CREE INC
Form 8-K
October 31, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 8-K

CURRENT REPORT
Pursuant to Section 13 OR 15(d) of The Securities Exchange Act of 1934

Date of Report (Date of Earliest Event Reported): October 28, 2013

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

North Carolina	0-21154	56-1572719
(State or other jurisdiction of incorporation)	(Commission File Number)	(I.R.S. Employer Identification Number)

4600 Silicon Drive Durham, North Carolina	27703
(Address of principal executive offices)	(Zip Code)

(919) 407-5300
Registrant’s telephone number, including area code

N/A
(Former name or former address, if changed since last report)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

[ ] Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
[ ] Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
[ ] Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
[ ] Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers

Severance Plan for Section 16 Officers

On October 28, 2013, the Compensation Committee of the Board of Directors of Cree, Inc. (the “Company”) amended the Cree, Inc. Severance Plan for Section 16 Officers (the “Severance Plan”). The Severance Plan is administered by the Compensation Committee and designed to supplement the Change in Control Agreements for the Company’s executive officers who are subject to the reporting requirements of Section 16 of the Securities Exchange Act of 1934, as amended (the “Officers”), by providing severance benefits in the event of termination of an Officer’s employment without cause or resignation for good reason. However, the Severance Plan will not apply to an Officer if he or she becomes entitled to the payment of severance benefits upon termination of employment in connection with a change in control pursuant to a separate agreement with the Company. The Company’s only Officers as of the date of this report are Charles M. Swoboda, the Company’s Chairman, Chief Executive Officer and President, Michael E. McDevitt, the Company’s Executive Vice President and Chief Financial Officer, Norbert W. G. Hiller, the Company’s Executive Vice President–LEDs, and Tyrone D. Mitchell, Jr., the Company’s Executive Vice President–Lighting.

If an Officer’s employment is terminated by the Company without cause or by the Officer for good reason, except in the event of termination of the Officer’s employment due to death or long-term disability or in the event such termination of employment is in connection with a change in control and the Officer is entitled to the payment of severance benefits pursuant to a separate agreement with the Company, then the Officer will receive continued payment of the Officer’s base salary for 12 months (18 months in the Chief Executive Officer’s case) and a lump sum payment equal to 12 (18 in the Chief Executive Officer’s case) multiplied by the COBRA premium applicable to the type of medical, dental and vision coverage then in effect for the Officer. In addition, the Chief Executive Officer will receive 1.5 times the annual payout at target under any performance unit grant in effect as of the termination date and the other Officers will receive an amount equal to the total payout at target for one year under the Company Management Incentive Compensation Plan and any performance unit grant in effect as of the termination date.

As a condition to the receipt of the severance benefits described in the prior paragraph, an Officer must execute and comply with a release agreement that includes a release of claims against the Company, its affiliates and representatives and a non-disparagement provision.

The foregoing description of the Severance Plan is subject to and qualified in its entirety by the Severance Plan, as amended, which is included as Exhibit 10.1 to this report and incorporated herein by reference.

Item 9.01 Financial Statements and Exhibits

(d) Exhibits

Exhibit No.	Description of Exhibit
Exhibit 10.1	Cree, Inc. Severance Plan for Section 16 Officers, as amended

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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 hereunto duly authorized.

CREE, INC.

By: /s/ Michael E. McDevitt
Michael E. McDevitt
Executive Vice President and Chief Financial Officer

Date: October 31, 2013

EXHIBIT INDEX

Exhibit No.	Description of Exhibit
Exhibit 10.1	Cree, Inc. Severance Plan for Section 16 Officers, as amended

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

General

The following discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related notes included in Item 1 of this Quarterly Report on Form 10-Q, together with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended June 30, 2007 ("2007 Form 10-K"). This discussion contains forward-looking statements which are based on our current expectations and experience and our perception of historical trends, current market conditions, including customer acceptance of our new products, current economic data, expected future developments, including foreign currency exchange rates, and other factors that we believe are appropriate under the circumstances. These statements involve risks and uncertainties that could cause actual results to differ materially from those suggested in the forward-looking statements, including the litigation resulting from the terminated merger agreement with a company formed by investment funds affiliated with Kohlberg Kravis Roberts & Co. L.P. and GS Capital Partners VI Fund, L.P.

