

CREE INC  
Form 10-Q  
April 23, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q  
(Mark One)

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

For the quarterly period ended March 30, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21154

CREE, INC.

(Exact name of registrant as specified in its charter)

North Carolina

(State or other jurisdiction of incorporation or organization)

56-1572719

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

4600 Silicon Drive

Durham, North Carolina

(Address of principal executive offices)

(919) 407-5300

(Registrant's telephone number, including area code)

27703

(Zip Code)

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

Yes  No

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

Yes  No

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

Large accelerated filer

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

Accelerated filer

Smaller reporting company

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

Yes  No

The number of shares outstanding of the registrant's common stock, par value \$0.00125 per share, as of April 16, 2014, was 121,938,248.



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 For the Quarterly Period Ended March 30, 2014  
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## PART I - FINANCIAL INFORMATION

## Item 1. Financial Statements

## CREE, INC.

## CONSOLIDATED BALANCE SHEETS

	March 30, 2014 (unaudited)	June 30, 2013
	(In thousands, except par value)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$268,838	\$190,069
Short-term investments	954,573	833,846
Total cash, cash equivalents and short-term investments	1,223,411	1,023,915
Accounts receivable, net	222,333	192,507
Inventories	251,234	197,001
Deferred income taxes	25,740	26,125
Prepaid expenses and other current assets	59,352	76,218
Total current assets	1,782,070	1,515,766
Property and equipment, net	575,945	542,833
Intangible assets, net	343,647	357,525
Goodwill	616,345	616,345
Other assets	45,041	19,941
Total assets	\$3,363,048	\$3,052,410
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable, trade	\$159,230	\$121,441
Accrued salaries and wages	44,030	41,407
Income taxes payable	16,060	1,315
Other current liabilities	44,400	43,248
Total current liabilities	263,720	207,411
Long-term liabilities:		
Deferred income taxes	27,249	25,504
Other long-term liabilities	40,691	12,843
Total long-term liabilities	67,940	38,347
Commitments and contingencies (Note 11)		
Shareholders' equity:		
Preferred stock, par value \$0.01; 3,000 shares authorized at March 30, 2014 and June 30, 2013; none issued and outstanding	—	—
Common stock, par value \$0.00125; 200,000 shares authorized at March 30, 2014 and June 30, 2013; 121,930 and 119,623 shares issued and outstanding at March 30, 2014 and June 30, 2013, respectively	151	148
Additional paid-in-capital	2,162,798	2,025,764
Accumulated other comprehensive income, net of taxes	10,117	8,244
Retained earnings	858,322	772,496
Total shareholders' equity	3,031,388	2,806,652
Total liabilities and shareholders' equity	\$3,363,048	\$3,052,410
The accompanying notes are an integral part of the consolidated financial statements.		



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CREE, INC.  
(UNAUDITED)  
CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended		Nine Months Ended	
	March 30, 2014	March 31, 2013	March 30, 2014	March 31, 2013
	(In thousands, except per share amounts)			
Revenue, net	\$405,259	\$348,934	\$1,211,351	\$1,010,973
Cost of revenue, net	255,265	215,924	754,822	628,438
Gross profit	149,994	133,010	456,529	382,535
Operating expenses:				
Research and development	46,626	39,036	132,805	116,524
Sales, general and administrative	65,368	62,140	197,589	174,885
Amortization of acquisition-related intangibles	7,257	7,719	21,800	23,108
Loss on disposal or impairment of long-lived assets	364	863	1,781	2,385
Total operating expenses	119,615	109,758	353,975	316,902
Operating income	30,379	23,252	102,554	65,633
Non-operating income, net	3,152	2,512	9,373	8,378
Income before income taxes	33,531	25,764	111,927	74,011
Income tax expense	5,367	3,607	17,585	15,328
Net income	\$28,164	\$22,157	\$94,342	\$58,683
Earnings per share:				
Basic	\$0.23	\$0.19	\$0.78	\$0.51
Diluted	\$0.23	\$0.19	\$0.77	\$0.50
Weighted average shares used in per share calculation:				
Basic	121,535	116,682	120,677	116,059
Diluted	123,695	118,608	123,140	116,768

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

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CREE, INC.

