

CREE INC
Form 10-K
August 20, 2008
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended June 29, 2008

or

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

For the transition period from _____ to _____

Commission file number 0-21154

CREE, INC.

(Exact name of registrant as specified in its charter)

North Carolina
(State or other jurisdiction

of incorporation or organization))

4600 Silicon Drive

Durham, North Carolina
(Address of principal executive offices)

56-1572719
(I.R.S. Employer

Identification No.)

27703
(Zip Code)

(919) 313-5300

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

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Title of each class	Name of each exchange on which registered
Common Stock, \$0.00125 par value	The NASDAQ Stock Market LLC
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The aggregate market value of common stock held by non-affiliates of the registrant as of December 30, 2007, the last business day of the registrant's most recently completed second fiscal quarter, was \$2,383,709,350 (based on the closing sale price of \$27.85 per share).

The number of shares of the registrant's Common Stock, \$0.00125 par value per share, outstanding as of August 12, 2008 was 88,097,596.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held October 30, 2008 are incorporated by reference into Part III.

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CREE, INC.

FORM 10-K

For the Fiscal Year Ended June 29, 2008

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Forward-Looking Information

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

PART I

**Item 1. Business
Overview**

Cree, Inc. (Cree, we, our, or us), develops and manufactures semiconductor materials and devices primarily based on silicon carbide (SiC), gallium nitride (GaN) and related compounds. The physical and electronic properties of SiC and GaN offer technical advantages over traditional silicon, gallium arsenide (GaAs), sapphire and other materials used for certain electronic applications. We currently focus our expertise in SiC and GaN on light emitting diode (LED) products, which consist of LED chips, LED components and LED lighting solutions. We also develop power and radio frequency (RF) products, including power switching and RF devices. We have products commercially available in each of these categories.

We derive the majority of our revenue from sales of our LED products. We also generate revenue from sales of SiC and GaN materials, including gemstone materials, and we earn revenue under government contracts that support some of our research and development programs to the extent the contract funding exceeds our direct cost of performing those activities.

History

Cree is a North Carolina Corporation established in 1987. The majority of our products historically have been manufactured at our main production facilities located in North Carolina, in a six-part process, which includes SiC crystal growth, wafering, polishing, epitaxial deposition, fabrication and testing. Additionally, we package certain LED components and power and RF products at our North Carolina facilities, our facility in Huizhou, China and in other foreign countries through the use of subcontractors. We also operate research and development facilities in Goleta, California and Hong Kong.

In fiscal 2005, we operated our business in two reportable segments. In the fourth quarter of fiscal 2005, we announced the closure of the Cree Microwave segment, our silicon-based RF and microwave semiconductor business located in Sunnyvale, California. Effective December 25, 2005, we reported Cree Microwave as a discontinued operation. For further information about this business closure, see Note 4, Discontinued Operations, in our consolidated financial statements included in Item 8 of this Annual Report. As a result of the closure of the Cree Microwave silicon business, we now operate our business in one reportable segment.

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In July 2006, we acquired INTRINSIC Semiconductor Corporation (INTRINSIC), which merged into Cree, Inc. in June 2007. This acquisition enabled us to accelerate the commercialization of low-defect SiC substrates and power devices.

In March 2007, we acquired COTCO Luminant Device Limited (COTCO) (now Cree Hong Kong Limited), which is headquartered in Hong Kong and has production facilities in China. This acquisition provided us a broader LED component portfolio, a lower cost manufacturing facility and expanded our sales distribution channels in China.

In February 2008, we acquired LED Lighting Fixtures, Inc. (LLF) (now Cree LED Lighting Solutions, Inc. or LLS). Through this acquisition we acquired what we believe to be key technologies to drive retrofit solutions to convert existing lighting infrastructure to energy-efficient lighting and to accelerate the adoption of LED lighting into the general illumination market.

For further information concerning our recent acquisitions, see Note 3, Acquisitions, in our consolidated financial statements included in Item 8 of this Annual Report.

Products

We produce LED products, SiC and GaN materials products, and power and RF products using our SiC and GaN materials.

LED Products.

LED revenue includes sales of LED chips, LED components and LED lighting solutions. LED revenue represented 84%, 78% and 81% of revenue from continuing operations for the fiscal years ended June 29, 2008, June 24, 2007 and June 25, 2006, respectively.

LED Chips. Our LED chips include blue and green devices made from GaN and related materials grown on SiC substrates. LED chips or die are solid-state electronic components used in a number of applications, including backlighting for mobile products, automotive interior lighting, full-color electronic displays, gaming equipment, consumer products and other electronic equipment. Some of our customers combine our blue LED chips with phosphors to create white LEDs. Our customers' white LED products are used in various applications for mobile products, including the backlight for full-color display screens, white keypads and the camera flash function. Our customers' white LEDs also are used as a light source for a number of specialized lighting applications. Some of our customers use our blue and green high-brightness LED chips for video screens, gaming displays such as pachinko, and automotive backlighting. LEDs offer several advantages over small incandescent bulbs, including longer life, lower maintenance costs, reduced energy consumption, and smaller space requirements. We have historically sold the majority of our LEDs in chip form to customers who package and sell them in a variety of applications. Our LED chips are currently available in a variety of brightness levels, wavelengths (color) and sizes.

LED Components. Our LED components include a range of packaged LED products from our XLamp® LED components for lighting applications to our high-brightness LED components consisting of surface mount (SMD) and through-hole LED products for signage, gaming and other applications.

Our XLamp LED components are high power or lighting class packaged LED products designed to meet a broad range of market needs for lighting applications including general illumination (both indoor and outdoor applications), portable, architectural, signal and transportation lighting.

Our high-brightness LED components consist of SMD and through-hole packaged LED products. Our SMD LED component products are available in a full range of colors designed to meet a broad range of market needs,

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including automotive, signage, gaming and specialty lighting. Our through-hole packaged LED component products provide users with a color and brightness consistency across a wide viewing area. These products are available in a full range of colors primarily designed for the signage and amusement markets.

LED Lighting Solutions. Our LED lighting solutions currently include the LR6, a six-inch architectural recessed LED down light, and the LR4, a four-inch architectural recessed LED down light. These lighting products are targeted for new construction, retrofit and renovation projects in residential and commercial applications.

Materials Products

Our materials products consist of SiC and GaN wafer and epitaxy products, as well as bulk SiC materials used for gemstone applications. Materials product revenue represented 6%, 10% and 9% of revenue from continuing operations for the fiscal years ended June 29, 2008, June 24, 2007 and June 25, 2006, respectively.

SiC Wafers. We manufacture SiC wafers for sale to corporate customers who use the wafers to manufacture products for optoelectronic, microwave and power switching applications. Corporate, government and university customers also buy SiC materials for research and development directed at optoelectronic, microwave and high power devices. We sell our wafers as a bare wafer or a customized wafer with epitaxial films of SiC or GaN materials. We currently sell two-inch, three-inch and four-inch wafers and are continuing to develop SiC wafers that are larger and of higher quality.

Bulk Materials Used for Gemstones. We manufacture SiC crystals in near colorless form for use in gemstone applications. Single crystalline SiC has characteristics that are similar to diamond, including properties relating to color, hardness and brilliance. We sell SiC in bulk crystal form exclusively to Charles & Colvard, Ltd. (Charles & Colvard). Charles & Colvard produces and markets gemstone products made from SiC crystals.

Power and RF Products

These products include SiC power devices and RF devices. Revenue from our power and RF products have represented 4% of our revenues from continuing operations for the fiscal years ended June 29, 2008, June 24, 2007 and June 25, 2006.

Power Devices. SiC-based power devices operate at significantly higher breakdown voltages than silicon-based power devices and provide faster switching speeds than comparable silicon-based power devices at similar breakdown voltages. These attributes create a lower switching loss, which yields power savings due to higher efficiency, enabling smaller and more efficient systems. Our current SiC-based power products include 300, 600 and 1,200-volt Schottky diodes. Our customers currently purchase Schottky diode products for use in power factor correction circuits for power supplies in computer servers and other applications such as solar inverters. We are developing additional SiC-based power devices that could have a number of potential uses in applications for power conditioning, solar inverters and power switching in power supplies and motor control applications.

RF Devices. RF devices made from SiC or GaN operate at higher voltages that allow for higher power densities as compared to silicon or GaAs-based devices. Additionally, this characteristic allows SiC-based and GaN-based devices to be significantly smaller while carrying the same or greater power level than silicon-based or GaAs-based devices. At this time, there is a higher cost associated with SiC and GaN than silicon for RF transistors. We currently offer 10-watt and 60-watt SiC transistors, or metal-semiconductor field effect transistor (MESFET) products, as well as a variety of GaN high electron mobility transistors (HEMTs) and monolithic microwave integrated circuits (MMICs), which are optimized for either broadband amplifiers or for WiMAX applications.

We also provide foundry services for wide bandgap MMICs. These RF circuits can be used in a variety of wide bandwidth communications applications, high-power radar amplifiers, electronic warfare and wireless infrastructure. The MMIC foundry service allows a customer to design its own custom RF circuit to be fabricated in our MMIC foundry, or have us provide custom MMIC design for the customer and fabricate the chips.

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Financial Information About Geographic Areas of Customers and Assets

We derive our product revenue primarily from international sales and contract revenue from agencies of the U.S. Government. For information concerning geographical areas of our customers and geographic information concerning our long-lived assets, please see Note 16, Geographic Segment Information, in our consolidated financial statements included in Item 8 of this Annual Report. International operations expose us to risks that are different from operating in the United States, including foreign currency translation and transaction risk, risk of changes in tax laws, application of import/export laws and regulations and other risks described further in Item 1A Risk Factors of this Annual Report.

Government Contract Funding

We derive a portion of our revenue from funding that we receive pursuant to research contracts or subcontracts funded by various agencies of the U.S. Government. We had 33, 21 and 26 government contracts in effect during the fiscal years ended June 29, 2008, June 24, 2007 and June 25, 2006, respectively, which represented 6%, 7% and 6% of revenue from continuing operations, respectively.

The revenue that we recognize pursuant to these contracts represents reimbursement by various U.S. Government entities that aid in the development of new technology. The applicable contracts generally provide that we may elect to retain ownership of inventions made in performing the work subject to a non-exclusive license retained by the U.S. Government to use the inventions for government purposes. Our government contracts typically cover work performed anywhere from several months or up to five years and require us to conduct the research effort described in the statement of work section of the contract. These contracts may be modified or terminated at the discretion of the government and typically are subject to appropriation and allocation of the required funding on an annual basis. For further information about our government contracts, see Note 2, Basis of Presentation and Summary of Significant Accounting Policies, in our consolidated financial statements included in Item 8 of this Annual Report.

Research and Development

We invest significant resources in research and development aimed at improving our semiconductor materials, production technology and developing new LED components and lighting systems. Our core materials research is directed at improving the quality and diameter of our SiC and GaN substrates. We are also working to improve the quality and attributes of the SiC and nitride epitaxial materials we grow to produce devices and to improve device yields by reducing variability in our processes. These efforts are in addition to ongoing projects focused on brighter LED chips, new and improved LED components, three-inch and four-inch LED wafer process development, new LED lighting solutions, higher power diodes/switches and higher power/higher linearity RF devices. We recorded \$58.8 million in fiscal 2008, \$58.8 million in fiscal 2007 and \$54.9 million in fiscal 2006 for direct expenditures relating to research and development activities from continuing operations. When customers participate in funding our research and development programs, we record the amount funded as a reduction of research and development expenses. For further information about our treatment of research and development, see Note 2, Basis of Presentation and Summary of Significant Accounting Policies, in our consolidated financial statements included in Item 8 of this Annual Report.

Sales and Marketing

We have traditionally marketed and sold our products to a relatively small group of customers through targeted selling, promotions, select advertising and attendance at trade shows. However, we continue to make significant investments to expand our global sales, marketing and distribution capabilities. Most notably, we are sponsoring and participating in several initiatives to enable and further support the adoption of LED lighting. These include our LED City[®], LED Workplace and LED University programs.

LED City. Our LED City program is an international initiative to promote the deployment of energy-efficient LED lighting to municipal infrastructure. Our partners include an expanding community of government and industry parties who are working to promote and utilize LED lighting technology across their infrastructure.

