

Fabrinet  
Form 10-Q  
February 07, 2017  
[Table of Contents](#)

**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 30, 2016**

**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)**

**Not Applicable**  
**(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 and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

As of January 27, 2017, the registrant had 36,954,711 ordinary shares, \$0.01 par value, outstanding.

---

**Table of Contents**

**FABRINET**

**FORM 10-Q**

**QUARTER ENDED DECEMBER 30, 2016**

**Table of Contents**

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	3
<b><u>Item 1. Financial Statements</u></b>	3
<u>Unaudited Condensed Consolidated Balance Sheets as of December 30, 2016 and June 24, 2016</u>	3
<u>Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended December 30, 2016 and December 25, 2015</u>	4
<u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended December 30, 2016 and December 25, 2015</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	31
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	44
<b><u>Item 4. Controls and Procedures</u></b>	45
<b><u>PART II. OTHER INFORMATION</u></b>	47
<b><u>Item 1. Legal Proceedings</u></b>	47
<b><u>Item 1A. Risk Factors</u></b>	47
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	63
<b><u>Item 6. Exhibits</u></b>	63
<b><u>Signature</u></b>	64
<b><u>Exhibit Index</u></b>	65

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

<i>(in thousands of U.S. dollars, except share data)</i>	<b>December 30, 2016</b>	<b>June 24, 2016</b>
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 85,619	\$ 142,804
Marketable securities	170,508	141,709
Trade accounts receivable, net	240,887	196,145
Inventory, net	214,375	181,499
Deferred tax assets		1,358
Prepaid expenses	2,407	3,114
Other current assets	4,604	6,662
Total current assets	718,400	673,291
Non-current assets		
Restricted cash in connection with business acquisition	3,126	
Property, plant and equipment, net	213,987	178,410
Intangibles, net	5,048	499
Goodwill	2,529	
Deferred tax assets	1,879	1,806
Deferred debt issuance costs on revolving loan and other non-current assets	950	1,851
Total non-current assets	227,519	182,566
<b>Total Assets</b>	<b>\$ 945,919</b>	<b>\$ 855,857</b>
<b>Liabilities and Shareholders Equity</b>		
Current liabilities		
Bank borrowings, net of unamortized debt issuance costs	\$ 38,287	\$ 24,307
Trade accounts payable	187,306	172,052
Fixed assets payable	17,094	20,628
Capital lease liability, current portion	362	
Income tax payable	2,491	2,010
Accrued payroll, bonus and related expenses	11,365	12,300
Accrued expenses	13,712	8,072
Other payables	12,440	16,356
Total current liabilities	283,057	255,725

<b>Non-current liabilities</b>		
Long-term loan from bank, non-current portion, net of unamortized debt issuance costs	29,412	36,100
Deferred tax liability		854
Capital lease liability, non-current portion	1,108	
Deferred liability in connection with business acquisition	3,126	
Severance liabilities	7,277	6,684
Other non-current liabilities	2,274	2,075
<b>Total non-current liabilities</b>	<b>43,197</b>	<b>45,713</b>
<b>Total Liabilities</b>	<b>326,254</b>	<b>301,438</b>
<b>Commitments and contingencies (Note 16)</b>		
<b>Shareholders' equity</b>		
Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of December 30, 2016 and June 24, 2016)		
Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 36,918,462 shares and 36,156,446 shares issued and outstanding as of December 30, 2016 and June 24, 2016, respectively)	369	362
Additional paid-in capital	121,366	102,325
Accumulated other comprehensive (loss) income	(1,269)	591
Retained earnings	499,199	451,141
<b>Total Shareholders' Equity</b>	<b>619,665</b>	<b>554,419</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 945,919</b>	<b>\$ 855,857</b>

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

**Table of Contents****FABRINET****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND  
COMPREHENSIVE INCOME**

<i>(in thousands of U.S. dollars, except per share amounts)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Revenues	\$ 351,156	\$ 233,038	\$ 683,199	\$ 449,471
Cost of revenues	(308,110)	(204,545)	(600,545)	(394,967)
Gross profit	43,046	28,493	82,654	54,504
Selling, general and administrative expenses	(17,651)	(13,715)	(33,483)	(25,615)
Other expense related to flooding				(864)
Operating income	25,395	14,778	49,171	28,025
Interest income	320	455	757	897
Interest expense	(555)	(419)	(1,876)	(821)
Foreign exchange gain (loss), net	1,945	6,166	3,602	(4,326)
Other income	147	106	289	209
Income before income taxes	27,252	21,086	51,943	23,984
Income tax expense	(1,960)	(1,283)	(3,885)	(2,578)
Net income	25,292	19,803	48,058	21,406
Other comprehensive loss, net of tax:				
Change in net unrealized loss on marketable securities	(353)	(310)	(540)	(223)
Change in net unrealized loss on derivative instruments			(158)	
Change in foreign currency translation adjustment	(1,903)		(1,162)	
Total other comprehensive loss, net of tax	(2,256)	(310)	(1,860)	(223)
Net comprehensive income	\$ 23,036	\$ 19,493	\$ 46,198	\$ 21,183
<b>Earnings per share</b>				
Basic	\$ 0.69	\$ 0.55	\$ 1.31	\$ 0.60
Diluted	\$ 0.67	\$ 0.54	\$ 1.28	\$ 0.59
<b>Weighted-average number of ordinary shares outstanding</b> (thousands of shares)				
Basic	36,848	35,812	36,626	35,695
Diluted	37,805	36,826	37,567	36,570

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



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

<i>(in thousands of U.S. dollars)</i>	<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>
<b>Cash flows from operating activities</b>		
Net income for the period	\$ 48,058	\$ 21,406
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	10,758	8,294
Loss (gain) on disposal of property, plant and equipment	19	(49)
Loss from sales and maturities of available-for-sale securities	15	124
Amortization of investment premium	228	457
Amortization of deferred debt issuance costs	1,072	358
Reversal of allowance for doubtful accounts	(40)	(7)
Unrealized (gain) loss on exchange rate and fair value of derivative instruments	(3,033)	5,566
Share-based compensation	14,208	5,783
Deferred income tax	938	413
Other non-cash expenses	586	765
Reversal of inventory obsolescence	(100)	(478)
Loss from written-off inventory due to flood loss		233
Changes in operating assets and liabilities		
Trade accounts receivable	(40,779)	(12,486)
Inventory	(29,286)	(10,004)
Other current assets and non-current assets	4,747	1,019
Trade accounts payable	11,026	(405)
Income tax payable	448	320
Other current liabilities and non-current liabilities	887	2,395
<b>Net cash provided by operating activities</b>	<b>19,752</b>	<b>23,704</b>
<b>Cash flows from investing activities</b>		
Purchase of marketable securities	(83,405)	(53,258)
Proceeds from sales of marketable securities	15,682	25,709
Proceeds from maturities of marketable securities	38,142	34,460
Payments in connection with business acquisition, net of cash acquired	(9,917)	
Purchase of property, plant and equipment	(44,412)	(26,407)
Purchase of intangibles	(319)	(210)
Proceeds from disposal of property, plant and equipment	127	58
<b>Net cash used in investing activities</b>	<b>(84,102)</b>	<b>(19,648)</b>
<b>Cash flows from financing activities</b>		
Payment of debt issuance costs		(359)
Proceeds of short-term loans from banks	15,744	18,000



Edgar Filing: Fabrinet - Form 10-Q

Repayment of long-term loans from bank	(9,800)	(3,000)
Repayment of capital lease liability	(92)	
Proceeds from issuance of ordinary shares under employee share option plans	5,848	2,025
Withholding tax related to net share settlement of restricted share units	(1,008)	(1,711)
Net cash provided by financing activities	10,692	14,955
<b>Net (decrease) increase in cash, cash equivalents and restricted cash</b>	<b>(53,658)</b>	<b>19,011</b>
<b>Movement in cash, cash equivalents and restricted cash</b>		
Cash, cash equivalents and restricted cash at beginning of period	142,804	112,978
(Decrease) increase in cash, cash equivalents and restricted cash	(53,658)	19,011
Effect of exchange rate on cash, cash equivalents and restricted cash	(401)	(630)
<b>Cash, cash equivalents and restricted cash at end of period</b>	<b>\$ 88,745</b>	<b>\$ 131,359</b>
<b>Non-cash investing and financing activities</b>		
Construction, software-related and equipment-related payables	\$ 17,094	\$ 6,657

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

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

<i>(amount in thousands)</i>	<b>As of December 30, 2016</b>	<b>As of December 25, 2015</b>
Cash and cash equivalents	\$ 85,619	\$ 131,359
Restricted cash in connection with business acquisition (non-current assets)	3,126	
<b>Cash, cash equivalents and restricted cash</b>	<b>\$ 88,745</b>	<b>\$ 131,359</b>

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

---

**Table of Contents**

**FABRINET**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(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 test. 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 Exception EMS Ltd. ( Exception EMS ).

**2. Accounting policies**

***Basis of presentation***

The accompanying unaudited condensed consolidated financial statements for Fabrinet as of December 30, 2016 and for the three and six months ended December 30, 2016 and December 25, 2015 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 24, 2016.

The balance sheet as of June 24, 2016 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 30, 2016 may not be indicative of results for the year ending June 30, 2017 or any future periods.

Where necessary, comparative figures have been reclassified to conform to the current period accounting policies and presentation adopted.

On September 14, 2016, the Company acquired 100% shareholding in Global CEM Solutions, Ltd. and all of its subsidiaries (including Exception EMS), a privately-held group located in Wiltshire, United Kingdom. The unaudited condensed consolidated financial statements of the Company include the financial position, results of operations and the cash flows of Exception EMS commencing as of the acquisition date. See Note 8 Business acquisitions for further details on the accounting for this transaction.

*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

---

**Table of Contents**

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 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 30, 2016 and December 25, 2015 each consisted of 13 weeks. The six months ended December 30, 2016 and December 25, 2015 consisted of 27 weeks and 26 weeks, respectively. Fiscal year 2017 will be comprised of 53 weeks and will end on June 30, 2017.

***Concentration of credit risk***

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents, marketable securities, derivatives and accounts receivable.

Cash, cash equivalents and marketable securities 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 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.

***Derivatives***

The derivatives assets and liabilities are recognized on the unaudited condensed consolidated balance sheets as other current assets or accrued expenses measured at fair value.

The Company applies hedge accounting to arrangements that qualify and are designated for cash flow hedge accounting treatment. Hedge accounting is discontinued prospectively if the hedging relationship ceases to be effective or the hedging or hedged items cease to exist as a result of maturity, sale, termination or cancellation.

