
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended December 28, 2018

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

Commission File Number: 001-34775

FABRINET

(Exact name of registrant as specified in its charter)

Cayman Islands
(State or other jurisdiction of
incorporation or organization)

98-1228572
(I.R.S. Employer
Identification No.)

c/o Intertrust Corporate Services (Cayman) Limited
190 Elgin Avenue
George Town
Grand Cayman
Cayman Islands

(Address of principal executive offices)

KY1-9005
(Zip Code)

+66 2-524-9600

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
Emerging growth company	<input type="checkbox"/>		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of January 25, 2019, the registrant had 36,904,637 ordinary shares, \$0.01 par value, outstanding.

**FABRINET
FORM 10-Q
QUARTER ENDED DECEMBER 28, 2018**

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

FABRINET

CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

<i>(in thousands of U.S. dollars, except share data)</i>	December 28, 2018	June 29, 2018
Assets		
Current assets		
Cash and cash equivalents	\$ 230,996	\$ 158,102
Restricted cash in connection with business acquisition	—	3,331
Short-term investments	151,508	174,269
Trade accounts receivable, net	261,519	246,912
Contract assets	13,336	—
Inventory, net	277,893	257,687
Prepaid expenses	9,809	8,061
Other current assets	5,044	5,948
Total current assets	<u>950,105</u>	<u>854,310</u>
Non-current assets		
Property, plant and equipment, net	212,314	219,640
Intangibles, net	4,283	4,880
Goodwill	3,698	3,828
Deferred tax assets	5,454	5,280
Other non-current assets	72	80
Total non-current assets	<u>225,821</u>	<u>233,708</u>
Total Assets	<u>\$ 1,175,926</u>	<u>\$ 1,088,018</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Bank borrowings	\$ 3,250	\$ 3,250
Trade accounts payable	248,253	220,159
Capital lease liability, current portion	409	451
Income tax payable	2,568	709
Deferred liability in connection with business acquisition	—	3,331
Accrued payroll, bonus and related expenses	16,327	13,476
Accrued expenses	9,106	9,013
Other payables	17,637	19,728
Total current liabilities	<u>297,550</u>	<u>270,117</u>
Non-current liabilities		
Long-term loan from bank	60,125	60,938
Deferred tax liability	2,939	2,284
Capital lease liability, non-current portion	302	516
Severance liabilities	11,173	10,162
Other non-current liabilities	2,304	3,062
Total non-current liabilities	<u>76,843</u>	<u>76,962</u>
Total Liabilities	<u>374,393</u>	<u>347,079</u>
Commitments and contingencies (Note 15)		
Shareholders' equity		
Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of December 28, 2018 and June 29, 2018)	—	—
Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 38,138,159 shares and 37,723,733 shares issued; and 36,849,056 shares and 36,434,630 shares outstanding as of December 28, 2018 and June 29, 2018, respectively)	381	377
Additional paid-in capital	151,639	151,797
Less: Treasury shares (1,289,103 shares and 1,289,103 shares as of December 28, 2018 and June 29, 2018, respectively)	(42,401)	(42,401)
Accumulated other comprehensive loss	(1,077)	(1,257)
Retained earnings	692,991	632,423
Total Shareholders' Equity	<u>801,533</u>	<u>740,939</u>
Total Liabilities and Shareholders' Equity	<u>\$ 1,175,926</u>	<u>\$ 1,088,018</u>

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

FABRINET

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (unaudited)

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
<i>(in thousands of U.S. dollars, except per share amounts)</i>				
Revenues	\$ 403,080	\$ 337,072	\$ 780,257	\$ 694,385
Cost of revenues	(357,516)	(299,906)	(694,417)	(616,887)
Gross profit	45,564	37,166	85,840	77,498
Selling, general and administrative expenses	(12,727)	(13,157)	(27,164)	(28,835)
Expenses related to reduction in workforce	(319)	(1,776)	(404)	(1,776)
Operating income	32,518	22,233	58,272	46,887
Interest income	1,182	596	2,626	1,405
Interest expense	(1,616)	(826)	(2,250)	(1,679)
Foreign exchange (loss) gain, net	(421)	(1,348)	2,647	(3,282)
Other income	562	250	639	347
Income before income taxes	32,225	20,905	61,934	43,678
Income tax expense	(712)	(1,592)	(2,571)	(3,332)
Net income	31,513	19,313	59,363	40,346
Other comprehensive income (loss), net of tax:				
Change in net unrealized gain (loss) on available-for-sale securities	598	(462)	886	(432)
Change in net unrealized loss on derivative instruments	—	—	(1)	(1)
Change in foreign currency translation adjustment	(505)	44	(705)	569
Total other comprehensive income (loss), net of tax	93	(418)	180	136
Net comprehensive income	\$ 31,606	\$ 18,895	\$ 59,543	\$ 40,482
Earnings per share				
Basic	\$ 0.86	\$ 0.52	\$ 1.62	\$ 1.08
Diluted	\$ 0.84	\$ 0.51	\$ 1.59	\$ 1.06
Weighted-average number of ordinary shares outstanding (thousands of shares)				
Basic	36,841	37,477	36,733	37,462
Diluted	37,471	38,156	37,305	38,160

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

FABRINET
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

<i>(in thousands of U.S. dollars)</i>	Six Months Ended	
	December 28, 2018	December 29, 2017
Cash flows from operating activities		
Net income for the period	\$ 59,363	\$ 40,346
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Depreciation and amortization	15,000	14,265
Loss on disposal of property, plant and equipment	528	—
Loss on disposal of intangibles	149	—
Loss from sales and maturities of available-for-sale securities	1,060	357
Amortization of investment premium	(533)	(163)
Amortization of deferred debt issuance costs	—	295
Allowance for doubtful accounts	—	5
Unrealized (gain) loss on exchange rate and fair value of derivative instruments	(5,775)	1,740
Share-based compensation	8,949	12,378
Deferred income tax	481	(153)
Other non-cash expenses	580	962
Inventory obsolescence	29	654
Changes in operating assets and liabilities		
Trade accounts receivable	(14,381)	5,707
Contract assets	(3,459)	—
Inventory	(28,909)	(1,047)
Other current assets and non-current assets	2,128	(6,801)
Trade accounts payable	29,276	(33,626)
Income tax payable	1,859	(791)
Other current liabilities and non-current liabilities	2,953	2,985
Net cash provided by operating activities	69,298	37,113
Cash flows from investing activities		
Purchase of short-term investments	(82,141)	(48,679)
Proceeds from sales of short-term investments	70,472	18,672
Proceeds from maturities of short-term investments	34,788	31,427
Purchase of property, plant and equipment	(9,732)	(21,405)
Purchase of intangibles	(251)	(689)
Proceeds from disposal of property, plant and equipment	5	35
Net cash provided by (used in) investing activities	13,141	(20,639)
Cash flows from financing activities		
Proceeds of short-term loans from bank	—	5,000
Repayment of short-term loans from bank	—	(1,003)
Repayment of long-term loans from bank	(813)	(6,800)
Repayment of capital lease liability	(255)	(174)
Repurchase of ordinary shares	—	(9,910)
Proceeds from issuance of ordinary shares under employee share option plans	—	990
Release of restricted cash held in connection with business acquisition	(3,478)	—
Withholding tax related to net share settlement of restricted share units	(9,103)	(3,744)
Net cash used in financing activities	(13,649)	(15,641)
Net increase in cash, cash equivalents and restricted cash	68,790	833
Movement in cash, cash equivalents and restricted cash		
Cash, cash equivalents and restricted cash at beginning of period	161,433	137,137
Increase in cash, cash equivalents and restricted cash	68,790	833
Effect of exchange rate on cash, cash equivalents and restricted cash	773	284
Cash, cash equivalents and restricted cash at end of period	\$ 230,996	\$ 138,254
Non-cash investing and financing activities		
Construction, software-related and equipment-related payables	\$ 2,888	\$ 5,658

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

FABRINET**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited) (Continued)**

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheets that sum to the total of the same amounts shown in the condensed consolidated statements of cash flows:

<i>(amount in thousands)</i>	As of December 28, 2018	As of December 29, 2017
Cash and cash equivalents	\$ 230,996	\$ 134,831
Restricted cash in connection with business acquisition (non-current assets)	—	3,423
Cash, cash equivalents and restricted cash	<u>\$ 230,996</u>	<u>\$ 138,254</u>

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

FABRINET
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)
(in thousands of U.S. dollars unless otherwise noted)

1. Business and organization

General

Fabrinet (“Fabrinet” or the “Parent Company”) was incorporated on August 12, 1999, and commenced operations on January 1, 2000. The Parent Company is an exempted company incorporated in the Cayman Islands, British West Indies. The “Company” refers to Fabrinet and its subsidiaries as a group.

The Company provides advanced optical packaging and precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (“OEMs”) of complex products, such as optical communication components, modules and sub-systems, industrial lasers, medical devices and sensors. The Company offers a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, complex printed circuit board assembly, advanced packaging, integration, final assembly and testing. The Company focuses primarily on the production of low-volume, high-mix products. The principal subsidiaries of Fabrinet include Fabrinet Co., Ltd. (“Fabrinet Thailand”), Casix, Inc. (“Casix”), Fabrinet West, Inc. (“Fabrinet West”) and Fabrinet UK Limited, which was formerly known as Exception EMS Ltd.

2. Accounting policies

Basis of presentation

The accompanying condensed consolidated financial statements for Fabrinet as of December 28, 2018 and for the three and six months ended December 28, 2018 and December 29, 2017 includes normal recurring adjustments, necessary for a fair statement of the financial statements set forth herein, in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial information and the rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, such information does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, please refer to the consolidated financial statements and footnotes thereto included in Fabrinet’s Annual Report on Form 10-K for the year ended June 29, 2018.

The balance sheet as of June 29, 2018 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The results for the three and six months ended December 28, 2018 may not be indicative of results for the year ending June 28, 2019 or any future periods.

Use of Estimates

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

Fiscal years

The Company utilizes a 52-53 week fiscal year ending on the Friday in June closest to June 30. The three months ended December 28, 2018 and December 29, 2017 each consisted of 13 weeks. The six months ended December 28, 2018 and December 29, 2017 each consisted of 26 weeks. Fiscal year 2019 will be comprised of 52 weeks and will end on June 28, 2019.

Changes in Accounting Policies

Except for the adoption of the new revenue recognition accounting standard described below and as disclosed in Note 3—Revenues, the Company has consistently applied the accounting policies to all periods presented in these condensed consolidated financial statements.

Adoption of New Accounting Standard

On June 30, 2018, the Company adopted Revenue from Contracts with Customers (Topic 606), which created Accounting Standards Codification Topic 606 (“ASC 606”), using the modified retrospective method applied to those contracts which were not completed as of June 29, 2018. The modified retrospective method requires the Company to recognize the cumulative effect of the adoption of ASC 606, for all contracts with customers, to the opening balance of equity at June 30, 2018. Accordingly, the Company’s comparative financial information as of June 29, 2018 has not been adjusted and continues to be reported under ASC 605, Revenue Recognition (“ASC 605”).

The cumulative effect adjustment recorded was based on the timing difference of revenue recognition between ASC 605 and ASC 606 related to certain manufacturing contracts with vendor-managed inventory arrangements. Under ASC 605, revenue for such contracts was recognized at the earlier of when the inventory was consumed by the customers or if not consumed, on the expiration of time specified in the contract. On adoption of ASC 606, revenue is recognized when inventory is shipped to the customers.

The following table shows the impact of adoption of ASC 606 on adoption date of June 29, 2018 on the condensed consolidated balance sheets:

Condensed Consolidated Balance Sheets

<i>(amount in thousands)</i>	Impact of Adopting ASC 606		
	Balance at June 29, 2018	Adjustment	Balance at June 30, 2018
Assets			
Contract assets	\$ —	\$ 9,877(1)	\$ 9,877
Inventory, net	\$ 257,687	\$ (8,672)(2)	\$ 249,015
Liabilities and Shareholders’ Equity			
Retained earnings	\$ 632,423	\$ 1,205(3)	\$ 633,628

- (1) Majority of adjustment relates to certain manufacturing contracts with vendor-managed inventory arrangements for which revenue was recognized on shipment.
- (2) Adjustment relates to reduction of finished goods inventory for certain vendor-managed inventory arrangements.
- (3) Adjustment relates to cumulative effect adjustment upon adoption of ASC 606.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, short-term investments, derivatives, accounts receivable and contract assets.

Cash, cash equivalents, and short-term investments are maintained with several financial institutions. Deposits held with banks may exceed the amount of insurance provided on such deposits. Generally, these deposits may be redeemed upon demand and are maintained with financial institutions with reputable credit and therefore bear minimal credit risk. The Company seeks to mitigate its credit risks by spreading such risks across multiple counterparties and monitoring the risk profiles of these counterparties. The Company limits its investments in short-term investments to term deposits and marketable securities to securities with a maturity not in excess of three years, and all marketable securities that the Company invests in are rated A1, P-1, F1, or better.

The Company performs ongoing credit evaluations for credit worthiness of its customers and usually does not require collateral from its customers. Management has implemented a program to closely monitor near term cash collection and credit exposures to mitigate any material losses.

New Accounting Pronouncements – not yet adopted by the Company

In August 2018, the Financial Accounting Standards Board (“FASB”) issued ASU 2018-13, “Fair Value Measurement (Topic 820), Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement.” This ASU is intended to improve the effectiveness of disclosures in the notes to the financial statements including 1) the development of a framework that promotes consistent decisions by the Board about disclosure requirements and 2) the appropriate exercise of discretion by reporting entities. The amendment modifies the disclosure requirements on transferring between level 1 and level 2 and valuation processes of level 3 fair value measurements. The amendments in this update are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In July 2018, the FASB issued ASU 2018-11, “Leases (Topic 842), Target Improvements.” This ASU provided guidance on comparative reporting requirements for initial adoption. This ASU also provides additional guidance for lessors, on separating lease and non-lease components in a contract and allocating the consideration in the contract to the separate components. For public business entities, this update is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In July 2018, the FASB issued ASU 2018-10, “Codification Improvements to Topic 842, Leases.” The amendment in this update affects narrow aspects of the guidance issued in the amendments in update 2016-02 on various matters. For public business entities, this update is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “Intangibles – Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment.” This amendment modified the concept of impairment assessment from the condition that exists when the carrying amount of goodwill exceeds its implied fair value to the condition that exists when the carrying amount of a reporting unit exceeds its fair value. Public companies that are SEC filers should adopt the amendment for its annual and any interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company does not expect the amendments will impact its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, “Lease (Topic 842).” The core principle of Topic 842 is that a lessee should recognize the lease assets and liabilities that arise from leases in the statement of financial position. For public business entities, this update is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

3. Revenues

The Company derives total revenues primarily from the assembly of products under supply agreements with its customers and the fabrication of customized optics and glass. The Company recognizes revenue relating to contracts with customers that depicts the transfer of promised goods or services to customers in an amount reflecting the consideration to which the Company expects to be entitled in exchange for such goods or services. In order to meet this requirement, the Company applies the following five steps: (1) identify the contract with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when a performance obligation is satisfied. Revenue is recognized net of any taxes collected from customers, which is subsequently remitted to governmental authorities.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer. In contracts with multiple performance obligations, the Company identifies each performance obligation and evaluates whether the performance obligation is distinct within the context of the contract at contract inception. The majority of the Company’s contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct.

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The Company manufactures products that are customized to customers' specifications, however, control of the products is typically transferred to the customer at the point in time the product is either shipped or delivered, depending on the terms of the arrangement, as the criteria for overtime recognition are not met. On the evaluation of the contracts, the Company identified that it did not have contractual rights to bill profit for work in progress in the event of a contract termination which is expected to be infrequent. Further, in limited circumstances, substantive acceptance by the customer exists which results in the deferral of revenue until acceptance is formally received from the customer. Judgment may be required in determining if the acceptance clause is substantive.

Certain customers may request the Company to store finished products purchased by them at the Company's warehouse. In these instances, the Company receives a written request from the customer asking the Company to hold the inventory at the Company's warehouse and the ordered goods cannot be used to fulfill other customer orders. In these situations, revenue is only recognized when the goods are completed and ready for shipment and transferred to the Company's warehouse.

Customers generally are obligated to purchase finished goods that the Company has manufactured according to their demand requirements. Materials that are not consumed by customers within a specified period of time, or are no longer required due to a product's cancellation or end-of-life, are typically designated as excess or obsolete inventory under the Company's contracts. Once materials are designated as either excess or obsolete inventory, customers are typically required to purchase such inventory from the Company even if the customer has chosen to cancel production of the related products. The excess or obsolete inventory is shipped to the customer and revenue is recognized upon shipment.

A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. In determining the transaction price, the Company evaluates whether the price is subject to refund or adjustment to determine the net consideration to which the Company expects to be entitled. The Company generally does not grant return privileges, except for defective products during the warranty period. The Company generally provides a warranty of between one to five years on the product.

Warranty provision

Provisions for estimated expenses relating to product warranties are made at the time the products are sold using historical experience. Generally, this warranty is limited to workmanship and the Company's liability is capped at the price of the product. The provisions will be adjusted when experience indicates an expected settlement will differ from initial estimates.

Contract Assets and Liabilities

A contract asset is recognized when the Company has recognized revenues, but not yet an invoice for payment. Contract assets are classified separately on the condensed consolidated balance sheets and transferred to accounts receivable when rights to payment become unconditional. The following table summarizes the activity in the Company's contract assets during the six-month period ended December 28, 2018:

<i>(amount in thousands)</i>	Contract Assets
Beginning balance, June 30, 2018	\$ —
Cumulative effect adjustment at June 30, 2018	9,877
Revenue recognized	58,484
Amounts collected or invoiced	(55,025)
Ending balance, December 28, 2018	<u>\$ 13,336</u>

The Company continually evaluates whether advanced payment arrangements with customers result in the recognition of contract liabilities. No such liabilities existed as of December 28, 2018 or June 29, 2018. Separately, accounts receivable, net, represents receivables from contracts with customers.

Contract Costs

The Company has elected the practical expedient to recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the Company otherwise would have recognized is one year or less. During the three and six months ended December 28, 2018, the Company did not have any incremental costs of obtaining a contract.

Shipping and Handling

Shipping costs billed to customers are recorded as revenue. Shipping and handling expense related to costs incurred to deliver product are recognized within cost of goods sold. The Company accounts for shipping and handling activities that occur after control has transferred as a fulfillment cost as opposed to a separate performance obligation, and the costs of shipping and handling are recognized concurrently with the related revenue.

