreements with customers are structured to mitigate our risks related to excess or obsolete inventory, enforcement of these provisions may result in material expense and delay in payment for inventory. If any of our significant customers becomes unable or unwilling to purchase inventory or does not agree to such contractual provisions in the future, our business, financial condition and operating results may be harmed.

***We conduct operations in a number of countries, which creates logistical and communications challenges for us and exposes us to other risks that could harm our business, financial condition and operating results.***

The vast majority of our operations, including manufacturing and customer support, are located primarily in the Asia-Pacific region. The distances between Thailand, the PRC and our customers and suppliers globally, create a number of logistical and communications challenges for us, including managing operations across multiple time zones, directing the manufacture and delivery of products across significant distances, coordinating the procurement of raw materials and their delivery to multiple locations and coordinating the activities and decisions of our management team, the members of which are based in different countries.

Our customers are located throughout the world. Total revenues from the bill-to location of customers outside of North America accounted for 51.1% and 57.1% of our total revenues for the three months ended September 30, 2011 and September 24, 2010, respectively. We expect that total revenues from the bill-to location of customers outside of North America will continue to account for a significant portion of our total revenues. Our customers also depend on international sales, which further exposes us to the risks associated with international operations. In addition, our international operations and sales subject us to a variety of domestic and foreign trade regulatory requirements.

***Political unrest and demonstrations, as well as changes in the political, social, business or economic conditions in Thailand, could harm our business, financial condition and operating results.***

The majority of our assets and manufacturing operations are located in Thailand. Therefore, political, social, business and economic conditions in Thailand have a significant effect on our business. As of January 19, 2011, Thailand had been assessed as a medium-high political risk by AON Political Risk, a risk management, insurance and consulting firm. Any changes to tax regimes, laws, exchange controls or political action in Thailand may harm our business, financial condition and operating results.

In September 2006, Thailand experienced a military coup that overturned the existing government, and in 2008, political unrest and demonstrations in Bangkok sparked a series of violent incidents that resulted in several deaths and numerous injuries. In April 2009, anti-government demonstrations in Bangkok caused severe traffic congestion and numerous injuries, and in March 2010, protestors again held demonstrations calling for new elections. These demonstrations in recent years in Bangkok and other parts of Thailand, which escalated in violence through May 2010, resulted in the country's worst political violence in nearly two decades with numerous deaths and injuries, as well as destruction of property. Certain hotels and businesses in Bangkok were closed for weeks as the protestors occupied Bangkok's commercial center, and governments around the world issued travel advisories urging their citizens to avoid non-essential travel to Bangkok.

Any succession crisis in the Kingdom of Thailand could cause new or increased instability and unrest. In the event that a violent coup were to occur or the current political unrest were to worsen, such activity could prevent shipments from entering or leaving the country and disrupt our ability to manufacture products in Thailand, and we could be forced to transfer our manufacturing activities to more stable, and potentially more costly, regions. Further, the Thai government recently raised the minimum wage standards for labor and could repeal certain promotional certificates that we have received or tax holidays for certain export and value added taxes that we enjoy, either preventing us from engaging in our current or anticipated activities or subjecting us to higher tax rates. A new regime could nationalize our business or otherwise seize our assets. Future political instability such as the coup that occurred in September 2006 or the demonstrations that occurred during 2008, 2009 and 2010 could harm our business, financial condition and operating results.

---

**Table of Contents**

***We expect to increase our manufacturing operations in the PRC, which will continue to expose us to risks inherent in doing business in the PRC, any of which risks could harm our business, financial condition and operating results.***

We anticipate that we will continue to invest in our customized optics manufacturing facilities located in Fuzhou, China. Because these operations are located in the PRC, they are subject to greater political, legal and economic risks than the geographies in which the facilities of many of our competitors and customers are located. In particular, the political and economic climate in the PRC (both at national and regional levels) is fluid and unpredictable. As of January 19, 2011, the PRC had been assessed as a medium political risk by AON Political Risk. A large part of the PRC's economy is still being operated under varying degrees of control by the PRC government. By imposing industrial policies and other economic measures, such as control of foreign exchange, taxation, import and export tariffs, environmental regulations, land use rights, intellectual property and restrictions on foreign participation in the domestic market of various industries, the PRC government exerts considerable direct and indirect influence on the development of the PRC economy. Many of the economic reforms carried out by the PRC government are unprecedented or experimental and are expected to change further. Any changes to the political, legal or economic climate in the PRC could harm our business, financial condition and operating results.

Our PRC subsidiary is a wholly foreign-owned enterprise and is therefore subject to laws and regulations applicable to foreign investment in the PRC, in general, and laws and regulations applicable to wholly foreign-owned enterprises, in particular. The PRC has made significant progress in the promulgation of laws and regulations pertaining to economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, the promulgation of new laws, changes in existing laws and abrogation of local regulations by national laws may have a negative impact on our business and prospects. In addition, these laws and regulations are relatively new, and published cases are limited in volume and non-binding. Therefore, the interpretation and enforcement of these laws and regulations involve significant uncertainties. Laws may be changed with little or no prior notice, for political or other reasons. These uncertainties could limit the legal protections available to foreign investors. Furthermore, any litigation in the PRC may be protracted and result in substantial costs and diversion of resources and management's attention.

