Non-GAAP Measures of Financial Performance

To supplement the Company's consolidated financial statements presented in accordance with generally accepted accounting principles, or GAAP, Cree uses non-GAAP measures of certain components of financial performance. These non-GAAP measures include non-GAAP gross margin, non-GAAP operating income, non-GAAP non-operating income, net, non-GAAP net income, non-GAAP diluted (loss) earnings per share and free cash flow.

Reconciliation to the nearest GAAP measure of all historical non-GAAP measures included in this press release can be found in the tables included with this press release. In this press release, Cree also presents its target for non-GAAP expenses, which are expenses less expenses in the various categories described below. Both our GAAP targets and non-GAAP targets do not include any estimated changes in the fair value of our Lextar investment.

Non-GAAP measures presented in this press release are not in accordance with or an alternative to measures prepared in accordance with GAAP and may be different from non-GAAP measures used by other companies. In addition, these non-GAAP measures are not based on any comprehensive set of accounting rules or principles. Non-GAAP measures have limitations in that they do not reflect all of the amounts associated with Cree's results of operations as determined in accordance with GAAP. These non-GAAP measures should only be used to evaluate Cree's results of operations in conjunction with the corresponding GAAP measures.

Cree believes that these non-GAAP measures, when shown in conjunction with the corresponding GAAP measures, enhance investors' and management's overall understanding of the Company's current financial performance and the Company's prospects for the future, including cash flows available to pursue opportunities to enhance shareholder value. In addition, because Cree has historically reported certain non-GAAP results to investors, the Company believes the inclusion of non-GAAP measures provides consistency in the Company's financial reporting.

For its internal budgeting process, and as discussed further below, Cree's management uses financial statements that do not include the items listed below and the income tax effects associated with the foregoing. Cree's management also uses non-GAAP measures, in addition to the corresponding GAAP measures, in reviewing the Company's financial results.

Cree excludes the following items from one or more of its non-GAAP measures when applicable:

Stock-based compensation expense. This expense consists of expenses for stock options, restricted stock, performance stock awards and employee stock purchases through its ESPP. Cree excludes stock-based compensation expenses from its non-GAAP measures because they are non-cash expenses that Cree does not believe are reflective of ongoing operating results.

Amortization or impairment of acquisition-related intangibles. Cree incurs amortization or impairment of acquisition-related intangibles in connection with acquisitions. Cree excludes these items because they arise from Cree's prior acquisitions and have no direct correlation to the ongoing operating results of Cree's business.

LED business restructuring charges or gains. In June 2015, Cree’s board of directors approved a plan to restructure the LED business. The restructuring, which was completed during fiscal 2016, reduced excess capacity and overhead in order to improve the cost structure moving forward. The components of the restructuring included the planned sale or abandonment of certain manufacturing equipment, facility consolidation and the elimination of certain positions. Because these charges relate to assets which have been retired prior to the end of their estimated useful lives and severance costs for eliminated positions, Cree does not consider these charges to be reflective of ongoing operating results. Similarly, Cree does not consider realized gains or losses on the sale of assets relating to the restructuring to be reflective of ongoing operating results.

Goodwill impairment charges. The Company determined that the carrying value of the Lighting Products segment was in excess of the segment's fair value during the third quarter of fiscal 2018 in connection with the preparation of the financial statements for such period, resulting in an impairment charge. Cree excludes this item from its non-GAAP measures because it is a non-cash expense that Cree does not believe to be reflective of ongoing operating results.

Transaction, transition and integration costs associated with purchase of RF Power business. The Company incurred transaction, transition and integration costs in fiscal 2018 in conjunction with the purchase of certain assets of the Infineon Technologies AG RF Power ("RF Power") business. Cree excludes these items because they have no direct correlation to the ongoing operating results of Cree's business.

Transaction costs associated with the terminated sale of the Wolfspeed business. The Company incurred transaction costs in fiscal 2017 in conjunction with the previously proposed sale of its Wolfspeed business to Infineon. Because these costs were incurred relative to a portion of the business which was previously reported as discontinued operations in fiscal 2017, Cree does not consider these amounts to be reflective of ongoing operating results.

Severance pay associated with termination of key executive personnel. The Company incurred costs in fiscal 2018 in conjunction with the termination of key executive personnel. Cree excludes these items because they have no direct correlation to the ongoing operating results of Cree's business.

Net changes associated with equity investment. The Company's common stock ownership investment in Lextar Electronics Corporation is accounted for utilizing the fair value option. As such, changes in fair value are recognized in income, including fluctuations due to the exchange rate between the New Taiwan Dollar and the United States Dollar. Cree excludes the impact of these gains or losses from its non-GAAP measures because they are non-cash impacts that Cree does not believe are reflective of ongoing operating results. Additionally, Cree excludes the impact of dividends received on its Lextar investment as Cree does not believe it is reflective of ongoing operating results.

Foreign exchange gain on acquisition of RF Power business. The Company incurred foreign exchange gains on hedges purchased for the RF Power business asset purchase. Cree excludes the impact of this gain because it is not considered to be reflective of ongoing operations.

Income tax effects of the foregoing non-GAAP items. This amount is used to present each of the amounts described above on an after-tax basis consistent with the presentation of non-GAAP net income. Non-GAAP net income is presented using a non-GAAP tax rate. The Company’s non-GAAP tax rate represents a recalculation of the GAAP tax rate reflecting the exclusion of the non-GAAP items.