Derivatives designated and qualifying as hedges of the exposure to variability in expected future cash flows, or other types of forecasted transactions, are considered cash flow hedges which include forward currency contracts. In a cash flow hedging relationship, the effective portion of the change in the fair value of the hedging derivative is initially recorded in accumulated other comprehensive income (loss) (AOCI), while any ineffective portion is recognized directly in earnings, as a component of other income (expense). The portion of gain or loss on the derivative

instrument remains in AOCI until the forecasted transaction is recognized in earnings.

The Company also enters into derivative contracts that are intended to economically hedge certain of the Company's risks. The changes in the fair value of the derivatives are recorded directly in earnings as a component of other income (expense). In accordance with the fair value measurement guidance, the Company's accounting policy is to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio. The Company executes derivative instruments with financial institutions that are credit-worthy, defined by us as institutions that hold an investment grade credit rating.

## **Table of Contents**

### ***Business acquisition***

For the acquisition of Exception EMS, the Company allocated the fair value of purchase consideration to the assets acquired and liabilities assumed based on their fair values at the acquisition date. The total consideration and the allocation of consideration to the individual net assets is preliminary, as there are remaining uncertainties to be resolved, including the settlement of the final net working capital adjustment and the finalization of the estimated fair value attributable to the acquired intangible assets.

The acquired intangible assets, which consist of customer relationships and backlog, are recorded as intangibles in the unaudited condensed consolidated balance sheets. The fair value of the acquired intangible assets was determined based on the multi-period excess earnings method. The Company reviews intangibles for impairment whenever changes or circumstances indicate the carrying amount may not be recoverable.

In connection with the business acquisition, \$3.1 million of cash for deferred consideration, net of foreign currency translation adjustment, was placed into an escrow account which is under the Company's control. However, the Company has contractually agreed to remit this deferred consideration to the sellers of Exception EMS, subject to the resolution of claims that the Company may make against the funds with respect to indemnification and other claims within 24 months from the closing date of the transaction. The cash is presented as restricted cash in the unaudited condensed consolidated balance sheets within non-current assets and the related liability is presented within non-current liabilities for the deferred consideration.

### ***Goodwill***

Goodwill arising from the acquisition is primarily attributable to the ability to expand future products and services and the assembled workforce. Goodwill is reviewed annually for impairment or more frequently whenever changes or circumstances indicate the carrying amount of goodwill may not be recoverable.

### ***Capital lease***

Certain machine and equipment held under capital leases are classified as property, plant and equipment and amortized using the straight-line method over the terms of the lease contracts. The related obligations from the capital lease are recorded as liabilities in the unaudited condensed consolidated balance sheets.

### ***New Accounting Pronouncements not yet adopted by the Company***

In January 2017, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( 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 is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-03, Accounting Changes and Error Corrections (Topic 250) and Investments Equity Method and Joint Ventures (Topic 323): Amendments to SEC Paragraphs Pursuant to Staff Announcements at the September 22, 2016 and November 17, 2016 EITF Meetings. The amendment provides guidance to the Company in relation to the disclosure of the impact that ASU 2014-09, ASU 2016-02 and ASU

2016-13 will have on the Company's financial statements when adopted. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.



---

**Table of Contents**

In January 2017, the FASB issued ASU 2017-01, **Business Combination (Topic 805): Clarifying the Definition of a Business**. This amendment clarifies the definition of a business to assist entities when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or business. For public companies, this ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. Early adoption is permitted for the transactions that occur before the issuance date or effective date of the amendment, only when the transaction has not been reported in financial statements that have been issued or made available for issuance. The Company does not expect that the adoption of this update will have a material impact to its consolidated financial statements.

In October 2016, the FASB issued ASU 2016-16, **Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory**, which eliminates the exception for an intra-entity transfer of an asset other than inventory that prohibits the recognition of current and deferred income taxes until the asset has been sold to an outside party. The entity should recognize income tax consequences of an intra-entity transfer of assets other than inventory when the transfer occurs. For public entities, this update is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. Early adoption is permitted for all entities as of the beginning of an annual reporting period for which financial statements have not been issued or made available for issuance. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, **Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)**. The amendments in this ASU provide guidance on the presentation of certain cash receipts and cash payments in the statement of cash flows in order to reduce diversity in existing practice. The amendments in ASU 2016-15 are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In June 2016, the FASB issued ASU 2016-13, **Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments**. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, **Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting**. This ASU simplifies several aspects of the accounting for share-based payment award transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The amendments in this update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods, for public companies. Early adoption is permitted for any entity in any interim or annual period. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, **Derivatives and Hedging (Topic 815)**, to clarify that a change in the counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815, does not, in and of itself, require a de-designation of the hedging relationship, provided that all other hedge accounting criteria continue to be met. This guidance is effective for public entities for financial statements issued for fiscal years

## Edgar Filing: Fabrinet - Form 10-Q

beginning after December 15, 2016 and 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 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.

---

**Table of Contents**

In January 2016, the FASB issued ASU 2016-01, *Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*. This new guidance requires certain equity investments to be measured at fair value, use of the exit price notion and separate presentation of financial assets and financial liabilities by measurement category and form of financial asset on the balance sheet or the accompanying notes to the financial statements. The ASU on recognition and measurement will take effect for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of the adoption of this update on its consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*. The amendments require management to evaluate, for each annual and interim reporting period, an entity’s ability to continue as a going concern when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations that become due within one year after the date that the financial statements are issued (or available to be issued). This ASU is effective for annual periods and interim reporting periods beginning after December 15, 2016. The Company does not expect that the adoption of this update will have an effect on its consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*, issued as a new Topic, Accounting Standards Codification. The core principle of this amendment is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This update is effective for public companies, as amended by ASU 2015-14, for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Earlier application of this guidance is permitted, but not before the original date of December 15, 2016, which can be adopted either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment as of the date of adoption. Subsequently, in March 2016 and April 2016, the FASB issued ASU 2016-08 and ASU 2016-10, respectively, to clarify the implementation guidance on principle versus agent considerations and address the potential diversity in practice at initial application and cost; and the complexity of applying Topic 606, both at transition and on an ongoing basis related to identification of performance obligations and licensing arrangements; and ASU 2016-12 and ASU 2016-20, in May 2016 and December 2016, respectively, to improve in certain aspects of Topic 606, with the same effective date as ASU 2015-14. The Company will adopt this standard during its fiscal year ending June 28, 2018. In the current period, the Company is assessing the contracts with its customers to identify the impact to its consolidated financial statements. The process is still ongoing and the Company expects to make significant progress in the coming quarters.

***New Accounting Pronouncements adopted by the Company***

In November 2016, the FASB issued ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*, which requires the statement of cash flows to explain the change during the period in the total of cash, cash equivalents and restricted cash or restricted cash equivalents. The Company has early adopted this update in the second quarter of fiscal year 2017 on a retrospective basis but there was no impact to the presentation of the comparative period in the unaudited condensed consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, *Balance Sheet Classification of Deferred Taxes*, which will require entities to present deferred tax assets (DTAs) and deferred tax liabilities (DTLs) as non-current in a classified balance sheet. The ASU simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and non-current in a classified balance sheet. The Company has early adopted this update in the first quarter of fiscal year 2017. Accordingly, as of December 30, 2016, DTAs of \$0.8 million were classified to non-current assets in the unaudited condensed consolidated balance sheets. The Company adopted this update on a prospective basis and

did not change the presentation of the comparative period.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments which require an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The Company has adopted this update and applied it on a prospective basis.

---

**Table of Contents**

In July 2015, the FASB issued ASU 2015-11, Inventory (Topic 330): Simplifying the Measurement of Inventory. The update provides the guidance that an entity, that measured inventory by using first-in, first-out or average cost, should measure inventory at the lower of cost and net realizable value. Subsequent measurement is unchanged for inventory measured using last-in, first-out or the retail inventory method. The Company has adopted this update with no impact to the unaudited condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The update requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle.

Additionally, in August 2015, the FASB issued ASU 2015-15, Interest Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements to amend ASU 2015-03. The Company has adopted this amendment retrospectively. As of December 30, 2016 and June 24, 2016, debt issuance costs of \$0.4 million and \$0.6 million, respectively, related to a recognized debt liability are presented in the balance sheet as a direct reduction of the carrying amount of the related debts.

In February 2015, the FASB issued ASU 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. ASU No. 2015-02 amended the process that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. The Company has adopted this update with no impact to the unaudited condensed consolidated financial statements.

In January 2015, the FASB issued ASU 2015-01, Income Statement Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items. The objective of this amendment is to reduce the complexity in accounting standards by eliminating the concept of extraordinary items from U.S. GAAP. To meet for extraordinary classification the underlying event or transaction should (a) possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity and (b) not reasonably be expected to recur in the foreseeable future. The Company has adopted this update with no impact to the unaudited condensed consolidated financial statements.

**3. 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:

**Table of Contents**

<i>(amount in thousands except per share amounts)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Net income attributable to shareholders	\$ 25,292	\$ 19,803	\$ 48,058	\$ 21,406
Weighted-average number of ordinary shares outstanding (thousands of shares)	36,848	35,812	36,626	35,695
Incremental shares arising from the assumed exercise of share options and vesting of restricted share units (thousands of shares)	957	1,014	941	875
Weighted-average number of ordinary shares for diluted earnings per ordinary share (thousands of shares)	37,805	36,826	37,567	36,570
Basic earnings per ordinary share	\$ 0.69	\$ 0.55	\$ 1.31	\$ 0.60
Diluted earnings per ordinary share	\$ 0.67	\$ 0.54	\$ 1.28	\$ 0.59
Outstanding share options excluded in the computation of diluted earnings per ordinary share <sup>(1)</sup>		31,244		31,244

- (1) These share options were not included in the computation of diluted earnings per ordinary share because the exercise price of the options was greater than the average market price of the underlying shares.

