

ILLUMINA INC
Form 10-Q
November 08, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended October 2, 2016

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 001-35406
Illumina, Inc.
(Exact name of registrant as specified in its charter)

Delaware 33-0804655
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

5200 Illumina Way, 92122
San Diego, CA
(Address of principal executive offices) (Zip Code)
(858) 202-4500
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if 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

As of October 21, 2016, there were 146.9 million shares of the registrant's common stock outstanding.

Table of Contents

ILLUMINA, INC.
INDEX

	Page
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets</u>	<u>3</u>
<u>Condensed Consolidated Statements of Income</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income</u>	<u>5</u>
<u>Condensed Consolidated Statement of Stockholders' Equity</u>	<u>6</u>
<u>Condensed Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>8</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>21</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>29</u>
<u>Item 4. Controls and Procedures</u>	<u>29</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>30</u>
<u>Item 1A. Risk Factors</u>	<u>30</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>30</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>30</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>30</u>
<u>Item 5. Other Information</u>	<u>31</u>
<u>Item 6. Exhibits</u>	<u>31</u>
<u>SIGNATURES</u>	<u>32</u>

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ILLUMINA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	October 2, 2016	January 3, 2016
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$794,697	\$768,770
Short-term investments	741,569	617,450
Accounts receivable, net	381,632	385,529
Inventory	312,242	270,777
Prepaid expenses and other current assets	47,696	54,297
Total current assets	2,277,836	2,096,823
Property and equipment, net	633,856	342,694
Goodwill	775,995	752,629
Intangible assets, net	255,560	273,621
Deferred tax assets	182,122	134,515
Other assets	102,458	87,465
Total assets	\$4,227,827	\$3,687,747
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$134,090	\$139,226
Accrued liabilities	315,204	386,844
Build-to-suit lease liability	178,311	9,495
Long-term debt, current portion	1,250	74,929
Total current liabilities	628,855	610,494
Long-term debt	1,040,765	1,015,649
Other long-term liabilities	204,273	180,505
Redeemable noncontrolling interests	34,257	32,546
Stockholders' equity:		
Common stock	1,882	1,859
Additional paid-in capital	2,738,001	2,497,501
Accumulated other comprehensive income	1,314	36
Retained earnings	1,361,652	1,022,765
Treasury stock, at cost	(1,862,702)	(1,673,608)
Total Illumina stockholders' equity	2,240,147	1,848,553
Noncontrolling interests	79,530	—
Total stockholders' equity	2,319,677	1,848,553
Total liabilities and stockholders' equity	\$4,227,827	\$3,687,747
See accompanying notes to the condensed consolidated financial statements.		

Table of Contents

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

	Three Months Ended		Nine Months Ended		
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015	
Revenue:					
Product revenue	\$ 513,744	\$ 470,824	\$ 1,506,416	\$ 1,392,711	
Service and other revenue	93,395	79,447	272,610	235,503	
Total revenue	607,139	550,271	1,779,026	1,628,214	
Cost of revenue:					
Cost of product revenue	132,423	120,954	382,856	360,037	
Cost of service and other revenue	37,606	29,590	117,156	94,289	
Amortization of acquired intangible assets	10,960	12,188	32,005	34,957	
Total cost of revenue	180,989	162,732	532,017	489,283	
Gross profit	426,150	387,539	1,247,009	1,138,931	
Operating expense:					
Research and development	125,917	99,226	374,500	287,180	
Selling, general and administrative	139,146	136,648	436,914	377,406	
Legal contingencies	—	15,000	(9,490) 15,000	
Headquarter relocation	385	(5,226) 1,069	(3,047)
Acquisition related expense (gain), net	—	1,109	—	(6,449)
Total operating expense	265,448	246,757	802,993	670,090	
Income from operations	160,702	140,782	444,016	468,841	
Other income (expense):					
Interest income	2,056	2,767	6,683	5,804	
Interest expense	(8,208) (12,821) (24,880) (35,190)
Cost-method investment gain, net	—	2,900	—	15,482	
Other (expense) income, net	(186) (4,711) 1,116	(6,802)
Total other expense, net	(6,338) (11,865) (17,081) (20,706)
Income before income taxes	154,364	128,917	426,935	448,135	
Provision for income taxes	37,429	13,296	106,387	93,609	
Consolidated net income	116,935	115,621	320,548	354,526	
Add: Net loss attributable to noncontrolling interests	11,953	2,556	18,339	2,556	
Net income attributable to Illumina stockholders	\$ 128,888	\$ 118,177	\$ 338,887	\$ 357,082	
Net income attributable to Illumina stockholders for earnings per share	\$ 128,682	\$ 118,128	\$ 335,597	\$ 357,033	
Earnings per share attributable to Illumina stockholders:					
Basic	\$ 0.88	\$ 0.81	\$ 2.29	\$ 2.47	
Diluted	\$ 0.87	\$ 0.79	\$ 2.27	\$ 2.39	
Shares used in computing earnings per common share:					
Basic	146,705	145,349	146,783	144,447	
Diluted	147,901	149,672	148,049	149,108	

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

ILLUMINA, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)
 (In thousands)

	Three Months Ended		Nine Months Ended	
	October 2,	September 27,	October 2,	September 27,
	2016	2015	2016	2015
Consolidated net income	\$116,935	\$ 115,621	\$320,548	\$ 354,526
Unrealized (loss) gain on available-for-sale securities, net of deferred tax	(1,004) 441	1,278	2,120
Total consolidated comprehensive income	115,931	116,062	321,826	356,646
Add: Comprehensive loss attributable to noncontrolling interests	11,953	2,556	18,339	2,556
Comprehensive income attributable to Illumina stockholders	\$127,884	\$ 118,618	\$340,165	\$ 359,202
See accompanying notes to the condensed consolidated financial statements.				

Table of Contents

ILLUMINA, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(In thousands)

	Illumina Stockholders						Total Stockholders' Equity
	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Noncontrolling Interests	
Balance as of January 3, 2016	\$1,859	\$2,497,501	\$ 36	\$1,022,765	\$(1,673,608)	\$ —	\$1,848,553
Net income (loss)	—	—	—	338,887	—	(6,547)	332,340
Unrealized gain on available-for-sale securities, net of deferred tax	—	—	1,278	—	—	—	1,278
Issuance of common stock, net of repurchases	23	47,115	—	—	(189,440)	—	(142,302)
Tax impact from the conversion of convertible notes	—	36	—	—	—	—	36
Share-based compensation	—	101,494	—	—	—	—	101,494
Net incremental tax benefit related to share-based compensation	—	109,292	—	—	—	—	109,292
Adjustment to the carrying value of redeemable noncontrolling interests	—	(12,023)	—	—	—	—	(12,023)
Vesting of redeemable equity awards	—	(1,481)	—	—	—	—	(1,481)
Vesting of non-redeemable equity awards	—	(28)	—	—	—	28	—
Issuance of subsidiary shares in business combination	—	2,102	—	—	—	198	2,300
Issuance of treasury stock	—	3,554	—	—	346	—	3,900
Contributions from noncontrolling interest owners	—	—	—	—	—	80,000	80,000
Proceeds from early exercise of equity awards from a subsidiary	—	—	—	—	—	5,851	5,851
Tax impact of deemed dividend from GRAIL, Inc.	—	(9,561)	—	—	—	—	(9,561)
Balance as of October 2, 2016	\$1,882	\$2,738,001	\$ 1,314	\$1,361,652	\$(1,862,702)	\$ 79,530	\$2,319,677

See accompanying notes to condensed consolidated financial statements.

