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 25, 2005

Commission file number: 0-21154

CREE, INC.
(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	**56-1572719** (I.R.S. Employer Identification No.)
4600 Silicon Drive **Durham, North Carolina** (Address of principal executive offices)	**27703** (Zip Code)

(919) 313-5300
(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 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 is a large accelerated filer, an accelerated filer or non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

The number of shares outstanding of the registrant's common stock, par value $0.00125 per share as of January 6, 2006 was 76,312,843.

CREE, INC.
FORM 10-Q

For the Three and Six Months Ended December 25, 2005

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements

CREE, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	December 25, 2005 (Unaudited)	June 26, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 67,087	$ 70,925
Short-term investments held-to-maturity	176,002	102,543
Accounts receivable, net	47,067	34,476
Interest receivable	3,178	2,139
Income tax receivable	-	9,900
Inventories, net	27,159	30,045
Deferred income taxes	10,420	23,531
Prepaid insurance	2,751	2,199
Prepaid expenses and other current assets	3,275	3,454
Assets of discontinued operations	3,037	3,149
Total current assets	339,976	282,361
Property and equipment, net	335,639	340,689
Long-term investments held-to-maturity	95,246	103,791
Patent and license rights, net	29,521	28,667
Marketable securities available for sale	26,684	20,937
Other assets	3,024	963
Total assets	$ 830,090	$ 777,408
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$ 22,132	$ 23,153
Accrued salaries and wages	8,714	8,934
Other accrued expenses	4,232	3,312
Deferred revenue	1,963	-
Liabilities of discontinued operations	1,699	637
Total current liabilities	38,740	36,036
Long-term liabilities:		
Deferred income taxes	30,889	28,454
Long-term liabilities of discontinued operations	2,090	-
Total long-term liabilities	32,979	28,454
Shareholders' equity:		
Preferred stock, par value $0.01; 3,000 shares authorized at December 25, 2005 and June 26, 2005; none issued and outstanding	-	-
Common stock, par value $0.00125; 200,000 shares authorized at December 25, 2005 and June 26, 2005; 76,154 and 75,568 shares issued and outstanding at December 25, 2005 and June 26, 2005, respectively	95	94
Additional paid-in-capital	550,686	548,342
Accumulated other comprehensive income, net of taxes	9,879	6,200
Retained earnings	197,711	158,282
Total shareholders' equity	758,371	712,918
Total liabilities and shareholders' equity	$ 830,090	$ 777,408

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

CREE, INC.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Revenue:				
Product revenue, net	$ 98,701	$ 90,055	$ 195,004	$ 178,805
Contract revenue, net	6,939	6,005	13,538	11,716
Total revenue	105,640	96,060	208,542	190,521
Cost of revenue:				
Product revenue, net	48,387	40,521	94,688	76,099
Contract revenue, net	5,023	5,053	9,457	9,344
Total cost of revenue	53,410	45,574	104,145	85,443
Gross profit	52,230	50,486	104,397	105,078
Operating expenses:				
Research and development	14,785	10,294	27,577	19,881
Sales, general and administrative	10,834	7,118	21,569	13,957
Loss on disposal of property and equipment	132	248	700	326
Total operating expenses	25,751	17,660	49,846	34,164
Income from operations	26,479	32,826	54,551	70,914
Non-operating income:				
Gain on investments in marketable securities	-	-	587	118
Loss on long-term investments	-	(1,992)	-	(1,992)
Other non-operating income	-	-	3	5
Interest income, net	2,969	1,139	5,295	2,288
Income from continuing operations before income taxes	29,448	31,973	60,436	71,333
Income tax expense	9,390	4,880	17,149	17,655
Income from continuing operations	20,058	27,093	43,287	53,678
Loss from discontinued operations, net of related income tax benefit	(2,349)	(2,071)	(3,858)	(4,228)
Net income	$ 17,709	$ 25,022	$ 39,429	$ 49,450
Earnings per share:				
Basic:				
Income from continuing operations	$ 0.26	$ 0.36	$ 0.57	$ 0.72
Loss from discontinued operations	$ (0.03)	$ (0.03)	$ (0.05)	$ (0.06)
Net income	$ 0.23	$ 0.33	$ 0.52	$ 0.66
Diluted:				
Income from continuing operations	$ 0.26	$ 0.35	$ 0.56	$ 0.70
Loss from discontinued operations	$ (0.03)	$ (0.03)	$ (0.05)	$ (0.06)
Net income	$ 0.23	$ 0.32	$ 0.51	$ 0.64
Shares used in per share calculation:				
Basic	75,996	75,383	75,784	74,443
Diluted	77,612	78,298	77,675	77,020

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

CREE, INC.
CONSOLIDATED STATEMENTS OF CASH FLOW
(In thousands)
(Unaudited)

	Six Months Ended	
	December 25, 2005	December 26, 2004
Cash flows from operating activities:		
Net income	$ 39,429	$ 49,450
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	35,664	32,222
Stock-based compensation	6,328	-
Impairment or loss on disposal of property, equipment and patents	4,077	326
Gain on sale of investment in marketable securities	(587)	(118)
Amortization of patent and licensing rights	1,168	803
Amortization of premium on investments held to maturity	746	1,229
Write-down of long-term investments	-	1,992
Deferred income taxes	-	(6,034)
Changes in operating assets and liabilities:		
Accounts and interest receivable	(15,136)	(6,103)
Inventories	4,671	(5,681)
Prepaid expenses and other current assets	9,609	(2,282)
Accounts payable, trade	(750)	13,281
Accrued expenses and other liabilities	2,469	13,551
Net cash provided by operating activities	87,688	92,636
Cash flows from investing activities:		
Purchase of property and equipment	(31,726)	(82,525)
Purchase of investments held to maturity	(111,581)	(77,525)
Proceeds from maturities of investments held to maturity	43,950	57,697
Proceeds from investments available for sale	954	-
Proceeds from sale of investment	1,972	-
Proceeds from sale of property and equipment	527	225
(Decrease) increase in other long-term assets	(2,062)	47
Purchase of patent and licensing rights	(2,107)	(1,663)
Net cash used in investing activities	(100,073)	(103,744)
Cash flows from financing activities:		
Net proceeds from issuance of common stock	8,547	48,177
Net cash provided by financing activities	8,547	48,177
Net (decrease) increase in cash and cash equivalents	(3,838)	37,069
Cash and cash equivalents:		
Beginning of period	$ 70,925	$ 81,472
End of period	$ 67,087	$ 118,541

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

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

Basis of Presentation

The consolidated balance sheet at December 25, 2005, the consolidated statements of income for the three and six months ended December 25, 2005 and December 26, 2004, and the consolidated statements of cash flow for the six months ended December 25, 2005 and December 26, 2004 have been prepared by the Company and have not been audited. In the opinion of management, all normal and recurring adjustments necessary to present fairly the consolidated financial position, results of operations and cash flows at December 25, 2005, and for all periods presented, have been made. The consolidated balance sheet at June 26, 2005 has been derived from the audited financial statements as of that date.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted. It is suggested that these condensed financial statements be read in conjunction with the consolidated financial statements and notes thereto included in the Company's fiscal 2005 Annual Report on Form 10-K. The results of operations for the period ended December 25, 2005 are not necessarily indicative of the operating results that may be attained for the entire fiscal year.

Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Cree, Inc., and its wholly owned subsidiaries Cree Microwave, LLC ("Cree Microwave"), Cree Employee Services Corporation, CI Holdings, Limited, Cree Asia-Pacific, Inc., Cree Japan, Inc., Cree International GmbH, Cree Europe GmbH and Cree Asia-Pacific Limited (collectively, the "Company"). All material intercompany accounts and transactions have been eliminated in consolidation.

Discontinued Operations

Effective December 25, 2005, the Company has discontinued the operations of its silicon-based radio frequency ("RF") and microwave semiconductor business conducted by Cree Microwave. In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), the Company has reflected the operating results for the Cree Microwave silicon-based RF and microwave business for the three and six months ended December 25, 2005 and 2004 and the assets and liabilities of the Cree Microwave silicon business on the balance sheet at December 25, 2005 and June 26, 2005 as a discontinued operation and has restated the three and six-month periods ended December 26, 2004 to reflect the discontinued operations.

As of December 25, 2005, the Company completed production of all last time buy orders for its silicon products and terminated remaining employees of the Cree Microwave subsidiary. Through the end of the second quarter of fiscal 2006, the Company has incurred pre-tax charges totaling $11.4 million related to the closure of this business. During the second quarter of fiscal 2006, the Company recorded a $232,000 charge for severance expense, a $468,000 write-down of inventory that was scrapped, a $93,000 fixed asset impairment and a $3.1 million charge for an accrual relating to the remaining lease contract obligation for the Sunnyvale facility. For the six months ended December 25, 2005, the Company recorded a $668,000 inventory impairment charge, a $624,000 severance expense charge, and a $303,000 charge for the impairment of property, equipment and patents and a charge of $3.1 million for the remaining lease obligation for the Sunnyvale facility. In the fourth quarter of fiscal 2005, the Company recorded a charge of $652,000 for inventory impairment, $5.5 million for the impairment of property, equipment and patents and $519,000 for severance expenses related to the Cree Microwave business.

The Company remains liable for the operating lease expenses of the Sunnyvale facility through November 2011. However, in accordance with the provisions of Statement of Financial Accounting Standards No. 146, “Accounting for Costs Associated with Exit or Disposal Activities” (“SFAS 146”), the Company has determined that the operations of the Sunnyvale facility had ceased and no longer provide economic benefit and as a result has recorded a liability of $3.1 million for the on-going lease obligation. This liability represents the fair value of the remaining lease liability based on an estimate of the present value of the remaining lease rentals reduced by an estimate of sublease rental income that may be obtained for the property through the expiration of the lease term.

The Company believes the significant write-downs related to the closure of the Sunnyvale facility have been completed; however, there may be future adjustments to the estimate for the accrual of the lease contract obligations. The following table summarizes the changes during the first six months of fiscal 2006 attributable to costs incurred and charged to expense, costs paid and any adjustments to the liability for the six months ended December 25, 2005 related to the exit activities for the Cree Microwave silicon business (in thousands):

	For the Six Months Ended December 25, 2005
Balance at June 26, 2005	$ 218
Current period severance accrual	624
Severance fees paid	(431)
Contract termination costs	3,075
Balance at December 25, 2005	$ 3,486

In accordance with the provisions of SFAS 144, the following table summarizes the amounts of revenue and pre-tax losses reported in discontinued operations for the respective income statement periods presented (in thousands):

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Product revenue, net	$ 3,312	$ 1,514	$ 4,266	$ 2,950
Loss before income taxes	$ (3,460)	$ (3,083)	$ (5,682)	$ (6,254)

Business Segments

As a result of the closure of the Cree Microwave silicon business, the Company now operates in one segment globally.

Reclassifications

Certain fiscal 2005 amounts in the accompanying consolidated financial statements have been reclassified to conform to the fiscal 2006 presentation. These reclassifications had no effect on previously reported consolidated net income or shareholders' equity.

Fiscal Year

The Company's fiscal year is a 52-or 53-week period ending on the last Sunday in the month of June. The Company's 2006 fiscal year extends from June 27, 2005 through June 25, 2006 and is a 52-week fiscal year. The Company's 2005 fiscal year extended from June 28, 2004 through June 26, 2005 and was a 52-week fiscal year.

Estimates

The preparation of the consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities, at December 25, 2005 and June 26, 2005 and the reported amounts of revenues and expenses during the three and six months ended December 25, 2005 and December 26, 2004. Actual amounts could differ from those estimates.

Earnings Per Share

The following computation reconciles the differences between the basic and diluted earnings per share presentations (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Basic:				
Net income	$ 17,709	$ 25,022	$ 39,429	$ 49,450
Weighted average common shares	75,966	75,383	75,784	74,443
Basic earnings per common share	$ 0.23	$ 0.33	$ 0.52	$ 0.66
Diluted:				
Net income	$ 17,709	$ 25,022	$ 39,429	$ 49,450
Diluted weighted average common shares:				
Weighted average common shares outstanding	75,966	75,383	75,784	74,443
Dilutive effect of stock options and warrants	1,646	2,915	1,891	2,577
Diluted weighted average common shares	77,612	78,298	77,675	77,020
Diluted earnings per common share	$ 0.23	$ 0.32	$ 0.51	$ 0.64

Potential common shares that would have the effect of increasing diluted earnings per share are considered to be antidilutive. In accordance with Statement of Financial Accounting Standards No. 128, "Earnings per Share," these shares were not included in calculating diluted earnings per share. For the three and six months ended December 25, 2005, there were 6.3 million and 5.4 million shares, respectively, not included in calculating diluted earnings per share because their effect was considered to be antidilutive. For the three and six months ended December 26, 2004, there were 1.8 million and 3.5 million shares, respectively, not included in calculating diluted earnings per share because their effect was considered to be antidilutive.

Revenue Recognition and Accounts Receivable

Revenue on product sales is recognized when persuasive evidence of a contract exists, such as when a purchase order or contract is received from the customer, the price is fixed, title of the goods has transferred and there is reasonable assurance of collection of the sales proceeds. The Company obtains written purchase authorizations from its customers for a specified amount of product at a specified price and considers delivery to have occurred at the time of shipment. The majority of the Company’s products have shipping terms that are free on board ("FOB") or free carrier alongside ("FCA") shipping point, which means that the Company fulfills the obligation to deliver when the goods are handed over and into the charge of the carrier at the Company's shipping dock. This means that the buyer bears all costs and risks of loss or damage to the goods from such above-referenced delivery point. The difference between FOB and FCA is that under FCA terms the customer designates a shipping carrier of choice to be used. In certain cases, the Company ships its products cost insurance freight ("CIF"). Under this arrangement, revenue is recognized under FOB shipping point terms; however, the Company is responsible for the cost of insurance to transport the product as well as the cost to ship the product.

For all of its sales other than those with CIF terms, the Company invoices its customers only for shipping costs necessary to physically move the product from its place of business to the customer’s location. The costs primarily consist of overnight shipping charges. The Company incurs the direct shipping costs on behalf of the customer and invoices the customer to obtain direct reimbursement for such costs. The Company accounts for its shipping costs by recording the amount of freight that is invoiced to its customers as revenue, with the corresponding cost recorded as cost of revenue. For the three and six-month periods ended December 25, 2005, amounts recognized as revenue for shipping and handling costs were $61,000 and $123,000, respectively. For the three and six-month periods ended December 26, 2004, amounts recognized as revenue for shipping and handling costs were $46,000 and $87,000, respectively. If inventory is maintained at a consigned location, revenue is recognized when the Company’s customer pulls product for its use and the title of the goods is transferred to the customer.

The Company provides its customers with limited rights of return for non-conforming shipments up to 36 months for Cree Microwave’s silicon-based products and for lesser periods for Cree, Inc. products. In addition, certain of the Company’s sales arrangements provide for limited product exchanges and reimbursement of certain sales costs. As a result, the Company records an allowance for sales returns at the time of sale, which is recorded as a reduction of product revenue.

During fiscal 2005, the Company determined that sufficient historical sales return information was available to enable the Company to reasonably estimate sales returns in accordance with criteria in Statement of Financial Accounting Standards No. 48, “Revenue Recognition When Right of Return Exists” (“SFAS 48”). Specifically, the Company reviews historical quarterly sales returns as a percentage of total sales. The returns are matched to the quarter when the sales were originally recorded. Based on a historical return percentage, the Company estimates its sales returns that have not yet occurred for product sales that have been recorded. The Company records the estimated sales returns as a reduction to product revenue in the consolidated statements of income and a reduction to accounts receivable in the consolidated balance sheets. During the second quarter of fiscal 2006, the Company reduced its allowance for sales returns by $1.3 million as the Company determined that it has experienced a trend of lower actual customer returns over the past few quarters. The allowance for sales returns at December 25, 2005 and June 26, 2005 was $8.2 million and $9.6 million, respectively.

In accordance with SFAS 48, the Company also records an estimate for the value of product returns that it believes will be returned to inventory in the future and resold. During the second quarter of fiscal 2006, the Company recorded a $184,000 reduction in its estimate for the value of product returns that it believed would be returned to inventory as a result of the $1.3 million reduction to the allowance for sales returns and trend of lower actual customer returns. As of December 25, 2005 and June 26, 2005, the Company estimated the cost of future product returns at $1.5 million and $1.7 million, respectively, which was reflected in other current assets in the consolidated balance sheets and recorded as a reduction in the cost of product revenue on the consolidated statements of income.

The Company also estimated an allowance for bad debt of $109,000 and $87,000 as of December 25, 2005 and June 26, 2005, respectively. The allowance for bad debt is recorded as a reduction in accounts receivable on the consolidated balance sheets and as sales, general and administrative expenses on the consolidated statements of income.

Revenue from contracts with the U.S. Government and certain private entities is recorded on the proportional performance method of accounting as contract expenses are incurred. Contract revenue represents reimbursement by various U.S. Government entities and other parties to aid in the development of new technologies. The applicable contracts generally provide that the Company may elect to retain ownership of inventions made in performing the work, subject to a non-exclusive license retained by the government to practice the inventions for government purposes. The contract funding may be based on either a cost-plus or a cost-share arrangement. The revenue recognized under each contract is determined by cost estimates that include direct costs plus an allocation for research and development, sales, general and administrative and the cost of capital expenses. Cost-plus revenue is determined based on actual costs plus a set percentage margin. For the cost-share contracts, the actual costs relating to the activities to be performed by the Company under the contract are divided between the U.S. Government and the Company based on the terms of the contract. The government’s cost share is then paid to the Company. Activities performed under these arrangements include research regarding silicon carbide (“SiC”) and gallium nitride (“GaN”) materials and devices. The contracts typically require the submission of a written report that documents the results of such research, as well as some material deliverables.

The revenue and expense classification for contract activities is based on the nature of the contract. For contracts where the Company anticipates that funding will exceed direct costs over the life of the contract, funding is reported as contract revenue and all direct costs are reported as costs of contract revenue. For contracts under which the Company anticipates that direct costs of the activities subject to the contract will exceed amounts to be funded over the life of the contract, costs are reported as research and development expenses and related funding is reported as an offset of those expenses.

Cash and Cash Equivalents

Cash and cash equivalents consist of unrestricted cash accounts and liquid investments with an original maturity of three months or less when purchased.

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, available for sale securities, accounts and interest receivable, accounts payable and other liabilities approximate fair values at December 25, 2005 and June 26, 2005.

Investments

Investments are accounted for using the specific identification method and in accordance with Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities” ("SFAS 115"). This statement requires certain securities to be classified into three categories:

Securities Held-to-Maturity: Debt securities that the Company has the positive intent and ability to hold to maturity are reported at amortized cost.

Trading Securities: Debt and equity securities that are bought and held principally for the purpose of selling in the near term are reported at fair value, with unrealized gains and losses included in earnings.

Securities Available-for-Sale: Debt and equity securities not classified as either securities held-to-maturity or trading securities are reported at fair value with unrealized gains or losses excluded from earnings and reported as a separate component of shareholders’ equity.

As of December 25, 2005 and June 26, 2005, the Company held a long-term equity investment in the common stock of Color Kinetics, Incorporated ("Color Kinetics"). The Company accounts for its shares in Color Kinetics as available-for-sale securities under SFAS 115. Accordingly, unrealized gains or losses on Color Kinetics' shares are excluded from earnings and are recorded as other comprehensive income, net of tax. Management classifies the shares as a long-term investment as the Company has the intent and the ability to hold these shares. During the first quarter of fiscal 2006, the Company sold 63,782 common shares of Color Kinetics for $954,000, and recognized a $587,000 gain. The Company held 1,795,660 common shares of Color Kinetics as of December 25, 2005. As of December 25, 2005 and June 26, 2005, the Company had recorded a cumulative unrealized gain on its investment in Color Kinetics of $16.3 million and $10.2 million, respectively, (or $9.9 million and $6.2 million, net of tax, respectively). The unrealized gain was based on the closing share price of the stock as of December 25, 2005 and June 26, 2005 to determine the fair market value for the Company's investment of $26.7 million and $20.9 million, respectively.

For the three and six months ended December 25, 2005, the Company recorded a reduction of approximately $132,000 and $2.3 million, respectively, in its income tax expense resulting from the reduction of its federal capital loss carry forward valuation allowance. In fiscal 2002, the Company recorded a deferred tax asset for the capital loss associated with certain other marketable securities that were carried forward for tax purposes. Additionally in fiscal 2002, the Company established a valuation allowance to fully reserve the tax benefits associated with the capital loss because the tax benefits were required to be offset against a capital gain. Based on Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"), the valuation allowance should be adjusted for any new realizable federal capital gains or losses. Once contractual restrictions on the Company's ability to transfer its shares of Color Kinetics stock expired in the second quarter of fiscal 2005, the increase in the market value of the Company's investment in Color Kinetics became an unrealized capital gain that the Company could offset against the fiscal 2002 loss carry forward. For this reason, during the second quarter of fiscal 2005, the Company's income tax expense was reduced by $7.9 million associated with the prior year capital loss and has been adjusted in each subsequent quarter. In future periods, the Company will continue to adjust its deferred tax asset valuation allowance in connection with any increase or decrease in the value of its investment in Color Kinetics, which could increase or decrease the income tax expense for such period.

As of December 25, 2005 and June 26, 2005, the Company held warrants to purchase stock in a privately held company with a carrying value of $37,000, representing the estimated value of the warrants.

As of December 26, 2004, the Company had an investment in the equity of a privately held company with a carrying value of $933,000. This privately held investment was accounted for under the cost method. Because the shares of stock the Company received for this investment were not publicly traded, there was no established market for these securities. The Company reviews the fair value of this investment on a regular basis to evaluate the carrying value of the investment. This review includes an analysis of the company's cash position, financing needs, earnings and revenue outlook, and operational performance. If the Company determines that the carrying value of an investment was at an amount in excess of fair value, it is the Company's policy to record a write-down of the investment. This write-down is estimated based on the information described above, and it is recorded as an investment loss on the Company's consolidated statement of income. During the second quarter of fiscal 2005, the Company recorded a write-down of $2.0 million on this investment, representing the Company's best estimate of other-than-temporary declines in value. This impairment charge was the "loss on long-term investments" included on the consolidated statements of income for the second quarter of fiscal 2005.

Inventories

Inventories are stated at the lower of cost or market, with cost determined using the first-in, first-out ("FIFO") method for finished goods and work-in-progress accounts. The Company uses the average cost method for raw materials. It is the Company's policy to record a reserve against inventory once it has been determined that conditions exist that may not allow the Company to sell the inventory for its intended purpose, the inventory's value is determined to be less than cost or it is determined to be obsolete. The charge for inventory reserves is recorded as a cost of product revenue on the consolidated statements of income. The Company evaluates inventory levels quarterly against sales forecasts on a part-by-part basis, in addition to determining its overall inventory risk. Reserves are adjusted quarterly to reflect inventory values i n excess of forecasted sales, as well as overall inventory risk assessed by management.

As of December 25, 2005, the Company maintained a $481,000 reserve for inventory. During the three and six months ended December 25, 2005, the Company scrapped $386,000 and $936,000, respectively, of previously reserved products as they could no longer be used in production or sold. The Company reduced the respective inventory reserves accordingly as of December 25, 2005.

The following is a summary of inventory (in thousands):

	December 25, 2005	June 26, 2005
Raw materials	$ 5,101	$ 4,802
Work-in-progress	11,394	15,103
Finished goods	11,145	10,626
	27,640	30,531
Inventory reserve	(481)	(486)
Total inventory, net	$ 27,159	$ 30,045

Property and Equipment

Property and equipment are recorded at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, which range from three to 40 years. Leasehold improvements are amortized over the lesser of the asset life or the life of the related lease. Expenditures for repairs and maintenance are charged to expense as incurred. The costs for major renewals and improvements are capitalized and depreciated over their estimated useful lives. The cost and related accumulated depreciation of the assets are removed from the accounts upon disposition and any resulting gain or loss is reflected in operations.

Impairment of Long-Lived Assets

In accordance with SFAS 144, the Company reviews long-lived assets for impairment based on changes in circumstances that indicate their carrying amounts may not be recoverable.

Patent and License Rights

Patent rights reflect costs incurred to enhance and maintain the Company's intellectual property position. License rights reflect costs incurred to use the intellectual property rights of others. The Company amortizes both on a straight-line basis over the lesser of 20 years from the date of patent application or over the license period. The related amortization expense was $594,000 and $1.2 million for the three and six months ended December 25, 2005, respectively. The related amortization expense was $397,000 and $803,000 for the three and six months ended December 26, 2004, respectively.

Shareholders' Equity

The following presents a summary of activity in shareholders' equity for the six months ended December 25, 2005 (in thousands):

	Common Stock Par Value	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance at June 26, 2005	$ 94	$ 548,342	$158,282	$ 6,200	$ 712,918
Issuance of common stock for cash, 586 shares	1	8,546	-	-	8,547
Stock-based compensation (a)	-	6,909	-	-	6,909
Reversal of income tax benefit from the exercise of previously issued stock options (b)	-	(13,111)	-	-	(13,111)
Net income	-	-	39,429	-	39,429
Unrealized gain on marketable securities, net of tax of $2,572	-	-	-	3,919	3,919
Reclassification of realized gain for sale of Color Kinetics' stock, net of tax of $157	-	-	-	(240)	(240)
Comprehensive income	-	-	-	-	43,108
Balance at December 25, 2005	$ 95	$ 550,686	$197,711	$ 9,879	$ 758,371

(a) Stock-based compensation reported on the Company's Consolidated Statement of Income for the six months ended December 25, 2005 was $6.3 million. Approximately $713,000 of stock-based compensation was allocated to inventory on the Company's Consolidated Balance Sheet as of December 25, 2005.