We begin our discussion with an overview of our company to give you an understanding of our business and the markets we serve. We then discuss our critical accounting policies. This is followed by a discussion of our results of operations for the three months ended September 30, 2007 and 2006. We include in this discussion an analysis of certain significant period-to-period variances in our consolidated statements of operations. We also provide specific information regarding our three reportable business segments: Automotive, Consumer and Professional. Our liquidity, capital resources and cash flows are discussed under the caption Financial Condition. We complete our discussion with a business outlook for future periods.

Overview

We design, manufacture and market high-quality, high fidelity audio products and electronic systems for the automotive, consumer and professional markets. We have developed, both internally and through a series of strategic acquisitions, a broad range of product offerings sold under renowned brand names in our principal markets. These brand names have a heritage of technological leadership and product innovation. Our three reportable business segments, Automotive, Consumer and Professional, are based on the end-user markets we serve.

Automotive designs, manufactures and markets audio, electronic and infotainment systems for vehicle applications. Our systems are generally shipped directly to our automotive customers for factory installation. Infotainment systems are a combination of infotainment and entertainment components that may include or control GPS navigation, traffic information, voice-activated telephone and climate control, rear seat entertainment, wireless Internet access, hard disk recording, MP3 playback and a high-end branded audio system. These systems include scaleable software to allow us to better serve a full range of vehicles from luxury through the entry-level vehicles. Future infotainment systems may also provide driver safety capabilities such as lane guidance, pre-crash emergency braking, adaptive cruise control and night vision. Automotive also provides aftermarket products such as personal navigation devices ("PNDs") to customers primarily in Europe. Our PNDs leverage many of the successful applications developed by our Automotive segment.

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Consumer designs, manufactures and markets audio, video and electronic systems for home, mobile and multimedia applications. Home product applications include systems to provide high-quality audio throughout the home and to enhance in-home video systems such as home theatres. Our aftermarket mobile products, such as iPod adaptors, speakers and amplifiers, deliver audio entertainment in the vehicle. Additionally, aftermarket mobile products include PNDs that provide GPS navigation, video and other infotainment capabilities. Our multimedia applications include loudspeaker accessories for personal computers, music phones, and portable electronic devices such as the iPod and other MP3 players. Our consumer products are primarily distributed through retail outlets.

Professional designs, manufactures and markets loudspeakers and electronic systems used by audio professionals in concert halls, stadiums, airports, houses of worship and other public spaces. We also develop products for recording, broadcast, cinema, touring and music reproduction applications. In addition, we have leading shares of both the portable PA market and musician vertical markets serving small bands, DJ's and other performers. These products are increasingly linked by our proprietary HiQnet network protocol which provides centralized monitoring and control of both complex and simple professional audio systems.

Our products are sold worldwide, with the largest markets being the United States and Germany. In the United States, our primary manufacturing facilities are located in California, Indiana, Kentucky, Missouri and Utah. Outside of the United States, we have significant manufacturing facilities in Germany, Austria, the United Kingdom, Mexico, Hungary, France and China. Our businesses operate using local currencies. Therefore, we are subject to currency fluctuations that are partially mitigated by the fact that we purchase raw materials and supplies locally when possible. We are especially affected by Euro exchange rates since a significant percentage of our sales are made in Euros.

We experience seasonal fluctuations in sales and earnings. Historically, our first quarter ending September 30 is generally the weakest due to the production schedules of our automotive customers and summer holidays in Europe. Our sales and earnings may also vary due to customer acceptance of our products, the timing of new product introductions, product offerings by our competitors and general economic conditions. Our reported sales and earnings may also fluctuate due to foreign currency exchange rates, especially for the Euro.

We achieved solid results for the first quarter ended September 30, 2007. Each of our three reportable business segments reported sales growth for the first quarter. Our initiative to develop cost saving strategies is underway and we expect to gain procurement, engineering and manufacturing efficiencies that we believe will improve margins over the course of this fiscal year. We continue to be a strong company with exceptional technology, products and market position. With the termination of the Merger Agreement behind us, we now look forward to turning our full attention to operating and improving our business.

Recent Developments

On October 22, 2007, we announced that we entered into an agreement with KKR, GSCP and companies formed by investment funds affiliated with KKR and GSCP to terminate the Merger Agreement dated April 26, 2007 without litigation or payment of a termination fee. In connection with the termination of the Merger Agreement, we sold $400 million of our 1.25 percent Convertible Senior Notes due 2012, convertible at a conversion price of $104 per share into cash, and at our option, if applicable, shares of our common stock.