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption of ASC 606 on the Company's condensed consolidated statements of operations and comprehensive income for the three and six months ended December 28, 2018 and condensed consolidated balance sheets as of December 28, 2018 was as follows:

Condensed Consolidated Statement of Operations

Three and Six Months Ended December 28, 2018

<i>(amount in thousands)</i>	Impact of Adopting ASC 606 (Three months)			Impact of Adopting ASC 606 (Six months)		
	As Reported	Adjustment	Balance without ASC 606 Adoption	As Reported	Adjustment	Balance without ASC 606 Adoption
Revenues	\$ 403,080	\$ (3,179)(1)	\$ 399,901	\$ 780,257	\$ (3,459)(1)	\$ 776,798
Cost of revenues	\$ (357,516)	\$ 2,791(2)	\$ (354,725)	\$ (694,417)	\$ 3,040(2)	\$ (691,377)
Gross profit	\$ 45,564	\$ (388)(3)	\$ 45,176	\$ 85,840	\$ (419)(3)	\$ 85,421
Net income	\$ 31,513	\$ (388)(3)	\$ 31,125	\$ 59,363	\$ (419)(3)	\$ 58,944
Earnings per share						
Basic	\$ 0.86	\$ (0.02)	\$ (0.84)	\$ 1.62	\$ (0.02)	\$ 1.60
Diluted	\$ 0.84	\$ (0.01)	\$ (0.83)	\$ 1.59	\$ (0.01)	\$ 1.58

- (1) Adjustment relates to certain manufacturing contracts with vendor-managed inventory arrangements for which revenue was recognized at shipping.
- (2) Adjustment relates to costs associated with revenue recognized.
- (3) Adjustment relates to net impact on net income upon adoption of ASC 606.

Condensed Consolidated Balance Sheets

As of December 28, 2018

<i>(amount in thousands)</i>	Impact of Adopting ASC 606		
	As Reported	Adjustments	Balance without ASC 606 Adoption
Assets			
Contract assets	\$ 13,336	\$ (13,336)(1)	\$ —
Inventory, net	\$ 277,893	\$ 11,712(2)	\$ 289,605
Liabilities and Shareholders' Equity			
Retained earnings	\$ 692,991	\$ (1,624)(3)	\$ 691,367

- (1) Majority of adjustment relates to certain manufacturing contracts with vendor-managed inventory arrangements for which revenue was recognized on shipment.
- (2) Adjustment relates to reduction of finished goods inventory for vendor-managed inventory.
- (3) Adjustment relates to cumulative effect adjustment upon adoption of ASC 606.

Revenue by Geographic Area:

Total revenues are attributed to a particular geographic area based on the bill-to-location of the customers. The Company operates primarily in three geographic regions: North America, Asia-Pacific and Europe. The following table presents total revenues by geographic regions:

<i>(amount in thousands)</i>	Three Months Ended December 28, 2018	As a % of Total Revenues	Six Months Ended December 28, 2018	As a % of Total Revenues
North America	\$ 182,698	45.3%	\$ 362,524	46.5%
Asia-Pacific	166,711	41.4	318,658	40.8
Europe	53,671	13.3	99,075	12.7
	<u>\$ 403,080</u>	<u>100.0%</u>	<u>\$ 780,257</u>	<u>100.0%</u>

The following table sets forth revenues by end market.

<i>(amount in thousands)</i>	Three Months Ended December 28, 2018	As a % of Total Revenues	Six Months Ended December 28, 2018	As a % of Total Revenues
Optical communications	\$ 305,547	75.8%	\$ 586,315	75.1%
Lasers, sensors and other	97,533	24.2	193,942	24.9
	<u>\$ 403,080</u>	<u>100.0%</u>	<u>\$ 780,257</u>	<u>100.0%</u>

4. Earnings per ordinary share

Basic earnings per ordinary share is computed by dividing reported net income by the weighted-average number of ordinary shares outstanding during each period. Diluted earnings per ordinary share is computed by calculating the effect of potential dilutive ordinary shares outstanding during the period using the treasury stock method. Dilutive ordinary equivalent shares consist of share options, restricted share units and performance share units. Earnings per ordinary share was calculated as follows:

<i>(amount in thousands except per share amounts)</i>	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Net income attributable to shareholders	\$ 31,513	\$ 19,313	\$ 59,363	\$ 40,346
Weighted-average number of ordinary shares outstanding (thousands of shares)	36,841	37,477	36,733	37,462
Incremental shares arising from the assumed exercise of share options and vesting of restricted share units (thousands of shares)	630	679	572	698
Weighted-average number of ordinary shares for diluted earnings per ordinary share (thousands of shares)	37,471	38,156	37,305	38,160
Basic earnings per ordinary share	\$ 0.86	\$ 0.52	\$ 1.62	\$ 1.08
Diluted earnings per ordinary share	\$ 0.84	\$ 0.51	\$ 1.59	\$ 1.06
Outstanding performance share units excluded in the computation of diluted earnings per ordinary share (thousands of shares) (1)	401	284	401	284

- (1) Outstanding performance share units were not included in the computation of diluted earnings per ordinary shares because they are not expected to vest based on the Company's current assessment of the related performance obligations.

As of December 28, 2018 and December 29, 2017, there were no anti-dilutive share options.

5. Cash, cash equivalents and short-term investments

The Company's cash, cash equivalents, and short-term investments can be analyzed as follows:

<i>(amount in thousands)</i>	<u>Carrying Cost</u>	<u>Unrealized Loss</u>	<u>Fair Value</u>		
			<u>Cash and Cash Equivalents</u>	<u>Marketable Securities</u>	<u>Other Investments</u>
As of December 28, 2018					
Cash	\$ 170,802	\$ —	\$ 170,802	\$ —	\$ —
Cash equivalents	60,194	—	60,194	—	—
Certificates of deposit	21,000	—	—	—	21,000
Corporate bonds and commercial papers	104,970	(518)	—	104,452	—
U.S. agency and U.S. treasury securities	25,275	(209)	—	25,066	—
Sovereign and municipal securities	1,004	(14)	—	990	—
Total	\$ 383,245	\$ (741)	\$ 230,996	\$ 130,508	\$ 21,000
As of June 29, 2018					
Cash	\$ 146,778	\$ —	\$ 146,778	\$ —	\$ —
Cash equivalents	11,324	—	11,324	—	—
Certificates of deposit	—	—	—	—	—
Corporate bonds and commercial papers	128,441	(736)	—	127,705	—
U.S. agency and U.S. treasury securities	43,734	(324)	—	43,410	—
Sovereign and municipal securities	3,185	(31)	—	3,154	—
Total	\$ 333,462	\$ (1,091)	\$ 158,102	\$ 174,269	\$ —

All highly liquid investments with original maturities of three months or less at the date of purchase are classified as cash equivalents. Management determines the appropriate classification of its investments at the time of purchase and re-evaluates the designations at each balance sheet date. The Company may sell certain of its short-term investments prior to their stated maturities for strategic reasons including, but not limited to, anticipation of credit deterioration and duration management. The maturities of the Company's short-term investments generally range from three months to three years. The Company's investments in marketable securities consist of investments in U.S. Treasuries and fixed income securities and have been classified and accounted for as available-for-sale.

The following table summarizes the cost and estimated fair value of marketable securities classified as available-for-sale securities based on stated effective maturities as of December 28, 2018:

<i>(amount in thousands)</i>	<u>Carrying Cost</u>	<u>Fair Value</u>
Due within one year	\$ 22,935	\$ 22,923
Due between one to three years	108,314	107,585
Total	\$ 131,249	\$ 130,508

During the six months ended December 28, 2018, the Company recognized a realized gain of \$0.3 million from sales and maturities of available-for-sale securities.

As of December 28, 2018, the Company considered the declines in market value of its marketable securities investment portfolio to be temporary in nature and did not consider any of its securities other-than-temporarily impaired. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's cost basis. No impairment losses were recorded for the six months ended December 28, 2018.

As of December 28, 2018, cash, cash equivalents, and marketable securities included bank deposits of \$40.0 million held in various financial institutions located in the United States in order to support the availability of the Facility Agreement (as defined in Note 11) and comply with covenants. Under the terms and conditions of the Facility Agreement, the Company shall maintain cash, cash equivalents and/or marketable securities in an aggregate amount not less than \$40.0 million in unencumbered deposits, and/or securities in accounts located in the United States at all times during the term of the Facility Agreement. As discussed in Note 11, the Company must comply with this covenant from and after the effective date of the Facility Agreement.

6. Fair value of financial instruments

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

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for assets or liabilities, either directly or indirectly. If the assets or liabilities have a specified (contractual) term, Level 2 inputs must be observable for substantially the full term of assets or liabilities.

Level 3 inputs are unobservable inputs for assets or liabilities, which require the reporting entity to develop its own valuation techniques and assumptions.

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

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The following table provides details of the financial instruments measured at fair value on a recurring basis, including:

<i>(amount in thousands)</i>	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
As of December 28, 2018				
Assets				
Cash equivalents	\$ —	\$ 60,194	\$ —	\$ 60,194
Certificates of deposit	—	21,000	—	21,000
Corporate bonds and commercial papers	—	104,452	—	104,452
U.S. agency and U.S. treasury securities	—	25,066	—	25,066
Sovereign and municipal securities	—	990	—	990
Derivative assets	—	—	—	—
Total	\$ —	\$ 211,702	\$ —	\$ 211,702
Liabilities				
Derivative liabilities	\$ —	\$ 855 ⁽¹⁾	\$ —	\$ 855
Total	\$ —	\$ 855	\$ —	\$ 855
As of June 29, 2018				
Assets				
Cash equivalents	\$ —	\$ 11,324	\$ —	\$ 11,324
Certificates of deposit	—	—	—	—
Corporate bonds and commercial papers	—	127,705	—	127,705
U.S. agency and U.S. treasury securities	—	43,410	—	43,410
Sovereign and municipal securities	—	3,154	—	3,154
Derivative assets	—	—	—	—
Total	\$ —	\$ 185,593	\$ —	\$ 185,593
Liabilities				
Derivative liabilities	\$ —	\$ 1,745 ⁽²⁾	\$ —	\$ 1,745
Total	\$ —	\$ 1,745	\$ —	\$ 1,745

- (1) Foreign currency forward contracts with a notional amount of \$8.0 million and Canadian dollars of \$0.4 million. Foreign currency option contracts with a notional amount of \$15.0 million. Interest rate swap agreement with notional amount of \$64.2 million subject to the Amortization Schedule.
- (2) Foreign currency forward contracts with a notional amount of \$7.0 million and Canadian dollars 0.4 million. Foreign currency option contracts with a notional amount of \$30.0 million.

Derivative Financial Instruments

As a result of foreign currency rate fluctuations, the U.S. dollar equivalent values of the Company's foreign currency denominated assets and liabilities are changed. The Company uses foreign currency contracts to manage the foreign exchange risk associated with certain foreign currency denominated assets and liabilities and other foreign currency transactions. The Company minimizes the credit risk in derivative instruments by limiting its exposure to any single counterparty and by entering into derivative instruments only with counterparties that meet the Company's minimum credit quality standard. As of December 28, 2018, the Company recognized the fair value of foreign currency forward contracts and foreign currency option contracts of \$7.0 thousand and fair value of interest rate swap of \$0.8 million as derivative liabilities in the condensed consolidated balance sheets under other current liabilities. As of June 29, 2018, the Company recognized the fair value of foreign currency forward contracts and foreign currency option contracts of \$1.7 million as derivative liabilities in the consolidated balance sheets under other current liabilities.

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As of December 28, 2018 and June 29, 2018, the Company had no foreign currency forward contracts designated as cash flow hedges.

On July 25, 2018, the Company entered into an interest rate swap agreement (the "Swap Agreement"), which the Company did not designate as hedging instruments. The Swap Agreement was used to mitigate interest rate risk and improve the interest rate profile of the Company's debt obligations. The Swap Agreement effectively has a notional amount of \$64.2 million and it effectively converts the floating interest rate of the term loans under the Facility Agreement to the fixed interest rate of 2.86% per annum through maturity in June 2023. The swap transactions are due and settled monthly. During the six months ended December 28, 2018, the Company included a net loss of \$1.0 million from the settlement of the Swap Agreement as interest expense in the condensed consolidated statements of operations and comprehensive income.

As of December 28, 2018, the Company had four outstanding foreign currency forward contracts with a notional amount of \$8.0 million, three outstanding U.S. dollars foreign currency option contracts with a notional amount of \$15.0 million and one outstanding Canadian dollars forward contract with notional amount of \$0.4 million with maturity dates from January through April 2019. These foreign currency forward contracts and option contracts were not designated for hedge accounting and were used to hedge fluctuations in the U.S. dollar value of forecasted transactions denominated in Thai baht and Canadian dollars. During the six months ended December 28, 2018, the Company included unrealized loss of \$9.7 thousand from changes in the fair value of foreign currency contracts in earnings as foreign exchange loss, net in the condensed consolidated statements of operations and comprehensive income.

As of December 29, 2017, the Company had 17 outstanding foreign currency forward contracts with an aggregate notional amount of \$31.5 million and Canadian dollars 0.3 million, maturing during January to March 2018. These foreign currency forward contracts were not designated for hedge accounting and were used to hedge fluctuations in the U.S. dollar value of forecasted transactions denominated in Thai baht and Canadian dollar. During the six months ended December 29, 2017, the Company included an unrealized loss of \$0.1 million from changes in the fair value of foreign currency contracts in earnings as foreign exchange loss, net in the condensed consolidated statements of operations and comprehensive income.

7. Trade accounts receivable, net

<i>(amount in thousands)</i>	As of December 28, 2018	As of June 29, 2018
Trade accounts receivable	\$ 261,579	\$ 246,972
Less: allowance for doubtful account	(60)	(60)
Trade accounts receivable, net	<u>\$ 261,519</u>	<u>\$ 246,912</u>

8. Inventory

<i>(amount in thousands)</i>	As of December 28, 2018	As of June 29, 2018
Raw materials	\$ 110,927	\$ 100,241
Work in progress	139,333	121,797
Finished goods	18,661	20,690
Goods in transit	11,559	17,516
	<u>280,480</u>	<u>260,244</u>
Less: Inventory obsolescence	(2,587)	(2,557)
Inventory, net	<u>\$ 277,893</u>	<u>\$ 257,687</u>

9. Intangibles

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

<i>(amount in thousands)</i>	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation Adjustment	Net
As of December 28, 2018				
Software	\$ 6,380	\$ (4,585)	\$ —	\$ 1,795
Customer relationships	4,373	(1,766)	(124)	2,483
Backlog	119	(114)	—	5
Total intangibles	<u>\$ 10,872</u>	<u>\$ (6,465)</u>	<u>\$ (124)</u>	<u>\$ 4,283</u>
As of June 29, 2018				
Software	\$ 6,269	\$ (4,324)	\$ —	\$ 1,945
Customer relationships	4,373	(1,413)	(42)	2,918
Backlog	119	(101)	(1)	17
Total intangibles	<u>\$ 10,761</u>	<u>\$ (5,838)</u>	<u>\$ (43)</u>	<u>\$ 4,880</u>

The Company recorded amortization expense relating to intangibles of \$0.3 million and \$0.4 million for the three months ended December 28, 2018 and December 29, 2017, respectively, and \$0.6 million and \$0.7 million for the six months ended December 28, 2018 and December 29, 2017, respectively.

The weighted-average remaining life of customer relationships and backlog are:

<i>(years)</i>	As of December 28, 2018	As of June 29, 2018
Customer relationships	5.8	6.1
Backlog	0.5	0.9

Based on the carrying amount of intangibles as of December 28, 2018, and assuming no future impairment of the underlying assets, the estimated future amortization during each fiscal year was as follows:

<i>(amount in thousands)</i>	
2019 (remaining six months)	\$ 696
2020	1,080
2021	936
2022	705
2023	443
Thereafter	423
Total	<u>\$4,283</u>

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The changes in the carrying amount of goodwill from the acquisition of Fabrinet UK were as follows:

<i>(amount in thousands)</i>	Goodwill
Balance as of June 29, 2018	\$ 3,828
Foreign currency translation adjustment	(130)
Balance as of December 28, 2018	<u>\$ 3,698</u>
Balance as of June 30, 2017	\$3,806
Foreign currency translation adjustment	22
Balance as of June 29, 2018	<u>\$3,828</u>

Goodwill is not deductible for tax purposes. Goodwill is reviewed annually for impairment or more frequently whenever changes or circumstances indicate the carrying amount of goodwill may not be recoverable.

11. Borrowings

The Company's total borrowings, including short-term and long-term borrowings, consisted of the following:

<u>Rate (1)</u>	<u>Conditions</u>	<u>Maturity</u>	<u>As of December 28, 2018</u>	<u>As of June 29, 2018</u>
Short-term borrowings:				
Current portion of long-term borrowing			\$ 3,250	\$ 3,250
Long-term borrowings:				
<i>Term loan borrowing:</i>				
LIBOR +1.50% per annum	Repayable in quarterly installments	June 2023	\$ 63,375	\$64,188
			63,375	64,188
Less: Current portion			(3,250)	(3,250)
Non-current portion of long-term borrowings			<u>\$ 60,125</u>	<u>\$60,938</u>

(1) LIBOR is London Interbank Offered Rate.

The movements of long-term borrowings for the six months ended December 28, 2018 and December 29, 2017 were as follows:

<i>(amount in thousands)</i>	Six Months Ended	
	December 28, 2018	December 29, 2017
Opening balance	\$ 64,188	\$ 36,400
Repayments during the period	(813)	(6,800)
Closing balance	<u>\$ 63,375</u>	<u>\$ 29,600</u>

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As of December 28, 2018, future maturities of long-term borrowings during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2019 (remaining six months)	\$ 2,438
2020	3,250
2021	3,250
2022	3,250
2023	51,187
Total	<u>\$63,375</u>

Credit facilities:

The Company entered into a syndicated senior credit facility agreement (the "Facility Agreement") with a consortium of banks on May 22, 2014. The Facility Agreement, led by Bank of America, provided for a \$200.0 million credit line, comprised of a \$150.0 million revolving loan facility and a \$50.0 million delayed draw term loan facility. The revolving loan facility contains an accordion feature permitting Fabrinet to request an increase in the facility up to \$100.0 million subject to customary terms and conditions and provided that no default or event of default exists at the time of request.

On February 26, 2015, the Company entered into the Second Amendment to the Facility Agreement. The amendment extended the availability period for draws on the term loan facility from May 21, 2015 to July 31, 2015. It also allowed the Company, upon the satisfaction of certain conditions, to designate from time to time one or more of its subsidiaries as borrowers under the Facility Agreement. On July 31, 2015, the Company entered into the Third Amendment to the Facility Agreement. This amendment extended the availability period for draws on the term loan facility from July 31, 2015 to July 31, 2016. On July 22, 2016, the Company entered into the Fourth Amendment to the Facility Agreement to change the timing of filing certain financial information with the bank.