**4. Cash, cash equivalents and marketable securities**

The Company's cash, cash equivalents, and marketable securities can be analyzed as follows:

<i>(amount in thousands)</i>	<b>Carrying Cost</b>	<b>Unrealized Loss</b>	<b>Fair Value</b>	
			<b>Cash and Cash Equivalents</b>	<b>Marketable Securities</b>
As of December 30, 2016				
Cash	\$ 81,867	\$	\$ 81,867	\$
Cash equivalents	3,752		3,752	
Corporate bonds and commercial papers	114,692	(38)		114,654
U.S. agency and U.S. treasury securities	54,211	(99)		54,112
Sovereign and municipal securities	1,746	(4)		1,742
<b>Total</b>	<b>\$ 256,268</b>	<b>\$ (141)</b>	<b>\$ 85,619</b>	<b>\$ 170,508</b>



**Table of Contents**

<i>(amount in thousands)</i>	<b>Carrying Cost</b>	<b>Unrealized Gain</b>	<b>Fair Value Cash and Cash Equivalents</b>	<b>Marketable Securities</b>
<b>As of June 24, 2016</b>				
Cash	\$ 136,754	\$	\$ 136,754	\$
Cash equivalents	6,050		6,050	
Corporate bonds and commercial papers	112,128	394		112,522
U.S. agency and U.S. treasury securities	28,028	2		28,030
Sovereign and municipal securities	1,154	3		1,157
<b>Total</b>	<b>\$ 284,114</b>	<b>\$ 399</b>	<b>\$ 142,804</b>	<b>\$ 141,709</b>

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 reevaluates the designations at each balance sheet date. The Company may sell certain of its marketable securities 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 marketable securities generally range from three months to three years. The Company's investments in marketable securities consist of investments in U.S. Treasury 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 30, 2016:

<i>(amount in thousands)</i>	<b>Carrying Cost</b>	<b>Fair Value</b>
Due within one year	\$ 22,773	\$ 22,763
Due between one to three years	147,876	147,745
<b>Total</b>	<b>\$ 170,649</b>	<b>\$ 170,508</b>

During the six months ended December 30, 2016, the Company recognized a realized loss of \$0.02 million from sales and maturities of available-for-sale securities.

As of December 30, 2016, 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 30, 2016.



## Edgar Filing: Fabrinet - Form 10-Q

As of December 30, 2016, 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. As discussed in Note 11, 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. The Company must comply with the covenant from and after the effective date of the Facility Agreement.

**Table of Contents****5. 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.

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

<i>(amount in thousands)</i>	<b>Fair Value Measurements at Reporting Date Using</b>			
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>As of December 30, 2016</b>				
<b>Assets</b>				
Cash equivalents	\$	\$ 3,752	\$	\$ 3,752
Corporate bonds and commercial papers		114,654		114,654
U.S. agency and U.S. treasury securities		54,112		54,112
Sovereign and municipal securities		1,742		1,742
<b>Total</b>	\$	\$ 174,260	\$	\$ 174,260
<b>Liabilities</b>				
Derivative liabilities	\$	\$ 1 <sup>(1)</sup>	\$	\$ 1
<b>Total</b>	\$	\$ 1	\$	\$ 1

**Table of Contents**

<i>(amount in thousands)</i>	Fair Value Measurements at Reporting Date Using			
	Level 1	Level 2	Level 3	Total
<b>As of June 24, 2016</b>				
<b>Assets</b>				
Cash equivalents	\$	\$ 6,050	\$	\$ 6,050
Corporate bonds and commercial papers		112,522		112,522
U.S. agency and U.S. treasury securities		28,030		28,030
Sovereign and municipal securities		1,157		1,157
Derivative assets		158 <sup>(2)</sup>		158
<b>Total</b>	<b>\$</b>	<b>\$ 147,917</b>	<b>\$</b>	<b>\$ 147,917</b>
<b>Liabilities</b>				
Derivative liabilities	\$	\$ 1,754 <sup>(3)</sup>	\$	\$ 1,754
<b>Total</b>	<b>\$</b>	<b>\$ 1,754</b>	<b>\$</b>	<b>\$ 1,754</b>

(1) Foreign currency forward contracts with notional amount of Canadian dollars 0.2 million.

(2) Foreign currency forward contracts with notional amount of \$7.0 million.

(3) Foreign currency forward contracts with notional amount of \$77.5 million and Canadian dollars 0.6 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 change. 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 30, 2016, the Company recognized the fair value of foreign currency forward contracts of \$0.001 million as derivative liabilities in the unaudited condensed consolidated balance sheet. As of June 24, 2016, the Company recognized the fair value of foreign currency forward contracts of \$0.2 million as derivative assets and \$1.7 million as derivative liabilities in the unaudited condensed consolidated balance sheet under other current assets and accrued expenses, respectively.

As of December 30, 2016, the Company had no foreign currency forward contracts designated as cash flow hedges. During the six months ended December 30, 2016, the Company discontinued cash flow hedges and recognized a gain from unwinding foreign currency forward contracts of \$0.3 million in the unaudited condensed consolidated statements of operations and comprehensive income.

As of December 30, 2016, the Company had one outstanding foreign currency forward contract with a notional amount of Canadian dollars 0.2 million, maturing in March 2017. This foreign currency forward contract was not designated for hedge accounting and was used to hedge fluctuations in the U.S. dollar value of forecasted transactions denominated in Canadian dollar. During the six months ended December 30, 2016, the Company included unrealized loss of \$0.001 million from changes in the fair value of foreign currency contracts in earnings in the unaudited condensed consolidated statements of operations and comprehensive income.

## Edgar Filing: Fabrinet - Form 10-Q

As of December 25, 2015, the Company had 32 outstanding foreign currency forward contracts with an aggregate notional amount of \$181.5 million and Canadian dollars 0.4 million, maturing during December 2015 to December 2016. 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 25, 2015, the Company included unrealized loss of \$6.2 million from changes in the fair value of foreign currency contracts in earnings in the unaudited condensed consolidated statements of operations and comprehensive income.

**Table of Contents****6. Trade accounts receivable, net**

<i>(amount in thousands)</i>	<b>As of December 30, 2016</b>	<b>As of June 24, 2016</b>
Trade accounts receivable	\$ 240,934	\$ 196,178
Less: allowance for doubtful account	(47)	(33)
<b>Trade accounts receivable, net</b>	<b>\$ 240,887</b>	<b>\$ 196,145</b>

As of December 30, 2016, trade accounts receivable of \$6.5 million were secured to short-term loans from bank (see Note 11).

**7. Inventory**

<i>(amount in thousands)</i>	<b>As of December 30, 2016</b>	<b>As of June 24, 2016</b>
Raw materials	\$ 64,101	\$ 58,199
Work in progress	114,352	94,762
Finished goods	27,008	21,593
Goods in transit	11,776	9,381
	217,237	183,935
Less: Inventory obsolescence	(2,862)	(2,436)
<b>Inventory, net</b>	<b>\$ 214,375</b>	<b>\$ 181,499</b>

**8. Business acquisition**

On September 14, 2016, the Company acquired 100% shareholding in Exception EMS, a privately-held group located in Wiltshire, United Kingdom, for cash consideration of approximately \$13.0 million, net of \$0.5 million cash acquired. Exception EMS provides contract electronics manufacturing services to the global electronics industry with innovative solutions, adding value to the design, manufacture and testing of printed circuit board assemblies. Pursuant to the acquisition agreement, the Company has placed \$3.1 million of cash, net of foreign currency translation adjustment, for deferred consideration in an escrow account which is under the Company's control. However, the Company has contractually agreed to remit this deferred consideration to the sellers of Exception EMS, subject to the resolution of claims that the Company may make against the funds with respect to indemnification and other claims within 24 months from the closing date of the transaction.

The Company has accounted for this acquisition under the provisions of business combinations accounting, in accordance with Accounting Standards Codification Topic 805 Business Combinations. Accordingly, the estimated fair value of the acquisition consideration was allocated to the assets acquired and the liabilities assumed based on

their respective fair values on the acquisition date. The Company has made certain estimates and assumptions in determining the allocation of the acquisition consideration.

**Table of Contents**

The total consideration and the allocation of consideration to the individual Exception EMS net assets is preliminary, as there are remaining uncertainties to be resolved, including the settlement of the final net working capital adjustment and the finalization of the estimated fair value attributable to the acquired intangible assets. As the functional currency of Exception EMS is pound sterling ( GBP ), for the six months ended December 30, 2016, the Company recognized a \$1.2 million loss from foreign currency translation adjustment in its unaudited condensed consolidated statements of operations and comprehensive income.

During the second quarter of fiscal year 2017, the Company recorded an adjustment to its initial preliminary purchase price allocation with respect to the assets acquired and liabilities assumed. This resulted in a change in goodwill which was previously reported at acquisition date of \$3.0 million to \$2.7 million.

The Company's preliminary allocation of the total purchase price for the acquisition is summarized below:

<i>(amount in thousands)</i>	<b>Purchase price allocation</b>
Cash	\$ 474
Accounts receivable	4,064
Inventory	3,490
Other current assets	427
Property, plant and equipment	5,678
Intangibles	4,492
Goodwill	2,735
Other non-current assets	516
Current liabilities	(6,796)
Other non-current liabilities	(1,563)
<b>Total fair value of assets acquired and liabilities assumed</b>	<b>\$ 13,517</b>
<b>Total purchase price, net of cash acquired</b>	<b>\$ 13,043</b>

In connection with the Company's acquisition of Exception EMS, the Company assumed lease agreements for certain machine and equipment, which are accounted for as capital leases. As of December 30, 2016, the Company included approximately \$1.9 million of capital lease assets and \$1.5 million of capital lease liability in the unaudited condensed consolidated balance sheets associated with these acquired lease agreements.

During the six months ended December 30, 2016, the Company incurred approximately \$1.5 million in transaction costs related to the acquisition, which primarily consisted of legal, accounting and valuation-related expenses. These expenses were recorded in selling, general and administrative expense in the accompanying unaudited condensed consolidated statements of operations and comprehensive income.

Pro forma results of operations for the acquisition have not been presented as they were not material to the Company's results of operations.

***Identifiable intangibles***

## Edgar Filing: Fabrinet - Form 10-Q

The acquired intangible assets include customer relationships and backlog. The fair value of the identified intangible assets was determined based on the multi-period excess earnings method.

Customer relationships represent the fair value of future projected revenues that was derived from the sale of products to existing customers of the acquired company. The fair value of \$4.4 million will be amortized over the respective estimated remaining useful life of ten years.



**Table of Contents**

Backlog represents the fair value of sales orders backlog as of the valuation date. The fair value of \$0.1 million will be amortized over the respective estimated remaining useful life of three years.

**Goodwill**

Goodwill arising from the acquisition is primarily attributable to the ability to expand future products and services and the assembled workforce. Goodwill is not deductible for tax purposes.