(UNAUDITED)

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended		Nine Months Ended	
	March 30, 2014	March 31, 2013	March 30, 2014	March 31, 2013
	(In thousands)			
Net income	\$28,164	\$22,157	\$94,342	\$58,683
Other comprehensive income:				
Currency translation (loss) gain, net of tax benefit (expense) of \$0, \$90, \$0 and (\$1), respectively	(163	) (145	) (28	) 5
Net unrealized gain (loss) on available-for-sale securities, net of tax (expense) of (\$126), (\$75), (\$1,191) and (\$22), respectively	191	67	1,901	(17
Other comprehensive income (loss)	28	(78	) 1,873	(12
Comprehensive income	\$28,192	\$22,079	\$96,215	\$58,671

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



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

	Nine Months Ended	
	March 30, 2014	March 31, 2013
	(In thousands)	
Cash flows from operating activities:		
Net income	\$94,342	\$58,683
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	120,219	114,370
Stock-based compensation	46,261	40,945
Excess tax benefit from share-based payment arrangements	(18,396)	(3,636)
Loss on disposal or impairment of long-lived assets	1,781	2,385
Amortization of premium/discount on investments	7,674	7,075
Changes in operating assets and liabilities:		
Accounts receivable, net	(29,829)	(29,624)
Inventories	(53,511)	(6,866)
Prepaid expenses and other assets	13,008	(6,472)
Accounts payable, trade	29,016	33,495
Accrued salaries and wages and other liabilities	17,605	13,715
Net cash provided by operating activities	228,170	224,070
Cash flows from investing activities:		
Purchases of property and equipment	(119,614)	(55,406)
Purchases of available-for-sale investments	(510,401)	(533,884)
Proceeds from maturities of available-for-sale investments	365,005	297,740
Proceeds from sale of property and equipment	117	301
Proceeds from sale of available-for-sale investments	22,387	36,089
Purchases of patent and licensing rights	(14,755)	(15,794)
Net cash used in investing activities	(257,261)	(270,954)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	89,476	43,352
Excess tax benefit from share-based payment arrangements	18,396	3,636
Repurchases of common stock	(107)	(638)
Net cash provided by financing activities	107,765	46,350
Effects of foreign exchange changes on cash and cash equivalents	95	87
Net increase (decrease) in cash and cash equivalents	78,769	(447)
Cash and cash equivalents:		
Beginning of period	190,069	178,885
End of period	\$268,838	\$178,438
The accompanying notes are an integral part of the consolidated financial statements.		

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

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

Overview

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

The Company develops and manufactures semiconductor materials and devices primarily based on silicon carbide (SiC), gallium nitride (GaN) and related compounds. In many cases, the properties of SiC and GaN offer technical advantages over traditional silicon, gallium arsenide (GaAs) and other materials used for electronic applications. The Company's LED products consist of LED components, LED chips and SiC materials. The Company's success in selling LED products depends upon its ability to offer innovative products and to enable its customers to develop and market LED-based products that successfully compete against other LED-based products and drive LED adoption against traditional lighting products.

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

In addition, the Company develops, manufactures and sells power and RF devices. The Company's power products are made from SiC and provide increased efficiency, faster switching speeds and reduced system size and weight over comparable silicon-based power devices. The Company's RF devices are made from GaN and provide improved efficiency, bandwidth and frequency of operation as compared to silicon or GaAs.

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

Cree, Inc. is a North Carolina corporation established in 1987 and is headquartered in Durham, North Carolina. As of March 30, 2014, the Company has three reportable segments:

LED Products

Lighting Products

Power and RF Products

For financial results by reportable segment, please refer to Note 12 "Reportable Segments."

Basis of Presentation

The consolidated balance sheet at March 30, 2014, the consolidated statements of income for the three and nine months ended March 30, 2014 and March 31, 2013, the consolidated statements of comprehensive income for the three and nine months ended March 30, 2014 and March 31, 2013, and the consolidated statements of cash flows for the nine months ended March 30, 2014 and March 31, 2013 (collectively, the consolidated financial statements) have been prepared by the Company and have not been audited. In the opinion of management, all normal and recurring adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows at March 30, 2014, and for all periods presented, have been made. All intercompany accounts and transactions have been eliminated. The consolidated balance sheet at June 30, 2013 has been derived from the audited financial statements as of that date. The nine month period ended March 30, 2014 includes one less week as compared to the nine month period ended March 31, 2013.

