

Fabrinet  
Form 10-Q  
February 02, 2016  
[Table of Contents](#)

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

**FORM 10-Q**

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended December 25, 2015**

**OR**

.. **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
Commission File Number: 001-34775**

**FABRINET**  
**(Exact name of registrant as specified in its charter)**

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

**Not Applicable**  
**(I.R.S. Employer**  
**Identification No.)**

**c/o Intertrust Corporate Services (Cayman) Limited**

**190 Elgin Avenue**

**George Town**

**Grand Cayman**

**Cayman Islands**  
**(Address of principal executive offices)**

**KY1-9005**  
**(Zip Code)**

**+66 2-524-9600**

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer

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

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

As of January 22, 2016, the registrant had 35,939,609 ordinary shares, \$0.01 par value, outstanding.



---

**Table of Contents**

**FABRINET**

**FORM 10-Q**

**QUARTER ENDED DECEMBER 25, 2015**

**Table of Contents**

|  | <b>Page No.</b> |
|--|-----------------|
| <b><u>PART I. FINANCIAL INFORMATION</u></b>  | 3               |
| <b><u>Item 1. Financial Statements</u></b>   | 3               |
| <u>Unaudited Condensed Consolidated Balance Sheets as of December 25, 2015 and June 26, 2015</u>   | 3               |
| <u>Unaudited Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended December 25, 2015 and December 26, 2014</u> | 4               |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended December 25, 2015 and December 26, 2014</u>                                    | 5               |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u>  | 6               |
| <b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>  | 22              |
| <b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>   | 34              |
| <b><u>Item 4. Controls and Procedures</u></b>  | 35              |
| <b><u>PART II. OTHER INFORMATION</u></b>   | 36              |
| <b><u>Item 1. Legal Proceedings</u></b>  | 36              |
| <b><u>Item 1A. Risk Factors</u></b>  | 36              |
| <b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>  | 50              |
| <b><u>Item 6. Exhibits</u></b>   | 50              |
| <b><u>Signature</u></b>  | 51              |
| <b><u>Exhibit Index</u></b>  | 52              |

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

| <i>(in thousands of U.S. dollars, except share data)</i>                                  | <b>December 25,<br/>2015</b> | <b>June 26,<br/>2015</b> |
|---|------------------------------|--------------------------|
| <b>Assets</b>   |                              |                          |
| Current assets  |                              |                          |
| Cash and cash equivalents   | \$ 131,359                   | \$ 112,978               |
| Marketable securities   | 135,199                      | 142,866                  |
| Trade accounts receivable, net  | 147,430                      | 134,952                  |
| Inventory, net  | 140,862                      | 130,613                  |
| Deferred tax assets   | 1,555                        | 1,662                    |
| Prepaid expenses  | 1,003                        | 2,135                    |
| Other current assets  | 1,612                        | 1,833                    |
| Total current assets  | 559,020                      | 527,039                  |
| Non-current assets  |                              |                          |
| Property, plant and equipment, net  | 159,415                      | 140,654                  |
| Intangibles, net  | 321                          | 137                      |
| Deferred tax assets   | 2,249                        | 2,249                    |
| Deferred debt issuance costs and others   | 2,581                        | 2,424                    |
| Total non-current assets  | 164,566                      | 145,464                  |
| <b>Total Assets</b>   | <b>\$ 723,586</b>            | <b>\$ 672,503</b>        |
| <b>Liabilities and Shareholders Equity</b>  |                              |                          |
| Current liabilities   |                              |                          |
| Bank borrowings, including revolving loan and current portion of long-term loan from bank | \$ 54,000                    | \$ 36,000                |
| Trade accounts payable  | 114,911                      | 115,319                  |
| Income tax payable  | 1,757                        | 1,470                    |
| Accrued payroll, bonus and related expenses   | 9,528                        | 9,804                    |
| Accrued expenses  | 12,512                       | 6,405                    |
| Other payables  | 14,445                       | 12,050                   |
| Total current liabilities   | 207,153                      | 181,048                  |
| Non-current liabilities   |                              |                          |
| Long-term loans from bank, non-current portion  | 1,500                        | 4,500                    |

Edgar Filing: Fabrinet - Form 10-Q

|   |                   |                   |
|---|-------------------|-------------------|
| Deferred tax liability  | 1,043             | 737               |
| Severance liabilities   | 5,767             | 5,477             |
| Other non-current liabilities   | 1,899             | 1,797             |
| Total non-current liabilities   | 10,209            | 12,511            |
| <b>Total Liabilities</b>  | <b>217,362</b>    | <b>193,559</b>    |
| Commitments and contingencies (Note 15)   |                   |                   |
| Shareholders' equity  |                   |                   |
| Preferred shares (5,000,000 shares authorized, \$0.01 par value; no shares issued and outstanding as of December 25, 2015 and June 26, 2015)  |                   |                   |
| Ordinary shares (500,000,000 shares authorized, \$0.01 par value; 35,871,740 shares and 35,437,654 shares issued and outstanding as of December 25, 2015 and June 26, 2015, respectively) | 359               | 354               |
| Additional paid-in capital  | 95,482            | 89,390            |
| Retained earnings   | 410,650           | 389,244           |
| Accumulated other comprehensive loss  | (267)             | (44)              |
| <b>Total Shareholders' Equity</b>   | <b>506,224</b>    | <b>478,944</b>    |
| <b>Total Liabilities and Shareholders' Equity</b>   | <b>\$ 723,586</b> | <b>\$ 672,503</b> |

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

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

| <i>(in thousands of U.S. dollars, except per share amounts)</i>                     | <b>Three Months Ended</b>    |                              | <b>Six Months Ended</b>      |                              |
|---|------------------------------|------------------------------|------------------------------|------------------------------|
|   | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Revenues  | \$ 233,038                   | \$ 188,353                   | \$ 449,471                   | \$ 377,678                   |
| Cost of revenues  | (204,545)                    | (167,292)                    | (394,967)                    | (336,111)                    |
| Gross profit  | 28,493                       | 21,061                       | 54,504                       | 41,567                       |
| Selling, general and administrative expenses  | (13,715)                     | (10,314)                     | (25,615)                     | (19,051)                     |
| Other expenses in relation to flood   |                              |                              | (864)                        |                              |
| Expenses related to reduction in workforce  |                              | (1,153)                      |                              | (1,153)                      |
| Operating income  | 14,778                       | 9,594                        | 28,025                       | 21,363                       |
| Interest income   | 455                          | 324                          | 897                          | 698                          |
| Interest expense  | (419)                        | (117)                        | (821)                        | (250)                        |
| Foreign exchange gain (loss), net   | 6,166                        | 83                           | (4,326)                      | (23)                         |
| Other income (expense)  | 106                          | (134)                        | 209                          | (31)                         |
| Income before income taxes  | 21,086                       | 9,750                        | 23,984                       | 21,757                       |
| Income tax expense  | (1,283)                      | (1,024)                      | (2,578)                      | (1,995)                      |
| Net income  | 19,803                       | 8,726                        | 21,406                       | 19,762                       |
| Other comprehensive loss, net of tax:   |                              |                              |                              |                              |
| Change in net unrealized holding losses on marketable securities                    | (262)                        | (486)                        | (175)                        | (486)                        |
| Other   | (48)                         |                              | (48)                         |                              |
| Total other comprehensive loss, net of tax  | (310)                        | (486)                        | (223)                        | (486)                        |
| Net comprehensive income  | \$ 19,493                    | \$ 8,240                     | \$ 21,183                    | \$ 19,276                    |
| <b>Earnings per share</b>   |                              |                              |                              |                              |
| Basic   | \$ 0.55                      | \$ 0.25                      | \$ 0.60                      | \$ 0.56                      |
| Diluted   | \$ 0.54                      | \$ 0.24                      | \$ 0.59                      | \$ 0.55                      |
| <b>Weighted-average number of ordinary shares outstanding</b> (thousands of shares) |                              |                              |                              |                              |
| Basic   | 35,812                       | 35,349                       | 35,695                       | 35,289                       |
| Diluted   | 36,826                       | 35,917                       | 36,570                       | 35,752                       |

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





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

| <i>(in thousands of U.S. dollars)</i>  | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|
|  | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| <b>Cash flows from operating activities</b>                                      |                              |                              |
| Net income for the period  | \$ 21,406                    | \$ 19,762                    |
| Adjustments to reconcile net income to net cash provided by operating activities |                              |                              |
| Depreciation   | 8,268                        | 5,907                        |
| Amortization of intangibles  | 26                           | 42                           |
| Gain on disposal of property, plant and equipment                                | (49)                         | (46)                         |
| Loss from sales and maturities of available-for-sale securities                  | 124                          |                              |
| Amortization of investment premium   | 457                          | 298                          |
| Amortization of deferred debt issuance costs                                     | 358                          | 228                          |
| Reversal of allowance for doubtful accounts                                      | (7)                          | (3)                          |
| Unrealized loss (gain) on exchange rate and fair value of derivative             | 5,566                        | (19)                         |
| Share-based compensation   | 5,783                        | 3,797                        |
| Deferred income tax  | 413                          | (84)                         |
| Other non-cash expenses  | 765                          | 725                          |
| (Reversal of) inventory obsolescence   | (478)                        | 317                          |
| Loss from written-off inventory  | 233                          |                              |
| Changes in operating assets and liabilities                                      |                              |                              |
| Trade accounts receivable  | (12,486)                     | (2,949)                      |
| Inventory  | (10,004)                     | (3,551)                      |
| Other current assets and non-current assets                                      | 1,019                        | (34)                         |
| Trade accounts payable   | (405)                        | 3,852                        |
| Income tax payable   | 320                          | 386                          |
| Other current liabilities and non-current liabilities                            | 2,395                        | 1,973                        |
| Net cash provided by operating activities  | 23,704                       | 30,601                       |
| <b>Cash flows from investing activities</b>                                      |                              |                              |
| Purchase of marketable securities  | (53,258)                     | (143,684)                    |
| Proceeds from sales of marketable securities                                     | 25,709                       | 1,056                        |
| Proceeds from maturities of marketable securities                                | 34,460                       | 543                          |
| Purchase of property, plant and equipment  | (26,407)                     | (5,372)                      |
| Purchase of intangibles  | (210)                        | (22)                         |
| Proceeds from disposal of property, plant and equipment                          | 58                           | 46                           |
| Net cash used in investing activities  | (19,648)                     | (147,433)                    |
| <b>Cash flows from financing activities</b>                                      |                              |                              |
| Payment of debt issuance costs   | (359)                        | (1,746)                      |
| Proceeds from revolving loans  | 18,000                       |                              |

Edgar Filing: Fabrinet - Form 10-Q

|   |                   |                   |
|---|-------------------|-------------------|
| Repayment of long-term loans from bank                                      | (3,000)           | (3,000)           |
| Proceeds from issuance of ordinary shares under employee share option plans | 2,025             | 415               |
| Withholding tax related to net share settlement of restricted share units   | (1,711)           | (293)             |
| <b>Net cash provided by (used in) financing activities</b>                  | <b>14,955</b>     | <b>(4,624)</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b>                 | <b>19,011</b>     | <b>(121,456)</b>  |
| <b>Movement in cash and cash equivalents</b>                                |                   |                   |
| Cash and cash equivalents at beginning of period                            | 112,978           | 233,477           |
| Increase (decrease) in cash and cash equivalents                            | 19,011            | (121,456)         |
| Effect of exchange rate on cash and cash equivalents                        | (630)             | (50)              |
| <b>Cash and cash equivalents at end of period</b>                           | <b>\$ 131,359</b> | <b>\$ 111,971</b> |
| <b>Non-cash investing and financing activities</b>                          |                   |                   |
| Construction and equipment-related payables                                 | \$ 6,657          | \$ 10,919         |

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

---

**Table of Contents**

**FABRINET**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands of U.S. dollars unless otherwise noted)**

**1. Business and organization**

**General**

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

The Company provides advanced optical packaging and precision optical, electro-mechanical and electronic manufacturing services to original equipment manufacturers ( OEMs ) of complex products, such as optical communication components, modules and sub-systems, industrial lasers, medical devices, and sensors. The Company offers a broad range of advanced optical and electro-mechanical capabilities across the entire manufacturing process, including process design and engineering, supply chain management, manufacturing, complex printed circuit board assembly, advanced packaging, integration, final assembly, and test. The Company focuses primarily on the production of low-volume, high-mix products. The subsidiaries of Fabrinet are Fabrinet Co., Ltd. ( Fabrinet Thailand ), Fabrinet USA, Inc., FBN New Jersey Manufacturing, Inc., Fabrinet China Holdings, Casix, Inc. ( Casix ), Fabrinet Pte., Ltd., Fabrilink SEZC, Fabrinet West, Inc., and Fabritek, Inc.

**2. Accounting policies**

***Basis of presentation***

The accompanying unaudited condensed consolidated financial statements for Fabrinet as of December 25, 2015 and for the three and six months ended December 25, 2015 and December 26, 2014 includes only normal recurring adjustments, necessary for a fair statement of the financial statements set forth herein, in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ) for interim financial information and rules and regulations of the Securities and Exchange Commission ( SEC ). Accordingly, such information does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, please refer to the consolidated financial statements and footnotes thereto included in Fabrinet s Annual Report on Form 10-K for the year ended June 26, 2015.