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On October 30, 2007, we entered into an accelerated share repurchase (“ASR”) agreement with Bear, Stearns International Limited and a separate ASR agreement with J.P. Morgan Securities Inc., as agent for JPMorgan Chase Bank, National Association, London Branch. Pursuant to these agreements, we purchased, in the aggregate, 4,775,549 shares of our common stock for a total purchase price of approximately $400 million, subject to adjustment.

Critical Accounting Policies

Our critical accounting policies are described under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2007 Form 10-K. These policies include allowance for doubtful accounts, inventory valuation, goodwill, pre-production and development costs, warranty liabilities, income taxes, and stock-based compensation. Also see Note 1, *Summary of Significant Accounting Policies* to our Consolidated Financial Statements included in our 2007 Form 10-K.

Results of Operations

Sales

Our net sales for the quarter ended September 30, 2007 were $947.0 million, a 15 percent increase compared to the prior year period. All three of our reporting segments reported higher sales compared to the same period in the prior year. The effects of foreign currency translation contributed approximately $42 million to the increase in sales. Exclusive of foreign currency, net sales were 9 percent higher than the prior year period. The growth in overall net sales was primarily due to increased shipments of infotainment systems to automotive customers, higher sales of personal navigation devices in Europe, and higher sales of consumer and professional products to major retailers.

Presented below is a summary of our net sales by reporting segment:

($000s omitted)	Three months ended September 30,				
		2007	%	2006	%
Net sales:					
Automotive	$	682,303	72%	600,998	73%
Consumer		119,438	13%	93,126	11%
Professional		145,221	15%	131,419	16%
Total	$	946,962	100%	825,543	100%

Automotive - Net sales for the quarter ended September 30, 2007 increased $81.3 million, or 14 percent compared to the same period last year. Foreign currency translation contributed approximately $36 million to the increase in sales. Since a significant percentage of our automotive sales are to customers in Europe, Automotive incurs most of our foreign currency translation exposure. New introductions of infotainment systems including Chrysler’s MyGig infotainment systems in North America, the roll-out of our first mid-level infotainment system for BMW and the extension of our Multi Media Interface infotainment system for the Audi A4 and A5 were primary factors contributing to the higher sales. A strong demand for Traffic Assist, our European aftermarket PND, also contributed significantly to the increase in sales over the prior year period.

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Consumer - Net sales for the quarter ended September 30, 2007 increased $26.3 million, or 28 percent, compared to the same period last year. Foreign currency translation contributed approximately $4 million to the increase in sales compared to the prior year. New product introductions and strong Harman/Kardon and multimedia sales contributed significantly to the sales increase at Consumer. Higher sales of consumer products for home applications including Harman/Kardon electronics and JBL loudspeakers, multimedia products and our consumer mobile PNDs, each contributed to the sales growth over the prior year period.

Professional - Net sales for the quarter ended September 30, 2007 increased $13.8 million, or 11 percent compared to the same period last year. Foreign currency translation contributed approximately $2 million to the increase in sales compared to the prior year period. The increase in sales compared to the same period last year was primarily due to new installed sound product introductions, higher JBL Professional sales to major US retailers and recently introduced digital consoles from Soundcraft and Studer.

Gross Profit

Gross profit as a percentage of net sales decreased 6.9 percentage points to 27.9 percent for the quarter ended September 30, 2007 compared to 34.8 percent of sales in the same period last year. The decrease was due to lower margins in our Automotive and Consumer business segments.

Presented below is a summary of our gross profit by reporting segment:

($000s omitted)	Three months ended September 30,				
		2007	Percent of net sales	2006	Percent of net sales
Gross Profit:					
Automotive	$	181,836	26.7%	214,740	35.7%
Consumer		28,107	23.5%	23,507	25.2%
Professional		55,882	38.5%	50,292	38.3%
Other		(1,250)		(1,250)	
Total	$	264,575	27.9%	287,289	34.8%

Automotive– Gross profit as a percentage of net sales decreased 9.0 percentage points for the quarter ended September 30, 2007 compared to the same period in the prior year. The gross margin decline was primarily due to higher costs incurred related to the ramp-up of mid-level infotainment systems for mass market vehicles. Margins were also affected by product mix, sales of PNDs with lower margins, higher fixed overhead expenses primarily due to the ramp-up of new manufacturing facilities to support new business and material cost increases.

Consumer– Gross profit as a percentage of net sales decreased 1.7 percentage points for the quarter ended September 30, 2007 compared to the same period in the prior year. Gross margins were affected by strong competition in the multimedia market. Sales of lower margin Harman/Kardon electronics, lower margin iPod docking stations and the discontinuance of mobile multimedia products contributed to the decrease in gross margins.