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Current partners include domestic cities such as Raleigh, NC, Austin, TX, Ann Arbor, MI and Anchorage, AK. International partners include the cities of Toronto, Canada, Torraca, Italy, and Tianjin, China, which is China's third largest city.

LED Workplace. Our LED Workplace program is an initiative to promote LED lighting as an energy-efficient, low-maintenance solution for offices and other workplaces. We were the first participant to join the initiative and are in the process of converting our Durham facilities entirely to LED lighting.

LED University. Our LED University program is an international community of universities working to accelerate the adoption of energy-efficient LEDs. Current partnering universities include North Carolina State University, Marquette University, University of Arkansas, University of California at Santa Barbara and Tianjin Polytechnic University (China).

Our direct sales and marketing team is headquartered in our Durham, North Carolina facility, with local sales offices in Shanghai and Shenzhen, China; Hong Kong; Tokyo, Japan; and Munich, Germany. We also have sales personnel in England, Italy, Korea, Malaysia, Singapore, Sweden and Taiwan. We plan to continue expanding our sales and marketing efforts globally to support our new product lines and promote the adoption of LED lighting.

Customers

We have historically had a few key customers who have represented more than 10% of our consolidated revenues. In fiscal 2008, revenues from sales to Sumitomo Corporation represented 13% and revenues from sales to Seoul Semiconductor Co., Ltd represented 13% of our total consolidated revenue. For further discussion regarding customer concentration, please see Note 13, Concentrations of Credit Risk, in our consolidated financial statements included in Item 8 of this Annual Report. The loss of any large customer could have a material adverse effect on our business and results of operations.

Seasonality

Sales of our products can be subject to seasonal fluctuations and variations in customer demand. If anticipated sales or shipments do not occur when expected, our results of operations for that quarter, and potentially for future quarters, may be adversely affected.

Backlog

As of June 29, 2008, we had a backlog of approximately \$89.3 million, consisting of approximately \$70.3 million of product orders and \$19.0 million under research contracts signed with the U.S. Government, for which approximately \$6.4 million of the contracted funds have not yet been appropriated. We estimate our entire backlog could be filled during fiscal 2009, with the exception of approximately \$5.0 million in U.S. Government funded contracts.

As of June 24, 2007, we had a backlog of approximately \$69.8 million, consisting of approximately \$33.2 million of product orders and \$36.6 million under research contracts signed with the U.S. Government, for which approximately \$19.0 million of the contracted funds had not yet been appropriated.

Our backlog could be adversely affected if our customers fail to honor their purchase commitments, reduce or cancel orders, or if the U.S. Government exercises its rights to terminate our government contracts or does not appropriate and allocate all of the funding contemplated by the contracts.

Sources of Raw Materials

We depend on a limited number of suppliers for certain raw materials, components and equipment used in our products, including certain key materials and equipment used in our crystal growth, wafering, polishing,

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epitaxial deposition, device fabrication and device assembly processes. We generally purchase these limited source items pursuant to purchase orders and have limited guaranteed supply arrangements with our suppliers. We believe our current supply of essential materials is sufficient to meet our needs. However, shortages have occurred from time to time and could occur again.

Competition

Our success depends on our ability to keep pace with the evolving technology standards of the industries we serve. These industries are characterized by rapid technological change, frequent introduction of new products, short product life cycles and changes in end user and customer requirements in a competitive pricing environment. The evolving nature of these industries may render our existing or future products obsolete, noncompetitive or unmarketable. Any of these developments could have an adverse effect on our business, results of operations and financial condition.

LED Products

LED Chips. The primary competition for our LED chips comes from companies that manufacture and/or sell nitride-based LED chips. We consider Nichia Corporation (Nichia), which sells packaged LEDs and most often competes directly with our chip customers, to be a competitor. Nichia currently sells the majority of its packaged LED products to markets requiring white LEDs, which Nichia fabricates combining its phosphor solution with blue LED chips. We believe, based on industry information, that Nichia currently has the largest market share for nitride-based LEDs.

Many Asia-based chip producers also produce blue, green and white LED products, such as Toyoda Gosei Co., Ltd. (Toyoda Gosei) and Epistar Corporation. They traditionally have been successful in securing new business, primarily in Asia, for blue keypad applications in mobile products and other cost sensitive applications. Some of these Asia-based competitors offer chips with brightness similar to some of our existing high-brightness products and have made some inroads into higher end applications like camera flash units.

Overall, we believe that price, performance and strength of intellectual property protection position are the most significant factors to compete successfully in the nitride LED market. We believe our products are well positioned to meet the market performance requirements; however, there is significant pricing pressure from a number of competitors. We continually strive to improve our competitive position by developing brighter and higher performance LED chips and focusing on lowering costs.

LED Components. The market for high power or lighting class LED components is concentrated primarily in the specialty lighting area, including portable torch lamps (flashlights); color changing and white architectural lighting; traffic signs and signals; interior and exterior automotive and truck lighting; and emergency vehicle lighting (for example, for fire and rescue vehicles). Philips Lumileds Lighting Company, LLC (Philips) is one of our main competitors in this market. Philips sells high power LED components that compete indirectly with our target customers for LED chips and compete directly with our XLamp LED components. Several other companies have products designed to compete with our XLamp LED components, including Avago Technologies Limited, Edison Opto Corporation, Kingbright Corporation, Nichia, OSRAM Semiconductor GmbH, Toyoda Gosei and Seoul Semiconductor Co., Ltd. We are positioning our XLamp LED components to compete in this market based on price, performance and usability.

Our high-brightness LED components compete with a larger number of competitors around the world in a variety of applications including automotive, signage, gaming and specialty lighting. We are positioning our high brightness LED components to compete in this market based on price, performance, availability and usability.

LED Lighting Solutions. Our competition for LED lighting fixtures is currently very limited and fragmented as the market is in its early stages of development. However, this will likely change as the technology continues to develop. Our LED lighting solutions products also compete with traditional lighting technologies such as incandescent and fluorescent lamp fixtures.

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Materials Products

We have continued to maintain our well-established quality and volume leadership position in the sale of SiC and GaN wafer and epitaxy products, as well as bulk SiC materials used for gemstone applications. We have seen limited competition in this market, although other companies continue to announce advancements and seek to become more competitive with us.

Power and RF Products

Power Devices. Our SiC-based power devices compete with similar devices offered by Infineon Technologies AG. There are also a number of other companies developing SiC-based power devices. In addition, our products compete with existing silicon-based power devices offered by a variety of manufacturers.

RF Devices. Currently, Eudyna Devices, Inc. is the main company offering products that compete directly with our SiC MESFET and GaN HEMT products, although several other companies such as RF Micro Devices Inc., Nitronex Corporation and Triquint Corporation have announced products for this market. Our products also face heavy competition from existing silicon and GaAs-based products.

Patents and Other Intellectual Property Rights

We believe it is important to protect our investment in technology by obtaining and enforcing intellectual property rights, including rights under patent, trademark, trade secret and copyright laws. We seek to protect inventions we consider significant by applying for patents in the United States and other countries when appropriate. We have also acquired, through license grants and assignments, rights to patents on inventions originally developed by others. As of June 29, 2008, we owned or held exclusive rights under 423 issued U.S. patents with expiration dates extending to 2026, as well as corresponding foreign patent rights. For proprietary technology that is not patented, we generally seek to protect the technology and related know-how and information as trade secrets. We also own other intellectual property rights, including trademark registrations in several countries for trademarks used in conjunction with our products.

Licensing activities and lawsuits to enforce intellectual property rights, particularly patent rights, are a common feature of the semiconductor industry. We both make and receive inquiries regarding possible patent infringements in the normal course of business. Depending on the circumstances, we may seek to negotiate a license or other acceptable resolution, including entering into cross-licensing arrangements with others, some of whom may be our competitors. If we are unable to achieve a resolution by agreement, we may seek to enforce our rights or defend our position through litigation. Patent litigation is expensive and the outcome is often uncertain. We believe that the strength of our portfolio of patent rights is important in helping us resolve or avoid such disputes with other companies in our industry. In addition, we believe that many customers ascribe additional value to our LEDs as a result of our portfolio, particularly for high-end products destined for the United States, as compared to LEDs from manufacturers who are not licensed under the relevant patents in the portfolio. We believe our ongoing efforts to enforce our patent rights against infringers are essential to sustaining this higher perceived value.

Environmental Regulation

We are subject to a variety of federal, state and local provisions regulating the discharge of materials into the environment or otherwise relating to the protection of the environment. These include statutory and regulatory provisions under which we are responsible for the management of hazardous materials we use and the disposition of hazardous wastes resulting from our manufacturing processes. Failure to comply with such provisions, whether intentional or inadvertent, could result in fines and other liabilities to the government or third parties, injunctions requiring us to suspend or curtail operations or other remedies, and could have a material adverse effect on our business.

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Working Capital

For a discussion of our working capital practices, see [Liquidity and Capital Resources](#) in Item 7 of this Annual Report.

Employees

As of June 29, 2008, we employed 3,168 regular full and part-time employees. We also employ individuals on a temporary full-time basis and use the services of contractors as necessary. Certain of our employees in various countries outside of the United States are subject to laws providing representation rights to these employees. We consider relations with our employees to be good.

Available Information

Our website address is www.cree.com. We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission (SEC). These reports may be accessed from our website by following the links under [Investor Relations](#), then [SEC Filings](#). The information found on our website is not part of this or any other report we file with or furnish to the SEC. We assume no obligation to update or revise any forward-looking statements in this Annual Report or in other reports filed with the SEC, whether as a result of new information, future events or otherwise, unless we are required to do so by law. A copy of this Annual Report and our other reports is available without charge upon written request to Investor Relations, Cree, Inc., 4600 Silicon Drive, Durham, North Carolina 27703.

Item 1A. Risk Factors

Described below are various risks and uncertainties that may affect our business. These risks and uncertainties are not the only ones we face. Additional risks and uncertainties, both known and unknown, including ones that we currently deem immaterial or that are similar to those faced by other companies in our industry or business in general, may also affect our business. If any of the risks described below actually occur, our business, financial condition or results of operations could be materially and adversely affected.

Our operating results and margins may fluctuate significantly.

We have experienced significant fluctuation in our revenue, earnings and margins over the past few years, and we may experience significant fluctuations in our revenue, earnings and margins in the future. Historically, the prices of our LEDs have declined based on market trends. We attempt to maintain our margins by constantly developing improved or new products, which provide greater value and result in higher prices, or by lowering the cost of our LEDs. If we are unable to do so, our margins will decline. Our operating results and margins may vary significantly in the future due to many factors, including the following:

average sales prices for our products declining at a greater rate than anticipated;

fluctuations in foreign currency as more of our revenue may be in non-U.S. currencies;

our ability to develop, manufacture and deliver products in a timely and cost-effective manner;

variations in the amount of usable product produced during manufacturing (our yield);

our ability to improve yields and reduce costs in order to allow lower product pricing without margin reductions;

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our increased reliance on and our ability to ramp up capacity at our factories and our subcontractors;

our ability to ramp up production of our new products;

our ability to convert our substrates used in our volume manufacturing to larger diameters;

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our ability to produce higher brightness and more efficient LED products that satisfy customer design requirements;

our ability to continue improving our current products and develop new products to specifications that meet the evolving needs of our customers;

changes in demand for our products and our customers' products that may cause fluctuations in revenue and possible inventory obsolescence;

raw material price fluctuations, including certain commodities consumed in our production process;

effects of an economic slow down on both consumer and non-consumer spending on products that incorporate our products;

changes in the competitive landscape, such as inventions of new technology, availability of higher brightness LED products, higher volume production and lower pricing from competitors;

changes in the mix of products we sell, which may vary significantly;

product returns or exchanges due to quality-related matters or improper use of our products;

changes in purchase commitments permitted under our contracts with large customers;

changes in production capacity and variations in the utilization of that capacity;

disruptions of manufacturing that could result from fire, flood, drought or other disasters, particularly in the case of our single site for SiC wafer and LED production or disruptions from some of our sole source vendors;

changes in legislation, regulations, or tax or accounting rules or changes in their interpretation; and

changes in the amount of litigation costs we incur to protect our intellectual property rights.

These or other factors could adversely affect our future operating results and margins. If our future operating results or margins are below the expectations of stock market analysts or our investors, our stock price will likely decline.