(b) During the quarter ended December 25, 2005, the Company reduced additional paid in capital by $13.1 million, which represented expected tax benefits from the exercise of previously issued stock options that will no longer be realized due to Internal Revenue code limitations. Management has evaluated the impact of the $13.1 million reduction of additional paid-in capital on prior periods and has determined that an adjustment to prior periods is not required as the amounts have been deemed to be immaterial and would have no effect on previously reported net income.

Research and Development

The U.S. Government and certain private entities have provided funding through research contracts for several of the Company's current research and development efforts. The contract funding may be based on either a cost-plus or a cost-share arrangement. The amount of funding under each contract is determined based on cost estimates that include direct costs, plus an allocation for research and development, sales, general and administrative and the cost of capital expenses. Cost-plus funding is determined based on actual costs plus a set percentage margin. For the cost-share contracts, the actual costs are divided between the U.S. Government and the Company based on the terms of the contract. The government's cost share is then paid to the Company. Activities performed under these arrangements include research regarding SiC and GaN materials and devices. The contracts typically require the submission of a written report that documents the results of such research, as well as some material deliverables.

The revenue and expense classification for contract activities is based on the nature of the contract. For contracts where the Company anticipates that funding will exceed direct costs over the life of the contract, funding is reported as contract revenue and all direct costs are reported as costs of contract revenue. For contracts where the Company anticipates that direct costs will exceed amounts to be funded over the life of the contract, costs are reported as research and development expenses and related funding as an offset of those expenses. The following table details information about contracts for which direct expenses exceeded funding by period as included in research and development expenses for the three and six-month periods ended December 25, 2005 and December 26, 2004, respectively:

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
	(in thousands)		(in thousands)	
Cost to perform government contract	$ 637	$ -	$ 1,097	$ -
Government funding	567	-	1,002	-
Net amount of research and development costs	$ 70	$ -	$ 95	$ -

Income Taxes

For the three and six months ended December 25, 2005, the Company recorded reductions in its income tax expense of approximately $132,000 and $2.3 million, respectively, related to realized and unrealized capital gains on its investment in Color Kinetics. In fiscal 2002, the Company recorded a capital loss associated with certain other marketable securities that was carried forward for tax purposes. However, the Company fully reserved the tax benefits associated with the loss because it was more likely than not such benefits would expire unused by the Company. Based on SFAS 109, the valuation allowance should be adjusted for any new realizable federal capital gains or losses. Therefore, once the Company's ability to transfer its shares of Color Kinetics stock was no longer contractually restricted, the increase in the market value of the Company's investment in Color Kinetics was an unrealized capital gain that the Company could offset against the fiscal 2002 loss carry forward. For this reason, a portion of the valuation allowance associated with the prior year capital loss was reversed in the second quarter of fiscal 2005 and has been adjusted in each subsequent quarter. In future periods, the Company will continue to adjust its deferred tax asset valuation allowance in connection with any increase or decrease in the value of its investment in Color Kinetics, which could increase or decrease the income tax expense for such period.

During the second quarter of fiscal 2005, the Company's income tax expense was reduced by an aggregate of $5.4 million of adjustments. As of December 26, 2004, the Company had a federal capital loss carryover of $39.8 million. The related deferred tax asset of $13.9 million was previously offset by a valuation allowance since it was more likely than not that the Company could not utilize the capital loss carryover. Based on Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes," the valuation allowance should be adjusted for any new realizable federal capital gains or losses. The contractual trading restrictions applicable to the Company's investment in Color Kinetics expired on December 22, 2004. As a result, the $22.5 million unrealized federal capital gain related to the Company's investment in Color Kinetics required a $7.9 million reversal of the valuation allowance, which decreased the Company's income tax expense for the three and six months ended December 26, 2004. Also, during the second quarter of fiscal 2005, the Company increased the valuation allowance related to privately held investments by $697,000 resulting from the tax effect of the $2.0 million reserve that was recorded in the second quarter of fiscal 2005. Additionally, the Company increased income tax expense by $1.8 million for a settlement of state income taxes, estimated state tax rate changes and other adjustments.

Stock-Based Compensation

At December 25, 2005, the Company has several equity-based compensation plans from which stock-based compensation awards can be granted to eligible employees, officers or directors. The plans are as follows:

Long-Term Incentive Compensation Plan - This plan provides for awards in the form of incentive stock options, nonqualified stock options, stock appreciation rights, restricted stock, stock units and performance units. Currently, this is the only plan under which awards are authorized to be granted. As approved by the shareholders in November 2004, the plan authorized issuance of up to 1,200,000 shares plus the number of shares then authorized for issuance under the Equity Compensation Plan, which were not thereafter used for awards under the Equity Compensation Plan. On November 3, 2005, the Company's shareholders approved an amendment to the Long-Term Incentive Compensation Plan, which increased the shares authorized for issuance under the plan by 2,000,000 shares. Awards issued under the plan to date include only nonqualified stock options and restricted stock.

Equity Compensation Plan - This plan provided for grants in both the form of incentive stock options and nonqualified stock options. The plan was terminated as to future grants in November 2004.

Stock Option Plan for Non-Employee Directors - This plan provided for fixed annual non-qualified option grants to the Company's non-employee directors. The plan was terminated as to future grants in 1997.

2001 Nonqualified Stock Option Plan - This plan provided for non-qualified option grants to eligible employees. The plan was terminated as to future grants in 2003.

Fiscal 2001 Stock Option Bonus Plan - This plan provided for non-qualified option grants to eligible employees for each quarter of fiscal 2001. The plan expired as to future grants in September 2001.

Fiscal 2002 Stock Option Bonus Plan - This plan provided for non-qualified option grants to eligible employees for each quarter of fiscal 2002. This plan expired as to future grants in September 2002.

The Company also has an Employee Stock Purchase Plan (the "ESPP") that provides employees of the Company and designated subsidiaries the opportunity to purchase common stock through payroll deductions. The Company established the original ESPP in 1999 and terminated it on October 31, 2005. The Company's shareholders approved the new 2005 ESPP on November 3, 2005 and it became effective November 3, 2005. Under the 1999 ESPP, the purchase price was set at the lower of 85% of the fair market value of common stock at the beginning of the participation period or 85% of the fair market value on the purchase date. Under the 2005 ESPP, the purchase price is set at 85% of the fair market value of common stock at the purchase date. Under the 1999 ESPP, the Company's board of directors had reserved a total of 1,350,000 shares of common stock for issuance. Under the 2005 ESPP, the Company's board of directors has reserved a total of 600,000 shares of common stock for issuance. The 2005 ESPP also limits employee contributions to 15% of each employee's compensation, and participation periods have a 12-month duration, beginning in May and November of each year.

Prior to June 27, 2005, the Company accounted for its equity-based compensation plans under the recognition and measurement provision of APB Opinion No. 25, “Accounting for Stock Issued to Employees” (“APB 25”), and related interpretations, as permitted by Statement of Financial Accounting Standards No. 123, “Accounting for Stock-Based Compensation” (“SFAS 123”). The Company did not recognize stock-based compensation cost in its Consolidated Statement of Income prior to June 27, 2005, as all options granted under its equity-based compensation plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective June 27, 2005, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment” (“SFAS 123R”), using the modified-prospective-transition method. Under this transition method, compensation cost recognized includes compensation costs for all share-based payments granted prior to, but not yet vested as of June 26, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and compensation cost for all share-based payments granted subsequent to June 26, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Results for prior periods have not been restated.

The fair value of each option award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model, which uses the assumptions noted in the following table. Expected volatility is based on implied volatilities from options traded on the Company’s common stock. The Company uses historical data to estimate option exercises and employee terminations used in the model. In addition, separate groups of employees that have similar historical exercise behavior are considered separately. The expected term of options granted is derived using the “simplified” method as allowed under the provisions of the Securities and Exchange Commission’s Staff Accounting Bulletin No. 107 (“SAB 107”) and represents the period of time that options granted are expected to be outstanding. The risk-free interest rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Stock Option Grants:				
Risk-free interest rate	4.36%	3.20%	3.94%	3.23%
Expected life, in years	4.5	4.0	4.5	4.0
Expected volatility	42.0%	70.0%	42.0%	70.0%
Dividend yield	0%	0%	0%	0%
Employee Stock Purchase Plan:				
Risk-free interest rate	4.27%	2.27%	4.27%	2.27%
Expected life, in years	0.5	0.8	0.5	0.8
Expected volatility	42.0%	70.0%	42.0%	70.0%
Dividend yield	0%	0%	0%	0%

Prior to June 27, 2005 and the adoption of SFAS 123R, the Company’s expected volatility on shares of its common stock was based on a weighted average of the implied volatility of publicly traded call options on its stock and the historical volatility of the Company’s stock price. However, as a result of adopting SFAS 123R and in accordance with SAB 107, the Company determined that the implied volatility relating to the call options represents its best estimate of future expected volatility.

As a result of adopting SFAS 123R, the Company's income from continuing operations before income taxes and net income for the three and six months ended December 25, 2005 are $3.5 million and $2.4 million lower and $6.3 million and $4.3 million, respectively, than if the Company had continued to account for share-based compensation under APB 25. Basic earnings per share for the three and six months ended December 25, 2005 would have been $0.26 and $0.58, respectively, if the Company had not adopted SFAS 123R, compared to reported basic earnings per share of $0.23 and $0.52, respectively. Diluted earnings per share for the three and six months ended December 25, 2005 would have been $0.26 and $0.56, respectively, if the Company had not adopted SFAS 123R, compared to reported diluted earnings per share of $0.23 and $0.51, respectively. In addition, in connection with the Company's adoption of SFAS 123R, net cash provided by operating activities increased by $6.3 million for the six months ended December 25, 2005. Net cash provided by financing activities was unchanged in the same period since there were no excess tax benefits from equity-based compensation plans.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS 123 to options granted under the Company's stock option plans for the three and six months ended December 26, 2004. For purposes of this pro forma disclosure, the value of the options is estimated using the Black-Scholes-Merton option-pricing model and amortized to expense over the options' vesting periods.

	Three Months Ended December 26, 2004	Six Months Ended December 26, 2004
	(in thousands, except per share amounts)	
Net income, as reported	$ 25,022	$ 49,450
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of tax	(5,835)	(10,494)
Pro forma net income	$ 19,187	$ 38,956
Earnings per share:		
Basic, as reported	$ 0.33	$ 0.66
Basic, pro forma	$ 0.25	$ 0.52
Diluted, as reported	$ 0.32	$ 0.64
Diluted, pro forma	$ 0.25	$ 0.51

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 151, "Inventory Costs" ("SFAS 151"). SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS 151 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

Contingencies

During the three months ended December 25, 2005, there were no material developments in the legal proceedings previously reported in the Company's Annual Report on Form 10-K for the fiscal year ended June 26, 2005 and the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 25, 2005. Please refer to Part I, Item 3 of the Annual Report on Form 10-K for the fiscal year ended June 26, 2005 and Part II, Item 1 of the Quarterly Report on Form 10-Q for the quarterly period ended September 25, 2005 respectively, for a description of our material legal proceedings.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Information set forth in this Quarterly Report on Form 10-Q contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (Exchange Act). All information contained in the following discussion relative to future markets for our products and trends in and anticipated levels of revenue, gross margins, and expenses, as well as other statements containing words such as "may," "will," "anticipate," "target," "plan," "estimate," "expect," and "intend" and other similar expressions constitute forward-looking statements. These forward-looking statements are subject to business, economic and other risks and uncertainties, both known and unknown, and actual results may differ materially from those contained in the forward-looking statements. Any forward-looking statements we make are as of the date made, and we have no duty to update them if our views later change.

Factors that could cause or contribute to such differences include: our ability to complete development and commercialization of products under development, such as our pipeline of brighter light emitting diodes (LEDs); our ability to lower costs; potential changes in demand; increasing price competition in key markets; the risk that due to the complexity of our manufacturing processes and the transition of production to three-inch wafers, we may experience production delays that preclude us from shipping sufficient quantities to meet customer orders or that result in higher production costs and lower margins; risks associated with the ramp up of production for our new products; risks resulting from the concentration of our business among few customers, including the risk that customers may reduce or cancel orders or fail to honor purchase commitments; the rapid development of new technology and competing products that may impair demand or render our products obsolete; the potential lack of customer acceptance for our products; Cree Microwave's ability to sublease its facility in Sunnyvale California; and risks associated with our on-going litigation. See "Risk Factors" below, as well as other risks and uncertainties referenced in this report, for additional risk factors that could cause actual results to differ.

Overview

We develop and manufacture semiconductor materials and electronic devices made from silicon carbide, or SiC, gallium nitride, or GaN, and related compounds. The majority of our products are manufactured at our main production facility in Durham, North Carolina. We also use a subcontractor in Asia to perform some of our manufacturing steps for certain LED products. We generate revenues from the following product lines:

- *LED chips and packaged products*. We derive the largest portion of our revenue from the sale of blue, green and near ultraviolet, or UV, LED chips. Some of our customers package our blue LEDs in combination with phosphors to create white LEDs. Our LED chips are packaged by our customers and used by manufacturers as a light source for mobile products, entertainment devices, indoor and outdoor full color displays, automotive interior lighting, miniature white lights, and other lighting applications. In fiscal 2005, we released a family of high power packaged LEDs called our XLamp® products that are designed to compete with conventional lighting technology for certain specialty lighting applications. We sell packaged LED products in a range of colors, including blue, green, white, amber and red. We currently are marketing these products for use in specialty lighting applications (such as lighting for pools and spas), architectural lighting, appliance lighting, flashlights and reading lamps. Sales of LED products represented 82% of our revenue from continuing operations for the three and six months ended December 25, 2005, respectively. Sales of LED products represented 82% and 83% of our revenue from continuing operations for the three and six months ended December 26, 2004, respectively.

- *Materials products*. Our customers purchase our SiC and GaN wafers for use in manufacturing LEDs and radio frequency, or RF, and power devices or for research and development. Sales of SiC and GaN wafers represented 5% of our revenue from continuing operations for the three and six months ended December 25, 2005, respectively. Sales of SiC and GaN wafers represented 7% of our revenue from continuing operations for the three and six months ended December 26, 2004, respectively. We also sell SiC materials in bulk crystal form to Charles & Colvard, Ltd., or Charles & Colvard, for their further processing into gemstone applications. Sales of SiC crystals for use in gemstone applications represented 3% of our revenue from continuing operations for the three and six months ended December 25, 2005, respectively. Sales of SiC crystals for use in gemstone applications represented 2% of our revenue from continuing operations for the three and six months ended December 26, 2004, respectively.

- *High power products*. These products include SiC power devices, and wide bandgap RF and microwave devices. Our customers currently purchase Schottky diode products for use in power factor correction circuits for power supplies in computer servers and other applications. We also provide discrete SiC RF transistors, as well as a foundry service for wide bandgap MMICs, for use in communication applications, high power radar amplifiers, electronic warfare and wireless infrastructure. Sales of high-power products represented 3% of our revenue from continuing operations for the three and six months ended December 25, 2005, respectively. Sales of high-power products represented 2% of our revenue from continuing operations for the three and six months ended December 26, 2004, respectively. Effective December 25, 2005, we discontinued the operations of our silicon-based RF and microwave semiconductor business, previously known as our Cree Microwave segment. All historical financial periods presented herein have been restated to reflect the Cree Microwave silicon-based RF and microwave business as a discontinued operation. This business produced silicon-based semiconductor components for power amplifiers used for analog and digital base stations. As of December 25, 2005, we completed the production of all last time buy orders for our silicon products and terminated the employment of the remaining employees of our Cree Microwave subsidiary. Sales of silicon-based RF and microwave devices at Cree Microwave are reflected in the loss from discontinued operations in the consolidated income statement and were $3.3 million and $4.3 million in the three and six months ended December 25, 2005, respectively. Sales of silicon-based RF and microwave devices at Cree Microwave were $1.5 million and $2.9 million in the three and six months ended December 26, 2004, respectively.

We also generate revenue under contracts funded by government agencies. Government entities assist us in the development of new technology by funding a portion of our research and development efforts. Revenue from contract research funding represented 7% and 6% of our revenue from continuing operations for the three and six months ended December 25, 2005, respectively. Revenue from contract research funding represented 6% of our revenue from continuing operations for the three and six months ended December 26, 2004, respectively.

Industry Dynamics

Our business is affected by a number of industry factors, including: trends in mobile product designs and sales, our LED brightness and technology, competitive LED pricing pressures, technology and the relative strength of each supplier's intellectual property. The most significant market currently for our blue and green LED chips is for illumination purposes in mobile products, including LCD backlighting, keypad illumination and flash units for cameras. LED sales for mobile products are impacted by the number of LEDs used in an application, which may vary depending on trends in the features of the application and the brightness of the LEDs used. Average LED sales prices decline each year as market players implement pricing strategies to strengthen or protect market share. To remain competitive, LED producers generally must increase product performance and reduce the average sales price. Finally, vigorous protection and pursuit of intellectual property rights characterize the semiconductor industry. Customers' purchasing decisions can be influenced by whether a product may infringe valid intellectual property rights.

Highlights and Outlook

Financial highlights from the second quarter of fiscal 2006

We reported our highest quarterly revenue in the second quarter of fiscal 2006 primarily due to growth in XLamp high-power packaged LEDs and materials products.

In the second quarter of fiscal 2006, revenue from continuing operations increased $2.7 million over revenue from continuing operations of $102.9 million recorded in the first quarter of fiscal 2006, primarily due to growth in XLamp sales and higher revenue from silicon carbide-based materials.

LED revenue grew $1.9 million over LED revenue recorded in the first quarter of fiscal 2006, primarily due to increased revenues from sales of our XLamp LEDs, related to purchases for new design wins from current and new customers. During the second quarter of fiscal 2006, we changed the way we classify our LED products. Our high-brightness category now includes products that typically offer at least 20 milliwatts of brightness and are primarily used as backlights for LCDs, outdoor displays and for general lighting purposes. Our high-brightness products include revenue from XLamp packaged LEDs. As a part of this change, our MegaBright™ products have been moved from the high-brightness category to the mid-brightness category. During the second quarter of fiscal 2006, we have also combined our standard brightness category with our mid-brightness devices, as we believe a separate category is no longer helpful. Under this new classification, revenue from our high-brightness LEDs declined from 43% of LED revenue in the first quarter of fiscal 2006 to 38% of LED revenue in the second quarter of fiscal 2006. Our mid-brightness LEDs increased from 57% of LED revenue in the first quarter of fiscal 2006 to 62% of LED revenue in the second quarter of fiscal 2006. This change in product mix resulted from a shift in demand toward chips that are sold for mobile product keypad designs. Although high-brightness sales declined from the first quarter of fiscal 2006 to the second quarter of fiscal 2006, the prior six-month sales trend is positive, as revenue from our high-brightness devices made up only 24% of LED revenue in the fourth quarter of fiscal 2005. During the second quarter of fiscal 2006, some of our customers reduced their high-brightness product demand, as some projects did not ramp as quickly as they expected and our customers managed their purchases in preparation for the seasonally slow March quarter in the mobile phone business. As a part of our normal quarterly review, we determined that we have experienced a lower trend of customer returns over the past few quarters. Therefore, in accordance with our revenue recognition policy, we reduced our sales return allowance, which increased revenue from continuing operations by $1.3 million during the second quarter of fiscal 2006.

During the second quarter of fiscal 2006, revenue from our materials products increased to 9% of our revenue from continuing operations. The increase in materials products revenue resulted primarily from increased demand for our silicon carbide bare wafers and gemstone materials from Charles & Colvard.

Our gross margin was 49.4% of revenue from continuing operations in the second quarter of fiscal 2006.

In the second quarter of fiscal 2006, cost of product revenue increased over the first quarter of fiscal 2006 due to higher product sales. Our LED product profitability remained relatively even as our blended average sales price and average costs decreased 5%, respectively, compared to the first quarter of fiscal 2006. Our average sales price declined in part due to normal price reductions and the shift in our product mix toward our lower priced mid-brightness products. Our average costs were lower in the second quarter of fiscal 2006 as compared to the first quarter of fiscal 2006, due to a combination of a higher percentage of our products being made from three-inch wafers and a product mix shift toward mid-brightness products. As we continued the migration of our production from two-inch wafers to three-inch wafers, approximately 80% of our LED chips, or approximately 60% of our LED wafers, were made from three-inch wafers during the second quarter of fiscal 2006. Three-inch wafers generally increase the number of chips made per wafer and lower the cost per chip. During the second quarter of fiscal 2006, the benefit of this migration to three-inch wafers resulted in a lower average cost of LED products as compared to the first quarter of fiscal 2006. We plan to continue to migrate more of our LED production from two-inch to three-inch SiC wafers during the remainder of fiscal 2006, which we target will increase the number of LED chips per wafer and therefore lower our overall LED chip cost. During the third quarter of fiscal 2006, we target LED price declines in a range of 3% to 5% based on our analysis of our current backlog for the third quarter.

Gross profit increased by $1.1 million during the second quarter of fiscal 2006 due to the reduction of our estimated sales return reserve net of related cost of sales. However, much of this benefit was offset by a $645,000 sequential increase in stock compensation expense being recorded to cost of sales. During the first quarter of fiscal 2006, only $567,000 of stock compensation expense was included in cost of sales as the remaining stock compensation expense was allocated to inventory in accordance with the Securities and Exchange Commission’s Staff Accounting Bulletin No. 107. For the next few quarters, we target that stock option expense recorded to cost of sales will approximate $1.2 million per quarter.

We achieved cash flow from operations of $87.7 million in the first half of fiscal 2006.

Cash and short and long-term investments increased by $61.0 million from $277.3 million at the end of fiscal 2005 to $338.3 million at the end of the second quarter of fiscal 2006 due to higher profits, which were somewhat offset by capital expenditures of $31.7 million.

Net income in all fiscal 2006 periods reflects stock compensation expense for the first time.

We recorded stock compensation expense for the first time in fiscal 2006 as we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), “Share-Based Payment”, or SFAS 123R, at the beginning of the fiscal year. We recorded $3.5 million and $6.3 million of stock compensation expense in the second quarter and first six months of fiscal 2006, respectively.

Outlook for the Second Half of Fiscal 2006

In the second half of fiscal 2006, we are working to increase the brightness of our LED chips and find ways to increase our customers' ratio of blue conversion to white in LED packages for white backlight applications. If we are successful in achieving these goals, we believe that we will have an opportunity to gain market share in the LCD backlight and camera flash markets for mobile products that use white LEDs. In addition to mobile products, we believe our new products can enable us to gain new customer designs for other high-brightness LED applications, such as specialty lighting, gaming machine designs, and displays.

We continue to expand our product offerings of our XLamp family of high-power packaged LED products. We are aiming to increase sales of XLamp products in the specialty lighting markets (such as lighting for pools and spas), including architectural lighting, appliance lights, flashlights and reading lights.

In order to expand our factory output and improve our yields, we plan to invest $90.0 million to $110.0 million during fiscal 2006 in capital equipment additions, which includes the build out of the fabrication facility in Research Triangle Park, North Carolina that we purchased in the third quarter of fiscal 2005. We also plan to expand our production at a subcontractor facility in Asia. During the third quarter of fiscal 2006, we need to expand our XLamp production capacity in order to meet targeted demand and reach our financial goals for the third quarter of fiscal 2006. We also may increase our research and development and sales and marketing spending as a percentage of revenue over our fiscal 2005 level.

Critical Accounting Policies

The following discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. In preparing our financial statements, we must make estimates and judgments that affect the reported amounts of assets and liabilities, revenues and expenses and related disclosure of contingent assets and liabilities at the date of our financial statements. We base our assumptions, estimates and judgments on historical experience, current trends and other factors that management believes to be relevant at the time the consolidated financial statements are prepared. On a regular basis, management reviews our accounting policies and assumptions, estimates and judgments to ensure that our financial statements are presented fairly and in accordance with generally accepted accounting principles. However, because future events and their effects cannot be determined with certainty, actual results could differ from our assumptions and estimates, and we may be exposed to gains or losses that could be material.

Our significant accounting policies are discussed in Note 2, "Summary of Significant Accounting Policies and Other Matters," of the Notes to Consolidated Financial Statements, included in Item 8, Financial Statements and Supplementary Data, of our Annual Report on Form 10-K. Management believes that the following accounting policies are the most critical to aid in fully understanding and evaluating our reported financial results, and they require management's most difficult, subjective or complex judgments, resulting from the need to make estimates about the effect of matters that are inherently uncertain. Management has reviewed these critical accounting policies and related disclosures with our independent auditor and the Audit Committee of our Board of Directors.