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Professional– Gross profit as a percentage of net sales increased a modest 0.2 percentage points for the quarter ended September 30, 2007 compared to the same period in the prior year. The slight gross margin improvement resulted from the introduction of new products.

Selling, General and Administrative Expenses

Selling, general and administrative expenses ("SG&A"), as a percentage of net sales, decreased 0.7 percentage points for the quarter ended September 30, 2007 compared to the same period in the prior year. The decrease primarily relates to lower research and development ("R&D") costs as a percent of sales. Research and development costs were $87.8 million, or 9.3 percent of net sales, for the quarter ended September 30, 2007 compared to $82.8 million, or 10.0 percent of net sales, in the same period last year. We expect R&D costs, as a percentage of net sales, to decrease during the year due to the increasing scalability of our infotainment systems and the beginning of production for certain automotive programs. Our SG&A expenses include $4.7 million of merger-related costs for the quarter ended September 30, 2007. We expect significant additional costs related to the resolution of the merger termination in the second quarter of fiscal 2008.

In June 2006, we initiated a restructuring program designed to increase efficiencies in our manufacturing, engineering and administrative organizations. Since the inception of the restructuring program, we have incurred restructuring charges of $16.9 million and made cash payments of $10.8 million.

Presented below is a summary of SG&A expenses by reporting segment:

($000s omitted)	Three months ended September 30,			
	2007	Percent of net sales	2006	Percent of net sales
SG&A Expenses:				
Automotive	$ 135,857	19.9%	124,572	20.7%
Consumer	31,200	26.1%	27,956	30.0%
Professional	35,494	24.4%	33,217	25.3%
Other	20,583	---	14,626	---
Total	$ 223,134	23.6%	200,371	24.3%

Automotive– SG&A expenses as a percentage of sales decreased 0.8 percentage points for the quarter ended September 30, 2007 compared to the same period last year. The decrease as a percentage of sales is due primarily to a decrease in R&D costs as a percent of net sales. R&D expenses were $69.6 million, or 10.2 percent of sales, for the quarter ended September 30, 2007 compared to $65.4 million, or 10.9 percent of sales, in the prior year period. The increase in the dollar amount of R&D expenses was due primarily to higher spending to support new automotive infotainment systems for programs launching in fiscal years 2008 and 2009.

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Consumer– SG&A expenses as a percentage of sales decreased 3.9 percentage points for the quarter ended September 30, 2007 compared to the same period last year. The decrease was primarily due to a decrease in R&D costs as a percent of net sales. Research and development expenses were $8.9 million, or 7.4 percent of sales, for the quarter ended September 30, 2007 compared to $8.9 million, or 9.5 percent of sales, in the same period last year.

Professional– SG&A expenses as a percentage of sales decreased 0.9 percentage points for the quarter ended September 30, 2007 compared to the same period last year. The decrease is related to leveraging the fixed portion of SG&A expenses over a higher sales base. Research and development expenses were $9.2 million, or 6.4 percent of sales, for the quarter ended September 30, 2007 compared to $8.5 million, or 6.5 percent of sales, in the same period last year.

Other– Corporate SG&A expenses for the three months ended September 30, 2007 increased $6.0 million compared to the same period last year. SG&A expenses increased primarily due to $4.7 million of merger-related costs and increased compensation expenses. We expect significant additional costs related to the resolution of the merger termination in the second quarter of fiscal 2008.

Operating Income

Operating income for the quarter ended September 30, 2007 was $41.4 million, or 4.4 percent of sales, compared to $86.9 million, or 10.5 percent of sales in the same period last year. The decrease in operating income was primarily driven by lower gross profit margins, primarily in our Automotive and Consumer segments.

Interest Expense, Net

Interest expense, net, was $1.4 million for the quarter ended September 30, 2007 compared to $0.1 million in the same quarter last year. Our first quarter fiscal 2008 interest expense, net, included $3.1 million of gross interest expense and $1.7 million of interest income. For the same period in the prior year, gross interest expense was $2.3 million and interest income was $2.2 million. Weighted average borrowings outstanding were $162.7 million for the quarter ended September 30, 2007 compared to $172.7 million for the same period in the prior year.

The weighted average interest rate on our revolver borrowings was 6.1 percent for the quarter ended September 30, 2007 compared to 5.4 percent in the same quarter last year. The weighted average interest rate increased due to an increase in LIBOR combined with an increase in the interest rate spread on our revolving credit facility from 40 basis points to 70 basis points that resulted from a change in our credit rating.