The balance sheet as of June 26, 2015 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements. The results for the three and six months ended December 25, 2015 and December 26, 2014 may not be indicative of results for the year ending June 24, 2016 or any future periods.

***Use of Estimates***

The preparation of the Company s condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

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

---

**Table of Contents**

***Fiscal years***

The Company utilizes a 52-53 week fiscal year ending on the Friday in June closest to June 30. The three months ended December 25, 2015 and December 26, 2014 each consisted of 13 weeks. The six months ended December 25, 2015 and December 26, 2014 each consisted of 26 weeks. Fiscal year 2016 will be comprised of 52 weeks and will end on June 24, 2016.

***Concentration of credit risk***

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

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

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

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

In January 2016, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2016-01, Financial Instruments Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities . This new guidance makes targeted improvements to existing U.S. GAAP by requiring certain equity investments to be measured at fair value, requiring use of the exit price notion when measuring the fair value of financial instruments for disclosure purposes and requiring separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements. The ASU on recognition and measurement will take effect for public companies for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In November 2015, the FASB issued ASU 2015-17, Balance Sheet Classification of Deferred Taxes , which will require entities to present deferred tax assets ( DTAs ) and deferred tax liabilities ( DTLs ) as non-current in a classified balance sheet. The ASU simplifies the current guidance, which requires entities to separately present DTAs and DTLs as current and non-current in a classified balance sheet. For public business entities, the amendments in this ASU are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In August 2015, the FASB issued ASU 2015-15, Interest Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements . This ASU amended the presentation or subsequent measurement of debt issuance costs related to the line-of-credit arrangement. The

## Edgar Filing: Fabrinet - Form 10-Q

Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date. This amendment deferred the effective date of ASU 2014-09 for all entities by one year. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

---

**Table of Contents**

In July 2015, the FASB issued ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. The update provides the guidance that an entity, that measured inventory by using first-in, first-out or average cost, should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using last-in, first-out or the retail inventory method. The update is effective for fiscal years beginning after December 15, 2016, including interim periods within these fiscal years. This update should be applied prospectively with earlier application permitted as of the beginning of an interim or annual reporting date. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, *Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The update requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the related debt liability instead of being presented as an asset. Debt disclosures will include the face amount of the debt liability and the effective interest rate. The update requires retrospective application and represents a change in accounting principle. The update is effective for fiscal years beginning after December 15, 2015. Early adoption is permitted for financial statements that have not been previously issued. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*. ASU No. 2015-02 amended the process that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. ASU No. 2015-02 is effective for fiscal years, and for interim periods within those fiscal years beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

In January 2015, the FASB issued ASU No. 2015-01, *Income Statement Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. The objective of this amendment is to reduce the complexity in accounting standards by eliminating the concept of extraordinary items from U.S. GAAP. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. The following criteria must both be met for extraordinary classification: (a) the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity; and (b) the underlying event or transaction should not reasonably be expected to recur in the foreseeable future. This amendment is effective for fiscal years and interim periods beginning after December 15, 2015. Early adoption is permitted provided that the guidance is applied from the beginning of the fiscal year of adoption. The Company does not expect that the adoption of this update will have an effect on its consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The amendments require management to evaluate, for each annual and interim reporting period, an entity's ability to continue as a going concern when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations that become due within one year after the date that the financial statements are issued (or available to be issued). This ASU is effective for annual periods and interim reporting periods beginning after December 15, 2016. The Company does not expect that the adoption of this update will have an effect on its consolidated financial statements.

In June 2014, the FASB issued ASU No. 2014-12, Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period . This ASU requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. This update is required to be adopted by all public companies for annual periods and interim reporting periods beginning after December 15, 2015. Early adoption of this ASU is permitted. The Company does not expect that the adoption of this update will have an effect on its consolidated financial statements.



**Table of Contents**

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), issued as a new Topic, Accounting Standards Codification. The core principle of this amendment is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with earlier adoption not being permitted. This ASU can be adopted either retrospectively to each prior reporting period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is currently evaluating the impact of adoption of this update on its consolidated financial statements.

**3. Earnings per ordinary share**

Basic earnings per ordinary share is computed by dividing reported net income by the weighted-average number of ordinary shares outstanding during each period. Diluted earnings per ordinary share is computed by dividing reported net income by the weighted-average number of ordinary shares and dilutive ordinary equivalent shares outstanding during each period. Dilutive ordinary equivalent shares consist of share options and restricted share units. The earnings per ordinary share was calculated as follows:

| <i>(amount in thousands except per share amounts)</i>   | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|---|---------------------------|--------------------------|--------------------------|--------------------------|
|   | <b>December 25, 2015</b>  | <b>December 26, 2014</b> | <b>December 25, 2015</b> | <b>December 26, 2014</b> |
| Net income attributable to shareholders   | \$ 19,803                 | \$ 8,726                 | \$ 21,406                | \$ 19,762                |
| Weighted-average number of ordinary shares outstanding (thousands of shares)  | 35,812                    | 35,349                   | 35,695                   | 35,289                   |
| Incremental shares arising from the assumed exercise of share options and vesting of restricted share units (thousands of shares) | 1,014                     | 568                      | 875                      | 463                      |
| Weighted-average number of ordinary shares for diluted earnings per ordinary share (thousands of shares)                          | 36,826                    | 35,917                   | 36,570                   | 35,752                   |
| Basic earnings per ordinary share   | \$ 0.55                   | \$ 0.25                  | \$ 0.60                  | \$ 0.56                  |
| Diluted earnings per ordinary share   | \$ 0.54                   | \$ 0.24                  | \$ 0.59                  | \$ 0.55                  |
| Outstanding share options excluded in the computation of diluted earnings per ordinary share <sup>(1)</sup>                       | 31,244                    | 71,580                   | 31,244                   | 71,580                   |

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

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

Edgar Filing: Fabrinet - Form 10-Q

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

| <i>(amount in thousands)</i>             | Carrying<br>Cost  | Unrealized<br>Loss | Fair Value                         |                          |
|--|-------------------|--------------------|------------------------------------|--------------------------|
|  |                   |                    | Cash<br>and<br>Cash<br>Equivalents | Marketable<br>Securities |
| As of December 25, 2015                  |                   |                    |                                    |                          |
| Cash                                     | \$                | \$                 | \$ 119,987                         | \$                       |
| Cash equivalents                         | 11,372            |                    | 11,372                             |                          |
| Corporate bonds and commercial papers    | 113,942           | (148)              |                                    | 113,794                  |
| U.S. agency and U.S. treasury securities | 20,745            | (71)               |                                    | 20,674                   |
| Sovereign and municipal securities       | 731               |                    |                                    | 731                      |
| <b>Total</b>                             | <b>\$ 146,790</b> | <b>\$ (219)</b>    | <b>\$ 131,359</b>                  | <b>\$ 135,199</b>        |

**Table of Contents**

| <i>(amount in thousands)</i>             | <b>Carrying<br/>Cost</b> | <b>Unrealized<br/>(Loss)/<br/>Gain</b> | <b>Cash<br/>and<br/>Cash<br/>Equivalents</b> | <b>Fair Value<br/>Marketable<br/>Securities</b> |
|--|--------------------------|--|--|---|
| <b>As of June 26, 2015</b>               |                          |  |  |   |
| Cash                                     | \$                       | \$                                     | \$ 105,548                                   | \$  |
| Cash equivalents                         | 7,430                    |  | 7,430  |   |
| Corporate bonds and commercial papers    | 120,144                  | (43)                                   |  | 120,101   |
| U.S. agency and U.S. treasury securities | 21,029                   | (2)                                    |  | 21,027  |
| Sovereign and municipal securities       | 1,737                    | 1                                      |  | 1,738   |
| <b>Total</b>                             | <b>\$ 150,340</b>        | <b>\$ (44)</b>                         | <b>\$ 112,978</b>                            | <b>\$ 142,866</b>                               |

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

The following table summarizes the cost and estimated fair value of marketable securities classified as available-for-sale securities based on stated effective maturities as of December 25, 2015:

| <i>(amount in thousands)</i>   | <b>Carrying<br/>Cost</b> | <b>Fair<br/>Value</b> |
|--------------------------------|--------------------------|-----------------------|
| Due within one year            | \$ 16,075                | \$ 16,068             |
| Due between one to three years | 119,343                  | 119,131               |
| <b>Total</b>                   | <b>\$ 135,418</b>        | <b>\$ 135,199</b>     |

During the three and six months ended December 25, 2015, the net realized loss recognized by the Company was \$0.03 million and \$0.1 million, respectively.

As of December 25, 2015, the Company considered the declines in market value of its marketable securities investment portfolio to be temporary in nature and did not consider any of its securities other-than-temporarily impaired. The Company typically invests in highly-rated securities, and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade, with the primary objective of minimizing the potential risk of principal loss. Fair values were determined for each individual security in the investment portfolio. When evaluating an investment for other-than-temporary impairment, the Company reviews factors such as the length of time and extent to which fair value has been below its cost basis, the financial condition of the issuer and any changes thereto, changes in market interest rates, and the Company's intent to sell, or whether it is more likely than not it will be required to sell, the investment before recovery of the investment's cost basis. No impairment losses were recorded for the three and six months ended December 25, 2015.

## Edgar Filing: Fabrinet - Form 10-Q

As of December 25, 2015, cash, cash equivalents, and marketable securities included bank deposits of \$40.0 million held in various financial institutions located in the United States in order to support the availability of the Facility Agreement (as defined in Note 10) and comply with covenants. As discussed in Note 10, under the terms and conditions of the Facility Agreement, the Company shall maintain cash, cash equivalents and/or marketable securities in an aggregate amount not less than \$40.0 million in unencumbered deposits, and/or securities in accounts located in the United States at all times during the term of the Facility Agreement. As discussed in Note 10, the Company must comply with this covenant from and after the effective date of the Facility Agreement.

**Table of Contents****5. Fair value of financial instruments**

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

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

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

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

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

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

| <i>(amount in thousands)</i>             | <b>Fair Value Measurements at Reporting Date Using</b> |                         |                |                   |
|--|--|-------------------------|----------------|-------------------|
|  | <b>Level 1</b>   | <b>Level 2</b>          | <b>Level 3</b> | <b>Total</b>      |
| <b>As of December 25, 2015</b>           |  |                         |                |                   |
| <b>Assets</b>                            |  |                         |                |                   |
| Cash equivalents                         | \$   | \$ 11,372               | \$             | \$ 11,372         |
| Corporate bonds and commercial papers    |  | 113,794                 |                | 113,794           |
| U.S. agency and U.S. treasury securities |  | 20,674                  |                | 20,674            |
| Sovereign and municipal securities       |  | 731                     |                | 731               |
| <b>Total</b>                             | <b>\$</b>  | <b>\$ 146,571</b>       | <b>\$</b>      | <b>\$ 146,571</b> |
| <b>Liabilities</b>                       |  |                         |                |                   |
| Derivative liabilities                   | \$   | \$ 6,209 <sup>(1)</sup> | \$             | \$ 6,209          |
| <b>Total</b>                             | <b>\$</b>  | <b>\$ 6,209</b>         | <b>\$</b>      | <b>\$ 6,209</b>   |

| <i>(amount in thousands)</i>          | <b>Fair Value Measurements at Reporting Date Using</b> |                |                |              |
|---------------------------------------|--|----------------|----------------|--------------|
|                                       | <b>Level 1</b>   | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
| <b>As of June 26, 2015</b>            |  |                |                |              |
| <b>Assets</b>                         |  |                |                |              |
| Cash equivalents                      | \$   | \$ 7,430       | \$             | \$ 7,430     |
| Corporate bonds and commercial papers |  | 120,101        |                | 120,101      |

Edgar Filing: Fabrinet - Form 10-Q

|  |    |                       |    |            |
|--|----|-----------------------|----|------------|
| U.S. agency and U.S. treasury securities |    | 21,027                |    | 21,027     |
| Sovereign and municipal securities       |    | 1,738                 |    | 1,738      |
| Derivative assets                        |    | 4 <sup>(2)</sup>      |    | 4          |
| Total                                    | \$ | \$ 150,300            | \$ | \$ 150,300 |
| <b>Liabilities</b>                       |    |                       |    |            |
| Derivative liabilities                   | \$ | \$ 371 <sup>(3)</sup> | \$ | \$ 371     |
| Total                                    | \$ | \$ 371                | \$ | \$ 371     |

- (1) Foreign currency forward contracts with notional amount of \$181.5 million and Canadian Dollars 0.4 million.
- (2) Foreign currency options with notional amount of \$3.0 million and forward contracts with notional amount of Canadian Dollars 0.4 million.
- (3) Foreign currency options with notional amount of \$41.0 million.

**Table of Contents****Derivative Financial Instruments**

The Company uses foreign currency contracts to manage the foreign exchange risk associated with certain foreign currency-denominated assets and liabilities. As a result of foreign currency fluctuations, the U.S. dollar equivalent values of the Company's foreign currency-denominated assets and liabilities change. The Company minimizes the credit risk in derivative instruments by limiting its exposure to any single counterparty and by entering into derivative instruments only with counterparties that meet the Company's minimum credit quality standard.

The derivative assets and liabilities are classified in other current assets and accrued expenses, respectively, on the unaudited condensed consolidated balance sheets. As of December 25, 2015 and June 26, 2015, the forward contracts and option contracts outstanding had a maturity date in one to eighteen months duration. The Company has not designated the foreign currency contracts as hedging instruments under the accounting standard for derivatives and hedging.