Loans under the Facility Agreement bear interest, at Fabrinet's option, at a rate per annum equal to a LIBOR rate plus a spread of 1.75% to 2.50%, or a base rate, determined in accordance with the Facility Agreement, plus a spread of 0.75% to 1.50%, in each case with such spread determined based on Fabrinet's consolidated total leverage ratio for the preceding four fiscal quarter period. Interest is due and payable quarterly in arrears for loans bearing interest at the base rate and at the end of an interest period (or at each three-month interval in the case of loans with interest periods greater than three months) in the case of loans bearing interest at the LIBOR rate.

Fabrinet's obligations under the Facility Agreement are guaranteed by certain of its existing and future direct material subsidiaries. In addition, the Facility Agreement is secured by Fabrinet's present and future accounts receivable, deposit accounts and cash, and a pledge of the capital stock of certain of Fabrinet's direct subsidiaries. Fabrinet is required to maintain at least \$40.0 million of cash, cash equivalents, and marketable securities at financial institutions located in the United States. Further, Fabrinet is required to maintain any of its deposits accounts or securities accounts with balances in excess of \$10.0 million in a jurisdiction where a control agreement, or the equivalent under the local law, can be effected.

The Facility Agreement contains customary affirmative and negative covenants. Negative covenants include, among other things, limitations on liens, indebtedness, investments, mergers, sales of assets, changes in the nature of the business, dividends and distributions, affiliate transactions and capital expenditures. The Facility Agreement contains financial covenants requiring Fabrinet to maintain: (i) a minimum tangible net worth of not less than \$200.0 million plus 50% of quarterly net income, exclusive of quarterly losses; (ii) a minimum debt service coverage ratio of not less than 1.50:1.00; (iii) a maximum senior leverage ratio of not more than 2.50:1.00; and (iv) a minimum quick ratio of not less than 1.10:1.00. Each of these financial covenants is calculated on a consolidated basis for the consecutive four fiscal quarter period then ended.

The Facility Agreement also contains customary events of default including, among other things, payment defaults, breaches of covenants or representations and warranties, cross-defaults with certain other indebtedness, bankruptcy and insolvency events and change in control of Fabrinet, subject to grace periods in certain instances. Upon an event of default, the lenders may terminate their commitments, declare all or a portion of the outstanding obligations payable by Fabrinet to be immediately due and payable and exercise other rights and remedies provided for under the Facility Agreement.

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On June 4, 2018, the Company entered into the Fifth Amendment to the Facility Agreement to (i) reduce the revolving commitments thereunder from \$150.0 million to \$25.0 million, (ii) extend the termination date of the revolving commitments from May 22, 2019 to June 4, 2023, (iii) refinance the then-existing term loan and revolving loans under the Facility Agreement into a \$65.0 million term loan and (iv) reduce the applicable interest rate margins and commitment fees. Term loans must be repaid in quarterly installments, beginning on June 30, 2018, with the remaining outstanding principal and accrued and unpaid interest being due and payable on June 4, 2023. After giving effect to the amendment, \$65.0 million aggregate principal amount of term loans and no revolving loans were outstanding under the Facility Agreement as of June 28, 2018. In addition, the Fifth Amendment to the Facility Agreement contains an accordion feature permitting the Company to request an increase in the revolving loan facility to provide up to an aggregate of \$200.0 million in additional commitments, subject to customary terms and conditions, and provided that no default or event of default exists at the time of such request. The Fifth Amendment is considered debt extinguishment of which the Company recognized interest expenses of \$0.1 million from remaining unamortized debt issuance costs in consolidated statements of operations and comprehensive income. As of December 28, 2018 and June 29, 2018, \$63.4 million and \$64.2 million aggregate principal amount of term loans and no revolving loans were outstanding under the Facility Agreement.

After the Fifth Amendment, loans under the Facility Agreement bear interest, at Fabrinet's option, at a rate per annum equal to a LIBOR rate plus a spread of 1.50% to 2.25%, or a base rate plus a spread of 0.50% to 1.25%, determined in accordance with the Facility Agreement in each case with such spread determined based on Fabrinet's consolidated total leverage ratio for the preceding four fiscal quarter period.

Fabrinet's obligations under the Facility Agreement are guaranteed by certain of its existing and future material direct subsidiaries. In addition, the Facility Agreement is secured by Fabrinet's present and future accounts receivable, deposit accounts and cash, and a pledge of the capital stock of certain of Fabrinet's direct subsidiaries. Fabrinet is required to maintain at least \$40.0 million of cash, cash equivalents, and marketable securities at financial institutions located in the United States. Further, Fabrinet is required to maintain any of its deposits accounts or securities accounts with balances in excess of \$20.0 million in a jurisdiction where a control agreement, or the equivalent under the local law, can be effected.

Moreover, the Fifth Amendment of Facility Agreement amends customary affirmative and negative covenants. Negative covenants include, among other things, limitations on liens, indebtedness, investments, mergers, sales of assets, changes in the nature of the business, dividends and distributions, affiliate transactions and capital expenditures. The Facility Agreement contains financial covenants requiring Fabrinet to maintain: (1) a minimum tangible net worth of not less than \$338.0 million plus 50% of quarterly net income after June 30, 2018, exclusive of quarterly losses; (2) a minimum debt service coverage ratio of not less than 1.50:1.00; (3) a maximum total leverage ratio of not more than 2.50:1.00; and (4) a minimum quick ratio of not less than 1.10:1.00. Each of these financial covenants is calculated on a consolidated basis for the consecutive four fiscal quarter period then ended. As of December 28, 2018, the Company was in compliance with all covenants under the Facility Agreement.

Fabrinet intends to use the proceeds of the credit line to finance its future expansion in the United States and Thailand, and for general corporate purposes including mergers and acquisitions of complementary manufacturing businesses or technology, although Fabrinet has no current commitments with respect to any such acquisitions.

On July 25, 2018, the Company entered into the Swap Agreement, which the Company did not designate as a hedging instrument. The Swap Agreement was used to mitigate interest rate risk and improve the interest rate profile of the Company's debt obligations. The terms of the Swap Agreement effectively convert the floating interest rate of the term loans under the Facility Agreement to the fixed interest rate of 2.86% per annum through maturity in June 2023. The swap transactions are due and settled monthly.

Undrawn available credit facilities classified by availability period of future borrowing as of December 28, 2018 and June 29, 2018 were as follows:

<i>(amount in thousands)</i>	December 28, 2018	June 29, 2018
Expiring within one year	\$ —	\$ —
Expiring beyond one year	\$ 25,000	\$25,000

12. Income taxes

As of December 28, 2018 and June 29, 2018, the liability for uncertain tax positions including accrued interest and penalties was \$1.8 million and \$2.3 million, respectively.

The Company files income tax returns in the United States and foreign tax jurisdictions. The tax years from 2013 to 2017 remain open to examination by U.S. federal and state, and foreign tax authorities. The Company's income tax is recognized based on the best estimate of the expected annual effective tax rate for the full financial year of each entity in the Company, adjusted for discrete items arising in that quarter. If the Company's estimated annual effective tax rate changes, the Company makes a cumulative adjustment in that quarter.

The effective tax rate for the Company for the three months ended December 28, 2018 and December 29, 2017 was 4.2% and 6.3%, respectively, of net income. The decrease was primarily due to the fact that the Company had higher income from no tax jurisdiction during the second quarter of fiscal year 2019 as compared to the same period in fiscal year 2018.

The effective tax rates for the Company for the six months ended December 28, 2018 and December 29, 2017 were 5.1% and 6.3%, respectively, of net income. The decrease was primarily due to the fact that the Company had higher income from no tax jurisdiction during the six months ended December 28, 2018, compared with the six months ended December 29, 2017.

13. Share-based compensation

Share-based compensation

In determining the grant date fair value of share equity awards, the Company is required to make estimates of expected dividends to be issued, expected volatility of Fabrinet's ordinary shares, expected forfeitures of the awards, risk free interest rates for the expected term of the awards and expected terms of the awards. Forfeitures are estimated at the time of grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates. The grant date fair value of restricted share units and performance share units is based on the market value of our ordinary shares on the date of grant.

The effect of recording share-based compensation expense for the three and six months ended December 28, 2018 and December 29, 2017 was as follows:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
<i>(amount in thousands)</i>				
Share-based compensation expense by type of award:				
Restricted share units	3,344	4,586	8,029	9,433
Performance share units	625	872	920	2,945
Total share-based compensation expense	3,969	5,458	8,949	12,378
Tax effect on share-based compensation expense	—	—	—	—
Net effect on share-based compensation expense	<u>\$ 3,969</u>	<u>\$ 5,458</u>	<u>\$ 8,949</u>	<u>\$ 12,378</u>

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Share-based compensation expense was recorded in the condensed consolidated statements of operations and comprehensive income as follows:

<i>(amount in thousands)</i>	Three Months ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Cost of revenue	\$ 1,300	\$ 1,812	\$ 3,147	\$ 3,713
Selling, general and administrative expense	2,669	3,646	5,802	8,665
Total share-based compensation expense	<u>\$ 3,969</u>	<u>\$ 5,458</u>	<u>\$ 8,949</u>	<u>\$ 12,378</u>

The Company did not capitalize any share-based compensation expense as part of any asset costs during the three and six months ended December 28, 2018 and December 29, 2017.

Share-based award activity

Fabrinet maintains the following equity incentive plans: the Amended and Restated 2010 Performance Incentive Plan (the “2010 Plan”) and the 2017 Inducement Equity Incentive Plan (the “2017 Inducement Plan”). The 2010 Plan and the 2017 Inducement Plan are collectively referred to as the “Share Option Plans.”

On December 14, 2017, Fabrinet’s shareholders approved amendments to the 2010 Plan to increase the number of ordinary shares authorized for issuance under the 2010 Plan by 2,100,000 shares. As of December 28, 2018, there were an aggregate of 917,199 restricted share units outstanding and 455,358 performance share units outstanding under the 2010 Plan. As of December 28, 2018, there were 1,918,441 ordinary shares available for future grant under the 2010 Plan.

On November 2, 2017, Fabrinet adopted the 2017 Inducement Plan with a reserve of 160,000 ordinary shares authorized for future issuance solely for the granting of inducement share options and equity awards to new key employee. The 2017 Inducement Plan was adopted without shareholder approval in reliance on the “employment inducement exemption” provided under the rules of the New York Stock Exchange. As of December 28, 2018, there were an aggregate of 48,653 restricted share units outstanding and 97,306 performance share units outstanding under the 2017 Inducement Plan. As of December 28, 2018, there were 14,041 ordinary shares available for future grant under the 2017 Inducement Plan.

Share options

Fabrinet’s board of directors has the authority to determine the type of option and the number of shares subject to an option. Options generally vest and become exercisable over four years and expire, if not exercised, within seven years of the grant date. In the case of a grantee’s first grant, 25 percent of the underlying shares vest 12 months after the vesting commencement date and 1/48 of the underlying shares vest monthly over each of the subsequent 36 months. In the case of any additional grants to a grantee, 1/48 of the underlying shares vest monthly over four years, commencing one month after the vesting commencement date. Share options have been granted to directors and employees.

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The following summarizes share option activity:

	Number of Shares	Number of Exercisable Options	Weighted- Average Exercise Price	Weighted- Average Grant Date Fair Value
Balance as of June 29, 2018	2,900	2,900	\$ 15.16	
Granted	—		—	—
Exercised	—		—	
Forfeited	—		—	
Expired	(2,900)		\$ 15.16	
Balance as of December 28, 2018	<u>—</u>	—	—	
Balance as of June 30, 2017	96,688	96,688	\$ 15.70	
Granted	—		—	—
Exercised	(62,631)		\$ 15.80	
Forfeited	—		—	
Expired	—		—	
Balance as of December 29, 2017	<u>34,057</u>	34,057	\$ 15.52	

As of December 28, 2018, there was no unrecognized compensation cost under the Share Option Plans.

Restricted share units and performance share units

Restricted share units and performance share units have been granted under the 2010 Plan and the 2017 Inducement Plan.

Restricted share units granted to employees generally vest in equal installments over three or four years on each anniversary of the vesting commencement date. Restricted share units granted to non-employee directors generally cliff vest 100% on the first of January, approximately one year from the grant date, provided the director continues to serve through such date.

Performance share units granted to executives will vest, if at all, at the end of a two-year performance period based on the Company's achievement of pre-defined performance criteria, which consist of revenue and gross margin targets. The actual number of performance share units that may vest at the end of the performance period ranges from 0% to 100% of the award grant.

The following table summarizes restricted share unit activity under the 2010 Plan and the 2017 Inducement Plan:

	Number of Shares	Weighted- Average Grant Date Fair Value Per Share
Balance as of June 29, 2018	1,073,580	\$ 35.19
Granted	305,836	\$ 48.33
Issued	(393,142)	\$ 34.40
Forfeited	(69,075)	\$ 38.53
Balance as of December 28, 2018	<u>917,199</u>	\$ 39.65
Balance as of June 30, 2017	1,058,605	\$ 31.59
Granted	430,948	\$ 37.12
Issued	(285,902)	\$ 27.00
Forfeited	(39,657)	\$ 35.97
Balance as of December 29, 2017	<u>1,163,994</u>	\$ 34.62

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The following table summarizes performance share unit activity under the 2010 Plan and the 2017 Inducement Plan:

	Number of Shares	Weighted- Average Grant Date Fair Value Per Share
Balance as of June 29, 2018	605,892	\$ 38.41
Granted	201,994	\$ 48.02
Issued	(227,268)	\$ 40.48
Forfeited	(27,954)	\$ 39.35
Balance as of December 28, 2018	<u>552,664</u>	\$ 41.02
Balance as of June 30, 2017	227,268	\$ 40.48
Granted	378,624	\$ 37.16
Issued	—	—
Forfeited	—	—
Balance as of December 29, 2017	<u>605,892</u>	\$ 38.41

As of December 28, 2018, there was \$17.6 million and \$3.4 million of unrecognized share-based compensation expense related to restricted share units and performance share units, respectively, under the 2010 Plan and the 2017 Inducement Plan that is expected to be recorded over a weighted-average period of 2.70 years and 1.65 years, respectively.

For the six months ended December 28, 2018 and December 29, 2017, the Company withheld an aggregate of 205,984 shares and 91,728 shares, respectively, upon the vesting of restricted share units, based upon the closing share price on the vesting date to settle the employees' minimum statutory obligation for the applicable income and other employment taxes. For the six months ended December 28, 2018 and December 29, 2017, the Company then remitted cash of \$9.1 million and \$3.7 million, respectively, to the appropriate taxing authorities, and presented it as a financing activity within the condensed consolidated statements of cash flows. The payment had the effect on shares issued by the Company as it reduced the number of shares that would have been issued on the vesting date and was recorded as a reduction of additional paid-in capital.

14. Shareholders' equity

Share capital

Fabrinet's authorized share capital is 500,000,000 ordinary shares, par value of \$0.01 per ordinary share, and 5,000,000 preferred shares, par value of \$0.01 per preferred share.

For the three months ended December 28, 2018, Fabrinet issued 19,278 ordinary shares upon the vesting of restricted share units, net of shares withheld.

For the six months ended December 28, 2018, Fabrinet issued 414,426 ordinary shares upon the vesting of restricted share units, net of shares withheld.

All such issued shares are fully paid.

Treasury stock

In August 2017, the Company's board of directors approved a share repurchase program to permit the Company to repurchase up to \$30.0 million worth of its issued and outstanding ordinary shares in the open market in accordance with applicable rules and regulations. In February 2018, the Company's board of directors approved a \$30.0 million increase to the share repurchase authorization. During the three and six months ended December 28, 2018, no shares were repurchased under the program. As of December 28, 2018, the Company had a remaining authorization to purchase up to an additional \$17.6 million worth of its ordinary shares under the share repurchase program. Shares repurchased under the share repurchase program are held as treasury shares.

15. Accumulated other comprehensive income (loss)

The changes in AOCI for the six months ended December 28, 2018 were as follows:

<i>(amount in thousands)</i>	Unrealized net (Losses) Gains on Available-for- sale securities	Unrealized net (Losses) Gains on Derivative Instruments	Foreign Currency Translation Adjustment	Total
Balance as of June 29, 2018	\$ (1,091)	\$ 33	\$ (199)	\$(1,257)
Other comprehensive income before reclassification adjustment	1,947	—	(705)	1,242
Amounts reclassified out of AOCI to foreign exchange loss in the condensed consolidated statements of operations and comprehensive income	(1,061)	(1)	—	(1,062)
Tax effects	—	—	—	—
Other comprehensive income (loss)	\$ 886	\$ (1)	\$ (705)	\$ 180
Balance as of December 28, 2018	\$ (205)	\$ 32	\$ (904)	\$(1,077)
Balance as of June 30, 2017	\$ (72)	\$ 34	\$ (310)	\$ (348)
Other comprehensive income before reclassification adjustment	(75)	—	569	494
Amounts reclassified out of AOCI to foreign exchange loss in the condensed consolidated statements of operations and comprehensive income	(357)	(1)	—	(358)
Tax effects	—	—	—	—
Other comprehensive (loss) income	\$ (432)	\$ (1)	\$ 569	\$ 136
Balance as of December 29, 2017	\$ (504)	\$ 33	\$ 259	\$ (212)

16. Commitments and contingencies

Bank guarantees

As of December 28, 2018 and June 29, 2018, there were outstanding bank guarantees given by a bank on behalf of our subsidiary in Thailand for electricity usage and other normal business amounting to \$1.5 million.

Operating lease commitments

The Company leases a portion of its capital equipment, vehicles, and certain land and buildings for its facilities in Thailand, Cayman Islands, China, the United States and the United Kingdom under operating lease arrangements that expire in various years through 2023. Rental expense under these operating leases amounted to \$0.9 million and \$0.9 million for the six months ended December 28, 2018 and December 29, 2017, respectively.

As of December 28, 2018, the future minimum lease payments due under non-cancelable operating leases during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2019 (remaining six months)	\$ 905
2020	1,724
2021	1,322
2022	1,194
2023	1,168
Thereafter	225
Total minimum operating lease payments	<u>\$6,538</u>

Capital lease commitments

In connection with the acquisition of Fabrinet UK, the Company assumed the capital lease commitments of several machines and equipment, with various expiration dates until September 2020. The equipment can be purchased at the determined prices upon expiration of such contracts.

As of December 28, 2018, the future minimum lease payments due under non-cancelable capital leases during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2019 (remaining six months)	\$ 212
2020	397
2021	102
Total minimum capital lease payments	<u>\$ 711</u>

Purchase obligations

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

On December 23, 2016, the Company entered into an agreement to purchase a parcel of land in Chonburi, Thailand, to support the expansion of the Company's production in Thailand. The aggregate purchase price was approximately \$5.6 million, of which the first installment of \$1.1 million was paid by the Company on January 10, 2017 and the remainder was fully paid on December 25, 2017.

As of December 28, 2018, the Company had an outstanding commitment to third parties of \$4.6 million.