Description of Policy	Judgments and Uncertainties	Effect If Actual Results Differ From Assumptions and Adjustments Recorded
Revenue Recognition:		
We provide our customers with limited rights of return for non-conforming shipments and product warranty claims. In addition, certain of our sales arrangements provide for limited product exchanges. As a result, we record an allowance for sales returns at the time of sale, which is recorded as a reduction of product revenue and accounts receivable. In connection with the reserve for sales returns, we also record an estimate for the value of product returns that we believe will be returned to inventory in the future and resold. This includes an estimate for costs of inventory that may be returned in the future. This estimate is recorded as other current assets and as a reduction in the cost of product sales.	We apply judgment in estimating the amount of product that will be returned in the future. Our estimate of product returns and the amount of those returns that will be placed back in inventory is based primarily on historical transactional experience and judgment regarding market factors and trends.	In the second quarter of fiscal 2006 we recorded a $1.3 million decrease in our sales return allowance as we have experienced a trend of lower customer returns over the past few prior quarters. In addition, we recorded a corresponding reduction in our estimate for product returns, which increased cost of sales by $184,000. Therefore, in accordance with our revenue recognition policy, we reduced our allowance for sales returns, which increased LED revenue by $1.3 million and cost of sales by $184,000 and resulted in an increase to net income of approximately $756,000 (net of income taxes). A 10% increase or decrease in our sales return estimates and estimates of products to be returned to inventory at December 25, 2005 would have affected net income by approximately $558,000 and $101,000, respectively, for the three and six months ended December 25, 2005.

Valuation of Long-Lived Assets:		
We review long-lived assets such as property and equipment and patents for impairment when events and circumstances indicate that the carrying value of the assets contained in our financial statements may not be recoverable. For example, pieces of our equipment may be scrapped or certain of our patents or patent applications may be abandoned. In these cases, we would directly write-off these long-lived assets. In addition, we evaluate all of our long-lived assets for potential impairment by comparing the carrying value of our assets to the estimated future cash flows of the assets (undiscounted and without interest charges). If the estimated future cash flows are less than the carrying value of the asset, we calculate an impairment loss. The impairment loss calculation compares the carrying value of the asset to the asset's estimated fair value, which may be based on estimated future cash flows. We recognize an impairment loss if the amount of the asset's carrying value exceeds the asset's estimated fair value. If we recognize an impairment loss, the adjusted carrying amount of the asset will be its new cost basis. For a depreciable (amortized) long-lived asset, the new cost basis will be depreciated (amortized) over the remaining useful life of that asset. We do not restore a previously recognized impairment loss if the asset's carrying value decreases below its estimated fair value.	Our impairment loss calculations require management to apply judgment in estimating future cash flows and asset fair values, including estimating useful lives of the assets. To make these judgments, we may use internal discounted cash flow estimates, quoted market prices when available and independent appraisals as appropriate to determine fair value. We derive the required cash flow estimates from our internal business plans.	If actual results are not consistent with our assumptions and judgments used in estimating future cash flows and asset fair values, we may be required to record additional impairment losses that could be material to our results of operations. Using this impairment review methodology, we recorded long-lived asset impairment charges of $639,000 in the first half of fiscal 2006 and $5.5 million during fiscal 2005. These impairment charges were primarily related to the planned and subsequent closure of our Cree Microwave-Sunnyvale facility and the disposal of certain assets.

Tax Contingencies:		
We are subject to periodic audits of our income tax returns by Federal, state and local agencies. These audits include questions regarding our tax filing positions, including the timing and amount of deductions and the allocation of income among various tax jurisdictions. In evaluating the exposures associated with our various tax filing positions, including state and local taxes, we record reserves for what we identify as probable exposures. A number of years may elapse before a particular matter for which we have established a reserve is audited and fully resolved. We have also established a valuation allowance for capital loss carry forwards and unrealized losses on certain securities, as we believe that it is more likely than not that the tax benefits of the items will not be realized.	The estimate of our tax contingencies reserve contains uncertainty because management must use judgment to estimate the exposures associated with various tax filing positions. To make these judgments, we make determinations about the likelihood that the specific taxing authority may challenge the tax deductions that we have taken on our tax return. Based on information about other tax settlements we estimate amounts that we may settle with taxing authorities in order to conclude audits.	To the extent we prevail in matters for which reserves have been established, or are required to pay amounts in excess of our reserves, our effective tax rate in a given financial statement period could be materially affected. An unfavorable tax settlement would require use of our cash and result in an increase in our effective rate in the year of resolution. A favorable tax settlement would be recognized as a reduction in our effective tax rate in the year of resolution. When we establish or reduce the valuation allowance against our deferred tax assets, our income tax expense will increase or decrease, respectively; in the period such determination is made. As of December 25, 2005, we had established tax reserves of $16.7 million and a valuation allowance of $9.0 million.

Inventories:		
We value our inventory at the lower of cost of the inventory or fair market value by establishing a write-down or an inventory loss reserve. We base our lower of cost or market write-down on the excess carrying value of the inventory, which is typically its cost, over the amount that we expect to realize from the ultimate sale of the inventory based upon our assumptions regarding the average sales price to be received for the product.	Our inventory reserve is based upon our analysis of sales levels by product and projections of future customer demand derived from historical order patterns and input received from our customers and our sales team. To mitigate uncertainties, we reserve for all inventory greater than 12 months old, unless there is an identified need for the inventory. In addition, we reserve for items that are considered obsolete based on changes in customer demand, manufacturing process changes or new product introductions that may eliminate demand for a product. When inventory is physically destroyed, we remove inventory and the associated reserve from our financial records.	If our estimates regarding customer demand and physical inventory losses are inaccurate or changes in technology affect demand for certain products in an unforeseen manner, we may be exposed to losses or gains in excess of our established reserves that could be material. A 10% increase or decrease in our actual inventory reserve at December 25, 2005 would have affected net earnings by approximately $33,000 for the six months ended December 25, 2005.
Accruals for Self Insured and Other Liabilities:		
We make estimates for the amount of costs that have been incurred but not yet billed for general services, including legal, accounting fees, costs pertaining to our self-funded medical insurance and other expenses.	Our liabilities contain uncertainties because we must make assumptions and apply judgment to estimate the ultimate cost to settle claims and claims incurred but not reported as of the balance sheet date. When estimating our liabilities, we consider a number of factors, including interviewing our service providers for bills that have not yet been received. For self-insured liabilities, we estimate our liabilities based on historical claims experience.	If actual costs billed to us are not consistent with our assumptions and judgments, our expenses could be understated or overstated and these adjustments could materially affect our net income.
Accounting for Stock Based Compensation:		
We account for stock-based employee compensation arrangements in accordance with the provisions of Statement of Financial Accounting Standards No. 123R, Shared-Based Payments (Revised). Under SFAS 123R, compensation cost is calculated on the date of the grant using the Black Scholes-Merton method. The compensation expense is then amortized over the vesting period.	We use the Black-Scholes-Merton model in determining fair value of our options at the grant date and apply judgment in estimating the key assumptions that are critical to the model such as the expected term, volatility and forfeiture rate of an option. Our estimate of these key assumptions is based on historical information and judgment regarding market factors and trends.	If actual results are not consistent with our assumptions and judgments used in estimating the key assumptions, we may be required to record additional compensation or income tax expense, which could be material to our results of operations.

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Results of Operations

The following table shows our consolidated statements of income data expressed as a percentage of revenue from continuing operations for the periods indicated:

	Three Months Ended		Six Months Ended	
	December 25, 2005	December 26, 2004	December 25, 2005	December 26, 2004
Revenue:				
Product revenue, net	93.4%	93.7%	93.5%	93.9%
Contract revenue, net	6.6	6.3	6.5	6.1
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Product revenue	45.8	42.1	45.4	39.9
Contract revenue	4.8	5.3	4.5	4.9
Total cost of revenue	50.6	47.4	49.9	44.8
Gross margin	49.4	52.6	50.1	55.2
Operating expenses:				
Research and development	14.0	10.7	13.2	10.4
Sales, general and administrative	10.2	7.4	10.3	7.3
Impairment or loss on disposal of long-lived assets	0.1	0.3	0.4	0.3
Income from operations	25.1	34.2	26.2	37.2
Non-operating income:				
Gain (loss) on investments	-	(2.1)	0.3	(1.0)
Other non-operating income	-	-	-	-
Interest income, net	2.8	1.2	2.5	1.2
Income from continuing operations before income taxes	27.9	33.3	29.0	37.4
Income tax expense	8.9	5.1	8.2	9.2
Income from continuing operations	19.0%	28.2%	20.8%	28.2%
Loss from discontinued operations, net of related income tax benefit	(2.2)	(2.2)	(1.8)	(2.2)
Net income	16.8%	26.0%	19.0%	26.0%

Three Months Ended December 25, 2005 and December 26, 2004

Revenue. Revenue from continuing operations increased 10% to $105.6 million in the second quarter of fiscal 2006 from $96.1 million in the second quarter of fiscal 2005. Higher revenue was attributable to greater product revenue, which increased 10% to $98.7 million in the second quarter of fiscal 2006 from $90.1 million in the second quarter of fiscal 2005. Much of the increase in revenue resulted from significantly higher unit shipments of our LED products, which increased 26% in the second quarter of fiscal 2006 as compared to the same quarter of the prior year. LED revenue was $86.5 million and $78.9 million, for the second quarter of fiscal 2006 and 2005, respectively. Our blended average LED sales price decreased 13% in the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2005. This decrease was due to increasing price competition in the marketplace for high-brightness and mid-brightness devices.

Our LED revenue increased 10% in the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2005 and made up 82% of our total revenue from continuing operations for the three months ended December 25, 2005. Revenue from sales of our high-brightness products increased to 38% from 12% of LED revenue for the three months ended December 25, 2005 compared to the three months ended December 26, 2004. Revenue from sales of our mid-brightness products declined as a percentage of total LED revenue to 62% as of December 25, 2005 from 88% as of December 26, 2004. The primary drivers of the increase in revenue from sales of high-brightness products and the related decrease in revenue from sales of mid-brightness products are increased high-brightness chip sales for mobile products requiring white LEDs in keypads, backlights for LCD displays and camera flashes. During the second quarter of fiscal 2006, revenue from continuing operations also increased by $1.3 million due to the reduction of our estimated sales return reserve, as we experienced a trend of lower customer returns over the past few quarters. Revenue from sales of our high-brightness products has also increased as a percentage of our LED revenue due to our success in selling our XLamp packaged products. Our XLamp revenue increased in the second quarter of fiscal 2006 as compared to the second quarter of fiscal 2005 as we have added several new customers for our XLamp products. The XLamp product was released to production in early fiscal 2005.

Wafer product revenue was $5.4 million and $7.1 million for the second quarter of fiscal 2006 and 2005, respectively. The average sales price increased 69% while units sold declined 54% during the second quarter of fiscal 2006 as compared to the prior year period. Therefore, wafer revenue decreased 23% as compared to the prior year period. The increase in the average sales price for our wafers and the reduction in units sold were due mostly to a change in our product mix as we sold more high-grade and custom wafers used by our customers for research and development projects and we sold fewer standard wafers that we previously sold in high volume. Wafer revenue made up 5% of our total revenue from continuing operations in the second quarter of fiscal 2006. SiC materials revenue for gemstone use was $3.6 million and $1.8 million for the second quarter of fiscal 2006 and 2005, respectively. Revenue from sales of our SiC materials for use in gemstones increased 101% during the second quarter of fiscal 2006 as compared to the prior year period due to higher customer demand from our sole customer for these products, Charles & Colvard. Revenue from gemstone materials was 3% of our revenue from continuing operations for the second quarter of fiscal 2006.

Revenue from our high-power devices increased 38% to $3.0 million in the second quarter of fiscal 2006 from $2.2 million in the second quarter of fiscal 2005. Much of the increase in revenue resulted from the growth of our MMIC foundry sales. Revenue from high power devices was 3% of our total revenue from continuing operations for the three months ended December 25, 2005.

Contract revenue was 7% of total revenue for the second quarter of fiscal 2006. Contract revenue increased 16% during the second quarter of fiscal 2006 compared to the same period of fiscal 2005 due to the start of new contracts that were awarded to us.

Gross Profit. Gross profit from continuing operations increased 3% to $52.2 million in the second quarter of fiscal 2006 from $50.5 million in the second quarter of fiscal 2005. Compared to the prior year period, gross margin decreased from 52.6% to 49.4% of revenue. During the second quarter of fiscal 2006, we recorded a $1.2 million expense to cost of sales for stock compensation resulting from the adoption of SFAS 123R at the beginning of our 2006 fiscal year, which had a negative effect on our gross margin of 1.2% on revenue from continuing operations. This decrease was also driven by lower gross margin on sales of LED chips, for which blended average selling prices were 13% lower and costs were reduced by only 9% over the same period of fiscal 2005. Our average sales price declined due to increasing price competition in the marketplace for mid-brightness and high-brightness devices. Our costs were reduced as we began to manufacture more of our products from three-inch wafers. Approximately 80% of our LED chips, or approximately 60% of our LED wafers were produced from three-inch wafers during the second quarter of fiscal 2006. Gross profit was impacted by a $1.3 million decrease in our sales return allowance, which increased revenue, as we estimate that we have experienced a trend of lower customer returns over the past few quarters. We recorded a corresponding reduction in our estimate for product returns of $184,000, which increased cost of sales. Overall, the adjustment increased gross profit by $1.1 million.

Wafer costs per unit for our materials sales were 24% higher in the second quarter of fiscal 2006 compared to the second quarter of fiscal 2005 due to a different mix of products sold in the current quarter. Contract margin improved to 28% in the second quarter of fiscal 2006 compared to 16% in the second quarter of fiscal 2005 due to the mix of new contracts that were awarded to us in fiscal 2005 and 2006.

Research and Development. Research and development expenses increased 44% in the second quarter of fiscal 2006 to $14.8 million from $10.3 million in the second quarter of fiscal 2005. During the second quarter of fiscal 2006, research and development costs included $1.0 million in stock compensation expense resulting from our adoption of SFAS 123R at the beginning of fiscal 2006. The remaining increase in research and development spending supported our continued development of higher brightness LED chips and high power LED components, our thin chip products, our XLamp high power packaged LEDs, and three-inch and four-inch LED wafer process development. In addition, we funded ongoing development for higher power and higher linearity RF and microwave devices, near ultraviolet laser diodes and higher power diodes and switches.

Sales, General and Administrative. Sales, general and administrative, or SG&A expenses increased 52% in the second quarter of fiscal 2006 to $10.8 million from $7.1 million in the second quarter of fiscal 2005. During the second quarter of fiscal 2006, SG&A costs included $1.1 million in stock compensation expense resulting from our adoption of SFAS 123R at the beginning of fiscal 2006. During the second quarter of fiscal 2005, SG&A expense levels were reduced by a $1.1 million for an insurance reimbursement for certain legal fees related to our securities litigation. SG&A expenses in the second quarter of fiscal 2006 also increased over the prior year quarter due to higher costs associated with our continued compliance with the Sarbanes-Oxley Act of 2002 and higher overall costs associated with our growth. In addition, we increased spending on sales and marketing in our high power packaged LED and power semiconductor products.

Impairment or Loss on Disposal of Long-Lived Assets. Impairment or loss on the disposal of long-lived assets decreased 47% to $132,000 in the second quarter of fiscal 2006 as compared to $248,000 in the second quarter of fiscal 2005 as a result of the long-lived assets disposed of in each comparative quarter.

Loss on Long-term Investments. For the second quarter of fiscal 2006, there was no loss recorded on long-term investments. The $2.0 million loss on investments in securities in the second quarter of fiscal 2005 was due to an other-than-temporary impairment in our investment in a private company. The write-down was based on our evaluation of the company's financial results and a third party proposal to purchase our investment.

Interest Income, Net. Interest income, net increased 161% to $3.0 million in the second quarter of fiscal 2006 from $1.1 million in the second quarter of fiscal 2005 due to a combination of our greater balance of invested assets and higher interest rates resulting from increases that have occurred over the past twelve months.

Income Tax Expense. Income tax expense from continuing operations for the second quarter of fiscal 2006 was $9.4 million compared to $4.9 million in the second quarter of fiscal 2005. During the second quarter of fiscal 2006, our income tax expense decreased by $132,000 for tax related adjustments to the valuation allowance previously established to offset our federal capital loss carryover deferred tax asset. We currently target that our effective tax rate for the remainder of fiscal 2006 will be approximately 32.1%, which does not reflect changes in the market price of shares of Color Kinetics' common stock, which we treat as a discrete item each quarter. As of December 26, 2004, we had a federal capital loss carryover of $39.8 million. The related deferred tax asset of $13.9 million was previously offset by a valuation allowance since it was more likely than not that we could not utilize the capital loss carryover. Based on Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes," the valuation allowance should be adjusted for any new realizable federal capital gains or losses. The contractual trading restrictions applicable to our investment in Color Kinetics expired on December 22, 2004. As a result, the $22.5 million unrealized federal capital gain related to our investment in Color Kinetics required a $7.9 million reversal of the valuation allowance, which decreased income tax expense for the three months ended December 26, 2004. Also, we increased the valuation allowance related to privately held investments by $697,000 resulting from the tax effect of the $2.0 million reserve that was recorded in the second quarter of fiscal 2005. Additionally, we increased income tax expense during the second quarter of fiscal 2005 by $1.8 million for a settlement of state income taxes, estimated state tax rate changes and other adjustments.

Loss from discontinued operations, net of tax. In accordance with Statement of Financial Accounting Standards No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” or SFAS 144, effective December 25, 2005, we have reflected our silicon RF and microwave business as a discontinued operation in the consolidated financial statements because we completed production of all last time buy orders for our silicon products, ceased use of our silicon fabrication facility in Sunnyvale, California and terminated the employment of the remaining employees of our Cree Microwave subsidiary. The net loss from discontinued operations for the second quarter of fiscal 2006 increased 13% from $2.1 million to $2.3 million as compared to the second quarter of fiscal 2005. During the second quarter of fiscal 2006, we recorded $3.9 million of pre-tax charges, or $2.7 million of after-tax charges related to the closure of the business. These charges included $232,000 for severance expenses, a $468,000 write-down of inventory that was scrapped, a $93,000 fixed asset impairment and a $3.1 million charge for an accrual relating to the remaining lease contract obligation for the Sunnyvale facility. The net loss from discontinued operations also included pre-tax stock compensation expenses of $126,000 for the three months ended December 25, 2005. During the second quarter of fiscal 2006, our silicon microwave business generated $3.2 million in revenue from last time buy orders that produced pre-tax income of $408,000, or $277,000 after-tax from operations. In the second quarter of fiscal 2005, our silicon microwave business generated a pre-tax operating loss of $3.1 million, or $2.1 million after-tax, as we produced revenue of $1.5 million offset by heavy fixed costs incurred to operate the Sunnyvale facility.

Six Months Ended December 25, 2005 and December 26, 2004

Revenue. Revenue from continuing operations increased 9% to $208.5 million in the first six months of fiscal 2006 from $190.5 million in the first six months of fiscal 2005. Higher revenue was attributable to greater product revenue, which increased 9% to $195.0 million in the first half of fiscal 2006 from $178.8 million in the first half of fiscal 2005. Much of the increase in revenue resulted from significantly higher unit shipments of our LED products, which increased 33% in the first six months of fiscal 2006 as compared to the same period of the prior year. LED revenue was $171.1 million and $157.8 million, for the first six months of fiscal 2006 and 2005, respectively. Our blended average LED sales price decreased 18% in the first six months of fiscal 2006 as compared to the first six months of fiscal 2005. This decrease was due to increasing price competition in the marketplace for high-brightness and mid-brightness devices.

Our LED revenue increased 8% in the first six months of fiscal 2006 as compared to the first six months of fiscal 2005 and made up 82% of our total revenue from continuing operations for the six months ended December 25, 2005. Revenue from our sales of high-brightness products increased to 40% of LED revenue as compared to 12% of LED revenues for the six months ended December 25, 2005 and December 26, 2004, respectively. Revenue from sales of our mid-brightness products declined as a percentage of total LED revenue to 60% as of December 25, 2005 from 88% as of December 26, 2004. The primary drivers of the increase in revenue from sales of high-brightness products and the related decrease in revenue from sales of our mid-brightness products are increased high-brightness chip sales for mobile products requiring white LEDs in keypads, backlights for LCD displays and camera flashes. During the second quarter of fiscal 2006, revenue increased by $1.3 million due to the reduction of our estimated sales return reserve, as we experienced a trend of lower customer returns over the past few quarters. Revenues from sales of our high-brightness products have also increased as a percentage of our LED revenue due to our success in selling our XLamp packaged products. Our XLamp revenue increased in the first six months of fiscal 2006 as compared to the first six months of fiscal 2005 as we have added several new customers for our XLamp products. The XLamp product was released to production in early fiscal 2005.

Wafer product revenue was $10.6 million and $13.8 million for the first six months of fiscal 2006 and 2005, respectively. The average sales price increased 50% while units sold declined 49% during the first six months of fiscal 2006 as compared to the prior year period. The increase in the average sales price for our wafers and the reduction in the units sold were due mostly to a change in our product mix as we sold more high-grade and custom wafers used by our customers for research and development projects and we sold fewer standard wafers that we previously sold in high volume. Wafer revenue made up 5% of our revenue from continuing operations in the first six months of fiscal 2006. SiC materials revenue for gemstone use was $6.8 million and $3.3 million for the six months of fiscal 2006 and 2005, respectively. Revenue from sales of our SiC materials for use in gemstones increased 105% during the first six months of fiscal 2006 as compared to the prior year period due to higher customer demand from our sole customer for these products, Charles & Colvard. Revenue from gemstone materials was 3% of our total revenue from continuing operations for the six months ended December 25, 2005.

Revenue from our high-power devices increased 70% to $6.3 million for the first six months of fiscal 2006 from $3.7 million for the prior year comparative period. Much of the increase in revenue resulted from the growth of our MMIC foundry sales. Revenue from high-power devices was 3% of our revenue from continuing operations for the six months ended December 25, 2005.

Contract revenue was 6% of revenue from continuing operations for the first six months of fiscal 2006. Contract revenue increased 16% during the first six months of fiscal 2006 compared to the same period of fiscal 2005 due to the start of new contracts that were awarded to us during fiscal 2005 and 2006.

Gross Profit. Gross profit from continuing operations decreased 1% to $104.4 million in the first six months of fiscal 2006 from $105.1 million in the comparative period in fiscal 2005. Compared to the prior year period, gross margin decreased from 55.2% to 50.1% of revenue. During the six months ended December 25, 2005, we recorded a $1.8 million expense to cost of sales for stock compensation resulting from the adoption of SFAS 123R at the beginning of fiscal year 2006, which had a negative effect on our gross margin of 0.8% of revenue from continuing operations. This decrease was also driven by lower gross margin on sales of LED chips, for which blended average selling prices were 18% lower and costs were reduced by only 9% over the same period of fiscal 2005. Our average sales price declined due to increasing price competition in the marketplace for mid-brightness and high-brightness devices. Our costs were reduced as we began to manufacture more of our products from three-inch wafers. Approximately 70% of our LED chips were produced from three-inch wafers during the first half of fiscal 2006. Gross profit was impacted by a $1.3 million decrease in our sales return allowance, which increased revenue from continuing operations, as we have experienced a trend of lower customer returns over the past few quarters. We recorded a corresponding reduction in our estimate for product returns of $184,000, which increased cost of sales. Overall, the adjustment increased gross profit by $1.1 million.

Wafer costs per unit for our materials sales were 19% higher in the first six months of fiscal 2006 compared to the first six months of fiscal 2005 due to a different mix of products sold in the current quarter. Contract margin improved to 30% in the first six months of fiscal 2006 compared to 20% in the first six months of fiscal 2005 due to the start of new contracts that were awarded to us during fiscal 2005 and 2006.

Research and Development. Research and development expenses increased 39% in the first six months of fiscal 2006 to $27.6 million from $19.9 million in the first six months of fiscal 2005. During the first six months of fiscal 2006, research and development costs included $2.1 million in stock compensation expense resulting from our adoption of SFAS 123R at the beginning of fiscal 2006. The remaining increase in research and development spending supported our continued development of higher brightness LED chips and high-power LED components, our XLamp high-power packaged LEDs, three-inch and four-inch LED wafer process development and other high-brightness LED research programs. In addition, we funded ongoing development for higher power and higher linearity RF and microwave devices, near ultraviolet laser diodes and higher power diodes and switches.

Sales, General and Administrative. Sales, general and administrative, or SG&A expenses increased 55% in the first six months of fiscal 2006 to $21.6 million from $14.0 million in the first six months of fiscal 2005. During the six months ended December 25, 2005, SG&A costs included $2.3 million in stock compensation expense resulting from our adoption of SFAS 123R at the beginning of fiscal 2006. During the first six months of fiscal 2005, SG&A expense levels were reduced by a $1.1 million insurance reimbursement for certain legal fees related to our securities litigation. SG&A expenses in the first six months of fiscal 2006 also increased over the first six months of fiscal 2005 due to higher costs associated with our continued compliance with the Sarbanes-Oxley Act of 2002 and higher overall costs associated with our growth. In addition, we increased spending on sales and marketing in our high power packaged LED and power semiconductor products.

Impairment or Loss on Disposal of Long-Lived Assets. Impairment or loss on the disposal of long-lived assets increased 114% to $700,000 in the first six months of fiscal 2006 as compared to $326,000 in the first six months of fiscal 2005. During the first six months of fiscal 2006, we recorded an impairment of $581,000 for building improvements that are no longer being used at our Durham facility.