**9. Intangibles**

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

<i>(amount in thousands)</i>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Foreign Currency Translation Adjustment</b>	<b>Net</b>
As of December 30, 2016				
Software	\$ 4,470	\$ (3,347)	\$	\$ 1,123
Customer relationships	4,372	(211)	(329)	3,832
Backlog	120	(18)	(9)	93
<b>Total intangibles</b>	<b>\$ 8,962</b>	<b>\$ (3,576)</b>	<b>\$ (338)</b>	<b>\$ 5,048</b>

<i>(amount in thousands)</i>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Foreign Currency Translation Adjustment</b>	<b>Net</b>
As of June 24, 2016				
Software	\$ 3,786	\$ (3,287)	\$	\$ 499
Customer relationships				
Backlog				
<b>Total intangibles</b>	<b>\$ 3,786</b>	<b>\$ (3,287)</b>	<b>\$</b>	<b>\$ 499</b>

In connection with the acquisition of Exception EMS, the Company recorded \$4.4 million of customer relationships and \$0.1 million of backlog. As of December 30, 2016, the weighted-average remaining life of customer relationships and backlog was 7.4 years and 2.2 years, respectively.

The Company recorded amortization expense relating to intangibles of \$0.3 million and \$0.01 million for the three months ended December 30, 2016 and December 25, 2015, respectively, and \$0.3 million and \$0.02 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

## Edgar Filing: Fabrinet - Form 10-Q

Based on the carrying amount of intangibles as of December 30, 2016, 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>	
2017 (remaining six months)	\$ 602
2018	1,014
2019	904
2020	792
2021	633
Thereafter	1,103
<b>Total</b>	<b>\$ 5,048</b>

**Table of Contents****10. Goodwill**

As of December 30, 2016, the Company recorded \$2.7 million of goodwill, in connection with the acquisition of Exception EMS, in the unaudited condensed consolidated balance sheets.

The changes in the carrying amount of goodwill were as follows:

<i>(amount in thousands)</i>	<b>Goodwill</b>
Balance as of June 24, 2016	\$
Addition in connection with business acquisition	2,735
Foreign currency translation adjustment	(206)
Balance as of December 30, 2016	\$ 2,529

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:

*(amount in thousands)*

<b>Rate <sup>(1)</sup></b>	<b>Conditions</b>	<b>Maturity</b>	<b>As of December 30, 2016</b>	<b>As of June 24, 2016</b>
Short-term borrowing:				
Revolving borrowing:				
LIBOR + 1.75% per annum	Repayable in			
	1 to 6 months	January 2017 <sup>(2)</sup>	\$ 20,000	\$ 6,500
Short-term loans from bank:				
Bank of England base rate +1.85% per annum	Repayable based on			
	credit terms of secured accounts receivable		3,377	
Bank of England base rate + 2.2% per annum <sup>(3)</sup>	Repayable on monthly basis	May 2017	55	
Current portion of long-term borrowing			15,100	18,100
			38,532	24,600
Less: Unamortized debt issuance costs			(245)	(293)

Edgar Filing: Fabrinet - Form 10-Q

			\$	38,287	\$	24,307
<b>Long-term borrowing:</b>						
LIBOR + 2.8% per annum	Repayable in quarterly installments	March 2017	\$	1,500	\$	4,500
<b>Term loan borrowing:</b>						
LIBOR +1.75% per annum	Repayable in quarterly installments	May 2019		43,200		50,000
				44,700		54,500
Less: Current portion				(15,100)		(18,100)
Unamortized debt issuance costs				(188)		(300)
Non-current portion			\$	29,412	\$	36,100

(1) LIBOR is London Interbank Offered Rate.

(2) In December 2016, the maturity date was extended to January 2017.

**Table of Contents**

(3) As of December 30, 2016, the carrying amount of plant and machinery of Exception EMS secured to such loan was \$4.3 million. Under the conditions stipulated in the loan agreement, this loan will be cross securitized, cross default and co-terminus with the short terms of loans of \$3.4 million which are secured by accounts receivable. Under the long-term borrowing contract of a subsidiary, the loan is secured by certain property, plant and equipment of the subsidiary. The carrying amount of assets secured and pledged as collateral to such loan as of December 30, 2016 and June 24, 2016 was \$46.4 million and \$47.7 million, respectively. This subsidiary is also required to comply with maximum ratios of debt to equity and minimum levels of debt service coverage ratios, and Fabrinet must maintain an effective shareholding ratio. The carrying amounts of bank borrowings approximate their fair value.

As of December 30, 2016 and June 24, 2016, the Company was in compliance with its bank borrowing agreements. In addition to financial ratios, certain of the Company's credit facilities include customary events of default.

The movements of long-term loans were as follows for the six months ended December 30, 2016 and December 25, 2015:

<i>(amount in thousands)</i>	<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Opening balance	\$ 54,500	\$ 10,500
Repayments during the period	(9,800)	(3,000)
Closing balance	\$ 44,700	\$ 7,500

As of December 30, 2016, future maturities of long-term debt during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2017 (remaining six months)	\$ 8,300
2018	13,600
2019	22,800
Total	\$ 44,700

**Credit facilities:**

Fabrinet 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, provides 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. The revolving loan facility will be terminated and all amounts outstanding will be due and payable in full on May 22, 2019. The principal amount of any drawn term loans must be repaid according to scheduled quarterly amortization payments, with final payment of all amounts outstanding, plus accrued interest, being due May 22, 2019.

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. The amendment extended the availability period for draws on the term loan facility from July 31, 2015 to July 31, 2016. As of December 30, 2016, \$20.0 million of the revolving borrowing and \$43.2 million of the term loan borrowing was outstanding under the Facility Agreement, resulting in available credit facilities of \$136.8 million. Borrowings under the revolving credit facility are classified as current liabilities in the unaudited condensed consolidated balance sheets as the Company has the periodic option to renew or pay, all or a portion of, the outstanding balance at the end of the maturity date, which is in the range of one to six months, without premium or penalty, upon notice to the administrative agent. During December 2016, the Company sent notices to the bank to renew the maturity date of its revolving borrowings. The bank approved the notices and extended the maturity to January 2017.

---

**Table of Contents**

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 plus a spread of 0.75% to 1.50%, 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. 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: (1) a minimum tangible net worth of not less than \$200.0 million plus 50% of quarterly net income, exclusive of quarterly losses; (2) a minimum debt service coverage ratio of not less than 1.50:1.00; (3) a maximum senior 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 30, 2016, the Company was in compliance with all covenants under the Facility Agreement.

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.

Fabrinet intends to use the proceeds of the credit line to finance its future manufacturing facility in 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.

***Short-term loans from bank***

In connection with the acquisition of Exception EMS, the Company assumed a secured borrowing agreement that is secured by trade accounts receivable of Exception EMS. As of December 30, 2016, the carrying amount of trade accounts receivable secured to the loans was \$6.5 million. The secured borrowing agreement contains certain covenants that Exception EMS is required to comply with: (1) the value of credit notes may not exceed 4% of the value of assigned debts measured on a monthly basis, and (2) rolling cash flow must be provided with the monthly management information. As of December 30, 2016, the subsidiary was in compliance with all covenants under the secured borrowing agreement.

As of December 30, 2016, the Company drew down \$3.4 million from this facility, which is recorded as short-term loans in the unaudited condensed consolidated balance sheets. The agreement bears interest for discount charge at

1.85% per annum above Bank of England base rate.



**Table of Contents**

Undrawn available credit facilities classified by availability period of future borrowing as of December 30, 2016 and June 24, 2016 were as follows:

<i>(amount in thousands)</i>	<b>December 30, 2016</b>	<b>June 24, 2016</b>
Short-term	\$ 3,395	\$ 1,414
Long-term	\$ 136,800	\$ 143,500

As of December 30, 2016, Fabrinet had made a request to drawdown \$14.0 million on its available outstanding revolving borrowing. The bank approved the request for drawdown and provided cash to settle this request to Fabrinet on January 3, 2017. Due to the settlement of the transaction taking place after the balance sheet date, the respective cash and loan amount are not recorded in the unaudited condensed consolidated balance sheet as of December 30, 2016.

**12. Income taxes**

As of December 30, 2016 and June 24, 2016, the liability for uncertain tax positions including accrued interest and penalties was \$1.9 million and \$1.8 million, respectively. The Company expects the estimated amount of liability associated with its uncertain tax positions to decrease within the next 12 months due to the lapse of the applicable statute of limitations in foreign tax jurisdictions.

The Company files income tax returns in the United States and foreign tax jurisdictions. The tax years from 2012 to 2016 remain open to examination by U.S. federal and state tax authorities, 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 30, 2016 and December 25, 2015 remained flat at 6.8% of net income. The Company's taxable income and income tax expenses for the three months ended December 30, 2016 increased proportionately on an absolute dollars basis, compared with the three months ended December 25, 2015.

The effective tax rate for the Company for the six months ended December 30, 2016 and December 25, 2015 remained flat at 6.7% of net income. The Company's taxable income and income tax expenses for the six months ended December 30, 2016 increased proportionately on an absolute dollars basis, compared with the six months ended December 25, 2015.

**13. Share-based compensation*****Share-based compensation***

In determining the grant date fair value of equity awards, the Company is required to determine the fair value of Fabrinet's ordinary shares and 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, expected terms of the awards, and the vesting period of the respective awards. Forfeitures are estimated at the time of

grant and revised if necessary in subsequent periods if actual forfeitures differ from those estimates.

**Table of Contents**

The effect of recording share-based compensation expense for the three and six months ended December 30, 2016 and December 25, 2015 was as follows:

<i>(amount in thousands)</i>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Share-based compensation expense by type of award:				
Share options	\$	\$ 2	\$	\$ 18
Restricted share units	7,633	3,108	12,453	5,765
Performance share units	964		1,755	
<b>Total share-based compensation expense</b>	<b>8,597</b>	<b>3,110</b>	<b>14,208</b>	<b>5,783</b>
Tax effect on share-based compensation expense				
<b>Net effect on share-based compensation expense</b>	<b>\$ 8,597</b>	<b>\$ 3,110</b>	<b>\$ 14,208</b>	<b>\$ 5,783</b>

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

<i>(amount in thousands)</i>	<b>Three Months ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Cost of revenue	\$ 1,514	\$ 540	\$ 2,528	\$ 1,077
Selling, general and administrative expense	7,083	2,570	11,680	4,706
<b>Total share-based compensation expense</b>	<b>\$ 8,597</b>	<b>\$ 3,110</b>	<b>\$ 14,208</b>	<b>\$ 5,783</b>

The Company did not capitalize any share-based compensation expense as part of any asset costs during the three and six months ended December 30, 2016 and December 25, 2015.

***Share-based award activity***

Share options have been granted to directors and employees. As of December 30, 2016, there were no share options outstanding under Fabrinet's Amended and Restated 1999 Share Option Plan (the "1999 Plan"). Additional option grants may not be made under the 1999 Plan.