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

From time to time we evaluate strategic opportunities available to us for product, technology or business acquisitions. For example, in July 2006 we acquired INTRINSIC, in March 2007 we acquired COTCO, and in February 2008 we acquired LLF. If we choose to make acquisitions, we face certain risks, such as failure of the acquired business to meet our performance expectations, diversion of management attention, retention of existing customers of our current and acquired business, and difficulty in integrating the acquired business's operations, personnel and financial and operating systems into our current business. We may not be able to successfully address these risks or any other problems that arise from our recent or future acquisitions. Any failure to successfully evaluate strategic opportunities and address risks or other problems that arise related to any acquisition could adversely affect our business, results of operations and financial condition.

If we are unable to effectively expand the distribution channels for our component products, our operating results may suffer.

We have expanded into new business channels that are different from those that we have historically operated in as we grow our business and sell more LED components versus LED chips. If we are unable to penetrate these new distribution channels to ensure our products are reaching the appropriate customer base, our financial results may be impacted. In addition, if we successfully penetrate these new distribution channels, we cannot guarantee that customers will accept our components or that we will be able to manufacture and deliver them in the timeline established by our customers.

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Our LED revenues are highly dependent on our customers' ability to produce and sell more integrated products using our LED products.

Because our customers integrate our LED products into the products that they market and sell, our LED revenues depend on getting our LED products designed into a larger number of our customers' products and our customers' ability to sell those products. For example, some of our current customers, as well as prospective customers, create white LED components using our blue LEDs, in combination with phosphors. Sales of blue LED chips are highly dependent upon our customers' ability to procure efficient phosphors, develop high quality and highly efficient white LED components and gain access to the necessary intellectual property rights. Even if our customers are able to develop competitive white LED components using our blue LED chips, there can be no assurance that our customers will be successful in the marketplace. We also have current and prospective customers that create lighting systems using our LED components. Sales of LED components for these applications are highly dependent upon our customers' ability to develop high quality and highly efficient lighting products, including thermal design, optical design and power conversion. The lighting industry has traditionally not had this level of technical expertise for LED related designs, which may limit the success of our customers' products. Even if our customers are able to develop efficient systems, there can be no assurance that our customers will be successful in the marketplace.

As a result of our entry into and continued expansion in new markets, such as packaged LEDs and LED lighting fixtures, our traditional customers may reduce orders.

Through acquisitions and organic growth, we have moved into and continue to expand in new markets, such as packaged LEDs and LED lighting fixtures, where some of our current customers may now perceive us as a competitor. In response, our customers may reduce their orders for our products. This reduction in orders could occur faster than our sales growth in these new markets, which could adversely affect our business, results of operations and financial condition.

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

Our future success may depend on our ability to develop new and lower cost solutions for existing and new markets and for customers to accept those solutions. We must introduce new products in a timely and cost-effective manner, and we must secure production orders for those products from our customers. The development of new products is a highly complex process, and we historically have experienced delays in completing the development and introduction of new products. The successful development and introduction of these products depends on a number of factors, including the following:

achievement of technology breakthroughs required to make commercially viable devices;

the accuracy of our predictions of market requirements and evolving standards;

acceptance of our new product designs;

acceptance of new technology in certain markets;

the availability of qualified research and development personnel;

our timely completion of product designs and development;

our ability to expand sales and influence key customers to adopt our products;

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our ability to develop repeatable processes to manufacture new products in sufficient quantities and at low enough costs for commercial sales;

our customers' ability to develop competitive products incorporating our products; and

acceptance of our customers' products by the market.

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

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We face significant challenges managing our growth.

We have experienced a period of significant growth over the past few years that may challenge our management and other resources. We are also in the process of transforming our business to support a global components customer base. In order to manage our growth and change in our strategy effectively, we must continue to:

expand global sales, marketing and distribution;

implement and improve operating and information technology systems;

maintain adequate manufacturing facilities and equipment to meet customer demand;

maintain a sufficient supply of raw materials to support our growth;

expand the skills and capabilities of our current management team;

add experienced senior level managers;

attract and retain qualified people with experience in engineering, design, sales and marketing; and

recruit and retain qualified manufacturing employees.

We expect to spend substantial amounts of money in supporting our growth and may have additional unexpected costs. We may not be able to expand quickly enough to exploit potential market opportunities. Our future operating results will also depend on expanding sales and marketing, research and development and administrative functions to support a global components customer base. If we cannot attract qualified people or manage growth and change effectively, our business, results of operations and financial condition could be adversely affected.

Litigation could adversely affect our operating results and financial condition.

We are defendants in pending litigation as described in Note 12, Commitments and Contingencies, in our consolidated financial statements included in Item 8 of this Annual Report that alleges, among other things, patent infringement. Defending against existing and potential litigation will likely require significant attention and resources and, regardless of the outcome, result in significant legal expenses, which will adversely affect our results unless covered by insurance or recovered from third parties. If our defenses are ultimately unsuccessful, or if we are unable to achieve a favorable resolution, we could be liable for damage awards that could materially adversely affect our results of operations and financial condition.

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

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

pay substantial damages;

indemnify our customers;

stop the manufacture, use and sale of products found to be infringing;

incur asset impairment charges;

discontinue the use of processes found to be infringing;

expend significant resources to develop non-infringing products and processes; and/or

obtain a license to use third party technology.

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There can be no assurance that third parties will not attempt to assert infringement claims against us, or our customers, with respect to our products. In addition, our customers may face infringement claims directed to the customer's products that incorporate our products, and an adverse result could impair the customer's demand for our products. We have also promised certain of our customers that we will indemnify them in the event they are sued by our competitors for infringement claims directed to the products we supply. Under this indemnification obligation we may be responsible for future payments to resolve infringement claims against them. From time to time we receive correspondence asserting that our products or processes are or may be infringing patents or other intellectual property rights of others. Our practice is to investigate such claims to determine whether the assertions have merit and, if so, we take appropriate steps to seek to obtain a license or to avoid the infringement. However, we cannot predict whether a license will be available or that we would find the terms of any license offered acceptable or commercially reasonable. Failure to obtain a necessary license could cause us to incur substantial liabilities and costs and to suspend the manufacture of products.

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

Our intellectual property position is based in part on patents owned by us and patents exclusively licensed to us by North Carolina State University, Boston University and others. The licensed patents include patents relating to the SiC crystal growth process that is central to our SiC materials and device business. We intend to continue to file patent applications in the future, where appropriate, and to pursue such applications with U.S. and foreign patent authorities.

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

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

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

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

As a result of acquisitions and organic growth, we have operations, manufacturing facilities and subcontract arrangements in foreign countries, which expose us to certain risks, including the following:

foreign exchange fluctuations, as we conduct operations and have sales denominated in non-U.S. currencies;

protection of intellectual property and trade secrets;

tariffs and other barriers;

timing and availability of export licenses;

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rising labor costs;

disruptions in the infrastructure of the foreign countries where we operate;

difficulties in accounts receivable collections;

difficulties in staffing and managing distant international operations;

the burden of complying with foreign and international laws and treaties; and

the burden of complying with and changes in international taxation policies.

In some instances, we have been provided and may continue to receive incentives from foreign governments to encourage our investment in certain countries, regions, or areas. In particular, we have received and may continue to receive such incentives in connection with our operations in China, as the Chinese national and local governments seek to encourage the development of the technology industry in China. Government incentives may include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to us due to our foreign operations. Any of these incentives could be reduced or eliminated by governmental authorities at any time. Any reduction or elimination of incentives currently provided to our operations could adversely affect our business and results of operations.

We are subject to risks related to international sales.

We expect that revenue from international sales will continue to represent the majority of our total revenue. International sales are subject to a variety of risks, including risks arising from currency fluctuations, tariffs, trade barriers, collection issues and taxes. Our international sales are subject to variability as prices become less competitive in countries with currencies that are low or are declining in value against the U.S. Dollar and more competitive in countries with currencies that are high or increasing in value against the U.S. Dollar. In addition, international sales are subject to numerous U.S. and foreign laws and regulations, including, without limitation, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and in the extreme case, we could be suspended or debarred from government contracts or our export privileges could be suspended, which could have a material adverse effect on our business.

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

As customer demand for our products, particularly new products, changes, we must be able to ramp up or adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase our capacity or if we increase our capacity too quickly, our business and results of operations could be adversely impacted. If we experience delays or unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets.

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

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

variability in our process repeatability and control;

contamination of the manufacturing environment;

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equipment failure, power outages or variations in the manufacturing process;

lack of consistency and adequate quality and quantity of piece parts and other raw materials;

losses from broken wafers or human errors;

defects in packaging either within our control or at our subcontractors; and

any transitions or changes in our production process, planned or unplanned.

If our yields decrease, our costs could increase, our margins could decline and our operating results would be adversely affected. In the past, we have experienced difficulties in achieving acceptable yields on new products, which has adversely affected our operating results. We may experience similar problems in the future, and we cannot predict when they may occur or their severity. In some instances, we may offer products for future delivery at prices based on planned yield improvements. Reduced yields or failure to achieve planned yield improvements could continue to significantly affect our margins and operating results.

We rely on a few key sole source and limited source suppliers.

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

We generally purchase these sole or limited source items with purchase orders, and we have limited guaranteed supply arrangements with such suppliers. We do not control the time and resources that these suppliers devote to our business, and we cannot be sure that these suppliers will perform their obligations to us. In the past, we have experienced decreases in our production yields when suppliers have varied from previously agreed upon specifications that have impacted our cost of sales.

Any delay in product delivery or other interruption or variation in supply from these suppliers could prevent us from meeting commercial demand for our products. If we were to lose key suppliers, our key suppliers were unable to support our demand or we were unable to identify and qualify alternative suppliers, our manufacturing operations could be interrupted or hampered significantly.

The markets in which we operate are highly competitive and have evolving technology standards.

The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture or sell nitride-based LED chips as well as those that sell packaged LEDs. Competitors are offering new blue, green and white LEDs with aggressive prices and improved performance. These competitors may reduce average sales prices faster than our cost reduction, and competitive pricing pressures may accelerate the rate of decline of our average sales prices. The market for SiC wafers is also becoming competitive as other firms in recent years have begun offering SiC wafer products or announced plans to do so.

Competition is increasing. In order to achieve our revenue growth objectives in fiscal 2009 and beyond, we need to continue to develop new products that enable our customers to win new designs and increase market share in key areas such as mobile products and general lighting class applications. One major supplier dominates the market in which products incorporating our LED chip products compete and we anticipate that the increased competition for these designs will result in pressure to lower sales prices of our products. Therefore, our ability to provide higher performance LEDs at lower costs will be critical to our success. Competitors may also try to align with some of our strategic customers. This could mean lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Competitors also could invent new technologies that may make our products obsolete. Any of these developments could have an adverse effect on our business, results of operations and financial condition.

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If government agencies discontinue or curtail their funding for our research and development programs, our business may suffer.

Changes in federal budget priorities could adversely affect our contract revenue. Historically, government agencies have funded a significant portion of our research and development activities. When the government changes budget priorities, such as in times of war, our funding has the risk of being redirected to other programs. Government contracts are also subject to the risk that the government agency may not appropriate and allocate all funding contemplated by the contract. In addition, our government contracts generally permit the contracting authority to terminate the contracts for the convenience of the government. The full value of the contracts would not be realized if they were prematurely terminated. Furthermore, we may be unable to incur sufficient allowable costs to generate the full estimated contract values and there is some risk that any technologies developed under these contracts may not have commercial value. If government funding is discontinued or reduced, our ability to develop or enhance products could be limited, and our business, results of operations and financial condition could be adversely affected.

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

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

regulatory penalties, fines and legal liabilities;

suspension of production;

alteration of our fabrication and assembly and test processes; and

curtailment of our operations or sales.

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

If our products fail to perform or meet customer requirements, we could incur significant additional costs.

The manufacture of our products involves highly complex processes. Our customers specify quality, performance and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment. We have experienced product quality, performance or reliability problems from time to time. Defects or failures may occur in the future. If failures or defects occur, we could:

lose revenue;

incur increased costs, such as warranty expense and costs associated with customer support;

experience delays, cancellations or rescheduling of orders for our products;

write down existing inventory; or

experience product returns.