Table of Contents

ILLUMINA, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited)
 (In thousands)

	Nine Months Ended	
	October 2, 2016	September 27, 2015
Cash flows from operating activities:		
Consolidated net income	\$ 320,548	\$ 354,526
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	65,433	52,774
Amortization of intangible assets	38,051	40,884
Share-based compensation expense	101,845	97,104
Accretion of debt discount	22,342	29,828
Incremental tax benefit related to share-based compensation	(109,934)	(121,703)
Deferred income tax expense	57,539	83,679
Cost-method investment gain, net	—	(15,482)
Change in fair value of contingent consideration	—	(6,449)
Other	5,190	6,178
Changes in operating assets and liabilities:		
Accounts receivable	4,999	(121,309)
Inventory	(41,757)	(43,598)
Prepaid expenses and other current assets	3,572	(4,982)
Other assets	(6,060)	(428)
Accounts payable	(7,307)	49,532
Accrued liabilities	(57,325)	23,884
Other long-term liabilities	9,949	(5,220)
Net cash provided by operating activities	407,085	419,218
Cash flows from investing activities:		
Purchases of available-for-sale securities	(679,064)	(713,862)
Sales of available-for-sale securities	406,286	335,351
Maturities of available-for-sale securities	148,290	189,929
Net cash paid for acquisitions	(17,841)	(35,226)
Net purchases of strategic investments	(9,075)	(4,100)
Purchases of property and equipment	(178,353)	(107,361)
Cash paid for intangible assets	(11,490)	(275)
Net cash used in investing activities	(341,247)	(335,544)
Cash flows from financing activities:		
Payments on financing obligations	(70,522)	(216,207)
Payments on acquisition related contingent consideration liability	(29,200)	(1,500)
Proceeds from issuance of debt	5,000	—
Incremental tax benefit related to share-based compensation	109,934	121,703
Common stock repurchases	(113,075)	(72,256)
Taxes paid related to net share settlement of equity awards	(76,365)	(95,157)
Proceeds from issuance of common stock	47,156	65,668
Proceeds from early exercise of equity awards from a subsidiary	5,851	—
Contributions from noncontrolling interest owners	80,000	32,128
Net cash used in financing activities	(41,221)	(165,621)
Effect of exchange rate changes on cash and cash equivalents	1,310	(2,678)

Edgar Filing: ILLUMINA INC - Form 10-Q

Net increase (decrease) in cash and cash equivalents	25,927	(84,625)
Cash and cash equivalents at beginning of period	768,770	636,154	
Cash and cash equivalents at end of period	\$794,697	\$ 551,529	

See accompanying notes to the condensed consolidated financial statements.

7

Table of Contents

Illumina, Inc.

Notes to Condensed Consolidated Financial Statements
(Unaudited)

Unless the context requires otherwise, references in this report to “Illumina,” “we,” “us,” the “Company,” and “our” refer to Illumina, Inc. and its consolidated subsidiaries.

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the fiscal year ended January 3, 2016, from which the balance sheet information herein was derived. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expense, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The unaudited condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, majority-owned or controlled companies, and variable interest entities (VIEs) for which the Company is the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation. In management’s opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

The Company evaluates its ownership, contractual and other interests in entities that are not wholly-owned by the Company to determine if these entities are VIEs, and, if so, whether the Company is the primary beneficiary of the VIE. In determining whether the Company is the primary beneficiary of a VIE and is therefore required to consolidate the VIE, the Company applies a qualitative approach that determines whether it has both (1) the power to direct the activities of the VIE that most significantly impact the VIE’s economic performance and (2) the obligation to absorb losses of, or the rights to receive benefits from, the VIE that could potentially be significant to that VIE. The Company continuously assesses whether it is the primary beneficiary of a VIE as changes to existing relationships or future transactions may result in the consolidation or deconsolidation, as the case may be. The Company has not provided financial or other support during the periods presented to its VIEs that it was not previously contractually required to provide.

The equity method is used to account for investments in which the Company has the ability to exercise significant influence, but not control, over the investee. Such investments are recorded within other assets, and the share of net income or losses of equity investments is recognized on a one quarter lag in other (expense) income, net.

Segment Information

The Company is organized into three operating segments for purposes of evaluating its business operations and reporting its financial results. One operating segment consists of Illumina’s core operations and the other two relate to the Company’s consolidated VIEs. The combined results of operations of the Company’s consolidated VIEs became material for the three and nine months ended October 2, 2016. As such, the Company commenced reporting two segments in the third quarter of 2016. Financial information for all periods presented has been classified to reflect

these changes to our reportable segments. For further information on the Company's segments, refer to note "9. Segment Information".

Fiscal Year

The Company's fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine months ended October 2, 2016 and September 27, 2015 were both 13 and 39 weeks, respectively.

Table of Contents

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Significant Accounting Policies

During the three and nine months ended October 2, 2016, there have been no changes to the Company's significant accounting policies as described in the Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board issued Accounting Standard Update (ASU) 2016-09, Compensation - Stock Compensation (Topic 718). The new standard requires income tax effects of stock compensation awards to be recognized in the income statement when the awards vest or are settled. The new standard also allows the Company to repurchase more of an employee's shares for tax withholding purposes without triggering liability accounting and to make a policy election to account for forfeitures as they occur. ASU 2016-09 will be effective for the Company beginning in the first quarter of 2017. The Company is currently evaluating the impact of ASU 2016-09 on its consolidated financial statements.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, Leases (Topic 842). The new standard requires lessees to recognize most leases on their balance sheets as lease liabilities with corresponding right-of-use assets and eliminates certain real estate-specific provisions. ASU 2016-02 will be effective for the Company beginning in the first quarter of 2019. ASU 2016-02 will be adopted on a modified retrospective transition basis for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial statements.

In May 2014, the Financial Accounting Standards Board issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard is based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 will be effective for the Company beginning in the first quarter of 2018 and allows for a full retrospective or a modified retrospective adoption approach. The Company is currently evaluating the impact of ASU 2014-09 on its consolidated financial statements.

Earnings per Share

Basic earnings per share attributable to Illumina stockholders is computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share attributable to Illumina stockholders is computed based on the sum of the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Per-share earnings of our VIEs are included in the Company's consolidated basic and diluted earnings per share computations based on the Company's share of the VIE's securities.

Potentially dilutive common shares consist of shares issuable under convertible senior notes, equity awards, and warrants. Convertible senior notes have a dilutive impact when the average market price of the Company's common stock exceeds the applicable conversion price of the respective notes. Potentially dilutive common shares from equity awards and warrants are determined using the average share price for each period under the treasury stock method. In addition, the following amounts are assumed to be used to repurchase shares: proceeds from exercise of equity awards and warrants; the average amount of unrecognized compensation expense for equity awards; and estimated tax benefits that will be recorded in additional paid-in capital when expenses related to equity awards become deductible.