As of December 30, 2016, there were an aggregate of 99,263 share options outstanding, 1,462,170 restricted share units outstanding and 234,678 performance share units outstanding under Fabrinet's 2010 Performance Incentive Plan (the "2010 Plan"). As of December 30, 2016, there were 1,230,956 ordinary shares available for future grant under the 2010 Plan. The 1999 Plan and 2010 Plan are collectively referred to as the "Share Option Plans."

*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.

**Table of Contents**

The following summarizes share option activity:

	<b>Number of Shares</b>	<b>Number of Exercisable Options</b>	<b>Weighted- Average Exercise Price Per Share</b>	<b>Weighted- Average Grant Date Fair Value Per Share</b>
Balance as of June 24, 2016	464,334	464,334	\$ 15.95	
Granted				
Exercised	(365,066)		\$ 16.02	
Forfeited				
Expired	(5)		\$ 5.75	
Balance as of December 30, 2016	99,263	99,263	\$ 15.71	

	<b>Number of Shares</b>	<b>Number of Exercisable Options</b>	<b>Weighted- Average Exercise Price Per Share</b>	<b>Weighted- Average Grant Date Fair Value Per Share</b>
Balance as of June 26, 2015	792,019	758,451	\$ 16.33	
Granted				
Exercised	(130,779)		\$ 15.48	
Forfeited	(213)		\$ 14.43	
Expired				
Balance as of December 25, 2015	661,027	660,035	\$ 16.50	

The following summarizes information for share options outstanding as of December 30, 2016 under the Share Option Plans:

	<b>Range of Exercise Price</b>	<b>Number of Shares Underlying Options</b>	<b>Weighted- Average Remaining Contractual Life (years)</b>	<b>Aggregate Intrinsic Value <i>(amount in thousands)</i></b>
	\$14.12 \$15.05	55,238	1.31	
	\$15.16 \$16.83	36,975	0.96	
	\$18.60 \$26.16	7,050	1.92	
Options outstanding		99,263	1.22	\$ 2,441

Options exercisable	99,263	1.22	\$	2,441
---------------------	--------	------	----	-------

As of December 30, 2016, 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 are types of share-based awards that may be granted under the 2010 Plan. 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. Restricted share units granted to employees generally vest in equal installments over three or four years on each anniversary of the vesting commencement date.

**Table of Contents**

Performance share units granted to executives will vest 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 Company has entered into an employment agreement, as amended on August 12, 2016, with an executive of the Company that provides for accelerated vesting of equity awards under certain circumstances, including upon termination of employment. In addition, if the executive's employment with the Company continues through and including February 20, 2017, (1) any outstanding equity awards granted to the executive prior to August 2016 will become 100% vested and (2) certain restricted share units granted to the executive in August 2016 will become 100% vested.

The following summarizes restricted share unit activity under the 2010 Plan:

	<b>Number of Shares</b>	<b>Weighted- Average Grant Date Fair Value Per Share</b>
Balance as of June 24, 2016	1,181,402	\$ 18.34
Granted	741,973	\$ 39.23
Issued	(423,035)	\$ 16.41
Forfeited	(38,170)	\$ 22.35
Balance as of December 30, 2016	1,462,170	\$ 29.40

	<b>Number of Shares</b>	<b>Weighted- Average Grant Date Fair Value Per Share</b>
Balance as of June 26, 2015	1,140,927	\$ 16.03
Granted	539,772	\$ 19.57
Issued	(388,425) <sup>(1)</sup>	\$ 15.27
Forfeited	(15,415)	\$ 18.39
Balance as of December 25, 2015	1,276,859	\$ 17.27

<sup>(1)</sup> Includes 849 shares vested on December 1, 2015, but not settled as of December 25, 2015.

The following summarizes performance share unit activity under the 2010 Plan:

	<b>Number of Shares</b>	<b>Weighted- Average Grant Date Fair Value Per Share</b>
Balance as of June 24, 2016		
Granted	234,678	\$ 40.48
Issued		
Forfeited		
Balance as of December 30, 2016	234,678	\$ 40.48



**Table of Contents**

As of December 30, 2016, there was \$32.3 million of unrecognized share-based compensation expense related to restricted share units and performance share units under the 2010 Plan that is expected to be recorded over a weighted-average period of 2.07 years.

For the six months ended December 30, 2016 and December 25, 2015, the Company withheld an aggregate of 26,085 shares and 84,269 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 30, 2016 and December 25, 2015, the Company then remitted cash of \$1.0 million and \$1.7 million, respectively, to the appropriate taxing authorities, and presented it as a financing activity within the unaudited 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 six months ended December 30, 2016, Fabrinet issued 365,066 ordinary shares upon the exercise of options, for cash consideration at a weighted-average exercise price of \$16.02 per share, and 396,950 ordinary shares upon the vesting of restricted share units, net of shares withheld.

All such issued shares are fully paid.

**15. Accumulated other comprehensive income**

The changes in AOCI for the six months ended December 30, 2016 were as follows:

	Unrealized net Gains (Losses) on Marketable Securities	Unrealized net Gains (Losses) on Derivative Instruments	Foreign Currency Translation Adjustment	Total
<i>(amount in thousands)</i>				
Balance as of June 24, 2016	\$ 399	\$ 192	\$	\$ 591
Other comprehensive income before reclassification adjustment	(525)		(1,162)	(1,687)
Amounts reclassified out of AOCI to foreign exchange loss in the unaudited condensed consolidated statement of operations and comprehensive income	(15)	(158)		(173)
Tax effects				

Edgar Filing: Fabrinet - Form 10-Q

Other comprehensive loss	\$	(540)	\$	(158)	\$	(1,162)	\$	(1,860)
Balance as of December 30, 2016	\$	(141)	\$	34	\$	(1,162)	\$	(1,269)

**Table of Contents****16. Commitments and contingencies*****Bank guarantees***

As of December 30, 2016 and June 24, 2016, there were outstanding bank guarantees given by banks on behalf of Fabrinet Thailand for electricity usage and other normal business amounting to \$1.4 million and \$0.8 million, respectively.

***Operating lease commitments***

The Company leases a portion of its office, capital equipment, and certain land and buildings for its facilities in the Cayman Islands, China, New Jersey and the United Kingdom under operating lease arrangements that expire in various calendar years through 2023. Rental expense under these operating leases amounted to \$0.8 million and \$0.6 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

As of December 30, 2016, the future minimum lease payments due under non-cancelable operating leases during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2017 (remaining six months)	\$ 867
2018	1,641
2019	1,104
2020	902
2021	503
Thereafter	850
<b>Total minimum operating lease payments</b>	<b>\$ 5,867</b>

***Capital lease commitments***

In connection with the acquisition of Exception EMS, 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 30, 2016, the future minimum lease payments due under non-cancelable capital leases during each fiscal year were as follows:

<i>(amount in thousands)</i>	
2017 (remaining six months)	\$ 180
2018	387
2019	419
2020	385
2021	99
<b>Total minimum capital lease payments</b>	<b>\$ 1,470</b>

***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.

**Table of Contents**

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 is approximately \$5.6 million, of which the first installment of \$1.1 million was paid by the Company on January 10, 2017. The Company expects to pay the remaining balance of the purchase price on or before December 25, 2017.

As of December 30, 2016, the Company had an outstanding commitment to third parties of approximately \$11.9 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 30, 2016, 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>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
North America	\$ 157,997	\$ 124,154	\$ 323,992	\$ 230,597
Asia-Pacific	136,692	84,354	251,437	168,243
Europe	56,467	24,530	107,770	50,631
	\$ 351,156	\$ 233,038	\$ 683,199	\$ 449,471

As of December 30, 2016 and December 25, 2015, the Company had approximately \$35.9 million and \$33.6 million of long-lived assets based in North America, with the substantial remainder of assets based in Asia-Pacific.

***Significant customers***

The Company had two customers that each contributed to 10% or more of its total accounts receivable as of December 30, 2016 and June 24, 2016, respectively.

**Table of Contents**

**18. Other expense related to flooding**

During the week of August 10, 2015, the Company's subsidiary in China temporarily suspended production in its manufacturing facility due to flooding caused by Typhoon Soudelor and resumed operations on August 15, 2015. During the six months ended December 25, 2015, the Company recognized \$0.9 million of losses incurred from the event in the unaudited condensed consolidated statements of operations and comprehensive income. The Company received a final payment of \$0.8 million from an insurer against the Company's claim for flood damage during the three months ended March 25, 2016.

**Table of Contents**

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

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

our goals and strategies;

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

our expectation that the portion of our future revenues attributable to customers in regions outside of North America will increase compared with the portion of those revenues for the six months ended December 30, 2016;

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 2017 selling, general and administrative (SG&A) expenses will increase on an absolute dollar basis and decrease as a percentage of revenue compared to fiscal year 2016;

our expectation that our employee costs will increase in Thailand and the People's Republic of China (PRC);

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.

## **Table of Contents**

*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 test. 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.

## **Business acquisition**

On September 14, 2016, we acquired 100% shareholding in Global CEM Solutions Ltd. and all of its subsidiaries, a privately-held group located in Wiltshire, United Kingdom ( Exception EMS ), for cash consideration of approximately \$13.0 million, net of cash acquired. This is a strategic acquisition involving new geographies, new sectors and new customers. Exception EMS provides contract electronics manufacturing services primarily to the European electronics market with innovative solutions, adding value to the design, manufacture and testing of printed circuit board assemblies. Its customers include industrial, energy, aerospace and defense companies, with approximately 80% of its revenue derived from customers in Europe. See Note 8 business acquisitions to the unaudited condensed consolidated financial statements for further details.

## **Flooding**

## Edgar Filing: Fabrinet - Form 10-Q

During the week of August 10, 2015, our subsidiary in China temporarily suspended production in its manufacturing facility due to flooding caused by Typhoon Soudelor and resumed operations on August 15, 2015. During the six months ended December 25, 2015, we recognized \$0.9 million of losses incurred from the event in the unaudited condensed consolidated statements of operations and comprehensive income. We received a final payment of \$0.8 million from an insurer against our claim for flood damage during the three months ended March 25, 2016.

**Table of Contents****Revenues**

Our total revenues increased by \$118.1 million, or 50.7%, to \$351.2 million for the three months ended December 30, 2016, compared with \$233.0 million for the three months ended December 25, 2015. Our total revenues increased by \$233.7 million, or 52.0%, to \$683.2 million for the six months ended December 30, 2016, compared with \$449.5 million for the six months ended December 25, 2015. The increase was primarily due to (1) an increase in our customers' demand for both optical and non-optical communications manufacturing services during the three and six months ended December 30, 2016, (2) the positive impact from an additional week of revenue during the six months ended December 30, 2016 and (3) \$6.2 million of revenue for the three months ended December 30, 2016 and \$7.0 million of revenue for the six months ended December 30, 2016 from companies we acquired in September 2016.