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

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

changes in tax laws or interpretation of such tax laws and changes in generally accepted accounting principles;

the jurisdiction in which profits are determined to be earned and taxed;

the resolution of issues arising from tax audits with various authorities;

changes in the valuation of our deferred tax assets and liabilities;

adjustments to estimated taxes upon finalization of various tax returns;

increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairment of goodwill in connection with acquisitions;

changes in available tax credits;

changes in share-based compensation expense; and

the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes.

Any significant increase in our future effective tax rates could adversely impact net income for future periods. In addition, the determination of our income tax provision requires significant judgment. To the extent our income tax liability materially differs from our income tax provisions and accruals due to factors, including the above, that were not anticipated at the time we estimated our tax provision, our net income or cash flows could be adversely affected.

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

In order to compete, we must attract, retain and motivate executives and other key employees, including those in managerial, technical, sales, marketing and support positions. We generally do not have long-term employment agreements or other arrangements with our employees that would deter them from leaving. Hiring and retaining qualified executives, scientists, engineers, technical staff and sales personnel are critical to our business, and competition for experienced employees in our industry can be intense. To help attract, retain and motivate key employees, we use share-based incentive awards such as employee stock options and restricted stock. If the value of such stock awards does not appreciate as measured by the performance of the price of our common stock or if our share-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain and motivate employees could be weakened, which could harm our business and results of operations.

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

We are exposed to market value and interest rate risk related to our investment portfolio. We have historically invested portions of our available cash in fixed interest rate securities such as high-grade corporate debt, commercial paper, government securities and other fixed interest rate investments. The primary objective of our investments is to preserve principal while maximizing yields. Although we only acquire investments

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rated A grade or better in accordance with our cash management policy, declines in the underlying interest rates will have a negative impact on the income generated from our investments, which could materially adversely affect our results of operations.

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Fluctuations in foreign currency exchange rates may affect our operating results as costs of operating certain of our foreign subsidiaries are incurred in other currencies.

We conduct business in countries outside the United States, which exposes us to fluctuations in foreign currency exchange rates. In addition, our financial statements are presented in U.S. Dollars, which requires that results of these foreign operations be translated at average exchange rates into U.S. Dollars for financial reporting purposes. As a result, fluctuations in exchange rates may affect our expenses and results of operations as well as the value of our assets and liabilities. We have not entered into any foreign currency derivative financial instruments; however, we may choose to do so in the future in an effort to manage or hedge our foreign exchange rate risk.

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

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

Our business may be adversely affected by our, or our customers', ability to access the capital markets.

Although we believe we have adequate liquidity and capital resources to fund our operations internally, in light of current market conditions, our inability or the inability of our customers to access the capital markets, on favorable terms or at all, may adversely affect our financial performance. The inability to obtain adequate financing from debt or capital sources could force us to self-fund strategic initiatives or even forgo certain opportunities, potentially harming our performance. Additionally, the inability of our customers to access capital efficiently could cause disruptions in their businesses, thereby negatively impacting ours.

Catastrophic events or geo-political conditions may disrupt our business.

A disruption or failure of our systems or operations in the event of a major earthquake, weather event, cyber-attack, terrorist attack or other catastrophic event could cause delays in completing sales or performing other mission-critical functions. A catastrophic event that results in the destruction or disruption to our supply chain or any of our critical business or information technology systems could severely affect our ability to conduct normal business operations and, as a result, our operating results could be adversely affected. Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could result in an adverse effect on our business and results of operations.

Our results of operations could vary as a result of the methods, estimates and judgments that we use in applying our accounting policies.

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results of operations (see "Critical Accounting Policies and Estimates" in Item 7 of this Annual Report). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations.

Table of Contents**Item 1B. Unresolved Staff Comments**

Not applicable.

Item 2. Properties

The table below sets forth information with respect to our significant owned and leased facilities as of June 29, 2008. The sizes of the locations represent the approximate gross square footage of each site's building.

Location	Size (approximate square footage)				
	Total	Production	Facility Services and Warehousing	Administrative Function	Housing / Other
Owned Facilities					
Durham, NC	689,000	469,000	106,000	114,000	
Research Triangle Park, NC	147,500	57,000	56,000	34,500	
Total Owned	836,500	526,000	162,000	148,500	
Leased Facilities					
Hong Kong	10,500			10,500	
Huizhou, China	183,600	113,000	19,000	38,000	13,600
Shanghai, China	50,700		16,100	34,600	
Durham, NC	15,700			15,700	
Goleta, CA	36,000			36,000	
Sunnyvale, CA	50,000				50,000
Misc. sales and support offices	15,600		3,300	12,300	
Total Leased	362,100	113,000	38,400	147,100	63,600
Total	1,198,600	639,000	200,400	295,600	63,600

In the United States, our corporate headquarters as well as our primary manufacturing operations are located at our Durham, North Carolina facility. This facility sits on approximately 48 acres of developed land that we own. We also own approximately 80 acres of undeveloped land near this site.

We are increasingly manufacturing our LED components at our leased facility in Huizhou, China, which represents our lowest cost manufacturing facility. This facility was obtained through our acquisition of COTCO in 2007. Our power and RF products are primarily produced at our owned manufacturing facility located in Research Triangle Park, North Carolina. This facility sits on approximately 55 acres of land that we own.

We also maintain sales and support offices, through our subsidiaries, in leased office premises in Shenzhen and Shanghai, China; Hong Kong; Tokyo, Japan; Penang, Malaysia; and Munich, Germany. In addition, we lease a facility in Goleta, California that is used for research and development and administrative functions.

We have ceased business operations at our Sunnyvale, California facility; however, we remain liable for the operating lease through 2011. We have sublet this facility through the remainder of the lease.

Item 3. Legal Proceedings

The information required by this item is set forth under Note 12 of Notes to Consolidated Financial Statements included in Item 8 of this Annual Report, and is incorporated herein by reference.

Item 4. *Submission of Matters to a Vote of Security Holders*

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2008.

Table of Contents**PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***
Common Stock Market Information

Our common stock is traded on the NASDAQ Global Select Market and is quoted under the symbol CREE. There were 663 holders of record of our common stock as of July 29, 2008. The following table sets forth, for the quarters indicated, the high and low sales prices as reported by NASDAQ.

	Fiscal 2008		Fiscal 2007	
	High	Low	High	Low
First Quarter	\$ 34.87	\$ 22.54	\$ 24.00	\$ 16.52
Second Quarter	33.68	20.48	23.68	15.25
Third Quarter	35.50	23.11	19.06	15.27
Fourth Quarter	31.80	23.02	28.55	16.16

We have never paid cash dividends on our common stock and do not anticipate that we will do so in the foreseeable future. There are no contractual restrictions in place that currently materially limit, or are likely in the future to materially limit, us from paying dividends on our common stock, but applicable state law may limit the payment of dividends. Our present policy is to retain earnings, if any, to provide funds for the operation and expansion of our business.

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Stock Performance Graph

The following information in this Item 5 of this Annual Report on Form 10-K is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Exchange Act or to the liabilities of Section 18 of the Exchange Act, and will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent we specifically incorporate it by reference into such filing.

The following graph compares the cumulative total return on our common stock with the cumulative total returns of The NASDAQ Composite Index and The NASDAQ Electronic Components Index for the five-year period commencing June 29, 2003. The stock price performance shown on the graph below is not necessarily indicative of future price performance.

	6/29/03	6/27/04	6/26/05	6/25/06	6/24/07	6/29/08
Cree, Inc.	100.00	142.47	156.74	146.23	159.09	140.38
NASDAQ Composite	100.00	126.78	128.17	136.47	164.73	150.56
NASDAQ Electronic Components	100.00	133.81	114.71	109.72	136.58	120.74

Table of Contents**Sale of Unregistered Securities**

Except as previously disclosed in our Current Report on Form 8-K filed March 3, 2008, there were no sales of unregistered securities during fiscal 2008.

Stock Repurchase Program

The following table summarizes our stock repurchase activity for the fourth quarter of fiscal 2008 (in thousands, except per share amounts):

Period	Issuer Purchases of Equity Securities			
	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Maximum Number of Shares that may yet be Purchased under the Program (1)
March 31 - April 27, 2008	725	\$ 26.53	725	3,658
April 28 - May 25, 2008	1,246	\$ 25.62	1,246	4,597
May 26 - June 29, 2008				4,597
Total	1,971	\$ 25.95	1,971	4,597

- (1) On January 18, 2001, we announced the authorization by our Board of Directors of a program to repurchase shares of our outstanding common stock. Several times since then, the Board of Directors has renewed the program and increased the number of shares that can be repurchased under the program. Most recently, on May 15, 2008, the Board of Directors approved the extension of our stock repurchase program through June 28, 2009. As of June 29, 2008, 14.3 million shares of our common stock had been approved for repurchase under the program, of which 4.6 million shares remain authorized for future repurchase.

Table of Contents**Item 6. Selected Financial Data**

The consolidated statement of income data set forth below with respect to the fiscal years ended June 29, 2008, June 24, 2007, and June 25, 2006 and the consolidated balance sheet data at June 29, 2008 and June 24, 2007 are derived from, and are qualified by reference to, the audited consolidated financial statements included elsewhere in this report and should be read in conjunction with those financial statements and notes thereto. The consolidated statement of income data for the fiscal years ended June 26, 2005 and June 27, 2004 and the consolidated balance sheet data at June 25, 2006, June 26, 2005 and June 27, 2004 are derived from audited consolidated financial statements not included herein. All consolidated statement of income data excludes Cree Microwave as it has been accounted for as a discontinued operation. Certain fiscal 2007, fiscal 2006, fiscal 2005 and fiscal 2004 amounts have been reclassified to conform to fiscal 2008 classifications. These reclassifications had no effect on previously reported income from continuing operations or shareholders' equity.

(in thousands, except per share amounts)	Fiscal Years Ended				
	June 29, 2008	June 24, 2007 ⁽¹⁾	June 25, 2006	June 26, 2005	June 27, 2004
Statement of Income Data:					
Product revenue, net	\$ 464,907	\$ 364,718	\$ 395,464	\$ 363,102	\$ 272,694
Contract revenue, net	28,389	29,403	27,488	21,356	26,947
Total revenue from continuing operations	\$ 493,296	\$ 394,121	\$ 422,952	\$ 384,458	\$ 299,641
Income from continuing operations	\$ 31,812	\$ 50,193	\$ 79,959	\$ 106,564	\$ 64,309
Income from continuing operations per share, basic	\$ 0.37	\$ 0.64	\$ 1.05	\$ 1.42	\$ 0.87
Income from continuing operations per share, diluted	\$ 0.36	\$ 0.63	\$ 1.02	\$ 1.38	\$ 0.85
Weighted Average Shares Outstanding:					
Basic	86,366	78,560	76,270	74,995	74,008
Diluted	88,077	79,496	78,207	77,172	75,745
Statement of Cash Flows Data:					
Net cash provided by operating activities	\$ 102,807	\$ 110,932	\$ 151,530	\$ 175,579	\$ 152,388
(in thousands)	June 29, 2008	June 24, 2007	June 25, 2006	June 26, 2005	June 27, 2004
Balance Sheet Data:					
Cash, cash equivalents and marketable investments	\$ 371,032	\$ 311,018	\$ 404,690	\$ 298,196	\$ 252,895
Working capital	\$ 408,193	\$ 379,683	\$ 339,108	\$ 246,325	\$ 189,911
Total assets	\$ 1,313,407	\$ 1,116,230	\$ 900,200	\$ 777,408	\$ 628,000
Shareholders' equity	\$ 1,145,740	\$ 1,015,999	\$ 827,613	\$ 712,918	\$ 579,132

Certain prior year amounts have been reclassified to conform to the current year presentation.

- (1) During fiscal 2007, we acquired COTCO. See Note 3, Acquisitions, in our consolidated financial statements included in Item 8 of this Annual Report for a description of the transaction and pro forma financial information for fiscal 2007 and fiscal 2006.

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Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operation* **Executive Summary**

The following discussion is designed to provide a better understanding of our consolidated financial statements, including a brief discussion of our business and products, key factors that impacted our performance, and a summary of our operating results. This executive summary should be read in conjunction with the more detailed discussion and analysis of our financial condition and results of operations in this Item 7, Risk Factors in Item 1A and our consolidated financial statements and the notes thereto included in Item 8 of this Annual Report.