Gain on Investments in Securities. Gain on investments in securities was $587,000 in the first six months of fiscal 2006, compared to a $1.9 million loss in the first six months of fiscal 2005. In the first six months of fiscal 2006, we sold a small portion of our investment in Color Kinetics for a realized gain of $587,000. The fiscal 2005 loss was due to an other-than-temporary impairment on our investment in a private company. The write-down was based on our evaluation of the company's financial results and a third party proposal to purchase our investment.

Interest Income, Net. Interest income, net increased 131% to $5.3 million in the first six months of fiscal 2006 from $2.3 million in the first six months of fiscal 2005, due to a combination of our greater balance of invested assets and higher interest rates resulting from rate increases that have occurred over the past twelve months.

Income Tax Expense. Income tax expense for the first six months of fiscal 2006 was $17.0 million compared to $17.7 million in the first six months of fiscal 2005. During the first six months of fiscal 2006, our income tax expense decreased by $2.3 million for tax related adjustments to the valuation allowance previously established to offset our federal capital loss carryover deferred tax asset. During the first six months of fiscal 2005, our income tax expense was reduced by an aggregate of $5.4 million of adjustments. As of December 26, 2004, we had a federal capital loss carryover of $39.8 million. The related deferred tax asset of $13.9 million was previously offset by a valuation allowance since it was more likely than not that we could not utilize the capital loss carryover. Based on Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes," the valuation allowance should be adjusted for any new realizable federal capital gains or losses. The contractual trading restrictions applicable to our investment in Color Kinetics expired on December 22, 2004. As a result, the $22.5 million unrealized federal capital gain related to our investment in Color Kinetics required a $7.9 million reversal of the valuation allowance, which decreased income tax expense for the six months ended December 26, 2004. Also, we increased the valuation allowance related to privately held investments by $697,000 resulting from the tax effect of the $2.0 million reserve that was recorded in the second quarter of fiscal 2005. Additionally, we increased income tax expense by $1.8 million during the first six months of fiscal 2005 for a settlement on state income taxes, estimated state tax rate changes and other adjustments.

Loss from discontinued operations, net of tax. In accordance with SFAS 144, effective December 25, 2005, we reflected our silicon RF and microwave business as a discontinued operation in the consolidated financial statements. The net loss from discontinued operations for the first six months of fiscal 2006 decreased 9% from $4.2 million to $3.9 million in the first six months of fiscal 2005. During the first six months of fiscal 2006, we recorded $4.7 million of pre-tax charges, or $3.2 million of after-tax charges related to the closure of the business. These charges included $623,000 for severance expenses, a $668,000 write-down of inventory that was scrapped, a $289,000 fixed asset and patent impairment and a $3.1 million charge for an accrual relating to the remaining lease contract obligation for the Sunnyvale facility. During the six months ended December 25, 2006, our silicon microwave business generated $4.3 million in revenue from last time buy orders that produced a $1.0 million pre-tax loss, or $700,000 after-tax from operations. The net loss from discontinued operations also included pre-tax stock compensation expense of $202,000 for the six months ended December 25, 2005. In the first six months of fiscal 2005, our silicon microwave business generated a pre-tax operating loss of $6.3 million, or $4.2 million after-tax, as we produced revenue of $2.9 million offset by heavy fixed costs incurred to operate the Sunnyvale facility.

Liquidity and Capital Resources

Our strong cash generating capability and financial condition gives us the ability to grow our business. Our principal source of liquidity is operating cash flows, which is derived from net income. This cash generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating, financing and investing needs.

Operating Activities:

In the first six months of fiscal 2006, our operations provided $87.7 million of cash as compared to $92.6 million of cash provided in the first six months of fiscal 2005. This $4.9 million decrease was primarily due to a reduction in the amount of working capital provided by operations of $11.9 million and a decrease in net income of $10.0 million being partly offset by increased non-cash expenses which include, higher depreciation and amortization of property, equipment and patents of $3.8 million, a $3.8 million charge for the impairment of long-lived assets due to the closure of our silicon microwave business, and a $6.3 million expense for stock based compensation expense as a result of adopting the provisions of SFAS 123R.

During the first six months of fiscal 2006, we used $1.0 million for servicing our working capital mostly due to higher accounts receivable, which was partly offset by lower inventory, prepaid expense and other current assets and higher accrued expenses. As of December 25, 2005, our inventory remained below our industry average at 46 days on hand. The decrease in inventory is primarily due to higher sales and our continued efforts to manage inventory levels. We normally target our accounts receivable balances to average between 45 and 60 days outstanding. However, due to focused collections, our days sales outstanding was 37 days and 32 days for the periods ended December 25, 2005 and June 26, 2005, respectively, based on our monthly revenue profile calculation. Additionally, our accounts payable and accrued expenses increased by $1.7 million during the first six months of fiscal 2006 primarily due to the timing of payments made to vendors.

Investing Activities:

In the first six months of fiscal 2006, we used $100.1 million for investing activities. The majority of this was attributable to $111.6 million used for the purchase of investments held to maturity and $33.8 million in property and equipment and patent and licensing rights. The majority of the increase was related to the $44.0 million reinvestment of operating cash in marketable investments to optimize investment yield and the addition of new equipment to increase manufacturing capacity in our manufacturing facilities.

Financing Activities:

In the first six months of fiscal 2006, we generated $8.5 million from financing activities. The entire amount represents proceeds that were received from the exercise of stock options.

As of December 25, 2005, there remained approximately 5.5 million shares of our common stock approved for repurchase under a repurchase program authorized by the Board of Directors that extends through June 2006. Since the inception of our stock repurchase programs in January 2001, we have repurchased 6.6 million shares of our common stock at an average price of $18.28 per share, with an aggregate value of $121.0 million. We intend to use available cash to purchase additional shares under the program. At the discretion of our management, the repurchase program can be implemented through open market or privately negotiated transactions. We will determine the time and extent of repurchases based on our evaluation of market conditions and other factors.

Fiscal 2006 Outlook:

We plan to meet the cash needs for the business for fiscal 2006 through cash from operations and cash on hand. We also target to meet long-term cash needs with cash flow from operations or cash on hand over the next two fiscal years. Actual results may differ from our targets for a number of reasons addressed in this report. We may also issue additional shares of common stock or use available cash on hand for the acquisition of complementary businesses or other significant assets. From time to time, we evaluate strategic opportunities and potential investments in complementary businesses and anticipate continuing to make such evaluations. As a result of our closure of the Cree Microwave-Sunnyvale facility, we anticipate that we will continue to make operating lease payments on the Sunnyvale facility through November 2011. Unless we successfully negotiate a buy out of our existing lease or sublease the facility in Sunnyvale, California we may incur cash out flows of approximately $6.3 million over the next six years to satisfy our obligation. During the second quarter of fiscal 2006, we recorded a $3.1 million charge related to an accrual for lease commitments on the Sunnyvale facility. This liability represents the fair value of the remaining lease liability based on an estimate of the present value of the remaining lease rentals reduced by an estimate of sublease rental income that may be obtained for the property through the expiration of the lease term. The expenses related to the Cree Microwave-Sunnyvale facility will continue to be presented as discontinued operations in the Company’s consolidated financial statements.

As of December 25, 2005, our cash and cash equivalents and short-term investments combined increased $69.6 million, or 40%, over balances reported as of June 25, 2005. Our long-term investments held to maturity decreased by $8.5 million, or 8%, over balances reported as of June 25, 2005. The net $61.1 million increase to cash and investments resulted from profits in the first six months of fiscal 2006. Our net property and equipment has decreased by $5.1 million or 1% since June 25, 2005 as depreciation expense more than offset investments made to expand production capacity. During the first six months of fiscal 2006, we spent $31.7 million on capital additions. We target capital spending in fiscal 2006 to be in a range of $90.0 million to $110.0 million. These investments are intended to aid us in meeting current and what we view as increasing future customer product demands on a cost-effective basis. We target that these investments in additional equipment will allow us to meet increased demand for our products and thus may lead to higher revenue for us. The increased property investment will also result in higher depreciation expense. We currently have no debt outstanding or off-balance sheet obligations, commitments or contingencies or guarantees and we do not use special purpose entities for any transactions.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of December 25, 2005, we held a long-term investment in the equity of Color Kinetics, which is treated for accounting purposes under Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (“SFAS 115”) as an available-for-sale security. This investment is carried at fair market value based upon the quoted market price of that investment as of December 25, 2005, with net unrealized gains or losses excluded from earnings and reported as a separate component of shareholders’ equity.

It is our policy to write down these types of equity investments to their market value and record the related write-down as an investment loss on our consolidated statements of operations if we believe that an other-than-temporary decline existed in our marketable equity securities. As of December 25, 2005, we do not believe that an other-than-temporary decline existed in our investment in Color Kinetics as the market value of the security was above our cost. This investment is subject to market risk of equity price changes. The fair market value of this investment as of December 25, 2005, using the closing sale price as of December 23, 2005, was $26.7 million, compared to the fair market value as of June 26, 2005, using the closing sale price as of June 24, 2005, which was $20.9 million.

As of December 25, 2005, we held warrants to purchase the capital stock of a private company valued at $37,000. We hold and expect to continue to consider investments in minority interests in companies having operations or technology in areas within our strategic focus. Many of our investments are in early stage companies or technology companies where operations are not yet sufficient to establish them as profitable concerns. One of our investments is in a publicly traded company whose share prices are subject to market risk. Management continues to evaluate its investment positions on an ongoing basis. See the footnote, “Investments,” in the consolidated financial statements included in Part 1 Item 1 of this report for further information on our policies regarding investments in private and public companies.

We have invested some of the proceeds from our cash from operations into high-grade corporate debt, commercial paper, government securities and other investments at fixed interest rates that vary by security. These investments are A grade or better in accordance with our cash management policy. At December 25, 2005, we had $271.2 million invested in these securities, compared to $206.3 million at June 26, 2005. Although these securities generally earn interest at fixed rates, the historical fair values of such investments have not differed materially from the amounts reported on our consolidated balance sheets. Therefore, we believe that potential changes in future interest rates will not create material exposure for us from differences between the fair values and the amortized cost of these investments. We generally are not subject to material market risk with respect to our investments classified as marketable securities as such investments are readily marketable, liquid and do not fluctuate substantially from stated values. The potential loss in fair value resulting from a hypothetical 10% decrease in quoted market price was approximately $27.1 million at December 25, 2005.

Under certain of our customer agreements, foreign currency exchange rates can affect our sales price. These contracts represent our main risk with respect to foreign currency. We have no commodity risk.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act as of the end of the period covered by this Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Form 10-Q, our disclosure controls and procedures are effective in that they provide reasonable assurances that the information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required by the United States Securities and Exchange Commission's rules and forms. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate.

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. There have been no changes to our internal control over financial reporting as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act during the second quarter of fiscal 2006 that we believe materially affected, or will be reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

During the three months ended December 25, 2005, there were no material developments in the legal proceedings previously reported in our Annual Report on Form 10-K for the fiscal year ended June 26, 2005 and our Quarterly Report on Form 10-Q for the quarterly period ended September 25, 2005. Please refer to Part I, Item 3 of the Annual Report on Form 10-K for the fiscal year ended June 26, 2005 and Part II, Item 1 of the Quarterly Report on Form 10-Q for the quarterly period ended September 25, 2005 respectively, for a description of our material legal proceedings.

Item 1A. Risk Factors

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

Our operating results and margins may fluctuate significantly.

Although we experienced significant revenue and earnings growth in the past year, we may not be able to sustain such growth or maintain our margins, and we may experience significant fluctuations in our revenue, earnings and margins in the future. Historically, the prices of our LEDs have declined based on market trends. We attempt to maintain our margins by constantly developing improved or new products, which provide greater value and result in higher prices, or by lowering the cost of our LEDs. If we are unable to do so, our margins will decline. Our operating results and margins may vary significantly in the future due to many factors, including the following:

- our ability to develop, manufacture and deliver products in a timely and cost-effective manner;
- variations in the amount of usable product produced during manufacturing (our "yield");
- our ability to improve yields and reduce costs in order to allow lower product pricing without margin reductions;
- our ability to ramp up our subcontractor in Asia;
- our ability to ramp up production for our new products;
- our ability to convert our substrates used in our volume manufacturing to larger diameters;
- our ability to produce higher brightness and more efficient LED products that satisfy customer design requirements;
- our ability to develop new products to specifications that meet the evolving needs of our customers;
- changes in demand for our products and our customers' products;
- effects of an economic slow down on consumer spending on such items as cell phones, electronic devices and automobiles;
- changes in the competitive landscape, such as availability of higher brightness LED products, higher volume production and lower pricing from Asian competitors;
- average sales prices for our products declining at a greater rate than anticipated;
- changes in the mix of products we sell, which may vary significantly;
- other companies' inventions of new technology that may make our products obsolete;
- product returns or exchanges that could impact our short-term results;
- changes in purchase commitments permitted under our contracts with large customers;
- changes in production capacity and variations in the utilization of that capacity;
- disruptions of manufacturing that could result from damage to our manufacturing facilities from causes such as fire, flood or other casualties, particularly in the case of our single site for SiC wafer and LED production;
- changes in accounting rules, such as recording expenses for stock option grants;

- our policy to fully reserve for all accounts receivable balances that are more than 90 days past due, which could impact our short-term results; and
- changes in Federal budget priorities could adversely affect our contract revenue.

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

If we are unable to produce and sell adequate quantities of our LED products and improve our yields, our operating results may suffer.

We believe that our ability to gain customer acceptance of our products and to achieve higher volume production and lower production costs for those products will be important to our future operating results. We must reduce costs of these products to avoid margin reductions from the lower selling prices we may offer due to our competitive environment and/or to satisfy prior contractual commitments. Achieving greater volumes and lower costs requires improved production yields for these products. We may encounter manufacturing difficulties as we ramp up our capacity to make our newest high brightness products. Our failure to produce adequate quantities and improve the yields of any of these products could have a material adverse effect on our business, results of operations and financial condition.

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

Our future success will depend on our ability to develop new SiC and GaN solutions for existing and new markets. We must introduce new products in a timely and cost-effective manner, and we must secure production orders from our customers. The development of new SiC and GaN products is a highly complex process, and we historically have experienced delays in completing the development and introduction of new products. Products currently under development include larger, higher quality substrates and epitaxy, wide bandgap RF and microwave products based on SiC and GaN, SiC power devices, near UV laser diodes, higher brightness LED products and high power packaged LEDs. The successful development and introduction of these products depends on a number of factors, including the following:

- achievement of technology breakthroughs required to make commercially viable devices;
- the accuracy of our predictions of market requirements and evolving standards;
- acceptance of our new product designs;
- acceptance of new technology in certain markets;
- the availability of qualified development personnel;
- our timely completion of product designs and development;
- our ability to develop repeatable processes to manufacture new products in sufficient quantities for commercial sales;
- our customers' ability to develop applications incorporating our products; and
- acceptance of our customers' products by the market.

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

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

We are in the process of taking steps to address our manufacturing capacity needs in order to meet current and future customer demand. If we are not able to increase our capacity or if we increase our capacity too quickly, our business and results from operations could be adversely impacted. For example, we are currently expanding our manufacturing capacity, including the build out of the fabrication facility in Research Triangle Park, North Carolina, that we acquired from a third party in the third quarter of fiscal 2005. If our expansion initiative is delayed, costs more than we anticipate or requires long transition or qualification periods, our business and financial results could be harmed. If our business does not grow fast enough to use this new capacity, our financial results could decline. We are also expanding capacity for our XLamp products and qualifying a subcontractor. If there are delays or unforeseen costs associated with this expansion, we may not be able to achieve our financial targets.

Our LED revenues are highly dependent on our customers' ability to produce competitive white LED products using our LED chips.

Some of our customers package our blue LEDs in combination with phosphors to create white LEDs. Growth in sales of our high-brightness LED chips used in white light applications is dependent upon our customers' ability to develop efficient white LED products using our chips. Nichia Corporation, or Nichia, currently has the majority of the market share for white LEDs and other companies, such as Toyoda Gosei Co. Ltd., have started to offer competitive blue chips and white products to compete with Nichia. The package design that our customers have used in their products generally has not been as efficient as the design that Nichia has used in its products. As a result, the white LEDs that our customers produce with our chips historically have not been as bright as Nichia's white LEDs. Even if our customers are able to develop more competitive white LED products, there can be no assurance that they will be able to compete with Nichia, which has an established market presence.

We are highly dependent on trends in mobile products to drive a substantial percentage of LED demand.

Our results of operations could be adversely affected if we experience reduced customer demand for LED products for use in mobile products. For the first half of fiscal 2006, we derived approximately one-half of our LED revenue from sales of our products into mobile products. Our design wins are spread over numerous models and customers. Our ability to maintain or increase our LED product revenue depends in part on the number of models into which our customers design our products and the overall demand for these products, which is impacted by seasonal fluctuations and market trends. Design cycles in the handset industry are short and demand is volatile, which makes production planning difficult to forecast. Brightness performance, smaller size and price considerations are important factors in increasing our market share for mobile products.

If we experience poor production yields, our margins could decline and our operating results may suffer.

Our materials products and our LED, power and RF device products are manufactured using technologies that are highly complex. We manufacture our SiC wafer products from bulk SiC crystals, and we use these SiC wafers to manufacture our LED products and our SiC-based RF and power semiconductors. During our manufacturing process, each wafer is processed to contain numerous die, which are the individual semiconductor devices. The RF and power devices and XLamp products then are further processed by incorporating them into packages for sale as packaged components. The number of usable crystals, wafers, dies and packaged components that result from our production processes can fluctuate as a result of many factors, including but not limited to the following:

- variability in our process repeatability and control;
- impurities in the materials used;
- contamination of the manufacturing environment;
- equipment failure, power outages or variations in the manufacturing process;
- lack of adequate quality and quantity of piece parts and other raw materials;
- losses from broken wafers or human errors; and
- defects in packaging either within our control or at our subcontractors.

We refer to the proportion of usable product produced at each manufacturing step relative to the gross number that could be constructed from the materials used as our manufacturing yield.

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

We depend on a few large customers, and our revenues can be affected by their contract terms.

Historically, a substantial portion of our revenue has come from large purchases by a small number of customers. Accordingly, our future operating results depend on the success of our largest customers and on our success in selling large quantities of our products to them. The concentration of our revenues with a few large customers makes us particularly susceptible to factors affecting those customers. For example, if demand for their products decreases, they may limit or stop purchasing our products and our operating results could suffer. For example, Sumitomo's inventory of our products can vary materially each quarter based on fluctuations in their customer demand. The Sumitomo contract provides that Sumitomo may decrease its purchase commitment or terminate the contract if its inventory of our products reaches a specified level. In general, the success of our relationships with our customers is subject to a number of factors, including the dynamics of the overall market. For example, if some of our competitors were to license technology or form alliances with other parties, our business may be impacted.

Our traditional LED chip customers may reduce orders as a result of our entry into the packaged LED markets.

We began shipping packaged LED devices in fiscal 2005. Some of our customers may reduce their orders for our chips as a result of us competing with them in the packaged LED business. This reduction in orders could occur faster than our packaged LED business can grow in the near term. This could reduce our overall revenue and profitability.

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

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

We expect competition to increase. In order to achieve our revenue growth objectives in fiscal 2006, we need to continue to develop new products that enable our customers to win new designs and increase market share in key applications such as mobile products. One major supplier dominates this market and we anticipate that the competition for these designs will be intense and may result in lower sales prices of our products. Therefore, our ability to provide higher performance LEDs at lower costs will be critical to our success. Competitors may also try to align with some of our strategic customers. This could mean lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Competitors also could invent new technologies that may make our products obsolete. Any of these developments could have an adverse effect on our business, results of operations and financial condition.

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

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

- pay substantial damages;
- indemnify our customers;
- stop the manufacture, use and sale of products found to be infringing;
- discontinue the use of processes found to be infringing;
- expend significant resources to develop non-infringing products and processes; and/or
- obtain a license to use third party technology.

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

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

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

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

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

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

We face significant challenges managing our growth.

We have experienced a period of significant growth that has challenged our management and other resources. We have grown from 680 employees on June 25, 2000 to 1,332 employees on June 26, 2005 and from revenues of $108.6 million for the fiscal year ended June 25, 2000 to $389.1 million for the fiscal year ended June 26, 2005. To manage our growth effectively, we must continue to:

- implement and improve operating systems;
- maintain adequate manufacturing facilities and equipment to meet customer demand;
- maintain a sufficient supply of raw materials to support our growth;
- improve the skills and capabilities of our current management team;
- add experienced senior level managers;
- attract and retain qualified people with experience in engineering, design and technical marketing support; and
- recruit and retain qualified manufacturing employees.

We will spend substantial amounts of money in supporting our growth and may have additional unexpected costs. We may not be able to expand quickly enough to exploit potential market opportunities. Our future operating results will also depend on expanding sales and marketing, research and development and administrative support. If we cannot attract qualified people or manage growth effectively, our business, operating results and financial condition could be adversely affected. For example, we are currently trying to build a worldwide team of sales, marketing and development and application support employees for our LED and high-power businesses. If we are not successful in recruiting personnel, our actual growth may be lower than our forecasts. Conversely, if the product demand from our customers does not expand as we anticipate, our margins may decrease in part due to higher costs associated with the greater capacity that has been added recently which would not be used.

Performance of our investments in other companies could affect our financial results.

From time to time, we have made investments in public and private companies that engage in complementary businesses. Should the value of any such investments we hold decline, the related write-down in value could have a material adverse effect on our financial results as reflected in our consolidated balance sheets. In addition, if the decline in value is determined to be other-than-temporary, the related write-down could have an adverse effect on our reported net income. We currently hold an interest in one public company. We do not currently hold any interests in private companies that have a net carrying value other than a $37,000 value relating to certain warrants held in a private company.

An investment in another company is subject to the risks inherent in the business of the company in which we have invested and to trends affecting the equity markets as a whole. Investments in private companies are subject to additional risks relating to the limitations on transferability of the interests due to the lack of a public market and to other transfer restrictions. Investments in publicly held companies are subject to market risks and may not be liquidated easily. As a result, we may not be able to reduce the size of our positions or liquidate our investments when we deem appropriate to limit our downside risk.

Our investments in other companies also may cause fluctuations in our earnings results. For example, during the first and second quarters of fiscal 2006, we recorded a decrease in our income tax expense related to an unrealized capital gain on the Color Kinetics investment of $2.0 million and $132,000, respectively, which we offset against a prior year tax carry forward. In future periods, we will be required to continue to adjust our deferred tax asset valuation allowance in connection with any increase or decrease in the value of our investment in Color Kinetics, which could increase or decrease our income tax expense for the period. This may cause fluctuations in our earnings results that do not accurately reflect our results from operations.

If delays occur in bringing the RTP facility on line, our financial results could suffer.

In the third quarter of fiscal 2005, we purchased an existing wafer fabrication facility in Research Triangle Park, North Carolina. We plan to complete our build out of the RTP facility and bring capacity for the production of high-power products online in the fourth quarter of fiscal 2006. If delays are incurred, our ability to meet future demand for high power products and contract revenue targets could be impacted.

We rely on a few key suppliers.

We depend on a limited number of suppliers for certain raw materials, components, services and equipment used in manufacturing our products, including key materials and equipment used in critical stages of our manufacturing processes. We generally purchase these limited source items with purchase orders, and we have no guaranteed supply arrangements with such suppliers. If we were to lose key suppliers or suppliers are unable to support our demand, our manufacturing operations could be interrupted or hampered significantly.

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

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

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

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

- lose revenue;
- incur increased costs, such as warranty expense and costs associated with customer support;
- experience delays, cancellations or rescheduling of orders for our products;
- write down existing inventory; or
- experience product returns.

We are subject to risks from international sales.

Sales to customers located outside the U.S. accounted for approximately 87%, 83% and 80% of our revenue in fiscal 2005, 2004 and 2003, respectively. We expect that revenue from international sales will continue to be the majority of our total revenue. International sales are subject to a variety of risks, including risks arising from currency fluctuations, trading restrictions, tariffs, trade barriers and taxes. Also, U.S. Government export controls could restrict or prohibit the exportation of products with defense applications. Because all of our foreign sales are denominated in U.S. dollars, our sales are subject to variability as prices become less competitive in countries with currencies that are low or are declining in value against the U.S. dollar and more competitive in countries with currencies that are high or increasing in value against the U.S. dollar.

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

From time to time we evaluate strategic opportunities available to us for product, technology or business acquisitions. For example, in fiscal 2004 we acquired the gallium nitride substrate and epitaxy business of ATMI, Inc. If we choose to make an acquisition, we face certain risks, such as failure of the acquired business in meeting our performance expectations, diversion of management attention, retention of existing customers of the acquired business and difficulty in integrating the acquired business’s operations, personnel and financial and operating systems into our current business. We may not be able to successfully address these risks or any other problems that arise from our recent or future acquisitions. Any failure to successfully evaluate strategic opportunities and address risks or other problems that arise related to any acquisition could adversely affect our business, results of operations and financial condition.

If we are unable to attract and hire a new Chief Financial Officer or if the search process takes longer than expected, our business could suffer.

We are actively seeking a new Chief Financial Officer in response to the August 2005 announcement that Cynthia B. Merrell, our current Chief Financial Officer, is resigning. Ms. Merrell has agreed to continue her service as Chief Financial Officer until we secure a qualified successor but not later than May 5, 2006. There is intense competition for qualified senior management, particularly those with the financial expertise needed for this position. If we are unable to attract and hire a new Chief Financial Officer in a timely manner, our business could suffer from the uncertainty caused by the continued management search process.