In loss periods, basic net loss per share and diluted net loss per share are identical because the otherwise dilutive potential common shares become anti-dilutive and are therefore excluded.

Table of Contents

The following table presents the calculation of weighted average shares used to calculate basic and diluted earnings per share (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Weighted average shares outstanding	146,705	145,349	146,783	144,447
Effect of potentially dilutive common shares from:				
Convertible senior notes	—	1,670	80	2,013
Equity awards	1,196	2,653	1,186	2,648
Weighted average shares used in calculating diluted earnings per share	147,901	149,672	148,049	149,108
Potentially dilutive shares excluded from calculation due to anti-dilutive effect	63	13	580	7

2. Balance Sheet Account Details

Short-Term Investments

The following is a summary of short-term investments (in thousands):

	October 2, 2016				January 3, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:								
Debt securities in government sponsored entities	\$29,687	\$ —	\$ (30)	\$29,657	\$14,634	\$ —	\$ (8)	\$14,626
Corporate debt securities	463,484	282	(474)	463,292	422,177	44	(1,127)	421,094
U.S. Treasury securities	248,542	182	(104)	248,620	182,144	3	(417)	181,730
Total available-for-sale securities	\$741,713	\$ 464	\$ (608)	\$741,569	\$618,955	\$ 47	\$ (1,552)	\$617,450

Realized gains and losses are determined based on the specific identification method and are reported in interest income.

Contractual maturities of available-for-sale debt securities as of October 2, 2016 were as follows (in thousands):

	Estimated Fair Value
Due within one year	\$279,548
After one but within five years	462,021
Total	\$741,569

The Company has the ability, if necessary, to liquidate any of its cash equivalents and short-term investments in order to meet its liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase nonetheless are classified as short-term on the accompanying condensed consolidated balance sheets.

Strategic Investments

As of October 2, 2016 and January 3, 2016, the aggregate carrying amounts of the Company's cost-method investments in non-publicly traded companies included in other assets were \$56.9 million and \$56.6 million, respectively. Revenue recognized from transactions with such companies was \$12.5 million and \$42.1 million, respectively, for the three and nine

10

Table of Contents

months ended October 2, 2016 and \$16.1 million and \$47.3 million, respectively, for the three and nine months ended September 27, 2015.

During the nine months ended September 27, 2015, the Company recognized a gain on a disposition of a cost-method investment of \$18.0 million. The Company's cost-method investments are assessed for impairment quarterly. The Company determines that it is not practicable to estimate the fair value of its cost-method investments on a regular basis and does not reassess the fair value of cost-method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. No material impairment loss was recorded during the three and nine months ended October 2, 2016 or September 27, 2015.

On April 14, 2016, the Company announced that it has committed to invest \$100.0 million in a new venture capital investment fund (the Fund). The capital commitment is callable over ten years, and up to \$40.0 million can be drawn down during the first year. The Company's investment in the Fund is accounted for as an equity method investment. During the nine months ended October 2, 2016, the Company transferred \$3.2 million of its cost-method investments to the Fund and contributed \$4.4 million in cash.

Inventory

Inventory consists of the following (in thousands):

	October 2, 2016	January 3, 2016
Raw materials	\$ 101,646	\$ 97,740
Work in process	166,050	138,322
Finished goods	44,546	34,715
Total inventory	\$ 312,242	\$ 270,777

Property and Equipment

Property and equipment, net consists of the following (in thousands):

	October 2, 2016	January 3, 2016
Leasehold improvements	\$ 197,534	\$ 178,019
Machinery and equipment	264,556	224,158
Computer hardware and software	153,851	136,550
Furniture and fixtures	20,448	18,539
Building	7,670	7,670
Construction in progress	308,825	44,501
Total property and equipment, gross	952,884	609,437
Accumulated depreciation	(319,028)	(266,743)
Total property and equipment, net	\$ 633,856	\$ 342,694

Property and equipment, net included accrued expenditures of \$194.4 million for the nine months ended October 2, 2016, which includes \$168.8 million in construction in progress recorded under build-to-suit lease accounting. Accrued capital expenditures were excluded from the condensed consolidated statements of cash flows. Accrued capital expenditures were immaterial for the nine months ended September 27, 2015.

Goodwill

The Company tests the carrying value of goodwill in accordance with accounting rules on impairment of goodwill, which require the Company to estimate the fair value of the reporting units annually, or when impairment indicators exist, and compare such amounts to their respective carrying values to determine if an impairment is required. The Company performed its annual assessment for goodwill impairment in the second quarter of 2016, noting no impairment.

Table of Contents

Changes in the Company's goodwill balance during the nine months ended October 2, 2016 are as follows (in thousands):

	Goodwill
Balance as of January 3, 2016	\$752,629
Current period acquisitions	23,366
Balance as of October 2, 2016	\$775,995

In January 2016, the Company closed two acquisitions consisting of \$17.8 million in upfront cash payments, equity instruments, and certain contingent consideration provisions.

Derivatives

The Company is exposed to foreign exchange rate risks in the normal course of business. The Company enters into foreign exchange contracts to manage foreign currency risks related to monetary assets and liabilities that are denominated in currencies other than the U.S. dollar. These foreign exchange contracts are carried at fair value in other assets or other liabilities and are not designated as hedging instruments. Changes in the value of the derivative are recognized in other expense, net, along with the remeasurement gain or loss on the foreign currency denominated assets or liabilities.

As of October 2, 2016, the Company had foreign exchange forward contracts in place to hedge exposures in the euro, Japanese yen, and Australian dollar. As of October 2, 2016 and January 3, 2016, the total notional amounts of outstanding forward contracts in place for foreign currency purchases were \$62.2 million and \$61.3 million, respectively.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	October 2, 2016	January 3, 2016
Deferred revenue, current portion	\$ 116,118	\$ 96,654
Accrued compensation expenses	89,527	120,662
Accrued taxes payable	30,855	44,159
Customer deposits	17,831	20,901
Acquisition related contingent liability, current portion	7,220	35,000
Other	53,653	69,468
Total accrued liabilities	\$ 315,204	\$ 386,844

Build-to-Suit Lease Liability

The Company evaluates whether it is the accounting owner during the construction period when the Company is involved in the construction of leased assets. As a result, the Company is considered the owner of three construction projects for accounting purposes only under build-to-suit lease accounting due to certain indemnification obligations related to the construction. As of October 3, 2016 and January 3, 2016, the Company has recorded \$178.3 million and \$9.5 million, respectively, in project construction costs incurred by the landlord as construction in progress and a corresponding build-to-suit lease liability. Once the landlord completes the construction projects, the Company will evaluate the lease in order to determine whether or not it meets the criteria for "sale-leaseback" treatment.

Warranties

The Company generally provides a one-year warranty on instruments. Additionally, the Company provides a warranty on consumables through the expiration date, which generally ranges from six to twelve months after the manufacture date. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses based on historical experience as well as anticipated product performance. The Company periodically reviews its warranty reserve for adequacy and adjusts the warranty accrual, if necessary, based on actual experience and estimated costs to be incurred. Warranty expense is recorded as a component of cost of product revenue.