Overview of our Business and Products

We are a manufacturer of semiconductor materials and devices primarily based on SiC, GaN and related compounds. We currently focus our expertise in SiC and GaN on LED products, which consist of LED chips, LED components and LED lighting solutions. We also develop power and RF products, including power switching and RF devices.

We derive the majority of our revenue from sales of our LED products. We also generate revenue from sales of SiC and GaN materials, including gemstone materials, and we earn revenue under government contracts that support some of our research and development programs to the extent the contract funding exceeds our direct cost of performing those activities. We generate revenues from the following product lines:

LED products. We derive the largest portion of our revenue from the sale of our LED products. Our LED products consist of our LED chips, LED components, including our XLamp LED components and high-brightness LED components, and LED lighting solutions.

Materials products. These products include our SiC and GaN wafers, which are used in manufacturing LEDs, RF and microwave devices, power devices and for research and development. They also include SiC material in bulk crystal form, which is used in gemstone applications.

Power and RF products. These products include power switching devices made from SiC, which provide faster switching speeds than comparable silicon-based power devices, and also include RF devices made from SiC or GaN, which allow for higher power densities as compared to silicon or gallium arsenide.

Contracts with government agencies. Government agencies provide us with funding to support the development of primarily SiC and GaN based new technology.

The majority of our products historically have been manufactured at our main production facilities in North Carolina. We also have been increasingly utilizing our facility in Huizhou, China for the manufacture of certain of our LED components and use contract manufacturers in Asia for certain aspects of our manufacturing process.

Operating Segments

We currently operate our business as one reportable segment. In fiscal 2005, we operated our business in two reportable segments. In the fourth quarter of fiscal 2005, we announced the closure of the Cree Microwave segment, our silicon-based RF and microwave semiconductor business located in Sunnyvale, California. Effective December 25, 2005, we reported Cree Microwave as a discontinued operation. For further information about this business closure, see Note 4, Discontinued Operations, in our consolidated financial statements included in Item 8 of this Annual Report.

Industry Dynamics

Our business is primarily focused on selling our LED products. LEDs are currently used to provide energy-efficient lighting in the automotive, mobile phone, liquid crystal display (LCD) backlighting, gaming, signals,

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indoor and outdoor illumination and video screen markets. LED lighting products are in the initial stages of introduction to the general illumination market. As LED technology continues to develop and improve, the potential market for LED lighting applications is expanding.

Select industry factors affecting our business include, among others:

Overall demand for products and applications using LEDs. LED lighting is a developing technology especially as it concerns the general illumination market. The pace of adoption of LED lighting technology in the general illumination market and others will impact the demand for LEDs.

Intense and constantly evolving competitive environment. Competition in the industry is intense. Product pricing pressures exist as market participants often undertake pricing strategies to gain or protect market share. To remain competitive, market participants generally must increase product performance and reduce costs to support lower average sales prices.

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

Fiscal 2008 Highlights

The following is a summary of key financial results and certain non-financial results achieved for the year ended June 29, 2008:

Our revenues from continuing operations for the year increased 25% to \$493.3 million. We experienced strong sales growth in our LED products, which increased \$107.2 million or 35% from the prior year. Revenues from the sale of our LED components increased substantially from the prior year, more than offsetting a decline in revenues attributable to sales of our LED chips. Revenues from the sales of our LED components represented approximately half of our total revenues from LED products in fiscal 2008.

Our gross margin was similar to the prior year at 34% of revenue, reflecting the continued investment in new product introductions and a competitive environment for our LED chips.

We achieved consolidated net income of \$33.4 million in fiscal 2008 compared to \$57.3 million in fiscal 2007. Net income per diluted share was \$0.38 in fiscal 2008 compared to \$0.72 in fiscal 2007.

We generated positive cash flow from operations of \$102.8 million in fiscal 2008 compared to \$110.9 million for fiscal 2007.

Combined cash, cash equivalents and marketable investments increased \$60.0 million or 19% to \$371.0 million at June 29, 2008 compared to \$311.0 million at June 24, 2007.

We purchased and retired nearly two million outstanding shares of our common stock.

We made significant progress in the integration of COTCO into our business.

We initiated the transition of our production process from a three-inch to four-inch wafer. This transition is targeted to improve our chip yield per wafer and consequently lower our cost per chip.

On February 29, 2008, we closed the acquisition of LLF. Through this acquisition we acquired what we believe to be key technologies to drive retrofit solutions to convert existing lighting infrastructure to energy-efficient lighting and to accelerate the adoption of LED lighting into the general illumination market.

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Business Outlook

We project that the markets for our products will remain highly competitive during fiscal 2009. We anticipate focusing on the following key areas, among others, in response to this competitive environment:

Continue efforts to enable LED lighting. We plan to continue to invest in and support initiatives that we believe will enable and potentially accelerate the adoption of LED lighting in the general illumination market. We believe these efforts can ultimately help to increase the demand for our LED products.

Invest in technology, product development and infrastructure. We plan to continue enhancing our existing products, developing new products and expanding our portfolio of intellectual property through significant investments in research and development. In addition, to support unit volume growth and to meet anticipated capacity needs in our Asian operations, we target investing no less in capital expenditures in fiscal 2009 than we have on average in recent history.

Expand our global sales and distribution channels. We intend to continue to expand our global direct sales force, agents, partnerships and distributor relationships.

Continue focus on operating improvements. We continue focusing on identifying new ways to improve our operating efficiency and processes in all facets of our operations, including those outside of manufacturing, to maintain and improve our profitability. This includes shifting production to our lower cost manufacturing facility in Huizhou, China or contract manufacturers in Asia, leveraging investments in information technology, constant monitoring and adjustment of our working capital to fluctuations in our business, robust budgeting and planning processes and continuing efforts to streamline our processes and procedures to properly manage operating expenses.

Continue to focus on growing our power and RF product revenue. We have had success in winning new designs in certain volume applications, yet we still have a limited number of customers. Our goal over the next year is to begin to realize more of the potential of power and RF products by expanding sales to a broader customer base, which should provide the increased volume needed to reduce costs and improve margins on these products.

Evaluate strategic opportunities. We intend to continue to evaluate and potentially pursue appropriate strategic opportunities such as technology licensing arrangements, acquisitions, partnerships or joint ventures that complement or expand our existing business.

Results of Operations

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

(dollars in thousands, except per share amounts)	2008		2007		2006	
	Dollars	% of Revenue	Dollars	% of Revenue	Dollars	% of Revenue
Net revenue	\$ 493,296	100.0%	\$ 394,121	100.0%	\$ 422,952	100.0%
Cost of revenue	327,469	66.4%	260,133	66.0%	222,059	52.5%
Gross margin	165,827	33.6%	133,988	34.0%	200,893	47.5%
Research and development	58,846	11.9%	58,836	14.9%	54,871	13.0%
Sales, general and administrative	76,607	15.5%	53,105	13.5%	44,760	10.6%

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Amortization of acquisition related intangibles	17,127	3.5%	4,192	1.1%		0.0%
Loss on disposal or impairment assets	1,206	0.2%	1,199	0.3%	2,421	0.6%
Income from operations	12,041	2.5%	16,656	4.2%	98,841	23.3%
Gain on sale of investments, net	14,117	2.9%	19,233	4.9%	587	0.1%
Other non-operating income	364	0.1%	238	0.1%	42	0.0%
Interest income, net	14,527	2.9%	14,984	3.8%	12,893	3.0%
Income before income taxes	41,049	8.4%	51,111	13.0%	112,363	26.4%
Income tax expense	9,237	1.9%	918	0.2%	32,404	7.7%
Income from continuing operations	31,812	6.5%	50,193	12.8%	79,959	18.7%
Net income (loss) discontinued operations	1,627	0.3%	7,141	1.8%	(3,286)	-0.8%
Net income	\$ 33,439	6.8%	\$ 57,334	14.6%	\$ 76,673	17.9%
Diluted EPS continuing operations	\$ 0.36		\$ 0.63		\$ 1.02	

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Revenues for fiscal 2008, 2007 and 2006 are comprised of the following (in thousands, except percentages):

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
LED products	\$ 414,948	\$ 307,761	\$ 343,394	\$ 107,187	35%	\$ (35,633)	-10%
Materials products	28,582	39,544	36,932	(10,962)	-28%	2,612	7%
Power and RF products	21,377	17,413	15,138	3,964	23%	2,275	15%
Total product revenues	464,907	364,718	395,464	100,189	27%	(30,746)	-8%
Contracts	28,389	29,403	27,488	(1,014)	-3%	1,915	7%
Total revenues	\$ 493,296	\$ 394,121	\$ 422,952	\$ 99,175	25%	\$ (28,831)	-7%

Revenues from continuing operations increased 25% to \$493.3 million in fiscal 2008 from \$394.1 million in fiscal 2007. Product revenue increased 27% to \$464.9 million in fiscal 2008 from \$364.7 million in fiscal 2007. The overall increase in revenue was driven by growth in our LED products that offset a decline in revenues related to our materials products.

Comparing fiscal 2007 to fiscal 2006, revenues from continuing operations decreased 7% to \$394.1 million from \$423.0 million. Product revenue decreased 8% to \$364.7 million from \$395.5 million in the year-to-year comparison. The decrease in product revenue resulted from the decline in revenue from LED chips, which was partially offset by increases in revenue from our LED components, materials products and power and RF devices.

LED Products (in thousands, except percentages)

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
LED products	\$ 414,948	\$ 307,761	\$ 343,394	\$ 107,187	35%	\$ (35,633)	-10%
Percent of total revenues	84%	78%	81%				

Revenue from our LED products increased 35% to \$414.9 million in fiscal 2008 from \$307.8 million in fiscal 2007. Growth was strongest from our LED components, which increased year over year and offset a decline in LED chip sales. The growth in revenues from sales of our high-brightness LED components was primarily attributable to the inclusion of the operations acquired through the acquisition of COTCO for the entire year in fiscal 2008 as opposed to only one quarter in fiscal 2007. Revenues generated from the sale of our XLamp LED components grew on the strength of higher sales volumes. The blended average selling price for our LED products increased 40% in fiscal 2008 from fiscal 2007 due to a shift in product mix to a higher proportion of revenues generated from sales of our LED components in fiscal 2008.

Revenues from LED products decreased 10% to \$307.8 million in fiscal 2007 from \$343.4 million in fiscal 2006. While unit shipments of our LED products increased 12% over fiscal 2006 due to higher customer demand for LED chips and LED components, our blended average sales price decreased 26% due to a combination of changes in product mix and price competition. Additionally, in fiscal 2007 we purchased the operations of COTCO, which previously was a customer for our LED products.

Table of Contents*Materials Products (in thousands, except percentages)*

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Materials products	\$ 28,582	\$ 39,544	\$ 36,932	\$ (10,962)	-28%	\$ 2,612	7%
Percent of total revenues	6%	10%	9%				

Revenues from materials products were \$28.6 million, \$39.5 million and \$36.9 million for fiscal 2008, 2007 and 2006, respectively. The decline of 28% from fiscal 2007 to fiscal 2008 was due primarily to lower sales to Charles & Colvard for use of our materials products in gemstone applications. The increase of 7% from fiscal 2006 to fiscal 2007 was due to changes in product mix resulting in a 3% decrease in the number of units sold offset by an 11% increase in the average sales price. Revenues from materials products comprised 6%, 10% and 9% of our total revenues for fiscal 2008, 2007 and 2006, respectively.

Power and RF Products (in thousands, except percentages)

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Power and RF products	\$ 21,377	\$ 17,413	\$ 15,138	\$ 3,964	23%	\$ 2,275	15%
Percent of total revenues	4%	4%	4%				

Revenue from our power and RF products increased 23% to \$21.4 million in fiscal 2008 from \$17.4 million in fiscal 2007. The increase in revenue was primarily the result of a 94% increase in unit shipments of products. The increase in unit shipments was offset by a 37% decrease in the blended average sales price due to changes in product mix. Revenues from power and RF products comprised 4% of our total revenues for fiscal 2008, 2007 and 2006.