Litigation could adversely affect our operating results and financial condition.

We are defendants in pending litigation (as described in “Part II, Item 1. Legal Proceedings” of our quarterly report on Form 10-Q for the quarterly period ended September 25, 2005 and “Part II, Item 3. Legal Proceedings” of our annual report on Form 10-K for the fiscal year ended June 26, 2005) that alleges, among other things, violations of securities laws and patent infringement. Defending against existing and potential litigation will likely require significant attention and resources and, regardless of the outcome, result in significant legal expenses, which will adversely affect our results unless covered by insurance or recovered from third parties. If our defenses are ultimately unsuccessful, or if we are unable to achieve a favorable resolution, we could be liable for damage awards that could materially adversely affect our results of operations and financial condition.

Compliance with changing regulation of corporate governance and public disclosure may result in additional risks and expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002 and new regulations from the Securities and Exchange Commission, are creating uncertainty for public companies such as ours. These laws, regulations and standards are subject to varying interpretations in many cases, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We are committed to maintaining high standards of corporate governance and public disclosure. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased sales, general and administrative expenses and a diversion of management time and attention. In particular, our compliance with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal control over financial reporting and our independent accountants’ audit of that assessment have required, and we expect such efforts to continue to require, the commitment of significant financial and managerial resources. We cannot assure that we will not discover a material weakness or significant deficiency in our internal control over financial reporting. If we discover a material weakness or significant deficiency, corrective action may be time-consuming, costly and further divert the attention of management. The disclosure of a material weakness or significant deficiency may cause our stock price to fluctuate significantly.

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

Our Annual Meeting of Shareholders was held on November 3, 2005. The following matters were submitted to a vote of the shareholders with the results shown below:

(a) Election of six directors, each elected to serve until the later of the next Annual Meeting of Shareholders or until such time as his successor has been duly elected and qualified.

Name	Votes For	Votes Withheld
Charles M. Swoboda	62,028,416	5,541,591
John W. Palmour, Ph. D.	62,077,136	5,492,871
Dolph W. von Arx	61,921,989	5,648,018
James E. Dykes	60,153,479	7,416,528
Robert J. Potter, Ph. D	60,164,968	7,405,039
Harvey A. Wagner	61,986,086	5,583,921

(b) Approval of the adoption of the 2005 Employee Stock Purchase Plan which replaces our 1999 Employee Stock Purchase Plan.

Votes For	Votes Against	Abstained
31,376,536	9,155,079	238,856

(c) Approval of the amendments to the 2004 Long-Term Incentive Compensation Plan.

Votes For	Votes Against	Abstained
29,359,001	11,053,508	357,961

(d) Ratification of the appointment of Ernst & Young LLP as independent auditors for the fiscal year ended June 25, 2006.

Votes For	Votes Against	Abstained
66,439,098	1,031,959	98,949

The matters listed above are described in detail in our definitive proxy statement dated September 26, 2005 for the Annual Meeting of Shareholders held on November 3, 2005.

Item 6. Exhibits

The following exhibits are being filed herewith and are numbered in accordance with Item 601 of Regulation S-K:

10.1 Director's Deferred Compensation Plan, as amended

10.2 Trust Agreement between the Company and Fidelity Management Trust Company, as amended, effective as of February 1, 2006

10.3 2004 Long-Term Incentive Compensation Plan, as amended (incorporated by reference to Exhibit 10.1 to the Company's Current Report filed on Form 8-K with the Securities and Exchange Commission on November 8, 2005)

10.4 Amendment dated January 18, 2006, to Letter Agreement, dated August 10, 2005, between Cynthia B. Merrell and the Company (incorporated by reference to Exhibit 10.1 to the Company's Current Report filed on Form 8-K with the Securities and Exchange Commission on January 18, 2006).

31.1 Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURE

Pursuant to the requirements 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.

CREE, INC.

Date: January 31, 2006

/s/ Cynthia B. Merrell
Cynthia B. Merrell
Chief Financial Officer and
Treasurer
(Authorized Officer and Chief
Financial and Accounting Officer)

EXHIBIT INDEX

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The CORPORATE*plan for Retirement*SM
EXECUTIVE PLAN

<u>BASIC PLAN DOCUMENT</u>

IMPORTANT NOTE

This document has not been approved by the Department of Labor, the Internal Revenue Service or any other governmental entity. An Adopting Employer must determine whether the plan is subject to the Federal securities laws and the securities laws of the various states. An Adopting Employer may not rely on this document to ensure any particular tax consequences or to ensure that the Plan is "unfunded and maintained primarily for the purpose of providing deferred compensation to a select group of management or highly compensated employees" under the Employee Retirement Income Security Act with respect to the Employers particular situation. Fidelity Management Trust Company, its affiliates and employees cannot provide you with legal advice in connection with the execution of this document. This document should be reviewed by the Employer's attorney prior to execution.

CORPORATEplan for EXECUTIVE
BASIC PLAN DOCUMENT

PREAMBLE

It is the intention of the Employer to establish herein an unfunded plan maintained solely for the purpose of providing deferred compensation for a select group of management or highly compensated employees as provided in ERISA.

Article 1. Adoption Agreement.

Article 2. Definitions.

2.01. Definitions.

(a) Wherever used herein, the following terms have the meanings set forth below, unless a different meaning is clearly required by the context:

(1) "Account" means an account established on the books of the Employer for the purpose of recording amounts credited on behalf of a Participant and any income, expenses, gains or losses included thereon.

(2) "Administrator" means the Employer adopting this Plan, or other person designated by the Employer in Section 1.01(b).

(3) "Adoption Agreement" means Article 1, under which the Employer establishes and adopts or amends the Plan and designates the optional provisions selected by the Employer. The provisions of the Adoption Agreement shall be an integral part of the Plan.

(4) "Beneficiary" means the person or persons entitled under Section 7.02 to receive benefits under the Plan upon the death of a Participant.

(5) "Bonus" means any performance-based Compensation based on services performed for the Employer over a period of at least 12 months.

(6) "Change of Control" means a change in the ownership or effective control of the Employer, or a substantial portion of the Employer's assets as defined in the regulations under Code Section 409A.

(7) "Code" means the Internal Revenue Code of 1986, as amended from time to time.

(8) “Compensation” means for purposes of Article 4 (Contributions) wages as defined in Section 3401(a) of the Code and all other payments of compensation to an employee by the Employer (in the course of the Employer’s trade or business) for which the Employer is required to furnish the employee a written statement under Section 6041(d) and 6051(a)(3) of the Code, excluding any items elected by the Employer in Section 1.04, reimbursements or other expense allowances, fringe benefits (cash and non-cash), moving expenses, deferred compensation and welfare benefits, but including amounts that are not includable in the gross income of the Participant under a salary reduction agreement by reason of the application of Sections 125, 132(f)(4), 402(e)(3), 402(h) or 403(b) of the Code. Compensation shall be determined without regard to any rules under Section 3401(a) of the Code that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in Section 3401(a)(2) of the Code).

Compensation shall also include amounts deferred pursuant to an election under Section 4.01.

In the case of any Self-Employed Individual or an Owner-Employee, Compensation means the Self-Employed Individual’s Earned income.

(9) “Earned Income” means the net earnings of a Self-Employed Individual derived from the trade or business with respect to which the Plan is established and for which the personal services of such individual are a material income-providing factor, excluding any items not included in gross income and the deductions allocated to such items, except that for taxable years beginning after December 31, 1989 net earnings shall be determined with regard to the deduction allowed under Section 164(f) of the Code, to the extent applicable to the Employer. Net earnings shall be reduced by contributions of the Employer to any qualified plan, to the extent a deduction is allowed to the Employer for such contributions under Section 404 of the Code.

(10) “Employee” means any employee of the Employer, Self-Employed Individual or Owner-Employee.

(11) “Employer” means the employer named in Section 1.02(a) and any Related Employers designated in Section 1.02(b).

(12) “Employment Commencement Date” means the date on which the Employee first performs an Hour of Service.

(13) “Entry Date” means the date(s) designated in Section 1.03(b).

(14) “ERISA” means the Employee Retirement Income Security Act of 1974, as from time to time amended.

(15) “Fund Share” means the share, unit, or other evidence of ownership in a Permissible Investment.

(16) “Hour of Service” means, with respect to any Employee,

(A) Each hour for which the Employee is directly or indirectly paid, or entitled to payment, for the performance of duties for the Employer or a Related Employer, each such hour to be credited to the Employee for the computation period in which the duties were performed;

(B) Each hour for which the Employee is directly or indirectly paid, or entitled to payment, by the Employer or Related Employer (including payments made or due from a trust fund or insurer to which the Employer contributes or pays premiums) on account of a period of time during which no duties are performed (irrespective of whether the employment relationship has terminated) due to vacation, holiday, illness, incapacity, disability, layoff, jury duty, military duty, or leave of absence, each such hour to be credited to the Employee for the Eligibility Computation Period in which such period of time occurs, subject to the following rules:

(i) No more than 501 Hours of Service shall be credited under this paragraph (B) on account of any single continuous period during which the Employee performs no duties;

(ii) Hours of Service shall not be credited under this paragraph (B) for a payment which solely reimburses the Employee for medically-related expenses, or which is made or due under a plan maintained solely for the purpose of complying with applicable workmen’s compensation, unemployment compensation or disability insurance laws; and

(iii) If the period during which the Employee performs no duties falls within two or more computation periods and if the payment made on account of such period is not calculated on the basis of units of time, the Hours of Service credited with respect to such period shall be allocated between not more than the first two such computation periods on any reasonable basis consistently applied with respect to similarly situated Employees; and

(C) Each hour not counted under paragraph (A) or (B) for which back pay, irrespective of mitigation of damages, has been either awarded or agreed to be paid by the Employer or a Related Employer, each such hour to be credited to the Employee for the computation period to which the award or agreement pertains rather than the computation period in which the award agreement or payment is made.

For purposes of determining Hours of Service, Employees of the Employer and of all Related Employers will be treated as employed by a single employer. For purposes of paragraphs (B) and (C) above, Hours of Service will be calculated in accordance with the provisions of Section 2530.200b-2(b) of the Department of Labor regulations, which are incorporated herein by reference.

Solely for purposes of determining whether a break in service for participation purposes has occurred in a computation period, an individual who is absent from work for maternity or paternity reasons shall receive credit for the hours of service which would otherwise been credited to such individual but for such absence, or in any case in which such hours cannot be determined, 8 hours of service per day of such absence. For purposes of this paragraph, an absence from work for maternity reasons means an absence (1) by reason of the pregnancy of the individual, (2) by reason of a birth of a child of the individual, (3) by reason of the placement of a child with the individual in connection with the adoption of such child by such individual, or (4) for purposes of caring for such child for a period beginning immediately following such birth or placement. The hours of service credited under this paragraph shall be credited (1) in the computation period in which the absence begins if the crediting is necessary to prevent a break in service in that period, or (2) in all other cases, in the following computation period.

(17) "Key Employee" means a Participant who is key employee pursuant to Code Section 416(i), without regard to paragraph (5) thereof. A Participant will not be considered a Key Employee unless the Employer is a corporation which has any of its stock publicly traded according to Code Section 409A and regulations thereunder.

(18) "Normal Retirement Age" means the normal retirement age specified in Section 1.07(f) of the Adoption Agreement.

(19) "Owner-Employee" means, if the Employer is a sole proprietorship, the individual who is the sole proprietor, or, if the Employer is a partnership, a partner who owns more than 10 percent of either the capital interest or the profits interest of the partnership.

(20) "Participant" means any Employee who participates in the Plan in accordance with Article 3 hereof.

(21) "Permissible Investment" means the investments specified by the Employer as available for investment of assets of the Trust and agreed to by the Trustee. The Permissible Investments under the Plan shall be listed in the Service Agreement.

(22) “Plan’’ means the plan established by the Employer as set forth herein as a new plan or as an amendment to an existing plan, by executing the Adoption Agreement, together with any and all amendments hereto.

(23) “Plan Year” means the 12-consecutive-month period designated by the Employer in Section 1.01(c).

(24) “Related Employer” means any employer other than the Employer named in Section 1.02(a), if the Employer and such other employer are members of a controlled group of corporations (as defined in Section 414(b) of the Code) or an affiliated service group (as defined in Section 414(m)), or are trades or businesses (whether or not incorporated) which are under common control (as defined in Section 414(c)), or such other employer is required to be aggregated with the Employer pursuant to regulations issued under Section 414(o).

(25) “Self-Employed Individual” means an individual who has Earned Income for the taxable year from the Employer or who would have had Earned Income but for the fact that the trade or business had no net profits for the taxable year.

(26) “Service Agreement” means the agreement between the Employer and Trustee regarding the arrangement between the parties for recordkeeping services with respect to the Plan.

(27) “Trust” means the trust created by the Employer.

(28) “Trust Agreement” means the agreement between the Employer and the Trustee, as set forth in a separate agreement, under which assets are held, administered, and managed subject to the claims of the Employer’s creditors in the event of the Employer’s insolvency, until paid to Plan Participants and their Beneficiaries as specified in the Plan.

(29) “Trust Fund” means the property held in the Trust by the Trustee.

(30) “Trustee” means the corporation or individual(s) appointed by the Employer to administer the Trust in accordance with the Trust Agreement.

(31) “Years of Service for Vesting” means, with respect to any Employee, the number of whole years of his periods of service with the Employer or a Related Employer (the elapsed time method to compute vesting service), subject to any exclusions elected by the Employer in Section 1.07(c). An Employee will receive credit for the aggregate of all time period(s) commencing with the Employee’s Employment Commencement Date and ending on the date a break in service begins, unless any such years are excluded by Section 1.07(c). An Employee will also receive credit for any period of severance of less than 12 consecutive months. Fractional periods of a year will be expressed in terms of days.

In the case of a Participant who has 5 consecutive 1-year breaks in service, all years of service after such breaks in service will be disregarded for the purpose of vesting the Employer-derived account balance that accrued before such breaks, but both pre-break and post-break service will count for the purposes of vesting the Employer-derived account balance that accrues after such breaks. Both accounts will share in the earnings and losses of the fund.

In the case of a Participant who does not have 5 consecutive 1-year breaks in service, both the pre-break and post-break service will count in vesting both the pre-break and post-break employer-derived account balance.

A break in service is a period of severance of at least 12 consecutive months. Period of severance is a continuous period of time during which the Employee is not employed by the Employer. Such period begins on the date the Employee retires, quits or is discharged, or if earlier, the 12-month anniversary of the date on which the Employee was otherwise first absent from service.

In the case of an individual who is absent from work for maternity or paternity reasons, the 12-consecutive month period beginning on the first anniversary of the first date of such absence shall not constitute a break in service. For purposes of this paragraph, an absence from work for maternity or paternity reasons means an absence (1) by reason of the pregnancy of the individual, (2) by reason of the birth of a child of the individual, (3) by reason of the placement of a child with the individual in connection with the adoption of such child by such individual, or (4) for purposes of caring for such child for a period beginning immediately following such birth or placement.

If the Plan maintained by the Employer is the plan of a predecessor employer, an Employee's Years of Service for Vesting shall include years of service with such predecessor employer. In any case in which the Plan maintained by the Employer is not the plan maintained by a predecessor employer, service for such predecessor shall be treated as service for the Employer to the extent provided in Section 1.08.

(b) Pronouns used in the Plan are in the masculine gender but include the feminine gender unless the context clearly indicates otherwise.

Article 3. Participation.

3.01. Date of Participation. An eligible Employee (as set forth in Section 1.03(a)) who has filed an election pursuant to Section 4.01 will become a Participant in the Plan on the first Entry Date coincident with or following the date on which such election would otherwise become effective, as determined under Section 4.01.

3.02. Resumption of Participation Following Reemployment. If a Participant ceases to be an Employee and thereafter returns to the employ of the Employer he will again become a Participant as of an Entry Date following the date on which he completes an Hour of Service for the Employer following his re employment, if he is an eligible Employee as defined in Section 1.03(a), and has filed an election pursuant to Section 4.01.

3.03. Cessation or Resumption of Participation Following a Change in Status. If any Participant continues in the employ of the Employer or Related Employer but ceases to be an eligible Employee as defined in Section 1.03(a), the individual shall continue to be a Participant until the entire amount of his benefit is distributed; however, the individual shall not be entitled to make Deferral Contributions or receive an allocation of Matching or Employer Contributions during the period that he is not an eligible Employee. Such Participant shall continue to receive credit for service completed during the period for purposes of determining his vested interest in his Accounts. In the event that the individual subsequently again becomes an eligible Employee, the individual shall resume full participation in accordance with Section 3.01.

Article 4. Contributions.

4.01. Deferral Contributions. Each Participant may elect to execute a salary reduction agreement with the Employer to reduce his Compensation by a specified percentage, not exceeding the percentage set forth in Section l.05(a) and equal to a whole number multiple of one (1) percent, per payroll period, subject to any election regarding Bonuses, as set out in Subsection 1.05(a)(2). Such agreement shall become effective on the first day of the period as set forth in the Participant's election. The election will be effective to defer Compensation relating to all services performed in a calendar year subsequent to the filing of such an election, subject to any election regarding Bonuses, as set out in Subsection l.05(a)(2). An election once made will remain in effect until a new election is made; provided, however that such an election choosing a distribution date pursuant to 1.06(b)(1)(B) will only be effective for the Plan Year indicated. A new election will be effective as of the first day of the following calendar year and will apply only to Compensation payable with respect to services rendered after such date, except that a separate election made pursuant to Section 1.05(a)(2) will be effective immediately if made no later than 6 months before the end of the period during which the services on which the Bonus is based are performed. If the Employer has selected 1.05(a)(2), no amount will be deducted from Bonuses unless the Participant has made a separate election. Amounts credited to a Participant's account prior to the effective date of any new election will not be affected and will be paid in accordance with that prior election. The Employer shall credit an amount to the account maintained on behalf of the Participant corresponding to the amount of said reduction. Under no circumstances may a salary reduction agreement be adopted retroactively. To the extent permitted in regulations under Code Section 409A, a Participant may revoke a salary reduction agreement for a calendar year during that year, provided, however, that such revocation shall apply only to Compensation not yet earned. In that event, the Participant shall be precluded from electing to defer future Compensation hereunder during the calendar year to which the revocation applies. Notwithstanding the above, in the calendar year in which the Plan first becomes effective or in the year in which the Participant first becomes eligible to participate, an election to defer compensation may be made within 30 days after the Participant is first eligible or the Plan is first effective, which election shall be effective with respect to Compensation payable with respect to services rendered after the date of the election.

4.02. Matching Contributions. If so provided by the Employer in Section 1.05(b), the Employer shall make a "Matching Contribution" to be credited to the account maintained on behalf of each Participant who had "Deferral Contributions" pursuant to Section 4.01 made on his behalf during the year and who meets the requirement, if any, of Section 1.05(b)(3). The amount of the "Matching Contribution" shall be determined in accordance with Section 1.05(b).

4.03. Employer Contributions. If so provided by the Employer in Section 1.05(c)(l), the Employer shall make an "Employer Contribution" to be credited to the account maintained on behalf of each Participant who meets the requirement, if any, of Section 1.05(c)(3) in the amount required by Section 1.05(c)(1). If so provided by the Employer in Section 1.05(c)(2), the Employer may make an "Employer Contribution" to be credited to the account maintained on behalf of any Participant in such an amount as the Employer, in its sole discretion, shall determine. In making "Employer Contributions" pursuant to Section l.05(c)(2), the Employer shall not be required to treat all Participants in the same manner in determining such contributions and may determine the "Employer Contribution" of any Participant to be zero.

4.04. Time of Making Contributions. The Employer shall remit contributions deemed made hereunder to the Trust as soon as practicable after such contributions are deemed made under the terms of the Plan.

Article 5. Participants' Accounts.

5.01. Individual Accounts. The Administrator will establish and maintain an Account for each Participant, which will reflect Matching, Employer and Deferral Contributions credited to the Account on behalf of the Participant and earnings, expenses, gains and losses credited thereto, and deemed investments made with amounts in the Participant's Account. The Administrator will establish and maintain such other accounts and records as it decides in its discretion to be reasonably required or appropriate in order to discharge its duties under the Plan. Participants will be furnished statements of their Account values at least once each Plan Year. The Administrator shall provide the Trustee with information on the amount credited to the separate account of each Participant maintained by the Administrator in its records.

Article 6. Investment of Contributions.

6.01. Manner of Investment. All amounts credited to the Accounts of Participants shall be treated as though invested and reinvested only in eligible investments selected by the Employer in the Service Agreement.

6.02. Investment Decisions. Investments in which the Accounts of Participants shall be treated as invested and reinvested shall be directed by the Employer or by each Participant, or both, in accordance with the Employer's election in Section 1.11(a).

(a) All dividends, interest, gains and distributions of any nature that would be earned in respect of Fund Shares in which the Account is treated as investing shall be credited to the Account as though reinvested in additional shares of that Permissible Investment.

(b) Expenses that would be attributable to the acquisition of investments shall be charged to the Account of the Participant for which such investment is treated as having been made.

Article 7. Right to Benefits.

7.01. Normal or Early Retirement. If provided by the Employer in Section 1.07(e), each Participant who attains his Normal Retirement Age or Early Retirement Age will have a nonforfeitable interest in his Account in accordance with the vesting schedule(s) elected in Section 1.07. If a Participant retires on or after attainment of Normal or Early Retirement Age, such retirement is referred to as a normal retirement. On or after his normal retirement, the balance of the Participant's Account, plus any amounts thereafter credited to his Account, subject to the provisions of Section 7.06, will be distributed to him in accordance with Article 8.

If provided by the Employer in Section 1.07, a Participant who separates from service before satisfying the age requirements for early retirement, but has satisfied the service requirement will be entitled to the distribution of his Account, subject to the provisions of Section 7.06, in accordance with Article 8, upon satisfaction of such age requirement.

7.02. Death. If a Participant dies before the distribution of his Account has commenced, or before such distribution has been completed, his Account shall become vested in accordance with the vesting schedule(s) elected in Section 1.07 and his designated Beneficiary or Beneficiaries will be entitled to receive the balance or remaining balance of his Account, plus any amounts thereafter credited to his Account, subject to the provisions of Section 7.06. Distribution to the Beneficiary or Beneficiaries will be made in accordance with Article 8. A distribution to a beneficiary of a Key Employee is not considered to be a distribution to a Key Employee for purposes of Sections 1.06 and 7.08.

A Participant may designate a Beneficiary or Beneficiaries, or change any prior designation of Beneficiary or Beneficiaries, by giving notice to the Administrator on a form designated by the Administrator. If more than one person is designated as the Beneficiary, their respective interests shall be as indicated on the designation form.

A copy of the death certificate or other sufficient documentation must be filed with and approved by the Administrator. If upon the death of the Participant there is, in the opinion of the Administrator, no designated Beneficiary for part or all of the Participant's Account, such amount will be paid to his surviving spouse or, if none, to his estate (such spouse or estate shall be deemed to be the Beneficiary for purposes of the Plan). If a Beneficiary dies after benefits to such Beneficiary have commenced, but before they have been completed, and, in the opinion of the Administrator, no person has been designated to receive such remaining benefits, then such benefits shall be paid to the deceased Beneficiary's estate.

7.03. Other Termination of Employment. If provided by the Employer in Section 1.07, if a Participant terminates his employment for any reason other than death or normal retirement, he will be entitled to a termination benefit equal to (i) the vested percentage(s) of the value of the Matching and Employer Contributions to his Account, as adjusted for income, expense, gain, or loss, such percentage(s) determined in accordance with the vesting scheduler(s) selected by the Employer in Section 1.07, and (ii) the value of the Deferral Contributions to his Account as adjusted for income, expense, gain or loss. The amount payable under this Section 7.03 will be subject to the provisions of Section 7.06 and will be distributed in accordance with Article 8. For purposes of the Plan, a termination of employment is a separation from service as defined pursuant to Code Section 409A and regulations thereunder.

7.04. Separate Account. If a distribution from a Participant's Account has been made to him at a time when he has a nonforfeitable right to less than 100 percent of his Account, the vesting schedule in Section 1.07 will thereafter apply only to amounts in his Account attributable to Matching and Employer Contributions allocated after such distribution. The balance of his Account immediately after such distribution will be transferred to a separate account that will be maintained for the purpose of determining his interest therein according to the following provisions.

At any relevant time prior to a forfeiture of any portion thereof under Section 7.05, a Participant's nonforfeitable interest in his Account held in a separate account described in the preceding paragraph will be equal to P(AB + (RxD))-(RxD), where P is the nonforfeitable percentage at the relevant time determined under Section 7.05; AB is the account balance of the separate account at the relevant time; D is the amount of the distribution; and R is the ratio of the account balance at the relevant time to the account balance after distribution. Following a forfeiture of any portion of such separate account under Section 7.05 below, any balance in the Participant's separate account will remain fully vested and nonforfeitable.

7.05. Forfeitures. If a Participant terminates his employment, any portion of his Account (including any amounts credited after his termination of employment) not payable to him under Section 7.03 will be forfeited by him.