The effects of derivative instruments which are not designated as hedging instruments on the Company's unaudited condensed consolidated statements of operations and comprehensive income were a gain from foreign currency forward contracts of \$6.2 million for the three months ended December 25, 2015, and a loss from foreign currency put option contracts of \$0.1 million and a gain from foreign currency put option contracts of \$0.02 million for the three months ended December 26, 2014.

**6. Allowance for doubtful accounts**

The activities and balances for allowance for doubtful accounts were as follows:

| <i>(amount in thousands)</i> | <b>Six Months Ended</b>      |                              |
|------------------------------|------------------------------|------------------------------|
|                              | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Balance, beginning of period | \$ 50                        | \$ 37                        |
| Credited to income           | (7)                          | (3)                          |
| Balance, end of period       | \$ 43                        | \$ 34                        |

**7. Inventory**

| <i>(amount in thousands)</i> | <b>As of<br/>December 25,<br/>2015</b> | <b>As of<br/>June 26,<br/>2015</b> |
|------------------------------|--|------------------------------------|
|                              | Raw materials                          | \$ 49,306                          |
| Work in progress             | 70,817                                 | 69,174                             |
| Finished goods               | 17,770                                 | 11,843                             |
| Goods in transit             | 5,448                                  | 6,488                              |

|                              |            |            |
|------------------------------|------------|------------|
|                              | 143,341    | 133,570    |
| Less: Inventory obsolescence | (2,479)    | (2,957)    |
| Inventory, net               | \$ 140,862 | \$ 130,613 |

### 8. Property, plant and equipment

On September 2, 2015, the Company entered into an agreement to purchase a parcel of land in Chonburi, Thailand, to support the expansion of the Company's production capacity and capabilities in Thailand. Title to the land was transferred to the Company on December 22, 2015. The aggregate purchase price was approximately \$12.4 million. The Company recorded the purchase of this land in property, plant and equipment on the unaudited condensed consolidated balance sheets as of December 25, 2015.



**Table of Contents****9. Intangibles**

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

| <i>(amount in thousands)</i> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b>    |
|------------------------------|--------------------------------------|-------------------------------------|---------------|
| As of December 25, 2015      |                                      |                                     |               |
| Software                     | \$ 3,567                             | \$ (3,246)                          | \$ 321        |
| <b>Total intangibles</b>     | <b>\$ 3,567</b>                      | <b>\$ (3,246)</b>                   | <b>\$ 321</b> |

| <i>(amount in thousands)</i> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Net</b>    |
|------------------------------|--------------------------------------|-------------------------------------|---------------|
| As of June 26, 2015          |                                      |                                     |               |
| Software                     | \$ 3,357                             | \$ (3,220)                          | \$ 137        |
| <b>Total intangibles</b>     | <b>\$ 3,357</b>                      | <b>\$ (3,220)</b>                   | <b>\$ 137</b> |

The Company recorded amortization expense relating to intangibles of \$0.01 million and \$0.02 million for the three months ended December 25, 2015 and December 26, 2014, respectively, and \$0.02 million and \$0.04 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

Based on the carrying amount of intangibles as of December 25, 2015, and assuming no future impairment of the underlying assets, the estimated future amortization at the end of each fiscal year in June is as follows:

| <i>(amount in thousands)</i> |               |
|------------------------------|---------------|
| 2016                         | \$ 37         |
| 2017                         | 70            |
| 2018                         | 69            |
| 2019                         | 69            |
| 2020                         | 64            |
| Thereafter                   | 12            |
| <b>Total</b>                 | <b>\$ 321</b> |

**10. Borrowings**

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

*(amount in thousands)*

| <b>Rate <sup>(1)</sup></b>             | <b>Conditions</b>                                     | <b>Maturity</b>             | <b>As of<br/>December 25,<br/>2015</b> | <b>As of<br/>June 26,<br/>2015</b> |
|--|---|-----------------------------|--|------------------------------------|
| Short-term borrowing:                  |   |                             |  |                                    |
| Revolving borrowing:                   |   |                             |  |                                    |
| LIBOR + 1.75% per annum                | Repayable in  | January 2016 <sup>(2)</sup> |  |                                    |
|  | 1 to 6 months   |                             | \$ 48,000                              | \$ 30,000                          |
| Current portion of long-term borrowing |   |                             | 6,000                                  | 6,000                              |
|  |   |                             | \$ 54,000                              | \$ 36,000                          |
| Long-term borrowing:                   |   |                             |  |                                    |
| LIBOR + 2.8% per annum                 | Repayable in quarterly<br>installments within 6 years | March 2017                  | \$ 7,500                               | \$ 10,500                          |
| <i>Less: Current portion</i>           |   |                             | (6,000)                                | (6,000)                            |
| Non-current portion                    |   |                             | \$ 1,500                               | \$ 4,500                           |

(1) LIBOR is London Interbank Offered Rate.

(2) In January 2016, the maturity date of these revolving borrowings were extended to mature in February 2016.

**Table of Contents**

Under the long-term borrowing contract of a subsidiary, the loan is secured by certain property, plant and equipment. The carrying amount of assets secured and pledged as collateral to such loan as of December 25, 2015 and June 26, 2015 was \$48.8 million and \$50.0 million, respectively. This subsidiary is also required to comply with maximum ratios of debt to equity and minimum levels of debt service coverage ratios, and Fabrinet must maintain an effective shareholding ratio. The carrying amounts of bank borrowings approximate their fair value.

As of December 25, 2015 and June 26, 2015, the Company was in compliance with its long-term bank borrowing agreement. In addition to financial ratios, certain of the Company's credit facilities include customary events of default.

The movements of long-term loans were as follows for the six months ended December 25, 2015 and December 26, 2014:

| <i>(amount in thousands)</i> | <b>Six Months Ended</b>      |                              |
|------------------------------|------------------------------|------------------------------|
|                              | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Opening book amount          | \$ 10,500                    | \$ 16,500                    |
| Repayment during the period  | (3,000)                      | (3,000)                      |
| Closing book amount          | \$ 7,500                     | \$ 13,500                    |

As of December 25, 2015, future maturities of long-term debt during each fiscal year were as follows:

| <i>(amount in thousands)</i> |                 |
|------------------------------|-----------------|
| 2016                         | \$ 3,000        |
| 2017                         | 4,500           |
| <b>Total</b>                 | <b>\$ 7,500</b> |

**Credit facilities:**

Fabrinet entered into a syndicated senior credit facility agreement (the Facility Agreement) with a consortium of banks on May 22, 2014. The Facility Agreement, led by Bank of America, provides for a \$200.0 million credit line, comprised of a \$150.0 million revolving loan facility and a \$50.0 million delayed draw term loan facility. The revolving loan facility contains an accordion feature permitting Fabrinet to request an increase in the facility up to \$100.0 million subject to customary terms and conditions and provided that no default or event of default exists at the time of request. The revolving loan facility terminates and all amounts outstanding are due and payable in full on May 22, 2019. The principal amount of any drawn term loans must be repaid according to scheduled quarterly amortization payments, with final payment of all amounts outstanding, plus accrued interest, being due May 22, 2019.

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

Amendment to the Facility Agreement. The amendment extended the availability period for draws on the term loan facility from July 31, 2015 to July 31, 2016. As of December 25, 2015, the outstanding revolving borrowing under the Facility Agreement was \$48.0 million, resulting in available credit facilities of \$152.0 million. Borrowings under the revolving credit facility are classified as current liabilities in the unaudited condensed consolidated balance sheets as the Company has the periodic option to renew, or pay all or a portion of, the outstanding balance at the end of the maturity date, which is in the range of one to six months, without premium or penalty, upon notice to the administrative agent. During January 2016, the Company sent notices to the bank to renew the maturity date of its revolving borrowings. The bank approved the notices and extended the maturity to February 2016.

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

**Table of Contents**

Fabrinet's obligations under the Facility Agreement are guaranteed by certain of its existing and future direct material subsidiaries. In addition, the Facility Agreement is secured by Fabrinet's present and future accounts receivable, deposit accounts and cash, and a pledge of the capital stock of certain of Fabrinet's direct subsidiaries. Fabrinet is required to maintain at least \$40.0 million of cash, cash equivalents, and marketable securities at financial institutions located in the United States. Further, Fabrinet is required to maintain any of its deposits accounts or securities accounts with balances in excess of \$10.0 million in a jurisdiction where a control agreement, or the equivalent under the local law, can be effected. The Facility Agreement contains customary affirmative and negative covenants. Negative covenants include, among other things, limitations on liens, indebtedness, investments, mergers, sales of assets, changes in the nature of the business, dividends and distributions, affiliate transactions and capital expenditures. The Facility Agreement contains financial covenants requiring Fabrinet to maintain: (i) a minimum tangible net worth of not less than \$200.0 million plus 50% of quarterly net income, exclusive of quarterly losses; (ii) a minimum debt service coverage ratio of not less than 1.50:1.00; (iii) a maximum senior leverage ratio of not more than 2.50:1.00; and (iv) a minimum quick ratio of not less than 1.10:1.00. Each of these financial covenants is calculated on a consolidated basis for the consecutive four fiscal quarter period then ended. As of December 25, 2015, the Company was in compliance with all covenants under the Facility Agreement.

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

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

Undrawn available credit facilities classified by available period of future borrowing as of December 25, 2015 and June 26, 2015 were as follows:

| <i>(amount in thousands)</i> | <b>December 25,<br/>2015</b> | <b>June 26,<br/>2015</b> |
|------------------------------|------------------------------|--------------------------|
| Short-term                   | \$ 1,386                     | \$ 1,480                 |
| Long-term                    | \$ 152,000                   | \$ 170,000               |

**11. Income taxes**

As of December 25, 2015 and June 26, 2015, the liability for uncertain tax positions including accrued interest and penalties was \$1.7 million and \$1.6 million, respectively. The Company expects the estimated amount of liability associated with its uncertain tax positions to decrease within the next 12 months due to the lapse of the applicable statute of limitations in foreign tax jurisdictions.

The Company files income tax returns in the United States and foreign tax jurisdictions. The tax years from 2011 to 2015 remain open to examination by U.S. federal and state tax authorities, and foreign tax authorities. The Company's income tax is recognized based on the best estimate of the expected annual effective tax rate for the full financial year of each entity in the Company, adjusted for discrete items arising in that quarter. If the Company's estimated annual

effective tax rate changes, the Company makes a cumulative adjustment in that quarter.

The effective tax rate for the Company for the three months ended December 25, 2015 and December 26, 2014 was 6.1% and 10.5% of net income, respectively. The decrease in the effective tax rate for the three months ended December 25, 2015 was primarily due to the fact that the Company had lower taxable income during the three months ended December 25, 2015 as compared to the three months ended December 26, 2014 because of an increase in unrealized gain from changes in the fair value of derivatives during the three months ended December 25, 2015, which are not subject to tax.

The effective tax rate for the Company for the six months ended December 25, 2015 and December 26, 2014 was 10.7% and 9.2% of net income, respectively. The increase in the effective tax rate for the six months ended December 25, 2015 was primarily due to the fact that the Company had higher taxable income during the six months ended December 25, 2015 as compared to the six months ended December 26, 2014, due to the expiration of a tax privilege of the Company's subsidiary in Thailand.

**Table of Contents****12. Share-based compensation*****Share-based compensation***

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

The effect of recording share-based compensation expense for the three and six months ended December 25, 2015 and December 26, 2014 was as follows:

| <i>(amount in thousands)</i>                       | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>December 25, 2015</b>  | <b>December 26, 2014</b> | <b>December 25, 2015</b> | <b>December 26, 2014</b> |
| Share-based compensation expense by type of award: |                           |                          |                          |                          |
| Share options                                      | \$ 2                      | \$ 71                    | \$ 18                    | \$ 191                   |
| Restricted share units                             | 3,108                     | 1,859                    | 5,765                    | 3,606                    |
| Total share-based compensation expense             | 3,110                     | 1,930                    | 5,783                    | 3,797                    |
| Tax effect on share-based compensation expense     |                           |                          |                          |                          |
| Net effect on share-based compensation expense     | \$ 3,110                  | \$ 1,930                 | \$ 5,783                 | \$ 3,797                 |

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

| <i>(amount in thousands)</i>                | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|---|---------------------------|--------------------------|--------------------------|--------------------------|
|   | <b>December 25, 2015</b>  | <b>December 26, 2014</b> | <b>December 25, 2015</b> | <b>December 26, 2014</b> |
| Cost of revenue                             | \$ 540                    | \$ 360                   | \$ 1,077                 | \$ 728                   |
| Selling, general and administrative expense | 2,570                     | 1,570                    | 4,706                    | 3,069                    |
| Total share-based compensation expense      | \$ 3,110                  | \$ 1,930                 | \$ 5,783                 | \$ 3,797                 |

The Company did not capitalize any share-based compensation expense as part of any asset costs during the three and six months ended December 25, 2015 and December 26, 2014.

***Share-based award activity***

## Edgar Filing: Fabrinet - Form 10-Q

Share options have been granted to directors and employees. As of December 25, 2015, there were 310 share options outstanding under Fabrinet's Amended and Restated 1999 Share Option Plan (the "1999 Plan"). Additional option grants may not be made under the 1999 Plan.