Indemnification of directors and officers

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

In accordance with Fabrinet's form of indemnification agreement for its directors and officers, Fabrinet has agreed to indemnify its directors and officers against certain liabilities and expenses incurred by such persons in connection with claims by reason of their being such a director or officer. Fabrinet maintains a director and officer liability insurance policy that may enable it to recover a portion of any future amounts paid under the indemnification agreements.

17. Business segments and geographic information

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is Fabrinet's chief executive officer. As of December 28, 2018, the Company operated and internally managed a single operating segment. Accordingly, the Company does not accumulate discrete information with respect to separate product lines and does not have separate reportable segments.

Total revenues are attributed to a particular geographic area based on the bill-to-location of the customers. The Company operates primarily in three geographic regions: North America, Asia-Pacific and Europe. The following table presents total revenues by geographic regions:

<i>(amount in thousands)</i>	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
North America	\$ 182,698	\$ 152,167	\$ 362,524	\$ 309,158
Asia-Pacific	166,711	130,354	318,658	273,217
Europe	53,671	54,551	99,075	112,010
	<u>\$ 403,080</u>	<u>\$ 337,072</u>	<u>\$ 780,257</u>	<u>\$ 694,385</u>

As of December 28, 2018 and December 29, 2017, the Company had approximately \$32.3 million and \$34.4 million, respectively, of long-lived assets based in North America, with the substantial remainder of assets based in Asia-Pacific and Europe.

Significant customers

The Company had a customer and two customers that contributed to 10% or more of its total trade accounts receivable as of December 28, 2018 and June 29, 2018.

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

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

- our goals and strategies;
- our and our customers' estimates regarding future revenues, operating results, expenses, capital requirements and liquidity;
- our expectation that the portion of our future revenues attributable to customers in regions outside of North America will be in line with the portion of those revenues for the six months ended December 28, 2018;
- our expectation that we will incur incremental costs of revenue as a result of our planned expansion of our business into new geographic markets;
- our expectation that our fiscal year 2019 selling, general and administrative ("SG&A") expenses will decrease as a percentage of revenue compared to fiscal year 2018 SG&A expenses;
- our expectation that our employee costs will increase in Thailand and the People's Republic of China ("PRC");
- our intent to apply for, and our expectation that we will be granted, a renewal of our 20-years period Cayman Islands tax exemption;
- our future capital expenditures and our needs for additional financing;
- the expansion of our manufacturing capacity, including into new geographies;
- the growth rates of our existing markets and potential new markets;
- our ability, and the ability of our customers and suppliers, to respond successfully to technological or industry developments;
- our suppliers' estimates regarding future costs;
- our ability to increase our penetration of existing markets and to penetrate new markets;
- our plans to diversify our sources of revenues;
- our plans to execute acquisitions;
- trends in the optical communications, industrial lasers, and sensors markets, including trends to outsource the production of components used in those markets;
- our ability to attract and retain a qualified management team and other qualified personnel and advisors; and
- competition in our existing and new markets.

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

Overview

We provide advanced optical packaging and precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers (“OEMs”) of complex products such as optical communication components, modules and sub-systems, industrial lasers, medical devices and sensors. We offer a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, complex printed circuit board assembly, advanced packaging, integration, final assembly and testing. Although we focus primarily on low-volume production of a wide variety of high complexity products, which we refer to as “low-volume, high-mix,” we also have the capability to accommodate high-volume production. Based on our experience with, and positive feedback we have received from our customers, we believe we are a global leader in providing these services to the optical communications, industrial lasers and automotive markets.

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

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

Revenues

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

Revenues by Geography

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

The percentage of our revenues generated from a bill-to location outside of North America decreased slightly from 54.9% in the three months ended December 29, 2017 to 54.7% in the three months ended December 28, 2018, and decreased from 55.5% in the six months ended December 29, 2017 to 53.5% in the six months ended December 28, 2018, primarily because the increase in sales to our customers in North America was higher than the increase in sales to our customers outside of North America. Based on the short and medium-term indications and forecasts from our customers, we expect that the portion of our future revenues attributable to customers in regions outside North America will be in line with the portion of revenues attributable to such customers during the six months ended December 28, 2018.

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The following table presents percentages of total revenues by geographic regions:

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
North America	45.3%	45.1%	46.5%	44.5%
Asia-Pacific	41.4	38.7	40.8	39.3
Europe	13.3	16.2	12.7	16.2
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Our Contracts

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

Cost of Revenues

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

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

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

We expect to incur incremental costs of revenue as a result of our planned expansion into new geographic markets, though we are not able to determine the amount of these incremental expenses.

Selling, General and Administrative Expenses

Our SG&A expenses primarily consist of corporate employee costs for sales and marketing, general and administrative and other support personnel, including research and development expenses related to the design of customized optics and glass, travel expenses, legal and other professional fees, share-based compensation expense and other general expenses not related to cost of revenues. In fiscal year 2019, we expect our SG&A expenses will decrease as a percentage of revenue compared with our fiscal year 2018 SG&A expenses.

The compensation committee of our board of directors approved a fiscal year 2019 executive incentive plan with quantitative objectives that are based solely on achieving certain revenue targets and non-GAAP gross margin targets for our fiscal year ending June 28, 2019. Bonuses under the fiscal year 2019 executive incentive plan are payable after the end of fiscal year 2019. In fiscal year 2018, the compensation committee approved a fiscal year 2018 executive incentive plan with quantitative objectives that were based solely on achieving certain revenue targets and non-GAAP gross margin targets for our fiscal year ended June 29, 2018. Because we did not achieve the targets under our fiscal year 2018 executive incentive plan, no bonuses were paid under such plan. In the three months ended September 29, 2017, the compensation committee awarded bonuses to our executive employees for Company achievements of performance under the fiscal 2017 executive incentive plan. Discretionary merit-based bonus awards are also available to our non-executive employees and payable on a quarterly basis.

In addition, during the six months ended December 28, 2018, \$1.4 million share-based compensation expenses recorded in fiscal year 2018 for the remaining portion of performance share units granted to our executives were reversed due to the unlikelihood that the performance targets would be achieved.

Additional Financial Disclosures

Foreign Exchange

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

In order to manage the risks arising from fluctuations in foreign currency exchange rates, we use derivative instruments. We may enter into exchange currency forward or put option contracts to manage foreign currency exposures associated with certain assets and liabilities and other forecasted foreign currency transactions and may designate these instruments as hedging instruments. The forward and put option contracts generally have maturities of up to 12 months. All foreign currency exchange contracts are recognized in the condensed consolidated balance sheets at fair value. Gain or loss on our forward and put option contracts generally offset the assets, liabilities, and transactions economically hedged.

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We had foreign currency denominated assets and liabilities in Thai baht, RMB and GBP as follows:

<i>(amount in thousands, except percentages)</i>	As of December 28, 2018			As of June 29, 2018		
	Currency	\$	%	Currency	\$	%
Assets						
Thai baht	1,495,411	\$46,084	84.3	980,778	\$29,568	60.7
RMB	26,427	3,850	7.0	18,455	2,789	5.7
GBP	3,769	4,770	8.7	12,514	16,392	33.6
Total		<u>\$54,704</u>	<u>100.0</u>		<u>\$48,749</u>	<u>100.0</u>
Liabilities						
Thai baht	1,840,234	\$56,710	87.7	1,401,473	\$42,251	84.5
RMB	31,130	4,535	7.0	19,893	3,007	6.0
GBP	2,729	3,454	5.3	3,615	4,735	9.5
Total		<u>\$64,699</u>	<u>100.0</u>		<u>\$49,993</u>	<u>100.0</u>

The Thai baht assets represent cash and cash equivalents, trade accounts receivable, deposits and other current assets. The Thai baht liabilities represent trade accounts payable, accrued expenses, income tax payable and other payables. We manage our exposure to fluctuations in foreign exchange rates by the use of foreign currency contracts and offsetting assets and liabilities denominated in the same currency in accordance with management's policy. As of December 28, 2018 there were \$8.0 million of foreign currency forward contracts and \$15.0 million of foreign currency option contracts outstanding on the Thai baht payables. As of June 29, 2018, there were \$7.0 million in foreign currency forward contracts and \$30.0 million of foreign currency option contracts outstanding on the Thai baht payables.

The RMB assets represent cash and cash equivalents, trade accounts receivable and other current assets. The RMB liabilities represent trade accounts payable, accrued expenses, income tax payable and other payables. As of December 28, 2018 and June 29, 2018, we did not have any derivative contracts denominated in RMB.

The GBP assets represent cash, trade accounts receivable, and other current assets. The GBP liabilities represent trade accounts payable and other payables. As of December 28, 2018 and June 29, 2018, we did not have any derivative contracts denominated in GBP.

For the six months ended December 28, 2018 and December 29, 2017, we recorded loss of \$7.0 thousand and \$0.1 million, respectively, related to derivatives that are not designated as hedging instruments in the condensed consolidated statements of operations and comprehensive income.

Currency Regulation and Dividend Distribution

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

- Foreign Currency Administration Rules, as amended on August 5, 2008, or the Exchange Rules;
- Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules; and
- Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, as promulgated by the State Administration of Foreign Exchange ("SAFE"), on August 29, 2008, or Circular 142.

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

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

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

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

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

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

Income Tax

Our effective tax rate is a function of the mix of tax rates in the various jurisdictions in which we do business. We are domiciled in the Cayman Islands. Under the current laws of the Cayman Islands, we are not subject to tax in the Cayman Islands on income or capital gains. We have received this undertaking for a 20-year period expiring August 24, 2019. The earliest we can apply for a renewal with the office of the Clerk of the Cabinet is three months prior to the expiration date. Therefore, we intend to request a renewal with the office of the Clerk of the Cabinet for another 20 years in May 2019, which we believe is likely to be granted.

Throughout the period of our operations in Thailand, we have generally received income tax and other incentives from the Thailand Board of Investment. Preferential tax treatment from the Thai government in the form of a corporate tax exemption is currently available to us through June 2020 and June 2026 on income generated from projects to manufacture certain products at our Pinehurst campus and Chonburi campus, respectively. Such preferential tax treatment is contingent on various factors, including the export of our customers' products out of Thailand and our agreement not to move our manufacturing facilities out of our current province in Thailand for at least 15 years from the date on which preferential tax treatment was granted (i.e., at least until June 2020 in the case of our Pinehurst campus and until June 2026 in the case of our Chonburi campus). In March 2016, the Thailand Revenue Department announced a permanent decrease of corporate income tax rates to 20% for tax periods beginning on or after January 1, 2016. As a result, corporate income tax rates for our Thai subsidiary are expected to remain at 20% from fiscal year 2017 onward.

The Tax Cuts and Jobs Act, or the Tax Reform Act, was enacted on December 22, 2017 and provides for significant changes to U.S. tax law. Among other provisions, the Tax Reform Act reduces the U.S. corporate income tax rate to 21% effective in 2018. The Tax Reform Act also contains a number of provisions that may impact us in future years. Since the Tax Reform Act was recently finalized and ongoing guidance and accounting interpretation is expected over the next twelve months, we have made certain provisional accounting estimates, as permitted under Staff Accounting Bulletin No. 118. The U.S. Treasury Department, the IRS, and other standard-setting bodies could interpret or issue guidance on how provisions of the Tax Reform Act will be applied or otherwise administered that is different from our interpretation. At December 28, 2018, we have completed our accounting for all of the enactment-date income tax effects of the Act and concluded that the impact to us is immaterial.

Critical Accounting Policies and Use of Estimates

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

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended June 29, 2018. The adoption of new accounting policies and the accounting standards are disclosed in Note 2 – Accounting policies to the condensed consolidated financial statements. There were no changes to our accounting policies other than the adoption of Revenue from Contracts with Customers (Topic 606), which created Accounting Standards Codification Topic 606 (“ASC 606”).

On June 30, 2018, we adopted ASC 606 using the modified retrospective method, which was applied to those contracts which were not completed as of June 29, 2018. The modified retrospective method requires us to recognize the cumulative effect of the adoption of ASC 606, for all contracts with customers, to the opening balance of equity at June 30, 2018. Accordingly, the comparative financial information as of June 29, 2018 has not been adjusted and continues to be reported under ASC 605, Revenue Recognition (“ASC 605”). Refer to Note 2 – Accounting policies and Note 3 – Revenues to the condensed consolidated financial statements for further details.

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Results of Operations

The following table sets forth a summary of our condensed consolidated statements of operations and comprehensive income. Note that period-to-period comparisons of operating results should not be relied upon as indicative of future performance.

<i>(amount in thousands)</i>	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Revenues	\$ 403,080	\$ 337,072	\$ 780,257	\$ 694,385
Cost of revenues	(357,516)	(299,906)	(694,417)	(616,887)
Gross profit	45,564	37,166	85,840	77,498
Selling, general and administrative expenses	(12,727)	(13,157)	(27,164)	(28,835)
Expenses related to reduction in workforce	(319)	(1,776)	(404)	(1,776)
Operating income	32,518	22,233	58,272	46,887
Interest income	1,182	596	2,626	1,405
Interest expense	(1,616)	(826)	(2,250)	(1,679)
Foreign exchange (loss) gain, net	(421)	(1,348)	2,647	(3,282)
Other income	562	250	639	347
Income before income taxes	32,225	20,905	61,934	43,678
Income tax expense	(712)	(1,592)	(2,571)	(3,332)
Net income	31,513	19,313	59,363	40,346
Other comprehensive income (loss), net of tax	93	(418)	180	136
Net comprehensive income	\$ 31,606	\$ 18,895	\$ 59,543	\$ 40,482

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

	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	(88.7)	(89.0)	(89.0)	(88.8)
Gross profit	11.3	11.0	11.0	11.2
Selling, general and administrative expenses	(3.2)	(3.9)	(3.5)	(4.1)
Expenses related to reduction in workforce	(0.0)	(0.5)	(0.0)	(0.3)
Operating income	8.1	6.6	7.5	6.8
Interest income	0.3	0.2	0.3	0.2
Interest expense	(0.4)	(0.3)	(0.3)	(0.2)
Foreign exchange (loss) gain, net	(0.1)	(0.4)	0.3	(0.5)
Other income	0.1	0.1	0.1	0.0
Income before income taxes	8.0	6.2	7.9	6.3
Income tax expense	(0.2)	(0.5)	(0.3)	(0.5)
Net income	7.8	5.7	7.6	5.8
Other comprehensive income (loss), net of tax	0.0	(0.1)	0.0	0.1
Net comprehensive income	7.8%	5.6%	7.6%	5.9%

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

<i>(amount in thousands)</i>	Three Months Ended		Six Months Ended	
	December 28, 2018	December 29, 2017	December 28, 2018	December 29, 2017
Optical communications	\$ 305,547	\$ 241,889	\$ 586,315	\$ 517,501
Lasers, sensors and other	97,533	95,183	193,942	176,884
Total	\$ 403,080	\$ 337,072	\$ 780,257	\$ 694,385

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

Comparison of Three and Six Months Ended December 28, 2018 with Three and Six Months Ended December 29, 2017

Total revenues.

Our total revenues increased by \$66.0 million, or 19.6%, to \$403.1 million for the three months ended December 28, 2018, compared with \$337.1 million for the three months ended December 29, 2017. This increase was primarily due to an increase in our customers' demand for both optical and non-optical communications manufacturing services during the three months ended December 28, 2018. Revenues from optical and non-optical communications products increased by \$63.7 million and \$2.3 million, or 26.3% and 2.5%, respectively, for the three months ended December 28, 2018.

Our total revenues increased by \$85.9 million, or 12.4%, to \$780.3 million for the six months ended December 28, 2018, compared with \$694.4 million for the six months ended December 29, 2017. This increase was primarily due to an increase in our customers' demand for both optical and non-optical communications manufacturing services during the six months ended December 28, 2018. Revenues from optical and non-optical communications products increased by \$68.8 million and \$17.1 million, or 13.3% and 9.6%, respectively, for the six months ended December 28, 2018.

Cost of revenues.

Our cost of revenues increased by \$57.6 million, or 19.2%, to \$357.5 million, or 88.7% of total revenues, for the three months ended December 28, 2018, compared with \$299.9 million, or 89.0% of total revenues, for the three months ended December 29, 2017. This increase in cost of revenues was in line with the increase in sales volume.

Our cost of revenues increased by \$77.5 million, or 12.6%, to \$694.4 million, or 89.0% of total revenues, for the six months ended December 28, 2018, compared with \$616.9 million, or 88.8% of total revenues, for the six months ended December 29, 2017. This increase in cost of revenues was in line with the increase in sales volume.

Gross profit.

Our gross profit increased by \$8.4 million, or 22.6%, to \$45.6 million, or 11.3% of total revenues, for the three months ended December 28, 2018, compared with \$37.2 million, or 11.0% of total revenues, for the three months ended December 29, 2017. The increase was primarily due to an increase in revenue and effective cost controls.

Our gross profit increased by \$8.3 million, or 10.8%, to \$85.8 million, or 11.0% of total revenues, for the six months ended December 28, 2018, compared with \$77.5 million, or 11.2% of total revenues, for the six months ended December 29, 2017. The increase was primarily due to an increase in revenues.

SG&A expenses.

Our SG&A expenses decreased by \$0.4 million, or 3.3%, to \$12.7 million, or 3.2% of total revenues, for the three months ended December 28, 2018, compared with \$13.1 million, or 3.9% of total revenues, for the three months ended December 29, 2017. The decrease was primarily due to (1) a decrease of executive and management expenses of \$0.5 million relating to the Executive Chairman who stepped down at the end of June 2018; and (2) a decrease of share-based compensation expenses of \$0.9 million including \$0.7 million from a reduction in restricted share-based compensation expenses and \$0.2 million from reversal of performance share, partially offset by (1) an increase of severance liabilities of \$0.4 million; and (2) an increase of public company costs and other expenses of \$0.7 million.

Our SG&A expenses decreased by \$1.6 million, or 5.8%, to \$27.2 million, or 3.5% of total revenues, for the six months ended December 28, 2018, compared with \$28.8 million, or 4.1% of total revenues, for the six months ended December 29, 2017. The decrease was primarily due to (1) a decrease of share-based compensation expenses of \$2.8 million including \$0.8 million from a reduction in restricted share-based compensation expenses and \$2.0 million from the reversal of performance share units; (2) a decrease of sale and marketing expenses of \$0.1 million, partially offset by (1) an increase of severance liabilities of \$0.5 million; (2) an increase of consulting expenses related to executive search of \$0.6 million; and (3) an increase of expenses related to new subsidiary in Israel of \$0.3 million.

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Operating income.

Our operating income increased by \$10.3 million to \$32.5 million, or 8.1% of total revenues, for the three months ended December 28, 2018, compared with \$22.2 million, or 6.6% of total revenues, for the three months ended December 29, 2017. The increase was primarily due to an increase in gross profit and a decrease of SG&A expenses.