7.06. Adjustment for Investment Experience. If any distribution under this Article 7 is not made in a single payment, the amount remaining in the Account after the distribution will be subject to adjustment until distributed to reflect the income and gain or loss on the investments in which such amount is treated as invested and any expenses properly charged under the Plan to such amounts.

7.07. Unforeseeable Emergency Withdrawals. Subject to the provisions of Article 8, a Participant shall not be permitted to withdraw his Account (and earnings thereon) prior to retirement or termination of employment, except that, to the extent permitted under Section 1.09, a Participant may apply to the Administrator to withdraw some or all of his Account if such withdrawal is made on account of an unforeseeable emergency as determined by the Administrator in accordance with the requirements of and subject to the limitations provided within Code Section 409A and regulations thereunder.

7.08. Change in Control Distributions. If the Employer has elected to apply Section 1.06(c), then, upon a Change in Control, notwithstanding any other provision of the Plan to the contrary, all Participants shall have a nonforfeitable right to receive the entire amount of their account balances under the Plan. All distributions due to a Change in Control shall be paid out to Participants as soon as administratively practicable, except that any such distribution to a Key Employee who has terminated employment pursuant to Section 7.03 shall not be earlier than the 1st day of the seventh month following that Key Employee's termination of employment.

Article 8. Distribution of Benefits.

8.01. Form of Distribution of Benefits to Participants and Beneficiaries. The Plan provides for distribution as a lump sum to be paid in cash on the date specified by the Employer in Section 1.06 pursuant to the method provided in Section 8.02. If elected by the Employer in Section 1.10 and specified in the Participant's deferral election, the distribution will be paid through a systematic withdrawal plan (installments) for a time period not exceeding 10 years beginning on the date specified by the Employer in Section 1.06.

8.02. Events Requiring Distribution of Benefits to Participants and Beneficiaries.

(a) If elected by the Employer in Section 1.06(a), the Participant will receive a distribution upon the earliest of the events specified by the Employer in Section 1.06(a), subject to the provisions of Section 7.08, and at the time indicated in Section 1.06(a)(2). If the Participant dies before any event in Section 1.06(a) occurs, the Participant shall be considered to have terminated employment and the Participant's benefit will be paid to the Participant's Beneficiary in the same form and at the same time as it would have been paid to the Participant pursuant to this Article 8.

(b) If elected by the Employer in Section l.06(b), the Participant will receive a distribution of all amounts not deferred pursuant to Section 1.06(b)(l)(B) (and earnings attributable to those amounts) upon termination of employment, subject to the delay applicable to Key Employees described therein, as applicable. If elected by the Employer in Section 1.06(b)(l)(B), the Participant shall have the election to receive distributions of amounts deferred pursuant to Section 4.01 (and earnings attributable to those amounts) after a date specified by the Participant in his deferral election which is at least 12 months after the first day of the calendar year in which such amounts would be earned. Amounts distributed to the Participant pursuant to Section 1.06(b) shall be distributed at the time indicated in Section 1.06(b)(2). Subject to the provisions of Section 7.08, the Participant shall receive a distribution in the form provided in Section 8.01. If the Participant dies before any event in Section 1.06(a) occurs, the Participant shall be considered to have terminated employment and the Participant's benefit will be paid to the Participant's Beneficiary in the same form and at the same time as it would have been paid to the Participant pursuant to this Article 8. However, if the Participant dies before the date specified by the Participant in an election pursuant to Section 1.06(b)(1)(B), then the Participant's benefit shall be paid to the Participant's Beneficiary in the form provided in Section 8.01 as if the Participant had elected to be paid at termination of employment.

8.03. Determination of Method of Distribution. The Participant will determine the method of distribution of benefits to himself and his Beneficiary, subject to the provisions of Section 8.02. Such determination will be made at the time the Participant makes a deferral election. A Participant's election cannot be altered, except, if elected by the Employer in Section 1.10(b), if the Participant's balance falls below the level described in regulations under Code Section 409A, the Participant's benefit payable due to termination of employment will be distributed in a lump sum rather than installments.

(a) When Section 1.06(a) has been elected by the Employer. The distribution period specified in a Participant's first deferral election specifying distribution under a systematic withdrawal plan shall apply to all subsequent elections of distributions under a systematic withdrawal plan made by the Participant. Once a Participant has made an election for the method of distribution, that election shall be effective for all contributions made on behalf of the Participant attributable to any Plan Year after that election was made and before the Plan Year for which that election has been altered in the manner prescribed by the Administrator. If the Participant does not designate in the manner prescribed by the Administrator the method of distribution, such method of distribution shall be a lump sum at termination of employment.

(b) When Section 1.06(b) has been elected by the Employer. The distribution period for distributions under a systematic withdrawal plan shall be specified in each Participant's contribution election selecting payments under a systematic withdrawal plan. If the Participant does not designate in the manner prescribed by the Administrator the method of distribution, such method of distribution for all such contributions shall be a lump sum at termination of employment.

8.04. Notice to Trustee. The Administrator will notify the Trustee, pursuant to the method stated in the Trust Agreement for providing direction, whenever any Participant or Beneficiary is entitled to receive benefits under the Plan. The Administrator's notice shall indicate the form, amount and frequency of benefits that such Participant or Beneficiary shall receive.

8.05. Time of Distribution. In no event will distribution to a Participant be made later than the date specified by the Participant in his salary reduction agreement. All distributions will be made as soon as administratively feasible following the distribution date specified in Section 1.06 or Section 7.08, if applicable.

Article 9. Amendment and Termination.

9.01 Amendment by Employer. The Employer reserves the authority to amend the Plan by filing with the Trustee an amended Adoption Agreement, executed by the Employer only, on which said Employer has indicated a change or changes in provisions previously elected by it. Such changes are to be effective on the effective date of such amended Adoption Agreement. Any such change notwithstanding, no Participant's Account shall be reduced by such change below the amount to which the Participant would have been entitled if he had voluntarily left the employ of the Employer immediately prior to the date of the change. The Employer may from time to time make any amendment to the Plan that may be necessary to satisfy the Code or ERISA. The Employer's board of directors or other individual specified in the resolution adopting this Plan shall act on behalf of the Employer for purposes of this Section 9.01.

9.02 Retroactive Amendments. An amendment made by the Employer in accordance with Section 9.01 may be made effective on a date prior to the first day of the Plan Year in which it is adopted if such amendment is necessary or appropriate to enable the Plan and Trust to satisfy the applicable requirements of the Code or ERISA or to conform the Plan to any change in federal law or to any regulations or ruling thereunder. Any retroactive amendment by the Employer shall be subject to the provisions of Section 9.01.

9.03. Termination. The Employer has adopted the Plan with the intention and expectation that contributions will be continued indefinitely. However, said Employer has no obligation or liability whatsoever to maintain the Plan for any length of time and may discontinue contributions under the Plan or terminate the Plan at any time by written notice delivered to the Trustee without any liability hereunder for any such discontinuance or termination.

9.04. Distribution upon Termination of the Plan. Upon termination of the Plan, no further Deferral, Employer or Matching Contributions shall be made under the Plan, but Accounts of Participants maintained under the Plan at the time of termination shall continue to be governed by the terms of the Plan until paid out in accordance with the terms of the Plan.

Article 10. Miscellaneous.

10.01. Communication to Participants. The Plan will be communicated to all Participants by the Employer promptly after the Plan is adopted.

10.02. Limitation of Rights. Neither the establishment of the Plan and the Trust, nor any amendment thereof, nor the creation of any fund or account, nor the payment of any benefits, will be construed as giving to any Participant or other person any legal or equitable right against the Employer, Administrator or Trustee, except as provided herein; and in no event will the terms of employment or service of any Participant be modified or in any way affected hereby.

10.03. Nonalienability of Benefits. The benefits provided hereunder will not be subject to alienation, assignment, garnishment, attachment, execution or levy of any kind, either voluntarily or involuntarily, and any attempt to cause such benefits to be so subjected will not be recognized, except to such extent as may be required by law.

10.04. <u>Facility of Payment</u>. In the event the Administrator determines, on the basis of medical reports or other evidence satisfactory to the Administrator, that the recipient of any benefit payments under the Plan is incapable of handling his affairs by reason of minority, illness, infirmity or other incapacity, the Administrator may disburse such payments, or direct the Trustee to disburse such payments, as applicable, to a person or institution designated by a court which has jurisdiction over such recipient or a person or institution otherwise having the legal authority under State law for the care and control of such recipient.

The receipt by such person or institution of any such payments shall be complete acquittance therefore, and any such payment to the extent thereof, shall discharge the liability of the Trust for the payment of benefits hereunder to such recipient.

10.05. <u>Information between Employer and Trustee</u>. The Employer agrees to furnish the Trustee, and the Trustee agrees to furnish the Employer with such information relating to the Plan and Trust as may be required by the other in order to carry out their respective duties hereunder, including without limitation information required under the Code or ERISA and any regulations issued or forms adopted thereunder.

10.06. <u>Notices</u>. Any notice or other communication in connection with this Plan shall be deemed delivered in writing if addressed as provided below and if either actually delivered at said address or, in the case of a letter, three business days shall have elapsed after the same shall have been deposited in the United States mails, first-class postage prepaid and registered or certified:

(a) If to the Employer or Administrator, to it at the address set forth in the Adoption Agreement, to the attention of the person specified to receive notice in the Adoption Agreement;

(b) If to the Trustee, to it at the address set forth in the Trust Agreement;

or, in each case at such other address as the addressee shall have specified by written notice delivered in accordance with the foregoing to the addressor's then effective notice address.

10.07. <u>Governing Law</u>. The Plan and the accompanying Adoption Agreement will be construed, administered and enforced according to ERISA, and to the extent not preempted thereby, the laws of the Commonwealth of Massachusetts, without regard to its conflicts of law principles.

Article 11. <u>Plan Administration</u>.

11.01. <u>Powers and responsibilities of the Administrator</u>. The Administrator has the full power and the full responsibility to administer the Plan in all of its details, subject, however, to the applicable requirements of ERISA. The Administrator's powers and responsibilities include, but are not limited to, the following:

(a) To make and enforce such rules and regulations as it deems necessary or proper for the efficient administration of the Plan;

(b) To interpret the Plan, its interpretation thereof in good faith to be final and conclusive on all persons claiming benefits under the Plan;

(c) To decide all questions concerning the Plan and the eligibility of any person to participate in the Plan;

(d) To administer the claims and review procedures specified in Section 11.03;

(e) To compute the amount of benefits which will be payable to any Participant, former Participant or Beneficiary in accordance with the provisions of the Plan;

(f) To determine the person or persons to whom such benefits will be paid;

(g) To authorize the payment of benefits;

(h) To comply with any applicable reporting and disclosure requirements of Part 1 of Subtitle B of Title 1 of ERISA;

(i) To appoint such agents, counsel, accountants, and consultants as may be required to assist in administering the Plan;

(j) By written instrument, to allocate and delegate its responsibilities, including the formation of an Administrative Committee to administer the Plan;

11.02. Nondiscriminatory Exercise of Authority. Whenever, in the administration of the Plan, any discretionary action by the Administrator is required, the Administrator shall exercise its authority in a nondiscriminatory manner so that all persons similarly situated will receive substantially the same treatment.

11.03. Claims and Review Procedures.

(a) Claims Procedure. If any person believes he is being denied any rights or benefits under the Plan, such person may file a claim in writing with the Administrator. If any such claim is wholly or partially denied, the Administrator will notify such person of its decision in writing. Such notification will contain (i) specific reasons for the denial, (ii) specific reference to pertinent Plan provisions, (iii) a description of any additional material or information necessary for such person to perfect such claim and an explanation of why such material or information is necessary, and (iv) information as to the steps to be taken if the person wishes to submit a request for review, including a statement of the such person's right to bring a civil action under Section 502(a) of ERISA following as adverse determination upon review. Such notification will be given within 90 days after the claim is received by the Administrator (or within 180 days, if special circumstances require an extension of time for processing the claim, and if written notice of such extension and circumstances is given to such person within the initial 90-day period).

If the claim concerns disability benefits under the Plan, the Plan Administrator must notify the claimant in writing within 45 days after the claim has been filed in order to deny it. If special circumstances require an extension of time to process the claim, the Plan Administrator must notify the claimant before the end of the 45-day period that the claim may take up to 30 days longer to process. If special circumstances still prevent the resolution of the claim, the Plan Administrator may then only take up to another 30 days after giving the claimant notice before the end of the original 30-day extension. If the Plan Administrator gives the claimant notice that the claimant needs to provide additional information regarding the claim, the claimant must do so within 45 days of that notice.

(b) Review Procedure. Within 60 days after the date on which a person receives a written notice of a denied claim (or, if applicable, within 60 days after the date on which such denial is considered to have occurred), such person (or his duly authorized representative) may (i) file a written request with the Administrator for a review of his denied claim and of pertinent documents and (ii) submit written issues and comments to the Administrator. This written request may include comments, documents, records, and other information relating to the claim for benefits. The claimant shall be provided, upon the claimant's request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim for benefits. The review will take into account all comments, documents, records, and other information submitted by the claimant relating to the claim, without regard to whether such information was submitted or considered in the initial benefit determination. The Administrator will notify such person of its decision in writing. Such notification will be written in a manner calculated to be understood by such person and will contain specific reasons for the decision as well as specific references to pertinent Plan provisions. The decision on review will be made within 60 days after the request for review is received by the Administrator (or within 120 days, if special circumstances require an extension of time for processing the request, such as an election by the Administrator to hold a hearing, and if written notice of such extension and circumstances is given to such person within the initial 60-day period). The extension notice shall indicate the special circumstances requiring an extension of time and the date by which the Plan expects to render the determination on review.

If the initial claim was for disability benefits under the Plan and has been denied by the Plan Administrator, the claimant will have 180 days from the date the claimant received notice of the claim's denial in which to appeal that decision. The review will be handled completely independently of the findings and decision made regarding the initial claim and will be processed by an individual who is not a subordinate of the individual who denied the initial claim. If the claim requires medical judgment, the individual handling the appeal will consult with a medical professional whom was not consulted regarding the initial claim and who is not a subordinate of anyone consulted regarding the initial claim and identify that medical professional to the claimant.

The Plan Administrator shall provide the claimant with written notification of a plan's benefit determination on review. In the case of an adverse benefit determination, the notification shall set forth, in a manner calculated to be understood by the claimant - the specific reason or reasons for the adverse determinations, reference to the specific plan provisions on which the benefit determination is based, a statement that the claimant is entitled to receive, upon the claimant's request and free of charge, reasonable access to, and copies of, all documents, records, and other information relevant to the claim for benefits.

Cree, Inc.
Directors' Deferred Compensation Plan

Amendment to Basic Plan Document

The following revisions to the CORPORATE*plan for Retirement* EXECUTIVE Plan Basic Plan Document (the "Basic Plan Document") apply with respect to the Cree, Inc. Directors' Deferred Compensation Plan established pursuant to the Basic Plan Document (the "Plan") effective February 1, 2006 (the initial effective date of the Plan).

1.

The Preamble of the Basic Plan Document is revised to read as follows:

> It is the intention of the Employer to establish herein an unfunded plan maintained solely for the purpose of providing deferred compensation for non-employee members of the Board of Directors of the Employer (each, a "Member").

2.

Each reference to "Employee" is replaced with a reference to "Member."

3.

Section 2.01(8) is amended to read as set forth in Section 1.04 of the Adoption Agreement.

4.

The text of the following sections is replaced with "[RESERVED]":

2.01(5)
2.01(9)
2.01(10)
2.01(12)
2.01(16)
2.01(19)
2.01(25)
2.01(31)
3.02

5.

Section 3.03 is amended to read as follows:

3.03. <u>Termination of Participation</u>. An individual's eligibility to participate actively by making deferrals under Section 4.01 shall cease on the date on which the individual cease to be a Member. An individual, who has been an active Participant in the Plan, will cease to be a Participant on the date his or her Account is fully paid out.

6.

Section 4.01 is amended to read as follows:

4.01. <u>Deferral Contributions</u>. Each Member may elect to execute an agreement with the Employer to reduce his Compensation by a specified percentage, equal to a whole number multiple of one (1) percent, of each payment of such Compensation. The election will be effective to defer Compensation relating to services performed for a date in, or period beginning in, the calendar year immediately following the filing of such an election. The employer shall credit an amount to the Account maintained on behalf of the Participant corresponding to the amount of said election. Under no circumstances may an election be adopted retroactively. An individual who newly becomes a Member and is not already eligible to participate in an account balance plan (within the meaning of Code section 409A and the administrative guidance thereunder) maintained by the Employer will have 30 days from the date he or she becomes a Member to make a deferral election with respect to Compensation paid for services performed for a date after, or a period beginning after, the filing of such election. It is expressly contemplated that an individual who has been nominated for Member status may also submit a deferral election prior to becoming a Member. Any such deferral election will become effective immediately upon commencement of the individual's status as a Member. A separate deferral election must be made by a Member for each calendar year. If a properly completed and executed deferral election is not actually received by the Plan Administrator by the prescribed time, the Member will be deemed to have elected not to defer any Compensation for the applicable calendar year. An election is irrevocable once received and determined by the Plan Administrator to have been properly completed. Increases or decreases in the amount or percentage a Member elects to defer are not permitted during a calendar year.

7.

The following new Section 8.06 is added to the Basic Plan Document:

8.06 Second Look Election.

(a) In General. Subject to Subsection (b) below, a Participant who has made a valid initial deferral in accordance with the Plan may subsequently make another one-time election regarding the time and/or form of payment of his or her deferral. This opportunity to modify the Participant's initial election is referred to as a "Second Look Election."

(b) Requirements for Second Look Elections. A Second Look Election must comply with all of the following requirements:

(1) The Participant may only make a Second Look Election if the election is made at least 12 months before the Participant's original payment date. In addition, the Second Look Election must delay the payment of the Participant's deferral to a date that is at least 5 years after the original payment date. If the payment date selected in a Second Look Election is, in fact, less than 5 years after the Participant's original payment date, or if the Second Look Election is, in fact, filed less than 12 months before the original payment date, the Second Look Election will be void. For example, if the original payment date is January 1, 2010, the Participant may make a Second Look Election no later than January 1, 2009 to delay payment to January 1, 2015. However, if Participant makes a Second Look Election on January 1, 2009 to receive payment upon termination of employment, the Second Look Election will be void if the termination of employment occurs earlier than January 1, 2015. Similarly, if the original payment date is termination of employment and the Participant makes a Second Look Election on January 1, 2010 to defer payment until January 1, 2015, the Second Look Election will be void if the Participant incurs a termination of employment prior to January 1, 2011.

(3) A Participant may make only one Second Look Election for each individual deferral, and all Second Look Elections must comply with all of the requirements of this Section 8.06.

(4) A Participant who changes the form of his or her payment election from lump sum to installments will be subject to the provisions of the Plan regarding installment payment elections, and such installment payments must begin no earlier than 5 years after the date on which the lump sum payment would have been paid based upon the Participant's initial election.

(5) If a Participant's initial election specified payment in the form of installments and the Participant wants to elect installment payments over a greater or lesser number of years, the election will be subject to the provisions of the Plan regarding installment payment elections, and the first payment date of the new installment payment schedule must be no earlier than 5 years after the first payment date that applied under the Participant's initial installment election.

(6) If a Participant's initial election specified payment in the form of installments and the Participant wants to elect instead payment in a lump sum, the earliest payment date of the lump sum must be no earlier than 5 years after the first payment date that applied under the Participant's initial installment election.

(7) For purposes of this Section, all of a Participant's installment payments related to a specific deferral election shall be treated as a single payment.

A Second Look Election will be void and payment will be made based on the Participant's original election under if all of the provisions of the foregoing Paragraphs of this Subsection are not satisfied in full. However, if a Participant's Second Look Election becomes effective in accordance with the provisions of this Subsection, the Participant 's original election shall be superseded (including any specific payment date specified therein), and this original election shall not be taken into account with respect to the deferral that is subject to the Second Look Election.

(c) Administrator's Role. Each Participant has the sole responsibility to elect a Second Look Election by contacting the Administrator (or, if authorized, the record-keeper for the Plan) and to comply with the requirements of this Section. The Administrator or the record-keeper may provide a notice of a Second Look Election opportunity to some or all Participants, but the Administrator and record-keeper are under no obligation to provide such notice (or to provide it to all Participants, in the event a notice is provided only to some Participants). The Administrator and record-keeper have no discretion to waive or otherwise modify any requirement for a Second Look Election set forth in this Section or in Section 409A.

8.

Section 10.07 is amended to read as follows:

10.07 Governing Law. The Plan and the accompanying Adoption Agreement will be construed, administered and enforced according to applicable federal and, to the extent not preempted by federal law, according to the laws of the Commonwealth of Massachusetts, without regard to its conflicts of law principles.

9.

Except as provided herein, the Basic Plan Document shall be unchanged.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed by a duly authorized officer as of the day and year first written above.

Cree, Inc.

By: /s/ Adam H. Broome

Title: Vice President, Legal

ADOPTION AGREEMENT
ARTICLE 1

1.01 PLAN INFORMATION

(a) Name of Plan:

This is the Cree, Inc. Directors' Deferred Compensation Plan (the "Plan").

(b) Name of Plan Administrator, if not the Employer:

	Cree. Inc. Employee Benefits Committee
Address:	4600 Silicon Drive Durham, NC 27703
Phone Number:	(919) 313-5300

The Plan Administrator is the agent for service of legal process for the Plan.

(c) Plan Year End is December 31.

(d) Plan Status (check one):

(1) R Effective Date of new Plan: February 1, 2006

(2) £ Amendment Effective Date:

The original effective date of the Plan:

1.02 EMPLOYER

(a) The Employer is:	Cree, Inc.
Address:	4600 Silicon Drive
	Durham, NC 27703
Contact's Name:	Brenda Castonguay
Telephone Number:	919-287-7509

(1) Employer's Tax Identification Number: 56-1572719
(2) Business form of Employer (check one):

(A) R Corporation (Other than a Subchapter S corporation)
(B) £ Other (e.g., Subchapter S corporation, partnership, sole proprietor)

(3) Employer's fiscal year end: last Sunday in June

(b) The term "Employer" includes the following Related Employer(s)
(as defined in Section 2.01(a)(24)):

1.03 COVERAGE

(a) ***The following Employees are eligible to participate in the Plan:*** ***SEE AMENDMENT TO THE ADOPTION AGREEMENT***

(1) £ Only those Employees listed in Attachment A will be eligible to participate in the Plan.

(2) £ Only those Employees in the eligible class described below will be eligible to participate in the Plan:

(3) £ Only those Employees described in the Board of Directors Resolutions attached hereto and hereby made a part hereof will be eligible to participate in the Plan.

(b) ***The Entry Date(s) shall be*** (check one):

(1) £ each January 1.

(2) £ each January 1 and each July 1.

(3) £ each January 1 and each April 1, July 1 and October 1.

(4) £ the first day of each month.

(5) R immediate upon meeting the eligibility requirements specified in Subsection 1.03(a).

1.04 COMPENSATION

For purposes of determining Contributions under the Plan, Compensation shall be as defined (check (a) or (b) below, us appropriate); ***SEE AMENDMENT TO THE ADOPTION AGREEMENT***

(a) £ ***in Section 2.01(a)(8)***, check (1) or (2) below, if and as appropriate)):

(1) £ but excluding (check the appropriate box(es)):

(A) £ Overtime Pay.

(B) £ Bonuses.

(C) £ Commissions.

(D) £ The value of a qualified or a non-qualified stock option granted to an Employee by the Employer to the extent such value is includable in the Employee's taxable income.

(E) £ The following:

(2) £ except as otherwise provided below:

(b) £ ***in the Plan maintained by the Employer to the extent it is in excess of the limit imposed under Code Section 401(a) (17).***

1.05 CONTRIBUTIONS

(a) Employee contributions (Complete all that apply) SEE AMENDMENT TO THE ADOPTION AGREEMENT

(1) £ Deferral Contributions. The Employer shall make a Deferral Contribution in accordance with, and subject to, Section 4.01 on behalf of each Participant who has an executed salary reduction agreement in effect with the Employer for the calendar year (or portion of the calendar year) in question, not to exceed ___% of Compensation, exclusive of any Bonus.

(2) £ Bonus Contributions. The Employer requires Participants to enter into a special salary reduction agreement to make Deferral Contributions of any percentage of Employer paid cash Bonuses, up to 100% of such Bonuses. (The Compensation definition elected by the Employer in Section 1.04 must include Bonuses if Bonus contributions are permitted.)

(b)* £ *Matching Contributions (Choose (1) or (2) below, and (3) below, as applicable.)

(1) £ The Employer shall make a Matching Contribution on behalf of each Participant in an amount equal to the following percentage of a Participant's Deferral Contributions during the Plan Year (check one):

(A) £ 50%
(B) £ 100%
(C) £ ___%
(D) £ (Tiered Match) ____% of the first ____% of the Participant's Compensation contributed to the Plan.
(E) £ The percentage declared for the year, if any, by a Board of Directors'resolution.
(F) £ Other:

(2) £ Matching Contribution Offset. For each Participant who has made 401(k) Deferrals at least equal to the maximum under Code Section 402(g) or, if less, the maximum permitted under the Qualified Plan, the Employer shall make a matching Contribution for the calendar year equal to (A) minus (B) below:

(A) The 401(m) Match that the Participant would have received under the Qualified Plan for such calendar year on the sum of the Participant's Deferral Contributions and the Participant's 401(k) Deferrals if no limits otherwise imposed by tax law applied to 401(m) Match and deeming the Participant's Deferral Contributions to be 401(k) Deferrals.