Contracts (in thousands, except percentages)

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Contracts	\$ 28,389	\$ 29,403	\$ 27,488	\$ (1,014)	-3%	\$ 1,915	7%
Percent of total revenues	6%	7%	6%				

Revenues from contracts were \$28.4 million, \$29.4 million, and \$27.5 million for fiscal 2008, 2007, and 2006, respectively. The fluctuations in contract revenue from year-to-year are generally due to changes in the timing of the initiation of new research contracts, the value of those contracts and timing of the work performed. Revenues from contracts comprised 6%, 7% and 6% of our total revenues for fiscal 2008, 2007 and 2006, respectively.

Gross Margin

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

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Products, net	\$ 160,244	\$ 127,593	\$ 193,052	\$ 32,651	26%	\$ (65,459)	-34%
Percent of total revenues	34%	35%	49%				
Contracts, net	5,583	6,395	7,841	(812)	-13%	(1,446)	-18%

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Percent of total revenues	20%	22%	29%				
Total gross margin	\$ 165,827	\$ 133,988	\$ 200,893	\$ 31,839	24%	\$ (66,905)	-33%
Percent of total revenues	34%	34%	47%				

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Total gross margin from continuing operations was 34%, 34% and 47% for fiscal 2008, 2007 and 2006, respectively. Our gross margin percentage remained consistent at 34% of revenues from fiscal 2007 to fiscal 2008. Lower gross margins on sales of LED chips in fiscal 2008 were offset by higher margins on our LED components. Overall declines in blended average selling prices were offset by lower costs per unit.

Gross margin from continuing operations in fiscal 2007 declined 33% to \$134.0 million from \$200.9 million in fiscal 2006. Our gross margin percentage decreased from 47% to 34% of revenue caused primarily by lower margins on sales of LED chips as average selling prices declined faster than product costs, higher costs related to our new LED component products and lower factory utilization.

Contract gross margins were \$5.6 million, \$6.4 million and \$7.8 million for fiscal 2008, 2007 and 2006, respectively. Gross margin percentage related to contracts will fluctuate year-to-year based upon the mix of active contracts between cost share versus for profit research arrangements, and mix of work actually performed on those contracts in any given year. Gross margin percentage related to contract revenue was 20%, 22% and 29% for fiscal 2008, 2007 and 2006, respectively.

Research and Development

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

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

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Research and development	\$ 58,846	\$ 58,836	\$ 54,871	\$ 10	0%	\$ 3,965	7%
Percent of total revenues	12%	15%	13%				

Year over year research and development expenses from continuing operations remained consistent in fiscal 2008 at \$58.8 million but decreased as a percent of sales from 15% in fiscal 2007 to 12% in fiscal 2008. In fiscal 2007, research and development expenses from continuing operations increased 7% to \$58.8 million from \$54.9 million in fiscal 2006. We are currently focusing our research and development activities on higher brightness LED chips, new and improved LED components, larger wafer and other production process improvement initiatives, power and RF devices and LED lighting solutions.

Sales, General and Administrative

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

	Fiscal Years Ended			Year-Over-Year Change			
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008		2006 to 2007	
Sales, general and administrative	\$ 76,607	\$ 53,105	\$ 44,760	\$ 23,502	44%	\$ 8,345	19%
Percent of total revenues	16%	13%	11%				

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Sales, general and administrative expenses, from continuing operations increased 44% in fiscal 2008 to \$76.6 million compared to \$53.1 million in fiscal 2007. The increase in costs in fiscal 2008 is primarily attributable to (1) the inclusion of a full year of the acquired operations of COTCO in fiscal 2008 as opposed to only one quarter in fiscal 2007 and (2) increased spending on sales and marketing. Additionally, costs increased due to the general expansion of our business, increased employee compensation costs, including costs related to salaries, stock based compensation and higher costs related to certain patent litigation.

In fiscal 2007, sales, general and administrative expenses from continuing operations increased 19% to \$53.1 million compared to \$44.8 million in fiscal 2006. The increase primarily related to increased costs incurred in connection with patent litigation, increased spending on sales and marketing to support our new product lines and additional expenses related to our acquisitions of INTRINSIC and COTCO.

Amortization of Acquisition Related Intangibles

As a result of our acquisitions, we have recorded various intangible assets including customer relationships and developed technologies. Amortization of intangible assets related to our acquisitions is as follows (in thousands):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
INTRINSIC	\$ 745	\$ 714	\$	\$ 31	\$ 714
COTCO	15,336	3,478		11,858	3,478
LLF	1,046			1,046	
Total	\$ 17,127	\$ 4,192	\$	\$ 12,935	\$ 4,192

Amortization of acquisition related intangibles from continuing operations was \$17.1 million in fiscal 2008 compared to \$4.2 million in fiscal 2007. The increase is due primarily to an increase in amortization of intangible assets in fiscal 2008 resulting from our acquisition of COTCO in fiscal 2007. During fiscal 2007, we acquired INTRINSIC and COTCO, resulting in \$63.7 million of amortizable intangible assets principally composed of customer relationships and developed technology. In fiscal 2008, we acquired LLF, resulting in an additional \$41.2 million of amortizable intangible assets. These intangible assets were principally composed of developed technology, that specifically relates to technologies underlying the development of LED lighting products for the general illumination market.

Loss on Disposal or Impairment of Long-Lived Assets

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

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Loss on disposal or impairment of long-lived assets	\$ 1,206	\$ 1,199	\$ 2,421	\$ 7	\$ (1,222)

We recorded a net loss of \$1.2 million on the disposal of long-lived assets in fiscal 2008 consistent with the net loss recognized in fiscal 2007. The fiscal 2008 loss was composed of losses due to the impairment of certain equipment, the impairment of capitalized patent costs and losses on the disposal of equipment. The decrease in losses in fiscal 2007 from fiscal 2006 was primarily due to a one-time \$1.1 million write-off in fiscal 2006 of building improvement and computer software that were no longer being used at our Durham, North Carolina facility.

Table of Contents***Gain on Sale of Investments, Net***

The following table sets forth our gain on sale of investments, net in dollars (in thousands):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Gain on sale of investments, net	\$ 14,117	\$ 19,233	\$ 587	\$ (5,116)	\$ 18,646

The gain on sale of investments was \$14.1 million in fiscal 2008 compared to a gain of \$19.2 million and \$0.6 million in fiscal 2007 and fiscal 2006, respectively. These gains principally relate to the sale of our holdings of Color Kinetics Incorporated (Color Kinetics) common stock over the respective three fiscal years. During fiscal 2008, 2007 and 2006, we sold 500,000 shares, 1,295,660 shares, and 63,782 shares of Color Kinetics common stock, respectively. As of June 29, 2008 we have fully liquidated our holdings in Color Kinetics.

Interest Income, Net

We have historically invested portions of our available cash in fixed interest rate securities such as high-grade corporate debt, commercial paper, government securities, and other fixed interest rate investments. The primary objective of our investments is to preserve principal while maximizing our yields. The following table sets forth our interest income (in thousands, except percentages):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Interest income, net	\$ 14,527	\$ 14,984	\$ 12,893	\$ (457) -3%	\$ 2,091 16%

Net interest income was \$14.5 million, \$15.0 million and \$12.9 million for fiscal 2008, 2007 and 2006, respectively. In fiscal 2008, investment income was largely consistent with fiscal 2007 as higher average investment balances offset declining interest rates earned on our fixed rate securities and cash and cash equivalent holdings. In fiscal 2007, investment income increased 16% to \$15.0 million from \$12.9 million in fiscal 2006 largely due to higher interest rates received on our fixed rate securities. For a discussion of certain risks related to our investment holdings, see the section entitled "Financial and Market Risks" that is included in this Item 7 as well as the discussion of risks pertaining to our investments included in Item 1A "Risk Factors" of this Annual Report.

Income Tax Expense

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

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Income tax expense	\$ 9,237	\$ 918	\$ 32,404	\$ 8,319	\$ (31,486)
Effective tax rate on continuing operations	23%	2%	29%		

We recorded income tax expense of \$9.2 million from continuing operations in fiscal 2008 as compared to income tax expense of \$0.9 million in fiscal 2007. The change is primarily due to certain discrete tax events in fiscal 2007, including the release of contingent tax reserves, the resolution of Internal Revenue Service audits of our fiscal 2003, 2004 and 2005 federal tax returns and the release of valuation allowances on deferred tax assets related to federal capital loss carryforwards.

Table of Contents**Income (Loss) from Discontinued Operations, Net of Tax**

As more fully described in Note 4, Discontinued Operations, to the accompanying consolidated financial statements, in fiscal 2006, we discontinued the operations of our Cree Microwave subsidiary. The following table sets forth our income (loss) from discontinued operations, net of tax (in thousands):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Income (loss) from discontinued operations, net of tax	\$ 1,627	\$ 7,141	\$ (3,286)	\$ (5,514)	\$ 10,427

During fiscal 2008, we recorded after-tax income of \$1.6 million from our discontinued operations compared to after-tax income of \$7.1 million in fiscal 2007 and a loss of \$3.3 million in fiscal 2006. In fiscal 2006 we recorded our estimate of the expected losses from the closure of our Cree Microwave business. In fiscal 2007, the primary driver of the after-tax income was the release of contingent tax reserves relating to our former Cree Microwave business as a result of the completion of Internal Revenue Service audits of fiscal 2003, 2004 and 2005 in the amount of \$7.3 million, which was partially offset by continued expenses arising from the Sunnyvale facility operating lease. In fiscal 2008, the income was due primarily to our sale of certain patents associated with our Cree Microwave business that resulted in a net gain of \$1.8 million, which was then offset by continued expenses arising from the Sunnyvale facility operating lease.

Liquidity and Capital Resources**Overview**

We require cash to fund our operating expenses and working capital requirements, including outlays for research and development, and to make capital expenditures, strategic acquisitions and investments. Our principal sources of liquidity are cash on hand, marketable investments and cash generated from operations. Our ability to generate cash from operations has been one of our fundamental strengths and has provided us with substantial flexibility in meeting our operating, financing and investing needs. We have no debt or lines of credit and have minimal lease commitments. In the near term, we expect to fund our primary cash requirements through cash generated from operations, and cash and cash equivalents on hand.

From time to time, we evaluate strategic opportunities and potential investments in complementary businesses and we anticipate continuing to make such evaluations. We may also issue debt, additional shares of common stock, or use available cash on hand for the acquisition of complementary businesses or other significant assets or for other strategic opportunities.

Contractual Obligations

At June 29, 2008, payments to be made pursuant to significant contractual obligations are as follows (in thousands):

Contractual Obligations	Total	Payments due by period			More Than Five Years
		Less than One Year	One to Three Years	Three to Five Years	
Long-term debt obligations	\$	\$	\$	\$	\$
Capital lease obligations					
Operating lease obligations	6,878	2,428	3,376	956	118
Purchase obligations	44,929	41,059	3,870		
COTCO contingent consideration	60,000	60,000			
Other long-term liabilities					
Total	\$ 111,807	\$ 103,487	\$ 7,246	\$ 956	\$ 118

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Operating leases include rental amounts due on leases of certain office and manufacturing space under the terms of non-cancelable operating leases. These leases expire at various times through December 2015. All of the lease agreements provide for rental adjustments for increases in base rent (up to specific limits), property taxes and general property maintenance that would be recorded as rent expense, if applicable.

Purchase obligations generally relate to the purchase of goods and services in the ordinary course of business such as raw materials, supplies and capital equipment. Our purchase obligations represent authorizations to purchase rather than binding agreements.

As the operations acquired through the COTCO acquisition achieved certain defined EBITDA targets for the year ended June 29, 2008, we are contractually obligated to make a payment in the amount of \$60.0 million to the former shareholder of COTCO or its designees in fiscal 2009, which we elected to pay in cash. If certain defined EBITDA targets are met by the operations acquired through the COTCO acquisition in fiscal 2009, an additional contingent payment of up to \$65.0 million may be due to the former shareholder. This additional contingent payment may be settled in cash or common stock at our option, subject to certain limitations.

As part of the acquisition of LLF, additional consideration of up to \$26.4 million may be payable to the former shareholders of LLF if defined product development targets and key employee retention measures are achieved over our next three fiscal years. These product development targets may or may not be met.