***Our business and operations would be adversely impacted in the event of a failure of our information technology infrastructure.***

We rely upon the capacity, reliability and security of our information technology hardware and software infrastructure. For instance, we use a combination of standard and customized software platforms to manage, record and report all aspects of our operations and, in many instances, enable our customers to remotely access certain areas of our databases to monitor yields, inventory positions, work-in-progress status and vendor quality data. We are constantly expanding and updating our information technology infrastructure in response to our changing needs. Any failure to manage, expand and update our information technology infrastructure or any failure in the operation of this infrastructure could harm our business.

Despite our implementation of security measures, our systems are vulnerable to damages from computer viruses, natural disasters, unauthorized access and other similar disruptions. Any system failure, accident or security breach could result in disruptions to our operations. To the extent that any disruptions or security breach results in a loss or damage to our data, or inappropriate disclosure of confidential information, it could harm our business. In addition, we may be required to incur significant costs to protect against damage caused by these disruptions or security breaches in the future.

***Consolidation in the markets we serve could harm our business, financial condition and operating results.***

Consolidation in the markets we serve has resulted in a reduction in the number of potential customers for our services. For example, in February 2008, EMCORE Corporation, one of our customers, acquired certain product lines and other assets from another of our customers. Also, in April 2009, Bookham, Inc. and Avanex Corporation, both of which are our customers, merged to form a new company called Oclaro, Inc. In July 2009, Newport Corporation, also our customer, acquired Oclaro's Focus photonics business, and Oclaro acquired Newport's high-power laser diode manufacturing operations. In May 2010, TE Connectivity acquired Zarlink Semiconductor's optical products business, and in January 2011, Molex Incorporated acquired the silicon photonics-based active optical cable assets of Luxtera, Inc. In some cases, consolidation among our customers has led to a reduction in demand for our services as customers acquired the capacity to manufacture products in-house.

Consolidation among our customers and their customers may continue and may adversely affect our business, financial condition and operating results in several ways. Consolidation among our customers and their customers may result in a smaller number of large customers whose size and purchasing power give them increased leverage that may result in, among other things, decreases in our average selling prices. In addition to pricing pressures, this consolidation may also reduce overall demand for our manufacturing services if customers obtain new capacity to manufacture products in-house or discontinue duplicate or competing product lines in order to streamline operations. If demand for our manufacturing services decreases, our business, financial condition and operating results could be harmed.



---

**Table of Contents**

***If we fail to adequately expand our manufacturing capacity, we will not be able to grow our business, which would harm our business, financial condition and operating results. Conversely, if we expand too much or too rapidly, we may experience excess capacity, which would harm our business, financial condition and operating results.***

We may not be able to pursue many large customer orders or sustain our historical growth rates if we do not have sufficient manufacturing capacity to enable us to commit to provide customers with specified quantities of products. If our customers do not believe that we have sufficient manufacturing capacity, they may: (i) outsource all of their production to another source that they believe can fulfill all of their production requirements; (ii) look to a second source for the manufacture of additional quantities of the products that we currently manufacture for them; (iii) manufacture the products themselves; or (iv) otherwise decide against using our services for their new products.

We most recently expanded our manufacturing capacity at our Thailand facilities in May 2008 with the completion of Pinehurst Building 5 and intend to further expand our manufacturing capacity in the future, such as our construction of Pinehurst Building 6 in Thailand during the remainder of calendar year 2011 and the first quarter of calendar year 2012. We must continue to devote significant resources to the expansion of our manufacturing capacity, and any such expansion will be expensive, will require management's time and may disrupt our operations. In the event we are unsuccessful in our attempts to expand our manufacturing capacity, our business, financial condition and operating results could be harmed.

However, if we expand our manufacturing capacity and are unable to promptly utilize the additional space due to reduced demand for our services, an inability to win new projects, new customers or penetrate new markets, or if the optics industry does not grow as we expect, we may experience periods of excess capacity, which could harm our business, financial condition and operating results.

***We may encounter difficulties completing or integrating acquisitions, asset purchases and other types of transactions that we may pursue in the future, which could disrupt our business, cause dilution to our shareholders and harm our business, financial condition and operating results.***

We have grown and may continue to grow our business through acquisitions, asset purchases and other types of transactions, including the transfer of products from our customers and their suppliers. Acquisitions and other strategic transactions typically involve many risks, including the following:

the integration of the acquired assets and facilities into our business may be difficult, time-consuming and costly, and may adversely impact our profitability;

we may lose key employees of the acquired companies or divisions;

we may issue additional ordinary shares, which would dilute our current shareholders' percentage ownership in us;

we may incur indebtedness to pay for the transactions;

we may assume liabilities, some of which may be unknown at the time of the transactions;

we may record goodwill and non-amortizable intangible assets that will be subject to impairment testing and potential periodic impairment charges;

we may incur amortization expenses related to certain intangible assets;



## Edgar Filing: Fabrinet - Form 10-Q

we may devote significant resources to transactions that may not ultimately yield anticipated benefits;

we may incur greater than expected expenses or lower than expected revenues;

we may assume obligations with respect to regulatory requirements, including environmental regulations, which may prove more burdensome than expected; or

---

## **Table of Contents**

we may become subject to litigation.