(B) The 401(m) Match actually allocated to such Participant under the Qualified Plan for the calendar year.

For purposes of this Section 1.05(b); "'Qualified Plan" means the Plan; "401(k) Deferrals" means contributions under the Qualified Plan's cash or deferred arrangement as defined in Code Section 401(k); and "401(m) Match" means a matching contribution as defined in Code Section 401(m).

(3) £ Matching Contribution Limits (check the appropriate box(es)):

(A) £ Deferral Contributions in excess of ___ % of the Participant's Compensation for the period in question shall not be considered for Matching Contributions.

Note: If the Employer elects a percentage limit in (A) above and requests the Trustee to account separately for matched and unmatched Deferral Contributions, the Matching Contributions allocated to each Participant must be computed, and the percentage limit applied, based upon each period.

(B) £ Matching Contributions for each Participant for each Plan Year shall be limited to $

(4) Eligibility Requirement(s) for Matching Contributions. A Participant who makes Deferral Contributions during the Plan Year under Section 1.05(a) shall be entitled to Matching Contributions for that Plan Year if the Participant satisfies the following requirement(s) (Check the appropriate box(es). Options (B) and (C) may not be elected together):

(A) £ Is employed by the Employer on the last day of the Plan Year.

(B) £ Earns at least 500 Hours of Service during the Plan Year.

(C) £ Earns at least 1,000 Hours of Service during the Plan Year.

(D) £ Other:

(E) £ No requirements.

Note: If option (A), (B) or (C) above is selected, then Matching Contributions can only be **made** by the Employer **after** the Plan Year ends. Any Matching Contribution made before Plan Year end shall not be subject to the eligibility requirements of this Section 1.05(b)(3)).

(c) Employer Contributions

(1) £ Fixed Employer Contributions. The Employer shall make an Employer Contribution on behalf of each Participant in an amount determined as described below (check at least one):

(A) £ In an amount equal to ___% of each Participant's Compensation each Plan Year.

(B) £ In an amount determined and allocated as described below:

(C) £ In an amount equal to (check at least one):

(i.) £ Any profit sharing contribution that the Employer would have made on behalf of the Participant under the following qualified defined contribution plan but for the limitations imposed by Code Section 401(a)(17):

(ii.) £ Any contribution described in Code Section 401(m) that the Employer would have made on behalf of the Participant under the following qualified defined contribution plan but for the limitations imposed by Code Section 401(a)(17):

(2) £ Discretionary Employer Contributions. The Employer may make Employer Contributions to the accounts of Participants in any amount, as determined by the Employer in its sole discretion from time to time, which amount may be zero.

(3) £ Eligibility Requirement(s) for Employer Contributions. A Participant shall only be entitled to Employer Contributions under Section 1.05(c)(l) for a Plan Year if the Participant satisfies the following requirement(s) (Check the appropriate box(es). Options (B) and (C) may not be elected together):

(A) £ Is employed by the Employer on the last day of the Plan Year.

(B) £ Earns at least 500 Hours of Service during the Plan Year.

(C) £ Earns at least 1,000 Hours of Service during the Plan Year.

(D) £ Other:

(E) £ No requirements.

1.06 DISTRIBUTION DATES

Distribution from a Participant's Account pursuant to Section 8.02 shall begin upon the following date(s) (check either (a) or (b); check (c), if desired):

(a) £ ***Non-Class Year Accounting (complete (1) and (2)).***

(1) The earliest of termination of employment with the Employer (see Plan Section 7.03) and the following event(s) (check appropriate box(es): if none selected, all distributions will be upon termination of employment):

(A) £ Attainment of Normal Retirement Age (as defined in Section 1.07(f)).

(B) £ Attainment of Early Retirement Age (as defined in Section 107(g)).

(C) £ The date on which the Participant becomes disabled (as defined in Section 1.07(h)).

(2) Timing of distribution (check either (A) or (B)).

(A) £ The distribution of the Participant's Account will be begin in the month following the event described in (a)(l) above, however, if the event is termination of employment, then such distribution will begin as soon as practicable on or after the 1st day of the seventh calendar month following such separation if the Participant was a Key Employee.

(B) £ The distribution of the Participant's Account will begin as soon as administratively feasible in the calendar year following distribution event described in (a)(l) above, provided however, that, if the event is termination of employ merit, in no event will such distribution begin earlier than the 1st day of the seventh calendar month following such separation if the Participant, was a Key Employee.

(b) R ***Class Year Accounting (complete (1) and (2)).***

(1) Upon (check at least one; (A) must be selected if plan has contributions pursuant to section 1.05(b) or (c)):

(A) R Termination of employment with the Employer (see Plan Section 7.03); provided however, that if the event is termination of employment, in no event will such distribution begin earlier than the 1st day of the seventh calendar month following such separation if the Participant was a Key Employee.

(B) R The date elected by the Participant, pursuant to Plan Section 8.02, and subject to the restrictions imposed in Plan Section 8.02 with respect to future Deferral Contributions, in which event such date of distribution must be at least one year after the date such Deferral Contribution would have been paid to the Participant in cash in the absence of the election to make the Deferral Contribution.

(2) Timing of distribution subject to Subsection (b)(l)(A) above (check either (A)or(B)).

(A) R The Distribution of the Participant's Account will begin <u>January 10th</u> (specify month and day) following the event described in (b)(l) above.

(B) £ The Distribution of the Participant's Account will begin ______ (specify month and day) of the calendar year following the event described in (b)(1) above.

(c) R ***Upon a Change of Control in accordance with Plan Section 7.08.***

Note: Internal Revenue Code Section 280G could impose certain, adverse tax consequences on both Participants and the Employer as a result of the application of this Section 1.06(c). The Employer should consult with its attorney prior to electing to apply Section 1.06(c).

1.07 VESTING SCHEDULE

(a) The Participant's vested percentage in Matching Contributions elected in Section 105(b) shall be based upon the schedule(s) selected below.

(1) R N/A -No Matching Contributions
(2) £ 100% Vesting immediately
(3) £ 3 year cliff (see **C** below)
(4) £ 5 year cliff (see **D** below)
(5) £ 6 year graduated (see **E** below)
(6) £ 7 year graduated (see **F** below)
(7) £ **G** below
(8) £ Other (Attachment "B")

Years of Service for Vesting	C	D	Vesting Schedule E	F	G
0	0%	0%	0%	0%	
1	0%	0%	0%	0%	
2	0%	0%	20%	0%	
3	100%	0%	40%	20%	
4	100%	0%	60%	40%	
5	100%	100%	80%	60%	
6	100%	100%	100%	80%	
7	100%	100%	100%	100%	100%

(b) The Participant's vested percentage in Employer Contributions elected in Section 1.055(e) shall be based upon the schedule(s) selected below.

(1) R N/A - No Employer Contributions
(2) £ 100% Vesting immediately
(3) £ 3 year cliff (see **C** below)
(4) £ 5 year cliff (see **D** below)
(5) £ 6 year graduated (see **E** below)
(6) £ 7 year graduated (see **F** below)
(7) £ **G** below
(8) £ Other (Attachment "B")

Years of Service for Vesting	C	D	Vesting Schedule E	F	G
0	0%	0%	0%	0%	
1	0%	0%	0%	0%	
2	0%	0%	20%	0%	
3	100%	0%	40%	20%	
4	100%	0%	60%	40%	
5	100%	100%	80%	60%	
6	100%	100%	100%	80%	
7	100%	100%	100%	100%	100%

(c) £ ***Years of Service for Vesting shall exclude*** (check one):

(1) £ for new plans, service prior to the Effective Date as defined in Section 1.01(d).

(2) £ for existing plans converting from another plan document, service prior to the original Effective Date as defined in Section 1.01(d)(2).

(d) £ ***A Participant will forfeit his Matching Contributions and Employer Contributions upon the occurrence of the following event(s):***

(e) A Participant will be 100% vested in his Matching Contributions and Employer Contributions upon (check the appropriate box(es), if any; if l.06(c) is selected, Participants will automatically vest upon Change of Control as defined in Section 1.12):

(1) £ Normal Retirement Age (as defined in Section 1.07(F)).

(2) £ Early Retirement Age (as defined in Section 1.07(g)).

(3) £ Death.

(4) £ The date on which the Participant becomes disabled as determined under Section l.07(h)of the Plan.

(f) Normal Retirement Age under the Plan is (check one):

(1) £ age 65.

(2) £ age ___ (specify from 55 through 64).

(3) £ the later of age ____ (cannot exceed 65) or the fifth anniversary of the Participant's Commencement Date.

If no box is checked in this Section 1.07(f), then Normal Retirement Age is 65.

(g) £ ***Early Retirement Age is the first day of the month after the Participant attains age ___ (specify 55 or greater) and completes ____ Years of Service for Vesting.***

(h) £ ***A Participant is considered disabled when that Participant (check one):***

(1) £ is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months.

(2) £ is, by reason of any medically determinable physical or mental impairment which can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than 3 months under an accident and health plan covering employees of the Employer.

1.08 <u>PREDECESSOR EMPLOYER SERVICE</u>

£ ***Service for purposes of vesting in Section 1.07(a) and (b) shall include service with the following employees):***

1.09 <u>UNFORESEEABLE EMERGENCY WITHDRAWALS</u>

Participant withdrawals for unforeseeable emergency prior to termination of employment (check one):

(a) R ***will be allowed in accordance with Section 7.07, subject to a $<u>1,000</u> minimum amount. (Must be at least $1,000)***

(b) £ ***will <u>not</u> be allowed.***

1.10 <u>DISTRIBUTIONS</u>

Subject to Articles 7 and 8 distributions under the Plan are always available as a lump sum. Check below to allow distributions in installment payments:

R ***under a systematic withdrawal plan (installments) not to exceed 10 years which (check one if box for this Section is selected):***

(a) R ***will not be accelerated, regardless of the Participant's Account balance.***

(b) £ ***will be accelerated to a lump sum distribution in accordance with Section 8.03.***

1.11 <u>INVESTMENT DECISIONS</u>

(a) Investment Directions

Investments in which the Accounts of Participants shall be treated as invested and reinvested shall be directed (check one):

(1) £ by the Employer among the options listed in (b) below.

(2) R by each Participant among the options listed in (b) below.

(3) £ in accordance with investment directions provided by each Participant for all contribution sources in a Participant's Account except the following sources shall be invested as directed by the Employer (check (A) and/or (B)):

(A) £ Nonelective Employer Contributions

(B) £ Matching Employer Contributions

The Employer must direct the applicable sources among the same investment options made available for Participant directed sources listed in the Service Agreement.

(b) Plan Investment Options

Participant Accounts will be treated as invested among the Investment Funds listed in the Service Agreement from time to time pursuant to Participant and/or Employer directions, as applicable.

Note: The method and frequency for change of investments will be determined under the rules applicable to the selected funds. Information will be provided regarding expenses, if any, for changes in investment options.

1.12 RELIANCE ON PLAN

An adopting Employer may not rely solely on this Plan to ensure that the Plan is "unfunded and maintained primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees" with respect to the Employer's particular situation. This Agreement must be reviewed by the Employer's attorney before it is executed.

This Adoption Agreement may be used only in conjunction with the CORPORATEplan for Retirement Executive Plan Basic Plan Document.

EXECUTION PAGE
(Fidelity's Copy)

IN WITNESS WHEREOF, the Employer has caused this Adoption Agreement to be executed this 8th day of December, 2005.

Employer	CREE, INC.
By	/s/ Adam H. Broome
Title	Vice President, Legal
Employer	CREE, INC.
By	/s/ Brenda Castonguay
Title	VP-HR

EXECUTION PAGE
(Employer's Copy)

IN WITNESS WHEREOF, the Employer has caused this Adoption Agreement to be executed this 8th day of December, 2005.

Employer	CREE, INC.
By	/s/ Adam H. Broome
Title	Vice President, Legal
Employer	CREE, INC.
By	/s/ Brenda Castonguay
Title	VP-HR

Attachment A

Pursuant to Section 1.03(a), the following are the Employees who are eligible to participate in the Plan:

Dolph W. von Arx
James E. Dykes
Robert J. Potter, Ph.D.
Harvey A. Wagner

Employer	CREE, INC.
By	/s/ Brenda Castonguay
Title	VP-HR
Date	December 8, 2005

Note: The Employer must revise Attachment A to add Employees as they become eligible or delete Employees who are no longer eligible. Attachment A should be signed and dated every time a change is made.

Attachment B

(a) £ ***The Participant's vested percentage in Matching Contributions elected in Section 1.05(b) shall be based upon the following schedule:***

(b) £ ***The Participant's vested percentage in Employer Contributions elected in Section l.05(c) shall be bused upon the following schedule:***

<u>Cree, Inc.</u>
<u>Directors' Deferred Compensation Plan</u>

Amendment to Adoption Agreement

The following revisions to the CORPORATE*plan for Retirement* EXECUTIVE Plan Adoption Agreement (the "Adoption Agreement") apply with respect to the Cree, Inc. Directors' Deferred Compensation Plan established pursuant to the Basic Plan Document (the "Plan") effective February 1, 2006 (the initial effective date of the Plan).

1.

Section 1.03 is amended to read as follows:

Each person who is a member of the Employer's Board of Directors and who is not also a common law employee of the Employer (a "Non-Employee Board Member") is eligible to participate in the Plan.

2.

Section 1.04 is amended to read as follows:

For purposes of determining Contributions under the Plan, Compensation shall be defined as follows:

1. Each retainer payment paid by the Employer to a Non-Employee Board Member ("Retainer Payment"); and

2. Each meeting fee paid by the Employer to a Non-Employee Board Member ("Meeting Fee").

3.

Section 1.05(a) is amended to read as follows:

The Employer shall make a Deferral Contribution in accordance with, and subject to, Section 4.01 on behalf of each Participant in an amount equal to the amount of Compensation that the Participant has elected to defer for the calendar year (or portion of the calendar year) to which such election applies. A Participant may elect to defer up to 100% of his or her Compensation for a calendar year. Each Participant must make a separate deferral election with respect to his Retainer Payments and his Meeting Fees for such calendar year. An election to defer Retainer Payments for a calendar year shall apply to each Retainer Payment (i) paid in such calendar year, if such payment applies to services performed entirely after the date of payment, or (ii) for services performed in a period beginning in such calendar year, if such payment is made after such period begins. An election to defer Meeting Fees for a calendar year shall apply to the Meeting Fees paid for all meetings held in such calendar year.

4.

Section 1.07 shall be amended by deleting subsection (f).

5.

Except as provided herein, the Adoption Agreement shall be unchanged.

IN WITNESS WHEREOF, the Company has caused this Amendment to be executed by a duly authorized officer as of the day and year first written above.

Cree, Inc.

By: /s/ Adam H. Broome

Title: Vice President, Legal

Exhibit 10.2

TRUST AGREEMENT

Between

Cree, Inc.

And

FIDELITY MANAGEMENT TRUST COMPANY

Cree, Inc. Directors' Deferred Compensation Plan

TRUST

Dated as of February 1, 2006

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TRUST AGREEMENT, dated as of February 1, 2006 , between Cree, Inc., a North Carolina corporation, having an office at 4600 Silicon Drive, Durham, NC 27703-8475 (the "Sponsor"), and **FIDELITY MANAGEMENT TRUST COMPANY**, a Massachusetts trust company, having an office at 82 Devonshire Street, Boston, Massachusetts 02109 (the "Trustee").

WITNESSETH:

WHEREAS, the Sponsor is the sponsor of the Cree, Inc. Directors' Deferred Compensation Plan (the "Plan"); and

WHEREAS, the Sponsor wishes to establish an irrevocable trust and to contribute to the trust assets that shall be held therein, subject to the claims of Sponsor's creditors in the event of Sponsor's Insolvency, as herein defined, until paid to Participants and their beneficiaries in such manner and at such times as specified in the Plan; and

WHEREAS, it is the intention of the parties that this Trust shall constitute an unfunded arrangement and shall not affect the status, of the Plan as an unfunded plan maintained for the purpose of providing deferred compensation for a select group of management or highly compensated employees for purposes of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"); and

WHEREAS, it is the intention of the Sponsor to make contributions to the trust to provide itself with a source of funds to assist it in the meeting of its liabilities under the Plan; and

WHEREAS, the Trustee is willing to hold and invest the aforesaid plan assets in trust among several investment options selected by the Sponsor; and

WHEREAS, the Sponsor wishes to have the Trustee perform certain ministerial recordkeeping and administrative functions under the Plan; and

WHEREAS, Cree, Inc. (the "Administrator") is the administrator of the Plan; and

WHEREAS, the Trustee is willing to perform recordkeeping and administrative services for the Plan if the services are purely ministerial in nature and are provided within a framework of plan provisions, guidelines and interpretations conveyed in writing to the Trustee by the Administrator.

NOW, THEREFORE, in consideration of the foregoing premises and the mutual covenants and agreements set forth below, the Sponsor and the Trustee agree as follows:

1 Definitions

The following terms as used in this Trust Agreement have the meaning indicated unless the context clearly requires otherwise:

(a) “Administrator” shall mean, with respect to the Plan, the person or entity which is the “administrator” of such Plan.

(b) ‘‘Agreement” shall mean this Trust Agreement, as the same may be amended and in effect from time to time.

(c) “Business Day” shall mean any day on which the New York Stock Exchange (NYSE) is open.

(d) “Code” shall mean the Internal Revenue Code of 1986, as it has been or may be amended from time to time.

(e) “ERISA” shall mean the Employee Retirement Income Security Act of 1974, as it has been or may be amended from time to time.

(f) “Fidelity Mutual Fund” shall mean any investment company advised by Fidelity Management & Research Company or any of its affiliates.

(g) “Mutual Fund” shall refer both to Fidelity Mutual Funds and Non-Fidelity Mutual Funds.

(h) “Non-Fidelity Mutual Fund” shall mean certain investment companies not advised by Fidelity Management &. Research Company or any of its affiliates.

(i) “Participant” shall mean, with respect to the Plan, any employee (or former employee) with an account under the Plan, which has not yet been fully distributed and/or forfeited, and shall include the designated beneficiary(ies) with respect to the account of any deceased employee (or deceased former employee) until such account has been fully distributed and/or forfeited.

(j) “Permissible Investment” shall mean the investments specified by the Employer as available for investment of assets of the Trust and agreed to by the Trustee and the Prototype Sponsor. The Permissible Investments under the Plan shall be listed in the Service Agreement.

(k) “Plan” shall mean the Cree, Inc. Directors’ Deferred Compensation Plan.

(1) “Reconciliation Period” shall mean the period beginning on the date of the initial transfer of assets to the Trust and ending on the date of the completion of the reconciliation of Participant records.

(m) “Reporting Date” shall mean the last day of each calendar quarter, the date as of which the Trustee resigns or is removed pursuant to this Agreement and the date as of which this Agreement terminates pursuant to Section 9 hereof.

(n) “Service Agreement” shall mean the agreement between the Trustee aid the Sponsor for the Trustee, through certain affiliates and related companies, to provide administrative and recordkeeping services for the Plan.

(o) "Sponsor" shall mean Cree, Inc., a North Caroline corporation, or any successor to all or substantially all of its businesses which, by agreement, operation of law or otherwise, assumes the responsibility of the Sponsor under this Agreement.

(p) "Trust" shall mean the Cree, Inc. Directors' Deferred Compensation Plan Trust, being the trust established by the Sponsor and the Trustee pursuant to the provisions of this Agreement.

(q) "Trustee" shall mean Fidelity Management Trust Company, a Massachusetts trust company and any successor to all or substantially all of its trust business. The term Trustee shall also include any successor trustee appointed pursuant to this, agreement to the extent such successor agrees to serve as Trustee under this Agreement.

2 Trust

(a) Establishment

The Sponsor hereby establishes the Trust, with the Trustee. The Trust shall consist of an initial contribution of money or other property acceptable to the Trustee in its sole discretion, made by the Sponsor or transferred from a previous trustee under the Plan, such additional sums of money as shall from time to time be delivered to the Trustee under the Plan, all investments made therewith and proceeds thereof, and all earnings and profits thereon, less the payments that are made by the Trustee as provided herein, without distinction between principal and income. The Trustee hereby accepts the Trust on the terms and conditions set forth in this Agreement. In accepting this Trust, the Trustee shall be accountable for the assets received by it, subject to the terms and conditions of this Agreement

(b) Grantor Trust

The Trust is intended to be a grantor trust, of which the Sponsor is the grantor, within the meaning of subpart E, part I, subchapter J, chapter 1, subtitle A of the Code, as amended, and shall be construed accordingly,

(c) Trust Assets

The principal of the Trust, and any earnings thereon shall be held separate and apart from other funds of the Sponsor and shall be used exclusively for the uses and purposes of Participants and general creditors as herein set forth. Participants and their beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of the Trust. Any rights created under the Plan and this Trust Agreement shall be mere unsecured contractual rights of Participants and their beneficiaries against the Sponsor. Any assets held by the Trust will be subject to the claims of the Sponsor's general creditors under federal and state law in the event of Insolvency, as defined in this Agreement.

(d) Non-Assignment

Benefit payments to Participants and their beneficiaries funded under this Trust may not be anticipated, assigned (either at law or in equity), alienated, pledged, encumbered, or subjected to attachment, garnishment, levy, execution, or other legal or equitable process.

3 Payments to Sponsor

Except as provided under this Agreement, the Sponsor shall have no right to retain or divert to others any of the Trust assets before all payment of benefits have been made to the Participants and their beneficiaries pursuant to the terms of the Plan.

4 Disbursements

(a) Directions from Administrator

(i) If it is indicated in the Service Agreement that the Trustee will make distributions of Plan benefits directly to Participants and beneficiaries, the Trustee shall disburse monies to Participants and their beneficiaries for benefit payments in the amounts that the Administrator directs from time to time in writing. The Trustee shall have no responsibility to ascertain whether the Administrator's direction complies with the terms of the Plan or of any applicable law. The Trustee shall be responsible for Federal or State income tax reporting or withholding with respect to such Plan benefits. The Trustee shall not be responsible for FICA (Social Security and Medicare), any Federal or State unemployment or local tax with respect to Plan distributions.

(ii) If it is indicated in the Service Agreement that the Sponsor shall be responsible for making distributions of benefits to Participants and beneficiaries, then the Trustee shall disburse monies to the Administrator for benefit payments in the amounts that the Administrator directs from time to time in writing. The Trustee shall have no responsibility to ascertain whether the Administrator's direction complies with the terms of the Plan or any applicable law. The Trustee shall not be responsible for: (1) making benefit payments to Participants under the Plan, (2) any federal, State or local income tax reporting or withholding with respect to such Plan benefits, and (3) FICA (Social Security and Medicare) or any Federal or State unemployment tax with respect to Plan distributions.

(b) Limitations

The Trustee shall not be required to make any disbursement in excess of the net realizable value of the assets of the Trust at the time of the disbursement. The Trustee shall not be required to make any disbursement in cash unless the Administrator has provided a written direction as to the assets to be converted to cash for the purpose of making the disbursement.

5 Investment of Trust

(a) Selection of Investment Options

The Trustee shall have no responsibility for the selection of investment options under the Trust and shall not render investment advice to any person in connection with the selection of such options.

(b) Available Investment Options

The Sponsor shall direct the Trustee as to what investment options the Trust shall be invested in (i) during the Reconciliation Period, and (ii) following the Reconciliation Period, subject to the following limitations. The Sponsor may determine to offer as investment options only Permissible Investments as described in the Service Agreement; provided, however, that the Trustee shall not be considered a fiduciary with investment discretion. The Sponsor may add or remove investment options with the consent of the Trustee and upon mutual amendment of the Service Agreement to reflect such additions.

(c) Investment Directions

In order to provide for an accumulation of assets comparable to the contractual liabilities accruing under the Plan, the Sponsor may direct the Trustee in writing to invest the assets held in the Trust to correspond to the hypothetical investments made for Participants in accordance with their direction under the Plan.

(d) Funding Mechanism

The Sponsor's designation of available investment options uinder paragraphs (a) and (b) above, the maintenance of accounts for each Plan Participant and the crediting of investments to such accounts, and the exercise by Participants o f any powers relating to investments under this Section 5 are solely for the purpose of providing a mechanism for measuring the obligation of the Sponsor to any particular Participant under the applicable Plan. As further provided in this Agreement, no Participant or beneficiary will have any preferential claim to or beneficial ownership interest in any asset or investment held in the Trust, and the rights of any Participant and his or her beneficiaries under the applicable Plan and this Agreement are solely those of an unsecured general creditor of the Sponsor with respect to the benefits of the Participant under the Plan.

(e) Mutual Funds

The Sponsor hereby acknowledges that it has received from the Trustee a copy of the prospectus for each Mutual Fund selected by the Sponsor as a Plan investment option. Trust investments in Mutual Funds shall be subject to the following limitations:

(i) Execution of Purchases and Sales

Purchases and sales of Permissible Investments (other than for Exchanges) shall be made on the date on which the Trustee receives from the Sponsor in good order all information and documentation necessary to accurately effect such purchases and sales (or in the case of a purchase, the subsequent date on which the Trustee has received a wire transfer of funds necessary to make such purchase). Exchanges of Permissible Investments shall be made on the same Business Day that the Trustee receives a proper direction if received before market close (generally 4:00 p.m. eastern time); if the direction is received after market close (generally 4:00 p.m. eastern time), the exchange shall be made the following Business Day.