Cree expects to incur many of these same expenses, including income taxes associated with these expenses, in future periods. In addition to the non-GAAP measures discussed above, Cree also uses free cash flow as a measure of operating performance and liquidity. Free cash flow represents operating cash flows less net purchases of property and equipment and patent and licensing rights. Cree considers free cash flow to be an operating performance and a liquidity measure that provides useful information to management and investors about the amount of cash generated by the business after the purchases of property and equipment, a portion of which can then be used to, among other things, invest in Cree's business, make strategic acquisitions, strengthen the balance sheet and repurchase stock. A limitation of the utility of free cash flow as a measure of operating performance and liquidity is that it does not represent the residual cash flow available to the company for discretionary expenditures, as it excludes certain mandatory expenditures such as debt service.

CREE, INC.
Unaudited Reconciliation of GAAP to Non-GAAP Measures
(in thousands, except per share amounts and percentages)

Non-GAAP Gross Margin

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
GAAP gross profit	$99,056	$86,076	$291,991	$336,574
GAAP gross margin percentage	27.8%	25.2%	26.9%	30.2%
Adjustment:				
Stock-based compensation expense	1,729	2,229	5,402	8,012
Transaction costs related to the acquisition of RF Power	128	—	128	—
Total adjustments to GAAP gross profit	$1,857	$2,229	$5,530	$8,012
Non-GAAP gross profit	$100,913	$88,305	$297,521	$344,586
Non-GAAP gross margin percentage	28.3%	25.9%	27.4%	30.9%

Non-GAAP Operating Income (Loss)

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
GAAP operating loss	($268,063)	($19,902)	($308,474)	($5,602)
GAAP operating loss	(75.3)%	(5.8)%	(28.5)%	(0.5)%
Adjustments:				
Stock-based compensation expense:				
Cost of revenue, net	1,729	2,229	5,402	8,012
Research and development	2,374	2,542	6,830	8,468
Sales, general and administrative	7,056	6,790	21,087	21,937
Total stock-based compensation	11,159	11,561	33,319	38,417
Amortization or impairment of acquisition-related intangibles	7,453	8,362	21,037	20,707
LED business restructuring charges	—	(5)	—	15
Goodwill impairment charges	247,455	—	247,455	—
Transaction costs related to the acquisition of RF Power	4,327	—	4,327	—
Transaction costs related to the terminated sale of the Wolfspeed business	—	6,854	—	11,826
Wolfspeed transaction termination fee	—	(12,500)	—	(12,500)
Executive Severance	1,343	—	6,223	—
Total adjustments to GAAP operating loss	271,737	14,272	312,361	58,465
Non-GAAP operating income (loss)	$3,674	($5,630)	$3,887	$52,863
Non-GAAP operating income (loss)	1.0 %	(1.6)%	0.4 %	4.7 %

Non-GAAP Non-Operating Income, net

	Three Months Ended		Nine Months Ended	
	March 25, 2018	**March 26, 2017**	**March 25, 2018**	**March 26, 2017**
GAAP non-operating (expense) income, net	($9,651)	$9,865	$16,011	$4,946
Adjustment:				
Net changes associated with equity method investment	12,096	(8,445)	(10,055)	(2,596)
Foreign exchange gain on RF Power acquisition	(1,941)	—	(1,941)	—
Non-GAAP non-operating income, net	$504	$1,420	$4,015	$2,350

Non-GAAP Net Income

	Three Months Ended		Nine Months Ended	
	March 25, 2018	**March 26, 2017**	**March 25, 2018**	**March 26, 2017**
GAAP net loss	($240,577)	($99,013)	($246,712)	($92,230)
Adjustments:				
Stock-based compensation expense	11,159	11,561	33,319	38,417
Amortization or impairment of acquisition-related intangibles	7,453	8,362	21,037	20,707
LED business restructuring charges	—	(5)	—	15
Goodwill impairment charges	247,455	—	247,455	—
Transaction costs related to the RF Power acquisition	4,327	—	4,327	—
Transaction costs related to the terminated sale of the Wolfspeed business	—	6,854	—	11,826
Wolfspeed transaction termination fee	—	(12,500)	—	(12,500)
Executive Severance	1,343	—	6,223	—
Net changes associated with equity method investment	12,096	(8,445)	(10,055)	(2,596)
Foreign exchange gain on RF Power acquisition	(1,941)	—	(1,941)	—
Total adjustments to GAAP net loss before provision for income taxes	281,892	5,827	300,365	55,869
Income tax effect	(37,474)	93,935	(46,363)	82,188
Non-GAAP net income	$3,841	$749	$7,290	$45,827
Non-GAAP Earnings per share				
Non-GAAP diluted earnings per share	$0.04	$0.01	$0.07	$0.46
Shares used in non-GAAP diluted earnings per share calculation				
Non-GAAP shares used	100,140	97,346	99,046	98,791

Free Cash Flow

	Three Months Ended		Nine Months Ended	
	March 25, 2018	March 26, 2017	March 25, 2018	March 26, 2017
Cash flows from operations	$19,609	$43,440	$125,423	$163,154
Less: PP&E spending	(43,211)	(21,684)	(128,433)	(56,895)
Less: Patents spending	(2,981)	(3,040)	(7,913)	(8,876)
Total free cash flow	($26,583)	$18,716	($10,923)	$97,383

CREE, INC.
Business Outlook Unaudited GAAP to Non-GAAP Reconciliation
(in millions)

	Three Months Ended June 24, 2018
GAAP net loss outlook range	($34) to ($38)
Adjustments:	
Stock-based compensation expense	11
Amortization or impairment of acquired intangibles	10
Amortization of Infineon RF Power Inventory basis step-up	5
Infineon RF Power transition and integration costs	5
Lighting Products restructuring costs	7
Total adjustments to GAAP net loss before provision for income taxes	38
Income tax effect	5
Non-GAAP net income outlook range	$5 to $9

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Source: Cree, Inc.