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

omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2013 (fiscal 2013).

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The results of operations for the three and nine months ended March 30, 2014 are not necessarily indicative of the operating results that may be attained for the entire fiscal year ending June 29, 2014 (fiscal 2014).

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities. Actual amounts could differ materially from those estimates.

Certain fiscal 2013 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2014 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

New Accounting Standards

Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists

In July 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward or Tax Credit Carryforward Exists. The ASU provides guidance regarding the presentation in the statement of financial position of an unrecognized tax benefit when a net operating loss carryforward or a tax credit carryforward exists. The ASU generally provides that an entity's unrecognized tax benefit, or a portion of its unrecognized tax benefit, should be presented in its financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward. The ASU applies prospectively to all entities that have unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists at the reporting date, and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The Company early adopted this guidance beginning with the first quarter of fiscal 2014. The Company's adoption of this guidance did not have a significant impact on its consolidated financial statements.

Note 2. Acquisitions

On August 17, 2011, the Company entered into a Stock Purchase Agreement with all of the shareholders of Ruud Lighting, Inc. (Ruud Lighting). Pursuant to the terms of the Stock Purchase Agreement and concurrently with the execution of the Stock Purchase Agreement, the Company acquired all of the outstanding share capital of Ruud Lighting in exchange for consideration consisting of 6.1 million shares of the Company's common stock valued at approximately \$211.0 million and \$372.2 million cash, subject to certain post-closing adjustments. Following the acquisition, the Company recorded certain post-closing purchase price adjustments resulting in a \$2.3 million reduction to the purchase price and a total purchase price of approximately \$666.0 million. See Note 11 "Commitments and Contingencies" for a discussion of the amounts received from the Stock Purchase Agreement escrow funds. The acquisition allowed the Company to expand its product portfolio into outdoor LED lighting.

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

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

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## Note 3. Financial Statement Details

## Accounts receivable, net

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

	March 30, 2014	June 30, 2013	
Billed trade receivables	\$254,274	\$220,307	
Unbilled contract receivables	1,427	1,171	
	255,701	221,478	
Allowance for sales returns, discounts and other incentives	(31,111	) (26,500	)
Allowance for bad debts	(2,257	) (2,471	)
Total accounts receivable, net	\$222,333	\$192,507	

## Inventories

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

	March 30, 2014	June 30, 2013
Raw material	\$84,302	\$62,253
Work-in-progress	81,846	68,146
Finished goods	85,086	66,602
Total inventories	\$251,234	\$197,001

## Other current liabilities

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

	March 30, 2014	June 30, 2013
Accrued taxes	\$17,812	\$21,436
Accrued professional fees	7,390	4,493
Accrued warranty	5,602	5,259
Accrued other	13,596	12,060
Total other current liabilities	\$44,400	\$43,248

## Accumulated other comprehensive income, net of taxes

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

	March 30, 2014	June 30, 2013	
Currency translation gain	\$8,464	\$8,492	
Net unrealized gain (loss) on available-for-sale securities	1,653	(248	)
Total accumulated other comprehensive income, net of taxes	\$10,117	\$8,244	

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## Non-operating income, net

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

	Three Months Ended		Nine Months Ended	
	March 30, 2014	March 31, 2013	March 30, 2014	March 31, 2013
Foreign currency (loss) gain, net	(\$368	) \$296	\$109	\$424
Gain on sale of investments, net	15	48	25	84
Interest income, net	3,415	2,018	8,562	5,756
Other, net	90	150	677	2,114
Total non-operating income, net	\$3,152	\$2,512	\$9,373	\$8,378

## Reclassifications out of accumulated other comprehensive income

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

Accumulated Other Comprehensive Income Component	Amount Reclassified from Accumulated Other Comprehensive Income				Affected Line Item in the Statement of Income
	Three Months Ended		Nine Months Ended		
	March 30, 2014	March 31, 2013	March 30, 2014	March 31, 2013	
Net unrealized gain on available-for-sale securities, net of tax expense	\$15	\$43	\$25	\$80	Non-operating income, net
	15	43	25	80	Income before income taxes
	2	6	4	17	Income tax expense
	\$13	\$37	\$21	\$63	Net income

## Note 4. Investments

Short-term investments consist of municipal bonds, corporate bonds, U.S. agency securities, non-U.S. certificates of deposit and non-U.S. government securities. All marketable investments are classified as available-for-sale.