Financial Condition

Our liquidity and capital resources depend on our cash flows from operations and our working capital. Our working capital increased to \$408.2 million as of June 29, 2008 from \$379.7 million at June 24, 2007, primarily due to positive cash flows from operations and cash generated through the exercise of employee stock options. At June 29, 2008, our inventory days on hand, calculated on an annual basis, were 95 as compared to 108 days at June 24, 2007. The decrease in inventory days reflects our efforts to integrate the operations and product lines acquired through our acquisition of COTCO. Accounts receivable days sales outstanding, calculated on an annual basis, were 81 days at June 29, 2008 as compared to 73 days at June 24, 2007. Accounts receivable days increased as we had a greater percentage of our sales fall later in the fourth fiscal quarter in fiscal 2008 as compared to fiscal 2007 and a shift in sales mix to customers who have generally longer payment terms or practices. With our strong working capital position, we believe that we have the ability to continue to invest in further development of our products and, when necessary or appropriate, make selective acquisitions or other strategic investments to strengthen our product portfolio or secure key intellectual properties.

The significant components of our working capital are liquid assets such as cash and cash equivalents, short-term investments, accounts receivable and inventories, reduced by trade accounts payable, accrued salaries and wages and other current liabilities. We continued to generate positive cash flows from operations in fiscal 2008, 2007 and 2006.

During fiscal 2008, as a result of a strategic change in the use of invested funds, changes in market factors surrounding certain underlying securities and consideration of the current conditions in the capital markets, we determined that we would make our complete portfolio of marketable securities available for current operations. As a result of this determination, investments with amortized cost of \$102.6 million were transferred from held-to-maturity to available-for-sale. Investments classified as available-for-sale are required to be carried at fair value, which resulted in a net increase in the carrying value of these investments of \$2.3 million with a corresponding increase in accumulated other comprehensive income net of the related tax effects. From this point forward, our investments in marketable securities will be accounted for at fair value with any unrealized gains or losses recognized through accumulated other comprehensive income net of the related tax effects.

As of June 29, 2008, substantially all of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at June 29, 2008 were in such position due to interest rate

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changes, sector credit rating changes or company-specific rating changes. As we intend and believe that we have the ability to hold such investments for a period of time that will be sufficient for anticipated recovery in market value, we currently expect to receive the full principal or recover our cost basis in these securities. When evaluating our investments for possible impairment, we review factors such as the length of time and extent to which fair value has been below our cost basis, the financial condition of the entity in which the investment is made, and our ability and intent to hold the investment for a period of time that may be sufficient for anticipated recovery in market value. The declines in value of the securities in our portfolio are considered to be temporary in nature and, accordingly, we do not believe these securities are impaired as of June 29, 2008.

We believe our current working capital and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for at least the next twelve months. We have and may continue to use a portion of our available cash and cash equivalents, or funds underlying our marketable securities, to repurchase shares of our common stock. We currently anticipate that we will continue to operate a cash-positive business in fiscal 2009.

Cash Flows

As discussed above, one of the primary sources of our liquidity is our ability to generate positive cash flows from operations. The following is a discussion of our primary sources and uses of cash in our operating, investing and financing activities.

Cash Flows from Operating Activities (in thousands, except percentages):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Cash provided by operating activities	\$ 102,807	\$ 110,932	\$ 151,530	\$ (8,125) -7%	\$ (40,598) -27%

Net cash provided by operating activities was \$102.8 million, \$110.9 million and \$151.5 million for fiscal 2008, 2007, and 2006, respectively. Cash provided by operating activities decreased on a year over year basis from fiscal 2007 to fiscal 2008 primarily as a result of lower net income and changes in operating assets and liabilities, such as an increase in accounts and interest receivable as opposed to a decrease in fiscal 2007. Cash provided by operating activities decreased on a year over year basis from fiscal 2006 to fiscal 2007 primarily as a result of lower net income adjusted for a \$19.2 million gain on sales of investments and changes in operating assets and liabilities, primarily an increase in inventories.

During fiscal 2008, 2007, and 2006, our cash flows from operations were primarily derived from earnings from operations prior to non-cash expenses such as depreciation and amortization, stock-based compensation, gains realized on the sale of investments and deferred income tax income or expense, and changes in our working capital, which is primarily composed of accounts receivable and inventories, partially offset by changes in current expenses such as accounts payable and accrued expenses.

Cash Flows from Investing Activities (in thousands):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Cash provided by (used in) investing activities	\$ 41,253	\$ (97,714)	\$ (161,124)	\$ 138,967	\$ 63,410

Net cash provided by (used in) investing activities was \$41.3 million, \$(97.7) million and \$(161.1) million for fiscal 2008, 2007, and 2006, respectively. Our investing activities primarily relate to transactions within our

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investments, strategic acquisitions, purchase of property, plant and equipment and purchase of patent and/or license rights. Cash provided by investing activities increased on a year over year basis during fiscal 2008 primarily as a result of increased cash generated from the maturity of our fixed income investments offset by reinvestment amounts, lower capital expenditures and less cash spent on strategic acquisitions.

Cash used in financing activities decreased on a year over year basis from fiscal 2006 to fiscal 2007 primarily as a result of a higher rate of investment in investment securities than maturities. Acquisition related cash outflows were \$7.2 million in fiscal 2008, relating to the cash consideration component of our acquisition of LLF, and \$123.1 million in fiscal 2007, relating to the cash consideration components of our acquisitions of INTRINSIC and COTCO. See Note 3, Acquisitions, to our consolidated financial statements for a further discussion of these acquisitions. Our investment in new property and equipment amounted to \$55.7 million, \$82.6 million and \$77.3 million during fiscal 2008, 2007, and 2006, respectively. Capital expenditures increased in fiscal 2007 and decreased in fiscal 2008 due to spending on major plant initiatives, which increased in fiscal 2007 but then decreased in fiscal 2008.

As the operations acquired through the COTCO acquisition achieved certain defined EBITDA targets for the year ended June 29, 2008, we are contractually obligated to make a payment in the amount of \$60.0 million to the former shareholder of COTCO or its designees in fiscal 2009, which we elected to pay in cash. This additional payment is reflected as a current obligation and increase to goodwill in our consolidated financial statements. If certain defined EBITDA targets are met by the operations acquired through the COTCO acquisition in fiscal 2009, an additional contingent payment of up to \$65.0 million may be due to the former shareholder. This additional contingent payment may be settled in cash or common stock at our option, subject to certain limitations. If this remaining contingent payment were to occur, it would result in an increase to purchased goodwill.

As part of the acquisition of LLF, additional consideration of up to \$26.4 million may be payable to the former shareholders of LLF if defined product development targets and key employee retention measures are achieved over our next three fiscal years. These product development targets may or may not be met but if such contingent payments occur, these will be considered as additional purchase price and result in an increase in goodwill.

We will continue to closely monitor our capital expenditures, while making strategic investments to develop our existing products, pursue strategic initiatives where appropriate and invest in our manufacturing and information technology infrastructure to meet the needs of our business. We target investing no less in capital expenditures in fiscal 2009 than we have on average in recent history.

Cash Flows from Financing Activities (in thousands):

	Fiscal Years Ended			Year-Over-Year Change	
	June 29, 2008	June 24, 2007	June 25, 2006	2007 to 2008	2006 to 2007
Cash provided by (used in) financing activities	\$ 16,389	\$ (8,061)	\$ 27,437	\$ 24,450	\$ (35,498)

Net cash provided by (used in) financing activities was \$16.6 million, \$(8.1) million and \$27.4 million for fiscal 2008, 2007 and 2006, respectively. Our cash flows from financing activities are principally composed of cash proceeds from the issuance of common stock primarily related to employee stock option exercises and employee stock plan purchases offset by cash outflows related to our repurchase of common stock. Cash provided by financing activities increased on a year over year basis from fiscal 2007 to fiscal 2008 primarily as a result of higher net proceeds from the issuance of common stock offset by our spending on the repurchase of common stock. Cash used in financing increased on a year over year basis from fiscal 2006 to fiscal 2007 primarily due to higher spending on the repurchase of common stock than cash proceeds received from the issuance of common stock.

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As of June 29, 2008, there remained approximately 4.6 million shares of our common stock approved for repurchase under the repurchase program authorized by our Board of Directors. Since the inception of our stock repurchase program, we have repurchased approximately 9.7 million shares of our common stock. At the discretion of our management, the repurchase program can be implemented through open market or privately negotiated transactions. We will determine the time and extent of repurchases based on our evaluation of market conditions and other factors.

Financial and Market Risks

We are exposed to financial and market risks, including changes in interest rates, currency exchange rates and investment risk. We currently do not use derivative financial instruments to mitigate any of these risks; however, we may choose to do so in the future. All of the potential changes noted below are based on sensitivity analyses performed on our financial positions at June 29, 2008 and June 24, 2007. Actual results may differ materially.

Interest Rates

We maintain an investment portfolio principally composed of high-grade corporate debt, commercial paper, government securities, and other investments at fixed interest rates that vary by security. In order to minimize risk, we only acquire investments rated A grade or better in accordance with our cash management policy. At June 29, 2008, we had \$109.4 million invested in these securities, compared to \$200.4 million at June 24, 2007. Although these securities generally earn interest at fixed rates, the historical fair values of such investments have not differed materially from the amounts reported in our consolidated balance sheets. The potential loss in fair value resulting from a hypothetical 10% decrease in quoted market price was approximately \$11.0 million at June 29, 2008 and \$20.0 million at June 24, 2007.

Currency Exchange Rates

As we operate internationally and have transactions denominated in foreign currencies, we are exposed to currency exchange rate risks. Additionally, certain of our foreign subsidiaries operate with a functional currency other than the U.S. Dollar, our reporting currency. This requires that results of these foreign operations be translated at average exchange rates into U.S. Dollars for financial reporting purposes. As a result, fluctuations in exchange rates may adversely affect our expenses and results of operations as well as the value of our assets and liabilities. Our primary exposures relate to the exchange rates between the U.S. Dollar, the Chinese Renminbi and Hong Kong Dollar.

Investment Risk

We have made and may make future investments in public or privately-held companies having operations or technologies in areas within our strategic focus. These investments may be marketable in the case of investments in the common stock of other publicly traded companies or potentially non-marketable in certain instances with investments in privately-held companies. Whether marketable or non-marketable, investments can be inherently risky as markets for the technologies or products of these companies may be in the early stages of development and may never materialize.

As of June 24, 2007, we held a long-term investment in the equity securities of Color Kinetics, which was treated for accounting purposes as an investment in available-for-sale securities. As such, this investment was carried at fair market value based upon the quoted market price of the stock, with any net unrealized gains or losses excluded from earnings and reported as a separate component of shareholders' equity. During 2008, we fully liquidated our investments in the common stock of Color Kinetics. We received proceeds of \$17.0 million and recognized a pre-tax gain of \$14.1 million from the sale during the period.

As of June 29, 2008, we have no significant investments in individual public or privately-held companies.

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Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use other forms of off-balance sheet arrangements. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of June 29, 2008, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases primarily for certain of our U.S. and international facilities in the normal course of business. These arrangements are often referred to as a form of off-balance-sheet financing. Future minimum lease payments under our operating leases as of June 29, 2008 are detailed above in *Liquidity and Capital Resources* in the section entitled *Contractual Obligations*.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States (US GAAP). In the application of US GAAP we are required to make estimates that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities in our Consolidated Financial Statements. In many instances, we could have reasonably used different accounting estimates. In other instances, changes in the accounting estimates from period to period are reasonably likely to occur. Accordingly, actual results could differ significantly from the estimates made by management. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation of our financial condition or results of operations may be affected.

On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, accounting for stock-based compensation, recoverability of long-lived assets, deferred tax asset valuation allowances, tax contingencies, valuation of inventories, contingent liabilities, and accruals for other liabilities, among others. We base our estimates on historical experience and on various other assumptions that are believed 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.

In addition to making critical accounting estimates, we must ensure that our financial statements are properly stated in accordance with US GAAP. In many cases, the accounting treatment of a particular transaction is specifically dictated by US GAAP and does not require a high degree of management judgment in its application, while in other cases, management's judgment is required in selecting among available alternative accounting standards that allow different accounting treatment for similar transactions.