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. While 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 increased from 46.7% in the three months ended December 25, 2015 to 55.0% in the three months ended December 30, 2016 and from 48.7% in the six months ended December 25, 2015 to 52.6% in the six months ended December 30, 2016, primarily because of an increase in sales to our customers outside North America, partially due to an increase in sales to our customers in Europe due to the acquisition of Exception EMS in September 2016. We expect that the portion of our future revenues attributable to customers in regions outside North America will continue to increase as compared with the portion of revenues attributable to such customers during the six months ended December 30, 2016.

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

	Three Months Ended		Six Months Ended	
	December 30, 2016	December 25, 2015	December 30, 2016	December 25, 2015
North America	45.0%	53.3%	47.4%	51.3%
Asia-Pacific	38.9	36.2	36.8	37.4
Europe	16.1	10.5	15.8	11.3

100.0%

100.0%

100.0%

100.0%

***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

---

**Table of Contents**

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.

**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 campus in Thailand, and capital equipment located at each of our manufacturing locations.

During the three and six months ended December 30, 2016 and December 25, 2015, discretionary merit-based bonus awards were made to our non-executive employees. Charges included in cost of revenues for bonus awards to non-executive employees were \$0.9 million and \$0.7 million for the three months ended December 30, 2016 and December 25, 2015, respectively, and \$ 1.8 million and \$1.5 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

Share-based compensation expense included in cost of revenues was \$1.5 million and \$0.5 million for the three months ended December 30, 2016 and December 25, 2015, respectively, and \$2.5 million and \$1.1 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

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.



---

**Table of Contents****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 2017, we expect our SG&A expenses will increase on an absolute dollar basis and decrease as a percentage of revenue compared with fiscal year 2016, due to the acquisition of Exception EMS and higher share-based compensation expenses as a result of restricted share units and performance share units granted to executives in August 2016.

The compensation committee of our board of directors approved a fiscal year 2017 executive incentive plan with quantitative objectives, based on achieving certain revenue targets and gross margin targets for our fiscal year ending June 30, 2017. Bonuses under our fiscal year 2017 executive incentive plan are payable after the end of fiscal year 2017. In fiscal year 2016, the compensation committee approved a fiscal year 2016 executive incentive plan with quantitative objectives, based on achieving certain revenue and non-GAAP earnings per share targets for our fiscal year ended June 24, 2016, as well as qualitative objectives, based on achieving individual performance goals. In the three months ended September 30, 2016, the compensation committee awarded bonuses to our executive employees for Company and individual achievements of performance under our fiscal 2016 executive incentive plan. Discretionary merit-based bonus awards were also available to our non-executive employees and were payable as of December 30, 2016.

Charges included in SG&A expenses for bonus awards to non-executive and executive employees were \$1.2 million and \$1.6 million for the three months ended December 30, 2016 and December 25, 2015, respectively, and \$2.1 million and \$2.2 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

Share-based compensation expense included in SG&A expenses was \$7.1 million and \$2.6 million for the three months ended December 30, 2016 and December 25, 2015, respectively, and \$11.7 million and \$4.7 million for the six months ended December 30, 2016 and December 25, 2015, respectively.

**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 addition, we were exposed to foreign exchange risk in connection with the long-term loan and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the Bank) in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency interest rate swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. Borrowings and interest under the



term loan have been scheduled to be repaid on a quarterly basis between September 2011 and March 2017. As of December 30, 2016, we had outstanding borrowings under the term loan facility of \$1.5 million. Under the terms of the cross currency swap arrangements, amounts drawn in Thai baht were converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of London Interbank Offered Rate (LIBOR) plus 2.8% per annum.

**Table of Contents**

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 unaudited condensed consolidated balance sheet at fair value. Gain or loss on our forward and put option contracts generally offset the assets, liabilities, and transactions economically hedged.

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 30, 2016			As of June 24, 2016		
	Currency	\$	%	Currency	\$	%
<b>Assets</b>						
Thai baht	552,392	\$ 15,417	50.7	834,536	\$ 23,594	91.3
RMB	17,572	2,533	8.3	14,835	2,255	8.7
GBP	10,142	12,465	41.0			
Total		\$ 30,415	100.0		\$ 25,849	100.0
<b>Liabilities</b>						
Thai baht	1,767,161	\$ 49,321	78.3	1,517,782	\$ 42,912	92.0
RMB	23,131	3,334	5.3	24,654	3,748	8.0
GBP	8,396	10,319	16.4			
Total		\$ 62,974	100.0		\$ 46,660	100.0

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 30, 2016, we did not have derivative contracts denominated in Thai baht. As of June 24, 2016, we had \$84.5 million in forward contracts outstanding against forecasted Thai baht payables.

The RMB assets represent cash and cash equivalents, accounts receivable and other current assets. The RMB liabilities represent trade accounts payable, accrued expenses, income tax payable and other payables. As of December 30, 2016 and June 24, 2016, we did not have any derivative contracts denominated in RMB.

The GBP assets primarily represent cash, accounts receivable and fixed assets. The GBP liabilities primarily represent short-term loans, trade accounts payable and other payables. As of December 30, 2016, we did not have any derivative contracts denominated in GBP.

For the six months ended December 30, 2016 and December 25, 2015, we recorded an unrealized loss of \$0.001 million and \$6.2 million, respectively, for the changes in fair value of derivatives that are not designated as hedging instruments in the unaudited 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

---

**Table of Contents**

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

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 ending August 24, 2019, and after the expiration date, we may request a renewal with the office of the Clerk of the Cabinet for another twenty years.

Throughout the period of our operations in Thailand, we have generally received income tax and other incentives from the Thailand Board of Investment. Preferential tax treatment from the Thai government in the form of a corporate tax exemption is currently available to us through June 2020 on income generated from projects to manufacture certain

products at our Pinehurst campus. 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. 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 remain at 20% from fiscal year 2017 onward.

**Table of Contents****Critical Accounting Policies and Use of Estimates**

We prepare our unaudited 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 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 unaudited condensed consolidated financial statements, as their application places the most significant demands on our management's judgment.

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended June 24, 2016. The adoption of new accounting policies and the accounting standards are disclosed in Note 2 Accounting policies to the unaudited condensed consolidated financial statements.

**Results of Operations**

The following table sets forth a summary of our unaudited 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>	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Revenues	\$ 351,156	\$ 233,038	\$ 683,199	\$ 449,471
Cost of revenues	(308,110)	(204,545)	(600,545)	(394,967)
Gross profit	43,046	28,493	82,654	54,504
Selling, general and administrative expenses	(17,651)	(13,715)	(33,483)	(25,615)
Other expense related to flooding				(864)
Operating income	25,395	14,778	49,171	28,025
Interest income	320	455	757	897
Interest expense	(555)	(419)	(1,876)	(821)
Foreign exchange gain (loss), net	1,945	6,166	3,602	(4,326)
Other income	147	106	289	209
Income before income taxes	27,252	21,086	51,943	23,984
Income tax expense	(1,960)	(1,283)	(3,885)	(2,578)
Net income	25,292	19,803	48,058	21,406
Other comprehensive loss, net of tax	(2,256)	(310)	(1,860)	(223)

Net comprehensive income	\$ 23,036	\$ 19,493	\$ 46,198	\$ 21,183
--------------------------	-----------	-----------	-----------	-----------

**Table of Contents**

The following table sets forth a summary of our unaudited 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 30, 2016	December 25, 2015	December 30, 2016	December 25, 2015
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	(87.7)	(87.8)	(87.9)	(87.9)
Gross profit	12.3	12.2	12.1	12.1
Selling, general and administrative expenses	(5.0)	(5.9)	(4.9)	(5.7)
Other expense related to flooding				(0.2)
Operating income	7.3	6.3	7.2	6.2
Interest income	0.1	0.2	0.1	0.2
Interest expense	(0.2)	(0.2)	(0.3)	(0.2)
Foreign exchange gain (loss), net	0.6	2.7	0.5	(1.0)
Other income	0.0	0.1	0.1	0.1
Income before income taxes	7.8	9.1	7.6	5.3
Income tax expense	(0.6)	(0.6)	(0.6)	(0.5)
Net income	7.2	8.5	7.0	4.8
Other comprehensive loss, net of tax	(0.6)	(0.1)	(0.3)	(0.1)
Net comprehensive income	6.6%	8.4%	6.7%	4.7%

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 30, 2016	December 25, 2015	December 30, 2016	December 25, 2015
Optical communications	\$ 274,244	\$ 168,694	\$ 531,051	\$ 323,456
Lasers, sensors and other	76,912	64,344	152,148	126,015
Total	\$ 351,156	\$ 233,038	\$ 683,199	\$ 449,471

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 30, 2016 with Three and Six Months Ended December 25, 2015***



*Total revenues.*

Our total revenues increased by \$118.1 million, or 50.7%, to \$351.2 million for the three months ended December 30, 2016, compared with \$233.0 million for the three months ended December 25, 2015. 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 30, 2016 and \$6.2 million of revenue from companies we acquired in September 2016. Revenues from optical communications products represented 78.1% of our total revenues for the three months ended December 30, 2016, compared to 72.4% for the three months ended December 25, 2015.

Our total revenues increased by \$233.7 million, or 52.0%, to \$683.2 million for the six months ended December 30, 2016, compared with \$449.5 million for the six months ended December 25, 2015. This increase was primarily due to (1) an increase in our customers' demand for both optical and non-optical communications manufacturing services during the six months ended December 30, 2016, (2) the positive impact from an additional week of revenue during the six months ended December 30, 2016 and (3) \$7.0 million of revenue from companies we acquired in September 2016. Revenues from optical communications products represented 77.7% of our total revenues for the six months ended December 30, 2016, compared to 72.0% for the six months ended December 25, 2015.

---

**Table of Contents***Cost of revenues.*

Our cost of revenues increased by \$103.6 million, or 50.6%, to \$308.1 million, or 87.7% of total revenues, for the three months ended December 30, 2016, compared with \$204.5 million, or 87.8% of total revenues, for the three months ended December 25, 2015. The increase in cost of revenues on an absolute dollars basis was primarily due to a proportional increase in sales volume. The increase in cost of revenues also included an increase of \$1.0 million in share-based compensation expenses, primarily due to the grant of a higher number of restricted share units.