Table of Contents

Changes in the Company's reserve for product warranties during the three and nine months ended October 2, 2016 and September 27, 2015 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Balance at beginning of period	\$ 15,679	\$ 16,365	\$ 16,717	\$ 15,616
Additions charged to cost of product revenue	3,878	6,916	17,200	20,737
Repairs and replacements	(5,180)	(5,348)	(19,540)	(18,420)
Balance at end of period	\$ 14,377	\$ 17,933	\$ 14,377	\$ 17,933

Leases

Changes in the Company's facility exit obligation related to its former headquarters lease during the three and nine months ended October 2, 2016 and September 27, 2015 are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Balance at beginning of period	\$ 20,557	\$ 36,677	\$ 22,160	\$ 37,700
Adjustment to facility exit obligation	66	(5,935)	87	(5,278)
Accretion of interest expense	320	590	983	1,926
Cash payments	(1,198)	(1,539)	(3,485)	(4,555)
Balance at end of period	\$ 19,745	\$ 29,793	\$ 19,745	\$ 29,793

On March 18, 2016, the Company entered into an agreement to sublease its office building in San Francisco, California. The Company will receive \$51.2 million in minimum lease payments during the initial term of approximately eight years.

On April 5, 2016, the Company entered into a lease agreement for certain office buildings being constructed in San Diego, California. Minimum lease payments during the initial term of ten years are estimated to be \$127.4 million.

Investments in Consolidated Variable Interest Entities

GRAIL, Inc.

In January 2016, the Company obtained a majority equity ownership interest in GRAIL, Inc. (GRAIL), a company formed with unrelated third party investors to pursue the development and commercialization of a blood test for asymptomatic cancer screening. The Company determined that GRAIL is a variable interest entity as the entity lacks sufficient equity to finance its activities without additional support. Additionally, the Company determined that it has (a) control of the entity's Board of Directors, which has unilateral power over the activities that most significantly impact the economic performance of GRAIL and (b) the obligation to absorb losses of and the right to receive benefits from GRAIL that are potentially significant to GRAIL. As a result, the Company is deemed to be the primary beneficiary of GRAIL and is required to consolidate GRAIL. On a fully diluted basis, the Company holds a 52% equity ownership interest in GRAIL as of October 2, 2016.

During the three months ended April 3, 2016, GRAIL completed its Series A convertible preferred stock financing, raising \$120.0 million, of which the Company invested \$40.0 million. Additionally, the Company and GRAIL executed a long-term supply agreement in which the Company contributed certain perpetual licenses, employees, and discounted supply terms in exchange for 112.5 million shares of GRAIL's Class B Common Stock. Such contributions are recorded at their historical basis as they remain within the control of the Company. The \$80.0 million received by

GRAIL from unrelated third party investors upon issuance of its Series A convertible preferred stock is classified as noncontrolling interests in stockholders' equity on the Company's consolidated balance sheet.

During the three months ended July 3, 2016, GRAIL authorized for issuance 97.5 million shares of Series A-1 convertible preferred stock, all of which were issued to Illumina in exchange for 97.5 million shares of Illumina's Class B Common Stock on June 23, 2016. As a result of the exchange, Illumina recorded a \$9.5 million deemed dividend net of tax of \$9.6 million through equity, which was eliminated in consolidation.

Table of Contents

For the three months ended October 2, 2016, the Company absorbed approximately 50% of GRAIL's losses based upon its proportional ownership of GRAIL's common stock. Prior to the exchange, for the six months ended July 3, 2016, the Company absorbed 90% of GRAIL's losses based upon its proportional ownership of GRAIL's common stock.

In accordance with GRAIL's Equity Incentive Plan, the Company may be required to redeem certain vested stock awards in cash at the then approximate fair market value. The fair value of the redeemable noncontrolling interests is considered a Level 3 instrument. Such redemption right is exercisable at the option of the holder of the awards after February 28, 2021, provided that an initial public offering of GRAIL has not been completed. As the redemption provision is outside of the control of the Company, the redeemable noncontrolling interests in GRAIL are classified outside of stockholders' equity on the accompanying condensed consolidated balance sheets. The balance of the redeemable noncontrolling interests is reported at the greater of its carrying value after receiving its allocation of GRAIL's profits and losses or its estimated redemption value at each reporting date.

The assets and liabilities of GRAIL, other than cash and cash equivalents, are not significant to the Company's financial position as of October 2, 2016. Additionally, GRAIL has an immaterial impact on the Company's condensed consolidated statements of income and cash flows for the three and nine months ended October 2, 2016.

Helix Holdings I, LLC

In July 2015, the Company obtained a 50% voting equity ownership interest in Helix Holdings I, LLC (Helix), a limited liability company formed with unrelated third party investors to pursue the development and commercialization of a marketplace for consumer genomics. The Company determined that Helix is a variable interest entity as the holder of the at-risk equity investments as a group lack the power to direct the activities of Helix that most significantly impact Helix's economic performance. Additionally, the Company determined that it has (a) unilateral power over one of the activities that most significantly impacts the economic performance of Helix through its contractual arrangements and no one individual party has unilateral power over the remaining significant activities of Helix and (b) the obligation to absorb losses of and the right to receive benefits from Helix that are potentially significant to Helix. As a result, the Company is deemed to be the primary beneficiary of Helix and is required to consolidate Helix.

As contractually committed, the Company contributed certain perpetual licenses, instruments, intangibles, initial laboratory setup, and discounted supply terms in exchange for voting equity interests in Helix. Such contributions are recorded at their historical basis as they remain within the control of the Company. Helix is financed through cash contributions made by the third party investors in exchange for voting equity interests in Helix.

Certain noncontrolling Helix investors may require the Company to redeem all noncontrolling interests in cash at the then approximate fair market value. The fair value of the redeemable noncontrolling interests is considered a Level 3 instrument. Such redemption right is exercisable at the option of certain noncontrolling interest holders after January 1, 2021, provided that a bona fide pursuit of the sale of Helix has occurred and an initial public offering of Helix has not been completed.

As the contingent redemption is outside of the control of Illumina, the redeemable noncontrolling interests in Helix are classified outside of stockholders' equity on the accompanying condensed consolidated balance sheets. The balance of the redeemable noncontrolling interests is reported at the greater of its carrying value after receiving its allocation of Helix's profits and losses or its estimated redemption value at each reporting date. As of October 2, 2016, the noncontrolling shareholders and Illumina each held 50% of Helix's outstanding voting equity interests.

The assets and liabilities of Helix are not significant to the Company's financial position as of October 2, 2016. Helix has an immaterial impact on the Company's condensed consolidated statements of income and cash flows for the three and nine months ended October 2, 2016.

As of October 2, 2016, the accompanying condensed consolidated balance sheet includes \$103.6 million of cash and cash equivalents attributable to GRAIL and Helix that will be used to settle their respective obligations and will not be available to settle obligations of the Company.