Our operating income increased by \$11.4 million to \$58.3 million, or 7.5% of total revenues, for the six months ended December 28, 2018, compared with \$46.9 million, or 6.8% of total revenues, for the six months ended December 29, 2017. The increase was primarily due to a decrease of SG&A expenses.

Interest income.

Our interest income increased by \$0.6 million, or 98.3%, to \$1.2 million, or 0.3% of total revenues, for the three months ended December 28, 2018, compared with \$0.6 million, or 0.2% of total revenues, for the three months ended December 29, 2017. The increase was primarily due to the higher weighted average interest rate compared to the same period in the last year and an increase in the average balance of our outstanding cash.

Our interest income increased by \$1.2 million, or 86.9%, to \$2.6 million, or 0.3% of total revenues, for the six months ended December 28, 2018, compared with \$1.4 million, or 0.2% of total revenues, for the six months ended December 29, 2017. The increase was primarily due to the higher weighted average interest rate compared to the same period in the last year and an increase in the average balance of our outstanding cash.

Interest expense.

Our interest expense increased by \$0.8 million to \$1.6 million for the three months ended December 28, 2018, compared with \$0.8 million for the three months ended December 29, 2017. The increase was due to the unrealized loss of \$0.8 million for mark-to-market of interest rate swap related to our term loan.

Our interest expense increased by \$0.6 million to \$2.3 million for the six months ended December 28, 2018, compared with \$1.7 million for the six months ended December 29, 2017. The increase was due to the unrealized loss of \$0.8 million for mark-to-market of interest rate swap related to our term loan.

Foreign exchange gain (loss), net.

We recorded foreign exchange loss, net of \$0.4 million for the three months ended December 28, 2018, compared with \$1.3 million loss for the three months ended December 29, 2017. We recorded foreign exchange gain, net of \$2.6 million for the six months ended December 28, 2018, compared with \$3.3 million loss for the six months ended December 29, 2017.

Income before income taxes.

We recorded income before income taxes of \$32.2 million and \$61.9 million for the three and six months ended December 28, 2018, compared with \$20.9 million and \$43.7 million for the three and six months ended December 29, 2017, respectively.

Income tax expense.

Our provision for income tax reflects an effective tax rate of 4.2% and 6.3% for the three months ended December 28, 2018 and December 29, 2017, respectively. The decrease was primarily due to the fact that we had higher income from no tax jurisdiction during the second quarter of fiscal year 2019 as compared to the same period in fiscal year 2018.

Our provision for income tax reflects an effective tax rate of 5.1% and 6.3% for the six months ended December 28, 2018 and December 29, 2017, respectively. The decrease was primarily due to the fact that we had higher income from no tax jurisdiction during the six months ended December 28, 2018 as compared to the same period in fiscal year 2018.

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Net income.

We recorded net income of \$31.5 million, or 7.8% of total revenues, for the three months ended December 28, 2018, compared with \$19.3 million, or 5.7% of total revenues, for the three months ended December 29, 2017. The increase was primarily due to (1) an increase of gross profit of \$8.4 million due to increase of revenue and effective cost control; (2) net decrease of SG&A of \$0.4 million; (3) a decrease of expenses related to reduction in workforce of \$1.5 million; (4) net decrease of interest income and expense of \$0.2 million; and (5) net decrease of foreign exchange loss of \$0.9 million.

We recorded net income of \$59.4 million, or 7.6% of total revenues, for the six months ended December 28, 2018, compared with \$40.3 million, or 5.8% of total revenues, for the six months ended December 29, 2017. The increase was primarily due to (1) an increase of gross profit of \$8.3 million due to increase of revenue; (2) net decrease of SG&A of \$1.7 million; (3) a decrease of expenses related to reduction in workforce of \$1.4 million; (4) net increase of interest income and expense of \$0.7 million; and (5) net decrease of foreign exchange loss of \$5.9 million.

Other comprehensive income.

We recorded other comprehensive income of \$93 thousand, or 0.0% of total revenues, for the three months ended December 28, 2018, compared with other comprehensive (loss) of \$(0.4) million, or (0.1)% of total revenues, for the three months ended December 29, 2017.

We recorded other comprehensive income of \$0.2 million, or 0.0% of total revenues, for the six months ended December 28, 2018, compared with other comprehensive income of \$0.1 million, or 0.1% of total revenues, for the six months ended December 29, 2017.

Liquidity and Capital Resources

Cash Flows and Working Capital

We primarily finance our operations through cash flow from operations. As of December 28, 2018 and December 29, 2017, we had cash, cash equivalents, and short-term investments of \$382.5 million and \$284.2 million, respectively, and outstanding debt of \$63.4 million and \$68.4 million, respectively.

Our cash and cash equivalents, which primarily consist of cash on hand, demand deposits, and liquid investments with original maturities of three months or less, are placed with banks and other financial institutions. The weighted-average interest rate on our cash and cash equivalents for the three and six months ended December 28, 2018 was 1.4% and 1.6% and for the three and six months ended December 29, 2017 was 1.0%.

Our cash investments are made in accordance with an investment policy approved by the Audit Committee of our board of directors. In general, our investment policy requires that securities purchased be rated A1, P-1, F1 or better. No security may have an effective maturity that exceeds three years. Our investments in fixed income securities are primarily classified as available-for-sale and are recorded at fair value. The cost of securities sold is based on the specific identification method. Unrealized gains and losses on these securities are recorded as other comprehensive income (loss) and are reported as a separate component of shareholders' equity.

During the six months ended December 28, 2018, we repaid a term loan of \$0.8 million under our Facility Agreement; as a result, as of December 28, 2018, we had a long-term borrowing of \$63.4 million under our Facility Agreement. We anticipate that our internally generated working capital, along with our cash and cash equivalents will be adequate to repay these obligations. To better manage our cash on hand, we held investments in short-term marketable securities and certificates of deposit of \$151.5 million as of December 28, 2018.

We believe that our current cash and cash equivalents, short-term investments, cash flow from operations, and funds available through our credit facility will be sufficient to meet our working capital and capital expenditure needs for at least the next 12 months. Our ability to sustain our working capital position is subject to a number of risks that we discuss in Part II, Item 1A of this Quarterly Report on Form 10-Q.

We also believe that our current manufacturing capacity is sufficient to meet our anticipated production requirements for at least the next few quarters.

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The following table shows our cash flows for the periods indicated:

<i>(amount in thousands)</i>	Six Months Ended	
	December 28, 2018	December 29, 2017
Net cash provided by operating activities	\$ 69,298	\$ 37,113
Net cash provided by (used in) investing activities	\$ 13,141	\$ (20,639)
Net cash used in financing activities	\$ (13,649)	\$ (15,641)
Net increase in cash, cash equivalents and restricted cash	\$ 68,790	\$ 833

Operating Activities

Net cash provided by operating activities increased by \$32.2 million, or 86.7%, to \$69.3 million for the six months ended December 28, 2018, compared with net cash provided in operating activities of \$37.1 million for the six months ended December 29, 2017. This increase was primarily due to (1) an increase of net income of \$19.0 million; (2) a decrease of \$62.9 million in payments to trade accounts payable due to better working capital management; and (3) an increase of income tax payable of \$2.7 million. These increases were offset by (1) an increase of \$20.1 million from trade accounts receivable and an increase of inventory of \$27.9 million primarily due to an increase of revenues; and (3) an increase of contract assets of \$3.5 million.

Investing Activities

Net cash provided by investing activities increased by \$33.8 million, or 163.7%, to \$13.1 million for the six months ended December 28, 2018, compared with net cash used in investing activities of \$20.6 million for the six months ended December 29, 2017. This increase was primarily due to (1) net cash received from short-term investments of \$21.7 million; and (2) a decrease of investments in property, plant and equipment of \$11.7 million primarily due to no new major investments.

Financing Activities

Net cash used in financing activities decreased by \$2.0 million, or 12.7%, to \$13.6 million for the six months ended December 28, 2018, compared with net cash used by financing activities of \$15.6 million for the six months ended December 29, 2017. This decrease was primarily due to (1) a decrease of \$2.0 million in net payments of loans from bank; and (2) a decrease of \$10.0 million in payments to repurchase of ordinary shares. These decreases were offset by (1) the release of restricted cash in connection with business acquisition of \$3.5 million; (2) an increase in withholding tax related to net share settlement of restricted share units of \$5.4 million; and (3) a decrease in cash received from issuance of ordinary shares under employee share option plans of \$1.0 million.

Off-Balance Sheet Commitments and Arrangements

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

Recent Accounting Pronouncements

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

We had cash, cash equivalents, and short-term investments totaling \$382.5 million and \$332.4 million as of December 28, 2018 and June 29, 2018, respectively. We have interest rate risk exposure relating to the interest income generated by excess cash invested in highly liquid investments with maturities of three months or less from the original dates of purchase. The cash, cash equivalents, and short-term investments are held for working capital purposes. We have not used derivative financial instruments in our investment portfolio. We have not been exposed nor do we anticipate being exposed to material risks due to changes in market interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates had declined by 10 basis points during the six months ended December 28, 2018 and December 29, 2017, our interest income would have decreased by approximately \$0.2 million and \$0.1 million, respectively, assuming consistent investment levels.

We also have interest rate risk exposure in movements in interest rates associated with our interest-bearing liabilities. The interest-bearing liabilities are denominated in U.S. dollars and the interest expense is based on the London Inter-Bank Offered Rate (LIBOR), plus an additional margin, depending on the lending institution. If the LIBOR had increased by 100 basis points during the six months ended December 28, 2018 and December 29, 2017, our interest expense would have increased by approximately \$0.2 million and \$0.3 million, respectively, assuming consistent borrowing levels.

We therefore entered into an interest rate swap agreement (the "Swap Agreement") to manage this risk and increase the profile of the Company's debt obligation. The terms of the Swap Agreement allow the Company to effectively convert the floating interest rate to a fixed interest rate. This locks the variable in interest expenses associated with our floating rate borrowings and results in fixed interest expenses which is unsusceptible to market rate increase. As we did not designate the Swap Agreement as a hedging instrument, the net position of gain or loss from the Swap Agreement is recognized as interest expense in the condensed consolidated statements of operations and comprehensive income.

We maintain an investment portfolio in a variety of financial instruments, including, but not limited to, U.S. government and agency bonds, corporate obligations, money market funds, asset-backed securities, and other investment-grade securities. The majority of these investments pay a fixed rate of interest. The securities in the investment portfolio are subject to market price risk due to changes in interest rates, perceived issuer creditworthiness, marketability, and other factors. These investments are generally classified as available-for-sale and, consequently, are recorded on our consolidated balance sheets at fair value with unrealized gains or losses reported as a separate component of shareholders' equity.

Investments in both fixed-rate and floating-rate interest earning instruments carry a degree of interest rate risk. The fair market values of our fixed-rate securities decline if interest rates rise, while floating-rate securities may produce less income than expected if interest rates fall. Due in part to these factors, our future investment income may be less than we expect because of changes in interest rates or we may suffer losses in principal if forced to sell securities that have experienced a decline in market value because of changes in interest rates.

Foreign Currency Risk

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

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

We attempt to hedge against these exchange rate risks by entering into derivative instruments that are typically one to eighteen months in duration, leaving us exposed to longer term changes in exchange rates. We recorded unrealized loss of \$9.7 thousand and unrealized gain of \$0.1 million related to derivatives that are not designated as hedging instruments, for the six months ended December 28, 2018 and December 29, 2017, respectively. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to incur foreign currency translation adjustments and may incur foreign currency exchange losses. For example, a 10% weakening in the U.S. dollar against the Thai baht, the RMB and the GBP would have resulted in a decrease in our net dollar position of approximately \$1.1 million and \$0.9 million as of December 28, 2018 and June 29, 2018, respectively. We cannot give any assurance as to the effect that future changes in foreign currency rates will have on our condensed consolidated financial position, operating results or cash flows.

Credit Risk

Credit risk refers to our exposures to financial institutions, suppliers and customers that have in the past and may in the future experience financial difficulty, particularly in light of recent conditions in the credit markets and the global economy. As of December 28, 2018, our cash and cash equivalents were held in deposits and highly liquid investment products with maturities of three months or less with banks and other financial institutions having credit ratings of A minus or above. Our short-term investments as of December 28, 2018 are held in various financial institutions with a maturity limit not to exceed three years, and all securities are rated A1, P-1, F1 or better. We continue to monitor our surplus cash and consider investment in corporate and U.S. government debt as well as certain available for sale securities in accordance with our investment policy. We generally monitor the financial performance of our suppliers and customers, as well as other factors that may affect their access to capital and liquidity. Presently, we believe that we will not incur material losses due to our exposures to such credit risk.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended December 28, 2018 other than those related to adoption of Contracts with Customers (Topic 606), which created Accounting Standards Codification Topic 606 ("ASC 606") that we adopted on June 30, 2018. We implemented changes to our processes for revenue recognition and the control activities within them that included the development of new policies based on the five-step model provided in the new revenue standard, new training, ongoing contract review requirements, and gathering of information provided for disclosures.

PART II: OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Investing in our ordinary shares involves a high degree of risk. You should carefully consider the following risks, as well as the other information contained in this Quarterly Report on Form 10-Q, including our condensed consolidated financial statements and the related notes, before investing in our ordinary shares. The risks and uncertainties described below are not the only ones that we may face. Additional risks and uncertainties of which we are unaware, or that we currently deem immaterial, also may become important factors that affect us or our ordinary shares. If any of the following risks actually occur, they may harm our business, financial condition and operating results. In this event, the market price of our ordinary shares could decline and you could lose some or all of your investment.

Risks Related to Our Business

Our sales depend on a small number of customers. A reduction in orders from any of these customers, the loss of any of these customers, or a customer exerting significant pricing and margin pressures on us could harm our business, financial condition and operating results.

We have depended, and will continue to depend, upon a small number of customers for a significant percentage of our total revenues. During the three months ended December 28, 2018 and December 29, 2017, we had a customer that accounted for 19% and 17%, respectively, of our total revenues. During the six months ended December 28, 2018 and December 29, 2017, we had a customer that accounted for 18% and 15% of our total revenues. Dependence on a small number of customers means that a reduction in orders from, a loss of, or other adverse actions by any one of these customers would reduce our revenues and could have a material adverse effect on our business, financial condition and operating results.

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

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

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

Consolidation in the markets we serve has resulted in a reduction in the number of potential customers for our services. For example, in December 2018, Lumentum Holdings Inc. completed the acquisition of Oclaro, Inc., both of which are our customers. In some cases, consolidation among our customers has led to a reduction in demand for our services as customers acquired the capacity to manufacture products in-house.

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

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

Our future success as a provider of precision optical, electro-mechanical and electronic manufacturing services for the optical communications market depends on the continued growth of the optics industry and, in particular, the continued expansion of global information networks, particularly those directly or indirectly dependent upon a fiber optic infrastructure. As part of that growth, we anticipate that demand for voice, video, and other data services delivered over high-speed connections (both wired and wireless) will continue to increase. Without network and bandwidth growth, the need for enhanced communications products would be jeopardized. Currently, demand for network services and for high-speed broadband access, in particular, is increasing but growth may be limited by several factors, including, among others: (1) relative strength or weakness of the global economy or certain countries or regions, (2) an uncertain regulatory environment, and (3) uncertainty regarding long-term sustainable business models as multiple industries, such as the cable, traditional telecommunications, wireless and satellite industries, offer competing content delivery solutions. The optical communications market also has experienced periods of overcapacity, some of which have occurred even during periods of relatively high network usage and bandwidth demands. If the factors described above were to slow, stop or reverse the expansion in the optical communications market, our business, financial condition and operating results would be negatively affected.

Natural disasters (like the 2011 flooding in Thailand), epidemics, acts of terrorism and other political and economic developments could harm our business, financial condition, and operating results.

Natural disasters, such as the 2011 flooding in Thailand, where most of our manufacturing operations are located, could severely disrupt our manufacturing operations and increase our supply chain costs. These events, over which we have little or no control, could cause a decrease in demand for our services, make it difficult or impossible for us to manufacture and deliver products and for our suppliers to deliver components allowing us to manufacture those products, require large expenditures to repair or replace our facilities, or create delays and inefficiencies in our supply chain. For example, the 2011 flooding in Thailand forced us to temporarily shut down all of our manufacturing facilities in Thailand and cease production permanently at our Chokchai facility in Thailand, which adversely affected our ability to meet our customers' demands during fiscal year 2012. In some countries in which we operate, including the PRC and Thailand, potential outbreaks of infectious diseases such as the H1N1 influenza virus, severe acute respiratory syndrome ("SARS") or bird flu could disrupt our manufacturing operations, reduce demand for our customers' products and increase our supply chain costs. In addition, increased international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures, conflicts in the Middle East and Asia, strained international relations arising from these conflicts and the related decline in consumer confidence and economic weakness, may hinder our ability to do business. Any escalation in these events or similar future events may disrupt our operations and the operations of our customers and suppliers, and may affect the availability of materials needed for our manufacturing services. Such events may also disrupt the transportation of materials to our manufacturing facilities and finished products to our customers. These events have had, and may continue to have, an adverse impact on the U.S. and world economy in general, and customer confidence and spending in particular, which in turn could adversely affect our total revenues and operating results. The impact of these events on the volatility of the U.S. and world financial markets also could increase the volatility of the market price of our ordinary shares and may limit the capital resources available to us, our customers and our suppliers.

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

Our current property and casualty insurance covers loss or damage to our property and third-party property over which we have custody and control, as well as losses associated with business interruption, subject to specified exclusions and limitations such as coinsurance, facilities location sub-limits and other policy limitations and covenants. Even with insurance coverage, natural disasters or other catastrophic events, including acts of war, could cause us to suffer substantial losses in our operational capacity and could also lead to a loss of opportunity and to a potential adverse impact on our relationships with our existing customers resulting from our inability to produce products for them, for which we might not be compensated by existing insurance. This in turn could have a material adverse effect on our business, financial condition and operating results.

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

Our quarterly revenues, gross profit margins, and operating results have fluctuated significantly and may continue to fluctuate significantly in the future. For example, any of the risks described in this “Risk Factors” section and, in particular, the following factors, could cause our quarterly and annual revenues, gross profit margins, and operating results to fluctuate from period to period:

- our ability to acquire new customers and retain our existing customers by delivering superior quality and customer service;
- the cyclical nature of the optical communications market, as well as the industrial lasers, medical and sensors markets;
- competition;
- our ability to achieve favorable pricing for our services;
- the effect of fluctuations in foreign currency exchange rates;
- our ability to manage our headcount and other costs; and
- changes in the relative mix in our revenues.

Therefore, we believe that quarter-to-quarter comparisons of our operating results may not be useful in predicting our future operating results. You should not rely on our results for one quarter as any indication of our future performance. Quarterly variations in our operations could result in significant volatility in the market price of our ordinary shares.