As of December 25, 2015, there were an aggregate of 660,717 share options outstanding, 1,276,859 restricted share units outstanding, and 2,499,260 ordinary shares available for future grant under Fabrinet's 2010 Performance Incentive Plan (the "2010 Plan"). The 1999 Plan and 2010 Plan are collectively referred to as the "Share Option Plans".

### *Share options*

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



**Table of Contents**

The following summarizes share option activity:

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

|                                 | <b>Number<br/>of<br/>Shares</b> | <b>Number<br/>of<br/>Exercisable<br/>Options</b> | <b>Weighted-<br/>Average<br/>Exercise<br/>Price<br/>Per<br/>Share</b> | <b>Weighted-<br/>Average<br/>Grant<br/>Date<br/>Fair<br/>Value<br/>Per<br/>Share</b> |
|---------------------------------|---------------------------------|--|---|--|
| Balance as of June 27, 2014     | 865,890                         | 666,305  | \$ 16.27  |  |
| Granted                         |                                 |  |   |  |
| Exercised                       | (26,677)                        |  | \$ 15.58  |  |
| Forfeited                       | (3,521)                         |  | \$ 16.93  |  |
| Expired                         | (3,804)                         |  | \$ 19.47  |  |
| Balance as of December 26, 2014 | 831,888                         | 743,800  | \$ 16.27  |  |

The following summarizes information for share options outstanding as of December 25, 2015 under the Share Option Plans:

| <b>Number<br/>of<br/>Shares<br/>Underlying<br/>Options</b> | <b>Exercise<br/>Price<br/>Per<br/>Share</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Life</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(amount in<br/>thousands)</b> |
|--|---|---|--|
|--|---|---|--|

Edgar Filing: Fabrinet - Form 10-Q

|                     |         |          | (years) |          |
|---------------------|---------|----------|---------|----------|
|                     | 310     | \$ 5.75  | 0.90    |          |
|                     | 345,338 | \$ 16.83 | 1.80    |          |
|                     | 30,000  | \$ 15.05 | 1.86    |          |
|                     | 23,844  | \$ 25.50 | 2.05    |          |
|                     | 7,400   | \$ 26.16 | 2.11    |          |
|                     | 8,300   | \$ 23.62 | 2.36    |          |
|                     | 25,859  | \$ 15.16 | 2.65    |          |
|                     | 191,121 | \$ 14.12 | 2.88    |          |
|                     | 22,760  | \$ 19.36 | 3.13    |          |
|                     | 5,550   | \$ 18.60 | 3.18    |          |
|                     | 545     | \$ 12.83 | 3.37    |          |
| Options outstanding | 661,027 |          | 2.23    | \$ 5,043 |
| Options exercisable | 660,035 |          | 2.22    | \$ 5,037 |

As of December 25, 2015, there was \$60 of unrecognized compensation expense related to share options under the Share Option Plans that is expected to be recognized over a weighted-average period of 0.18 years.

**Table of Contents***Restricted share units*

Restricted share units are one type of share-based award that may be granted under the 2010 Plan. Restricted share units granted to non-employee directors generally cliff vest 100% on the first of January, approximately one year from the grant date, provided the director continues to serve through such date. Restricted share units granted to employees generally vest in four equal installments over four years on each anniversary of the vesting commencement date.

On May 24, 2015 the Company entered into an amended and restated employment agreement with an executive of the Company that provides for accelerated vesting of equity awards under certain circumstances. Under the agreement, any equity award granted to the executive after February 20, 2017, shall vest over a period not longer than two years following the applicable grant date. If the executive's employment with the Company continues through and including February 20, 2017, any then outstanding equity award grants will become 100% vested.

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

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

|                                 | <b>Number<br/>of<br/>Shares</b> | <b>Weighted-<br/>Average<br/>Grant<br/>Date Fair<br/>Value<br/>Per<br/>Share</b> |
|---------------------------------|---------------------------------|--|
| Balance as of June 27, 2014     | 762,295                         | \$ 14.23   |
| Granted                         | 557,798                         | \$ 17.62   |
| Issued                          | (209,119) <sup>(2)</sup>        | \$ 17.72   |
| Forfeited                       | (13,370)                        | \$ 15.68   |
| Balance as of December 26, 2014 | 1,097,604                       | \$ 16.03   |

- (1) Includes 849 shares vested on December 1, 2015, but not settled as of December 25, 2015.
- (2) Includes 283 shares vested on December 23, 2014, but not settled as of December 26, 2014.

As of December 25, 2015, there was \$11.4 million of unrecognized share-based compensation expense related to restricted share units under the 2010 Plan that is expected to be recorded over a weighted-average period of 2.92 years.

For the six months ended December 25, 2015 and December 26, 2014, the Company withheld an aggregate of 84,269 shares and 16,399 shares, respectively, upon the vesting of restricted share units, based upon the closing share price on the vesting date to settle the employees' minimum statutory obligation for the applicable income and other employment taxes. For the six months ended December 25, 2015 and December 26, 2014, the Company then remitted cash of \$1.7 million and \$0.3 million, respectively, to the appropriate taxing authorities, and presented it in a financing activity within the unaudited condensed consolidated statements of cash flows. The payment had the effect on shares issued by the Company as it reduced the number of shares that would have been issued on the vesting date and was recorded as a reduction of additional paid-in capital.

**Table of Contents****13. Shareholders' equity***Share capital*

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

For the six months ended December 25, 2015, Fabrinet issued 130,779 ordinary shares upon the exercise of options, for cash consideration at a weighted-average exercise price of \$15.48 per share, and 303,307 ordinary shares upon the vesting of restricted share units, net of shares withheld.

For the six months ended December 26, 2014, Fabrinet issued 26,677 ordinary shares upon the exercise of options, for cash consideration at a weighted-average exercise price of \$15.58 per share, and 192,437 ordinary shares upon the vesting of restricted share units, net of shares withheld.

All such issued shares are fully paid.

**14. Accumulated other comprehensive loss**

The changes in accumulated other comprehensive loss, net of tax, for the six months ended December 25, 2015 were as follows:

| <i>(amount in thousands)</i>                                     | <b>Unrealized<br/>Holding<br/>Losses on<br/>Marketable<br/>Securities</b> | <b>Other</b> | <b>Total</b> |
|--|---|--------------|--------------|
| Balance as of June 26, 2015                                      | \$ (44)   | \$           | \$ (44)      |
| Other comprehensive loss before reclassification adjustment      | (218)   | (48)         | (266)        |
| Amounts reclassified out of accumulated other comprehensive loss | 43  |              | 43           |
| Tax effects  |   |              |              |
| Other comprehensive loss   | \$ (175)  | \$ (48)      | \$ (223)     |
| Balance as of December 25, 2015                                  | \$ (219)  | \$ (48)      | \$ (267)     |

**15. Commitments and contingencies***Bank guarantees*

As of December 25, 2015 and June 26, 2015, there were outstanding bank guarantees given by banks on behalf of Fabrinet Thailand for electricity usage and other normal business amounting to \$0.8 million and \$0.8 million, respectively.

***Operating lease commitments***

The Company leases a portion of its office, capital equipment, and certain land and buildings for its facilities in the Cayman Islands, China, and New Jersey under operating lease arrangements that expire in various calendar years through 2020. Rental expense under these operating leases amounted to \$0.6 million and \$0.5 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

**Table of Contents**

As of December 25, 2015, the future minimum lease payments due under non-cancelable leases were as follows at the end of each fiscal year below:

|   |                 |
|---|-----------------|
| <i>(amount in thousands)</i>                  |                 |
| 2016  | \$ 590          |
| 2017  | 1,034           |
| 2018  | 1,034           |
| 2019  | 572             |
| 2020  | 368             |
| Thereafter                                    | 19              |
| <b>Total minimum operating lease payments</b> | <b>\$ 3,617</b> |

***Purchase obligations***

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

As of December 25, 2015, the Company had an outstanding commitment to third parties of approximately \$33.3 million, mainly related to the construction of a new manufacturing building at the Company's Chonburi campus.

***Indemnification of directors and officers***

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

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

**16. Business segments and geographic information**

Operating segments are defined as components of an enterprise for which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company's chief operating decision maker is Fabrinet's chief executive officer. As of December 25,

Edgar Filing: Fabrinet - Form 10-Q

2015 and December 26, 2014, the Company operated and internally managed a single operating segment. Accordingly, the Company does not accumulate discrete information with respect to separate product lines and does not have separate reportable segments.



**Table of Contents**

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

| <i>(amount in thousands)</i> | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                              | <b>December 25, 2015</b>  | <b>December 26, 2014</b> | <b>December 25, 2015</b> | <b>December 26, 2014</b> |
| North America                | \$ 124,154                | \$ 93,658                | \$ 230,597               | \$ 184,701               |
| Asia-Pacific                 | 84,354                    | 70,914                   | 168,243                  | 148,716                  |
| Europe                       | 24,530                    | 23,781                   | 50,631                   | 44,261                   |
|                              | \$ 233,038                | \$ 188,353               | \$ 449,471               | \$ 377,678               |

As of December 25, 2015 and December 26, 2014, the Company had approximately \$33.6 million and \$0.3 million of long-lived assets based in North America, with the substantial remainder of assets based in Asia-Pacific.

**Significant customers**

The Company had three and two customers that each contributed to 10% or more of its total account receivable as of December 25, 2015 and June 26, 2015, respectively.

**17. Other expenses in relation to flood**

During the week of August 10, 2015, the Company's subsidiary in China temporarily suspended production in its manufacturing facility due to flooding caused by Typhoon Soudelor. The subsidiary resumed operations on August 15, 2015. During the three months ended December 25, 2015, the Company did not recognize expenses in relation to flood. During the six months ended December 25, 2015, the Company recognized \$0.9 million of losses incurred from the event in the unaudited condensed consolidated statements of operations and comprehensive income and submitted claims to its insurers for inventory and equipment losses attributable to the effects of the flooding.

A number of exclusions and limitations in the insurance policies (such as coinsurance, facilities location sub-limits and policy covenants) may reduce the aggregate amount that the Company will ultimately recover from its insurers. Based on the information that the Company has at this time, the Company believes that it will ultimately recover a majority of its losses. The Company will recognize insurance recoveries if and when they become realizable and probable.

The following is a summary of all known losses incurred from this event and recognized in the unaudited condensed consolidated statements of operations and comprehensive income for the six months ended December 25, 2015.

| <i>(amount in thousands)</i>          |        |
|---------------------------------------|--------|
| Loss from inventory                   | \$ 233 |
| Repaired costs of equipment           | 567    |
| Flood protection and salvage expenses | 64     |

Total

\$ 864

**18. Subsequent event**

During January 2016, the Company incurred severance expenses of approximately \$0.7 million in connection with a separation agreement which the Company entered into with a former named executive officer who resigned from the Company effective December 31, 2015.

**Table of Contents**

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

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

our goals and strategies;

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

our expectation that the portion of our future revenues attributable to customers in regions outside of North America will continue to decrease compared with the portion of those revenues for the six months ended December 25, 2015;

our expectation that we will incur significant incremental costs of revenue as a result of our continued diversification into the industrial lasers and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities;

our expectation that we will incur incremental costs of revenue as a result of our planned expansion of our business into new geographic markets;

our expectation that our fiscal year 2016 selling, general and administrative (SG&A) expenses will increase on an absolute dollar basis and as a percentage of revenue compared to fiscal year 2015;

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

our future capital expenditures and our needs for additional financing;

the expansion of our manufacturing capacity, including into new geographies;

the growth rates of our existing markets and potential new markets;

our ability, and the ability of our customers and suppliers, to respond successfully to technological or industry developments;

our suppliers' estimates regarding future costs;

our ability to increase our penetration of existing markets and to penetrate new markets;

our plans to diversify our sources of revenues;

trends in the optical communications, industrial lasers, and sensors markets, including trends to outsource the production of components used in those markets;

our ability to attract and retain a qualified management team and other qualified personnel and advisors; and

competition in our existing and new markets.

## **Table of Contents**

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

## **Overview**

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

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

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

## **China Flooding**

During the week of August 10, 2015, our subsidiary in China temporarily suspended production in its manufacturing facility due to flooding caused by Typhoon Soudelor. The subsidiary resumed operations on August 15, 2015. During the three months ended December 25, 2015, we did not recognize expenses in relation to flood. During the six months ended December 25, 2015, we recognized \$0.9 million of losses incurred from the event in the unaudited condensed consolidated statements of operations and comprehensive income and submitted claims to our insurers for inventory and equipment losses attributable to the effects of the flooding.

A number of exclusions and limitations in the insurance policies (such as coinsurance, facilities location sub-limits and policy covenants) may reduce the aggregate amount that we will ultimately recover from our insurers. Based on the information that we have at the time of filing this Quarterly Report on Form 10-Q, we believe that we will ultimately recover a majority of our losses.

Edgar Filing: Fabrinet - Form 10-Q

The following is a summary of all known losses incurred from this event and recognized in the unaudited condensed consolidated statements of operations and comprehensive income for the six months ended December 25, 2015.