Acquisitions are inherently risky, and we can provide no assurance that our previous or future acquisitions will be successful or will not harm our business, financial condition and operating results.

*We may experience manufacturing yields that are lower than expected, potentially resulting in increased costs, which could harm our business, operating results and customer relations.*

Manufacturing yields depend on a number of factors, including the following:

the quality of input, materials and equipment;

the quality and feasibility of our customer's design;

the repeatability and complexity of the manufacturing process;

the experience and quality of training of our manufacturing and engineering teams; and

the monitoring of the manufacturing environment.

Lower volume production due to continually changing designs generally results in lower yields. Manufacturing yields and margins can also be lower if we receive or inadvertently use defective or contaminated materials from our suppliers. In addition, our customer contracts typically provide that we will supply products at a fixed price each quarter, which assumes specific production yields and quality metrics. If we do not meet the yield assumptions and quality metrics used in calculating the price of a product, we may not be able to recover the costs associated with our failure to do so. Consequently, our operating results and profitability may be harmed.

*If the products that we manufacture contain defects, we could incur significant correction costs, demand for our services may decline and we may be exposed to product liability and product warranty claims, which could harm our business, financial condition, operating results and customer relations.*

We manufacture products to our customers' specifications, and our manufacturing processes and facilities must comply with applicable statutory and regulatory requirements. In addition, our customers' products and the manufacturing processes that we use to produce them are often complex. As a result, products that we manufacture may at times contain manufacturing or design defects, and our manufacturing processes may be subject to errors or fail to be in compliance with applicable statutory or regulatory requirements. Additionally, not all defects are immediately detectable. The testing procedures of our customers are generally limited to the evaluation of the products that we manufacture under likely and foreseeable failure scenarios. For various reasons (including, among others, the occurrence of performance problems that are unforeseeable at the time of testing or that are detected only when products are fully deployed and operated under peak stress conditions), these products may fail to perform as expected after their initial acceptance by a customer.

We generally provide a warranty of between one to two years on the products that we manufacture for our customers. This warranty typically guarantees that products will conform to our customers' specifications and be free from defects in workmanship. Defects in the products we manufacture, whether caused by a design, engineering, manufacturing or component failure or by deficiencies in our manufacturing processes and whether during or after the warranty period, could result in product or component failures, which may damage our business reputation, whether or not we are indemnified for such failures. We could also incur significant costs to repair or replace defective products under warranty, particularly when such failures occur in installed systems. In some instances, we may also be required to incur costs to repair or replace defective products outside of the warranty period in the event that a recurring defect is discovered in a certain percentage of a customer's products delivered over an agreed upon period of time. We have experienced product or component failures in the past and remain exposed to such failures, as the products that we manufacture are widely deployed throughout the world in multiple environments and applications. Further, due to the difficulty in determining whether a given defect resulted from our customer's design of the product or our manufacturing process, we may be exposed to product liability or product warranty claims arising from defects that are not our fault. In addition, if the number or type of defects exceeds certain percentage limitations contained in our contractual arrangements, we may be required to conduct extensive failure

analysis, re-qualify for production or cease production of the specified products.

---

## **Table of Contents**

Product liability claims may include liability for personal injury or property damage. Product warranty claims may include liability to pay for a recall, repair or replacement of a product or component. Although liability for these claims is generally assigned to our customers in our contracts, even where they have assumed liability, our customers may not, or may not have the resources to, satisfy claims for costs or liabilities arising from a defective product. Additionally, under one of our contracts, in the event the products we manufacture do not meet the end-customer's testing requirements or otherwise fail, we may be required to pay penalties to our customer, including a fee during the time period that the customer or end-customer's production line is not operational as a result of the failure of the products that we manufacture, all of which could harm our business, operating results and customer relations. If we engineer or manufacture a product that is found to cause any personal injury or property damage or is otherwise found to be defective, we could incur significant costs to resolve the claim. While we maintain insurance for certain product liability claims, we do not maintain insurance for any recalls and, therefore, would be required to pay any associated costs that are determined to be our responsibility. A successful product liability or product warranty claim in excess of our insurance coverage or any material claim for which insurance coverage is denied, limited, is not available or has not been obtained could harm our business, financial condition and operating results.