Table of Contents

Redeemable Noncontrolling Interests

The activity of the redeemable noncontrolling interests during the nine months ended October 2, 2016 is as follows (in thousands):

	Redeemable Noncontrolling Interests
Balance as of January 3, 2016	\$ 32,546
Vesting of redeemable equity awards	1,481
Net loss attributable to noncontrolling interests	(11,793)
Adjustment up to the redemption value	12,023
Balance as of October 2, 2016	\$ 34,257

3. Fair Value Measurements

The following table presents the Company's hierarchy for assets and liabilities measured at fair value on a recurring basis as of October 2, 2016 and January 3, 2016 (in thousands):

	October 2, 2016				January 3, 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds (cash equivalents)	\$503,593	\$—	\$—	\$503,593	\$391,246	\$—	\$—	\$391,246
Debt securities in government-sponsored entities	—	29,657	—	29,657	—	14,626	—	14,626
Corporate debt securities	—	463,292	—	463,292	—	421,094	—	421,094
U.S. Treasury securities	248,620	—	—	248,620	181,730	—	—	181,730
Deferred compensation plan assets	—	29,901	—	29,901	—	26,245	—	26,245
Total assets measured at fair value	\$752,213	\$522,850	\$—	\$1,275,063	\$572,976	\$461,965	\$—	\$1,034,941
Liabilities:								
Acquisition related contingent consideration liabilities	\$—	\$—	\$5,300	\$5,300	\$—	\$—	\$35,000	\$35,000
Deferred compensation liability	—	28,447	—	28,447	—	24,925	—	24,925
Total liabilities measured at fair value	\$—	\$28,447	\$5,300	\$33,747	\$—	\$24,925	\$35,000	\$59,925

The Company holds available-for-sale securities that consist of highly liquid, investment grade debt securities. The Company considers information provided by the Company's investment accounting and reporting service provider in the measurement of fair value of its debt securities. The investment service provider provides valuation information from an industry-recognized valuation service. Such valuations may be based on trade prices in active markets for identical assets or liabilities (Level 1 inputs) or valuation models using inputs that are observable either directly or indirectly (Level 2 inputs), such as quoted prices for similar assets or liabilities, yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures. The Company's deferred compensation plan assets consist primarily of investments in life insurance contracts carried at cash surrender value, which reflects the net asset value of the underlying publicly traded mutual funds. The Company performs control procedures to corroborate

the fair value of its holdings, including comparing valuations obtained from its investment service provider to valuations reported by the Company's asset custodians, validation of pricing sources and models, and review of key model inputs if necessary.

As a result of an acquisition completed in January 2016, the Company recorded \$5.3 million in contingent consideration liabilities, the majority of which are payable within 12 months after the acquisition date. The Company reassesses the fair value of any contingent consideration liabilities on a quarterly basis using the income approach. Assumptions used to estimate the acquisition date fair value of the contingent consideration include discount rates ranging from 4% to 6% and the probability of achieving certain milestones. This fair value measurement of the contingent consideration is based on significant inputs not

Table of Contents

observed in the market and thus represents a Level 3 measurement. Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value.

Changes in estimated fair value of contingent consideration liabilities during the nine months ended October 2, 2016 are as follows (in thousands):

	Contingent Consideration Liability (Level 3 Measurement)
Balance as of January 3, 2016	\$ 35,000
Additional liability recorded as a result of a current period acquisition	5,300
Cash payments	(35,000)
Balance as of October 2, 2016	\$ 5,300

4. Debt

Convertible Senior Notes

As of October 2, 2016, the Company had outstanding \$632.5 million in principal amount of 0% convertible senior notes due June 15, 2019 (2019 Notes) and \$517.5 million in principal amount of 0.5% convertible senior notes due June 15, 2021 (2021 Notes).

0% Convertible Senior Notes due 2019 and 0.5% Convertible Senior Notes due 2021

In June 2014, the Company issued \$632.5 million aggregate principal amount of 2019 Notes and \$517.5 million aggregate principal amount of 2021 Notes. The Company used the net proceeds plus cash on hand to repurchase a portion of the outstanding 2016 Notes in privately negotiated transactions concurrently with the issuance of the 2019 and 2021 Notes. The 2019 and 2021 Notes' mature on June 15, 2019 and June 15, 2021, respectively, and the implied estimated effective rates of the liability components of the Notes were 2.9% and 3.5%, respectively, assuming no conversion.

Both the 2019 and 2021 Notes will be convertible into cash, shares of common stock, or a combination of cash and shares of common stock, at the Company's election, based on an initial conversion rate, subject to adjustment, of 3.9318 shares per \$1,000 principal amount of the notes (which represents an initial conversion price of approximately \$254.34 per share), only in the following circumstances and to the following extent: (1) during the five business-day period after any 10 consecutive trading day period (the measurement period) in which the trading price per 2019 and 2021 Note for each day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such day; (2) during any calendar quarter (and only during that quarter) after the calendar quarter ending September 30, 2014, if the last reported sale price of the Company's common stock for 20 or more trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect on the last trading day of the immediately preceding calendar quarter; (3) upon the occurrence of specified events described in the indenture for the 2019 and 2021 Notes; and (4) at any time on or after March 15, 2019 for the 2019 Notes, or March 15, 2021 for the 2021 Notes, through the second scheduled trading day immediately preceding the maturity date.

Neither the 2019 nor the 2021 Notes were convertible as of October 2, 2016 and had no dilutive impact during the three and nine months ended October 2, 2016. If the 2019 and 2021 Notes were converted as of October 2, 2016, the

if-converted value would not exceed the principal amount.

0.25% Convertible Senior Notes due 2016

In 2011, the Company issued \$920.0 million aggregate principal amount of 0.25% convertible senior notes due 2016 (2016 Notes) with a maturity date of March 15, 2016. The effective rate of the liability component was estimated to be 4.5%. Based upon meeting the stock trading price conversion requirement during the three months ended March 30, 2014, the 2016 Notes became convertible on April 1, 2014 through, and including, March 11, 2016. All notes were converted by March 11, 2016.

Table of Contents

During the nine months ended October 2, 2016, the Company recorded a loss on extinguishment of debt calculated as the difference between the estimated fair value of the debt and the carrying value of the notes as of the settlement date. To measure the fair value of the converted notes as of the settlement date, the applicable interest rate was estimated using Level 2 observable inputs and applied to the converted notes using the same methodology as in the issuance date valuation. The loss recorded on extinguishment of debt for the nine months ended October 2, 2016 was immaterial.

The following table summarizes information about the conversion of the 2016 Notes during the nine months ended October 2, 2016 (in thousands):

	2016
	Notes
Cash paid for principal of notes converted	\$75,543
Conversion value over principal amount paid in shares of common stock	\$63,753
Number of shares of common stock issued upon conversion	409

Summary of Convertible Senior Notes

The following table summarizes information about the equity and liability components of all convertible senior notes outstanding as of the period reported (dollars in thousands). The fair values of the respective notes outstanding were measured based on quoted market prices, and is a Level 2 measurement.

	October 2, 2016	January 3, 2016
Principal amount of convertible notes outstanding	\$1,150,000	\$1,225,547
Unamortized discount of liability component	(112,716)	(134,969)
Net carrying amount of liability component	1,037,284	1,090,578
Less: current portion	—	(74,929)
Long-term debt	\$1,037,284	\$1,015,649
Carrying value of equity component, net of debt issuance cost	\$161,237	\$213,811
Fair value of outstanding notes	\$1,224,169	\$1,456,451
Weighted-average remaining amortization period of discount on the liability component	3.9 years	4.6 years

Other

As of October 2, 2016, the accompanying condensed consolidated balance sheets include \$1.3 million and \$3.4 million in current and long-term debt, respectively, related to an outstanding line of credit held by Helix.