*(amount in thousands)*

|                                       |        |
|---------------------------------------|--------|
| Loss from inventory                   | \$ 233 |
| Repaired costs of equipment           | 567    |
| Flood protection and salvage expenses | 64     |
| Total                                 | \$ 864 |

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

Our total revenues increased by \$44.7 million, or 23.7%, to \$233.0 million for the three months ended December 25, 2015, compared with \$188.4 million for the three months ended December 26, 2014. Our total revenues increased by \$71.8 million, or 19.0%, to \$449.5 million for the six months ended December 25, 2015, compared with \$377.7 million for the six months ended December 26, 2014. The increases were primarily due to (i) an increase in our customers' demand for both optical and non-optical communications manufacturing services during the three and six months ended December 25, 2015 and (ii) our inability to recognize \$4.8 million of consignment revenue during the three and six months ended December 26, 2014, respectively, because of certain consignment revenue recognition issues previously disclosed. We refer to finished goods held in our warehouse on behalf of our customers as consignment goods or consignment inventory, and when the finished goods are sold, we refer to the related revenue as consignment revenue.

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

**Revenues by Geography**

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

The percentage of our revenues generated from a bill-to location outside of North America decreased from 50.3% in the three months ended December 26, 2014 to 46.7% in the three months ended December 25, 2015 and from 51.1% in the six months ended December 26, 2014 to 48.7% in the six months ended December 25, 2015, primarily because of a decrease in sales to our customers in Asia-Pacific and Europe. We expect that the portion of our future revenues attributable to customers in regions outside North America will continue to decrease as compared with the portion of revenues attributable to such customers during the six months ended December 25, 2015.

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

|               | Three Months Ended   |                      | Six Months Ended     |                      |
|---------------|----------------------|----------------------|----------------------|----------------------|
|               | December 25,<br>2015 | December 26,<br>2014 | December 25,<br>2015 | December 26,<br>2014 |
| North America | 53.3%                | 49.7%                | 51.3%                | 48.9%                |
| Asia-Pacific  | 36.2                 | 37.7                 | 37.4                 | 39.4                 |
| Europe        | 10.5                 | 12.6                 | 11.3                 | 11.7                 |

100.0%

100.0%

100.0%

100.0%

***Our Contracts***

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



---

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

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

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

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

During the three and six months ended December 25, 2015, discretionary merit-based bonus awards were made to our non-executive employees. Charges included in cost of revenues for bonus distributions to non-executive employees were \$0.7 million and \$0.6 million for the three months ended December 25, 2015 and December 26, 2014, respectively, and \$1.5 million and \$1.2 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

Share-based compensation expense included in cost of revenues was \$0.5 million and \$0.4 million for the three months ended December 25, 2015 and December 26, 2014, respectively, and \$1.1 million and \$0.7 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

We expect to incur significant incremental costs of revenue as a result of our continued diversification into the industrial lasers, automotive, and sensors markets and other end-markets outside of the optical communications market or our further development of customized optics and glass manufacturing capabilities. We also expect to incur incremental costs of revenue as a result of our planned expansion into new geographic markets, though we are not able to determine the amount of these incremental expenses.

**Selling, General and Administrative Expenses**

Our SG&A expenses primarily consist of corporate employee costs for sales and marketing, general and administrative, and other support personnel, including research and development expenses related to the design of customized optics and glass, travel expenses, legal and other professional fees, share-based compensation expense, and other general expenses not related to cost of revenues. In fiscal year 2016, we expect our SG&A expenses will

increase on an absolute dollar basis and as a percentage of revenue compared with fiscal year 2015 due to the startup expenses of our new manufacturing facility in the United States.

The compensation committee of our board of directors approved a fiscal year 2016 executive incentive plan with quantitative objectives, based on achieving certain revenue and non-GAAP earnings per share targets for our fiscal year ending June 24, 2016, as well as qualitative objectives, based on achieving individual performance goals. Bonuses under our fiscal year 2016 executive incentive plan are payable after the end of fiscal year 2016. In fiscal year 2015, the compensation committee approved a fiscal year 2015 executive incentive plan with quantitative objectives, based on achieving certain revenue and non-GAAP earnings per share targets for our fiscal year ended June 26, 2015, as well as qualitative objectives, based on achieving individual performance goals. In the three months ended September 25, 2015, the compensation committee awarded bonuses to our executive employees for Company and individual achievements of performance under our fiscal 2015 executive incentive plan. Discretionary merit-based bonus awards were also available to our non-executive employees and were payable as of December 25, 2015.

**Table of Contents**

Charges included in SG&A expenses for bonus distributions to non-executive and executive employees were \$1.6 million and \$0.6 million for the three months ended December 25, 2015 and December 26, 2014, respectively, and \$2.2 million and \$1.2 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

Share-based compensation expense included in SG&A expenses was \$2.6 million and \$1.6 million for the three months ended December 25, 2015 and December 26, 2014, respectively, and \$4.7 million and \$3.1 million for the six months ended December 25, 2015 and December 26, 2014, respectively.

**Additional Financial Disclosures****Foreign Exchange**

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

In addition, we are exposed to foreign exchange risk in connection with the long-term loan and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the Bank) in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency interest rate swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. Borrowings and interest under the term loan have been scheduled to be repaid on a quarterly basis between September 2011 and March 2017. As of December 25, 2015, we had outstanding borrowings under the term loan facility of \$7.5 million. Under the terms of the cross currency swap arrangement amounts drawn in Thai baht were converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of London Interbank Offered Rate (LIBOR) plus 2.8% per annum.

In order to manage the risks arising from fluctuations in foreign currency exchange rates, we use derivative financial instruments. We may enter into forward exchange currency contracts or put option contracts to help manage currency exposures associated with certain assets and liabilities, primarily short-term obligations. The forward exchange contracts and put option contracts generally have original maturities of one to eighteen months. All foreign currency exchange contracts are recognized on the unaudited condensed consolidated balance sheet at fair value. As we did not apply hedge accounting to these instruments, the change in the fair value of the derivatives is recorded in foreign exchange (loss) gain, net on the condensed consolidated statements of operations and comprehensive income. The gains and losses on our forward exchange contracts and put option contracts generally offset the assets, liabilities, and transactions economically hedged.

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

| <i>(amount in thousands, except percentages)</i> | As of December 25, 2015 |    |   | As of June 26, 2015 |    |   |
|--|-------------------------|----|---|---------------------|----|---|
|  | Currency                | \$ | % | Currency            | \$ | % |

Edgar Filing: Fabrinet - Form 10-Q

| <b>Assets</b>      |           |           |       |         |           |       |
|--------------------|-----------|-----------|-------|---------|-----------|-------|
| Thai baht          | 393,596   | \$ 10,912 | 66.1  | 377,785 | \$ 11,596 | 51.3  |
| RMB                | 36,273    | 5,605     | 33.9  | 67,455  | 11,029    | 48.7  |
| Total              |           | \$ 16,517 | 100.0 |         | \$ 22,625 | 100.0 |
| <b>Liabilities</b> |           |           |       |         |           |       |
| Thai baht          | 1,036,513 | \$ 28,736 | 83.5  | 860,425 | \$ 26,410 | 88.8  |
| RMB                | 36,684    | 5,669     | 16.5  | 20,461  | 3,347     | 11.2  |
| Total              |           | \$ 34,405 | 100.0 |         | \$ 29,757 | 100.0 |

The Thai baht assets represent cash and cash equivalents, trade accounts receivable, deposits and other current assets. The Thai baht liabilities represent trade accounts payable, accrued expenses and other payables. We manage our exposure to fluctuations in foreign exchange rates by the use of foreign currency contracts and offsetting assets and liabilities

## **Table of Contents**

denominated in the same currency in accordance with management's policy. As of December 25, 2015, there were \$181.5 million in forward contracts outstanding on the Thai baht payables. As of June 26, 2015, there were \$41.0 million in put option contracts outstanding on the Thai baht payables.

The RMB assets represent cash and cash equivalents, accounts receivable and other current assets. The RMB liabilities represent trade accounts payable, accrued expenses and other payables. As of December 25, 2015 and June 26, 2015, we did not have any selling RMB to U.S. dollar forward or put option contracts.

We have not designated the foreign currency forward contracts and option contracts as hedging instruments under the accounting standard for derivatives and hedging. Accordingly, for the three months ended December 25, 2015 and December 26, 2014, we recorded an amount of \$6.2 million for the unrealized gain from changes in the fair market value of the derivatives and \$0.1 million for the unrealized loss from changes in the fair market value of the derivatives, respectively, in our condensed consolidated statements of operations and comprehensive income.

### ***Currency Regulation and Dividend Distribution***

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

Foreign Currency Administration Rules, as amended on August 5, 2008, or the Exchange Rules;

Administration Rules of the Settlement, Sale and Payment of Foreign Exchange (1996), or the Administration Rules; and

Notice on Perfecting Practices Concerning Foreign Exchange Settlement Regarding the Capital Contribution by Foreign-invested Enterprises, as promulgated by the State Administration of Foreign Exchange, or State Administration of Foreign Exchange (SAFE), on August 29, 2008, or Circular 142.

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

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

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

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

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

## **Table of Contents**

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

### ***Income Tax***

Our effective tax rate is a function of the mix of tax rates in the various jurisdictions in which we do business. We are domiciled in the Cayman Islands. Under the current laws of the Cayman Islands, we are not subject to tax in the Cayman Islands on income or capital gains. We have received this undertaking for a 20-year period ending August 24, 2019, and after the expiration date, we may request a renewal with the office of the Clerk of the Cabinet for another twenty years.

Throughout the period of our operations in Thailand, we have generally received income tax and other incentives from the Thailand Board of Investment. Preferential tax treatment from the Thai government in the form of a corporate tax exemption is currently available to us through June 2020 on income generated from the manufacture of products at Pinehurst Building 6. Such preferential tax treatment is contingent on various factors, including the export of our customers' products out of Thailand and our agreement not to move our manufacturing facilities out of our current province in Thailand for at least 15 years. Additionally, in December 2011, the Thailand Revenue Department announced a reduction in corporate income tax rates for tax periods beginning on or after January 1, 2012. As a result of the announcement, corporate income tax rates for our Thai subsidiary were reduced from 23% in fiscal year 2013 to 20% in fiscal year 2014, fiscal year 2015, and fiscal year 2016.

### **Critical Accounting Policies and Use of Estimates**

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

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the fiscal year ended June 26, 2015.

### **Results of Operations**

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





**Table of Contents**

| <i>(amount in thousands)</i>                 | <b>Three Months Ended</b>    |                              | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
|  | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Revenues                                     | \$ 233,038                   | \$ 188,353                   | \$ 449,471                   | \$ 377,678                   |
| Cost of revenues                             | (204,545)                    | (167,292)                    | (394,967)                    | (336,111)                    |
| Gross profit                                 | 28,493                       | 21,061                       | 54,504                       | 41,567                       |
| Selling, general and administrative expenses | (13,715)                     | (10,314)                     | (25,615)                     | (19,051)                     |
| Other expenses in relation to flood          |                              |                              | (864)                        |                              |
| Expenses related to reduction in workforce   |                              | (1,153)                      |                              | (1,153)                      |
| Operating income                             | 14,778                       | 9,594                        | 28,025                       | 21,363                       |
| Interest income                              | 455                          | 324                          | 897                          | 698                          |
| Interest expense                             | (419)                        | (117)                        | (821)                        | (250)                        |
| Foreign exchange gain (loss), net            | 6,166                        | 83                           | (4,326)                      | (23)                         |
| Other income (expense)                       | 106                          | (134)                        | 209                          | (31)                         |
| Income before income taxes                   | 21,086                       | 9,750                        | 23,984                       | 21,757                       |
| Income tax expense                           | (1,283)                      | (1,024)                      | (2,578)                      | (1,995)                      |
| Net income                                   | 19,803                       | 8,726                        | 21,406                       | 19,762                       |
| Other comprehensive loss, net of tax         | (310)                        | (486)                        | (223)                        | (486)                        |
| Net comprehensive income                     | \$ 19,493                    | \$ 8,240                     | \$ 21,183                    | \$ 19,276                    |

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

|  | <b>Three Months Ended</b>    |                              | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|------------------------------|------------------------------|
|  | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Revenues                                     | 100.0%                       | 100.0%                       | 100.0%                       | 100.0%                       |
| Cost of revenues                             | (87.8)                       | (88.8)                       | (87.9)                       | (89.0)                       |
| Gross profit                                 | 12.2                         | 11.2                         | 12.1                         | 11.0                         |
| Selling, general and administrative expenses | (5.9)                        | (5.5)                        | (5.7)                        | (5.1)                        |
| Other expenses in relation to flood          |                              |                              | (0.2)                        |                              |
| Expenses related to reduction in workforce   |                              | (0.6)                        |                              | (0.3)                        |
| Operating income                             | 6.3                          | 5.1                          | 6.2                          | 5.6                          |
| Interest income                              | 0.2                          | 0.2                          | 0.2                          | 0.2                          |
| Interest expense                             | (0.2)                        | (0.1)                        | (0.2)                        | (0.1)                        |

Edgar Filing: Fabrinet - Form 10-Q

|                                      |       |       |       |       |
|--------------------------------------|-------|-------|-------|-------|
| Foreign exchange gain (loss), net    | 2.7   | 0.0   | (1.0) | (0.0) |
| Other income (expense)               | 0.1   | (0.1) | 0.1   | (0.0) |
| Income before income taxes           | 9.1   | 5.1   | 5.3   | 5.7   |
| Income tax expense                   | (0.6) | (0.5) | (0.5) | (0.5) |
| Net income                           | 8.5   | 4.6   | 4.8   | 5.2   |
| Other comprehensive loss, net of tax | (0.1) | (0.3) | (0.1) | (0.2) |
| Net comprehensive income             | 8.4%  | 4.3%  | 4.7%  | 5.0%  |

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

| <i>(amount in thousands)</i> | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                              | <b>December 25, 2015</b>  | <b>December 26, 2014</b> | <b>December 25, 2015</b> | <b>December 26, 2014</b> |
| Optical communications       | \$ 168,694                | \$ 133,807               | \$ 323,456               | \$ 269,063               |
| Lasers, sensors and other    | 64,344                    | 54,546                   | 126,015                  | 108,615                  |
| <b>Total</b>                 | <b>\$ 233,038</b>         | <b>\$ 188,353</b>        | <b>\$ 449,471</b>        | <b>\$ 377,678</b>        |

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

---

**Table of Contents*****Comparison of Three and Six Months Ended December 25, 2015 with Three and Six Months Ended December 26, 2014****Total revenues.*

Our total revenues increased by \$44.7 million, or 23.7%, to \$233.0 million for the three months ended December 25, 2015, compared with \$188.4 million for the three months ended December 26, 2014. This increase was primarily due to (i) an increase in customers' demand for both optical and non-optical communications manufacturing services during the three months ended December 25, 2015 and (ii) our inability to recognize \$4.8 million of consignment revenue during the three months ended December 26, 2014 because of certain consignment revenue recognition issues previously disclosed. Revenues from optical communications products represented 72.4% of our total revenues for the three months ended December 25, 2015, compared to 71.0% for the three months ended December 26, 2014.