***If we are unable to meet regulatory quality standards applicable to our manufacturing and quality processes for the products we manufacture, our business, financial condition or operating results could be harmed.***

As a manufacturer of products for the optics industry, we are required to meet certain certification standards, including the following: ISO 9001:2008 for Manufacturing Quality Systems; ISO 14001 for Environmental Quality Systems; TL9000 for Telecommunications Industry Quality Certification; TS16949:2002 for Automotive Industry Quality Certification; ISO 13485:2003 for Medical Devices; AS9100 for Aerospace Industry Quality Certification; OHSAS 18001 for Health and Safety; and various additional standards imposed by the U.S. Food and Drug Administration, or FDA, with respect to the manufacture of medical devices.

Additionally, we are required to register with the FDA and other regulatory bodies and are subject to continual review and periodic inspection for compliance with these requirements, which require manufacturers to adhere to certain regulations, including testing, quality control and documentation procedures. We hold the following additional certifications: SONY Green Partner for Environmental Management Systems and CSR-DIW for Corporate Social Responsibility in Thailand. In the European Union, we are required to maintain certain ISO certifications in order to sell our precision optical, electro-mechanical and electronic manufacturing services and we must undergo periodic inspections by regulatory bodies to obtain and maintain these certifications. If any regulatory inspection reveals that we are not in compliance with applicable standards, regulators may take action against us, including issuing a warning letter, imposing fines on us, requiring a recall of the products we manufactured for our customers, or closing our manufacturing facilities. If any of these actions were to occur, it could harm our reputation as well as our business, financial condition and operating results.

***If we fail to attract additional skilled employees or retain key personnel, our business, financial condition and operating results could suffer.***

Our future success depends, in part, upon our ability to attract additional skilled employees and retain our current key personnel. We have identified several areas where we intend to expand our hiring, including human resources, supply chain management, business development and finance. We may not be able to hire and retain such personnel at compensation levels consistent with our existing compensation and salary structure. Our future also depends on the continued contributions of our executive management team, including Mr. Mitchell, and other key management and technical personnel, each of whom would be difficult to replace. We do not have key person life insurance or long-term employment contracts with any of our key personnel. The loss of any of our executive officers or key personnel or the inability to continue to attract qualified personnel could harm our business, financial condition and operating results.

***Failure to comply with applicable environmental laws and regulations could have a material adverse effect on our business, results of operations and financial condition.***

The sale and manufacturing of products in certain states and countries may subject us to environmental laws and regulations. Although we do not anticipate any material adverse effects based on the nature of our operations and these laws and regulations, we will need to ensure that we and our suppliers comply with such laws and regulations as they are enacted. If we fail to timely comply with such laws and regulations, our customers may cease doing business with us, which would have a material adverse effect on our business, results of operations and financial condition. In addition, if we were found to be in violation of these laws, we could be subject to governmental fines, liability to our customers and damage to our reputation, which would also have a material adverse effect on our business, results of operations and financial condition.

---

**Table of Contents**

***Our business, operating results and financial condition may be negatively impacted by general economic and financial market conditions.***

The 2008 global economic crisis has caused disruptions and extreme volatility in global financial markets, increased rates of default and bankruptcy, and impacted levels of business and consumer spending. These macroeconomic developments have negatively affected and may continue to negatively affect our business, operating results and financial condition in a number of ways. For example, in fiscal 2009, various customers delayed or decreased spending on new projects with us while others delayed paying us for products and services that we had previously provided. Additionally, as a result of these macroeconomic developments, in fiscal 2009, there was a decline in demand for our customers' products across all of the industries we serve, which caused our customers to reduce their inventories, resulting in a 13.7% decline in our total revenues and a 25.2% decline in our net income from fiscal 2008 to fiscal 2009. Further, concern about the stability of the markets generally and the strength of counterparties led many lenders and institutional investors to reduce, and in some cases, cease to provide credit to businesses and consumers, including to our suppliers and customers, which further exacerbated downward pressure on demand for our products and services.

If these significant adverse global economic conditions were to return, they could, among other things, make it more difficult for us, our customers and our suppliers to obtain credit, cause our customers or potential customers to reduce or delay their orders with us or cancel their orders altogether, lead to further downward pricing pressures, result in further delays in paying us or result in insolvency for key suppliers or customers, any of which could harm our business, financial condition and operating results.

***We have incurred and will continue to incur significant increased costs as a result of operating as a public company, and our management will be required to continue to devote substantial time to various compliance initiatives.***

The Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as other rules implemented by the U.S. Securities and Exchange Commission (SEC) and the New York Stock Exchange (NYSE), impose various requirements on public companies, including requiring changes in corporate governance practices. These and proposed corporate governance laws and regulations under consideration may further increase our compliance costs. If compliance with these various legal and regulatory requirements diverts our management's attention from other business concerns, it could have a material adverse effect on our business, financial condition and results of operations. The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. While we were able to assert in our Form 10-K for the fiscal year ended June 24, 2011 that our internal control over financial reporting was effective as of July 24, 2011, we cannot predict the outcome of our testing in future periods. If we are unable to assert in any future reporting periods that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our stock price.