Our cost of revenues increased by \$205.6 million, or 52.0%, to \$600.5 million, or 87.9% of total revenues, for the six months ended December 30, 2016, compared with \$395.0 million, or 87.9% of total revenues, for the six months ended December 25, 2015. The increase in cost of revenues on an absolute dollars basis was primarily due to a proportional increase in sales volume. The increase in cost of revenues also included an increase of \$1.5 million in share-based compensation expenses, primarily due to the grant of a higher number of restricted share units.

*Gross profit.*

Our gross profit increased by \$14.6 million, or 51.1%, to \$43.0 million, or 12.3% of total revenues, for the three months ended December 30, 2016, compared with \$28.5 million, or 12.2% of total revenues, for the three months ended December 25, 2015. Our gross profit increased by \$28.2 million, or 51.7%, to \$82.7 million, or 12.1% of total revenues, for the six months ended December 30, 2016, compared with \$54.5 million, or 12.1% of total revenues, for the six months ended December 25, 2015.

*SG&A expenses.*

Our SG&A expenses increased by \$3.9 million, or 28.7%, to \$17.7 million, or 5.0% of total revenues, for the three months ended December 30, 2016, compared with \$13.7 million, or 5.9% of total revenues, for the three months ended December 25, 2015. Our SG&A expenses increased in absolute dollars primarily due to an increase of \$4.5 million in share-based compensation expenses, partially due to the recognition of \$2.8 million related to accelerated vesting of an executive equity award during the three months ended December 30, 2016, and an increase of \$0.9 million in expenses related to our subsidiary in the United Kingdom, offset by a decrease of \$1.3 million in expenses related to our facility in the United States.

Our SG&A expenses increased by \$7.9 million, or 30.7%, to \$33.5 million, or 4.9% of total revenues, for the six months ended December 30, 2016, compared with \$25.6 million, or 5.7% of total revenues, for the six months ended December 25, 2015. Our SG&A expenses increased in absolute dollars primarily due to an increase of \$1.5 million in expenses relating to merger and acquisition activities and an increase in share-based compensation expenses of \$7.0 million, partially due to the recognition of \$2.8 million related to accelerated vesting of an executive equity award during the six months ended December 30, 2016, offset by a decrease of \$1.5 million in expenses related to our facility in the United States.

*Other expense related to flooding.*

In the three and six months ended December 30, 2016 and the three months ended December 25, 2015, we did not have any expenses related to flooding. In the six months ended December 25, 2015, we recognized other expense related to flooding of \$0.9 million, which mainly consisted of \$0.6 million of repaired cost of equipment and \$0.2 million of inventory losses.

*Operating income.*

## Edgar Filing: Fabrinet - Form 10-Q

Our operating income increased by \$10.6 million to \$25.4 million, or 7.3% of total revenues, for the three months ended December 30, 2016, compared with \$14.8 million, or 6.3% of total revenues, for the three months ended December 25, 2015.

Our operating income increased by \$21.1 million to \$49.2 million, or 7.2% of total revenues, for the six months ended December 30, 2016, compared with \$28.0 million, or 6.2% of total revenues, for the six months ended December 25, 2015.

---

**Table of Contents***Interest income.*

Our interest income decreased by \$0.1 million to \$0.3 million, or 0.1% of total revenues, for the three months ended December 30, 2016, compared with \$0.4 million, or 0.2% of total revenues, for the three months ended December 25, 2015. Our interest income decreased by \$0.1 million to \$0.8 million, or 0.1% of total revenues, for the six months ended December 30, 2016, compared with \$0.9 million, or 0.2% of total revenues, for the six months ended December 25, 2015. The decrease was primarily due to a decrease in the average of our outstanding cash balance.

*Interest expense.*

Our interest expense increased by \$0.1 million to \$0.5 million for the three months ended December 30, 2016, compared with \$0.4 million for the three months ended December 25, 2015. Our interest expense increased by \$1.1 million to \$1.9 million for the six months ended December 30, 2016, compared with \$0.8 million for the six months ended December 25, 2015. The increase was primarily due to an increase in the average balance of our outstanding bank borrowings.

*Foreign exchange gain (loss), net.*

Our foreign exchange gain, net, decreased by \$4.2 million to \$1.9 million, or 0.6% of total revenues, for the three months ended December 30, 2016, compared with foreign exchange gain, net, of \$6.2 million, or 2.7% of total revenues, for the three months ended December 25, 2015. The decrease was due to changes in the fair value of forward contracts as of December 30, 2016 that were not designated as hedging instruments.

Our foreign exchange (loss), net, increased by \$7.9 million to foreign exchange gain, net, of \$3.6 million, or 0.5% of total revenues, for the six months ended December 30, 2016, compared with foreign exchange (loss), net, of \$(4.3) million, or (1.0)% of total revenues, for the six months ended December 25, 2015. The increase was due to changes in the fair value of forward contracts as of December 30, 2016 that were not designated as hedging instruments.

*Income before income taxes.*

We recorded income before income taxes of \$27.3 million and \$51.9 million for the three and six months ended December 30, 2016, respectively, compared with \$21.1 million and \$24.0 million for the three and six months ended December 25, 2015, respectively.

*Income tax expense.*

Our provision for income tax reflects an effective tax rate of 6.8% for both the three months ended December 30, 2016 and December 25, 2015. Even though our taxable income and income tax expenses for the three months ended December 30, 2016 increased, they increased proportionately on an absolute dollars basis, compared with the three months ended December 25, 2015 and did not impact the effective tax rate.

Our provision for income tax reflects an effective tax rate of 6.7% for both the six months ended December 30, 2016, and December 25, 2015. Even though our taxable income and income tax expenses for the six months ended December 30, 2016 increased, they increased proportionately on an absolute dollars basis, compared with the six months ended December 25, 2015 and did not impact the effective tax rate.

*Net income.*

## Edgar Filing: Fabrinet - Form 10-Q

We recorded net income of \$25.3 million, or 7.2% of total revenues, for the three months ended December 30, 2016, compared with \$19.8 million, or 8.5% of total revenues, for the three months ended December 25, 2015.

We recorded net income of \$48.1 million, or 7.0% of total revenues, for the six months ended December 30, 2016, compared with \$21.4 million, or 4.8% of total revenues, for the six months ended December 25, 2015.

## **Table of Contents**

### *Other comprehensive loss.*

We recorded other comprehensive loss of \$2.3 million, or 0.6% of total revenues, for the three months ended December 30, 2016, compared with other comprehensive loss of \$0.3 million, or 0.1% of total revenues, for the three months ended December 25, 2015. The increase was primarily due to the foreign currency translation adjustment of \$1.9 million in connection with the operations of Exception EMS.

We recorded other comprehensive loss of \$1.9 million, or 0.3% of total revenues, for the six months ended December 30, 2016, compared with other comprehensive loss of \$0.2 million, or 0.1% of total revenues, for the six months ended December 25, 2015. The increase was primarily due to the foreign currency translation adjustment of \$1.2 million in connection with the operations of Exception EMS.

## **Liquidity and Capital Resources**

### *Cash Flows and Working Capital*

We primarily finance our operations through cash flow from operations. As of December 30, 2016 and December 25, 2015, we had cash, cash equivalents, and marketable securities of \$256.1 million and \$266.6 million, respectively, and outstanding debt of \$68.1 million and \$55.5 million, respectively.

Our cash and cash equivalents, which primarily consist of cash on hand, demand deposits, and liquid investments with 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 30, 2016 was 0.5% and 0.4%, respectively, and for the three and six months ended December 25, 2015 was 1.2% and 0.6%, respectively.

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 30, 2016, we borrowed a revolving loan of \$13.5 million and repaid a term loan of \$6.8 million under our Facility Agreement; as a result, as of December 30, 2016, we had a long-term borrowing of \$43.2 million and short-term borrowing of \$20.0 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 of \$170.5 million as of December 30, 2016.

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

In December 2015, we began construction of a new manufacturing facility at our Chonburi campus, which we substantially completed in the first quarter of fiscal year 2017. We continued renovating the facilities during the second quarter of fiscal year 2017 and expect to begin operations at this new facility in the third quarter of fiscal year 2017. We believe that our current manufacturing capacity is sufficient to meet our anticipated production

requirements for at least the next few quarters. We maintain a long-term loan associated with construction of production facilities at our Pinehurst campus in Thailand that will come due within the next 12 months.

**Table of Contents**

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

<i>(amount in thousands)</i>	<b>Six Months Ended</b>	
	<b>December 30, 2016</b>	<b>December 25, 2015</b>
Net cash provided by operating activities	\$ 19,752	\$ 23,704
Net cash used in investing activities	\$ (84,102)	\$ (19,648)
Net cash provided by financing activities	\$ 10,692	\$ 14,955
Net (decrease) increase in cash, cash equivalents and restricted cash	\$ (53,658)	\$ 19,011

*Operating Activities*

Net cash provided by operating activities decreased by \$4.0 million, or 16.7%, to \$19.8 million for the six months ended December 30, 2016, compared with net cash provided by operating activities of \$23.7 million for the six months ended December 25, 2015. This decrease was due to a number of factors, including increases in accounts receivable of \$28.3 million and inventory of \$19.3 million due to higher sales and customer demand, offset by an increase in net income of \$26.7 million, and a decrease in payments to vendors of \$11.4 million, as compared with the six months ended December 25, 2015.

*Investing Activities*

Net cash used in investing activities increased by \$64.5 million, or 328.0%, to \$84.1 million for the six months ended December 30, 2016, compared with net cash used in investing activities of \$19.6 million for the six months ended December 25, 2015. This increase was primarily due to an increase of \$18.0 million in the purchase of property, plant and equipment primarily for our new facility in Chonburi, Thailand, a net increase of \$36.5 million in marketable securities and the net payment of \$9.9 million in connection with the acquisition of Exception EMS.

*Financing Activities*

Net cash provided by financing activities decreased by \$4.3 million, or 28.5%, to \$10.7 million for the six months ended December 30, 2016, compared with net cash provided by financing activities of \$15.0 million for the six months ended December 25, 2015. This decrease was primarily due to an increase of \$6.8 million in repayment of long-term loans from banks, offset by an increase of \$3.8 million in proceeds from the issuance of ordinary shares under our employee share option plans.

**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 unaudited condensed consolidated financial statements. Furthermore, we do not have any retained or contingent interest in assets transferred to an unconsolidated entity that serves as credit, liquidity or market risk support to such entity. We also do not have any variable interest in any unconsolidated entity that provides financing, liquidity, market risk or credit support to us or engages in leasing, hedging or research and development services with us.