Our total revenues increased by \$71.8 million, or 19.0%, to \$449.5 million for the six months ended December 25, 2015, compared with \$377.7 million for the six months ended December 26, 2014. This increase was primarily due to (i) an increase in customers' demand for both optical and non-optical communications manufacturing services during the six months ended December 25, 2015 and (ii) our inability to recognize \$4.8 million of consignment revenue during the six months ended December 26, 2014 because of certain consignment revenue recognition issues previously disclosed. Revenues from optical communications products represented 72.0% of our total revenues for the six months ended December 25, 2015, compared to 71.2% for the six months ended December 26, 2014.

*Cost of revenues.*

Our cost of revenues increased by \$37.3 million, or 22.3%, to \$204.5 million, or 87.8% of total revenues, for the three months ended December 25, 2015, compared with \$167.3 million, or 88.8% of total revenues, for the three months ended December 26, 2014. The increase in cost of revenues on an absolute dollar basis was primarily due to an increase in sales volume, partially offset by a more favorable product mix. Cost of revenues also included share-based compensation expense of \$0.5 million for the three months ended December 25, 2015, compared with \$0.4 million for the three months ended December 26, 2014.

Our cost of revenues increased by \$58.9 million, or 17.5%, to \$395.0 million, or 87.9% of total revenues, for the six months ended December 25, 2015, compared with \$336.1 million, or 89.0% of total revenues, for the six months ended December 26, 2014. The increase in cost of revenues on an absolute dollar basis was primarily due to an increase in sales volume, partially offset by a more favorable product mix. Cost of revenues also included share-based compensation expense of \$1.1 million for the six months ended December 25, 2015, compared with \$0.7 million for the six months ended December 26, 2014.

*Gross profit.*

Our gross profit increased by \$7.4 million, or 35.3%, to \$28.5 million, or 12.2% of total revenues, for the three months ended December 25, 2015, compared with \$21.1 million, or 11.2% of total revenues, for the three months ended December 26, 2014. Our gross profit increased by \$12.9 million, or 31.1%, to \$54.5 million, or 12.1% of total revenues, for the six months ended December 25, 2015, compared with \$41.6 million, or 11.0% of total revenues, for the six months ended December 26, 2014.

The improvement in gross profit margin during the three and six months ended December 25, 2015, compared with the three and six months ended December 26, 2014, was related to a more favorable product mix during the three and six months ended December 25, 2015.

*SG&A expenses.*

Our SG&A expenses increased by \$3.4 million, or 33.0%, to \$13.7 million, or 5.9% of total revenues, for the three months ended December 25, 2015, compared with \$10.3 million, or 5.5% of total revenues, for the three months ended December 26, 2014. Our SG&A expenses increased in absolute dollars and as a percentage of revenue due primarily to an increase in expenses relating to our new manufacturing facility in the United States of \$1.9 million and severance and related payments of \$0.6 million to an employee who left the Company in December 2015. We also recorded share-based compensation charges of \$2.6 million for the three months ended December 25, 2015, compared with \$1.6 million for the three months ended December 26, 2014.

**Table of Contents**

Our SG&A expenses increased by \$6.6 million, or 34.5%, to \$25.6 million, or 5.7% of total revenues, for the six months ended December 25, 2015, compared with \$19.1 million, or 5.0% of total revenues, for the six months ended December 26, 2014. Our SG&A expenses increased in absolute dollars and as a percentage of revenue due primarily to an increase in expenses relating to our new manufacturing facility in the United States of \$4.1 million and an increase in sales and marketing expenses of \$1.6 million. We also recorded share-based compensation charges of \$4.7 million for the six months ended December 25, 2015, compared with \$3.1 million for the six months ended December 26, 2014.

*Other expenses in relation to flood.*

In the three months ended December 25, 2015, we did not have expense in relation to flood. In the six months ended December 25, 2015, we recognized other expenses in relation to flood, which mainly consisted of \$0.6 million of repaired cost of equipment and \$0.2 million of inventory losses, which occurred at our subsidiary in China in August 2015.

*Expenses related to reduction in workforce*

During the three months ended December 26, 2014, we implemented a reduction in workforce and incurred expenses of approximately \$1.2 million which represented severance and benefits costs associated with the termination of approximately 100 employees in accordance with contractual obligations and local regulations.

*Operating income.*

Our operating income increased by \$5.2 million to \$14.8 million, or 6.3% of total revenues, for the three months ended December 25, 2015, compared with \$9.6 million, or 5.1% of total revenues, for the three months ended December 26, 2014.

Our operating income increased by \$6.7 million to \$28.0 million, or 6.2% of total revenues, for the six months ended December 25, 2015, compared with \$21.4 million, or 5.7% of total revenues, for the six months ended December 26, 2014.

*Interest income.*

Our interest income increased by \$0.2 million to \$0.5 million, or 0.2% of total revenues, for the three months ended December 25, 2015, compared with \$0.3 million, or 0.2% of total revenues, for the three months ended December 26, 2014.

Our interest income increased by \$0.2 million to \$0.9 million, or 0.2% of total revenues, for the six months ended December 25, 2015, compared with \$0.7 million, or 0.2% of total revenues, for the six months ended December 26, 2014.

*Interest expense.*

Our interest expense increased by \$0.3 million to \$0.4 million for the three months ended December 25, 2015, compared with \$0.1 million for the three months ended December 26, 2014. Our interest expense increased by \$0.5 million to \$0.8 million for the six months ended December 25, 2015, compared with \$0.3 million for the six months ended December 26, 2014. The increases were due to an increase in the average balance of our bank borrowings resulting from a drawdown of a revolving loan under our Facility Agreement taken during the third quarter of fiscal

year 2015, as well as the amortization of additional deferred debt issuance costs.

*Foreign exchange gain (loss), net.*

Our foreign exchange gain, net, increased by \$6.1 million to \$6.2 million, or 2.7% of total revenues, for the three months ended December 25, 2015, compared with \$0.1 million, or 0.1% of total revenues, for the three months ended December 26, 2014. Our foreign exchange loss, net, increased by \$4.3 million to \$4.3 million, or 1.0% of total revenues, for the six months ended December 25, 2015, compared with \$0.01 million, or 0.01% of total revenues, for the six months ended December 26, 2014. The increases were due to changes in the fair value of outstanding derivatives as of December 25, 2015.

*Income before income taxes.*

We recorded income before income taxes of \$21.1 million and \$24.0 million for the three and six months ended December 25, 2015, respectively, compared with income before income taxes of \$9.8 million and \$21.8 million for the three and six months ended December 26, 2014, respectively.

---

**Table of Contents**

*Income tax expense.*

Our provision for income tax reflects an effective tax rate of 6.1% for the three months ended December 25, 2015, compared with an effective tax rate of 10.5% for the three months ended December 26, 2014. The decrease was primarily due to the fact that the Company had lower taxable income during the three months ended December 25, 2015 as compared to the three months ended December 26, 2014 because of an increase in unrealized gain from changes in the fair value of derivatives during the three months ended December 25, 2015, which are not subject to tax.

Our provision for income tax reflects an effective tax rate of 10.7% for the six months ended December 25, 2015, compared with an effective tax rate of 9.2% for the six months ended December 26, 2014. The increase was primarily due to the fact that we had higher taxable income during the six months ended December 25, 2015 as compared to the six months ended December 26, 2014, due to the expiration of a tax privilege of our subsidiary in Thailand.

*Net income.*

We recorded net income of \$19.8 million, or 8.5% of total revenues, for the three months ended December 25, 2015, compared with \$8.7 million, or 4.6% of total revenues, for the three months ended December 26, 2014.

We recorded net income of \$21.4 million, or 4.8% of total revenues, for the six months ended December 25, 2015, compared with \$19.8 million, or 5.2% of total revenues, for the six months ended December 26, 2014.

*Other comprehensive loss.*

We recorded other comprehensive loss of \$0.3 million, or 0.1% of total revenues, for the three months ended December 25, 2015, compared with \$0.5 million, or 0.3% of total revenues, for the three months ended December 26, 2014.

We recorded other comprehensive loss of \$0.2 million, or 0.1% of total revenues, for the six months ended December 25, 2015, compared with \$0.5 million, or 0.1% of total revenues, for the six months ended December 26, 2014.

**Liquidity and Capital Resources**

***Cash Flows and Working Capital***

We primarily finance our operations through cash flow from operations. As of December 25, 2015 and December 26, 2014, we had cash, cash equivalents, and marketable securities of \$266.6 million and \$253.3 million, respectively, and outstanding debt of \$55.5 million and \$13.5 million, respectively.

Our cash and cash equivalents, which primarily consist of cash on hand, demand deposits, and liquid investments with original maturities of three months or less, are placed with banks and other financial institutions. The weighted-average interest rate on our cash and cash equivalents for the three and six months ended December 25, 2015 was 1.2% and 0.6%, respectively, and for the three and six months ended December 26, 2014 was 0.7% and 0.6%, respectively.

Our cash investments are made in accordance with an investment policy approved by the Audit Committee of our Board of Directors. In general, our investment policy requires that securities purchased be rated A1, P-1, F1 or better.

## Edgar Filing: Fabrinet - Form 10-Q

No security may have an effective maturity that exceeds three years. Our investments in fixed income securities are primarily classified as available-for-sale securities and are recorded at fair value. The cost of securities sold is based on the specific identification method. Unrealized gains and losses on these securities are recorded as other comprehensive income (loss) and are reported as a separate component of shareholders' equity.

During the three months ended December 25, 2015, we borrowed an additional \$18.0 million under our Facility Agreement, \$12.4 million of which was used to fund the purchase of land in Chonburi, Thailand. As of December 25, 2015, we had a short-term borrowing of \$48.0 million under our Facility Agreement. In addition, to better manage our cash on hand, we invested in short-term marketable securities of \$135.2 million as of December 25, 2015.

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



**Table of Contents**

In September 2015, we entered into an agreement to purchase land in Chonburi, Thailand. In December 2015, the land purchase was completed and we began construction of a new manufacturing facility on such land, which we expect to complete in the second quarter of fiscal year 2017. We believe that our current manufacturing capacity is sufficient to meet our anticipated production requirements for at least the next few quarters. Should there be a major delay in construction beyond our estimated completion date, we may not have the capacity to meet our anticipated production requirements. We maintain a long-term loan associated with construction of production facilities at our Pinehurst campus in Thailand that will come due within the next 15 months. We also have a sufficient credit facility in place to fund the amount needed to construct a new building at our Chonburi campus. We anticipate that our internally generated working capital, along with our cash and cash equivalents will be adequate to repay these obligations.

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

| <i>(amount in thousands)</i>                         | <b>Six Months Ended</b>      |                              |
|--|------------------------------|------------------------------|
|  | <b>December 25,<br/>2015</b> | <b>December 26,<br/>2014</b> |
| Net cash provided by operating activities            | \$ 23,704                    | \$ 30,601                    |
| Net cash used in investing activities                | \$ (19,648)                  | \$ (147,433)                 |
| Net cash provided by (used in) financing activities  | \$ 14,955                    | \$ (4,624)                   |
| Net increase (decrease) in cash and cash equivalents | \$ 19,011                    | \$ (121,456)                 |
| Cash and cash equivalent, beginning of period        | \$ 112,978                   | \$ 233,477                   |
| Cash and cash equivalents, end of period             | \$ 131,359                   | \$ 111,971                   |

*Operating Activities*

Net cash provided by operating activities decreased by \$6.9 million, or 22.5%, to \$23.7 million for the six months ended December 25, 2015, compared with net cash provided by operating activities of \$30.6 million for the six months ended December 26, 2014. This decrease was due to numbers of factors, including an increase in accounts receivable of \$9.6 million and inventory of \$6.5 million related to higher sales and customer demand and an increase in payments to vendors of \$4.2 million, offset by an increase in the unrealized loss exchange rate and fair value of derivatives of \$5.6 million and an increase in depreciation of \$2.4 million.