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The following tables summarize marketable investments (in thousands):

	March 30, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	\$306,484	\$1,598	(\$289 )	\$307,793
Corporate bonds	227,500	1,742	(574 )	228,668
U.S. agency securities	27,095	189	—	27,284
Non-U.S. certificates of deposit	383,758	—	—	383,758
Non-U.S. government securities	7,045	25	—	7,070
Total	\$951,882	\$3,554	(\$863 )	\$954,573

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Municipal bonds	\$250,206	\$817	(\$1,314 )	\$249,709
Corporate bonds	192,147	1,678	(1,765 )	192,060
U.S. agency securities	39,288	186	—	39,474
Non-U.S. certificates of deposit	345,000	—	—	345,000
Non-U.S. government securities	7,608	14	(19 )	7,603
Total	\$834,249	\$2,695	(\$3,098 )	\$833,846

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

	March 30, 2014					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	\$61,656	(\$289 )	\$—	\$—	\$61,656	(\$289 )
Corporate bonds	82,888	(536 )	1,979	(38 )	84,867	(574 )
Non-U.S. government securities	—	—	—	—	—	—
Total	\$144,544	(\$825 )	\$1,979	(\$38 )	\$146,523	(\$863 )
Number of securities with an unrealized loss		71		1		72

	June 30, 2013					
	Less than 12 Months		Greater than 12 Months		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Municipal bonds	\$126,926	(\$1,314 )	\$—	\$—	\$126,926	(\$1,314 )
Corporate bonds	102,010	(1,765 )	—	—	102,010	(1,765 )
Non-U.S. government securities	5,534	(19 )	—	—	5,534	(19 )
Total	\$234,470	(\$3,098 )	\$—	\$—	\$234,470	(\$3,098 )
Number of securities with an unrealized loss		123		—		123

The Company utilizes specific identification in computing realized gains and losses on the sale of investments. Realized gains from the sale of investments for the nine months ended March 30, 2014 of \$25 thousand were included in "Non-operating income,





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net" and unrealized gains and losses are included as a separate component of equity, net of tax, unless the loss is determined to be other-than-temporary.

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

Accordingly, the Company considers declines in its securities to be temporary in nature, and does not consider its securities to be impaired as of March 30, 2014 and June 30, 2013.

The contractual maturities of marketable investments as of March 30, 2014 were as follows (in thousands):

	Within One Year	After One, Within Five Years	After Five, Within Ten Years	After Ten Years	Total
Municipal bonds	\$70,398	\$213,400	\$23,995	\$—	\$307,793
Corporate bonds	33,506	176,288	18,874	—	228,668
U.S. agency securities	8,083	19,201	—	—	27,284
Non-U.S. certificates of deposit	383,758	—	—	—	383,758
Non-U.S. government securities	4,054	3,016	—	—	7,070
Total	\$499,799	\$411,905	\$42,869	\$—	\$954,573

#### Note 5. Fair Value of Financial Instruments

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

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

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

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

The financial assets for which the Company performs recurring fair value remeasurements are cash equivalents and short-term investments. As of March 30, 2014, financial assets utilizing Level 1 inputs included money market funds. Financial assets utilizing Level 2 inputs included municipal bonds, corporate bonds, U.S. agency securities, non-U.S. certificates of deposit and non-U.S. government securities. Level 2 assets are valued using a third-party pricing services consensus price, which is a weighted average price based on multiple sources. These sources determine prices utilizing market income models which factor in, where applicable, transactions of similar assets in active markets, transactions of identical assets in infrequent markets, interest rates, bond or credit default swap spreads and volatility. The Company does not have any financial assets requiring the use of Level 3 inputs. There were no transfers between Level 1 and Level 2 during the nine months ended March 30, 2014.

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

	March 30, 2014				June 30, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents:								
Non-U.S. certificates of deposit	\$—	\$12,163	\$—	\$12,163	\$—	\$—	\$—	\$—
Municipal bonds	—	—	—	—	—	2,009	—	2,009
Money market funds	67,553	—	—	67,553	12,589	—	—	12,589
Total cash equivalents	67,553	12,163	—	79,716	12,589	2,009	—	14,598
Short-term investments:								