Miscellaneous Expenses

Miscellaneous, net expenses were $0.7 million for the quarter ended September 30, 2007 compared to $0.9 million in the same period last year. For the quarters ended September 30, 2007 and 2006, miscellaneous expenses were primarily bank charges.

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Income Taxes

Income tax expense for the quarter ended September 30, 2007 was $3.7 million compared to $29.6 million for the same period last year. The effective tax rate for the quarter ended September 30, 2007 was 9.3 percent compared to 34.5 percent in the prior year period. The tax rate reduction for the quarter ended September 30, 2007 includes $5.7 million in previously unrecognized tax benefits as a result of a tax audit in Germany. We also realized a $4.4 million tax benefit related to a change in German tax laws. We currently expect the tax rate for the full fiscal year 2008 to be approximately 27 percent.

Financial Condition

Liquidity and Capital Resources

We primarily finance our working capital requirements through cash generated by operations, borrowings under our revolving credit facility and trade credit. Cash and cash equivalents were $77.1 million at September 30, 2007 compared to $106.1 million at June 30, 2007. During the three-month period ended September 30, 2007, cash was used to make tax payments (primarily in Germany), repay our senior notes, make investments in our manufacturing facilities and meet the working capital needs of our business segments.

We will continue to have cash requirements to support seasonal working capital needs, investments in our manufacturing facilities, interest and principal payments, dividend payments and stock option activity. We intend to use cash on hand, cash generated by operations and borrowings under our revolving credit facility to meet these requirements. We believe that cash from operations and our borrowing capacity, if needed, will be adequate to meet our normal cash requirements over the next twelve months. Below is a more detailed discussion of our cash flow activities during the quarter ended September 30, 2007.

Operating Activities

For the three months ended September 30, 2007, our net cash used for operations was $101.6 million compared to net cash used in operations of $43.5 million in the same period last year. The reduction in operating cash flows was primarily due to increased tax payments, decreased accounts payable and an increase in accounts receivable. At September 30, 2007, working capital, excluding cash and short-term debt, was $522.0 million, compared with $329.9 million at June 30, 2007. The $192.1 million increase was primarily due to higher inventories and accounts receivable, a decrease in taxes payable due to tax payments primarily in Germany and a decrease in accounts payable due to timing of vendor payments.

Investing Activities

Net cash used in investing activities was $32.6 million for the three months ended September 30, 2007 compared to $13.1 million in the same period last year. Capital expenditures for the three months ended September 30, 2007 were $27.5 million compared to $12.4 million for the same period last year. The increase in capital spending is primarily due to the launch of new automotive programs and a new manufacturing facility in China. We anticipate making significant investments in facilities, manufacturing equipment and tooling in fiscal 2008 to support the continued growth in our automotive infotainment systems business.

Financing Activities

Our total debt at September 30, 2007 was $183.0 million, primarily comprised of $179.9 million of borrowings under our revolving credit facility and capital leases and other short-term borrowings of $3.1 million.

We are party to a $300 million committed multi-currency revolving credit facility with a group of banks. This facility expires in June 2010. At September 30, 2007 we had borrowings of $179.9 million and outstanding letters of credit of $5.5 million under this facility. Unused availability under the revolving credit facility was $114.6 million at September 30, 2007.

Our long-term debt agreements contain financial and other covenants that, among other things, limit our ability to incur additional indebtedness, restrict subsidiary dividends and distributions, limit our ability to encumber certain assets and restrict our ability to issue capital stock of our subsidiaries. Our long-term debt agreements permit us to pay dividends or repurchase our capital stock without any dollar limitation provided that we would be in compliance with the financial covenants in our revolving credit facility after giving effect to such dividend or repurchase. At September 30, 2007, we were in compliance with the terms of our long-term debt agreements.

On October 22, 2007, we entered into a note purchase agreement with affiliates of KKR and GSCP, as well as two financial institutions under which they purchased $400 million of our 1.25 percent Convertible Senior Notes due 2012. The Notes are convertible into cash and, at the Company's option, if applicable, shares of the Company's common stock, based on a conversion rate of 9.6154 shares of common stock per $1,000 principal amount of Notes (which is equal to an initial conversion price of approximately $104 per share) only in certain circumstances as set forth in the Indenture. The conversion rate is subject to adjustment in certain circumstances as described in the Indenture. The notes include a settlement provision commonly referred to as a "net share settlement." Net share settlements are currently under review by the FASB. If FASB adopts the proposed new accounting standard, we would incur higher interest expense and thus lower earnings per share.

Equity

Total shareholders' equity at September 30, 2007 was $1.576 billion compared with $1.494 billion at June 30, 2007. The increase is primarily due to net income of $36.5 million and favorable foreign currency translation increase of $36.6 million. As a result of the implementation of FIN 48, we recognized a $6.9 million reduction to our unrecognized tax benefit. The $6.9 million reduction was included in our balance sheet as an adjustment to the July 1, 2007 retained earnings. There were no shares of our common stock repurchased during the three months ended September 30, 2007.

Business Outlook

Our first quarter sales were a record and reflect continued top-line strength. We believe all three of our core business segments will continue to produce higher sales for the remainder of this fiscal year. For the full fiscal year ending June 30, 2008, we currently believe our net sales will be approximately $4.1 billion, an increase of 16 percent. We expect earnings per share before transaction, legal and restructuring costs to meet or exceed the prior fiscal year.

On October 30, 2007, we entered into an accelerated share repurchase ("ASR") agreement with Bear, Stearns International Limited and a separate ASR agreement with J.P. Morgan Securities Inc., as agent for JPMorgan Chase Bank, National Association, London Branch. Pursuant to these agreements, we purchased, in the aggregate, 4,775,549 shares of our common stock for a total purchase price of approximately $400 million,

subject to adjustment. We immediately retired for accounting purposes the 4,775,549 shares of our common stock, which represented approximately 7 percent of the then outstanding shares of our common stock. We expect that the share repurchase will improve our fiscal 2008 earnings per share by approximately 4 percent.

Our current expectations for fiscal 2008 could be affected by the potential impact of changes in currency exchange rates, softness in automobile sales and increases in research and development costs to support new infotainment business.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are required to include information about potential effects of changes in interest rates and currency exchange rates in our periodic reports filed with the Securities and Exchange Commission. Since June 30, 2007, there have been no material changes in the quantitative or qualitative aspects of our market risk profile.

Interest Rate Sensitivity/Risk

At September 30, 2007, none of our borrowings had interest determined on a fixed-rate basis. The interest rates on the balance of our debt are subject to changes in U.S. and European short-term interest rates. To assess exposure to interest rate changes, we have performed a sensitivity analysis assuming a hypothetical 100 basis point increase or decrease in interest rates across all outstanding debt and investments. Our analysis indicates that the effect on net income at September 30, 2007 of such an increase or decrease in interest rates would be approximately $0.2 million.

Foreign Currency Risk

We maintain significant operations in Germany, the United Kingdom, France, Austria, Hungary, Mexico, Switzerland and Sweden. As a result, we are subject to market risks arising from changes in foreign currency exchange rates, principally the change in the value of the Euro compared to the U.S. dollar. Our subsidiaries purchase products and raw materials in various currencies. As a result, we may be exposed to the cost changes relative to local currencies in the markets to which we sell our products. To mitigate these risks, we enter into forward foreign exchange contracts. Also, foreign currency positions are partially offsetting and are netted against one another to reduce exposure.

We presently estimate the effect of changes in currency exchange rates, principally the change in the value of the Euro compared to the U.S. dollar, has an impact on our reported results when the financial statements of foreign subsidiaries are translated into U.S. dollars. Over half of our sales are currently denominated in Euros. Currency translation for the Euro versus the U.S. dollar had a significant impact on earnings for the first quarter of fiscal 2007 compared to the prior year first quarter due to the strengthening of the Euro relative to the U.S. dollar. The first quarter average exchange rate for the Euro versus the U.S. dollar increased 7.89 percent from the prior year’s first quarter average exchange rate.

To assess exposure to changes in currency exchange rates, we prepared an analysis assuming a hypothetical 10 percent change in currency exchange rates across all currencies used by our subsidiaries. This analysis indicated that a 10 percent increase or decrease in exchange rates would have increased or decreased income before income taxes by approximately $5.0 million for the three months ended September 30, 2007.

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Competitive conditions in the markets in which we operate may limit our ability to increase prices in the event of adverse changes in currency exchange rates. For example, certain products made in Europe are sold in the U.S. Sales of these products are affected by the value of the Euro relative to other currencies. Any long-term strengthening of the Euro could depress the demand for these European manufactured products and reduce sales. However, due to the multiple currencies involved in our business and the netting effect of various simultaneous transactions, our foreign currency positions are partially offsetting.

Actual gains and losses in the future may differ materially from the hypothetical gains and losses discussed above based on changes in the timing and amount of interest rate foreign currency exchange rate movements and our actual exposure and hedging transactions.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures - Under the supervision and with the participation of our management, including our Executive Chairman, Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our Executive Chairman, Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. We note that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions.

Change in Internal Control Over Financial Reporting - There has not been any change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) as promulgated by the Securities and Exchange Commission under the Securities Act of 1934) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Helen Rodgers Living Trust v. Harman International Industries, Incorporated

On May 8, 2007, Helen Rodgers Living Trust ("Plaintiff") filed a putative class action lawsuit against the Company and all of its directors in the Superior Court of the District of Columbia seeking declaratory and injunctive relief, damages and costs. The original complaint alleged that the Company's directors breached their fiduciary duties to the Company's stockholders by entering into a merger agreement with a company ("Parent") formed by investment funds affiliated with KKR and GSCP. According to Plaintiff, the consideration to be offered to the Company's stockholders under the merger agreement was "inadequate" and that the merger agreement "inequitably favor[ed] . . . insiders" of the Company. The original complaint also alleged that the termination fee in the merger agreement was excessive, that the Company's directors purportedly would not "fairly and adequately" evaluate any alternative bids, and that the provision in the merger agreement that allowed the Company to solicit proposals for alternative bidders during a 50-day period ending in June 2007 was "illusory."

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On June 29, 2007, Plaintiff filed its first amended complaint. While the first amended complaint continued to raise the allegations made in the original complaint, the new focus of Plaintiff's case was that the merger agreement "inequitably favor[ed] . . . insiders" of the Company by allowing such insiders to exchange otherwise worthless "underwater" options for Parent shares on a "one option for one Parent share basis," and by allowing them to separately negotiate with Parent for more favorable treatment of their options. The first amended complaint also alleged that the disclosures contained in the Company's preliminary proxy statement/prospectus were inadequate.

On June 29, 2007, Plaintiff filed a motion for preliminary injunction. The motion sought to enjoin the conversion of the "underwater" options into Parent shares, and also sought to "unw[i]nd or otherwise cancel[]" the challenged options. In the motion, Plaintiff did not seek to enjoin the shareholder vote or the merger. After Defendants filed their opposition to the motion for preliminary injunction on July 23, 2007, Plaintiff agreed to voluntarily withdraw its motion.

Thereafter, on September 4, 2007, Plaintiff was granted leave to file a second amended complaint. The second amended complaint narrows Plaintiff's claims by eliminating, among other things, the vast majority of its disclosure claims and the allegations relating to "underwater" options. Defendants answered Plaintiff's second amended complaint on September 21, 2007, denying Plaintiff's claims for breach of fiduciary duty and disclosure deficiencies.

We believe the lawsuit is without merit and intend vigorously to defend against it.

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On October 1, 2007, a purported class action lawsuit was filed against the Company and certain of its officers in the United States District Court for the District of Columbia seeking compensatory damages and costs on behalf of all persons who purchased the Company's common stock between April 26, 2007 and September 24, 2007 (the "Class Period"). The complaint purports to allege claims for violation of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The complaint alleges that defendants omitted to disclose material adverse facts about the Company's financial condition and business prospects. The complaint contends that had these facts not been concealed at the time the merger agreement was entered, there would not have been a merger agreement, or it would have been at a much lower price, and the price of the Company's common stock therefore would not have been artificially inflated during the Class Period. The plaintiff alleges that, following the reports that the proposed merger was not going to be completed, the price of the Company's common stock declined causing the plaintiff class significant losses.

We believe the lawsuit is without merit and intend vigorously to defend against it.

Item 1A. Risk Factors

On October 22, 2007, the Company entered into a Termination and Settlement Agreement with KKR, KHI Parent Inc., KHI Merger Sub Inc. and GSCP. Under the agreement, effective on October 23, 2007, each of (i) the Agreement and Plan of Merger, dated April 26, 2007, among the Company, KHI Parent Inc. and KHI Merger Sub Inc., (ii) the related guarantees and (iii) the Election Agreement, dated April 26, 2007, between KHI Parent Inc. and Dr. Sidney Harman, was terminated in its entirety. As a result, the risk factors included in Item 1A "Risk Factors – Risks Related to the Merger with Parent" of our Annual Report on Form 10-K for the fiscal year ended June 30, 2007 are no longer applicable.

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The risk factors applicable to Harman as a stand alone company included in Item 1A "Risk Factors – Risks Related to Harman" of our Annual Report on Form 10-K for the fiscal year ended June 30, 2007 are updated to include the following:

We are engaged in ongoing litigation and may be the subject of additional litigation that may result in payments to third parties, which could harm our business and financial results.

As more fully described in Part II, Item 1 "Legal Proceedings," of this report, we are currently involved in litigation arising from the proposed merger with a company formed by investment funds affiliated with KKR and GSCP that was terminated in October 2007. In addition, additional litigation may be initiated against us and others based on activities and disclosures related to the proposed merger and its termination. We cannot predict the outcome of any such proceeding or the likelihood that further proceedings will be instituted against us. In the event that there is an adverse ruling in any legal proceeding, we may be required to make payments to third parties that could harm our business or financial results. Furthermore, regardless of the merits of any claim, the continued maintenance of these legal proceedings may result in substantial legal expense and could also result in the diversion of our management's time and attention away from our other business.

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

We did not repurchase any shares of our common stock in the quarter ended September 30, 2007. Our share repurchase program was first publicly announced on June 16, 1998. In August 2005, the Board authorized the purchase of up to an additional four million shares, bringing the total authorized to 20 million shares. The total number of shares repurchased through September 30, 2007 was 18,198,082. A maximum of 1,801,918 shares may yet be purchased under our share repurchase program. We suspended our share repurchase program due to the formerly proposed merger with a company formed by investment funds affiliated with KKR and GSCP. No determination has been made regarding when the program will be reinstated. For a description of limitations on repurchases of shares and on the payment of dividends, see *Management's Discussion and Analysis of Financial Condition and Results of Operations – Financial Condition.*

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Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K

4.1	Indenture, related to the 1.25 percent Convertible Senior Notes due 2012, dated as of October 23, 2007, between Harman International Industries, Incorporated and Wells Fargo Bank, National Association, as trustee (including the form of 1.25 percent Convertible Senior Note due 2012) (filed as Exhibit 4.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2007, Commission File No. 001-09764, and hereby incorporated by reference).
4.2	Registration Rights Agreement, dated as of October 23, 2007, between Harman International Industries, Incorporated, KKR I-H Limited, GS Capital Partners VI Fund, L.P., GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P., GS Capital Partners VI GmbH & Co. KG, Citibank, N.A. and HSBC USA Inc. (filed as Exhibit 4.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2007, Commission File No. 001-09764, and hereby incorporated by reference).
10.1	Note Purchase Agreement, dated October 22, 2007, by and among Harman International Industries, Incorporated, KKR I-H Limited, GS Capital Partners VI Fund, L.P., GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P., GS Capital Partners VI GmbH & Co. KG, Citibank, N.A., HSBC USA Inc. and, for limited purposes, Kohlberg Kravis Roberts & Co. L.P. (filed as Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2007, Commission File No. 001-09764, and hereby incorporated by reference).
10.2	Termination and Settlement Agreement, dated October 22, 2007, by and among Harman International Industries, Incorporated, KHI Parent Inc., KHI Merger Sub Inc., KKR 2006 Fund L.P., Kohlberg Kravis Roberts & Co. L.P., GS Capital Partners VI Fund, L.P., GS Capital Partners VI Parallel, L.P., GS Capital Partners VI Offshore Fund, L.P. and GS Capital Partners VI GmbH & Co. KG (filed as Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 25, 2007, Commission File No. 001-09764, and hereby incorporated by reference).
10.3	Confirmation between Harman International Industries, Incorporated and Bear, Stearns International Limited, dated October 30, 2007 (filed as Exhibit 10.1 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 31, 2007, Commission File No. 001-09764, and hereby incorporated by reference).

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10.4	Confirmation between Harman International Industries, Incorporated and J.P. Morgan Securities Inc., as agent for JPMorgan Chase Bank, National Association, London Branch, dated October 30, 2007 (filed as Exhibit 10.2 to the Current Report on Form 8-K filed with the Securities and Exchange Commission on October 31, 2007, Commission File No. 001-09764, and hereby incorporated by reference).
31.1	Certification of Sidney Harman pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Dinesh C. Paliwal pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3	Certification of Kevin L. Brown pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Sidney Harman, Dinesh C. Paliwal and Kevin L. Brown, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

Harman International Industries, Incorporated
(Registrant)

Date: November 9, 2007	By:/s/ Kevin L. Brown Kevin L. Brown Executive Vice President and Chief Financial Officer (Principal Financial Officer)