*Investing Activities*

Net cash used in investing activities decreased by \$127.8 million, or 86.7%, to \$19.6 million for the six months ended December 25, 2015, compared with net cash used in investing activities of \$147.4 million for the six months ended December 26, 2014. This decrease was primarily due to a net decrease in available-for-sale securities of \$149.0 million, offset by an increase in purchase of property, plant, and equipment of \$21.0 million primarily to support our manufacturing operations in the United States and construct a new facility in Thailand.

*Financing Activities*

Net cash provided by financing activities increased by \$19.6 million, or 423.4%, to \$15.0 million for the six months ended December 25, 2015, compared with net cash used in financing activities of \$4.6 million for the six months ended December 26, 2014. This increase was primarily due to a drawdown of \$18.0 million under our Facility Agreement, \$12.4 million of which was used to fund the purchase of land in Chonburi, Thailand during the three months ended December 25, 2015.

**Off-Balance Sheet Commitments and Arrangements**

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

**Recent Accounting Pronouncements**

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

---

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

We had cash, cash equivalents, and marketable securities totaling \$266.6 million and \$255.8 million as of December 25, 2015 and June 26, 2015, respectively. Our exposure to interest rate risk primarily relates to the interest income generated by excess cash invested in highly liquid investments with maturities of three months or less from the original dates of purchase. The cash, cash equivalents, and marketable securities are held for working capital purposes. We have not used derivative financial instruments in our investment portfolio. We have not been exposed nor do we anticipate being exposed to material risks due to changes in market interest rates. Declines in interest rates, however, will reduce future investment income. If overall interest rates had declined by 10 basis points during the six months ended December 25, 2015 and December 26, 2014, our interest income would have decreased by approximately \$0.1 million and \$0.1 million, respectively, assuming consistent investment levels.

Interest rate risk also refers to our exposure to movements in interest rates associated with our interest bearing liabilities. The interest bearing liabilities are denominated in U.S. dollars and the interest expense is based on the London Inter-Bank Offered Rate (LIBOR), plus an additional margin, depending on the lending institution. If the LIBOR had increased by 100 basis points during the six months ended December 25, 2015 and December 26, 2014, our interest expense would have increased by approximately \$0.1 million and \$0.1 million, respectively, assuming consistent borrowing levels.

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

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

***Foreign Currency Risk***

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

As a consequence, our gross profit margins, operating results, profitability and cash flows are adversely impacted when the dollar depreciates relative to the Thai baht or the RMB. We have a particularly significant currency rate exposure to changes in the exchange rate between the Thai baht and the U.S. dollar. We must translate foreign currency-denominated results of operations, assets and liabilities for our foreign subsidiaries to U.S. dollars in our unaudited condensed consolidated financial statements. Consequently, increases and decreases in the value of the U.S.

dollar compared with such foreign currencies will affect our reported results of operations and the value of our assets and liabilities on our unaudited condensed consolidated balance sheets, even if our results of operations or the value of those assets and liabilities has not changed in its original currency. These transactions could significantly affect the comparability of our results between financial periods or result in significant changes to the carrying value of our assets, liabilities and shareholders' equity.

---

**Table of Contents**

In addition, we are exposed to foreign exchange risk in connection with the credit facility and cross currency swap arrangements we entered into with TMB Bank Public Company Limited (the Bank) in May 2011 for the construction of Pinehurst Building 6. The terms of the contract with the Bank provide the following facilities: (1) a term loan facility for up to Thai baht 960 million (equal to \$30.0 million) with a fixed interest rate of 5.28% per annum, (2) a hedging facility for currency swaps with a notional amount of \$30.0 million, and (3) a settlement limit of Thai baht 65 million, subject to certain terms and conditions as set forth therein. Borrowings and interest under the term loan are scheduled to be repaid on a quarterly basis between September 2011 and March 2017. Under the terms of the cross currency interest rate swap arrangement, all amounts drawn down in Thai baht were converted to U.S. dollars for repayment by us on a quarterly basis at the floating rate of LIBOR plus 2.8% per annum.

We attempt to hedge against these exchange rate risks by entering into hedging contracts that are typically one to eighteen months in duration, leaving us exposed to longer term changes in exchange rates. We recorded foreign exchange gain of \$6.2 million and \$0.1 million for the three months ended December 25, 2015 and December 26, 2014, respectively. As foreign currency exchange rates fluctuate relative to the U.S. dollar, we expect to incur foreign currency translation adjustments and may incur foreign currency exchange losses. For example, a 10% weakening in the U.S. dollar against the Thai baht and the RMB would have resulted in a decrease in our net dollar position of approximately \$2.0 million and \$0.8 million as of December 25, 2015 and June 26, 2015, respectively. We cannot give any assurance as to the effect that future changes in foreign currency rates will have on our unaudited condensed consolidated financial position, operating results or cash flows.

***Credit Risk***

Credit risk refers to our exposures to financial institutions, suppliers and customers that have in the past and may in the future experience financial difficulty, particularly in light of recent conditions in the credit markets and the global economy. As of December 25, 2015, our cash and cash equivalents were held in deposits and highly liquid investment products with maturities of three months or less with banks and other financial institutions having credit ratings of A minus or above. Our marketable securities as of December 25, 2015 are held in various financial institutions with a maturity limit not to exceed 3 years, and all securities are rated A1, P-1, F1 or better. We continue to monitor our surplus cash and consider investment in corporate and U.S. government debt as well as certain available for sale securities in accordance with our investment policy. We generally monitor the financial performance of our suppliers and customers, as well as other factors that may affect their access to capital and liquidity. Presently, we believe that we will not incur material losses due to our exposures to such credit risk.

**ITEM 4. CONTROLS AND PROCEDURES*****Evaluation of Disclosure Controls and Procedures***

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our chief executive officer and chief financial officer concluded that as of the end of the period covered by this Quarterly Report on Form 10-Q our disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and include controls and procedures designed to ensure that the information required to be disclosed by us in such reports is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow timely decisions regarding required disclosures. Management's assessment of the effectiveness of our internal control over financial reporting is expressed at the level

of reasonable assurance because a control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

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

There were no changes in our internal control over financial reporting during the three months ended December 25, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II: OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

**ITEM 1A. RISK FACTORS**

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

**Risks Related to Our Business**

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

We have depended, and will continue to depend, upon a small number of customers for a significant percentage of our total revenues. During the three months ended December 25, 2015 and December 26, 2014, we had two customers that each contributed 10% or more of our total revenues, respectively. These customers together accounted for 31% and 30% of our total revenues, respectively, during the periods. During the six months ended December 25, 2015 and December 26, 2014, we had two customers that each contributed 10% or more of our total revenues, respectively. These customers together accounted for 30% and 31% of our total revenues, respectively, during the periods. Dependence on a small number of customers means that a reduction in orders from, a loss of, or other adverse actions by any one of these customers would reduce our revenues and could have a material adverse effect on our business, operating results and share price.

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

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

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

Natural disasters, such as the October and November 2011 flooding in Thailand, where most of our manufacturing operations are located, could severely disrupt our manufacturing operations and increase our supply chain costs. These events, over which we have little or no control, could cause a decrease in demand for our services, make it difficult or impossible for us to manufacture and deliver products and for our suppliers to deliver components allowing us to manufacture those products, require large expenditures to repair or replace our facilities, or create delays and inefficiencies in our supply chain. For example, the October and November 2011 flooding in Thailand forced us to temporarily shut down all of our manufacturing facilities in Thailand and cease production permanently at our Chokchai facility in Thailand, which adversely affected our ability to meet our customers' demands during fiscal year 2012. In some countries in which we operate, including the PRC and Thailand, potential outbreaks of infectious diseases such as the H1N1 influenza virus, severe acute respiratory syndrome (SARS) or bird flu could disrupt our manufacturing operations, reduce demand for our customers' products and increase our supply chain costs. In addition, increased international political instability, evidenced by the threat or occurrence of terrorist attacks, enhanced national security measures, conflicts in the Middle East and Asia, strained international relations arising from these conflicts and the related decline in consumer



---

**Table of Contents**

confidence and economic weakness, may hinder our ability to do business. Any escalation in these events or similar future events may disrupt our operations and the operations of our customers and suppliers, and may affect the availability of materials needed for our manufacturing services. Such events may also disrupt the transportation of materials to our manufacturing facilities and finished products to our customers. These events have had, and may continue to have, an adverse impact on the U.S. and world economy in general, and customer confidence and spending in particular, which in turn could adversely affect our total revenues and operating results. The impact of these events on the volatility of the U.S. and world financial markets also could increase the volatility of the market price of our ordinary shares and may limit the capital resources available to us, our customers and our suppliers.

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

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

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

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

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

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

our ability to acquire new customers and retain our existing customers by delivering superior quality and customer service;

the cyclical nature of the optical communications market, as well as the industrial lasers, medical and sensors markets;

competition;

our ability to achieve favorable pricing for our services;

our ability to manage our headcount and other costs; and

changes in the relative mix in our revenues.

---

**Table of Contents**

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

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

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

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

Our current and prospective customers tend to evaluate our capabilities against the merits of their internal manufacturing as well as the capabilities of third-party manufacturers. We believe the internal manufacturing capabilities of current and prospective customers are our primary competition. This competition is particularly strong when our customers have excess manufacturing capacity, as was the case when the markets that we serve experienced a significant downturn from 2001 through 2004 and again in 2008 and 2009, that resulted in underutilized capacity. Many of our potential customers continue to have excess manufacturing capacity at their facilities. In addition, as a result of the October and November 2011 flooding in Thailand, some of our customers began manufacturing products internally or using other third-party manufacturers that were not affected by the flooding. If our customers choose to manufacture products internally rather than to outsource production to us, or choose to outsource to a third-party manufacturer, our business, financial condition and operating results could be harmed.

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

Many of our customers and potential competitors have longer operating histories, greater name recognition, larger customer bases and significantly greater resources than we have. These advantages may allow them to devote greater resources than we can to the development and promotion of service offerings that are similar or superior to our service offerings. These competitors may also engage in more extensive research and development, undertake more far-reaching marketing campaigns, adopt more aggressive pricing policies or offer services that achieve greater market acceptance than ours. These competitors may also compete with us by making more attractive offers to our existing and potential employees, suppliers and strategic partners. Further, consolidation in the optics industry could lead to larger and more geographically diverse competitors. New and increased competition could result in price reductions

for our services, reduced gross profit margins or loss of market share. We may not be able to compete successfully against our current and future competitors, and the competitive pressures we face may harm our business, financial condition and operating results.

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

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

---

**Table of Contents**

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

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

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

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

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

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

Also, we have significant exposure to changes in the exchange rate between the RMB and the U.S. dollar. The expenses of our PRC subsidiary are denominated in RMB. Currently, RMB are convertible in connection with trade- and service-related foreign exchange transactions, foreign debt service and payment of dividends. The PRC government may at its discretion restrict access in the future to foreign currencies for current account transactions. If this occurs, our PRC subsidiary may not be able to pay us dividends in U.S. dollars without prior approval from the PRC State Administration of Foreign Exchange. In addition, conversion of RMB for most capital account items, including direct investments, is still subject to government approval in the PRC. This restriction may limit our ability

to invest the earnings of our PRC subsidiary. As of December 25, 2015, the U.S. dollar had depreciated approximately 6.7% against the RMB since December 27, 2013. There remains significant international pressure on the PRC government to adopt a substantially more liberalized currency policy. Any appreciation in the value of the RMB against the U.S. dollar could negatively impact our operating results.

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

We rely on a single source or a limited number of suppliers for critical materials used in a significant number of the products we manufacture. We generally purchase these single or limited source materials through standard purchase orders and do not maintain long-term supply agreements with our suppliers. We generally use a rolling 12 month forecast based on anticipated product orders, customer forecasts, product order history, backlog, and warranty and service demand to determine our materials requirements. Lead times for the parts and components that we order vary significantly and depend on factors such as manufacturing cycle times, manufacturing yields and the availability of raw materials used to produce the parts or components. Historically, we have experienced supply shortages resulting from various causes, including

**Table of Contents**

reduced yields by our suppliers, which prevented us from manufacturing products for our customers in a timely manner. Our revenues, profitability and customer relations could be harmed by a stoppage or delay of supply, a substitution of more expensive or less reliable parts, the receipt of defective parts or contaminated materials, an increase in the price of supplies, or an inability to obtain reductions in price from our suppliers in response to competitive pressures.

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

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

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

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

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

Our customers are located throughout the world. Total revenues from the bill-to-location of customers outside of North America accounted for 46.7% and 50.3% of our total revenues for the three months ended December 25, 2015 and December 26, 2014, respectively, and 48.7% and 51.1% of our total revenues for the six months ended December 25, 2015 and December 26, 2014, respectively. We expect that total revenues from the bill to location of customers outside of North America will continue to account for a significant portion of our total revenues. Our customers also depend on international sales, which further exposes us to the risks associated with international operations. In addition, our international operations and sales subject us to a variety of domestic and foreign trade regulatory requirements.

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

The majority of our assets and manufacturing operations are located in Thailand. Therefore, political, social, business and economic conditions in Thailand have a significant effect on our business. In March 2015, Thailand was assessed as a medium-high political risk by AON Political Risk, a risk management, insurance and consulting firm. Any changes to tax regimes, laws, exchange controls or political action in Thailand may harm our business, financial condition and operating results.

Thailand has a history of political unrest that includes the involvement of the military as an active participant in the ruling government. In recent years, political unrest in the country has sparked political demonstrations and, in some instances, violence. Most recently, in May 2014, the Thai military took over the government in a coup, and it continues to rule the country today. It is unknown how long it may take for the current political situation to be resolved and for democracy to be restored, or what effects the current political situation may have on Thailand and the surrounding region. Any succession crisis in the Kingdom of Thailand could cause new or increased political instability, which could prevent shipments from entering or leaving the country and disrupt our ability to manufacture products in Thailand, and we could be forced to transfer our manufacturing activities to more stable, and potentially more costly, regions.

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



---

**Table of Contents**

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

We anticipate that we will continue to invest in our customized optics manufacturing facilities located in Fuzhou, China. Because these operations are located in the PRC, they are subject to greater political, legal and economic risks than the geographies in which the facilities of many of our competitors and customers are located. In particular, the political and economic climate in the PRC (both at national and regional levels) is fluid and unpredictable. In March 2015, the PRC was assessed as a medium-high political risk by AON Political Risk. A large part of the PRC's economy is still being operated under varying degrees of control by the PRC government. By imposing industrial policies and other economic measures, such as control of foreign exchange, taxation, import and export tariffs, environmental regulations, land use rights, intellectual property and restrictions on foreign participation in the domestic market of various industries, the PRC government exerts considerable direct and indirect influence on the development of the PRC economy. Many of the economic reforms carried out by the PRC government are unprecedented or experimental and are expected to change further. Any changes to the political, legal or economic climate in the PRC could harm our business, financial condition and operating results.

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

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

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

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



---

**Table of Contents**

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

Consolidation in the markets we serve has resulted in a reduction in the number of potential customers for our services. In some cases, consolidation among our customers has led to a reduction in demand for our services as customers acquired the capacity to manufacture products in-house.

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

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

Volatility and disruption in the capital and credit markets, depressed consumer confidence, and negative global economic conditions have affected levels of business and consumer spending. Concerns about the potential default of various national bonds and debt backed by individual countries as well as the politics impacting these, could negatively impact the U.S. and global economies and adversely affect our financial results. In particular, recent economic uncertainty in Europe has led to reduced demand in some of our customers' optical communications product portfolios. If economic conditions in Europe do not recover or if they continue to deteriorate, our operating results could be harmed.

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

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

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

In February 2015, we expanded our manufacturing capacity with the purchase of land and a building in Santa Clara, California. In December 2015, we completed the purchase of land in Chonburi, Thailand and began construction of a new manufacturing facility on such land, which we expect to complete in the second quarter of fiscal year 2017. Should there be a major delay in construction beyond our estimated completion date, we may not have the capacity to

meet our anticipated production requirements. We may continue to devote significant resources to the expansion of our manufacturing capacity, and any such expansion will be expensive, will require management's time and may disrupt our operations. In the event we are unsuccessful in our attempts to expand our manufacturing capacity, our business, financial condition and operating results could be harmed.

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

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

## Table of Contents

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

the quality of input, materials and equipment;

the quality and feasibility of our customer's design;

the repeatability and complexity of the manufacturing process;

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

the monitoring of the manufacturing environment.

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

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

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

We generally provide a warranty of between one to two years on the products that we manufacture for our customers. This warranty typically guarantees that products will conform to our customers' specifications and be free from defects in workmanship. Defects in the products we manufacture, whether caused by a design, engineering, manufacturing or component failure or by deficiencies in our manufacturing processes and whether during or after the warranty period, could result in product or component failures, which may damage our business reputation, whether or not we are indemnified for such failures. We could also incur significant costs to repair or replace defective products under warranty, particularly when such failures occur in installed systems. In some instances, we may also be required to incur costs to repair or replace defective products outside of the warranty period in the event that a recurring defect is discovered in a certain percentage of a customer's products delivered over an agreed upon period of time. We have

experienced product or component failures in the past and remain exposed to such failures, as the products that we manufacture are widely deployed throughout the world in multiple environments and applications. Further, due to the difficulty in determining whether a given defect resulted from our customer's design of the product or our manufacturing process, we may be exposed to product liability or product warranty claims arising from defects that are not our fault. In addition, if the number or type of defects exceeds certain percentage limitations contained in our contractual arrangements, we may be required to conduct extensive failure analysis, re-qualify for production or cease production of the specified products.

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

---

**Table of Contents**

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

As a manufacturer of products for the optics industry, we are required to meet certain certification standards, including the following: ISO9001 for Manufacturing Quality Management Systems; ISO14001 for Environmental Management Systems; TL9000 for Telecommunications Industry Quality Certification; ISO/TS16949 for Automotive Industry Quality Certification; ISO13485 for Medical Devices Industry Quality Certification; AS9100 for Aerospace Industry Quality Certification; and OHSAS18001 for Occupational Health and Safety Management Systems. We also maintain compliance with various additional standards imposed by the U.S. Food and Drug Administration, or FDA, with respect to the manufacture of medical devices.

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

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

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

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

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

that can be used in the products we manufacture for our customers.

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



---

**Table of Contents**

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

The Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, as well as other rules implemented by the SEC and the New York Stock Exchange (NYSE), impose various requirements on public companies, including requiring changes in corporate governance practices. These and proposed corporate governance laws and regulations under consideration may further increase our compliance costs. If compliance with these various legal and regulatory requirements diverts our management's attention from other business concerns, it could have a material adverse effect on our business, financial condition and results of operations. The Sarbanes-Oxley Act requires, among other things, that we assess the effectiveness of our internal control over financial reporting annually and disclosure controls and procedures quarterly. While we were able to assert in our Annual Report on Form 10-K that our internal control over financial reporting was effective as of June 26, 2015, we cannot predict the outcome of our testing in future periods. If we are unable to assert in any future reporting periods that our internal control over financial reporting is effective (or if our independent registered public accounting firm is unable to express an opinion on the effectiveness of our internal controls), we could lose investor confidence in the accuracy and completeness of our financial reports, which would have an adverse effect on our share price.

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

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

We base our tax position upon the anticipated nature and conduct of our business and upon our understanding of the tax laws of the various countries in which we have assets or conduct activities. However, our tax position is subject to review and possible challenge by tax authorities and to possible changes in law, which may have retroactive effect. Fabrinet (the Cayman Islands Parent) is an exempted company incorporated in the Cayman Islands. We maintain manufacturing operations in Thailand, the PRC and the United States, any of which jurisdictions could assert tax claims against us. We cannot determine in advance the extent to which some jurisdictions may require us to pay taxes or make payments in lieu of taxes. Preferential tax treatment from the Thai government in the form of a corporate tax exemption is currently available to us through June 2020 on income generated from the manufacture of products at Pinehurst Building 6. Such preferential tax treatment is contingent on various factors, including the export of our customers' products out of Thailand and our agreement not to move our manufacturing facilities out of our current province in Thailand for at least 15 years. We will lose this favorable tax treatment in Thailand unless we comply with these restrictions, and as a result we may delay or forego certain strategic business decisions due to these tax considerations. In addition, we benefit from reductions in corporate tax rates in Thailand for fiscal years 2013 to 2016.

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

Certain of our subsidiaries provide products and services to, and may from time to time undertake certain significant transactions with, us and our other subsidiaries in different jurisdictions. For instance, we have intercompany agreements in place that provide for our California and Singapore subsidiaries to provide administrative services for the Cayman Islands Parent, and the Cayman Islands Parent has entered into manufacturing agreements with our Thai subsidiary. In general, related party transactions and, in particular, related party financing transactions, are subject to close review by tax authorities. Moreover, several jurisdictions in which we operate have tax laws with detailed transfer pricing rules that require all transactions with non-resident related parties to be priced using arm's length pricing principles and require the existence of contemporaneous documentation to support such pricing. Tax authorities in various jurisdictions could challenge the validity of our related party transfer pricing policies. Such a challenge generally involves a complex area of

**Table of Contents**

taxation and a significant degree of judgment by management. If any taxation authorities are successful in challenging our financing or transfer pricing policies, our income tax expense may be adversely affected and we could become subject to interest and penalty charges, which may harm our business, financial condition and operating results.

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

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

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

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

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

we may incur indebtedness to pay for the transactions;

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

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

we may incur amortization expenses related to certain intangible assets;

we may devote significant resources to transactions that may not ultimately yield anticipated benefits;

we may incur greater than expected expenses or lower than expected revenues;

we may assume obligations with respect to regulatory requirements, including environmental regulations, which may prove more burdensome than expected; or

we may become subject to litigation.

Acquisitions are inherently risky, and we can provide no assurance that our previous or future acquisitions will be successful or will not harm our business, financial condition and operating results.

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

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

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

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

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

**Table of Contents**

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

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

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

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

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

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

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

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

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

---

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

We use professional investment management firms to manage our excess cash and cash equivalents. Our marketable securities as of December 25, 2015 are primarily investments in a fixed income portfolio, including corporate bonds and commercial paper, U.S. agency and U.S. Treasury securities, and sovereign and municipal securities. Our investment portfolio may become impaired by deterioration of the capital markets. We follow an established investment policy and set of guidelines to monitor and help mitigate our exposure to interest rate and credit risk. The policy sets forth credit quality standards and limits our exposure to any one issuer, as well as our maximum exposure to various asset classes. The policy also provides that we may not invest in marketable securities with a maturity in excess of three years.

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

Should financial market conditions worsen, investments in some financial instruments may pose risks arising from market liquidity and credit concerns. In addition, any deterioration of the capital markets could cause our other income and expense to vary from expectations. As of December 25, 2015, we did not record any impairment charges associated with our investment portfolio of marketable securities, and although we believe our current investment portfolio has little risk of material impairment, we cannot predict future market conditions or market liquidity, or credit availability, and can provide no assurance that our investment portfolio will remain materially unimpaired.

***Energy price volatility may negatively impact our results of operations.***

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

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

Our revenues, expenses and results of operations have fluctuated in the past and are likely to do so in the future from quarter to quarter and year to year due to the risk factors described in this section and elsewhere in this Quarterly Report on Form 10-Q. In addition to market and industry factors, the price and trading volume of our ordinary shares may fluctuate in response to a number of events and factors relating to us, our competitors, our customers and the markets we serve, many of which are beyond our control. Factors such as variations in our total revenues, earnings

and cash flow, announcements of new investments or acquisitions, changes in our pricing practices or those of our competitors, commencement or outcome of litigation, sales of ordinary shares by us or our principal shareholders, fluctuations in market prices for our services and general market conditions could cause the market price of our ordinary shares to change substantially. Any of these factors may result in large and sudden changes in the volume and price at which our ordinary shares trade. Among other things, volatility and weakness in our share price could mean that investors may not be able to sell their shares at or above the prices they paid. Volatility and weakness could also impair our ability in the future to offer our ordinary shares or convertible securities as a source of additional capital and/or as consideration in the acquisition of other businesses.

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



**Table of Contents**

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

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

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

Based upon estimates of the value of our assets, which are based in part on the trading price of our ordinary shares, we do not expect to be a passive foreign investment company, or PFIC, for U.S. federal income tax purposes for the taxable year 2015 or for the foreseeable future. However, despite our expectations, we cannot assure you that we will not be a PFIC for the taxable year 2015 or any future year because our PFIC status is determined at the end of each year and depends on the composition of our income and assets during such year. If we are a PFIC, our U.S. investors will be subject to increased tax liabilities under U.S. tax laws and regulations and to burdensome reporting requirements.

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

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

establish a classified board of directors;

prohibit our shareholders from calling meetings or acting by written consent in lieu of a meeting;

limit the ability of our shareholders to propose actions at duly convened meetings; and

authorize our board of directors, without action by our shareholders, to issue preferred shares and additional ordinary shares.

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

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

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

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

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

---

**Table of Contents**

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

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

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

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

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

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

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

***Sales of Unregistered Securities***

Not applicable.

***Purchases of Equity Securities by the Issuer and Affiliated Purchasers***

Not applicable.

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

**ITEM 6. EXHIBITS**

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

Table of Contents

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 2, 2016.

**FABRINET**

By: /s/ TOH-SENG NG

Name: **Toh-Seng Ng**

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

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

| <b>Exhibit<br/>Number</b> | <b>Description</b>   | <b>Incorporated by reference herein</b> |                    |                    |                 |
|---------------------------|--|---|--------------------|--------------------|-----------------|
|                           |  | <b>Form</b>                             | <b>Exhibit No.</b> | <b>Filing Date</b> | <b>File No.</b> |
| 10.1                      | Construction Contract, dated October 30, 2015, by and among Fabrinet Co., Ltd. and Standard Performance Co., Ltd.  |   |                    |                    |                 |
| 31.1                      | Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002          |   |                    |                    |                 |
| 31.2                      | Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002          |   |                    |                    |                 |
| 32.1                      | Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |   |                    |                    |                 |
| 101.INS                   | XBRL Instance.   |   |                    |                    |                 |
| 101.SCH                   | XBRL Taxonomy Extension Schema.  |   |                    |                    |                 |
| 101.CAL                   | XBRL Taxonomy Extension Calculation Linkbase.  |   |                    |                    |                 |
| 101.DEF                   | XBRL Taxonomy Extension Definition Linkbase.   |   |                    |                    |                 |
| 101.LAB                   | XBRL Taxonomy Extension Label Linkbase.  |   |                    |                    |                 |
| 101.PRE                   | XBRL Taxonomy Extension Presentation Linkbase.   |   |                    |                    |                 |