If we are unable to continue diversifying our precision optical and electro-mechanical manufacturing services across other markets within the optics industry, such as the semiconductor processing, biotechnology, metrology and material processing markets, or if these markets do not grow as fast as we expect, our business may not grow as fast as we expect, which could adversely impact our business, financial condition and operating results.

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

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

Our current and prospective customers tend to evaluate our capabilities against the merits of their internal manufacturing as well as the capabilities of other third-party manufacturers. We believe the internal manufacturing capabilities of current and prospective customers are our primary competition. This competition is particularly strong when our customers have excess manufacturing capacity, as was the case when the markets that we serve experienced a significant downturn in 2008 and 2009 that resulted in underutilized capacity. Should our existing and potential customers have excess manufacturing capacity at their facilities, it could adversely affect our business. In addition, as a result of the 2011 flooding in Thailand, some of our customers began manufacturing products internally or using other third-party manufacturers that were not affected by the flooding. If our customers choose to manufacture products internally rather than to outsource production to us, or choose to outsource to a third-party manufacturer, our business, financial condition and operating results could be harmed.

Competitors in the market for optical manufacturing services include Benchmark Electronics, Inc., Celestica Inc., Sanmina-SCI Corporation, Jabil Circuit, Inc., and Venture Corporation Limited. Our customized optics and glass operations face competition from companies such as Browave Corporation, Fujian Castech Crystals, Inc., Photop Technologies, Inc., and Research Electro-Optic, Inc. Our UK competitors for printed circuit board assemblies include STI Limited and Axiom Manufacturing Services Limited. Other existing contract manufacturing companies, original design manufacturers or outsourced semiconductor assembly and test companies could also enter our target markets. In addition, we may face more competitors as we attempt to penetrate new markets.

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

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

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

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

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

We provide manufacturing services to companies, and rely on suppliers, that have in the past and may in the future experience financial difficulty, particularly in light of uncertainty in the credit markets and the overall economy that affected access to capital and liquidity. As a result, we devote significant resources to monitor receivables and inventory balances with certain of our customers. If our customers experience financial difficulty, we could have difficulty recovering amounts owed to us from these customers, or demand for our services from these customers could decline. If our suppliers experience financial difficulty, we could have trouble sourcing materials necessary to fulfill production requirements and meet scheduled shipments. Any such financial difficulty could adversely affect our operating results and financial condition by resulting in a reduction in our revenues, a charge for inventory write-offs, a provision for doubtful accounts, and an increase in working capital requirements due to increases in days in inventory and in days in accounts receivable. For example, in July 2014, one of our customers filed for bankruptcy protection under the Local Trade Court in France; however, the potential losses from this particular customer did not have a significant effect on our consolidated financial statements, although that may not necessarily be the case were there to be a bankruptcy of a significant customer in the future.

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

Volatility in the functional and non-functional currencies of our entities and the U.S. dollar could seriously harm our business, financial condition, and operating results. The primary impact of currency exchange fluctuations is on our cash, receivables, and payables of our operating entities. We may experience significant unexpected gains or losses from fluctuations in exchange rates. For example, in the three months ended December 28, 2018, we experienced a \$0.4 million foreign exchange loss, which negatively affected our net income per share by \$0.01.

Our customer contracts generally require that our customers pay us in U.S. dollars. However, the majority of our payroll and other operating expenses are paid in Thai baht. As a result of these arrangements, we have significant exposure to changes in the exchange rate between the Thai baht and the U.S. dollar, and our operating results are adversely impacted when the U.S. dollar depreciates relative to the Thai baht and other currencies. We have experienced such depreciation in the U.S. dollar as compared with the Thai baht, and our results have been adversely impacted by this fluctuation in exchange rates. As of December 28, 2018, the U.S. dollar had depreciated approximately 8.3% against the Thai baht since December 30, 2016. Further, while we attempt to hedge against certain exchange rate risks, we typically enter into hedging contracts with maturities of up to 12 months, leaving us exposed to longer term changes in exchange rates.

Also, we have significant exposure to changes in the exchange rate between the Chinese Renminbi (“RMB”) and pound sterling (“GBP”) and the U.S. dollar. The expenses of our subsidiaries located in the PRC and the United Kingdom are denominated in RMB and GBP, respectively. Currently, RMB are convertible in connection with trade- and service-related foreign exchange transactions, foreign debt service, and payment of dividends. The PRC government may at its discretion restrict access in the future to foreign currencies for current account transactions. If this occurs, our PRC subsidiary may not be able to pay us dividends in U.S. dollars without prior approval from the PRC State Administration of Foreign Exchange. In addition, conversion of RMB for most capital account items, including direct investments, is still subject to government approval in the PRC. This restriction may limit our ability to invest the earnings of our PRC subsidiary. As of December 28, 2018, the U.S. dollar had appreciated approximately 4.7% against the RMB since December 30, 2016. There remains significant international pressure on the PRC government to adopt a substantially more liberalized currency policy. GBP are convertible in connection with trade- and service-related foreign exchange transactions and foreign debt service. As of December 28, 2018, the U.S. dollar had appreciated approximately 2.4% against the GBP since December 30, 2016. Any appreciation in the value of the RMB and GBP against the U.S. dollar could negatively impact our operating results.

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

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

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

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

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

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

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

Our customers are located throughout the world. Total revenues from the bill-to-location of customers outside of North America accounted for 54.7% and 54.9% of our total revenues for the three months ended December 28, 2018 and December 29, 2017, respectively. We expect that total revenues from the bill-to-location of customers outside of North America will continue to account for a significant portion of our total revenues. Our customers also depend on international sales, which further exposes us to the risks associated with international operations. In addition, our international operations and sales subject us to a variety of domestic and foreign trade regulatory requirements.

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

The majority of our assets and manufacturing operations are located in Thailand. Therefore, political, social, business and economic conditions in Thailand have a significant effect on our business. In March 2018, Thailand was assessed as a medium-high political risk by AON Political Risk, a risk management, insurance and consulting firm. Any changes to tax regimes, laws, exchange controls or political action in Thailand may harm our business, financial condition and operating results.

Thailand has a history of political unrest that includes the involvement of the military as an active participant in the ruling government. In recent years, political unrest in the country has sparked political demonstrations and, in some instances, violence. In May 2014, the Thai military took over the government in a coup, and it continues to rule the country today. It is unknown how long it will take for the current political situation to be resolved and for democracy to be restored, or what effects the current political situation may have on Thailand and the surrounding region. After several delays, however, the next general elections in Thailand presently are scheduled in late March 2019.

In October 2016, Thailand's King Bhumibol Adulyadej died at the age of 88, and was succeeded by his son King Maha Vajiralongkorn. While this was a peaceful succession, any future succession crisis or political instability in the Kingdom of Thailand could prevent shipments from entering or leaving the country, disrupt our ability to manufacture products in Thailand, and force us to transfer our operations to more stable, and potentially more costly, regions.

Further, the Thai government may raise the minimum wage standards for labor and could repeal certain promotional certificates that we have received or tax holidays for certain export and value added taxes that we enjoy, either preventing us from engaging in our current or anticipated activities or subjecting us to higher tax rates. A new regime could nationalize our business or otherwise seize our assets and any other future political instability could harm our business, financial condition and operating results.

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

We anticipate that we will continue to invest in our customized optics manufacturing facilities located in Fuzhou, China. Because these operations are located in the PRC, they are subject to greater political, legal and economic risks than the geographies in which the facilities of many of our competitors and customers are located. In particular, the political and economic climate in the PRC (both at national and regional levels) is fluid and unpredictable. In March 2018, AON Political Risk assessed the PRC as a medium political risk. A large part of the PRC's economy is still being operated under varying degrees of control by the PRC government. By imposing industrial policies and other economic measures, such as control of foreign exchange, taxation, import and export tariffs, environmental regulations, land use rights, intellectual property and restrictions on foreign participation in the domestic market of various industries, the PRC government exerts considerable direct and indirect influence on the development of the PRC economy. Many of the economic reforms carried out by the PRC government are unprecedented or experimental and are expected to change further. Any changes to the political, legal or economic climate in the PRC could harm our business, financial condition and operating results.

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

Our business and operations would be adversely impacted in the event of a failure of our information technology infrastructure and/or cyber security attacks.

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

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

Unfavorable worldwide economic conditions may negatively affect our business, operating results and financial condition.

Volatility and disruption in the capital and credit markets, depressed consumer confidence, and negative global economic conditions have affected levels of business and consumer spending. Concerns about the potential default of various national bonds and debt backed by individual countries as well as the politics impacting these, could negatively impact the U.S. and global economies and adversely affect our financial results. In particular, Brexit and economic uncertainty in Europe has led to reduced demand in some of our customers’ optical communications product portfolios. Brexit could also lead to economic and legal uncertainty, including significant volatility in global stock markets and currency exchange rates, and increasingly divergent laws and regulations as the United Kingdom determines which European Union laws to replace or replicate. Any of these effects of Brexit, among others, could adversely affect our financial results.

Uncertainty about worldwide economic conditions poses a risk as businesses may further reduce or postpone spending in response to reduced budgets, tight credit, negative financial news and declines in income or asset values, which could adversely affect our business, financial condition and operating results and increase the volatility of our share price. In addition, our ability to access capital markets may be restricted, which could have an impact on our ability to react to changing economic and business conditions and could also adversely affect our business, financial condition and operating results.

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

We may not be able to pursue many large customer orders or sustain our historical growth rates if we do not have sufficient manufacturing capacity to enable us to commit to provide customers with specified quantities of products. If our customers do not believe that we have sufficient manufacturing capacity, they may: (1) outsource all of their production to another source that they believe can fulfill all of their production requirements; (2) look to a second source for the manufacture of additional quantities of the products that we currently manufacture for them; (3) manufacture the products themselves; or (4) otherwise decide against using our services for their new products.

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We expanded our manufacturing capacity by building a new facility in Chonburi, Thailand, which was completed in March 2017. We may continue to devote significant resources to the expansion of our manufacturing capacity, and any such expansion will be expensive, will require management's time and may disrupt our operations. In the event we are unsuccessful in our attempts to expand our manufacturing capacity, our business, financial condition and operating results could be harmed.

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

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

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

- the quality of input, materials and equipment;
- the quality and feasibility of our customers' design;
- the repeatability and complexity of the manufacturing process;
- the experience and quality of training of our manufacturing and engineering teams; and
- the monitoring of the manufacturing environment.

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

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

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

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

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

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

As a manufacturer of products for the optics industry, we are required to meet certain certification standards, including the following: ISO9001 for Manufacturing Quality Management Systems; ISO14001 for Environmental Management Systems; TL9000 for Telecommunications Industry Quality Certification; IATF16949 for Automotive Industry Quality Certification; ISO13485 for Medical Devices Industry Quality Certification; AS9100 for Aerospace Industry Quality Certification; NADCAP (National Aerospace and Defense Contractors Accreditation Program) for Quality Assurance throughout the Aerospace and Defense Industries; and OHSAS18001 for Occupational Health and Safety Management Systems. We also maintain compliance with various additional standards imposed by the U.S. Food and Drug Administration, or FDA, with respect to the manufacture of medical devices.

Additionally, we are required to register with the FDA and other regulatory bodies and are subject to continual review and periodic inspection for compliance with various regulations, including testing, quality control and documentation procedures. We hold the following additional certifications: ANSI ESD S20.20 for facilities and manufacturing process control, in compliance with ESD standard; Transported Asset Protection Association, or TAPA, for Logistic Security Management System; and CSR-DIW for Corporate Social Responsibility in Thailand. In the European Union, we are required to maintain certain ISO certifications in order to sell our precision optical, electro-mechanical and electronic manufacturing services and we must undergo periodic inspections by regulatory bodies to obtain and maintain these certifications. If any regulatory inspection reveals that we are not in compliance with applicable standards, regulators may take action against us, including issuing a warning letter, imposing fines on us, requiring a recall of the products we manufactured for our customers, or closing our manufacturing facilities. If any of these actions were to occur, it could harm our reputation as well as our business, financial condition and operating results.

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

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

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

The sale and manufacturing of products in certain states and countries may subject us to environmental laws and regulations. In addition, rules adopted by the U.S. Securities and Exchange Commission ("SEC") implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 impose diligence and disclosure requirements regarding the use of "conflict" minerals mined from the Democratic Republic of Congo and adjoining countries in the products we manufacture for our customers. Compliance with these rules has resulted in additional cost and expense, including for due diligence to determine and verify the sources of any conflict minerals used in the products we manufacture, and may result in additional costs of remediation and other changes to processes or sources of supply as a consequence of such verification activities. These rules may also affect the sourcing and availability of minerals used in the products we manufacture, as there may be only a limited number of suppliers offering "conflict free" metals that can be used in the products we manufacture for our customers.

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

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

We are subject to income and other taxes in Thailand, the PRC, the United Kingdom and the United States. Our effective income tax rate, provision for income taxes and future tax liability could be adversely affected by numerous factors, including the results of tax audits and examinations, income before taxes being lower than anticipated in countries with lower statutory tax rates and higher than anticipated in countries with higher statutory tax rates, changes in income tax rates, changes in the valuation of deferred tax assets and liabilities, failure to meet obligations with respect to tax exemptions, and changes in tax laws and regulations. Our U.S. federal and state tax returns remain open to examination for the tax years 2014 through 2017. In addition, tax returns that remain open to examination in Thailand, the PRC and the United Kingdom range from the tax years 2012 through 2017. The results of audits and examinations of previously filed tax returns and continuing assessments of our tax exposures may have an adverse effect on our provision for income taxes and tax liability.

We base our tax position upon the anticipated nature and conduct of our business and upon our understanding of the tax laws of the various countries in which we have assets or conduct activities. However, our tax position is subject to review and possible challenge by tax authorities and to possible changes in law, which may have retroactive effect. Fabrinet (the “Cayman Islands Parent”) is an exempted company incorporated in the Cayman Islands. We maintain manufacturing operations in Thailand, the PRC, the United Kingdom and the United States. We cannot determine in advance the extent to which some jurisdictions may require us to pay taxes or make payments in lieu of taxes. Under the current laws of the Cayman Islands, we are not subject to tax in the Cayman Islands on income or capital gains. We have received this undertaking for a 20-year period expiring August 24, 2019. The earliest we can apply for a renewal with the office of the Clerk of the Cabinet is three months prior to the expiration date. Therefore, we intend to request a renewal with the office of the Clerk of the Cabinet for another 20 years in May 2019, which we believe is likely to be granted. In the event that the Cayman Islands does not renew our request for tax-free treatment, our financial condition and operating results would be harmed.

Preferential tax treatment from the Thai government in the form of a corporate tax exemption is also currently available to us through June 2020 and June 2026 on income generated from projects to manufacture certain products at our Pinehurst campus and Chonburi campus, respectively. Such preferential tax treatment is contingent on various factors, including the export of our customers’ products out of Thailand and our agreement not to move our manufacturing facilities out of our current province in Thailand for at least 15 years from the date on which preferential tax treatment was granted (i.e., at least until June 2020 in the case of our Pinehurst campus and until June 2026 in the case of our Chonburi campus). We will lose this favorable tax treatment in Thailand unless we comply with these restrictions, and as a result we may delay or forego certain strategic business decisions due to these tax considerations.

There is also a risk that Thailand or another jurisdiction in which we operate may treat the Cayman Islands Parent as having a permanent establishment in such jurisdiction and subject its income to tax. If we become subject to additional taxes in any jurisdiction or if any jurisdiction begins to treat the Cayman Islands Parent as having a permanent establishment, such tax treatment could materially and adversely affect our business, financial condition and operating results.

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

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

We have grown and may continue to grow our business through acquisitions, asset purchases and other types of transactions, including the transfer of products from our customers and their suppliers. Most recently, we acquired Fabrinet UK in September 2016. Acquisitions and other strategic transactions typically involve many risks, including the following:

- the integration of the acquired assets, information systems and facilities into our business may be difficult, time-consuming and costly, and may adversely impact our profitability;
- we may lose key employees of the acquired companies or divisions;
- we may issue additional ordinary shares, which would dilute our current shareholders' percentage ownership in us;
- we may incur indebtedness to pay for the transactions;
- we may assume liabilities, some of which may be unknown at the time of the transactions;
- we may record goodwill and non-amortizable intangible assets that will be subject to impairment testing and potential periodic impairment charges;
- we may incur amortization expenses related to certain intangible assets;
- we may devote significant resources to transactions that may not ultimately yield anticipated benefits;
- we may incur greater than expected expenses or lower than expected revenues;
- we may assume obligations with respect to regulatory requirements, including environmental regulations, which may prove more burdensome than expected; or
- we may become subject to litigation.

Acquisitions are inherently risky, and we can provide no assurance that the acquisition of Fabrinet UK or any future acquisitions will be successful or will not harm our business, financial condition and operating results.

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

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

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

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

Our services involve the creation and use of intellectual property rights, which subject us to the risk of intellectual property infringement claims from third parties and claims arising from the allocation of intellectual property rights among us and our customers.

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

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

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

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

The Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as other rules implemented by the SEC and the New York Stock Exchange ("NYSE"), impose various requirements on public companies, including requiring changes in corporate governance practices. These and proposed corporate governance laws and regulations under consideration may further increase our compliance costs. If compliance with these various legal and regulatory requirements diverts our management's attention from other business concerns, it could have a material adverse effect on our business, financial condition and operating results. The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. While we were able to assert in our Annual Report on Form 10-K that our internal control over financial reporting was effective as of June 29 2018, we cannot predict the outcome of our testing in future periods. If we are unable to assert in any future reporting periods that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our share price.

Given the nature and complexity of our business and the fact that some members of our management team are located in Thailand while others are located in the United States, control deficiencies may periodically occur. For example, following an internal investigation by the Audit Committee of our board of directors in September 2014 concerning various accounting cut-off issues, we identified certain significant deficiencies in our internal control over financial reporting, which have been remediated. While we have ongoing measures and procedures to prevent and remedy control deficiencies, if they occur there can be no assurance that we will be successful or that we will be able to prevent material weaknesses or significant deficiencies in our internal control over financial reporting in the future. Moreover, if we identify deficiencies in our internal control over financial reporting that are deemed to be material weaknesses in future periods, the market price of our ordinary shares could decline and we could be subject to potential delisting by the NYSE and review by the NYSE, the SEC, or other regulatory authorities, which would require the expenditure by us of additional financial and management resources. As a result, our shareholders could lose confidence in our financial reporting, which would harm our business and the market price of our ordinary shares.

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

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

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

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

We are subject to the risk of increased tariffs on products and goods that we purchase from off-shore sources (particularly Chinese sources) and that are directly or indirectly imported into the United States.