Given the nature and complexity of our business and the fact that some members of our management team are located in Thailand while others are located in the U.S., control deficiencies may periodically occur. While we have ongoing measures and procedures to prevent and remedy such deficiencies, if they occur there can be no assurance that we will be successful or that we will be able to prevent material weaknesses or significant deficiencies in our internal control over financial reporting in the future. Moreover, if we or our independent registered public accounting firm identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses in future periods, the market price of our ordinary shares could decline and we could be subject to potential delisting by the NYSE and review by the NYSE, the SEC, or other regulatory authorities, which would require the expenditure by us of additional financial and management resources. As a result, our shareholders could lose confidence in our financial reporting, which would harm our business and the market price of our ordinary shares.

---

**Table of Contents**

***We are subject to the risk of increased income taxes, which could harm our business, financial condition and operating results.***

We base our tax position upon the anticipated nature and conduct of our business and upon our understanding of the tax laws of the various countries in which we have assets or conduct activities. However, our tax position is subject to review and possible challenge by tax authorities and to possible changes in law, which may have retroactive effect. We were formed in the Cayman Islands and we maintain manufacturing operations in Thailand, the PRC and the U.S. Any of these jurisdictions could assert tax claims against us. We cannot determine in advance the extent to which some jurisdictions may require us to pay taxes or make payments in lieu of taxes. Preferential tax treatment from the Thai government is currently available to us for a period of five years from July 2010, which will be contingent on, among other things, the export of our customers' products out of Thailand and our agreement not to move our manufacturing facilities out of our current province in Thailand for at least 15 years. We will lose this favorable tax treatment in Thailand unless we comply with these restrictions, and as a result we may delay or forego certain strategic business decisions due to these tax considerations. We cannot guarantee that such preferential tax treatment will continue. Our PRC subsidiary does not qualify for any such tax incentives, and we do not anticipate that it will qualify for any tax incentives in the future. There is also a risk that Thailand or another jurisdiction in which we operate may treat our Cayman Islands parent as having a permanent establishment in such jurisdiction and subject its income to tax. If we become subject to additional taxes in any jurisdiction or if any jurisdiction begins to treat our Cayman Islands parent as having a permanent establishment, such tax treatment could materially and adversely affect our business, financial condition and operating results.

Certain of our subsidiaries provide products and services to, and may from time to time undertake certain significant transactions with, us and our other subsidiaries in different jurisdictions. For instance, we have intercompany agreements in place that provide for our California and Singapore subsidiaries to provide administrative services for our Cayman Islands parent, and our Cayman Islands parent has entered into manufacturing agreements with our Thai subsidiary. In general, related party transactions and, in particular, related party financing transactions, are subject to close review by tax authorities. Moreover, several jurisdictions in which we operate have tax laws with detailed transfer pricing rules that require all transactions with non-resident related parties to be priced using arm's length pricing principles and require the existence of contemporaneous documentation to support such pricing. International tax authorities could challenge the validity of our related party transfer pricing policies. Such a challenge generally involves a complex area of taxation and a significant degree of judgment by management. If any taxation authorities are successful in challenging our financing or transfer pricing policies, our income tax expense may be adversely affected and we could become subject to interest and penalty charges, which may harm our business, financial condition and operating results.

***We may not be able to obtain capital when desired on favorable terms, if at all, or without dilution to our shareholders.***

We anticipate that our current cash and cash equivalents, together with cash provided by operating activities, funds available through our working capital credit facilities and proceeds that we receive from our insurers for losses we suffered as a result of recent Thai flooding, will be sufficient to meet our current and anticipated needs for general corporate purposes for at least the next 12 months. We operate in a market, however, that makes our prospects difficult to evaluate. It is possible that we may not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs. If this occurs, we may need additional financing to execute on our current or future business strategies.

Furthermore, if we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our shareholders could be significantly diluted, and these newly-issued securities may have rights, preferences or privileges senior to those of existing shareholders. If adequate additional funds are not available or are not available on acceptable terms, if and when needed, our ability to fund our operations, take advantage of unanticipated opportunities, develop or enhance our manufacturing services, hire additional technical and other personnel, or otherwise respond to competitive pressures could be significantly limited.

***Intellectual property infringement claims against our customers or us could harm our business, financial condition and operating results.***

Our services involve the creation and use of intellectual property rights, which subject us to the risk of intellectual property infringement claims from third parties and claims arising from the allocation of intellectual property rights among us and our customers. For example, in December 2008, Fabrinet USA, Inc. was served with a complaint, along with one of our customers, filed by Avago Technologies in the United States District Court for the Northern District of California, San Jose Division (Case No. C08-05394SI), alleging infringement of two patents by certain of our customer's products. On January 28, 2009, Avago Technologies dismissed the complaint against Fabrinet USA, Inc. by filing a notice of voluntary dismissal without prejudice with the United States District Court.