5. Share-based Compensation Expense

Share-based compensation expense for all stock awards consists of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, September 27,		October 2, September 27,	
	2016	2015	2016	2015
Cost of product revenue	\$1,799	\$ 2,567	\$5,949	\$ 7,012
Cost of service and other revenue	1,261	498	2,114	1,243
Research and development	11,515	9,098	32,889	31,152
Selling, general and administrative	20,008	20,066	60,893	57,697
Share-based compensation expense before taxes	34,583	32,229	101,845	97,104
Related income tax benefits	(7,604)	(9,876)	(23,082)	(28,304)

Share-based compensation expense, net of taxes \$26,979 \$ 22,353 \$78,763 \$ 68,800

Table of Contents

The assumptions used for the specified reporting periods and the resulting estimates of weighted-average fair value per share for stock purchased under the Employee Stock Purchase Plan (ESPP) during the nine months ended October 2, 2016 are as follows:

	Employee Stock Purchase Rights 0.40%
Risk-free interest rate	-
	0.50%
Expected volatility	40% - 44%
	0.5 -
Expected term	1.0 year
Expected dividends	0 %
Weighted-average fair value per share	\$47.88

As of October 2, 2016, approximately \$203.2 million of unrecognized compensation cost related to stock options, restricted stock, and ESPP shares granted to date is expected to be recognized over a weighted-average period of approximately 2.4 years.

6. Stockholders' Equity

As of October 2, 2016, approximately 7.5 million shares remained available for future grants under the 2015 Stock Plan and the 2005 Solexa Equity Plan.

Restricted Stock

The Company's restricted stock activity and related information for the nine months ended October 2, 2016 is as follows (units in thousands):

	Restricted Stock Awards (RSA)	Restricted Stock Units (RSU)	Performance Stock Units (PSU)(1)	Weighted-Average Grant-Date Fair Value per Share		
				RSA	RSU	PSU
Outstanding at January 3, 2016	21	2,206	583	\$47.93	\$131.80	\$169.41
Awarded	22	174	30	\$179.00	\$156.32	\$156.75
Vested	—	(383)	—	\$—	\$85.57	—
Cancelled	—	(197)	(99)	\$—	\$136.40	\$163.51
Outstanding at October 2, 2016	43	1,800	514	\$114.59	\$143.46	\$169.81

(1) The number of units reflect the estimated number of shares to be issued at the end of the performance period.

Stock Options

The Company's stock option activity under all stock option plans during the nine months ended October 2, 2016 is as follows:

Options	Weighted-Average
---------	------------------

Edgar Filing: ILLUMINA INC - Form 10-Q

	(in thousands)	Exercise Price
Outstanding at January 3, 2016	1,599	\$ 41.95
Exercised	(532)	\$ 29.65
Cancelled	(2)	\$ 46.35
Outstanding at October 2, 2016	1,065	\$ 48.08

At October 2, 2016, outstanding options to purchase 1.1 million shares were exercisable with a weighted-average exercise price per share of \$48.08.

Table of Contents

Employee Stock Purchase Plan

The price at which common stock is purchased under the ESPP is equal to 85% of the fair market value of the common stock on the first day of the offering period or purchase date, whichever is lower. During the nine months ended October 2, 2016, approximately 0.2 million shares were issued under the ESPP. As of October 2, 2016, there were approximately 14.3 million shares available for issuance under the ESPP.

Share Repurchases

On July 28, 2016, the Company's Board of Directors authorized a new share repurchase program, which supersedes all prior and available repurchase authorizations, to repurchase \$250.0 million of outstanding common stock. During the three months ended October 2, 2016, 0.1 million shares for \$13.1 million were repurchased. During the nine months ended October 2, 2016, the Company repurchased approximately 0.8 million shares for \$113.1 million in aggregate. Authorizations to repurchase up to an additional \$236.9 million of the Company's common stock remained available as of October 2, 2016.

7. Income Taxes

The Company's effective tax rate may vary from the U.S. federal statutory tax rate due to the change in the mix of earnings in tax jurisdictions with different statutory rates, benefits related to tax credits, and the tax impact of non-deductible expenses and other permanent differences between income before income taxes and taxable income. The effective tax rates for the three and nine months ended October 2, 2016 were 24.2% and 24.9%, respectively. For the three and nine months ended October 2, 2016, the variance from the U.S. federal statutory tax rate of 35% was primarily attributable to the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom; offset slightly by the tax impact associated with the investments in our consolidated variable interest entities.

8. Legal Proceedings

The Company is involved in various lawsuits and claims arising in the ordinary course of business, including actions with respect to intellectual property, employment, and contractual matters. In connection with these matters, the Company assesses, on a regular basis, the probability and range of possible loss based on the developments in these matters. A liability is recorded in the financial statements if it is believed to be probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable results could occur, assessing contingencies is highly subjective and requires judgments about future events. The Company regularly reviews outstanding legal matters to determine the adequacy of the liabilities accrued and related disclosures. The amount of ultimate loss may differ from these estimates. Each matter presents its own unique circumstances, and prior litigation does not necessarily provide a reliable basis on which to predict the outcome, or range of outcomes, in any individual proceeding. Because of the uncertainties related to the occurrence, amount, and range of loss on any pending litigation or claim, the Company is currently unable to predict their ultimate outcome, and, with respect to any pending litigation or claim where no liability has been accrued, to make a meaningful estimate of the reasonably possible loss or range of loss that could result from an unfavorable outcome. In the event that opposing litigants or claims ultimately succeed at trial and any subsequent appeals on their claims, any potential loss or charges in excess of any established accruals, individually or in the aggregate, could have a material adverse effect on the Company's business, financial condition, results of operations, and/or cash flows in the period in which the unfavorable outcome occurs or becomes probable, and potentially in future periods.

On July 1, 2016, the Company entered into a Settlement and License Agreement with Enzo Life Sciences, Inc. (Enzo) that settled all claims in the litigation. Pursuant to the terms of the Settlement and License Agreement, the Company

paid Enzo a one-time payment of \$21.0 million for release of past damages claimed and a fully paid-up non-exclusive license to U.S. Patent No. 7,064,197. None of the parties made any admission of liability in entering into the Settlement and License Agreement. The Company allocated the \$21.0 million settlement on a relative fair value basis, resulting in \$11.5 million capitalized as an intangible asset and a corresponding gain recorded in legal contingencies for the value of the license, which will be amortized over a period of 7 years on a straight-line basis, and the remaining \$9.5 million related to past damages claimed. The fair value of the license and past damages was estimated using a discounted cash flow model, and is considered to be a Level 3 measurement.

Table of Contents

9. Segment Information

The Company has two reportable segments: Core Illumina and one segment related to the combined activities of the Company's consolidated VIEs, GRAIL and Helix. The Company reports segment information based on the management approach. This approach designates the internal reporting used by the Chief Operating Decision Maker ("CODM") for making decisions and assessing performance as the source of the Company's reportable segments. The CODM allocates resources and assesses the performance of each operating segment using information about its revenues and income (losses) from operations. Based on the information used by the CODM, the Company has determined its reportable segments as follows:

Core Illumina:

Core Illumina's products and services serve customers in the research, clinical and applied markets, and enable the adoption of a variety of genomic solutions. Core Illumina includes all operations of the Company, excluding the results of its two consolidated VIEs.