**Recent Accounting Pronouncements**



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

---

**Table of Contents****ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*****Interest Rate Risk***

We had cash, cash equivalents, and marketable securities totaling \$256.1 million and \$284.5 million as of December 30, 2016 and June 24, 2016, 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 marketable securities 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 30, 2016 and December 25, 2015, our interest income would have decreased by approximately \$0.1 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 30, 2016 and December 25, 2015, our interest expense would have increased by approximately \$0.2 million and \$0.1 million, respectively, assuming consistent borrowing levels.

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 or 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 or the RMB. We have a particularly significant currency rate exposure to changes in the exchange rate between the Thai baht and the U.S. dollar. We must translate foreign currency-denominated results of operations, assets and liabilities for our foreign subsidiaries to U.S. dollars in our unaudited 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 unaudited condensed consolidated balance sheets, even if our results of operations or the value of those assets and liabilities has not changed in its original currency. These transactions could significantly affect the comparability of our results between financial periods or result in significant changes to the carrying value of our assets, liabilities and shareholders' equity.

In addition, we were exposed to foreign exchange risk in connection with the credit facility and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the "Bank") in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up

---

**Table of Contents**

to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. Borrowings and interest under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. As of December 30, 2016, we had outstanding borrowings under the term loan facility of \$1.5 million. Under the terms of the cross currency interest rate swap arrangement, all amounts drawn down in Thai baht were converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of LIBOR plus 2.8% per annum.

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. During the six months ended December 30, 2016, we discontinued our cash flow hedges which hedged forecasted foreign currency transactions related to the construction cost of a new manufacturing building at our Chonburi campus, which resulted in the recognition of a gain on forward derivative contracts of \$0.3 million. We recorded unrealized loss of \$0.001 million and \$6.2 million related to derivatives that are not designated as hedging instruments, for the six months ended December 30, 2016 and December 25, 2015, 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 and the RMB would have resulted in a decrease in our net dollar position of approximately \$3.9 million and \$2.0 million as of December 30, 2016 and June 24, 2016, respectively. We cannot give any assurance as to the effect that future changes in foreign currency rates will have on our unaudited 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 30, 2016, 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 marketable securities as of December 30, 2016 are held in various financial institutions with a maturity limit not to exceed 3 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.

**Table of Contents**

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

During the six months ended December 30, 2016, we continued to implement formal controls and procedures over business combination accounting which we applied. There were no changes in our internal control over financial reporting during the three months ended December 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**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 and will continue to 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 30, 2016 and December 25, 2015, we had two customers and one customer that contributed 10% or more of our total revenues, respectively. These customers together accounted for 30% and 31% of our total revenues during the respective periods. During the six months ended December 30, 2016 and December 25, 2015, we had one customer that contributed 10% or more of our total revenues. This customer accounted for 20% and 30% of our total revenues, respectively, during the periods. 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, operating results and share price.

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 Brexit, adverse conditions in the credit markets, and the continual uncertainty in the global economies. 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.

***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 October and November 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 October and November 2011 flooding in Thailand forced us to temporarily shut down all



---

**Table of Contents**

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 results of operations.***

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 would not be compensated by existing insurance. This in turn could have a material adverse effect on our financial condition and results of operations.

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

Our future success as a provider of precision optical, electro-mechanical and electronic manufacturing services for the optical communications market depends on the continued growth of the optics industry and, in particular, the continued expansion of global information networks, particularly those directly or indirectly dependent upon a fiber 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.

***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:

**Table of Contents**

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;

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 continue to have excess manufacturing capacity at their facilities, it could adversely affect our business. In addition, as a result of the October and November 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 Casteck Crystals, Inc., Photop Technologies, Inc., and Research Electro-Optic, Inc. Other existing contract manufacturing companies, original design manufacturers or outsourced semiconductor assembly and test companies could also enter our target markets. In addition, we may face more competitors as we attempt to penetrate new markets.

---

**Table of Contents**

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

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

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

---

**Table of Contents**

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 30, 2016, the U.S. dollar had appreciated approximately 9.3% against the Thai baht since December 26, 2014. 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 RMB and GBP and the U.S. dollar. The expenses of our PRC and the United Kingdom subsidiaries 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 30, 2016, the U.S. dollar had appreciated approximately 11.9% against the RMB since December 26, 2014. 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 transaction and foreign debt service. As of December 30, 2016, the U.S. dollar had appreciated approximately 7.4% against the GBP since the acquisition date on September 14, 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.



---

**Table of Contents**

***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 55.0% and 46.7% of our total revenues for the three months ended December 30, 2016 and December 25, 2015, respectively, and 52.6% and 48.7% of our total revenues for the six months ended December 30, 2016 and December 25, 2015, 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 2016, 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 may 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. Most recently, in October 2016, Thailand's King Bhumibol Adulyadej died at the age of 88. Aside from the mourning among Thai people across Thailand, the condition in the country is still calm and peaceful, and we do not see any negative impact to our business in Thailand. Any succession crisis in the Kingdom of Thailand could cause new or increased political instability, which could prevent shipments from entering or leaving the country and disrupt our ability to manufacture products in Thailand, and we could be forced to transfer our manufacturing activities to more stable, and potentially more costly, regions.

Further, the Thai government 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 2016, 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

---

**Table of Contents**

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.

***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. 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.

***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

---

**Table of Contents**

U.S. and global economies and adversely affect our financial results. In particular, Brexit and recent 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. If economic conditions in Europe do not recover or if they continue to deteriorate, our operating results could be harmed.

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 results of operations 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 results of operations and financial condition.

***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.

Most recently, we expanded our manufacturing capacity with the substantial completion of a new manufacturing facility in Chonburi, Thailand. 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 customer's design;

the repeatability and complexity of the manufacturing process;

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

the monitoring of the manufacturing environment.

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

---

**Table of Contents**

*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 detectible. The testing procedures of our customers are generally limited to the evaluation of the products that we manufacture under likely and foreseeable failure scenarios. For various reasons (including, among others, the occurrence of performance problems that are unforeseeable at the time of testing or that are detected only when products are fully deployed and operated under peak stress conditions), these products may fail to perform as expected after their initial acceptance by a customer.

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

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; ISO/TS16949 for Automotive Industry Quality Certification; ISO13485 for Medical Devices Industry Quality Certification; AS9100 for Aerospace Industry Quality Certification; 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.



---

**Table of Contents**

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, including Mr. David T. Mitchell, and other key management and technical personnel, each of whom would be difficult to replace. We do not have key person life insurance or long-term employment contracts with any of our key personnel. The loss of any of our executive officers or key personnel or the inability to continue to attract qualified personnel could harm our business, financial condition and operating results.

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

The sale and manufacturing of products in certain states and countries may subject us to environmental laws and regulations. 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, results of operations and financial condition. In addition, if we were found to be in violation of these laws, we could be subject to governmental fines, liability to our customers and damage to our reputation, which would also have a material adverse effect on our business, results of operations and financial condition.

***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 results of operations. The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. While we were able to assert in our Annual Report on Form 10-K that our internal control over

---

**Table of Contents**

financial reporting was effective as of June 24, 2016, 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.

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

We base our tax position upon the anticipated nature and conduct of our business and upon our understanding of the tax laws of the various countries in which we have assets or conduct activities. However, our tax position is subject to review and possible challenge by tax authorities and to possible changes in law, which may have retroactive effect. Fabrinet (the Cayman Islands Parent) is an exempted company incorporated in the Cayman Islands. We maintain manufacturing operations in Thailand, the PRC and the United States, any of which jurisdictions could assert tax claims against us. We cannot determine in advance the extent to which some jurisdictions may require us to pay taxes or make payments in lieu of taxes. Preferential tax treatment from the Thai government in the form of a corporate tax exemption is currently available to us through June 2020 on income generated from the manufacture of products at Pinehurst Building 6. 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. 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. In addition, we benefit from permanent reductions in corporate tax rates in Thailand for fiscal year 2017 onward.

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.

**Table of Contents**

*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 Exception EMS in September 2016. Acquisitions and other strategic transactions typically involve many risks, including the following:

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

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

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

we may incur indebtedness to pay for the transactions;

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

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

we may incur amortization expenses related to certain intangible assets;

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 Exception EMS 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. We operate in a market, however, that makes our prospects difficult to evaluate. It is possible that we may not generate sufficient cash flow from operations or otherwise have the capital resources to meet our future capital needs. If this occurs, we may need additional financing to execute on our current or future business strategies.

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

**Table of Contents**

***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.

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

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

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

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

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

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

We are subject to governmental export and import controls in Thailand, the PRC, 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.

***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 debt-to-equity ratio, 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



## **Table of Contents**

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 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 marketable securities as of December 30, 2016 are 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 marketable securities 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 30, 2016, we did not record any impairment charges associated with our investment portfolio of marketable securities, 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 results of operations.***

We, along with our suppliers and customers, rely on various energy sources in our manufacturing and transportation activities. Energy prices have been subject to increases and volatility caused by market fluctuations, supply and demand, currency fluctuation, production and transportation disruption, world events and government regulations. While 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.

---

**Table of Contents**

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

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

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

***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 2016 or for the foreseeable future. However, despite our expectations, we cannot assure you that we will not be a PFIC for the taxable year 2016 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.

---

**Table of Contents**

***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, 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.

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 amended and restated memorandum and articles of association to determine whether or not, and under what conditions, our corporate records may be inspected by our shareholders, but are not obliged to make them available to our shareholders. This may make it more difficult for you to obtain the information needed to establish any facts necessary for a shareholder motion or to solicit proxies from other shareholders in connection with a proxy contest.

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

**Table of Contents**

**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*

Not applicable.

**ITEMS 3, 4 and 5 are not applicable and have been omitted.**

**ITEM 6. EXHIBITS**

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

Table of Contents

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 7, 2017.

**FABRINET**

By: /s/ TOH-SENG NG

Name: **Toh-Seng Ng**

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



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

<b>Exhibit Number</b>	<b>Description</b>	<b>Form</b>	<b>Incorporated by reference herein</b>		
			<b>Exhibit No.</b>	<b>Filing Date</b>	<b>File No.</b>
10.1	Letter Agreement, dated October 31, 2016, between Fabrinet USA, Inc. and Hong Hou	8-K	10.1	November 4, 2016	001-34755
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				
101.INS	XBRL Instance.				
101.SCH	XBRL Taxonomy Extension Schema.				
101.CAL	XBRL Taxonomy Extension Calculation Linkbase.				
101.DEF	XBRL Taxonomy Extension Definition Linkbase.				
101.LAB	XBRL Taxonomy Extension Label Linkbase.				
101.PRE	XBRL Taxonomy Extension Presentation Linkbase.				