(ii) Voting

At the time of mailing of notice of each annual or special stockholder's meeting of any Mutual Fund, the Trustee shall send a copy of the notice and all proxy solicitation materials to the Sponsor, together with a voting direction form for return to the Trustee or its designee. The Trustee shall vote the shares held in the Trust in the manner as directed by the Sponsor. The Trustee shall not vote shares for which it has received no corresponding directions from the Sponsor. The Sponsor shall also have the right to direct the Trustee as to the manner in which all shareholder rights, other than the right to vote, shall be exercised. The Trustee shall have no duty to solicit directions from the Sponsor.

(f) Trustee Powers

The Trustee shall have the following powers and authority:

(i) Subject to paragraphs (b), (c) and (d) of this Section 5, to sell, exchange, convey, transfer, or otherwise dispose of any property held in the Trust, by private contract or at public auction. No person dealing with the Trustee shall be bound to see to the application of the purchase money or other property delivered to the Trustee or to inquire into the validity, expediency, or propriety of any such sale or other disposition.

(ii) To cause any securities or other property held as part of the Trust to be registered in the Trustee's own name, in the name of one or more of its nominees, or in the Trustee's account with the Depository Trust Company of New York and to hold any investments in bearer form, but the books and records of the Trustee shall at all times show that all such investments are part of the Trust.

(iii) To keep that portion of the Trust in cash or cash balances as the Sponsor or Administrator may, from time to time, deem to be in the best interest of the Trust.

(iv) To make, execute, acknowledge, and deliver any and all documents of transfer or conveyance and to carry out the powers herein granted.

(v) To borrow funds from a bank or other financial institution not affiliated with the Trustee in order to provide sufficient liquidity to process Plan transactions in a timely fashion, provided that the cost of borrowing shall be allocated in a reasonable fashion to the investment fund(s) in need of liquidity.

(vi) To settle, compromise, or submit to arbitration any claims, debts, or damages due to or arising from the Trust; to commence or defend suits or legal or administrative proceedings; to represent the Trust in all suits and legal and administrative hearings; and to pay all reasonable expenses arising from any such action, from the Trust if not paid by these Sponsor.

(vii) To employ legal, accounting, clerical, and other assistance as may be required in carrying out the provisions of this Agreement and to pay their reasonable expenses and compensation from the Trust if not paid by the Sponsor.

(viii) To do all other acts although not specifically mentioned herein, as the Trustee may deem necessary to carry out any of the foregoing powers and the purposes of the Trust.

Notwithstanding any powers granted to Trustee pursuant to this Trust Agreement or to applicable law, Trustee shall not have any power that could give this Trust the objective of carrying on a business and dividing the gains therefrom, within the meaning of Section 301.7701-2 of the Procedure and Administrative Regulations promulgated pursuant to the Internal Revenue Code.

6 Recordkeeping and Administrative Services to Be Performed

(a) General

The Trustee shall perform those recordkeeping and administrative functions described in the Service Agreement attached hereto. These recordkeeping and administrative functions shall be performed within the framework of the Administrator's written directions regarding the Plan's provisions, guidelines and interpretations.

(b) Accounts

The Trustee shall keep accurate accounts of all investments, receipts, disbursements, and other transactions hereunder, and shall report the value of the assets held in the Trust as of the last day of each fiscal quarter of the Plan and, if not on the last day of a fiscal quarter, the date on which the Trustee resigns or is removed as provided in this Agreement or is terminated as provided in this Agreement, Within thirty (30) days following each Reporting Date or within sixty (60) days in the case of a Reporting Date caused by the resignation or removal of the Trustee, or the termination of this Agreement, the Trustee shall file with the Administrator a written account setting forth all investments, receipts, disbursements, and other transactions effected by the Trustee between the Reporting Date and the prior Reporting Date, and setting forth the value of the Trust as of the Reporting Date. Except as otherwise required under applicable law, upon the expiration of six (6) months from the date of filing such account with the Administrator, the Trustee shall have no liability or further accountability to anyone with respect to the propriety of its acts or transactions shown in such account, except with respect to such acts or transactions as to which the Sponsor shall within such six (6) month period file with the Trustee written objections.

(c) Inspection and Audit

All records generated by the Trustee in accordance with paragraphs (a) and (b) shall be open to inspection and audit, during the Trustee's regular business hours prior to the termination of this Agreement, by the Administrator or any person designated by the Administrator. Upon the resignation or removal of the Trustee or the termination of this Agreement, the Trustee shall provide to the Administrator, at no expense to the Sponsor, in the format regularly provided to the Administrator, a statement of each Participant's accounts as of the resignation, removal, or termination, and the Trustee shall provide to the Administrator or the Plan's new recordkeeper such further records as are reasonable, at the Sponsor's expense.

(d) Effect of Plan Amendment

The Trustee's provision of the recordkeeping and administrative services set forth in this Section shall be conditioned on the Sponsor delivering to the Trustee a copy of any amendment to the Plan as soon as administratively feasible following the amendment's adoption, and on the Administrator providing the Trustee on a timely basis with all the information the Administrator deems necessary for the Trustee to perform the recordkeeping and administrative services and such other information as the Trustee may reasonably request.

(e) Returns, Reports and Information

Except as set forth in the Service Agreement, the Administrator shall be responsible for the preparation and filing of all returns, reports, and information required of the Trust or Plan by law. The Trustee shall provide the Administrator with such information as the Administrator may reasonably request to make these filings. The Administrator shall also be responsible for making any disclosures to Participants required by law.

7 Compensation and Expenses

Sponsor shall pay to Trustee, within thirty (30) days of receipt of the Trustee's bill, the fees for services in accordance with the Service Agreement. All fees for services are specifically outlined in the Service Agreement and are based on any assumptions identified therein.

All reasonable expenses of plan administration as shown on the Service Agreement, as amended from time to time, shall be a charge against and paid from the appropriate plan Participants' accounts, except to the extent such amounts are paid by the Plan Sponsor in a timely manner.

All expenses of the Trustee relating directly to the acquisition and disposition of investments constituting part of the Trust, and all taxes of any kind whatsoever that may be levied or assessed under existing or future laws upon or in respect of the Trust or the income thereof, shall be a charge against and paid from the appropriate Participants' accounts.

8 Directions and Indemnification

(a) Identity of Administrator

The Trustee shall be fully protected in relying on the fact that the Administrator under the Plan is the individual or persons named as such above or such other individuals or persons as the Sponsor may notify the Trustee in writing.

(b) Directions from Administrator

Whenever the Administrator provides a direction to the Trustee, the Trustee shall not be liable for any loss, or by reason of any breach, arising from the direction if the direction is contained in a writing (or is oral and immediately confirmed in a writing) signed by any individual whose name and signature have been submitted (and not withdrawn) in writing to the Trustee by the Administrator in the manner described in the Service Agreement, provided the Trustee reasonably believes the signature of the individual to be genuine. Such direction may be made via electronic data transfer ("EDT") in accordance with procedures agreed to by the Administrator and the Trustee; provided, however, that the Trustee shall be fully protected in relying on such direction as if it were a direction made in writing by the Administrator. The Trustee shall have no responsibility to ascertain any direction's (i) accuracy, (ii) compliance with the terms of the Plan or any applicable law, or (iii) effect for tax purposes or otherwise.

(c) Directions from Participants

The Trustee shall not be liable for any loss, which arises, from any Participant's exercise or non-exercise of rights under this Agreement over the hypothetical assets in the Participant's accounts.

(d) Indemnification

The Sponsor shall indemnify the Trustee against, and hold the Trustee harmless from, any and all loss, damage, penalty, liability, cost, and expense, including without limitation, reasonable attorneys' fees and disbursements, that may be incurred by, imposed upon, or asserted against the Trustee by reason of any claim, regulatory proceeding, or litigation arising from any act done or omitted to be done by any individual or person with respect to the Plan or Trust, excepting only any and all loss, etc., arising solely from the Trustee's negligence or bad faith.

(e) Survival

The provisions of this Section 8 shall survive the termination of this Agreement.

9 Resignation or Removal of Trustee

(a) Resignation and Removal

(i) The Trustee may resign at any time in accordance with the notice provisions set forth below.

(ii) The Sponsor may remove the Trustee at any time in accordance with the notice provisions set forth below.

(b) Termination

This Agreement may be terminated at any time by the Sponsor upon prior written notice to the Trustee in accordance with the notice provisions set forth below.

(c) Notice Period

In the event either party desires to terminate this Agreement or any Services hereunder, the party shall provide at least sixty-(60) days prior written notice of the termination date to the other party; provided, however, that the receiving party may agree, in writing, to a shorter notice period.

(d) Transition Assistance

In the event of termination of this Agreement, if requested by Sponsor, Fidelity shall assist Sponsor in developing a plan for the orderly transition of the Plan Data, cash and assets then constituting the Trustee and Services provided by Fidelity hereunder to Sponsor or its designee. Fidelity shall provide such assistance for a period not extending beyond sixty (60) days from the termination date of this Agreement, Fidelity shall provide to Sponsor, or to any person designated by Sponsor, at a mutually agreeable time, one file of the Plan Data prepared and maintained by Fidelity in the ordinary course of business, in Fidelity's format. Fidelity may provide other or additional transition assistance as mutually determined for additional fees, which shall be due and payable by the Sponsor prior to any termination of this Agreement.

(e) Failure to Appoint Successor

If, by the termination date, the Sponsor has not notified the Trustee in writing as to the individual or entity to which the assets and cash are to be transferred and delivered, the Trustee may bring an appropriate action or proceeding for leave to deposit the assets and cash in a court of competent jurisdiction. The Trustee shall be reimbursed by the Sponsor for all costs and expenses of the action or proceeding including, without limitation, reasonable attorneys' fees and disbursements.

10 Successor Trustee

(a) Appointment

If the office of Trustee becomes vacant for any reason, the Sponsor may in writing appoint a successor trustee under this Agreement. The successor trustee shall have all of the rights, powers, privileges, obligations, duties, liabilities, and immunities granted to the Trustee under this Agreement. The successor trustee and predecessor trustee shall not be liable for the acts or omissions of the other with respect to the Trust.

(b) Acceptance

When the successor trustee accepts its appointment under this Agreement, title to and possession of the Trust assets shall immediately vest in the successor trustee without any further action on the part of the predecessor trustee. The predecessor trustee shall execute all instruments and do all acts that reasonably may be necessary or reasonably may be requested in writing by the Sponsor or the successor trustee to vest title to all Trust assets in the successor trustee or to deliver all Trust assets to the successor trustee.

(c) Corporate Action

Any successor of the Trustee or successor trustee, through sale or transfer of the business or trust department of the Trustee or successor trustee, or through reorganization, consolidation, or merger, or any similar transaction, shall, upon consummation of the transaction, become the successor trustee under this Agreement.

11 Resignation, Removal, and Termination Notices

All notices of resignation, removal, or termination under this Agreement must be in writing and mailed to the party to which the notice is being given by certified or registered mail, return receipt requested, to the Sponsor at the address designated in the Service Agreement, and to the Trustee c/o John M. Kimpel, Fidelity Investments, 82 Devonshire Street, F7A. Boston, Massachusetts 02109, or to such other addresses as the parties have notified each other of in the foregoing manner.

12 Duration

This Trust shall continue in effect without limit as to time, subject, however, to the provisions of this Agreement relating to amendment, modification, and termination thereof.

13 Insolvency of Sponsor

(a) Trustee shall cease disbursement of funds for payment of benefits to Participants and their beneficiaries if the Sponsor is Insolvent. Sponsor shall be considered "Insolvent" for purposes of this Trust Agreement if (i) Sponsor is unable to pay its debts as they become due, or (ii) Sponsor is subject to a pending proceeding as a debtor under the United States Bankruptcy Code.

(b) All times during the continuance of this Trust, the principal and income of the Trust shall be subject to claims of general creditors of the Sponsor under federal and state law as set forth below.

(i) The Board of Directors and the Chief Executive Officer of the Sponsor shall have the duty to inform Trustee in writing of Sponsor's Insolvency. If a person claiming to be a creditor of the Sponsor alleges in writing to Trustee that Sponsor has become Insolvent, Trustee shall determine whether Sponsor is Insolvent and, pending such determination, Trustee shall discontinue disbursements for payment of benefits to Participants or their beneficiaries.

(ii) Unless Trustee has actual knowledge of Sponsor's Insolvency, or has received notice from Sponsor or a person claiming to be a creditor alleging that Sponsor is Insolvent, Trustee shall have no duty to inquire whether Sponsor is Insolvent. Trustee may in all events rely on such evidence concerning Sponsor's solvency as may be furnished to Trustee and that provides Trustee with a reasonable basis for making a determination concerning Sponsor's solvency.

(iii) If at any time Trustee has determined that Sponsor is Insolvent, Trustee shall discontinue disbursements for payments to Participants or their beneficiaries and shall hold the assets of the Trust for the benefit of Sponsor's general creditors. Nothing In this Trust Agreement shall in any way diminish any rights of Participants or their beneficiaries to pursue their rights as general creditors of Sponsor with respect to benefits due under the Plan or otherwise.

(iv) Trustee shall resume disbursement for the payment of benefits to Plan Participants or their beneficiaries in accordance with this Agreement only after Trustee has determined that Sponsor is not Insolvent (or is no longer Insolvent).

(c) Provided that there are sufficient assets, if Trustee discontinues the payment of benefits from the Trust pursuant to (a) hereof and subsequently resumes such payments, the first payment following such discontinuance shall include the aggregate amount of all payments due to Participants or their beneficiaries under the terms of the Plan for the period of such discontinuance, less the aggregate amount of any payments made to Participants or their beneficiaries by Sponsor in lieu of the payments provided for hereunder during any such period of discontinuance.

14 Amendment or Modification

This Agreement may be amended or modified at any time and from time to time only by an instrument executed by both the Sponsor and the Trustee.

15 Electronic Services

(a) The 'Trustee may provide communications and services ("Electronic Services") and/or software products ("Electronic Products") via electronic media, including, but not limited to Fidelity Plan Sponsor WebStation. The Sponsor and its agents agree to use such Electronic Services and Electronic Products only in the course of reasonable administration of or participation in the Plan and to keep confidential and not publish, copy, broadcast, retransmit, reproduce, commercially exploit or otherwise re disseminate the Electronic Products or Electronic Services or any portion thereof without the Trustee's written consent, except, in cases where Trustee has specifically notified the Sponsor that the Electronic Products or Services are suitable for delivery to Sponsor's Participants, for non-commercial personal use by Participants or beneficiaries with respect to their participation in the Plan or for their other retirement planning purposes.

(b) The Sponsor shall be responsible for installing and maintaining all Electronic Products, (including any programming required to accomplish the installation) and for displaying any and all content associated with Electronic Services on its computer network and/or intranet so that such content will appear exactly as it appears when delivered to Sponsor. All Electronic Products and Services shall be clearly identified as originating from the Trustee or its affiliate. The Sponsor shall promptly remove Electronic Products or Services from its computer network and/or intranet, or replace the Electronic Products or Services with updated products or services provided by the Trustee, upon written notification (including written notification via facsimile) by the Trustee.

(c) All Electronic Products shall be provided to the Sponsor without any express or implied legal warranties or acceptance of legal liability by the Trustee, and all Electronic Services shall be provided to the Sponsor without acceptance of legal liability related to or arising out of the electronic nature of the delivery' or provision of such Services. Except as otherwise stated in this Agreement, no rights are conveyed to any property, intellectual or tangible, associated with the contents of the Electronic Products or Services and related material. The Trustee hereby grants to the Sponsor a non-exclusive, non-transferable revocable right and license to use the Electronic Products and Services in accordance with the terms and conditions of this Agreement

(d) To the extent that any Electronic Products or Services utilize Internet services to transport data or communications, the Trustee will take, and Sponsor agrees to follow, reasonable security precautions, however, the Trustee disclaims any liability for interception of any such data or communications. The Trustee reserves the right not to accept data or communications transmitted via electronic media by the Sponsor or a third party if it determines that the media does not provide adequate data security, or if it is not administratively feasible for the Trustee to use the data security provided. The Trustee shall not be responsible for, and makes no warranties regarding access, speed or availability of Internet or network services, or any other service required for electronic communication. The Trustee shall not be responsible for any loss or damage related to or resulting from any changes or modifications to the Electronic Products or Services after delivering it to the Sponsor.

16 General

(a) Performance by Trustee, its Agents or Affiliates

The Sponsor acknowledges and authorizes that the services to be provided under this Agreement shall be provided by the Trustee, its agents or affiliates, including but not limited to Fidelity Investments Institutional Operations Company, Inc. or its successor, and that certain of such services may be provided pursuant to one or more other contractual agreements or relationships

(b) Entire Agreement

This Agreement contains all of the terms agreed upon between the parties with respect to the subject matter hereof.

(c) Waiver

No waiver by either party of any failure or refusal to comply with an obligation hereunder shall be deemed a waiver of any other or subsequent failure or refusal to so comply.

(d) Successors and Assigns

The stipulations in this Agreement shall inure to the benefit of, and shall bind, the successors and assigns of the respective parties.

(e) Partial Invalidity

If any term or provision of this Agreement or the application thereof to any person or circumstances shall, to any extent, be invalid or unenforceable, the remainder of this Agreement, or the application of such term or provision to persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby, and each term and provision of this Agreement shall be valid and enforceable to the fullest extent permitted by law.

(f) Section Headings

The headings of the various sections and subsections of this Agreement have been inserted only for the purposes of convenience and are not part of this Agreement and shall not be deemed in any manner to modify, explain, expand or restrict any of the provisions of this Agreement.

17 Assignment

This Agreement, and any of its rights and obligations hereunder, may not be assigned by any party without the prior written consent of the other party(ies), and such consent may be withheld in any party's sole discretion. Notwithstanding the foregoing, Trustee may assign this Agreement in whole or in part, and any of its rights and obligations hereunder, to a subsidiary or affiliate of Trustee without consent of the Sponsor. All provisions in this Agreement shall extend to and be binding upon the parties hereto and their respective successors and permitted assigns.

18 Force Majeure

No party shall be deemed in default of this Agreement to the extent that any delay or failure in performance of its obligation(s) results, without its fault or negligence, from any cause beyond its reasonable control, such as acts of God, acts of civil or military authority, embargoes, epidemics, war, riots, insurrections, fires, explosions, earthquakes, floods, unusually severe weather conditions, power outages or strikes. This clause shall not excuse any of the parties to the Agreement from any liability which results from failure to have in place reasonable disaster recovery and safeguarding plans adequate for protection of all data each of the parties to the Agreement are responsible for maintaining for the Plan.

19 Confidentiality

Both parties to this Agreement recognize that in the course of implementing and providing the services described herein, each party may disclose to the other confidential information. All such confidential information, individually and collectively, and other proprietary information disclosed by either party shall remain the sole property of the party disclosing the same, and the receiving party shall have no interest or rights with respect thereto if so designated by the disclosing party to the receiving party. Each party agrees to maintain all such confidential information in trust and confidence to the same extent that it protects its own proprietary information, and not to disclose such confidential information to any third party without the written consent of the other party. Each party further agrees to take all reasonable precautions to prevent any unauthorized disclosure of confidential information. In addition, each party agrees not to disclose or make public to anyone, in any manner, the terms of this Agreement, except as required by law, without the prior written consent of the other party.

20 Governing Law

(a) Massachusetts Law Controls

This Agreement is being made in the Commonwealth of Massachusetts, and the Trust shall be administered as a Massachusetts trust. The validity, construction, effect, and administration of this Agreement shall be governed by and interpreted in accordance with the laws of the Commonwealth of Massachusetts, except to the extent those laws are superseded under Section 514 of ERISA.

(b) Trust Agreement Controls

The Trustee is not a party to the Plan, and in the event of any conflict between the provisions of the Plan and the provisions of this Agreement, the provisions of this Agreement shall control.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their duly authorized officers as of the day and year first above written.

Plan Sponsor Name: Cree, Inc.

By: /s/ Adam H. Broome

Name: Adam H. Broome

Title: Vice President, Legal

Date: December 8, 2005

FIDELITY MANAGEMENT TRUST COMPANY

By: /s/ Jean A. Sturgeon

Name: Jean A. Sturgeon

Title: Authorized Signatory

Date: 12/12/2005

AMENDMENT TO
TRUST AGREEMENT
Between
CREE, INC.
And
FIDELITY MANAGEMENT TRUST COMPANY

THIS AMENDMENT, effective the 1st day of February, 2006, by CREE, INC. (the "Sponsor") and FIDELITY MANAGEMENT TRUST COMPANY (the "Trustee");

WITNESSETH:

WHEREAS, the Sponsor and the Trustee entered into a certain Trust Agreement dated February 1, 2006 (the "Trust Agreement"); and

WHEREAS, the Sponsor and the Trustee desire to amend the Trust Agreement to modify the indemnification provisions thereof.

NOW, THEREFORE, in consideration of the premises herein contained, the Sponsor and the Trustee agree to amend the Trust Agreement by deleting subparagraph (d) of Section 8 of the Trust Agreement and substituting in lieu thereof the following:

> (d) Indemnification. Except as provided below, Sponsor shall defend and indemnify Trustee, its affiliates and their respective directors, officers, employees and agents and hold them harmless against that portion of any and all liabilities, losses, costs or expenses (including reasonable legal fees and expenses) of whatsoever kind and nature which may be imposed on, incurred by or asserted against Trustee at any time if such liability, loss, cost or expense results from the Sponsor's negligence, or willful misconduct relating to or arising out of the Sponsor's obligations under this Agreement or the Sponsor's breach of this Agreement. Notwithstanding the foregoing, Trustee shall be entitled to no indemnification hereunder to the extent its liabilities, losses, costs or expenses are attributed to its own gross negligence or willful misconduct.
>
> Trustee shall defend and indemnify the Sponsor, its affiliates and their respective directors, officers, employees and agents and hold them harmless against that portion of any and all liabilities, losses, costs or expenses (including reasonable legal fees and expenses) of whatsoever kind and nature which may be imposed on, incurred by or asserted against the Sponsor at any time if such liability, loss, cost or expense results from Trustee's negligence, bad faith, or willful misconduct relating to or arising out of the Trustee's obligations under this Agreement or Trustee's breach of this Agreement. Notwithstanding the foregoing, the Sponsor shall be entitled to no indemnification hereunder to the extent its liabilities, losses, costs or expenses are attributed to its own gross negligence or willful misconduct.

The party seeking indemnification above must notify the indemnifying party within 30 days in writing of any actual or threatened action, suit or proceeding to which it claims such indemnification applies. Failure to so notify the indemnifying party shall not be deemed a waiver of the right to seek indemnification, unless the actions of the indemnifying party have been prejudiced by the failure of the other party to provide notice within the required time period. The indemnifying party may then take steps to be joined as a party to such proceeding, and the party seeking indemnification shall not oppose any such joinder. Whether or not such joinder takes place, the indemnifying party shall provide the defense with respect to claims to which this section applies and in doing so shall have the right to control the defense and settlement with respect to such claims. The party seeking indemnification may assume responsibility for the direction of its own defense at any time, including the right to settle or compromise any claim against it without the consent of the indemnifying party, provided that in doing so it shall be deemed to have waived its right to indemnification except in cases where the indemnifying party has declined to defend against the claim.

IN WITNESS WHEREOF, the Sponsor and the Trustee have caused this instrument to be executed by their duly authorized officers as of the day and year first above written.

CREE, INC.

By:	/s/ Adam H. Broome
Name:	Adam H. Broome
Title:	Vice President, Legal
Date:	December 8, 2005

FIDELITY MANAGEMENT TRUST COMPANY

By:	/s/ Jean A. Sturgeon
Name:	Jean A. Sturgeon
Title:	Authorized Signatory
Date:	12/12/2005

Exhibit 31.1

Certification by Chief Executive Officer
pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as
adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Charles M. Swoboda, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cree, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 31, 2006

/s/ Charles M. Swoboda
Charles M. Swoboda
Chairman, President and Chief Executive Officer

Exhibit 31.2

Certification by Chief Financial Officer
pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as
adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

I, Cynthia B. Merrell, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cree, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: January 31, 2006

/s/ Cynthia B. Merrell
Cynthia B. Merrell
Chief Financial Officer

Certification by Chief Executive Officer
pursuant to 18 U.S.C. Section 1350,
as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Cree, Inc. (the "Company") on Form 10-Q for the quarterly period ended December 25, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Charles M. Swoboda, Chairman, President and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Charles M. Swoboda
Charles M. Swoboda
Chairman, President and Chief Executive Officer

January 31, 2006

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed "filed" by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

Certification by Chief Financial Officer
pursuant to 18 U.S.C. Section 1350,
as adopted pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the Quarterly Report of Cree, Inc. (the “Company”") on Form 10-Q for the quarterly period ended December 25, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Cynthia B. Merrell, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Cynthia B. Merrell
Cynthia B. Merrell
Chief Financial Officer

January 31, 2006

This Certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and shall not be deemed “filed” by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and shall not be incorporated by reference into any filing of the Company under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, whether made before or after the date of this Report, irrespective of any general incorporation language contained in such filing.

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.