Our customers may require that we indemnify them against the risk of intellectual property infringement arising out of our manufacturing processes. If any claims are brought against us or our customers for such infringement, whether or not these claims have merit, we could be required to expend significant resources in defense of such claims. In the event of an infringement claim, we may be required to spend a significant amount of money to develop non-infringing alternatives or obtain licenses. We may not be successful in developing such alternatives or obtaining such licenses on reasonable terms or at all, which could harm our business, financial condition and operating results.



---

**Table of Contents**

***Any failure to protect our customers' intellectual property that we use in the products we manufacture for them could harm our customer relationships and subject us to liability.***

We focus on manufacturing complex optical products for our customers. These products often contain our customers' intellectual property, including trade secrets and know-how. Our success depends, in part, on our ability to protect our customers' intellectual property. We may maintain separate and secure areas for customer proprietary manufacturing processes and materials and dedicate floor space, equipment, engineers and supply chain management to protect our customers' proprietary drawings, materials and products. The steps we take to protect our customers' intellectual property may not adequately prevent its disclosure or misappropriation. If we fail to protect our customers' intellectual property, our customer relationships could be harmed and we may experience difficulty in establishing new customer relationships. In addition, our customers might pursue legal claims against us for any failure to protect their intellectual property, possibly resulting in harm to our reputation and our business, financial condition and operating results.

***There are inherent uncertainties involved in estimates, judgments and assumptions used in the preparation of financial statements in accordance with U.S. GAAP. Any changes in estimates, judgments and assumptions could have a material adverse effect on our business, financial condition and operating results.***

The preparation of financial statements in accordance with U.S. GAAP involves making estimates, judgments and assumptions that affect reported amounts of assets (including intangible assets), liabilities and related reserves, revenues, expenses and income. Estimates, judgments and assumptions are inherently subject to change in the future, and any such changes could result in corresponding changes to the amounts of assets, liabilities, revenues, expenses and income. Any such changes could have a material adverse effect on our business, financial condition and operating results.

***We are subject to governmental export and import controls in several jurisdictions that could subject us to liability or impair our ability to compete in international markets.***

We are subject to governmental export and import controls in Thailand, the PRC and the U.S. that may limit our business opportunities. Various countries regulate the import of certain technologies and have enacted laws that could limit our ability to export or sell the products we manufacture. The export of certain technologies from the U.S. and other nations to the PRC is barred by applicable export controls, and similar prohibitions could be extended to Thailand, thereby limiting our ability to manufacture certain products. Any change in export or import regulations or related legislation, shift in approach to the enforcement of existing regulations, or change in the countries, persons or technologies targeted by such regulations, could limit our ability to offer our manufacturing services to existing or potential customers, which could harm our business, financial condition and operating results.

***The loan agreements for our long-term debt obligations contain financial ratio covenants that may impair our ability to conduct our business.***

We have loan agreements for our long-term debt obligations, which contain financial ratio covenants that may limit management's discretion with respect to certain business matters. These covenants require us to maintain a specified debt-to-equity ratio and debt service coverage ratio (earnings before interest and depreciation and amortization plus cash on hand minus short-term debt), which may restrict our ability to incur additional indebtedness and limit our ability to use our cash. In the event of our default on these loans or a breach of a covenant, the lenders may immediately cancel the loan agreement, deem the full amount of the outstanding indebtedness immediately due and payable, charge us interest on a monthly basis on the full amount of the outstanding indebtedness and, if we cannot repay all of our outstanding obligations, sell the assets pledged as collateral for the loan in order to fulfill our obligation. We may also be held responsible for any damages and related expenses incurred by the lender as a result of any default. Any failure by us or our subsidiaries to comply with these agreements could harm our business, financial condition and operating results.



---

## **Table of Contents**

### ***Energy price increases may negatively impact our results of operations.***

We, along with our suppliers and customers, rely on various energy sources in our manufacturing and transportation activities. Energy prices have been subject to increases and volatility caused by market fluctuations, supply and demand, currency fluctuation, production and transportation disruption, world events and government regulations. While significant uncertainty currently exists about the future levels of energy prices, a significant increase is possible. Increased energy prices could increase our raw material and transportation costs. In addition, increased transportation costs of our suppliers and customers could be passed along to us. We may not be able to increase our prices enough to offset these increased costs. In addition, any increase in our prices may reduce our future customer orders which could harm our business, financial condition and operating results.