Our significant accounting policies are discussed in Note 2, *Basis of Presentation and Summary of Significant Accounting Policies*, to the consolidated financial statements included in Item 8 of this Annual Report. We believe that the following are our most critical accounting policies and estimates, each of which is critical to the portrayal of our financial condition and results of operations and requires our most difficult, subjective and complex judgments. Our management has reviewed our critical accounting policies and the related disclosures with the Audit Committee of our Board of Directors.

Revenue Recognition

We provide our customers with limited rights of return for non-conforming shipments and product warranty claims. In addition, certain of our sales arrangements provide for limited product exchanges and the potential for reimbursement of certain sales costs. As a result, we record an allowance, which is recorded as a reduction of product revenue in the consolidated statements of income and as a reduction to accounts receivable in the consolidated balance sheets.

We estimate our allowance in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 48, *Revenue Recognition When Right of Return Exists* (SFAS 48). Specifically, we

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review historical sales returns and other relevant data and match returns or other credits to the quarter when the sales were originally recorded. Based on historical return percentages and other relevant factors, we estimate our potential future exposure on recorded product sales. The allowance for sales returns at June 29, 2008 and June 24, 2007 was \$5.9 million and \$4.6 million, respectively.

In accordance with SFAS 48, we also record an asset for the estimated value of these product returns that we believe will be returned to inventory and resold. As of June 29, 2008 and June 24, 2007, we estimated the cost of future product returns at \$2.8 million and \$1.3 million, respectively.

Accounting for Stock-Based Compensation

We account for awards of stock-based compensation under our employee stock-based compensation plans using the fair value method as prescribed by SFAS No. 123 (revised 2004), Share-Based Payment (SFAS 123R). Accordingly, we estimate the grant date fair value of our stock-based awards and amortize this fair value to compensation expense over the requisite service period or vesting term. To estimate the fair value of our stock option awards we currently use the Black-Scholes option-pricing model. The determination of the fair value of stock-based awards on the date of grant using an option-pricing model is affected by our then current stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends.

Due to the inherent limitations of option-valuation models available today, including future events that are unpredictable and the estimation process utilized in determining the valuation of the stock-based awards, the ultimate value realized by award holders may vary significantly from the amounts expensed in our financial statements. For restricted stock awards, grant date fair value is based upon the market price of our common stock on the date of the grant. This fair value is then amortized to compensation expense over the requisite service period or vesting term.

SFAS 123R also requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from initial estimates. Our determination of an estimated forfeiture rate is primarily based upon a review of historical experience but may also include consideration of other facts and circumstances we believe are indicative of future activity. The assessment of an estimated forfeiture rate will not alter the total compensation expense to be recognized, only the timing of this recognition as compensation expense is adjusted to reflect instruments that actually vest.

If actual results are not consistent with our assumptions and judgments used in estimating key assumptions, we may be required to adjust compensation expense, which could be material to our results of operations.

Recoverability of Long-Lived Assets

Our assessment of the recoverability of long-lived assets involves significant judgment and estimation. Factors that may require estimates when performing recoverability and impairment tests include, among others, the economic life of the asset, sales volumes, prices, cost of capital, tax rates and capital spending. These factors are often interdependent and therefore do not change in isolation. We may also use internal discounted cash flow estimates, quoted market prices when available and independent appraisals as appropriate to determine fair value.

We test goodwill for impairment at least annually and more frequently upon the occurrence of certain events that may indicate potential impairment. Testing is performed at a reporting unit level using a two-step process. The first step compares the fair value of the reporting unit with its carrying value. If the fair value of the reporting unit exceeds its carrying value, no impairment is recorded. If the carrying amount of the reporting unit exceeds its fair value, the second step of the impairment analysis is performed. The second step is used to measure the amount of the impairment loss and compares the implied fair value of the reporting unit's goodwill

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with the carrying amount of the reporting unit's goodwill. If the carrying amount exceeds the implied fair value of the goodwill, an impairment loss is recognized for the excess. However, it should be noted that the loss recognized shall not be in excess of the carrying amount. Once a goodwill impairment loss is recognized, the adjusted carrying value shall be its new accounting basis.

We evaluate certain other long-lived assets such as property, equipment and definite lived intangible assets (such as patents) for impairment whenever events or circumstances indicate that the carrying value of the assets recorded in our financial statements may not be recoverable. If impairment is indicated, we first determine if the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the asset being evaluated. If so, an impairment loss is measured and recorded for the amount by which the carrying amount of the long-lived asset being tested exceeds its fair value. We may use a variety of methods to determine the fair value of assets in these cases, including cash flow analyses and appraisals.

If future results are not consistent with our current assumptions and judgments used in estimating future cash flows and asset fair values, we may be required to record additional impairment losses that could be material to our results of operations. We do not restore a previously recognized impairment loss if the asset's carrying value decreases below its estimated fair value. We recorded \$1.2 million, \$1.3 million and \$1.7 million of long-lived asset impairment charges during the fiscal years ended June 29, 2008, June 24, 2007 and June 25, 2006, respectively.

Deferred Tax Asset Valuation Allowances

We have established a valuation allowance for capital loss carryforwards where we believe that it is more likely than not that the tax benefits of the items will not be realized due to insufficient availability of capital gains in the carryforward period. In addition, we have established a valuation allowance related to state income tax credits recorded on the financial statements during the year for which we believe we will have insufficient state taxable income in the carryforward period to utilize the losses. In assessing the adequacy of a recorded valuation allowance, we consider all positive and negative evidence and a variety of factors, including historical and projected future taxable income and prudent and feasible tax planning strategies. When we establish or increase a valuation allowance, our income tax expense increases in the period such determination is made. If we decrease a valuation allowance, our income tax expense decreases in the period such determination is made.

Tax Contingencies

We are subject to periodic audits of our income tax returns by federal, state and local agencies. The audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In accordance with Financial Accounting Standards Board (FASB) Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109, we evaluate the exposures associated with our various tax filing positions. FIN 48 states that a tax benefit should not be recognized for financial statement purposes for an uncertain tax filing position where it is not more likely than not (likelihood of greater than 50%) to be sustained by the taxing authorities based on the technical merits of the position.

In accordance with the provisions of FIN 48, we have recorded unrecognized tax benefits (as a reduction to the deferred tax asset or as an increase to the FIN 48 liability account included in other liabilities) to remove some or all of the tax benefit of any of our tax positions at the time we determine that the positions become uncertain based upon one of the following: (1) the tax position is not more likely than not to be sustained, (2) the tax position is more likely than not to be sustained, but for a lesser amount, or (3) the tax position is more likely than not to be sustained, but not in the financial period in which the tax position was originally taken. For purposes of evaluating whether or not a tax position is uncertain, (1) we presume the tax position will

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be examined by the relevant taxing authority that has full knowledge of all relevant information, (2) the technical merits of a tax position are derived from authorities such as legislation and statutes, legislative intent, regulations, rulings and case law and their applicability to the facts and circumstances of the tax position, and (3) each tax position is evaluated without considerations of the possibility of offset or aggregation with other tax positions taken. We adjust these unrecognized tax benefits, including any impact on the related interest and penalties, in light of changing facts and circumstances, such as the progress of a tax audit.

A number of years may elapse before a particular matter for which we have established an unrecognized tax benefit is audited and fully resolved. To the extent we prevail in matters for which we have recorded an unrecognized benefit or are required to pay amounts in excess of what we have recorded, our effective tax rate in a given financial statement period could be materially affected. An unfavorable tax settlement might require use of our cash and/or result in an increase in our effective tax rate in the year of resolution. A favorable tax settlement would be recognized as a reduction in our effective tax rate in the year of resolution.

Inventories

We write down our inventory for estimated obsolescence equal to the difference between the cost of inventory and its estimated market value based upon an aging analysis of the inventory on hand, specifically known inventory-related risks (such as technological obsolescence), and assumptions about future demand. In particular, we fully reserve for all inventory greater than 12 months old, unless there is an identified need for the inventory.

We also analyze sales levels by product type, including historical and future estimated customer demand for those products to determine if any additional reserves are appropriate. For example, we take reserve for items that are considered obsolete based upon changes in customer demand, manufacturing process changes or new product introductions that may eliminate demand for the product. If our estimates regarding customer demand are inaccurate, or market conditions and technology change in ways that are less favorable than those projected by management, we may be required to take additional inventory write-downs, which could have an adverse effect on our consolidated financial results.

Contingent Liabilities

We provide for contingent liabilities in accordance with SFAS No. 5, *Accounting for Contingencies* (SFAS 5). In accordance with SFAS 5, a loss contingency is charged to income when (1) it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements, and (2) the amount of the loss can be reasonably estimated.

Periodically, we review the status of each significant matter to assess the potential financial exposure. If a potential loss is considered probable and the amount can be reasonably estimated as defined by SFAS 5, we reflect the estimated loss in our results of operations. Significant judgment is required to determine the probability that a liability has been incurred or an asset impaired and whether such loss is reasonably estimable. Because of uncertainties related to these matters, accruals are based on the best information available at the time. Further, estimates of this nature are highly subjective, and the final outcome of these matters could vary significantly from the amounts that have been included in the accompanying consolidated financial statements. In determining the probability of an unfavorable outcome of a particular contingent liability and whether such liability is reasonably estimable, we consider the individual facts and circumstances related to the liability, opinions of legal counsel and recent legal rulings by the appropriate regulatory bodies, among other factors. As additional information becomes available, we reassesses the potential liability related to our pending claims and litigation and may revise our estimates accordingly. Such revisions in the estimates of the potential liabilities could have a material impact on our results of operations and financial position. See also a discussion of specific contingencies in Note 12, *Commitments and Contingencies*, to our consolidated financial statements in Item 8 of this Annual Report.

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Accruals for Other Liabilities

We make estimates for the amount of costs that have been incurred but not yet billed for our self-funded medical insurance and general services, including legal fees, accounting fees and other expenses.

Our liabilities contain uncertainties because we must make assumptions and apply judgment to estimate the ultimate cost to settle claims and claims incurred but not reported as of the balance sheet date. When estimating our liabilities, we consider a number of factors, including interviewing our service providers for bills that have not yet been received. For self-insured liabilities, we estimate our liabilities based on historical claims experience.

If actual costs billed to us are not consistent with our assumptions and judgments, our expenses could be understated or overstated and these adjustments could materially affect our net income.

Recent Accounting Pronouncements

See Note 2, *Basis of Presentation and Summary of Significant Accounting Policies*, to our consolidated financial statements in Item 8 of this Annual Report for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects, if any, on our consolidated financial statements.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

See the section entitled *Financial and Market Risks* included in *Management's Discussion and Analysis of Financial Condition and Results of Operations* in Item 7 of this Annual Report.

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Item 8. *Financial Statements and Supplementary Data*

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Cree, Inc.

We have audited the accompanying consolidated balance sheets of Cree, Inc. as of June 29, 2008 and June 24, 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended June 29, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Cree, Inc. at June 29, 2008 and June 24, 2007, and the consolidated results of its operations and its cash flows for each of the three years in the period ended June 29, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 11 to the financial statements, in 2008, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes, an interpretation of Financial Accounting Standard No. 109*.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Cree, Inc.'s internal control over financial reporting as of June 29, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 18, 2008 expressed an unqualified opinion thereon.

Raleigh, North Carolina

August 18, 2008

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	June 29, 2008	June 24, 2007
	(Thousands, except share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 261,633	\$ 93,881
Short-term investments:	50,795	148,774
Total cash, cash equivalents, and short-term investments	312,428	242,655
Accounts receivable, net	110,376	79,668
Income tax receivable	9,825	7,947
Inventories, net	80,161	71,068
Deferred income taxes	4,578	23,573
Prepaid expenses and other current assets	12,900	8,920
Assets of discontinued operations	2,600	301
Total current assets	532,868	434,132
Property and equipment, net	348,013	372,345
Long-term investments	58,604	68,363
Intangible assets, net	126,037	96,138
Goodwill	244,003	141,777
Deferred income taxes		1,227
Other assets	3,882	2,248
Total assets	\$ 1,313,407	\$ 1,116,230
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	\$ 37,402	\$ 32,940
Accrued salaries and wages	13,471	10,241
Income taxes payable	5,314	4,504
Deferred income taxes		844
Other current liabilities	7,938	5,415
Consideration payable related to COTCO acquisition	60,000	
Liabilities of discontinued operations	550	505
Total current liabilities		