The U.S. Presidential Administration has recently imposed tariffs on a wide-range of products and goods manufactured in China that are directly or indirectly imported into the United States, and it has announced plans to impose additional tariffs on products and goods manufactured in China. In response, various countries and economic regions have announced plans or intentions to impose retaliatory tariffs on a wide-range of products they import from the United States. These newly imposed, announced and threatened U.S. tariffs and retaliatory tariffs could have the effect of increasing the cost of materials we use to manufacture certain products, which could result in lower margins. The tariffs could also result in disruptions to our supply chain, as suppliers struggle to fill orders from companies trying to purchase goods in bulk ahead of announced tariffs. Although we currently believe that the incremental costs to us of these tariffs will be immaterial, if the amount of these tariffs increases or if the tariffs apply to additional categories of components used in our manufacturing activities, and if we are unable to pass on the costs of tariffs to our customers, our operating results would be harmed.

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

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

Our business could be negatively affected as a result of activist shareholders.

If an activist investor takes an ownership position in our ordinary shares, responding to actions by such activist shareholder could be costly and time-consuming, disrupt our operations and divert the attention of management and our employees. Additionally, perceived uncertainties as to our future direction as a result of shareholder activism or changes to the composition of our board of directors may lead to the perception of a change in the direction of our business or other instability, which may be exploited by our competitors, cause concern to our current or potential customers, and make it more difficult to attract and retain qualified personnel. If customers choose to delay, defer or reduce transactions with us or do business with our competitors instead of us because of any such issues, then our business, financial condition and operating results would be adversely affected. In addition, our share price could experience periods of increased volatility as a result of shareholder activism.

Our investment portfolio may become impaired by deterioration of the capital markets.

We use professional investment management firms to manage our excess cash and cash equivalents. Our short-term investments as of December 28, 2018 is primarily investments in a fixed income portfolio, including corporate bonds and commercial paper, U.S. agency and U.S. Treasury securities, and sovereign and municipal securities. Our investment portfolio may become impaired by deterioration of the capital markets. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes. The policy also provides that we may not invest in short-term investments with a maturity in excess of three years.

We regularly review our investment portfolio to determine if any security is other-than-temporarily impaired, which would require us to record an impairment charge in the period any such determination is made. In making this judgment, we evaluate, among other things, the duration and extent to which the fair value of a security is less than its cost; the financial condition of the issuer and any changes thereto; and our intent to sell, or whether we will more likely than not be required to sell, the security before recovery of its amortized cost basis. Our assessment on whether a security is other-than-temporarily impaired could change in the future due to new developments or changes in assumptions related to any particular security.

Should financial market conditions worsen, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of December 28, 2018, we did not record any impairment charges associated with our investment portfolio of short-term investments, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions or market liquidity, or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

Energy price volatility may negatively impact our business, financial condition and operating results.

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

Risks Related to Ownership of Our Ordinary Shares

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

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

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

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

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

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

Based upon estimates of the value of our assets, which are based in part on the trading price of our ordinary shares, we do not expect to be a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for the taxable year 2019 or for the foreseeable future. However, despite our expectations, we cannot assure you that we will not be a PFIC for the taxable year 2019 or any future year because our PFIC status is determined at the end of each year and depends on the composition of our income and assets during such year. If we are a PFIC, our U.S. investors will be subject to increased tax liabilities under U.S. tax laws and regulations and to burdensome reporting requirements.

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

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

- establish a classified board of directors;
- prohibit our shareholders from calling meetings or acting by written consent in lieu of a meeting;
- limit the ability of our shareholders to propose actions at duly convened meetings; and
- authorize our board of directors, without action by our shareholders, to issue preferred shares and additional ordinary shares.

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

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

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

The Companies Law permits mergers and consolidations between Cayman Islands companies and between Cayman Islands companies and non-Cayman Islands companies. Dissenting shareholders have the right to be paid the fair value of their shares (which, if not agreed between the parties, will be determined by the Cayman Islands court) if they follow the required procedures, subject to certain exceptions. Court approval is not required for a merger or consolidation which is effected in compliance with these statutory procedures.

In addition, there are statutory provisions that facilitate the reconstruction and amalgamation of companies, provided that the arrangement is approved by a majority in number of each class of shareholders and creditors with whom the arrangement is to be made, and who must in addition represent three-fourths in value of each such class of shareholders or creditors, as the case may be, that are present and voting either in person or by proxy at a meeting convened for that purpose. The convening of the meeting and subsequently the arrangement must be sanctioned by the Grand Court of the Cayman Islands. A dissenting shareholder has the right to express to the court the view that the transaction ought not to be approved.

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When a takeover offer is made and accepted by holders of 90.0% of the shares within four months, the offeror may, within a two-month period, require the holders of the remaining shares to transfer such shares on the terms of the offer. An objection can be made to the Grand Court of the Cayman Islands but this is unlikely to succeed unless there is evidence of fraud, bad faith or collusion.

If the arrangement and reconstruction is thus approved, the dissenting shareholder would have no rights comparable to appraisal rights, which would otherwise ordinarily be available to dissenting shareholders of a corporation incorporated in a jurisdiction in the United States, providing rights to receive payment in cash for the judicially determined value of the shares. This may make it more difficult for you to assess the value of any consideration you may receive in a merger or consolidation or to require that the offeror give you additional consideration if you believe the consideration offered is insufficient.

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

Subject to limited exceptions, under Cayman Islands law, a minority shareholder may not bring a derivative action against the board of directors.

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

The Cayman Islands Parent is a Cayman Islands exempted company and substantially all of our assets are located outside of the United States. Given our domicile and the location of our assets, it may be difficult to enforce in U.S. courts judgments obtained in U.S. courts based on the civil liability provisions of the U.S. federal securities laws against us. In addition, there is uncertainty as to whether the courts of the Cayman Islands, Thailand or the PRC would recognize or enforce judgments of U.S. courts against us predicated upon the civil liability provisions of the securities laws of the United States or any state. In particular, a judgment in a U.S. court would not be recognized and accepted by Thai courts without a re-trial or examination of the merits of the case. In addition, there is uncertainty as to whether such Cayman Islands, Thai or PRC courts would be competent to hear original actions brought in the Cayman Islands, Thailand or the PRC against us predicated upon the securities laws of the United States or any state.

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

Sales of Unregistered Securities

Not applicable.

Purchases of Equity Securities by the Issuer and Affiliated Purchasers

On August 21, 2017, we announced that our board of directors had approved a share repurchase program to permit us to repurchase up to \$30.0 million worth of our issued and outstanding ordinary shares in the open market in accordance with applicable rules and regulations, at such time and such prices as management may decide. In February 2018, our board of directors approved an increase of \$30.0 million to this share repurchase authorization, bringing the aggregate authorization to \$60.0 million. The repurchased shares will be held as treasury stock. During the three months ended December 28, 2018, no shares were repurchased under this program. As of December 28, 2018, we had a remaining authorization to purchase up to an additional \$17.6 million worth of our ordinary shares.

The following table summarizes share repurchase activity for the three months ended December 28, 2018:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of Publicly Announced Program	Maximum Approximate Dollar Value of Shares That May Yet Be Purchased Under the Program
September 29, 2018 – October 26, 2018	—	\$ —	—	\$ 17,598,987
October 27, 2018 – November 23, 2018	—	\$ —	—	\$ 17,598,987
November 24, 2018 – December 28, 2018	—	\$ —	—	\$ 17,598,987
Total	—	\$ —	—	\$ 17,598,987

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ITEMS 3 and 4 are not applicable and have been omitted.

ITEM 5. OTHER INFORMATION

On November 5, 2018, we issued a press release regarding our financial results for the fiscal quarter ended September 28, 2018. A copy of that press release is furnished herewith as Exhibit 99.1 pursuant to Item 2.02 of Form 8-K. On November 5, 2018, we also held our financial results conference call for the fiscal quarter ended September 28, 2018. A copy of the script for that conference call is furnished herewith as Exhibit 99.2, and a recorded version of the conference is available on our website. This information under this Item 5 and Exhibits 99.1 and 99.2 shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, nor shall they be deemed incorporated by reference in any filing under the Securities Act.

ITEM 6. EXHIBITS

<u>Exhibit Number</u>	<u>Description</u>	<u>Incorporated by reference herein</u>		
		<u>Form</u>	<u>Exhibit No.</u>	<u>Filing Date</u>
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002			
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002			
99.1	Press Release dated November 5, 2018			
99.2	November 5, 2018 Financial Results Conference Call Script			
101.INS	XBRL Instance.			
101.SCH	XBRL Taxonomy Extension Schema.			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.			
101.DEF	XBRL Taxonomy Extension Definition Linkbase.			
101.LAB	XBRL Taxonomy Extension Label Linkbase.			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.			

CERTIFICATION

I, Seamus Grady, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Fabrinet;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 5, 2019

/s/ SEAMUS GRADY

Seamus Grady
Chief Executive Officer (Principal Executive Officer)

CERTIFICATION

I, Toh-Seng Ng, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Fabrinet;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 5, 2019

/s/ TOH-SENG NG

Toh-Seng Ng

Executive Vice President, Chief Financial Officer (Principal
Financial and Accounting Officer)

CERTIFICATIONS OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER**PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

I, Seamus Grady, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Fabrinet for the fiscal quarter ended December 28, 2018 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fabrinet.

Date: February 5, 2019

By: /s/ SEAMUS GRADY

Name: Seamus Grady

Title: Chief Executive Officer (Principal Executive Officer)

I, Toh-Seng Ng, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report on Form 10-Q of Fabrinet for the fiscal quarter ended December 28, 2018 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in this Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of Fabrinet.

Date: February 5, 2019

By: /s/ TOH-SENG NG

Name: Toh-Seng Ng

Title: Executive Vice President, Chief Financial Officer
(Principal Financial and Accounting Officer)



Fabrinet Announces First Quarter Fiscal Year 2019 Financial Results

November 5, 2018

BANGKOK—(BUSINESS WIRE)—Nov. 5, 2018—Fabrinet (NYSE: FN), a leading provider of advanced optical packaging and precision optical, electromechanical and electronic manufacturing services to original equipment manufacturers of complex products, today announced its financial results for its first quarter ended September 28, 2018.

Seamus Grady, Chief Executive Officer of Fabrinet, said, “With a strong start to the year, we exceeded our guidance for revenue and profitability in the first quarter. Our sequential growth, which was better than anticipated, was driven primarily by double-digit growth in both telecom and datacom optical communications products. We are optimistic that the momentum we experienced during the first quarter will continue into the second quarter, as we leverage the combination of our leading market position and strong execution to deliver further financial success.”

First Quarter Fiscal Year 2019 Financial Highlights

As of the first quarter of fiscal 2019, Fabrinet is reporting results under the new revenue recognition standard Accounting Standards Codification Topic 606 (“ASC 606”), using the modified retrospective method. Financial results for reporting periods prior to fiscal year 2019 are presented as previously disclosed in conformity with the new revenue recognition standard Accounting Standards Codification Topic 606 (“ASC 605”). A reconciliation to ASC 605 is included at the end of this press release.

GAAP Results

- Revenue for the first quarter of fiscal year 2019 was \$377.2 million, compared to revenue of \$357.3 million for the comparable period in fiscal year 2018.
- GAAP net income for the first quarter of fiscal year 2019 was \$27.9 million, compared to GAAP net income of \$21.0 million for the first quarter of fiscal year 2018. GAAP net income for the first quarter of fiscal year 2019 included a foreign exchange benefit of \$3.1 million, or \$0.08 per diluted share, compared to a foreign exchange loss of \$1.9 million, or \$0.05 per diluted share, for the first quarter of fiscal year 2018.
- GAAP net income per diluted share for the first quarter of fiscal year 2019 was \$0.75, compared to GAAP net income per diluted share of \$0.55 for the first quarter of fiscal year 2018.

Non-GAAP Results

- Non-GAAP net income for the first quarter of fiscal year 2019 was \$34.1 million, compared to non-GAAP net income of \$28.6 million for the first quarter of fiscal year 2018. Non-GAAP net income for the first quarter of fiscal year 2019 included a foreign exchange loss of \$3.1 million, or \$0.08 per diluted share, compared to a foreign exchange loss of \$1.9 million, or \$0.05 per diluted share, for the first quarter of fiscal year 2018.
- Non-GAAP net income per diluted share for the first quarter of fiscal year 2019 was \$0.92, compared to non-GAAP net income per diluted share of \$0.75 for the same period a year ago.

Share Repurchase Program Update

There was no share repurchase activity during the three months ended September 28, 2018. As of September 28, 2018, Fabrinet had a remaining authorization to purchase up to an additional \$17.6 million worth of its ordinary shares.

Business Outlook

The guidance provided below is based on ASC 605. As of the first quarter of fiscal 2019, Fabrinet is reporting results under ASC 606, which it is adopting for fiscal year 2019 on a modified retrospective method. A reconciliation to ASC 605 is included at the end of this press release.

Based on information available as of November 5, 2018, Fabrinet is issuing guidance for its second fiscal quarter of 2019 ending December 28, 2018, as follows:

- Fabrinet expects second quarter revenue to be in the range of \$380 million to \$388 million.
- GAAP net income per diluted share is expected to be in the range of \$0.77 to \$0.80, based on approximately 37.6 million fully diluted shares outstanding.
- Non-GAAP net income per diluted share is expected to be in the range of \$0.91 to \$0.94, based on approximately 37.6 million fully diluted shares outstanding.

Conference Call Information

What: Fabrinet First Quarter Fiscal-Year 2019 Financial Results Call
When: Monday, November 5, 2018
Time: 5:00 p.m. ET
Live Call: (888) 357-3694, domestic
(253) 237-1137, international
Passcode: 3789048
Replay: (855) 859-2056, domestic
(404) 537-3406, international
Passcode: 3789048
Webcast: <http://investor.fabrinet.com/> (live and replay)

This press release and any other information related to the call will also be posted on Fabrinet's website at <http://investor.fabrinet.com>. A recorded version of this webcast will be available approximately two hours after the call and will be archived on Fabrinet's website for a period of one year.

About Fabrinet

Fabrinet is a leading provider of advanced optical packaging and precision optical, electro-mechanical, and electronic manufacturing services to original equipment manufacturers of complex products, such as optical communication components, modules and subsystems, automotive components, medical devices, industrial lasers and sensors. Fabrinet offers a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, advanced packaging, integration, final assembly and test. Fabrinet focuses on production of high complexity products in any mix and any volume. Fabrinet maintains engineering and manufacturing resources and facilities in Thailand, the United States of America, the People's Republic of China and the United Kingdom. For more information visit: www.fabrinet.com.

Forward-Looking Statements

"Safe Harbor" Statement Under U.S. Private Securities Litigation Reform Act of 1995

This press release contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements include: (1) statements regarding our optimism that our first quarter momentum will continue into the second quarter of fiscal year 2019 and that we will deliver further financial success; and (2) all of the statements under the "Business Outlook" section regarding our expected revenue, GAAP and non-GAAP net income per share, and fully diluted shares outstanding for the second quarter of fiscal year 2019. These forward-looking statements involve risks and uncertainties, and actual results could vary materially from these forward-looking statements. Important factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to: less customer demand for our products and services than forecasted; less growth in the optical communications, industrial lasers and sensors markets than we forecast; difficulties expanding into additional markets, such as the semiconductor processing, biotechnology, metrology and materials processing markets; increased competition in the optical manufacturing services markets; difficulties in delivering products and services that compete effectively from a price and performance perspective; our reliance on a small number of customers and suppliers; difficulties in managing our operating costs; difficulties in managing and operating our business across multiple countries (including Thailand, the People's Republic of China, the U.S. and the U.K.); and other important factors as described in reports and documents we file from time to time with the Securities and Exchange Commission (SEC), including the factors described under the section captioned "Risk Factors" in our Quarterly Report on Form 10-K, filed on August 22, 2018. We disclaim any obligation to update information contained in these forward-looking statements whether as a result of new information, future events, or otherwise.

Use of Non-GAAP Financials

We refer to the non-GAAP financial measures cited above in making operating decisions because they provide meaningful supplemental information regarding our ongoing operational performance. Non-GAAP net income excludes: share-based compensation expenses; depreciation of fair value uplift; severance payments; expenses related to our CFO search; debt administration expense; amortization of intangibles; business combination expenses; loss (gain) on foreign currency contracts; amortization of debt issuance costs; restructuring charges; and ASC 606 adjustments. We have excluded these items in order to enhance investors' understanding of our underlying operations. The use of these non-GAAP financial measures has material limitations because they should not be used to evaluate our company without reference to their corresponding GAAP financial measures. As such, we compensate for these material limitations by using these non-GAAP financial measures in conjunction with GAAP financial measures.

These non-GAAP financial measures are used to: (1) measure company performance against historical results, (2) facilitate comparisons to our competitors' operating results, and (3) allow greater transparency with respect to information used by management in making financial and operational decisions. In addition, these non-GAAP financial measures are used to measure company performance for the purposes of determining employee incentive plan compensation.