### **Risks Related to Ownership of Our Ordinary Shares**

#### ***Our share price may be volatile due to fluctuations in our operating results and other factors, including the activities and operating results of our customers or competitors, any of which could cause our stock price to decline.***

Our revenues, expenses and results of operations have fluctuated in the past and are likely to do so in the future from quarter to quarter and year to year due to the risk factors described in this section and elsewhere in this Quarterly Report on Form 10-Q. In addition to market and industry factors, the price and trading volume of our ordinary shares may fluctuate in response to a number of events and factors relating to us, our competitors, our customers and the markets we serve, many of which are beyond our control. Factors such as variations in our total revenues, earnings and cash flow, announcements of new investments or acquisitions, changes in our pricing practices or those of our competitors, commencement or outcome of litigation, sales of ordinary shares by us or our principal shareholders, fluctuations in market prices for our services and general market conditions could cause the market price of our ordinary shares to change substantially. Any of these factors may result in large and sudden changes in the volume and price at which our ordinary shares trade. For example, on March 8, 2011, the closing price of our ordinary shares on the NYSE was \$27.10 per share. Following the earnings announcement of one of our customers, the closing price of our ordinary shares fell to \$20.49 per share on March 9, 2011. In addition, from July 8, 2011, following the announcement by Oclaro, Inc. of their delivery of a notice of termination of our volume supply agreement, through July 14, 2011, our share price on the NYSE declined approximately 22%. Among other things, volatility and weakness in our stock price could mean that investors may not be able to sell their shares at or above the prices they paid. Volatility and weakness could also impair our ability in the future to offer our ordinary shares or convertible securities as a source of additional capital and/or as consideration in the acquisition of other businesses.

Furthermore, the stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many companies. These fluctuations often have been unrelated or disproportionate to the operating performance of those companies. These broad market and industry fluctuations, as well as general economic, political and market conditions such as recessions, interest rate changes or international currency fluctuations, may cause the market price of our ordinary shares to decline. In the past, companies that have experienced volatility in the market price of their stock have been subject to securities class action litigation. We may be the target of this type of litigation in the future. Securities litigation against us could result in substantial costs and divert our management's attention from other business concerns, which could seriously harm our business.

#### ***If securities or industry analysts do not publish research or if they publish misleading or unfavorable research about our business, the market price and trading volume of our ordinary shares could decline.***

The trading market for our ordinary shares depends in part on the research and reports that securities or industry analysts publish about us or our business. If securities or industry analysts stop covering us, or if too few analysts cover us, the market price of our ordinary shares would be adversely impacted. If one or more of the analysts who covers us downgrades our ordinary shares or publishes misleading or unfavorable research about our business, our market price would likely decline. If one or more of these analysts ceases coverage of us or fails to publish reports on us regularly, demand for our ordinary shares could decrease, which could cause the market price or trading volume of our ordinary shares to decline.

---

**Table of Contents**

***We may become a passive foreign investment company, which could result in adverse U.S. tax consequences to U.S. investors.***

Based upon the value of our assets, which is determined in part on the trading price of our ordinary shares, we do not expect to be a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for the taxable year 2011 or for the foreseeable future. However, despite our expectations, we cannot assure you that we will not be a PFIC for the taxable year 2011 or any future year because our PFIC status is determined at the end of each year and depends on the composition of our income and assets during such year. If we are a PFIC, our U.S. investors will be subject to increased tax liabilities under U.S. tax laws and regulations and to burdensome reporting requirements.

***We are controlled by a small group of existing shareholders, whose interests may differ from the interests of our other shareholders.***

As of September 30, 2011, our existing shareholders Asia Pacific Growth Fund III, L.P., an affiliate of H&Q Asia Pacific, and Mr. Mitchell, our chief executive officer and chairman of the board of directors, beneficially owned approximately 26.7% and 8.4%, respectively, of our outstanding ordinary shares. In addition, Mr. Mitchell and a representative of H&Q Asia Pacific serve on our board of directors. Accordingly, they have had, and will continue to have, significant influence in determining the outcome of any corporate transaction or other matter submitted to our shareholders for approval, including mergers, consolidations and the sale of all or substantially all of our assets, election of directors and other significant corporate actions. They will also have the power to prevent or cause a change in control. The interests of these shareholders may differ from the interests of our other shareholders.

***Certain provisions in our constitutional documents may discourage our acquisition by a third party, which could limit your opportunity to sell shares at a premium.***

Our constitutional documents include provisions that could limit the ability of others to acquire control of us, modify our structure or cause us to engage in change-of-control transactions, including, among other things, provisions that:

establish a classified board of directors;

prohibit our shareholders from calling meetings or acting by written consent in lieu of a meeting;

limit the ability of our shareholders to propose actions at duly convened meetings; and

authorize our board of directors, without action by our shareholders, to issue preferred shares and additional ordinary shares.

These provisions could have the effect of depriving you of an opportunity to sell your ordinary shares at a premium over prevailing market prices by discouraging third parties from seeking to acquire control of us in a tender offer or similar transaction.

***Our shareholders may face difficulties in protecting their interests because we are organized under Cayman Islands law.***

Our corporate affairs are governed by our amended and restated memorandum and articles of association, by the Companies Law (as amended) of the Cayman Islands and the common law of the Cayman Islands. The rights of our shareholders and the fiduciary responsibilities of our directors under the laws of the Cayman Islands are not as clearly established as under statutes or judicial precedent in existence in jurisdictions in the U.S. Therefore, you may have more difficulty in protecting your interests than would shareholders of a corporation incorporated in a jurisdiction in the U.S., due to the comparatively less developed nature of Cayman Islands law in this area.