Consolidated VIEs:

GRAIL: GRAIL was created to enable the early detection of cancer in asymptomatic individuals through a simple blood screen based on the concentration of circulating tumor nucleic acids. GRAIL is currently in the early stages of developing this test and as such, has no revenues to date.

Helix: Helix was established to enable individuals to explore their genetic information by providing affordable sequencing and database services for consumers through third party partners, driving the creation of an ecosystem of consumer applications.

Management evaluates the performance of the Company's operating segments based upon income (loss) from operations. The Company does not allocate expenses between segments. Core Illumina sells products and provides services to GRAIL and Helix in accordance with contractual agreements between the entities.

The following table presents the operating performance of each reportable segment (in thousands):

	Three Months Ended		Nine Months Ended	
	October 2, 2016	September 27, 2015	October 2, 2016	September 27, 2015
Segment revenues:				
Core Illumina	\$615,135	\$ 550,271	\$1,792,150	\$ 1,628,214
Consolidated VIEs	—	—	—	—
Elimination of intersegment revenues	(7,996)	—	(13,124)	—
Consolidated revenues	\$607,139	\$ 550,271	\$1,779,026	\$ 1,628,214
Segment operating income (loss):				
Core Illumina	\$190,742	\$ 145,893	\$501,411	\$ 473,952
Consolidated VIEs	(25,136)	(5,111)	(49,700)	(5,111)
Elimination of intersegment earnings	(4,904)	—	(7,695)	—
Consolidated operating income	\$160,702	\$ 140,782	\$444,016	\$ 468,841

Table of Contents

The following table presents the total assets of each reportable segment (in thousands):

	October 2, 2016	January 3, 2016
Segment assets:		
Core Illumina	\$4,095,182	\$3,657,953
Consolidated VIEs	190,904	30,447
Elimination of intersegment assets	(58,259)	(653)
Consolidated total assets	\$4,227,827	\$3,687,747

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

Our Management’s Discussion and Analysis of Financial Condition and Results of Operations (MD&A) will help readers understand our results of operations, financial condition, and cash flow. It is provided in addition to the accompanying condensed consolidated financial statements and notes. This MD&A is organized as follows:

Business Overview and Outlook. High level discussion of our operating results and significant known trends that affect our business.

Results of Operations. Detailed discussion of our revenues and expenses.

Liquidity and Capital Resources. Discussion of key aspects of our statements of cash flows, changes in our financial position, and our financial commitments.

Off-Balance Sheet Arrangements. We have no off-balance sheet arrangements.

Critical Accounting Policies and Estimates. Discussion of significant changes since our most recent Annual Report on Form 10-K we believe are important to understanding the assumptions and judgments underlying our financial statements.

Recent Accounting Pronouncements. Summary of recent accounting pronouncements applicable to our condensed consolidated financial statements.

This MD&A discussion contains forward-looking statements that involve risks and uncertainties. Please see “Consideration Regarding Forward-Looking Statements” at the end of this MD&A section for additional factors relating to such statements. This MD&A should be read in conjunction with our condensed consolidated financial statements and accompanying notes included in this report and our Annual Report on Form 10-K for the fiscal year ended January 3, 2016. Operating results are not necessarily indicative of results that may occur in future periods.

Business Overview and Outlook

This overview and outlook provides a high level discussion of our operating results and significant known trends that affect our business. We believe that an understanding of these trends is important to understanding our financial results for the periods being reported herein as well as our future financial performance. This summary is not intended to be exhaustive, nor is it intended to be a substitute for the detailed discussion and analysis provided elsewhere in this Quarterly Report on Form 10-Q.

About Illumina

Our Company is organized into three operating segments for purposes of evaluating its business operations and reporting its financial results. One segment consists of Illumina's core operations. The other two relate to the activities of our consolidated VIEs, GRAIL and Helix, which are combined into one reportable segment. For information on GRAIL and Helix, refer to Note 9 of the Notes to the Condensed Consolidated Financial Statements provided in this Quarterly Report on Form 10-Q.

Our focus on innovation has established us as the global leader in DNA sequencing and array-based technologies, serving customers in the research, clinical, and applied markets. Our products are used for applications in the life sciences, oncology, reproductive health, agriculture, and other emerging market segments.

Our portfolio of integrated systems, consumables, and analysis tools is designed to accelerate and simplify genetic analysis. This portfolio addresses a range of genomic complexity, price points, and throughput, enabling customers to select the best solution for their research or clinical challenge.

Our financial results have been, and will continue to be, impacted by several significant trends, which are described below. While these trends are important to understanding and evaluating our financial results, this discussion should be read in conjunction with our condensed consolidated financial statements and the notes thereto in Item 1, Part I of this report, and the other transactions, events, and trends discussed in "Risk Factors" in Item 1A, Part II of this report and Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

Next-Generation Sequencing

Next-generation sequencing has become an essential technology in our markets, and our portfolio of sequencing platforms represents a family of systems that are designed to meet the workflow, output, and accuracy demands of a full range of sequencing applications. We believe that the expanding sequencing market, along with an increase in the number of samples available and enhancements in our sequencing portfolio, will continue to drive demand for our next-generation sequencing technologies. As a result, we believe that our sequencing consumables revenue will continue to grow in future periods.

Arrays

As a complement to next-generation sequencing, we believe arrays offer a less expensive, faster, and highly accurate technology for use when genetic content is already known. The information content of arrays is fixed and reproducible, providing a repeatable, standardized technology to read out subsets of nucleotide bases within the overall genome. We believe that our customers will migrate certain array studies to sequencing. However, we expect that demand from customers in reproductive health, agriculture, and applied markets will partially mitigate this decline. Demand in the array market has trended toward lower complexity arrays that can be used on larger numbers of samples, resulting in a lower selling price per sample. We believe that our innovation in array products supports the lower selling price.

Financial Overview

Consolidated financial results for the first three quarters of 2016 include the following:

Net revenue increased 9.3% during the first three quarters of 2016 to \$1,779.0 million compared to the first three quarters of 2015 due to the growth in sales of our sequencing consumables and services, partially offset by lower shipments of our high-throughput platforms.

-

Edgar Filing: ILLUMINA INC - Form 10-Q

Gross profit as a percentage of revenue (gross margin) was 70.1% in the first three quarters of 2016 compared to 69.9% in the first three quarters of 2015. Gross margins increased primarily due to a greater mix of sequencing consumables, partially offset by a decline in service margin. Our gross margin in future periods will depend on several factors, including: market conditions that may impact our pricing power; sales mix changes among consumables, instruments, and services; product mix changes between established products and new products in new markets; royalties; our cost structure for manufacturing operations; and product support obligations.

Income from operations decreased \$24.8 million in the first three quarters of 2016 compared to the first three quarters of 2015 primarily due to the increase in research and development and selling, general and administrative expenses, which we expect will continue to grow. The increase in operating expenses was partially offset by higher gross profit.