FABRINET

CONSOLIDATED BALANCE SHEETS

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

	September 28, 2018	June 29, 2018
Assets		
Current assets		
Cash and cash equivalents	\$ 219,976	\$ 158,102
Restricted cash in connection with business acquisition	—	3,331
Marketable securities	132,383	174,269
Trade accounts receivable, net	258,705	246,912
Contract assets	10,157	—
Inventory, net	278,397	257,687
Prepaid expenses	10,978	8,061
Other current assets	6,512	5,948
Total current assets	<u>917,108</u>	<u>854,310</u>
Non-current assets		
Property, plant and equipment, net	216,849	219,640
Intangibles, net	4,590	4,880
Goodwill	3,822	3,828
Deferred tax assets	5,378	5,280
Deferred debt issuance costs on revolving loan and other non-current assets	57	80
Total non-current assets	<u>230,696</u>	<u>233,708</u>
Total Assets	<u>\$ 1,147,804</u>	<u>\$1,088,018</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Bank borrowings	\$ 3,250	\$ 3,250
Trade accounts payable	249,080	220,159
Capital lease liability, current portion	434	451
Income tax payable	2,389	709
Deferred liability in connection with business acquisition	—	3,331
Accrued payroll, bonus and related expenses	19,484	13,476
Accrued expenses	10,277	9,013
Other payables	20,862	19,728
Total current liabilities	<u>305,776</u>	<u>270,117</u>
Non-current liabilities		
Long-term loan from bank	60,125	60,938
Deferred tax liability	2,387	2,284
Capital lease liability, non-current portion	414	516
Severance liabilities	10,835	10,162
Other non-current liabilities	2,110	3,062
Total non-current liabilities	<u>75,871</u>	<u>76,962</u>
Total Liabilities	<u>381,647</u>	<u>347,079</u>
Commitments and contingencies		
Shareholders' equity		
Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of September 28, 2018 and June 29, 2018)	—	—
Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 38,118,609 shares and 37,723,733 shares issued, and 36,829,506 shares and 36,434,630 shares outstanding as of September 28, 2018 and June 29, 2018, respectively)	381	377
Additional paid-in capital	147,869	151,797
Treasury shares at cost (1,289,103 shares and 1,289,103 shares as of September 28, 2018 and June 29, 2018, respectively)	(42,401)	(42,401)
Accumulated other comprehensive loss	(1,170)	(1,257)
Retained earnings	661,478	632,423
Total Shareholders' Equity	<u>766,157</u>	<u>740,939</u>
Total Liabilities and Shareholders' Equity	<u>\$ 1,147,804</u>	<u>\$1,088,018</u>

FABRINET

**CONSOLIDATED STATEMENTS OF OPERATIONS AND
COMPREHENSIVE INCOME**

<i>(in thousands of U.S. dollars, except per share amounts)</i>	Three Months Ended	
	September 28, 2018	September 29, 2017
Revenues	\$ 377,177	\$ 357,313
Cost of revenues	(336,901)	(316,981)
Gross profit	40,276	40,332
Selling, general and administrative expenses	(14,437)	(15,678)
Expenses related to reduction in workforce	(85)	—
Operating income	25,754	24,654
Interest income	1,444	809
Interest expense	(634)	(853)
Foreign exchange gain (loss), net	3,068	(1,934)
Other income	77	97
Income before income taxes	29,709	22,773
Income tax expense	(1,859)	(1,740)
Net income	27,850	21,033
Other comprehensive (loss) income, net of tax:		
Change in net unrealized gain on marketable securities	288	29
Change in net unrealized loss on derivative instruments	(1)	(1)
Change in foreign currency translation adjustment	(200)	526
Total other comprehensive (loss) income, net of tax	87	554
Net comprehensive income	\$ 27,937	\$ 21,587
Earnings per share		
Basic	\$ 0.76	\$ 0.56
Diluted	\$ 0.75	\$ 0.55
Weighted-average number of ordinary shares outstanding (thousands of shares)		
Basic	36,625	37,447
Diluted	37,140	38,163

FABRINET
CONSOLIDATED STATEMENTS OF CASH FLOWS

<i>(in thousands of U.S. dollars)</i>	Three Months Ended	
	September 28, 2018	September 29, 2017
Cash flows from operating activities		
Net income for the period	\$ 27,850	\$ 21,033
Adjustments to reconcile net income to net cash provided by used in operating activities		
Depreciation and amortization	7,412	7,419
Loss (Gain) on disposal of property, plant and equipment	46	(131)
Loss on written-off of intangibles	149	—
Loss from sales and maturities of available-for-sale securities	178	353
Amortization of investment (premium) discount	(94)	(216)
Amortization of deferred debt issuance costs	—	150
(Reversal of) allowance for doubtful accounts	—	(1)
Unrealized (gain) loss on exchange rate and fair value of derivative instruments	(4,232)	2,026
Share-based compensation	4,980	6,920
Deferred income tax	3	(307)
Other non-cash expenses	590	629
Reversal of inventory obsolescence	(478)	(292)
Changes in operating assets and liabilities		
Trade accounts receivable	(10,887)	(11,122)
Contract assets	(280)	—
Inventory	(28,904)	(16,032)
Other current assets and non-current assets	(1,029)	(7,263)
Trade accounts payable	29,182	(11,323)
Income tax payable	1,680	493
Other current liabilities and non-current liabilities	8,427	4,610
Net cash provided by (used in) operating activities	34,593	(3,054)
Cash flows from investing activities		
Purchase of marketable securities	(1,955)	(26,969)
Proceeds from sales of marketable securities	24,181	11,730
Proceeds from maturities of marketable securities	19,863	14,947
Purchase of property, plant and equipment	(5,410)	(11,203)
Purchase of intangibles	(78)	(702)
Proceeds from disposal of property, plant and equipment	—	142
Net cash provided by (used in) investing activities	36,601	(12,055)
Cash flows from financing activities		
Repayment of short-term loans from bank	—	(992)
Repayment of long-term loans from bank	(813)	(3,400)
Repayment of capital lease liability	(123)	(95)
Proceeds from issuance of ordinary shares under employee share option plans	—	931
Release of restricted cash held in connection with business acquisition	(3,478)	—
Withholding tax related to net share settlement of restricted share units	(8,904)	(3,550)
Net cash used in financing activities	(13,318)	(7,106)
Net decrease in cash, cash equivalents and restricted cash	57,876	(22,215)
Movement in cash, cash equivalents and restricted cash		
Cash, cash equivalents and restricted cash at beginning of period	161,433	137,137
Increase (decrease) in cash, cash equivalents and restricted cash	57,876	(22,215)
Effect of exchange rate on cash, cash equivalents and restricted cash	667	123
Cash, cash equivalents and restricted cash at end of period	\$ 219,976	\$ 115,045
Non-cash investing and financing activities		
Construction, software-related and equipment-related payables	\$ 3,830	\$ 4,658

FABRINET
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the consolidated balance sheets that sum to the total of same amounts shown in the consolidated statements of cash flows:

<i>(amount in thousands)</i>	As of September 28, 2018	As of September 29, 2017
Cash and cash equivalents	\$ 219,976	\$ 111,631
Restricted cash in connection with business acquisition (non-current assets)	—	3,414
Cash, cash equivalents and restricted cash	<u>\$ 219,976</u>	<u>\$ 115,045</u>

FABRINET
RECONCILIATION OF ASC 605 TO ASC 606

<i>(in thousands of U.S. dollars, except per share amounts)</i>	Three Months Ended September 28, 2018		
	ASC 605	ASC 606	Impact
Revenues	\$ 376,897	\$ 377,177	\$ (280)
Cost of revenues	(336,652)	(336,901)	249
Gross profit	40,245	40,276	(31)
Selling, general and administrative expenses	(14,437)	(14,437)	—
Expenses related to reduction in workforce	(85)	(85)	—
Operating income	25,723	25,754	(31)
Interest income	1,444	1,444	—
Interest expense	(634)	(634)	—
Foreign exchange gain (loss), net	3,068	3,068	—
Other income	77	77	—
Income before income taxes	29,678	29,709	(31)
Income tax expense	(1,859)	(1,859)	—
Net income	27,819	27,850	(31)
Other comprehensive (loss) income, net of tax:			
Change in net unrealized gain on marketable securities	288	288	—
Change in net unrealized loss on derivative instruments	(1)	(1)	—
Change in foreign currency translation adjustment	(200)	(200)	—
Total other comprehensive (loss) income, net of tax	87	87	—
Net comprehensive income	<u>\$ 27,906</u>	<u>\$ 27,937</u>	<u>(31)</u>
Earnings per share			
Basic	\$ 0.76	\$ 0.76	—
Diluted	\$ 0.75	\$ 0.75	—
Weighted-average number of ordinary shares outstanding (thousands of shares)			
Basic	36,625	36,625	—
Diluted	37,140	37,140	—

FABRINET
RECONCILIATION OF GAAP MEASURES TO NON-GAAP MEASURES

	Three Months Ended			
	September 28, 2018		September 29, 2017	
	(ASC 606)		ASC (605)	
	Net income	Diluted EPS	Net income	Diluted EPS
(in thousands of U.S. dollars, except per share data)				
GAAP measures	\$27,850	\$ 0.75	\$21,033	\$ 0.55
Items reconciling GAAP net income & EPS to non-GAAP net income & EPS:				
Related to cost of revenues:				
Share-based compensation expenses	1,847	0.05	1,901	0.05
Depreciation of fair value uplift	89	0.00	67	0.00
Total related to gross profit	<u>1,936</u>	<u>0.05</u>	<u>1,968</u>	<u>0.05</u>
Related to selling, general and administrative expenses:				
Share-based compensation expenses	3,133	0.08	5,019	0.13
Expenses related to CFO search	190	0.01	—	—
Amortization of intangibles	192	0.01	169	0.00
Business combination expenses	182	0.00	106	0.00
Severance payment	585	0.02	—	—
Total related to selling, general and administrative expenses	<u>4,282</u>	<u>0.12</u>	<u>5,294</u>	<u>0.14</u>
Related to other incomes and other expenses:				
Restructuring charges	85	0.00	—	—
Amortization of debt issuance costs	—	—	273	0.01
Total related to other incomes and other expenses	<u>85</u>	<u>0.00</u>	<u>273</u>	<u>0.01</u>
Total related to net income & EPS	<u>6,303</u>	<u>0.17</u>	<u>7,535</u>	<u>0.20</u>
Non-GAAP measures	\$34,153	\$ 0.92	\$28,568	\$ 0.75
ASC 606 adoption impact on gross profit	(31)	(0.00)	—	—
Non-GAAP measures (ASC 605)	\$34,122	\$ 0.92	\$28,568	\$ 0.75
Shares used in computing diluted net income per share				
GAAP diluted shares		37,140		38,163
Non-GAAP diluted shares		37,140		38,163

FABRINET
RECONCILIATION OF NET CASH PROVIDED BY OPERATING ACTIVITIES TO FREE CASH FLOW

(amount in thousands)

	Three Months Ended	
	September 28, 2018	September 29, 2017
Net cash provided by operating activities	\$ 34,593	\$ (3,054)
Less: Purchase of property, plant and equipment	(5,410)	(11,203)
Non-GAAP free cash flow	<u>\$ 29,183</u>	<u>\$ (14,257)</u>

FABRINET
GUIDANCE FOR QUARTER ENDING DECEMBER 28, 2018
RECONCILIATION OF GAAP MEASURES TO NON-GAAP MEASURES

	Diluted EPS
GAAP net income per diluted share:	\$0.77 to \$0.80
Related to cost of revenues:	
Share-based compensation expenses	0.04
Total related to gross profit	0.04
Related to selling, general and administrative expenses:	
Share-based compensation expenses	0.09
Expenses related to our CFO search	0.01
Total related to selling, general and administrative expenses	0.10
Total related to net income & EPS	0.14
Non-GAAP net income per diluted share	<u>\$0.91 to \$0.94</u>

Source: Fabrinet

Fabrinet
Garo Toomajanian
ir@fabrinet.com

FN 1Q19 Earnings Conf. Call Script – November 5, 2018

Operator

Good day, ladies and gentlemen. Welcome to Fabrinet's financial results conference call for the first quarter of fiscal year 2019. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions on how to participate will be given at that time. As a reminder, today's call is being recorded.

I would now like to turn the call over to your host, Garo Toomajanian, Investor Relations.

Garro Toomajanian – ICR – Investor Relations

Thank you, operator, and good afternoon everyone. Thank you for joining us on today's conference call to discuss Fabrinet's financial and operating results for the first quarter of fiscal year 2019 which ended September 28, 2018. With me on the call today are Seamus Grady, Chief Executive Officer, and TS Ng, Chief Financial Officer. This call is being webcast and a replay will be available on the investor section of our website located at investor.fabrinet.com. Please refer to our website for important information, including our earnings press release and investor presentation, which include our GAAP to non-GAAP reconciliation.

I would like to remind you that today's discussion will contain forward-looking statements about the future financial performance of the company. Forward-looking statements are subject to risks and uncertainties that could cause actual results to differ materially from management's current expectations.

These statements reflect our opinions only as of the date of this presentation and we undertake no obligation to revise them in light of new information or future events except as required by law. For a description of the risk factors that may affect our results, please refer to our recent SEC filings, in particular the section captioned risk factors, in our Form 10-K filed on August 22, 2018.

We will begin the call with remarks from Seamus and TS, followed by time for questions. I would now like to turn the call over to Fabrinet's CEO, Seamus Grady.

Seamus?

Seamus Grady – Fabrinet – Chief Executive Officer

Thank you Garo, and good afternoon everyone. Revenue in the first quarter came in well above the high-end of our guidance range at \$377 million – an all-time record for quarterly revenue.

Strong revenue combined with a foreign exchange gain produced non-GAAP net income of 92 cents per share, which was also above the high end of our guidance.

This earnings performance also helped drive strong cash flows, with operating cash flow of nearly \$35 million in the first quarter, and free cash flow of \$29 million.

We had anticipated that our modest sequential growth in the fourth quarter would continue into the first quarter, and our actual performance was considerably better than we had anticipated. And as TS will detail in a moment, we expect fiscal Q2 to represent another quarter of sequential growth.

With increasing demand, we continued to see component constraints during the first quarter. We were again able to successfully mitigate these shortage risks during the quarter, and we will continue to take appropriate steps to manage these supply challenges going forward.

In the last several months, there have been a lot of discussions related to tariffs on products coming to the US from China. I can report that we have not seen any negative impact from these tariffs, and we don't anticipate that we will in the future. With the vast majority of our manufacturing in Thailand, we could actually benefit from tariffs on products being manufactured in China, if component and equipment makers look for suppliers in other countries.

Looking at our first quarter performance by end-market, both optical communications and non-optical communications business grew from a year ago.

Optical communications revenue of \$281 million was up 2% from a year ago, and up 16% from the fourth quarter, with revenue for both telecom and datacom products growing double-digits from the fourth quarter.

Telecom revenue was \$179 million, an increase of 14% from the fourth quarter, and datacom revenue was \$102 million, up 19% from the fourth quarter.

By technology, silicon photonics-based optical communications revenue was \$83 million, up 19% from the fourth quarter.

Variants of the QSFP28 form factor, which can be both silicon-photonics and non-silicon-photonics-based, generated revenue of \$45 million, which was up marginally from a strong Q4 which saw 20% sequential growth.

By data rate, 100G programs continue to dominate optical communications production, and grew slightly faster than optical communications overall to \$155 million, or 41% of total revenue.

Speed-rated products at 400G and faster data rates represented more than 4% of total revenue.

Turning now to non-optical communications, revenue was \$96 million, compared to the record \$103 million we generated in the fourth quarter.

Still, quarterly revenue for non-optical communications was the second highest in our history, with industrial lasers again delivering a strong performance with revenue of over \$49 million.

Automotive revenue declined slightly from a record fourth quarter to \$22 million. Revenue from sensors and from other products were both up from a year ago but down from the fourth quarter, with sensors at \$4 million and other revenue at \$21 million, representing normal quarter-to-quarter variability.

While this variability is likely to continue, especially as newer programs ramp, we remain optimistic about our long-term growth opportunities in our non-optical communications business.

Revenue from new business reached nearly \$138 million, up 10% from \$125 million in the fourth quarter.

Our new product introduction – or NPI- services continue to be an important driver of new business, as these services can turn into long-term programs generating significant revenue over several years.

As we have mentioned previously, we are in the process of looking to establish a New Product Introduction facility in Israel to support our existing Customers there, as well as to develop new Customers.

This would enable us to replicate the success we have seen in Fabrinet West and Fabrinet UK. We are working closely with our existing Customers in Israel to determine the best approach going forward.

In summary, we are off to a strong start in fiscal 2019 with first quarter revenue and earnings above our guidance ranges.

Moreover, with strong momentum across our business, we are forecasting continued growth in the second quarter, which TS will detail in a moment.

Now let me turn the call over to TS to discuss the details of our first quarter performance and our outlook. TS...

TS Ng – Fabrinet – Chief Financial Officer

Thank you, Seamus, and good afternoon everyone. I will provide you with more details on our performance by end market and our financial results for Q1, as well as our guidance for Q2 of fiscal year 2019.

Total revenue in the first quarter of fiscal year 2019 was \$377.2 million, which was \$22 million above the high end of our guidance range.

Non-GAAP net income was 92 cents per share, and was also above our guidance range. Net income in the first quarter benefited by 8 cents per share from a mark-to-market foreign exchange gain. Excluding this impact, non-GAAP net income was still slightly above the top of our guidance range.

Note that as of the first quarter of fiscal 2019 these results are being reported under ASC 606, though the change had an immaterial impact on our results. Under the previous accounting standard, ASC 605, our revenue would have been \$300,000 less, or a difference of less than 0.1%, and net income would have been a negligible \$30,000 less. .

Looking at the first quarter in more detail, as Seamus mentioned, we saw strong sequential growth from optical communications programs in first quarter, with a pause in the sequential growth of non-optical programs after a record fourth quarter. Optical communications increased to 74% of revenue, the highest level in a year, with non-optical communications representing 26% of revenue.

Now turning to the details of our P&L, a reconciliation on GAAP to-non-GAAP measures is included in our earnings press release and investor presentation, which you can find on our website.

Non-GAAP gross margin in the first quarter was 11.2%, reflecting an anticipated sequential decline in gross margin that we previously discussed as we absorb the impact of annual merit increases that take effect in the first quarter. During the quarter, as Seamus noted earlier, we were able to overcome industry-wide component supply challenges which helped us exceed our revenue guidance for the quarter. Notwithstanding this, these component supply challenges caused some operating inefficiencies and less favorable material pricing that negatively impacted our gross margin for the quarter. We remain optimistic, however, in our target range for non-GAAP gross margin remains 12 to 12.5%, and we expect to return to this range on a quarterly basis during fiscal year 2019.

Non-GAAP operating expense was \$10.2 million in the first quarter, down slightly both year over year and from the fourth quarter. As a result, non-GAAP operating income was \$32 million, an increase from the fourth quarter and a year ago, and non-GAAP operating margin was 8.5%, compared to 8.6% in the fourth quarter.

Taxes in the quarter were \$1.9 million, and our normalized effective tax rate was 6.7%. We continue to anticipate an effective tax rate of 6-7% for the fiscal year.

Non-GAAP net income was \$34.1 million in the first quarter, or 92 cents per diluted share, up from 81 cents in Q4 and 75 cents a year ago.

On a GAAP basis, which includes share-based compensation expenses, and amortization of debt issuance costs, net income for the first quarter was \$29.7 million or 75 cents per diluted share, a record performance.

Turning to the balance sheet and cash flow statement, at the end of the first quarter, cash and investments were \$352.4 million. This represents an increase of \$16.7 million from the end of the fourth quarter primarily from operating cash flow of \$34.6 million, offset by cap ex of \$5.4 million, withholding tax related to net share settlement of RSUs \$8.9 million, purchase of marketable securities of \$2.0 million, and repayments of long-term bank loans of \$0.8 million. Free cash flow, which is operating cash flow less cap ex, was \$29.2 million in the first quarter.

We did not repurchase any shares during the first quarter. As such, as of the end of the quarter, \$17.6 million remained in our repurchase authorization. Management will continue to evaluate the buyback program based on stock market condition and our cash position each quarter.

I would now like to turn to our guidance for the second quarter of fiscal year 2019. While we are now reporting under ASC 606, this guidance is based on ASC 605, and we will provide a reconciliation with our second quarter results.

With continuing demand in the optical communications market and ongoing momentum in a variety of non-optical communications programs, we are optimistic that our sequential growth will extend into the second quarter.

For the second quarter of fiscal 2019, we anticipate revenue to be in the range of \$380 to \$388 million. From an earnings perspective, we anticipate non-GAAP net income per share in the second quarter to be in the range of 91 to 94 cents, and GAAP net income per share of 77 to 80 cents, based on approximately 37.6 million fully diluted shares outstanding.

In summary, we are off to a good start in fiscal 2019 with financial results that exceeded our expectations. We are enthusiastic about our momentum which we expect to continue into the second quarter.

Operator, we would now like to open the call for questions.