While Cayman Islands law allows a dissenting shareholder to express the shareholder's view that a court sanctioned reorganization of a Cayman Islands company would not provide fair value for the shareholder's shares, Cayman Islands statutory law does not specifically provide for shareholder appraisal rights on a merger or consolidation of a company. This may make it more difficult for you to assess the value of any consideration you may receive in a merger or consolidation or to require that the offeror give you additional consideration if you believe the consideration offered is insufficient.

## Edgar Filing: Fabrinet - Form 10-Q

Shareholders of Cayman Islands exempted companies such as our company have no general rights under Cayman Islands law to inspect corporate records and accounts or to obtain copies of lists of shareholders. Our directors have discretion under our amended and restated memorandum and articles of association to determine whether or not, and under what conditions, our corporate records may be inspected by our shareholders, but are not obliged to make them available to our shareholders. This may make it more difficult for you to obtain the information needed to establish any facts necessary for a shareholder motion or to solicit proxies from other shareholders in connection with a proxy contest.

## **Table of Contents**

Subject to limited exceptions, under Cayman Islands law, a minority shareholder may not bring a derivative action against the board of directors. Our Cayman Islands counsel has advised us that they are not aware of any reported class action or derivative action having been brought in a Cayman Islands court.

*Certain judgments obtained against us by our shareholders may not be enforceable.*

We are a Cayman Islands company and substantially all of our assets are located outside of the United States. In addition, many of our directors and officers are nationals and residents of countries other than the United States. A substantial portion of the assets of these persons is located outside of the United States. As a result, it may be difficult to effect service of process within the United States upon these persons. It may also be difficult to enforce in U.S. courts judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us and our officers and directors who are not resident in the United States and the substantial majority of whose assets are located outside of the United States. In addition, there is uncertainty as to whether the courts of the Cayman Islands, Thailand or the PRC would recognize or enforce judgments of U.S. courts against us or such persons predicated upon the civil liability provisions of the securities laws of the United States or any state. In particular, a judgment in a U.S. court would not be recognized and accepted by Thai courts without a re-trial or examination of the merits of the case. In addition, there is uncertainty as to whether such Cayman Islands, Thai or PRC courts would be competent to hear original actions brought in the Cayman Islands, Thailand or the PRC against us or such persons predicated upon the securities laws of the United States or any state.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

### *Sales of Unregistered Securities*

None.

### *Purchases of Equity Securities by the Issuer and Affiliated Purchasers*

None.

## **ITEM 6. EXHIBITS**

The exhibits listed in the accompanying Exhibit Index are filed or incorporated by reference as part of this Quarterly Report on Form 10-Q.

**Table of Contents**

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) 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, on November 9, 2011.

**FABRINET**

By: /s/ MARK J. SCHWARTZ  
Name: **Mark J. Schwartz**  
Title: **Executive Vice President, Chief Financial**

**Officer and Secretary**

**Table of Contents****EXHIBIT INDEX**

| Exhibit Number | Description  | Incorporated by reference herein |             |                 |           |
|----------------|--|----------------------------------|-------------|-----------------|-----------|
|                |  | Form                             | Exhibit No. | Filing Date     | File No.  |
| 10.1           | Facility Agreement, dated May 12, 2011, between TMB Bank Public Company Limited, Fabrinet and Fabrinet Co., Ltd.   | 8-K                              | 10.1        | August 16, 2011 | 001-34755 |
| 10.2           | General Terms and Conditions of Facility, dated May 12, 2011, between TMB Bank Public Company Limited, Fabrinet and Fabrinet Co., Ltd.   | 8-K                              | 10.2        | August 16, 2011 | 001-34755 |
| 10.3           | Confirmation for Cross Currency Swap Transaction, dated May 12, 2011, between TMB Bank Public Company Limited, Fabrinet and Fabrinet Co. Ltd.                                  | 8-K                              | 10.3        | August 16, 2011 | 001-34755 |
| 31.1           | Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002          |                                  |             |                 |           |
| 31.2           | Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002          |                                  |             |                 |           |
| 32.1           | Certifications of Chief Executive Officer and 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.INS*       | XBRL Instance.   |                                  |             |                 |           |
| 101.SCH*       | XBRL Taxonomy Extension Schema.  |                                  |             |                 |           |
| 101.CAL*       | XBRL Taxonomy Extension Calculation Linkbase.  |                                  |             |                 |           |
| 101.DEF*       | XBRL Taxonomy Extension Definition Linkbase.   |                                  |             |                 |           |
| 101.LAB*       | XBRL Taxonomy Extension Label Linkbase.  |                                  |             |                 |           |
| 101.PRE*       | XBRL Taxonomy Extension Presentation Linkbase.   |                                  |             |                 |           |

\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections.