Verisk Analytics, Inc.
Form 10-Q
August 02, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to
Commission File Number: 001-34480

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

Delaware	26-2994223
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
545 Washington Boulevard Jersey City, NJ	07310-1686
(Address of principal executive offices)	(Zip Code)

(201) 469-2000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý 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 ý	Accelerated filer ¨
Non-accelerated filer o (Do not check if a 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 ý

As of July 29, 2016, there were 168,970,219 shares outstanding of the registrant's Common Stock, par value $.001.

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PART I — FINANCIAL INFORMATION
Item 1. Financial Statements
VERISK ANALYTICS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)
As of June 30, 2016 and December 31, 2015

	2016	2015
	(In thousands, except for share and per share data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$196,402	$138,348
Available-for-sale securities	3,372	3,576
Accounts receivable, net of allowance for doubtful accounts of $3,137 and $2,642, respectively	241,326	250,947
Prepaid expenses	30,870	34,126
Income taxes receivable	5,748	48,596
Other current assets	19,199	52,913
Current assets held-for-sale	—	76,063
Total current assets	496,917	604,569
Noncurrent assets:		
Fixed assets, net	334,631	350,311
Intangible assets, net	1,104,262	1,245,083
Goodwill	2,629,941	2,753,026
Pension assets	39,534	32,922
Other assets	119,778	25,845
Noncurrent assets held-for-sale	—	581,896
Total assets	$4,725,063	$5,593,652
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$163,413	$222,112
Short-term debt and current portion of long-term debt	2,256	874,811
Pension and postretirement benefits, current	1,831	1,831
Deferred revenues	431,171	340,833
Income tax payable	16,495	—
Current liabilities held-for-sale	—	39,670
Total current liabilities	615,166	1,479,257
Noncurrent liabilities:		
Long-term debt	2,273,032	2,270,904
Pension benefits	12,698	12,971
Postretirement benefits	1,868	1,981
Deferred income taxes, net	314,705	329,175
Other liabilities	57,730	58,360
Noncurrent liabilities held-for-sale	—	68,993
Total liabilities	3,275,199	4,221,641
Commitments and contingencies		
Stockholders' equity:		
	137	137

Common stock, $.001 par value; 2,000,000,000 shares authorized; 544,003,038 shares issued and 168,719,149 and 169,424,981 shares outstanding, respectively		
Additional paid-in capital	2,071,497	2,023,390
Treasury stock, at cost, 375,283,889 and 374,578,057 shares, respectively	(2,680,728)	(2,571,190)
Retained earnings	2,516,101	2,161,726
Accumulated other comprehensive losses	(457,143)	(242,052)
Total stockholders' equity	1,449,864	1,372,011
Total liabilities and stockholders' equity	$4,725,063	$5,593,652

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

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VERISK ANALYTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)
For The Three and Six Months Ended June 30, 2016 and 2015

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands, except for share and per share data)			
Revenues	$498,296	$428,599	$990,997	$812,892
Expenses:				
Cost of revenues (exclusive of items shown separately below)	178,466	154,639	351,743	288,423
Selling, general and administrative	75,557	82,336	146,594	132,050
Depreciation and amortization of fixed assets	29,388	22,677	61,275	42,065
Amortization of intangible assets	23,806	22,904	47,677	30,359
Total expenses	307,217	282,556	607,289	492,897
Operating income	191,079	146,043	383,708	319,995
Other income (expense):				
Investment income (loss) and others, net	846	(259)	890	(761)
Gain on derivative instruments	—	85,187	—	85,187
Interest expense	(31,435)	(37,662)	(63,467)	(55,924)
Total other income (expense), net	(30,589)	47,266	(62,577)	28,502
Income from continuing operations before income taxes	160,490	193,309	321,131	348,497
Provision for income taxes	(53,754)	(34,392)	(104,665)	(93,207)
Income from continuing operations	106,736	158,917	216,466	255,290
Discontinued operations:				
Income from discontinued operations	254,745	7,717	256,525	12,021
Provision for income taxes from discontinued operations	(99,745)	(3,314)	(118,616)	(5,305)
Income from discontinued operations	155,000	4,403	137,909	6,716
Net income	$261,736	$163,320	$354,375	$262,006
Basic net income per share:				
Income from continuing operations	$0.64	$0.97	$1.29	$1.59
Income from discontinued operations	0.92	0.02	0.81	0.04
Basic net income per share	$1.56	$0.99	$2.10	$1.63
Diluted net income per share:				
Income from continuing operations	$0.62	$0.95	$1.26	$1.55
Income from discontinued operations	0.91	0.02	0.81	0.04
Diluted net income per share	$1.53	$0.97	$2.07	$1.59
Weighted average shares outstanding:				
Basic	168,296,318	164,141,804	168,375,034	161,114,861
Diluted	171,218,782	167,586,100	171,349,833	164,533,656

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

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VERISK ANALYTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)
For The Three and Six Months Ended June 30, 2016 and 2015

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Net income	$261,736	$163,320	$354,375	$262,006
Other comprehensive loss, net of tax:				
Foreign currency translation adjustment	(141,178)	(4,209)	(216,521)	(4,429)
Unrealized holding gain on available-for-sale securities	92	7	203	69
Pension and postretirement liability adjustment	720	387	1,227	1,001
Total other comprehensive loss	(140,366)	(3,815)	(215,091)	(3,359)
Comprehensive income	$121,370	$159,505	$139,284	$258,647

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

VERISK ANALYTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)
For The Year Ended December 31, 2015 and The Six Months Ended June 30, 2016

	Common Stock Issued	Par Value	Unearned KSOP Contributions	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Losses	Total Stockholders' Equity
	(In thousands, except for share data)							
Balance, January 1, 2015	544,003,038	$137	$(161)	$1,171,196	$(2,533,764)	$1,654,149	$(80,514)	$211,043
Net income	—	—	—	—	—	507,577	—	507,577
Other comprehensive loss	—	—	—	—	—	—	(161,538)	(161,538)
Treasury stock acquired (1,088,474 shares)	—	—	—	100,000	(120,456)	—	—	(20,456)
KSOP shares earned (47,686 shares reissued from treasury stock)	—	—	161	13,588	327	—	—	14,076
Shares issued from equity offering (10,604,000 shares reissued from treasury stock)	—	—	—	651,258	69,590	—	—	720,848
Stock options exercised, including tax benefit of $27,992 (1,739,847 shares reissued from treasury stock)	—	—	—	57,503	11,730	—	—	69,233
Restricted stock lapsed, including tax benefit of $1,238 (177,252 shares reissued from treasury stock)	—	—	—	68	1,170	—	—	1,238
Employee stock purchase plan (25,599 shares reissued from treasury stock)	—	—	—	1,625	173	—	—	1,798
Stock based compensation	—	—	—	30,116	—	—	—	30,116
Net share settlement from restricted stock awards (32,882	—	—	—	(2,350)	—	—	—	(2,350)

shares withheld for tax settlement)								
Other stock issuances (5,844 shares reissued from treasury stock)	—	—	—	386	40	—	—	426
Balance, December 31, 2015	544,003,038	137	—	2,023,390	(2,571,190)	2,161,726	(242,052)	1,372,011
Net income	—	—	—	—	—	354,375	—	354,375
Other comprehensive loss	—	—	—	—	—	—	(215,091)	(215,091)
Treasury stock acquired (1,663,095 shares)	—	—	—	—	(116,363)	—	—	(116,363)
KSOP shares issued (109,316 shares reissued from treasury stock)	—	—	—	7,433	781	—	—	8,214
Stock options exercised, including tax benefit of $9,944 (655,448 shares reissued from treasury stock)	—	—	—	25,542	4,673	—	—	30,215
Restricted stock lapsed, including tax benefit of $1,713 (163,574 shares reissued from treasury stock)	—	—	—	545	1,168	—	—	1,713
Employee stock purchase plan (16,390 shares reissued from treasury stock)	—	—	—	1,135	117	—	—	1,252
Stock based compensation	—	—	—	16,423	—	—	—	16,423
Net share settlement of restricted stock awards (36,581 shares withheld for tax settlement)	—	—	—	(2,930)	—	—	—	(2,930)
Other stock issuances (12,535 shares reissued from treasury stock)	—	—	—	(41)	86	—	—	45
Balance, June 30, 2016	544,003,038	$137	$—	$2,071,497	$(2,680,728)	$2,516,101	$(457,143)	$1,449,864

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

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VERISK ANALYTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
For The Six Months Ended June 30, 2016 and 2015

	2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income	$354,375	$262,006
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization of fixed assets	68,331	53,070
Amortization of intangible assets	53,581	42,953
Amortization of debt issuance costs and original issue discount	2,472	10,634
Allowance for doubtful accounts	1,327	456
KSOP compensation expense	8,214	7,969
Stock based compensation	16,468	19,047
Gain on derivative instruments	—	(85,187)
Gain on sale of discontinued operations	(269,385)	—
Realized loss (gain) on available-for-sale securities, net	274	(14)
Deferred income taxes	6,123	(7,390)
Loss (gain) on disposal of fixed assets, net	811	(3)
Excess tax benefits from exercised stock options and restricted stock awards	(6,570)	(8,419)
Changes in assets and liabilities, net of effects from acquisitions:		
Accounts receivable	21,179	37,981
Prepaid expenses and other assets	(1,503)	9,747
Income taxes	61,707	11,858
Accounts payable and accrued liabilities	(26,399)	(27,393)
Deferred revenues	92,581	38,305
Pension and postretirement benefits	(5,232)	(7,129)
Other liabilities	131	(2,990)
Net cash provided by operating activities	378,485	355,501
Cash flows from investing activities:		
Acquisitions, net of cash acquired of $1,034 and $35,398, respectively	(6,200)	(2,811,759)
Purchase of non-controlling interest in non-public companies	—	(101)
Proceeds from sale of discontinued operations	719,374	—
Escrow funding associated with acquisition	—	(78,694)
Proceeds from the settlement of derivative instruments	—	85,187
Capital expenditures	(62,231)	(60,092)
Purchases of available-for-sale securities	(25)	(29)
Proceeds from sales and maturities of available-for-sale securities	283	230
Other investing activities, net	(620)	—
Net cash provided by (used in) investing activities	650,581	(2,865,258)
Cash flows from financing activities:		
Proceeds from issuance of long-term debt, net of original issue discount	—	1,243,966
(Repayment) proceeds of short-term debt, net	(870,000)	30,000
Proceeds from issuance of short-term debt with original maturities greater than three months	—	830,000
Repayment of current portion of long-term debt	—	(170,000)
Repayment of long-term debt	—	(50,000)
Payment of debt issuance costs	—	(23,053)

Repurchases of common stock	(116,363)	—
Excess tax benefits from exercised stock options and restricted stock awards	6,570	8,419
Proceeds from stock options exercised	16,326	18,103
Proceeds from issuance of stock as part of a public offering	—	720,848
Net share settlement of restricted stock awards	(2,930)	(2,350)
Other financing activities, net	(3,536)	(2,569)
Net cash (used in) provided by financing activities	(969,933)	2,603,364
Effect of exchange rate changes	(1,079)	12,525
Increase in cash and cash equivalents	58,054	106,132
Cash and cash equivalents, beginning of period	138,348	39,359
Cash and cash equivalents, end of period	$196,402	$145,491
Supplemental disclosures:		
Taxes paid	$149,597	$87,914
Interest paid	$62,902	$37,977
Noncash investing and financing activities:		
Promissory note received for sale of discontinued operations	$82,900	$—
Equity interest received for sale of discontinued operations	$8,400	$—
Deferred tax liability established on date of acquisition	$293	$258,976
Tenant improvement included in other liabilities	$34	$448
Capital lease obligations	$637	$905
Capital expenditures included in accounts payable and accrued liabilities	$1,629	$4,658

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

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VERISK ANALYTICS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
(Amounts in thousands, except for share and per share data, unless otherwise stated)
1. Organization:
Verisk Analytics, Inc. and its consolidated subsidiaries (“Verisk” or the “Company”) enable risk-bearing businesses to better understand and manage their risks. The Company provides its customers proprietary data that, combined with analytic methods, create embedded decision support solutions. The Company is one of the largest aggregators and providers of data pertaining to property and casualty (“P&C”) insurance risks in the United States of America (“U.S.”). The Company offers predictive analytics and decision support solutions to customers in rating, underwriting, claims, catastrophe and weather risk, global risk analytics, natural resources intelligence, economic forecasting, and many other fields.
Verisk was established to serve as the parent holding company of Insurance Services Office, Inc. (“ISO”) upon completion of the initial public offering ("IPO"), which occurred on October 9, 2009. ISO was formed in 1971 as an advisory and rating organization for the P&C insurance industry to provide statistical and actuarial services, to develop insurance programs and to assist insurance companies in meeting state regulatory requirements. For over the past decade, the Company has broadened its data assets, entered new markets, placed a greater emphasis on analytics, and pursued strategic acquisitions. Verisk trades under the ticker symbol “VRSK” on the NASDAQ Global Select Market.
2. Basis of Presentation and Summary of Significant Accounting Policies:
The accompanying unaudited condensed consolidated financial statements have been prepared on the basis of accounting principles generally accepted in the U.S. (“U.S. GAAP”). The preparation of financial statements in conformity with these accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include acquisition purchase price allocations, the fair value of goodwill, the realization of deferred tax assets and liabilities, fair value of stock based compensation, assets and liabilities for pension and postretirement benefits, and the estimate for the allowance for doubtful accounts. Actual results may ultimately differ from those estimates.
Certain reclassifications have been made related to the debt disclosure within the condensed consolidated financial statements and the notes to conform to the respective 2016 presentation in connection with the adoption of Accounting Standards Update ("ASU") 2015-03, Simplifying the Presentation of Debt Issuance Costs ("ASU No. 2015-03"). On March 31, 2016, the Company's healthcare business qualified as assets held-for-sale. Accordingly, the respective assets and liabilities have been classified as held-for-sale in the condensed consolidated balance sheet at December 31, 2015. The Company's healthcare business was sold on June 1, 2016. The results of operations and the gain on sale of the Company's healthcare business are reported as a discontinued operation for the periods presented herein (See Note 6).
The condensed consolidated financial statements as of June 30, 2016 and for the three and six months ended June 30, 2016 and 2015, in the opinion of management, include all adjustments, consisting of normal recurring items, to present fairly the Company’s financial position, results of operations and cash flows. The operating results for the three and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for the full year. The condensed consolidated financial statements and related notes for the three and six months ended June 30, 2016 have been prepared on the same basis as and should be read in conjunction with the annual report on Form 10-K for the year ended December 31, 2015. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to the rules of the Securities and Exchange Commission (“SEC”). The Company believes the disclosures made are adequate to keep the information presented from being misleading.
Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-03. The amendments in this update require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The Company adopted the guidance on January 1, 2016 and as a result, debt issuance costs of $22,275 were reclassified from "Other assets" to "Long-term debt" on the Company's condensed consolidated balance sheet as of December 31, 2015.

In April 2015, the FASB issued ASU No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement ("ASU No. 2015-05"). This guidance is intended to help entities evaluate the accounting for fees paid by a customer in a cloud computing arrangement, primarily to determine whether the arrangement includes a sale or license of software. The Company adopted the guidance on January 1, 2016. The adoption of ASU No. 2015-05 did not have a material impact on the Company's condensed consolidated financial statements.

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In September 2015, the FASB issued ASU No. 2015-16, Simplifying the Accounting for Measurement-Period Adjustments ("ASU No. 2015-16"). ASU No. 2015-16 requires, for business combinations, that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. The Company adopted the guidance on January 1, 2016. Adoption of this guidance did not have a material impact on the results of operations or financial position (see Note 5).

In January 2016, the FASB issued ASU No. 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities (“ASU No. 2016-01”). The amendments in this update require all equity investments to be measured at fair value with changes in the fair value recognized through net income (other than those accounted for under equity method of accounting or those that result in consolidation of the investee). The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value either upon occurrence of an observable price change or upon identification of an impairment. The amendments in ASU No. 2016-01 are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For amendments applicable to the Company, early adoption is not permitted. The Company will conform to ASC No. 2016-01 in the condensed consolidated financial statements in future periods.

In February 2016, the FASB issued ASU No. 2016-02, Leases ("ASU No. 2016-02"). This ASU amends the existing accounting considerations and treatments for leases through the creation of Topic 842, Leases, to increase transparency and comparability among organizations by requiring the recognition of lease assets and lease liabilities on the balance sheet and disclosing key information about lease arrangements. The amendments in ASU No. 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments is permitted for all entities. The Company has decided not to early adopt ASU No. 2016-02 and is currently evaluating the impact the amendments may have on its condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-07, Equity Method and Joint Ventures (“ASU No. 2016-07”). The amendments in the update eliminate the requirement that an entity retroactively adopt the equity method of accounting if an investment qualifies for use of the equity method as a result of an increase in the level of ownership or degree of influence. The amendments require that the equity method investor add the cost of acquiring the additional interest in the investee to the current basis of the investor’s previously held interest and adopt the equity method of account as of the date the investment becomes qualified for equity method accounting. The amendments in ASU No. 2016-07 are effective for all entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company has not elected to early adopt. The adoption of ASU No. 2016-07 is not expected to have a material impact on the Company’s condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-08, Principal Versus Agent Considerations (“ASU No. 2016-08”). The amendments to this update are intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amendments in ASU No. 2016-08 are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently evaluating ASU No. 2016-08 and has not determined the impact this standard may have on its financial statements nor decided upon the method of adoption.

In March 2016, the FASB issued ASU No. 2016-09, Improvements to Employee Share-Based Payment Accounting (“ASU No. 2016-09”). The objective of this update is to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in ASU No. 2016-09 are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for any entity in any interim or annual period. The Company has not elected to early adopt. The Company is currently evaluating ASU No. 2016-09 and has not determined the impact this amendment may have on its financial statements.

In April 2016, the FASB issued ASU No. 2016-10, Identifying Performance Obligations and Licensing (“ASU No. 2016-10”). The amendments in this update clarify the following two aspects of Accounting Standards Codification ("ASC") 606 ("ASC 606"), Revenue From Contracts With Customers: identifying performance obligations and the licensing implementation guidance, while retaining the related principles for those areas. The amendments in ASU No. 2016-10 are effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The Company is currently evaluating ASU No. 2016-10 and has not determined the impact this standard may have on its financial statements nor decided upon the method of adoption.

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In May 2016, the FASB issued ASU No. 2016-11, Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-16 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting (SEC Update) ("ASU No. 2016-11"). Specifically, registrants should not rely on the following SEC Staff Observer comments upon adoption of ASC 606: a. Revenue and Expense Recognition for Freight Services in Process, b. Accounting for Shipping and Handling Fees and Costs, c. Accounting for Consideration Given by a Vendor to a Customer, and d. Accounting for Gas-Balancing Arrangements. The adoption of ASU No. 2016-11 is not expected to have a material impact on the Company’s condensed consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, Narrow-Scope Improvements and Practical Expedients ("ASU No. 2016-12"). ASU No. 2016-12 does not change the core principle of the guidance in ASC 606. Rather, this update affects only the narrow scope improvements to the guidance on collectability, noncash consideration, and completed contracts at transition. The effective date and transition requirements for ASU 2016-12 are the same as the effective date and transition requirements for ASC 606. The adoption of ASU No. 2016-12 is not expected to have a material impact on the Company’s condensed consolidated financial statements.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments ("ASU No. 2016-13"). Financial assets measured at amortized cost basis, including but not limited to loans, debt securities and trade receivables , that have the contractual right to receive cash are within the scope of this guidance. Under ASU No. 2016-13, these financial assets should be presented at the net amount expected to be collected. The income statement should reflect the measurement of credit losses that have taken place during the period. The amendments in ASU No. 2016-13 are effective for fiscal years beginning after December 15, 2019. Earlier adoption is permitted. The Company has decided not to early adopt ASU No. 2016-13. The adoption of ASU No. 2016-13 is not expected to have a material impact on the Company’s condensed consolidated financial statements.

3. Investments:

Available-for-sale securities consisted of the following:

	Adjusted Cost	Gross Unrealized Gain (Loss)	Fair Value
June 30, 2016			
Registered investment companies	$ 3,090	$ 282	$ 3,372
December 31, 2015			
Registered investment companies	$ 3,622	$ (46)	$ 3,576

In addition to the available-for-sale securities above, the Company has equity investments in non-public companies in which the Company acquired non-controlling interests and for which no readily determinable market value exists. These securities were accounted for in accordance with ASC 323-10-25, The Equity Method of Accounting for Investments in Common Stock ("ASC 323-10-25"). At June 30, 2016 and December 31, 2015, the carrying value of such securities was $16,887 and $8,487, respectively, and has been included in “Other assets” in the accompanying condensed consolidated balance sheets.

4. Fair Value Measurements:

Certain assets and liabilities of the Company are reported at fair value in the accompanying condensed consolidated balance sheets. To increase consistency and comparability of assets and liabilities recorded at fair value, ASC 820-10, Fair Value Measurements (“ASC 820-10”), established a three-level fair value hierarchy to prioritize the inputs to valuation techniques used to measure fair value. ASC 820-10 requires disclosures detailing the extent to which companies measure assets and liabilities at fair value, the methods and assumptions used to measure fair value and the effect of fair value measurements on earnings. In accordance with ASC 820-10, the Company applied the following fair value hierarchy:

Level 1 - Assets or liabilities for which the identical item is traded on an active exchange, such as publicly-traded instruments.

Level 2 - Assets and liabilities valued based on observable market data for similar instruments.

Level 3 -	Assets or liabilities for which significant valuation assumptions are not readily observable in the market; instruments valued based on the best available data, some of which are internally-developed, and considers risk premiums that market participants would require.

The fair values of cash and cash equivalents (other than money-market funds, which are recorded on a reported net asset value basis disclosed below), accounts receivable, securities accounted for under ASC 323-10-25, accounts payable and accrued

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liabilities, deferred revenues, and short-term debt approximate their carrying amounts because of the short-term nature of these instruments.

The following table summarizes fair value measurements by level for cash equivalents and registered investment companies that were measured at fair value on a recurring basis:

	Quoted Prices in Active Markets for Identical Assets (Level 1)
June 30, 2016	
Registered investment companies (1)	$ 3,372
December 31, 2015	
Registered investment companies (1)	$ 3,576

(1) Registered investment companies are classified as available-for-sale securities and are valued using quoted prices in active markets multiplied by the number of shares owned.

The Company has not elected to carry its long-term debt at fair value. The carrying value of the long-term debt represents amortized cost. The Company assesses the fair value of its long-term debt based on quoted market prices if available, and if not, an estimate of interest rates available to the Company for debt with similar features, the Company’s current credit rating and spreads applicable to the Company. The following table summarizes the carrying value and estimated fair value of the long-term debt as of June 30, 2016 and December 31, 2015, respectively:

	Fair Value Hierarchy	2016 Carrying Value	Estimated Fair Value	2015 Carrying Value	Estimated Fair Value
Financial instrument not carried at fair value:					
Subordinated promissory note receivable	Level 2	$83,078	$82,900	$—	$—
Long-term debt excluding capitalized leases	Level 2	$2,275,767	$2,462,613	$2,274,144	$2,328,134

5. Acquisitions:

2016 Acquisition

On April 14, 2016, the Company acquired 100 percent of the stock of Risk Intelligence Ireland ("RII"), a leading provider of fraud detection, compliance, risk control, and process automation services to the Irish insurance industry, for a net cash purchase price of $6,200. RII enhances the ability of the Company's Risk Assessment segment to serve the international insurance market. The allocations of the purchase price will be finalized once all information is obtained, but not to exceed one year from the acquisition date.

2015 Acquisitions

On May 19, 2015, the Company acquired 100 percent of the stock of Wood Mackenzie Limited ("Wood Mackenzie") for a net cash purchase price of $2,889,629, including $78,694 of an indemnity escrow, which the Company financed through a combination of debt and equity offerings, borrowings under the Company's credit facility, and cash on hand. Due to the fact that a portion of the purchase price was funded in pounds sterling and the remainder in U.S. dollars, the Company entered into a foreign currency hedging instrument to purchase pounds sterling. The Company recorded a gain on the hedge of $85,187 for the three and six months ended June 30, 2015. The proceeds from the gain were utilized to partially fund the acquisition of Wood Mackenzie. Wood Mackenzie is a global provider of data analytics and commercial intelligence for the energy, chemicals, metals and mining verticals. This acquisition advances the Company’s strategy to expand internationally and positions the Company in the global energy market. Wood Mackenzie is included in the energy and specialized markets vertical, formerly named the specialized markets vertical, of the Decision Analytics segment.

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As of June 30, 2016, the Company finalized the purchase accounting for the acquisition of Wood Mackenzie. The final purchase price allocations of the acquisition resulted in the following:

	Wood Mackenzie
Cash and cash equivalents	$35,398
Accounts receivable	80,307
Current assets	97,397
Fixed assets	71,929
Intangible assets	1,111,950
Goodwill and other	2,002,418
Other assets	1,993
Total assets acquired	3,401,392
Current liabilities	121,996
Deferred revenues	142,457
Deferred income taxes, net	204,289
Other liabilities	7,623
Total liabilities assumed	476,365
Net assets acquired	2,925,027
Cash acquired	(35,398)
Net cash purchase price	$2,889,629

The impact of finalization of the purchase accounting for Wood Mackenzie was not material to the condensed consolidated statements of operations for the three and six months ended June 30, 2016 and 2015.

The Company determined the fair values of the assets and liabilities of Wood Mackenzie with the assistance of valuations performed by third party specialists, discounted cash flow analysis and estimates made by management. The final amounts assigned to intangible assets by type for the Wood Mackenzie acquisition are summarized in the table below:

	Weighted Average Useful Life	Total
Technology-related	7 years	$104,663
Marketing-related	20 years	232,935
Customer-related	15 years	278,106
Database-related	20 years	496,246
Total intangible assets		$1,111,950

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Supplemental information on an unaudited pro forma basis is presented below as if the acquisition of Wood Mackenzie occurred at the beginning of 2015. The pro forma information for the three and six months ended June 30, 2015 presented below is based on estimates and assumptions, which the Company believes to be reasonable but not necessarily indicative of the condensed consolidated financial position or results of operations in future periods or the results that actually would have been realized had this acquisition been completed at the beginning of 2015. The unaudited pro forma information includes intangible asset amortization charges and incremental borrowing costs as a result of the acquisition, net of related tax, estimated using the Company's effective tax rate for continuing operations for the three and six months ended June 30, 2015:

	Three Months Ended June 30, 2015	Six Months Ended June 30, 2015
	(unaudited)	
Pro forma revenues	$477,561	$952,606
Pro forma income from continuing operations	$140,378	$255,129
Pro forma basic income from continuing operations per share	$0.86	$1.58
Pro forma diluted income from continuing operations per share	$0.84	$1.55

On November 6, 2015, the Company acquired 100 percent of the stock of Infield Systems Limited ("Infield"). Infield is a provider of business intelligence, analysis, and research to the oil, gas, and associated marine industries. Infield has become part of Wood Mackenzie and continues to provide services to enhance Wood Mackenzie's upstream and supply chain capabilities in the Decision Analytics segment. The Company paid a net cash purchase price of $13,804.
On November 20, 2015, the Company acquired 100 percent of the stock of The PCI Group ("PCI"). PCI is a consortium of five specialist companies that offer integrated data and subscriptions research in the chemicals, fibers, films, and plastics sectors. PCI has become part of Wood Mackenzie and continues to provide services to enhance Wood Mackenzie's chemicals capabilities in the Decision Analytics segment. The Company paid a net cash purchase price of $37,387.
The preliminary allocations of the purchase prices for the acquisitions of Infield and PCI are subject to revisions as additional information is obtained about the facts and circumstances that existed as of the acquisition dates. The revisions may have a significant impact on the condensed consolidated financial statements. The allocations of the purchase prices will be finalized once all information is obtained, but not to exceed one year from the acquisition dates. The primary areas of the purchase price allocations that are not yet finalized relate to fixed assets and operating leases, income and non-income taxes, deferred revenues, the valuation of intangible assets acquired, and residual goodwill.

The goodwill associated with the stock purchases of Wood Mackenzie, Infield and PCI is not deductible for tax purposes. For the six months ended June 30, 2015, the Company incurred transaction costs related to the Wood Mackenzie acquisition of $26,617 included within "Selling, general and administrative" expenses and $13,336 included within "Interest expense" in the accompanying condensed consolidated statements of operations.

Acquisition Escrows

Pursuant to the related acquisition agreements, the Company has funded various escrow accounts to satisfy pre-acquisition indemnity and tax claims arising subsequent to the acquisition date, as well as a portion of the contingent payments. At June 30, 2016 and December 31, 2015, the current portion of the escrows amounted to $4,856 and $38,656, and the noncurrent portion of the escrows amounted to $0 and $4,591, respectively. The current and noncurrent portions of the escrows have been included in "Other current assets" and "Other assets" in the accompanying condensed consolidated balance sheets, respectively.
6. Discontinued Operations:

On June 1, 2016, the Company sold 100 percent of the stock of its healthcare business, Verisk Health ("Verisk Health"), in exchange for a purchase price that consisted of $719,374 of cash consideration after a working capital adjustment of $626, a subordinated promissory note with a face value of $100,000 and an eight year maturity (the "Note"), and other contingent consideration (collectively, the "Sale"). The Company recognized income from the discontinued operation, net of tax, of $155,000 and $137,909 for the three and six months ended June 30, 2016, respectively. Results of operations for the healthcare business are reported as a discontinued operation for the three and six months ended June 30, 2016 and for all prior periods presented.

The Note has a stated interest rate of 9.0% per annum, increasing to 11.0% per annum at the earlier of specified refinancings or acquisitions, or the fourth anniversary of the closing of the Sale. Interest shall accrue from the closing date and on each anniversary of the Sale until the Note is paid in full on the unpaid principal amount of the Note outstanding at the interest rate in effect (computed

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on the basis of a 360-day year of twelve 30-day months). On each anniversary of the Sale, accrued interest shall be paid in kind by adding the amount of such accrued interest to the outstanding principal amount of the Note. The issuer of the Note may, at its option at any time prior to the maturity date, prepay any, or all, of the principal amount of the Note, plus accrued but unpaid interest as of the elected prepayment date, without any premium or penalty. There is a mandatory prepayment of the Note as a result of (i) the proceeds of a specified dividend recapitalization received by the issuer, (ii) the consummation of a change of control of the issuer, or (iii) the sale, transfer or other disposition by the parent of the issuer of more than 10.0% of the capital stock of the issuer. As of June 30, 2016, the Company had a receivable of $83,078 outstanding under the Note. The fair value of the Note is based on management estimates with the assistance of valuations performed by third party specialists, discounted cash flow analysis based on current market conditions and assumptions that the Note would be paid in full at maturity, including accrued interest, with no prepayment election.

The Company also received a 10.0% interest in the issuer's stock, the exercise value of which will be contingent on the parent of the issuer realizing a specified rate of return on its investment. As of June 30, 2016, the Company had an equity investment of $8,400 related to such interest accounted for in accordance with ASC 323-10-25. The value of the equity investment is based on management estimates with the assistance of valuations performed by third party specialists. Refer to Note 3. Investments for further discussion.

The following table summarizes the results from the discontinued operation for the three and six months ended June 30:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues from discontinued operations	$43,173	$69,051	$112,323	$144,155
Expenses:				
Cost of revenues (exclusive of items shown separately below)	31,399	40,557	75,878	90,989
Selling, general and administrative	26,448	8,956	36,559	17,548
Depreciation and amortization of fixed assets	70	5,951	7,056	11,005
Amortization of intangible assets	—	5,908	5,904	12,594
Total expenses	57,917	61,372	125,397	132,136
Operating income	(14,744)	7,679	(13,074)	12,019
Other income (expense):				
Gain on sale	269,385	—	269,385	—
Investment income and others, net	104	38	214	2
Total other income	269,489	38	269,599	2
Income from discontinued operations before income taxes	254,745	7,717	256,525	12,021
Provision for income taxes (including tax on gain of $118,019)	(99,745)	(3,314)	(118,616)	(5,305)
Income from discontinued operations, net of tax	$155,000	$4,403	$137,909	$6,716

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The following table summarizes the assets held-for-sale and the liabilities held-for-sale as of December 31, 2015:

	December 31, 2015
Accounts receivable, net of allowance for doubtful accounts of $2,428	$ 69,152
Prepaid expenses	6,615
Income tax receivable	257
Other current assets	39
Total current assets held-for-sale	$ 76,063
Fixed assets, net	$ 67,857
Intangible assets, net	131,662
Goodwill	381,800
Other assets	577
Total noncurrent assets held-for-sale	$ 581,896
Accounts payable and accrued liabilities	$ 23,552
Deferred revenues	16,118
Total current liabilities held-for-sale	$ 39,670
Deferred income taxes, net	$ 67,255
Other liabilities	1,738
Total noncurrent liabilities held-for-sale	$ 68,993

Net cash provided by operating activities and net cash used in investing activities from the discontinued operation for the six months ended June 30 are presented below:

	Six Months Ended June 30,	
	2016	2015
Net cash provided by operating activities	$21,443	$54,017
Net cash used in investing activities	$(10,649)	$(10,800)

The Company has also entered into a transitional service agreement ("TSA") with the buyer of Verisk Health. Under the TSA, the Company provides various services for terms generally up to 12 months and receives a level of cost reimbursement from the buyer.

7. Goodwill and Intangible Assets:

The following is a summary of the change in goodwill from December 31, 2015 through June 30, 2016, both in total and as allocated to the Company’s operating segments:

	Risk Assessment	Decision Analytics	Total
Goodwill at December 31, 2015 (1)	$ 55,555	$2,697,471	$2,753,026
Current year acquisition	4,639	—	4,639
Purchase accounting reclassification	—	8,641	8,641
Foreign currency translation	(66)	(136,299)	(136,365)
Goodwill at June 30, 2016 (1)	$ 60,128	$2,569,813	$2,629,941

(1) The balances at December 31, 2015 are net of the reclassification of goodwill to noncurrent assets held-for-sale of $381,800. Refer to Note 6. Discontinued Operations for further discussion.

Goodwill and intangible assets with indefinite lives are subject to impairment testing annually as of June 30, or whenever events or changes in circumstances indicate that the carrying amount may not be fully recoverable.

Goodwill impairment testing compares the carrying value of each reporting unit to its fair value. If the fair value of the reporting unit exceeds the carrying value of the net assets, including goodwill assigned to that reporting unit, goodwill is not impaired. If the carrying value of the reporting unit's net assets including goodwill exceeds the fair value of the reporting unit, then the Company will determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, then an

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impairment loss is recorded for the difference between the carrying amount and the implied fair value of goodwill. The Company completed the required annual impairment test as of June 30, 2016, and concluded that there was no impairment of goodwill.

The Company's intangible assets and related accumulated amortization consisted of the following:

	Weighted Average Useful Life	Cost	Accumulated Amortization	Net
June 30, 2016				
Technology-based	7 years	$318,501	$(186,321)	$132,180
Marketing-related	18 years	238,075	(42,932)	195,143
Contract-based	6 years	4,996	(4,996)	—
Customer-related	14 years	488,605	(113,093)	375,512
Database-related	20 years	425,488	(24,061)	401,427
Total intangible assets		$1,475,665	$(371,403)	$1,104,262
December 31, 2015				
Technology-based	7 years	$327,767	$(175,746)	$152,021
Marketing-related	18 years	259,158	(37,798)	221,360
Contract-based	6 years	4,996	(4,996)	—
Customer-related	14 years	512,632	(96,549)	416,083
Database-related	20 years	470,367	(14,748)	455,619
Total intangible assets		$1,574,920	$(329,837)	$1,245,083

Amortization expense related to intangible assets for the three months ended June 30, 2016 and 2015 was $23,806 and $22,904, respectively. Amortization expense related to intangible assets for the six months ended June 30, 2016 and 2015 was $47,677 and $30,359, respectively. Estimated amortization expense for the remainder of 2016 and the years through 2021 and thereafter for intangible assets subject to amortization is as follows:

Year	Amount
2016	$45,410
2017	90,393
2018	90,260
2019	89,727
2020	89,047
2021 and thereafter	699,425
	$1,104,262

8. Income Taxes:

The Company's effective tax rate for the three and six months ended June 30, 2016 was 33.49% and 32.59% , respectively, compared to the effective tax rate for the three and six months ended June 30, 2015 of 17.79% and 26.75%. The effective tax rate for the three and six months ended June 30, 2016 is higher than the June 30, 2015 effective tax rate primarily due to non-recurring tax benefits related to the Wood Mackenzie acquisition in 2015. The difference between statutory tax rates and the Company's effective tax rate is primarily attributable to state taxes and tax benefits related to the Wood Mackenzie acquisition.

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9. Debt:

The following table presents short-term and long-term debt by issuance as of June 30, 2016 and December 31, 2015:

	Issuance Date	Maturity Date	2016	2015
Short-term debt and current portion of long-term debt:				
Syndicated revolving credit facility	Various	Various	$—	$870,000
Capital lease obligations	Various	Various	2,256	4,811
Short-term debt and current portion of long-term debt			2,256	874,811
Long-term debt:				
Senior notes:				
4.000% senior notes, less unamortized discount and debt issuance costs of $10,999 and $11,619, respectively	5/15/2015	6/15/2025	889,001	888,381
5.500% senior notes, less unamortized discount and debt issuance costs of $5,138 and $5,226, respectively	5/15/2015	6/15/2045	344,862	344,774
4.125% senior notes, less unamortized discount and debt issuance costs of $3,809 and $4,117, respectively	9/12/2012	9/12/2022	346,191	345,883
4.875% senior notes, less unamortized discount and debt issuance costs of $1,670 and $2,002, respectively	12/8/2011	1/15/2019	248,330	247,998
5.800% senior notes, less unamortized discount and debt issuance costs of $2,617 and $2,892, respectively	4/6/2011	5/1/2021	447,383	447,108
Capital lease obligations	Various	Various	1,973	2,317
Syndicated revolving credit facility debt issuance costs	Various	Various	(4,708)	(5,557)
Long-term debt			2,273,032	2,270,904
Total debt			$2,275,288	$3,145,715

As of June 30, 2016 and December 31, 2015, the Company had senior notes with an aggregate principal amount of $2,300,000 outstanding and was in compliance with their financial debt covenants.

As of June 30, 2016, the Company had a borrowing capacity of $1,500,000 under the committed senior unsecured Syndicated Revolving Credit Facility (the "Credit Facility") with Bank of America N.A., JP Morgan Chase, N.A., Sun Trust Bank, Wells Fargo Bank N.A., Citizens Bank, N.A., Morgan Stanley Senior Funding, Inc., HSBC Bank USA, N.A., Royal Bank of Canada, BNP Paribas, TD Bank, N.A., The Northern Trust Company, and Capital One N.A. The Credit Facility may be used for general corporate purposes, including working capital needs and capital expenditures, acquisitions and the share repurchase program (the "Repurchase Program"). The Company was in compliance with all financial debt covenants under the Credit Facility as of June 30, 2016. As of June 30, 2016 and December 31, 2015, the Company had outstanding borrowings under the Credit Facility of $0 and $870,000, respectively. During the six months ended June 30, 2016, the Company utilized a portion of the proceeds from the sale of Verisk Health and cash flows from operations to repay the outstanding borrowings under the Credit Facility. On May 26, 2016, the Company entered into the Second Amendment to the Credit Facility, which reduced the borrowing capacity from $1,750,000 to $1,500,000 and amended the pricing grid.

10. Stockholders' Equity:

The Company has 2,000,000,000 shares of authorized common stock. The common shares have rights to any dividend declared by the board of directors (the "Board"), subject to any preferential or other rights of any outstanding preferred stock, and voting rights to elect all twelve members of the Board.

The Company has 80,000,000 shares of authorized preferred stock, par value $0.001 per share. The preferred shares have preferential rights over the common shares with respect to dividends and net distribution upon liquidation. The Company did not issue any preferred shares as of June 30, 2016.

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Share Repurchase Program

Since the introduction of the Repurchase Program as a feature of the Company's capital management strategies in 2010, the Company has authorized repurchases of up to $2,300,000 of its common stock and has repurchased shares with an aggregate value of $1,947,011. The Company repurchased 1,663,095 shares of common stock with an aggregate value of $116,363 during the six months ended June 30, 2016. As of June 30, 2016, the Company had $352,989 available to repurchase shares. The Company has no obligation to repurchase stock under this program and intends to use this authorization as a means of offsetting dilution from the issuance of shares under the KSOP, the Verisk 2013 Equity Incentive Plan (the “2013 Incentive Plan”), the Verisk 2009 Equity Incentive Plan (the “2009 Incentive Plan”), and the ISO 1996 Incentive Plan (the “1996 Incentive Plan”), while providing flexibility to repurchase additional shares if warranted. This authorization has no expiration date and may be increased, reduced, suspended, or terminated at any time. Shares that are repurchased under the Repurchase Program will be recorded as treasury stock and will be available for future issuance.

Treasury Stock

As of June 30, 2016, the Company’s treasury stock consisted of 375,283,889 shares of common stock. During the six months ended June 30, 2016, the Company reissued 957,263 shares of common stock from the treasury shares at a weighted average price of $7.13 per share.

Earnings Per Share (“EPS”)

Basic EPS is computed by dividing income from continuing operations, income from discontinued operations and net income, respectively, by the weighted average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding, using the treasury stock method, if the dilutive potential common shares, including stock options, nonvested restricted stock, and nonvested restricted stock units, had been issued.
The following is a reconciliation of the numerators and denominators of the basic and diluted EPS computations for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator used in basic and diluted EPS:				
Income from continuing operations	$106,736	$158,917	$216,466	$255,290
Income from discontinued operations (Note 6)	155,000	4,403	137,909	6,716
Net income	$261,736	$163,320	$354,375	$262,006
Denominator:				
Weighted average number of common shares used in basic EPS	168,296,318	164,141,804	168,375,034	161,114,861
Effect of dilutive shares:				
Potential common shares issuable from stock options and stock awards	2,922,464	3,444,296	2,974,799	3,418,795
Weighted average number of common shares and dilutive potential common shares used in diluted EPS	171,218,782	167,586,100	171,349,833	164,533,656

The potential shares of common stock that were excluded from diluted EPS were 2,757,489 and 1,784,103 for the three months ended June 30, 2016 and 2015, and 2,215,987 and 892,981 for the six months ended June 30, 2016 and 2015, respectively, because the effect of including these potential shares was anti-dilutive.

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Accumulated Other Comprehensive Losses

The following is a summary of accumulated other comprehensive losses as of June 30, 2016 and December 31, 2015:

	2016	2015
Foreign currency translation adjustment	$(382,349)	$(165,828)
Unrealized holding gains on available-for-sale securities, net of tax	206	3
Pension and postretirement adjustment, net of tax	(75,000)	(76,227)
Accumulated other comprehensive losses	$(457,143)	$(242,052)

The before tax and after tax amounts of other comprehensive income for the three and six months ended June 30, 2016 and 2015 are summarized below:

	Before Tax	Tax Benefit (Expense)	After Tax
For the Three Months Ended June 30, 2016			
Foreign currency translation adjustment	$(141,178)	$ —	$(141,178)
Unrealized holding gain on available-for-sale securities before reclassifications	(315)	120	(195)
Amount reclassified from accumulated other comprehensive losses (1)	464	(177)	287
Unrealized holding loss on available-for-sale securities	149	(57)	92
Pension and postretirement adjustment before reclassifications	1,807	(544)	1,263
Amortization of net actuarial loss and prior service benefit reclassified from accumulated other comprehensive losses (2)	(883)	340	(543)
Pension and postretirement adjustment	924	(204)	720
Total other comprehensive loss	$(140,105)	$ (261)	$(140,366)
For the Three Months Ended June 30, 2015			
Foreign currency translation adjustment	$(4,209)	$ —	$(4,209)
Unrealized holding gain on available-for-sale securities before reclassifications	(8)	3	(5)
Amount reclassified from accumulated other comprehensive losses (1)	19	(7)	12
Unrealized holding loss on available-for-sale securities	11	(4)	7
Pension and postretirement adjustment before reclassifications	1,460	(623)	837
Amortization of net actuarial loss and prior service benefit reclassified from accumulated other comprehensive losses (2)	(730)	280	(450)
Pension and postretirement adjustment	730	(343)	387
Total other comprehensive loss	$(3,468)	$ (347)	$(3,815)

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	Before Tax	Tax Benefit (Expense)	After Tax
For the Six Months Ended June 30, 2016			
Foreign currency translation adjustment	$(216,521)	$—	$(216,521)
Unrealized holding loss on available-for-sale securities before reclassifications	54	(21)	33
Amount reclassified from accumulated other comprehensive losses (1)	274	(104)	170
Unrealized holding loss on available-for-sale securities	328	(125)	203
Pension and postretirement adjustment before reclassifications	3,532	(1,217)	2,315
Amortization of net actuarial loss and prior service benefit reclassified from accumulated other comprehensive losses (2)	(1,766)	678	(1,088)
Pension and postretirement adjustment	1,766	(539)	1,227
Total other comprehensive loss	$(214,427)	$(664)	$(215,091)
For the Six Months Ended June 30, 2015			
Foreign currency translation adjustment	$(4,429)	$—	$(4,429)
Unrealized holding loss on available-for-sale securities before reclassifications	97	(37)	60
Amount reclassified from accumulated other comprehensive losses (1)	14	(5)	9
Unrealized holding loss on available-for-sale securities	111	(42)	69
Pension and postretirement adjustment before reclassifications	3,288	(1,274)	2,014
Amortization of net actuarial loss and prior service benefit reclassified from accumulated other comprehensive losses (2)	(1,644)	631	(1,013)
Pension and postretirement adjustment	1,644	(643)	1,001
Total other comprehensive loss	$(2,674)	$(685)	$(3,359)

(1) This accumulated other comprehensive loss component, before tax, is included under “Investment income and others, net” in the accompanying condensed consolidated statements of operations.

(2) These accumulated other comprehensive loss components, before tax, are included under “Cost of revenues” and “Selling, general and administrative” in the accompanying condensed consolidated statements of operations. These components are also included in the computation of net periodic (benefit) cost (see Note 12 Pension and Postretirement Benefits for additional details).

11. Equity Compensation Plans:

All of the Company’s outstanding stock options and restricted stock awards are covered under the 2013 Incentive Plan, 2009 Incentive Plan or the 1996 Incentive Plan. Awards under the 2013 Incentive Plan may include one or more of the following types: (i) stock options (both nonqualified and incentive stock options), (ii) stock appreciation rights, (iii) restricted stock, (iv) restricted stock units, (v) performance awards, (vi) other share based awards, and (vii) cash. Employees, directors and consultants are eligible for awards under the 2013 Incentive Plan. The Company issued common stock under these plans from the Company’s treasury shares. As of June 30, 2016, there were 8,678,784 shares of common stock reserved and available for future issuance under the 2013 Incentive Plan. Cash received from stock option exercises for the six months ended June 30, 2016 and 2015 was $16,326 and $18,103, respectively.

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The Company granted equity awards to key employees of the Company. The nonqualified stock options have an exercise price equal to the closing price of the Company's common stock on the grant date, with a ten-year contractual term. The fair value of the restricted stock is determined using the closing price of the Company's common stock on the grant date. The restricted stock is not assignable or transferable until it becomes vested. The Company recognizes the expense of the equity awards ratably over the vesting period. A summary of the equity awards granted for the six months ended June 30, 2016 is presented below.

Grant Date	Service Vesting Period	Stock Options	Restricted Stock	Common Stock
April 1, 2016	Four-year graded vesting	1,219,096	244,244	—
April 1, 2016	Not applicable	—	—	567
April 4, 2016	Four-year graded vesting	2,212	415	—
April 18, 2016	Four-year graded vesting	1,266	239	—
April 25, 2016	Three-year graded vesting	3,344	946	—
May 2, 2016	Four-year graded vesting	12,931	2,438	—
May 3, 2016	Four-year graded vesting	3,379	632	—
June 6, 2016	Four-year graded vesting	4,029	751	—
		1,246,257	249,665	567

On July 1, 2016, the Company granted 2,471 shares of common stock, 26,417 nonqualified stock options that were immediately vested, 51,381 nonqualified stock options with a one-year service period, and 10,968 deferred stock units to the directors of the Company. The nonqualified stock options have an exercise price equal to the closing price of the Company's common stock at the grant date and a ten-year contractual term.

The fair value of the stock options granted for the six months ended June 30, 2016 and 2015 was estimated using a Black-Scholes valuation model that uses the weighted average assumptions noted in the following table:

	2016		2015	
Option pricing model	Black-Scholes		Black-Scholes	
Expected volatility	20.29	%	20.25	%
Risk-free interest rate	1.15	%	1.51	%
Expected term in years	4.5		4.6	
Dividend yield	—	%	—	%
Weighted average grant date fair value per stock option	$15.33		$12.91	

The expected term for the stock options granted was estimated based on studies of historical experience and projected exercise behavior. However, for certain awards granted, for which no historical exercise pattern exists, the expected term was estimated using the simplified method. The risk-free interest rate is based on the yield of U.S. Treasury zero coupon securities with a maturity equal to the expected term of the equity award. The volatility factor is calculated using historical daily closing prices over the most recent period that is commensurate with the expected term of the stock option award. The volatility factor for stock options granted in 2016 was based on the volatility of the Company's stock. The expected dividend yield was based on the Company's expected annual dividend rate on the date of grant.

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A summary of the stock options outstanding and exercisable as of December 31, 2015 and June 30, 2016 and changes during the interim period are presented below:

	Number of Options	Weighted Average Exercise Price	Aggregate Intrinsic Value
Outstanding at December 31, 2015	9,117,733	$ 40.17	$ 334,691
Granted	1,246,257	$ 80.15	
Exercised	(655,448)	$ 30.93	$ 30,973
Cancelled or expired	(137,177)	$ 71.53	
Outstanding at June 30, 2016	9,571,365	$ 45.55	$ 340,039
Exercisable at June 30, 2016	6,765,200	$ 34.17	$ 317,357
Exercisable at December 31, 2015	6,541,229	$ 29.81	$ 307,924

Intrinsic value for stock options is calculated based on the exercise price of the underlying awards and the quoted price of Verisk common stock as of the reporting date. In accordance with ASC 718, Stock Compensation ("ASC 718"), excess tax benefit from exercised stock options and restricted stock lapsed is recorded as an increase to additional paid-in capital and a corresponding reduction in income taxes payable. This tax benefit is calculated as the excess of the intrinsic value of options exercised and restricted stock lapsed in excess of compensation recognized for financial reporting purposes. The amount of the tax benefit that has been realized, as a result of those excess tax benefits, is presented as a financing cash inflow within the accompanying condensed consolidated statements of cash flows. For the six months ended June 30, 2016 and 2015, the Company recorded excess tax benefits of $11,657 and $7,848, respectively. The Company realized $6,570 and $8,419 of tax benefit within the Company’s quarterly tax payments through June 30, 2016 and 2015, respectively. Stock based compensation expense for the six months ended June 30, 2016 and 2015 was $16,468 and $19,047, respectively.

The Company estimates expected forfeitures of equity awards at the date of grant and recognizes compensation expense only for those awards that the Company expects to vest. The forfeiture assumption is ultimately adjusted to the actual forfeiture rate. Changes in the forfeiture assumptions may impact the total amount of expense ultimately recognized over the requisite service period and may impact the timing of expense recognized over the requisite service period.

A summary of the status of the restricted stock awarded under the 2013 Incentive Plan as of December 31, 2015 and June 30, 2016 and changes during the interim period are presented below:

	Number of Shares	Weighted Average Grant Date Fair Value Per Share
Outstanding at December 31, 2015	533,768	$ 66.25
Granted	249,665	$ 80.15
Vested	(212,123)	$ 63.80
Forfeited	(26,145)	$ 71.24
Outstanding at June 30, 2016	545,165	$ 72.77

As of June 30, 2016, there was $75,229 of total unrecognized compensation costs, exclusive of the impact of vesting upon retirement eligibility, related to nonvested share-based compensation arrangements granted under the 2009 and 2013 Incentive Plans. That cost is expected to be recognized over a weighted average period of 2.98 years. As of June 30, 2016, there were 2,806,165 and 544,885 nonvested stock options and restricted stock, respectively, of which 2,353,193 and 457,990 are expected to vest. The total grant date fair v0pt;">
$85,492

$93,714

($8,222
)

(9
)%
Percent of revenue
10
%

11
%

10
%

11
%

Research and development expenses for the three months ended December 27, 2015 decreased 11% to $42.0 million from $47.0 million for the three months ended December 28, 2014. For the six months ended December 27, 2015, research and development expenses decreased 9% to $85.5 million from $93.7 million for the six months ended December 28, 2014. These decreases were primarily due to cost management and the nature of current research and development projects. Our research and development expenses vary significantly from quarter to quarter based on a number of factors, including the timing of new product introductions and the number and nature of our ongoing research and development activities.

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Sales, General and Administrative

Sales, general and administrative expenses were comprised primarily of costs associated with our sales and marketing personnel and our executive and administrative personnel (for example, finance, human resources, information technology and legal) and consisted of salaries and related compensation costs; consulting and other professional services (such as litigation and other outside legal counsel fees, audit and other compliance costs); marketing and advertising expenses; facilities and insurance costs; and travel and other costs. The following table sets forth our sales, general and administrative expenses in dollars and as a percentage of revenue (in thousands, except percentages):

	Three Months Ended					Six Months Ended				
	December 27, 2015	December 28, 2014	Change			December 27, 2015	December 28, 2014	Change		
Sales, general and administrative	$74,691	$72,375	$2,316	3	%	$149,954	$142,067	$7,887	6	%
Percent of revenue	17 %	18 %				17 %	17 %			

Sales, general and administrative expenses for the three months ended December 27, 2015 increased 3% to $74.7 million from $72.4 million for the three months ended December 28, 2014. For the six months ended December 27, 2015, sales, general and administrative expenses increased 6% to $150.0 million from $142.1 million for the six months ended December 28, 2014. These increases were primarily due to an increase in spending on legal fees related to enforcing our patent rights and costs pursuant to our restructuring plan discussed above partially offset by lower spend on corporate sales and marketing expenses.

Amortization or Impairment of Acquisition-Related Intangibles

As a result of our acquisitions, we have recognized various amortizable intangible assets, including customer relationships, developed technology, non-compete agreements and trade names. Amortization of intangible assets related to our acquisitions was as follows (in thousands, except percentages):

	Three Months Ended					Six Months Ended				
	December 27, 2015	December 28, 2014	Change			December 27, 2015	December 28, 2014	Change		
Customer relationships	$1,607	$1,345	$262	19	%	$3,214	$2,689	$525	20	%
Developed technology	4,946	4,660	286	6	%	9,891	9,321	570	6	%
Non-compete agreements	509	490	19	4	%	1,019	980	39	4	%
Trade names, finite-lived	—	—	—			—	4	(4)	(100	)%
Total amortization	$7,062	$6,495	$567	9	%	$14,124	$12,994	$1,130	9	%

Amortization of acquisition-related intangibles increased for the three and six months ended December 27, 2015 compared to the three and six months ended December 28, 2014 due to the amortization of intangibles related to the Arkansas Power Electronics International, Inc. (APEI) acquisition in July 2015 as discussed in Note 2, “Acquisition,” in our consolidated financial statements in Part I, Item 1 of this Quarterly Report.

Loss on Disposal or Impairment of Long-Lived Assets

We operate a capital intensive business. As such, we dispose of a certain level of our equipment in the normal course of business as our production processes change due to production improvement initiatives or product mix changes. Due to the risk of technological obsolescence or changes in our production process, we regularly review our equipment and capitalized patent costs for possible impairment.

The following table sets forth our loss on disposal or impairment of long-lived assets (in thousands, except percentages):

	Three Months Ended					Six Months Ended				
	December 27, 2015	December 28, 2014	Change			December 27, 2015	December 28, 2014	Change		
Loss on disposal or impairment of long-lived	$2,014	$735	$1,279	174	%	$16,587	$2,182	$14,405	660	%

assets
We recognized a net loss of $2.0 million and $0.7 million on the disposal of long-lived assets for the three months ended December 27, 2015 and December 28, 2014, respectively. For the six months ended December 27, 2015, we recognized a net loss of $16.6 million compared to a net loss of $2.2 million for the six months ended December 28, 2014. These increases in net loss were primarily due to the planned sale or abandonment of certain long-lived assets to reduce excess manufacturing capacity pursuant to our restructuring plan discussed above.

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Non-Operating Income (Loss), net

The following table sets forth our non-operating income (loss) income, net (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 27, 2015	December 28, 2014	Change		December 27, 2015	December 28, 2014	Change	
Gain on sale of investments, net	$14	$774	($760)	(98)%	$16	$776	($760)	(98)%
Gain (loss) on equity method investment	7,026	679	6,347	935 %	(12,922)	679	(13,601)	(2,003)%
Foreign currency loss, net	(385)	(2,365)	1,980	(84)%	(4,679)	(2,596)	(2,083)	80 %
Interest income, net	1,220	2,586	(1,366)	(53)%	2,517	5,618	(3,101)	(55)%
Other, net	140	54	86	159 %	277	155	122	79 %
Non-operating income (loss), net	$8,015	$1,728	$6,287	364 %	($14,791)	$4,632	($19,423)	(419)%

Gain on sale of investments, net. Gain on sale of investments, net was $14 thousand for the three months ended December 27, 2015 compared to $774 thousand for the three months ended December 28, 2014. For the six months ended December 27, 2015, gain on sale of investment, net was $16 thousand compared to $776 thousand for the six months ended December 28, 2014. Gain on sale of investments, net was lower for the three and six months ended December 27, 2015 due to lower sales of investments.

Gain (loss) on equity method investment. Gain on our equity method investment in Lextar Electronics Corporation (Lextar) was $7.0 million for the three months ended December 27, 2015 compared to $0.7 million for the three months ended December 28, 2014. Loss on equity method investment was $12.9 million for the six months ended December 27, 2015 compared to a gain on equity method investment of $0.7 million for the six months ended December 28, 2014. Lextar’s stock is publicly traded on the Taiwan Stock Exchange and its share price declined from 21.55 New Taiwan Dollar (TWD) at June 28, 2015 to 13.90 TWD at September 27, 2015 and increased to 16.65 TWD at December 27, 2015. This volatile stock price trend may continue in the future given the risks inherent in Lextar’s business and trends affecting the Taiwan and global equity markets. Any future stock price changes will be recorded as further gains or losses on equity method investment based on the increase or decrease, respectively, in the fair value of the investment during the applicable fiscal period. Further losses could have a material adverse effect on our results of operations.

Foreign currency loss, net. Foreign currency loss, net consisted primarily of remeasurement adjustments resulting from our investment in Lextar and consolidating our international subsidiaries. The foreign currency loss for the three months ended December 27, 2015 and three months ended December 28, 2014 was primarily due to fluctuation in the exchange rate between the TWD and the United States Dollar related to our Lextar investment. The foreign currency loss for the six months ended December 27, 2015 was primarily due to fluctuation in the exchange rate between the Chinese Yuan and the United States Dollar as well as between the TWD and the United States Dollar related to our Lextar investment.

Interest income, net. Interest income, net was $1.2 million for the three months ended December 27, 2015 compared to $2.6 million for the three months ended December 28, 2014. For the six months ended December 27, 2015, interest income, net was $2.5 million compared to $5.6 million for the six months ended December 28, 2014. The decrease in interest income, net for the three and six months ended December 27, 2015 was primarily due to lower invested balances and higher interest expense associated with our line of credit as compared to the three and six months ended December 28, 2014.

Other, net. Other, net was $0.1 million for both the three months ended December 27, 2015 and the three months ended December 28, 2014. For the six months ended December 27, 2015, other, net was $0.3 million compared to $0.2 million for the six months ended December 28, 2014.

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Income Tax Expense (Benefit)

The following table sets forth our income tax expense (benefit) in dollars and our effective tax rate (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	December 27, 2015	December 28, 2014	Change		December 27, 2015	December 28, 2014	Change	
Income tax expense (benefit)	$3,489	($238)	$3,727	(1,566)%	($4,384)	$2,993	($7,377)	(246)%
Effective tax rate	20.0%	(2.0)%			31.2%	11.4%		

The variation between our effective income tax rate and the U.S. statutory rate of 35 percent is due to a percentage of our projected income for the full year being derived from international locations with lower tax rates than the U.S. and the impact of tax credits available in the current year. A change in the mix of pretax income in our various tax jurisdictions can have a material impact on our periodic effective tax rate.

We recognized income tax expense of $3.5 million for an effective tax rate of 20% for the three months ended December 27, 2015 as compared to a benefit of $0.2 million for an effective tax rate of (2.0)% for the three months ended December 28, 2014. For the six months ended December 27, 2015, we recognized income tax benefit of $4.4 million for an effective tax rate of 31.2% compared to an income tax expense of $3.0 million for an effective tax rate of 11.4% for the six months ended December 28, 2014. The increase in our effective tax rate for the three and six months ended December 27, 2015 was primarily due to the first quarter and year-to-date pre-tax loss derived from our restructuring plan costs and the loss on our Lextar equity investment in fiscal 2016.

Liquidity and Capital Resources

Overview

We require cash to fund our operating expenses and working capital requirements, including outlays for research and development, capital expenditures, strategic acquisitions and investments. Our principal sources of liquidity are cash on hand, marketable securities, cash generated from operations and availability under our line of credit. Our ability to generate cash from operations has been one of our fundamental strengths and has provided us with substantial flexibility in meeting our operating, financing and investing needs. We have a $500 million line of credit as discussed in Note 7, "Long-term Debt," in our consolidated financial statements included in Part I, Item 1 of this Quarterly Report. The purpose of this facility is to provide short term flexibility to optimize returns on our cash and investment portfolio while funding share repurchases, capital expenditures and other general business needs.

Based on past performance and current expectations, we believe our current working capital, availability under our line of credit and anticipated cash flows from operations will be adequate to meet our cash needs for our daily operations and capital expenditures for at least the next 12 months. We may use a portion of our available cash and cash equivalents, line of credit or funds underlying our marketable securities to repurchase shares of our common stock pursuant to repurchase programs authorized by our Board of Directors. With our strong working capital position, we believe that we have the ability to continue to invest in further development of our products and, when necessary or appropriate, make selective acquisitions or other strategic investments to strengthen our product portfolio, secure key intellectual properties or expand our production capacity.

From time to time, we evaluate strategic opportunities, including potential acquisitions, divestitures or investments in complementary businesses, and we anticipate continuing to make such evaluations. We may also access capital markets through the issuance of debt or additional shares of common stock in connection with the acquisition of complementary businesses or other significant assets or for other strategic opportunities. In May 2015, we announced that Wolfspeed filed a confidential registration statement for an initial public offering. An initial public offering would raise capital to invest directly in the Power and RF Products business to support targeted future growth. Additionally, on July 8, 2015, Cree closed on the acquisition of APEI as discussed in Note 2, "Acquisition," in our consolidated financial statements in Part I, Item 1 of this Quarterly Report.

Liquidity

Our liquidity and capital resources primarily depend on our cash flows from operations and our working capital. The significant components of our working capital are liquid assets such as cash and cash equivalents, short-term investments, accounts receivable and inventories reduced by trade accounts payable.

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The following table presents the components of our cash conversion cycle:

	Three Months Ended		
	December 27, 2015	June 28, 2015	Change
Days of sales outstanding[(a)]	38	44	(6)
Days of supply in inventory[(b)]	84	83	1
Days in accounts payable[(c)]	(42)	(48)	6
Cash conversion cycle	80	79	1

a) Days of sales outstanding (DSO) measures the average collection period of our receivables. DSO is based on the ending net trade receivables and the revenue, net for the quarter then ended. DSO is calculated by dividing ending accounts receivable, net of applicable allowances and reserves, by the average net revenue per day for the respective 90 day period.

b) Days of supply in inventory (DSI) measures the average number of days from procurement to sale of our product. DSI is based on ending inventory and cost of revenue, net for the quarter then ended. DSI is calculated by dividing ending inventory by average cost of revenue, net per day for the respective 90 day period.

c) Days in accounts payable (DPO) measures the average number of days our payables remain outstanding before payment. DPO is based on ending accounts payable and cost of revenue, net for the quarter then ended. DPO is calculated by dividing ending accounts payable by the average cost of revenue, net per day for the respective 90 day period.

The increase in the cash conversion cycle was primarily driven by a decrease in days in accounts payable, an increase in days of supply in inventory, partially offset by a decrease in days of sales outstanding during the three months ended December 27, 2015.

As of December 27, 2015, we had unrealized losses on our investments of $0.6 million. All of our investments had investment grade ratings, and any such investments that were in an unrealized loss position at December 27, 2015 were in such position due to interest rate changes, sector credit rating changes or company-specific rating changes. As we intend and believe that we have the ability to hold such investments for a period of time that will be sufficient for anticipated recovery in market value, we currently expect to receive the full principal or recover our cost basis in these securities. The declines in value of the securities in our portfolio are considered to be temporary in nature and, accordingly, we do not believe these securities are impaired as of December 27, 2015.

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Cash Flows

In summary, our cash flows were as follows (in thousands, except percentages):

	Six Months Ended December 27, 2015	December 28, 2014	Change	
Net cash provided by operating activities	$123,796	$28,052	$95,744	341 %
Net cash (used in) provided by investing activities	(55,008)	33,239	(88,247)	(265)%
Net cash used in financing activities	(116,798)	(147,609)	30,811	(21)%
Effects of foreign exchange changes on cash and cash equivalents	(1,114)	(546)	(568)	104 %
Net decrease in cash and cash equivalents	($49,124)	($86,864)	$37,740	

The following is a discussion of our primary sources and uses of cash in our operating, investing and financing activities.

Cash Flows from Operating Activities

Net cash provided by operating activities increased to $123.8 million for the six months ended December 27, 2015 from $28.1 million for the six months ended December 28, 2014. This increase was primarily due to cash generated from working capital.

Cash Flows from Investing Activities

Our investing activities primarily relate to transactions within our short-term investments, purchases of property and equipment and payments for patents and licensing rights. Net cash used in investing activities was $55.0 million for the six months ended December 27, 2015 and net cash provided by investing activities was $33.2 million for the six months ended December 28, 2014. Net proceeds from the sale of short-term investments decreased $192.2 million for the six months ended December 27, 2015 compared to the six months ended December 28, 2014. This was partially offset by a $33.5 million decrease in our capital spending for the six months ended December 27, 2015 compared to the six months ended December 28, 2014. The six months ended December 27, 2015 included $12.5 million in net spend to acquire APEI while the six months ended December 28, 2014 included the $80.6 million investment in Lextar.

For fiscal 2016, we target approximately $135.0 million of capital investment, which is primarily related to infrastructure projects to support our longer term growth and strategic priorities.

Cash Flows from Financing Activities

Net cash used in financing activities was $116.8 million for the six months ended December 27, 2015 compared to $147.6 million for the six months ended December 28, 2014. For the six months ended December 27, 2015, our financing activities primarily consisted of the repurchase of common stock worth approximately $131.7 million, partially offset by proceeds of $10.0 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises and net borrowings on our line of credit of $5.0 million. For the six months ended December 28, 2014, our financing activities primarily consisted of the repurchase of common stock worth approximately $320.3 million, partially offset by net borrowings on our line of credit of $150.0 million, and proceeds of $22.7 million from net issuances of common stock pursuant to the exercise of employee stock options, including the excess tax benefit on those exercises.

Off-Balance Sheet Arrangements

We do not use off-balance sheet arrangements with unconsolidated entities or related parties, nor do we use any other forms of off-balance sheet arrangements. Accordingly, our liquidity and capital resources are not subject to off-balance sheet risks from unconsolidated entities. As of December 27, 2015, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

We have entered into operating leases primarily for certain of our U.S. and international facilities in the normal course of business. Please refer to Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended June 28, 2015, in the section entitled “Contractual Obligations” for the future minimum lease payments due under our operating leases as of June 28, 2015. There have been no significant changes to the contractual obligations discussed therein.

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Critical Accounting Policies and Estimates

For information about our critical accounting policies and estimates, see the "Critical Accounting Policies and Estimates" section of "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the fiscal year ended June 28, 2015.

Recent Accounting Pronouncements

For a description of recent accounting pronouncements, including the expected dates of adoption and the estimated effects, if any, on our consolidated financial statements, see Note 1, "Basis of Presentation and New Accounting Standards," to our unaudited consolidated financial statements in Part I, Item 1 of this Quarterly Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

For quantitative and qualitative disclosures about our market risks, see "Part II. Item 7A. Quantitative and Qualitative Disclosures About Market Risk" of our Annual Report on Form 10-K for the fiscal year ended June 28, 2015. There have been no material changes to the amounts presented therein.

Item 4. Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Form 10-Q. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Form 10-Q, our disclosure controls and procedures are effective in that they provide reasonable assurances that the information we are required to disclose in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods required by the SEC's rules and forms and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We routinely review our internal control over financial reporting and from time to time make changes intended to enhance the effectiveness of our internal control over financial reporting. We will continue to evaluate the effectiveness of our disclosure controls and procedures and internal control over financial reporting on an ongoing basis and will take action as appropriate. There have been no changes to our internal control over financial reporting, as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act, during the second quarter of fiscal 2016 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The information required by this item is set forth under Note 12, "Commitments and Contingencies," to our unaudited financial statements in Part I, Item 1 of this Quarterly Report and is incorporated herein by reference.

Item 1A. Risk Factors

Described below are various risks and uncertainties that may affect our business. The descriptions below include any material changes to and supersede the description of the risk factors affecting our business previously disclosed in "Part I, Item IA. Risk Factors" of our Annual Report on Form 10-K for the fiscal year ended June 28, 2015 and any subsequent periodic reports. If any of the risks described below actually occurs, our business, financial condition or results of operations could be materially and adversely affected.

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Our operating results are substantially dependent on the development and acceptance of new products.

Our future success may depend on our ability to develop new, higher performing and lower cost solutions for existing and new markets and for customers to accept those solutions. We must introduce new products in a timely and cost-effective manner, and we must secure production orders for those products from our customers. The development of new products is a highly complex process, and we have in some instances experienced delays in completing the development and introduction of new products. Our research and development efforts are aimed at solving increasingly complex problems, and we do not expect that all of our projects will be successful. The successful development, introduction and acceptance of new products depend on a number of factors, including the following:

- achievement of technology breakthroughs required to make commercially viable devices;
- the accuracy of our predictions for market requirements;
- our ability to predict, influence and/or react to evolving standards;
- acceptance of our new product designs;
- acceptance of new technology in certain markets;
- the availability of qualified research and development personnel;
- our timely completion of product designs and development;
- our ability to develop repeatable processes to manufacture new products in sufficient quantities, with the desired specifications and at competitive costs;
- our ability to effectively transfer products and technology from development to manufacturing;
- our customers’ ability to develop competitive products incorporating our products; and
- market acceptance of our customers’ products.

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

We operate in industries that are subject to significant fluctuation in supply and demand and ultimately pricing that affects our revenue and profitability.

The LED lighting industry is in the relatively early stages of adoption and is characterized by constant and rapid technological change, rapid product obsolescence and price erosion, evolving standards, short product life-cycles and fluctuations in product supply and demand. The LED industry has experienced significant fluctuations, often in connection with, or in anticipation of, product cycles and changes in general economic conditions. As the markets for our products mature, additional fluctuations may result from variability and consolidations within the industry’s customer base. These fluctuations have been characterized by lower product demand, production overcapacity, higher inventory levels and increased pricing pressure. These fluctuations have also been characterized by higher demand for key components and equipment used in, or in the manufacture of, our products resulting in longer lead times, supply delays and production disruptions.

We have experienced these conditions in our business and may experience such conditions in the future, which could have a material negative impact on our business, results of operations or financial condition. For example, in the fourth quarter of fiscal 2015, we announced a restructuring plan for our LED business that will reduce excess capacity and overhead as well as increase reserves as the result of a more aggressive pricing environment. We may not be able to achieve the level of benefits that we expect to realize from this restructuring within the expected timeframes, if at all, which could have a material negative impact on our business.

In addition, as we diversify our product offerings and as pricing differences in the average selling prices among our product lines widen, a change in the mix of sales among our product lines may increase volatility in our revenue and gross margin from period to period.

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We face significant challenges managing our growth as the market adopts LEDs for general lighting.
Our potential for growth depends significantly on the adoption of LEDs within the general lighting market and our ability to affect this rate of adoption. Although the market for LED lighting has grown rapidly in recent years, adoption of LEDs for general lighting is still in the relatively early stages. In order to manage our growth and business strategy effectively relative to the uncertain pace of adoption, we must continue to:

- expand the capability of information systems to support a more complex business;
- maintain, expand and purchase adequate manufacturing facilities and equipment, as well as secure sufficient third-party manufacturing resources, to meet customer demand;
- manage an increasingly complex supply chain that has the ability to scale to maintain a sufficient supply of raw materials and deliver on time to our manufacturing facilities or our third party manufacturing facilities;
- expand research and development, sales and marketing, technical support, distribution capabilities, manufacturing planning and administrative functions;
- manage organizational complexity and communication;
- expand the skills and capabilities of our current management team;
- add experienced senior level managers;
- attract and retain qualified employees; and
- adequately maintain and adjust the operational and financial controls that support our business.

We are also increasingly dependent on information technology to enable us to improve the effectiveness of our operations and to maintain financial accuracy and efficiency. For example, we are implementing a new information technology platform at our Racine operations that goes live beginning with our March 2016 fiscal quarter. If we do not allocate and effectively manage the resources necessary to successfully implement, integrate, train personnel and sustain this new platform, we could be subject to transaction errors, processing inefficiencies, loss of customers, business disruptions or loss of or damage to intellectual property through security breach in the near term. Additionally, if we do not allocate and effectively manage the resources necessary to build, implement, upgrade, integrate and sustain the proper technology infrastructure over the longer term, we could be subject to the same risks outlined above.
While we intend to focus on managing our costs and expenses, over the long term we expect to invest to support our growth and may have additional unexpected costs. Such investments take time to become fully operational, and we may not be able to expand quickly enough to exploit targeted market opportunities. There are also inherent execution risks in starting up a new factory or expanding production capacity that could increase costs and reduce our operating results, including design and construction cost overruns, poor production process yields and reduced quality control during the start-up phase.
In connection with our efforts to cost-effectively manage our growth, we have increasingly relied on contractors for production capacity, logistics support and certain administrative functions including hosting of certain information technology software applications. If these service providers do not perform effectively, we may not be able to achieve the expected cost savings and may incur additional costs to correct errors or fulfill customer demand. Depending on the function involved, such errors may also lead to business disruption, processing inefficiencies, the loss of or damage to intellectual property through security breach, or an impact on employee morale. Our operations may also be negatively impacted if any of these service providers do not have the financial capability to meet our growing needs.
If we are unable to effectively develop, manage and expand our sales channels for our products, our operating results may suffer.
We have expanded into business channels that are different from those in which we have historically operated as we grow our business and sell more LED and lighting products. Lighting sales agents have in the past and may in the future choose to drop our product lines from their portfolio to avoid losing access to our competitors’ lighting products, resulting in a disruption in the project pipeline and lower than targeted sales for our lighting products. We sell a portion of our lighting products through retailers who may alter their promotional pricing or inventory strategies, which could impact our targeted sales of these products. If we are unable to effectively penetrate these channels or

develop alternate channels to ensure our products are reaching the intended customer base, our financial results may be adversely impacted. In addition, if we successfully penetrate or develop these channels, we cannot guarantee that customers will accept our products or that we will be able to manufacture and deliver them in the timeline established by our customers.

We sell a substantial portion of our products to distributors. We rely on distributors to develop and expand their customer base as well as anticipate demand from their customers. If they are not successful, our growth and profitability may be adversely impacted. Distributors must balance the need to have enough products in stock in order to meet their customers' needs against their internal target inventory levels and the risk of potential inventory obsolescence. The risks of inventory obsolescence are especially relevant to technological products. The distributors' internal target inventory levels vary depending on market cycles and a number of factors within each distributor over which we have very little, if any, control.

We typically recognize revenue on products sold to distributors when the item is shipped and title passes to the distributor (sell-in method). Certain distributors have limited rights to return inventory under stock rotation programs and have limited price protection rights for which we make estimates. We evaluate inventory levels in the distribution channel, current economic trends and other related factors in order to account for these factors in our judgments and estimates. As inventory levels and product return trends change, we may have to revise our estimates and incur additional costs, and our gross margins and operating results could be adversely impacted.

The markets in which we operate are highly competitive and have evolving technical requirements.

The markets for our products are highly competitive. In the LED market, we compete with companies that manufacture and sell LED chips and LED components. In the lighting market, we compete with companies that manufacture and sell traditional and LED lighting products, many of which have larger and more established sales channels. Competitors continue to offer new products with aggressive pricing, additional features and improved performance. Competitive pricing pressures remain a challenge and continue to accelerate the rate of decline of our sales prices, particularly in our LED Products segment. Aggressive pricing actions by our competitors in our lighting business could reduce margins if we are not able to reduce costs at an equal or greater rate than the sales price decline.

With the growth potential for LEDs, we will continue to face increased competition in the future across our businesses. If the investment in capacity exceeds the growth in demand, such as exists in the current LED market, the LED market is likely to become more competitive with additional pricing pressures. Additionally, new technologies could emerge or improvements could be made in existing technologies that may also reduce the demand for lighting and LEDs in certain markets. There are also new technologies, such as organic LEDs (OLEDs), which could potentially reduce LED demand for backlighting, potentially impacting the overall LED market.

As competition increases, we need to continue to develop new products that meet or exceed the needs of our customers. Therefore, our ability to continually produce more efficient, higher brightness and lower cost LEDs and lighting products that meet the evolving needs of our customers will be critical to our success. Competitors may also try to align with some of our strategic customers. This could lead to lower prices for our products, reduced demand for our products and a corresponding reduction in our ability to recover development, engineering and manufacturing costs. Any of these developments could have an adverse effect on our business, results of operations or financial condition.

Global economic conditions could materially adversely impact demand for our products and services.

Our operations and performance depend significantly on worldwide economic conditions. Uncertainty about global economic conditions could result in customers postponing purchases of our products and services in response to tighter credit, unemployment, negative financial news and/or declines in income or asset values and other macroeconomic factors, which could have a material negative effect on demand for our products and services and, accordingly, on our business, results of operations or financial condition.

Additionally, our international sales are subject to variability as our selling prices become less competitive in countries with currencies that are declining in value against the U.S. Dollar and more competitive in countries with currencies that are increasing in value against the U.S. Dollar. In addition, our international purchases can become more expensive if the U.S. Dollar weakens against the foreign currencies in which we are billed.

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

As customer demand for our products changes, we must be able to adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase or decrease our production capacity at our targeted rate or if there are unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets.

Due to the proportionately high fixed cost nature of our business (such as facility costs), if demand does not materialize at the rate forecasted, we may not be able to scale back our manufacturing expenses or overhead costs to correspond to the demand. This could result in lower margins and adversely impact our business and results of operations. Additionally, if product demand decreases or we fail to forecast demand accurately, our results may be adversely impacted due to higher costs resulting from lower factory utilization, causing higher fixed costs per unit produced. Further, we may be required to recognize impairments on our long-lived assets or recognize excess inventory write-off charges, as we did in the fourth quarter of fiscal 2015. We may in the future be required to recognize excess capacity charges, which would have a negative impact on our results of operations.

In addition, our efforts to improve quoted delivery lead-time performance may result in corresponding reductions in order backlog. A decline in backlog levels could result in more variability and less predictability in our quarter-to-quarter net revenue and operating results.

If our products fail to perform or fail to meet customer requirements or expectations, we could incur significant additional costs, including costs associated with the recall of those items.

The manufacture of our products involves highly complex processes. Our customers specify quality, performance and reliability standards that we must meet. If our products do not meet these standards, we may be required to replace or rework the products. In some cases, our products may contain undetected defects or flaws that only become evident after shipment. Even if our products meet standard specifications, our customers may attempt to use our products in applications for which they were not designed or in products that were not designed or manufactured properly, resulting in product failures and creating customer satisfaction issues.

We have experienced product quality, performance or reliability problems from time to time and defects or failures may occur in the future. If failures or defects occur, they could result in significant losses or product recalls due to:

- costs associated with the removal, collection and destruction of the product;
- payments made to replace product;
- costs associated with repairing the product;
- the write-down or destruction of existing inventory;
- insurance recoveries that fail to cover the full costs associated with product recalls;
- lost sales due to the unavailability of product for a period of time;
- delays, cancellations or rescheduling of orders for our products; or
- increased product returns.

A significant product recall could also result in adverse publicity, damage to our reputation and a loss of customer or consumer confidence in our products. We also may be the target of product liability lawsuits or regulatory proceedings by the Consumer Product Safety Commission (CPSC) and could suffer losses from a significant product liability judgment or adverse CPSC finding against us if the use of our products at issue is determined to have caused injury or contained a substantial product hazard.

We provide warranty periods ranging from 90 days to 10 years on our products. The standard warranty on nearly all of our new LED lighting products, which now represent the majority of our revenue, is 10 years. Although we believe our reserves are appropriate, we are making projections about the future reliability of new products and technologies, and we may experience increased variability in warranty claims. Increased warranty claims could result in significant losses due to a rise in warranty expense and costs associated with customer support.

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We rely on a number of key sole source and limited source suppliers and are subject to high price volatility on certain commodity inputs, variations in parts quality, and raw material consistency and availability.

We depend on a number of sole source and limited source suppliers for certain raw materials, components, services and equipment used in manufacturing our products, including key materials and equipment used in critical stages of our manufacturing processes. Although alternative sources generally exist for these items, qualification of many of these alternative sources could take up to six months or longer. Where possible, we attempt to identify and qualify alternative sources for our sole and limited source suppliers.

We generally purchase these sole or limited source items with purchase orders, and we have limited guaranteed supply arrangements with such suppliers. Some of our sources can have variations in attributes and availability which can affect our ability to produce products in sufficient volume or quality. We do not control the time and resources that these suppliers devote to our business, and we cannot be sure that these suppliers will perform their obligations to us. Additionally, general shortages in the marketplace of certain raw materials or key components may adversely impact our business. In the past, we have experienced decreases in our production yields when suppliers have varied from previously agreed upon specifications or made other modifications we do not specify, which impacted our cost of revenue.

Additionally, the inability of our suppliers to access capital efficiently could cause disruptions in their businesses, thereby negatively impacting ours. This risk may increase if an economic downturn negatively affects key suppliers or a significant number of our other suppliers. Any delay in product delivery or other interruption or variation in supply from these suppliers could prevent us from meeting commercial demand for our products. If we were to lose key suppliers, if our key suppliers were unable to support our demand for any reason or if we were unable to identify and qualify alternative suppliers, our manufacturing operations could be interrupted or hampered significantly.

We rely on arrangements with independent shipping companies for the delivery of our products from vendors and to customers both in the United States and abroad. The failure or inability of these shipping companies to deliver products or the unavailability of shipping or port services, even temporarily, could have a material adverse effect on our business. We may also be adversely affected by an increase in freight surcharges due to rising fuel costs and added security.

In our fabrication process we consume a number of precious metals and other commodities, which are subject to high price volatility. Our operating margins could be significantly affected if we are not able to pass along price increases to our customers. In addition, production could be disrupted by the unavailability of the resources used in production such as water, silicon, electricity and gases. Future environmental regulations could restrict supply or increase the cost of certain of those materials.

We depend on a limited number of customers, including distributors and retailers, for a substantial portion of our revenue, and the loss of, or a significant reduction in purchases by, one or more of these customers could adversely affect our operating results.

We receive a significant amount of our revenue from a limited number of customers, including distributors and retailers, two of which represented greater than 10% of our consolidated revenue in fiscal 2015. Most of our customer orders are made on a purchase order basis, which does not generally require any long-term customer commitments. Therefore, these customers may alter their purchasing behavior with little or no notice to us for various reasons, including developing, or, in the case of our distributors, their customers developing, their own product solutions; choosing to purchase product from our competitors; incorrectly forecasting end market demand for their products; or experiencing a reduction in their market share in the markets for which they purchase our products. In the case of retailers, these customers may alter their promotional pricing; increase promotion of competitors' products over our products; or reduce their inventory levels; all of which could negatively impact our financial condition and results of operations. If our customers alter their purchasing behavior, if our customers’ purchasing behavior does not match our expectations or if we encounter any problems collecting amounts due from them, our financial condition and results of operations could be negatively impacted.

Our results may be negatively impacted if customers do not maintain their favorable perception of our brand and products.

We have a developing brand with increasing value. Maintaining and continually enhancing the value of this brand is critical to the success of our business. Brand value is based in large part on customer perceptions. Success in promoting and enhancing brand value depends in large part on our ability to provide high-quality products. Brand value could diminish significantly due to a number of factors, including adverse publicity about our products (whether valid or not), a failure to maintain the quality of our products (whether perceived or real), the failure of our products to deliver consistently positive consumer experiences, the products becoming unavailable to consumers or consumer perception that we have acted in an irresponsible manner. Damage to our brand, reputation or loss of customer confidence in our brand or products could result in decreased demand for our products and have a negative impact on our business, results of operations or financial condition.

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Variations in our production yields could impact our ability to reduce costs and could cause our margins to decline and our operating results to suffer.

All of our products are manufactured using technologies that are highly complex. The number of usable items, or yield, from our production processes may fluctuate as a result of many factors, including but not limited to the following:

- variability in our process repeatability and control;
- contamination of the manufacturing environment;
- equipment failure, power outages, information or other system failures or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts, other raw materials and other bill of materials items;
- inventory shrinkage or human errors;
- defects in production processes (including system assembly) either within our facilities or at our suppliers; and
- any transitions or changes in our production process, planned or unplanned.

In the past, we have experienced difficulties in achieving acceptable yields on certain products, which has adversely affected our operating results. We may experience similar problems in the future, and we cannot predict when they may occur or their severity.

In some instances, we may offer products for future delivery at prices based on planned yield improvements or increased cost efficiencies from other production advances. Failure to achieve these planned improvements or advances could have a significant impact on our margins and operating results.

In addition, our ability to convert volume manufacturing to larger diameter substrates can be an important factor in providing a more cost effective manufacturing process. If we are unable to make this transition in a timely or cost effective manner, our results could be negatively impacted.

There are risks associated with the previously-announced proposed IPO of our Power and RF Products segment that may adversely impact our results of operations.

The completion of the proposed IPO of Wolfspeed, our Power and RF Products segment, is subject to numerous conditions, including market conditions, and may not occur on favorable terms or at all. We have not yet determined the number of shares of common stock of our Power and RF subsidiary that will be sold in the proposed IPO or the valuation of such shares. Therefore, the amount of cash proceeds we expect to receive in the proposed IPO and related transactions is uncertain.

In connection with the proposed IPO:

- our stock price could fluctuate significantly in response to developments related to the proposed IPO or other actions or market speculation regarding the proposed IPO;
- we may encounter difficulties in hiring, retaining and motivating key personnel during this process or as a result of uncertainties generated by this process or any developments or actions relating to it;
- we will incur substantial increases in general and administrative expense associated with the need to retain and compensate third-party consultants and advisors (including legal counsel); and
- although we have not made any determination regarding whether we will dispose of our remaining interests in Wolfspeed following the proposed IPO, to the extent that further dispositions result in our owning less than a controlling financial interest, Wolfspeed's financial results may no longer be consolidated with our financial results and we may be required to report Wolfspeed’s operating results as discontinued operations, which may materially and adversely affect our consolidated results of operations.

We may not complete the proposed IPO, in which event we will have incurred significant expenses that we will be unable to recover, and for which we will not receive any benefit. If the proposed IPO is completed, Wolfspeed would be a new publicly traded company. We cannot make any assurances that the proposed IPO, if completed, will increase the market value of Cree.

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

From time to time, we evaluate strategic opportunities available to us for product, technology or business transactions, such as business acquisitions, investments, joint ventures, divestitures, or spin-offs. If we choose to enter into such transactions, we face certain risks including:

- the failure of an acquired business, investee or joint venture to meet our performance expectations;
- identification of additional liabilities relating to an acquired business;
- loss of existing customers of our current and acquired businesses due to concerns that new product lines may be in competition with the customers' existing product lines;
- difficulty integrating an acquired business's operations, personnel and financial and operating systems into our current business;
- diversion of management attention;
- uncertainty of the financial markets or circumstances that cause conditions that are less favorable and/or different than expected;
- difficulty separating the operations, personnel and financial and operating systems of a spin-off or divestiture from our current business; and
- expenses incurred to complete a transaction may be significantly higher than anticipated.

We may not be able to adequately address these risks or any other problems that arise from our prior or future acquisitions, investments, joint ventures, divestitures or spin-offs. Any failure to successfully evaluate strategic opportunities and address risks or other problems that arise related to any such business transaction could adversely affect our business, results of operations or financial condition.

As a result of our continued expansion into new markets, we may compete with existing customers who may reduce their orders.

Through acquisitions and organic growth, we continue to expand into new markets and new market segments. Many of our existing customers who purchase our LED products develop and manufacture products using those chips and components that are offered into the same lighting markets. As a result, some of our current customers perceive us as a competitor in these market segments. In response, our customers may reduce or discontinue their orders for our LED products. This reduction in or discontinuation of orders could occur faster than our sales growth in these new markets, which could adversely affect our business, results of operations or financial condition.

Our revenue is highly dependent on our customers' ability to produce, market and sell more integrated products.

Our revenue in our LED Products and Power and RF Products segments depends on getting our products designed into a larger number of our customers' products and in turn, our customers' ability to produce, market and sell their products. For example, we have current and prospective customers that create, or plan to create, lighting systems using our LED components. Even if our customers are able to develop and produce LED lighting products or products that incorporate our Power and RF products, there can be no assurance that our customers will be successful in marketing and selling these products in the marketplace.

The adoption of or changes in government and/or industry policies, standards or regulations relating to the efficiency, performance, use or other aspects of lighting could impact the demand for our products.

The adoption of or changes in government and/or industry policies, standards or regulations relating to the efficiency, performance or other aspects of LED lighting may impact the demand for our products. Demand for our products may also be impacted by changes in government and/or industry policies, standards or regulations that discourage the use of certain traditional lighting technologies. These constraints may be eliminated or delayed by legislative action, which could have a negative impact on demand for our products. For example, Energy Star just announced its release of Energy Star Lamps V2.0 specification on December 31, 2015 that will replace V1.2 on January 2, 2017. The ability of us and our competitors to meet these new requirements could impact competitive dynamics in the market.

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If governments, their agencies or utilities reduce their demand for our products or discontinue or curtail their funding, our business may suffer.

Changes in governmental budget priorities could adversely affect our business and results of operations. U.S. and foreign government agencies have purchased products directly from us and products from our customers, and U.S. government agencies have historically funded a portion of our research and development activities. When the government changes budget priorities, such as in times of war or financial crisis, or reallocates its research and development spending to areas unrelated to our business, our research and development funding and our product sales to government entities and government-funded customers are at risk. For example, demand and payment for our products and our customers' products may be affected by public sector budgetary cycles, funding authorizations or utility rebates. Funding reductions or delays could negatively impact demand for our products. If government or utility funding is discontinued or significantly reduced, our business and results of operations could be adversely affected.

We are exposed to fluctuations in the market value of our investment portfolio and in interest rates, and therefore, impairment of our investments or lower investment income could harm our earnings.

We are exposed to market value and inherent interest rate risk related to our investment portfolio. We have historically invested portions of our available cash in fixed interest rate securities such as high-grade corporate debt, commercial paper, municipal bonds, certificates of deposit, government securities and other fixed interest rate investments. The primary objective of our cash investment policy is preservation of principal. However, these investments are generally not Federal Deposit Insurance Corporation insured and may lose value and/or become illiquid regardless of their credit rating.

From time to time, we have also made investments in public and private companies that engage in complementary businesses. For example, during fiscal 2015 we made an investment in Lextar Electronics Corporation (Lextar), a public company in Taiwan. An investment in another company is subject to the risks inherent in the business of that company and to trends affecting the equity markets as a whole. Investments in publicly held companies are subject to market risks and, like our investment in Lextar, may not be liquidated easily. As a result, we may not be able to reduce the size of our position or liquidate our investments when we deem appropriate to limit our downside risk. Should the value of any such investments we hold decline, the related write-down in value could have a material adverse effect on our financial condition and results of operations. For example, the value of our Lextar investment declined from the date of our investment in December 2014 through the end of fiscal 2015, and this downward stock price trend has continued during fiscal 2016, with variability between quarters, and may continue in the future. As required by Rule 3-09 of Regulation S-X, we filed Lextar's financial statements, prepared by Lextar and audited by its independent public accounting firm, as of and for the year ended December 31, 2014 as an exhibit to our Annual Report on Form 10-K for the fiscal year ended June 28, 2015.

Our operations in foreign countries expose us to certain risks inherent in doing business internationally, which may adversely affect our business, results of operations or financial condition.

We have operations, manufacturing facilities and contract manufacturing arrangements in foreign countries that expose us to certain risks. For example, fluctuations in exchange rates may affect our revenue, expenses and results of operations as well as the value of our assets and liabilities as reflected in our financial statements. We are also subject to other types of risks, including the following:

- protection of intellectual property and trade secrets;
- tariffs, customs, trade sanctions and other barriers to importing/exporting materials and products in a cost effective and timely manner, or changes in applicable tariffs or custom rules;
- timing and availability of export licenses;
- rising labor costs;
- disruptions in or inadequate infrastructure of the countries where we operate;
- difficulties in collecting accounts receivable;
- difficulties in staffing and managing international operations;
- the burden of complying with foreign and international laws and treaties; and
- the burden of complying with and changes in international taxation policies.

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In some instances, we have received and may continue to receive incentives from foreign governments to encourage our investment in certain countries, regions or areas outside of the United States. In particular, we have received and may continue to receive such incentives in connection with our operations in Asia, as Asian national and local governments seek to encourage the development of the technology industry. Government incentives may include tax rebates, reduced tax rates, favorable lending policies and other measures, some or all of which may be available to us due to our foreign operations. Any of these incentives could be reduced or eliminated by governmental authorities at any time or as a result of our inability to maintain minimum operations necessary to earn the incentives. Any reduction or elimination of incentives currently provided for our operations could adversely affect our business and results of operations. These same governments also may provide increased incentives to or require production processes that favor local companies, which could further negatively impact our business and results of operations. Abrupt political change, terrorist activity and armed conflict pose a risk of general economic disruption in affected countries, which could also result in an adverse effect on our business and results of operations.
In order to compete, we must attract, motivate and retain key employees, and our failure to do so could harm our results of operations.
Hiring and retaining qualified executives, scientists, engineers, technical staff and sales personnel is critical to our business, and competition for experienced employees in our industry can be intense. As a global company, this issue is not limited to the United States, but includes our other locations such as Europe and China. For example, there is substantial competition in China for qualified and capable personnel, particularly experienced engineers and technical personnel, which may make it difficult for us to recruit and retain qualified employees. Also, within Huizhou, China, there are other large companies building manufacturing plants that will likely compete for qualified employees. If we are unable to staff sufficient and adequate personnel at our China facilities, we may experience lower revenue or increased manufacturing costs, which would adversely affect our results of operations.
To help attract, motivate and retain key employees, we use benefits such as stock-based compensation awards. If the value of such awards does not appreciate, as measured by the performance of the price of our common stock or if our stock-based compensation otherwise ceases to be viewed as a valuable benefit, our ability to attract, retain and motivate employees could be weakened, which could harm our business and results of operations.
Litigation could adversely affect our operating results and financial condition.
We are often involved in litigation, primarily patent litigation. Defending against existing and potential litigation will likely require significant attention and resources and, regardless of the outcome, result in significant legal expenses, which could adversely affect our results unless covered by insurance or recovered from third parties. If our defenses are ultimately unsuccessful or if we are unable to achieve a favorable resolution, we could be liable for damage awards that could materially affect our results of operations and financial condition.
Where necessary, we may initiate litigation to enforce our patent or other intellectual property rights, which could adversely impact our relationship with certain customers. Any such litigation may require us to spend a substantial amount of time and money and could distract management from our day-to-day operations. Moreover, there is no assurance that we will be successful in any such litigation.
Our business may be impaired by claims that we, or our customers, infringe the intellectual property rights of others.
Vigorous protection and pursuit of intellectual property rights characterize our industry. These traits have resulted in significant and often protracted and expensive litigation. Litigation to determine the validity of patents or claims by third parties of infringement of patents or other intellectual property rights could result in significant legal expense and divert the efforts of our technical personnel and management, even if the litigation results in a determination favorable to us. In the event of an adverse result in such litigation, we could be required to:

- pay substantial damages;
- indemnify our customers;
- stop the manufacture, use and sale of products found to be infringing;
- incur asset impairment charges;
- discontinue the use of processes found to be infringing;

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- expend significant resources to develop non-infringing products or processes; or
- obtain a license to use third party technology.

There can be no assurance that third parties will not attempt to assert infringement claims against us, or our customers, with respect to our products. In addition, our customers may face infringement claims directed to the customer's products that incorporate our products, and an adverse result could impair the customer's demand for our products. We have also promised certain of our customers that we will indemnify them in the event they are sued by our competitors for infringement claims directed to the products we supply. Under these indemnification obligations, we may be responsible for future payments to resolve infringement claims against them.

From time to time, we receive correspondence asserting that our products or processes are or may be infringing patents or other intellectual property rights of others. If we believe the assertions may have merit or in other appropriate circumstances, we may take steps to seek to obtain a license or to avoid the infringement. We cannot predict, however, whether a license will be available; that we would find the terms of any license offered acceptable; or that we would be able to develop an alternative solution. Failure to obtain a necessary license or develop an alternative solution could cause us to incur substantial liabilities and costs and to suspend the manufacture of affected products.

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

Our intellectual property position is based in part on patents owned by us and patents licensed to us. We intend to continue to file patent applications in the future, where appropriate, and to pursue such applications with U.S. and certain foreign patent authorities.

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

We periodically discover products that are counterfeit reproductions of our products or that otherwise infringe on our intellectual property rights. The actions we take to establish and protect trademarks, patents and other intellectual property rights may not be adequate to prevent imitation of our products by others, and therefore, may adversely affect our sales and our brand and result in the shift of customer preference away from our products. Further, the actions we take to establish and protect trademarks, patents and other intellectual property rights could result in significant legal expense and divert the efforts of our technical personnel and management, even if the litigation or other action results in a determination favorable to us.

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

We may be required to recognize a significant charge to earnings if our goodwill or other intangible assets become impaired.

Goodwill and purchased intangible assets with indefinite lives are not amortized, but are reviewed for impairment annually and more frequently when events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. We assess the recoverability of the unamortized balance of our finite-lived intangible assets when indicators of potential impairment are present. Factors that may indicate that the carrying value of our goodwill or other intangible assets may not be recoverable include a decline in our stock price and market capitalization and slower growth rates in our industry. The recognition of a significant charge to earnings in our consolidated financial statements resulting from any impairment of our goodwill or other intangible assets could adversely impact our results of operations.

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We may be subject to confidential information theft or misuse, which could harm our business and results of operations.

We face attempts by others to gain unauthorized access to our information technology systems on which we maintain proprietary and other confidential information. Our security measures may be breached as the result of industrial or other espionage actions of outside parties, employee error, malfeasance or otherwise, and as a result, an unauthorized party may obtain access to our systems. Additionally, outside parties may attempt to access our confidential information through other means, for example by fraudulently inducing our employees to disclose confidential information. We actively seek to prevent, detect and investigate any unauthorized access, which sometimes occurs. We might be unaware of any such access or unable to determine its magnitude and effects. The theft and/or unauthorized use or publication of our trade secrets and other confidential business information as a result of such an incident could adversely affect our competitive position and the value of our investment in research and development could be reduced. Our business could be subject to significant disruption and we could suffer monetary or other losses.

We are subject to risks related to international sales and purchases.

We expect that revenue from international sales will continue to represent a significant portion of our total revenue. As such, a significant slowdown or instability in relevant foreign economies, including economic instability in Europe, or lower investments in new infrastructure could have a negative impact on our sales. We also purchase a portion of the materials included in our products from overseas sources.

Our international sales and purchases are subject to numerous U.S. and foreign laws and regulations, including, without limitation, tariffs, trade sanctions, trade barriers, regulations relating to import-export control, technology transfer restrictions, the International Traffic in Arms Regulation promulgated under the Arms Export Control Act, the Foreign Corrupt Practices Act and the anti-boycott provisions of the U.S. Export Administration Act. If we fail to comply with these laws and regulations, we could be liable for administrative, civil or criminal liabilities, and, in the extreme case, we could be suspended or debarred from government contracts or have our export privileges suspended, which could have a material adverse effect on our business.

International sales and purchases are also subject to a variety of other risks, including risks arising from currency fluctuations, collection issues and taxes. We have entered and may in the future enter into foreign currency derivative financial instruments in an effort to manage or hedge some of our foreign exchange rate risk. We may not be able to engage in hedging transactions in the future, and, even if we do, foreign currency fluctuations may still have a material adverse effect on our results of operations.

Our business may be adversely affected by uncertainties in the global financial markets and our or our customers' or suppliers' ability to access the capital markets.

Global financial markets continue to reflect uncertainty about a sustained global economic recovery. Given these uncertainties, there could be future disruptions in the global economy, financial markets and consumer confidence. If economic conditions deteriorate unexpectedly, our business and results of operations could be materially and adversely affected. For example, our customers, including our distributors and their customers, may experience difficulty obtaining the working capital and other financing necessary to support historical or projected purchasing patterns, which could negatively affect our results of operations.

Although we believe we have adequate liquidity and capital resources to fund our operations internally and under our existing line of credit, our inability to access the capital markets on favorable terms in the future, or at all, may adversely affect our financial performance. The inability to obtain adequate financing from debt or capital sources in the future could force us to self-fund strategic initiatives or even forego certain opportunities, which in turn could potentially harm our performance.

Changes in our effective tax rate may affect our results.

Our future effective tax rates may be affected by a number of factors including:

- the jurisdiction in which profits are determined to be earned and taxed;
- changes in government administrations, such as the Presidency and Congress of the U.S. as well as in the states and countries in which we operate;
- changes in tax laws or interpretation of such tax laws and changes in generally accepted accounting principles;

- the resolution of issues arising from tax audits with various authorities;
- changes in the valuation of our deferred tax assets and liabilities;

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- adjustments to estimated taxes upon finalization of various tax returns;
- increases in expenses not deductible for tax purposes, including impairment of goodwill in connection with acquisitions;
- changes in available tax credits;
- the recognition and measurement of uncertain tax positions;
- the lack of sufficient excess tax benefits (credits) in our additional paid-in-capital pool in situations where our realized tax deductions for certain stock-based compensation awards (such as non-qualified stock options and restricted stock) are less than those originally anticipated; and
- the repatriation of non-U.S. earnings for which we have not previously provided for U.S. taxes or any changes in legislation that may result in these earnings being taxed within the U.S., regardless of our decision regarding repatriation of funds.

Any significant increase or decrease in our future effective tax rates could impact net income (loss) for future periods. In addition, the determination of our income tax provision requires complex estimations, significant judgments and significant knowledge and experience concerning the applicable tax laws. To the extent our income tax liability materially differs from our income tax provisions due to factors, including the above, which were not anticipated at the time we estimated our tax provision, our net income (loss) or cash flows could be affected.

Failure to comply with applicable environmental laws and regulations worldwide could harm our business and results of operations.

The manufacturing, assembling and testing of our products require the use of hazardous materials that are subject to a broad array of environmental, health and safety laws and regulations. Our failure to comply with any of these applicable laws or regulations could result in:

- regulatory penalties, fines, legal liabilities and the forfeiture of certain tax benefits;
- suspension of production;
- alteration of our fabrication, assembly and test processes; and
- curtailment of our operations or sales.

In addition, our failure to manage the use, transportation, emission, discharge, storage, recycling or disposal of hazardous materials could subject us to increased costs or future liabilities. Existing and future environmental laws and regulations could also require us to acquire pollution abatement or remediation equipment, modify our product designs or incur other expenses, such as permit costs, associated with such laws and regulations. Many new materials that we are evaluating for use in our operations may be subject to regulation under existing or future environmental laws and regulations that may restrict our use of one or more of such materials in our manufacturing, assembly and test processes or products. Any of these restrictions could harm our business and results of operations by increasing our expenses or requiring us to alter our manufacturing processes.

Our results could vary as a result of the methods, estimates and judgments that we use in applying our accounting policies, including changes in the accounting standards to be applied.

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results (see “Critical Accounting Policies and Estimates” in Management’s Discussion and Analysis of Financial Condition and Results of Operations included in Part I, Item 2 of this Quarterly Report). Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions, and factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations or financial condition.

Likewise, our results may be impacted due to changes in the accounting standards to be applied, such as the increased use of fair value measurement standards and changes in revenue recognition requirements.

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Catastrophic events may disrupt our business.

A disruption or failure of our systems or operations in the event of a natural disaster, health pandemic, such as an influenza outbreak within our workforce, or man-made catastrophic event could cause delays in completing sales, continuing production or performing other critical functions of our business, particularly if a catastrophic event occurred at our primary manufacturing locations or our subcontractors' locations. Any of these events could severely affect our ability to conduct normal business operations and, as a result, our operating results could be adversely affected. There may also be secondary impacts that are unforeseeable as well, such as impacts to our customers, which could cause delays in new orders, delays in completing sales or even order cancellations.

Our stock price may be volatile.

Historically, our common stock has experienced substantial price volatility, particularly as a result of significant fluctuations in our revenue, earnings and margins over the past few years, and variations between our actual financial results and the published expectations of analysts. For example, the closing price per share of our common stock on the NASDAQ Global Select Market ranged from a low of $22.12 to a high of $39.56 during the 12 months ended December 27, 2015. If our future operating results or margins are below the expectations of stock market analysts or our investors, our stock price will likely decline.

Speculation and opinions in the press or investment community about our strategic position, financial condition, results of operations or significant transactions can also cause changes in our stock price. In particular, speculation around our market opportunities for energy efficient lighting may have a dramatic effect on our stock price, especially as various government agencies announce their planned investments in energy efficient technology, including lighting.

We have outstanding debt which could materially restrict our business and adversely affect our financial condition, liquidity and results of operations.

Our indebtedness consists of borrowings from our revolving line of credit. Our ability to pay interest and repay the principal for our indebtedness is dependent upon our ability to manage our business operations and generate sufficient cash flows to service such debt. There can be no assurance that we will be able to manage any of these risks successfully.

The level of outstanding debt under this line of credit may adversely affect our operating results and financial condition by, among other things:

- increasing our vulnerability to downturns in our business, to competitive pressures and to adverse general economic and industry conditions;
- requiring the dedication of an increased portion of our expected cash flows from operations to service our indebtedness, thereby reducing the amount of expected cash flow available for other purposes, including capital expenditures, research and development and stock repurchases;
- limiting our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- placing us at a competitive disadvantage compared to our peers that may have less indebtedness than we have by limiting our ability to borrow additional funds needed to operate and grow our business; and
- increasing our interest expense if interest rates increase.

Our line of credit requires us to maintain compliance with certain financial ratios. In addition, our line of credit contains certain restrictions that could limit our ability to, among other things: incur additional indebtedness, dispose of assets, create liens on assets, make acquisitions or engage in mergers or consolidations, and engage in certain transactions with our subsidiaries and affiliates. These restrictions could limit our ability to plan for or react to changing business conditions, or could otherwise restrict our business activities and plans.

Our ability to comply with our loan covenants may also be affected by events beyond our control and if any of these restrictions or terms is breached, it could lead to an event of default under our line of credit. A default, if not cured or waived, may permit acceleration of our indebtedness. In addition, our lenders could terminate their commitments to make further extensions of credit under our line of credit. If our indebtedness is accelerated, we cannot be certain that we will have sufficient funds to pay the accelerated indebtedness or that we will have the ability to refinance accelerated indebtedness on terms favorable to us or at all.

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Regulations related to conflict-free minerals may force us to incur additional expenses.
The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC established new annual disclosure and reporting requirements for those companies who may use "conflict" minerals mined from the DRC and adjoining countries in their products. Due diligence efforts were required to begin in the 2013 calendar year. Our most recent disclosure regarding our due diligence was filed in June 2015 for calendar year 2014. These requirements could affect the sourcing and availability of certain minerals used in the manufacture of our products. As a result, we may not be able to obtain the relevant minerals at competitive prices and there will likely be additional costs associated with complying with the due diligence procedures as required by the SEC. In addition, because our supply chain is complex, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins of all minerals used in our products through the due diligence procedures that we implement, and we may incur additional costs as a result of changes to product, processes or sources of supply as a consequence of these requirements.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sale of Unregistered Securities

There were no unregistered securities sold during the second quarter of fiscal 2016.

Stock Repurchase Program

The following table summarizes stock repurchase activity for the second quarter of fiscal 2016 (in thousands, except price per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs[1]	Approximate Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs[1]
Shares repurchased under our Stock Repurchase Program				
September 28, 2015 to October 25, 2015	—	$—	2,723	$430,341
October 26, 2015 to November 22, 2015	570	$23.36	3,293	$417,028
November 23, 2015 to December 27, 2015	1,880	$26.00	5,173	$368,148
Total	2,450	$25.38		

(1) On June 18, 2015, our Board of Directors approved our fiscal 2016 stock repurchase program, authorizing us to repurchase shares of our common stock having an aggregate purchase price not exceeding $500 million for all purchases from June 29, 2015 through the expiration of the program on June 26, 2016.

Since the inception of our stock repurchase program in January 2001 through December 27, 2015, we have repurchased 33.6 million shares of our common stock at an average price of $29.37 per share with an aggregate value of $986.9 million. The repurchase program can be implemented through open market or privately negotiated transactions at the discretion of our management.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 5. Other Information

Not applicable.

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Item 6. Exhibits

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

Exhibit No.	Description
31.1	Certification by Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101	The following materials from Cree, Inc.'s Quarterly Report on Form 10-Q for the fiscal quarter ended December 27, 2015 formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets; (ii) Consolidated Statements of Income (Loss); (iii) Consolidated Statements of Comprehensive Income (Loss); (iv) Consolidated Statements of Cash Flows; and (v) Notes to Consolidated Financial Statements

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CREE, INC.

January 20, 2016

/s/ MICHAEL E. MCDEVITT
Michael E. McDevitt
Executive Vice President and Chief Financial Officer
(Authorized Officer and Principal Financial and Chief Accounting Officer)

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