Our effective tax rate was 24.9% in the first three quarters of 2016, compared to 20.9% in the first three quarters of 2015. The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom, partially offset by the tax impact associated with the investments in our consolidated variable interest entities. Our future effective tax rate may vary from the U.S. federal statutory tax rate due to the mix of earnings in tax jurisdictions with different statutory tax rates and the other factors discussed in the risk factor “We are subject to risks related to taxation in multiple jurisdictions” in Part I Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016. We anticipate that our effective tax rate will trend lower than the U.S. federal statutory tax rate in the future due to the portion of our earnings that will be subject to lower statutory tax rates.

Cash, cash equivalents, and short-term investments were \$1.5 billion as of October 2, 2016.

Results of Operations

To enhance comparability, the following table sets forth our unaudited condensed consolidated statements of income for the specified reporting periods stated as a percentage of total revenue.

	Q3 2016	Q3 2015	YTD 2016	YTD 2015
Revenue:				
Product revenue	84.6 %	85.6 %	84.7 %	85.5 %
Service and other revenue	15.4	14.4	15.3	14.5
Total revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Cost of product revenue	21.8	22.0	21.5	22.1
Cost of service and other revenue	6.2	5.4	6.6	5.8
Amortization of acquired intangible assets	1.8	2.2	1.8	2.2
Total cost of revenue	29.8	29.6	29.9	30.1
Gross profit	70.2	70.4	70.1	69.9
Operating expense:				
Research and development	20.7	18.0	21.0	17.6
Selling, general and administrative	22.9	24.8	24.5	23.2
Legal contingencies	—	2.7	(0.5)	0.9
Headquarter relocation	0.1	(0.9)	0.1	(0.2)
Acquisition related expense (gain), net	—	0.2	—	(0.4)
Total operating expense	43.7	44.8	45.1	41.1
Income from operations	26.5	25.6	25.0	28.8
Other income (expense):				
Interest income	0.3	0.5	0.4	0.4
Interest expense	(1.3)	(2.3)	(1.5)	(2.2)

Edgar Filing: ILLUMINA INC - Form 10-Q

Cost-method investment gain, net	—	0.5	—	1.0
Other (expense) income, net	—	(0.9)	0.1	(0.5)
Total other expense, net	(1.0)	(2.2)	(1.0)	(1.3)
Income before income taxes	25.5	23.4	24.0	27.5
Provision for income taxes	6.2	2.4	6.0	5.7
Consolidated net income	19.3	21.0	18.0	21.8
Add: Net loss attributable to noncontrolling interests	1.9	0.5	1.0	0.1
Net income attributable to Illumina stockholders	21.2 %	21.5 %	19.0 %	21.9 %

Our fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine month periods ended October 2, 2016 and September 27, 2015 were both 13 and 39 weeks, respectively.

Table of Contents

Revenue

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Product revenue	\$513,744	\$470,824	\$42,920	9 %	\$1,506,416	\$1,392,711	\$113,705	8 %
Service and other revenue	93,395	79,447	13,948	18	272,610	235,503	37,107	16
Total revenue	\$607,139	\$550,271	\$56,868	10 %	\$1,779,026	\$1,628,214	\$150,812	9 %

Product revenue consists primarily of revenue from the sale of consumables and instruments. Service and other revenue consist primarily of sequencing and genotyping service revenue as well as instrument service contract revenue. Our consolidated VIEs are in the development stage and have no revenues to date.

QTD 2016 vs. QTD 2015

Revenue increased \$56.9 million, or 10%, to \$607.1 million in Q3 2016 compared to \$550.3 million in Q3 2015.

Consumables revenue increased \$75.3 million, or 23%, to \$396.4 million in Q3 2016 compared to \$321.1 million in Q3 2015, driven primarily by growth in both of our sequencing and microarray consumables.

Instrument revenue decreased \$33.0 million, or 23%, to \$112.4 million in Q3 2016 compared to \$145.4 million in Q3 2015, primarily due to lower shipments of our high-throughput platforms.

Service and other revenue increased \$13.9 million, or 18%, to \$93.4 million in Q3 2016 compared to \$79.4 million in Q3 2015, driven by revenue from genotyping services and extended maintenance service contracts associated with a larger sequencing installed base.

YTD 2016 vs. YTD 2015

Revenue increased \$150.8 million, or 9%, to \$1,779.0 million in the first three quarters of 2016 compared to \$1,628.2 million in the first three quarters of 2015.

Consumables revenue increased \$203.7 million, or 22%, to \$1,136.5 million in the first three quarters of 2016 compared to \$932.8 million in the first three quarters of 2015, driven by growth in the sequencing instrument installed base.

Instrument revenue decreased \$91.5 million, or 20%, to \$355.6 million in the first three quarters of 2016 compared to \$447.1 million in the first three quarters of 2015, primarily due to lower shipments of our high-throughput platforms.

Service and other revenue increased \$37.1 million, or 16%, to \$272.6 million in the first three quarters of 2016 compared to \$235.5 million in the first three quarters of 2015, driven by revenue from genotyping services and extended instrument service contracts associated with a larger sequencing installed base, partially offset by our noninvasive prenatal testing customers shifting to in-house testing on our sequencers.

Gross Margin

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Gross profit	\$426,150	\$387,539	\$38,611	10%	\$1,247,009	\$1,138,931	\$108,078	9%
Gross margin	70.2	% 70.4	%		70.1	% 69.9	%	

QTD 2016 vs. QTD 2015

Gross margin decreased to 70.2% in Q3 2016 from 70.4% in Q3 2015. Gross margin decreased primarily due to a decline in service margin, partially offset by a greater mix of sequencing consumables.

YTD 2016 vs. YTD 2015

Gross margin increased to 70.1% in the first three quarters of 2016 compared to 69.9% in the first three quarters of 2015, primarily due to a greater mix of sequencing consumables, partially offset by a decline in service margin.

22

Table of Contents

Operating Expense

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Research and development	\$ 125,917	\$ 99,226	\$ 26,691	27 %	\$ 374,500	\$ 287,180	\$ 87,320	30 %
Selling, general and administrative	139,146	136,648	2,498	2	436,914	377,406	59,508	16
Legal contingencies	—	15,000	(15,000)	(100)	(9,490)	15,000	(24,490)	(163)
Headquarter relocation	385	(5,226)	5,611	(107)	1,069	(3,047)	4,116	(135)
Acquisition related expense (gain), net	—	1,109	(1,109)	(100)	—	(6,449)	6,449	(100)
Total operating expense	\$ 265,448	\$ 246,757	\$ 18,691	8 %	\$ 802,993	\$ 670,090	\$ 132,903	20 %

QTD 2016 vs. QTD 2015

Research and development (R&D) expense increased by \$26.7 million, or 27%, in Q3 2016 from Q3 2015. Core Illumina R&D expense increased by \$12.4 million, or 13%, in Q3 2016 from Q3 2015 primarily due to increased employee and related expenses as we continue to invest in the development of products as well as enhancements to existing products. Our consolidated VIEs contributed \$14.3 million to the increase, primarily due to increased employee headcount and product development related expenses.

Selling, general and administrative (SG&A) expense increased by \$2.5 million, or 2%, in Q3 2016 from Q3 2015. Our consolidated VIEs contributed \$4.5 million to the increase, primarily due to increased employee headcount, offset by lower professional service fees related to the Helix start-up. This was partially offset by a decrease in Core Illumina SG&A expense of \$2.0 million, or 2%, primarily due to a decrease in employee related expenses.

Legal contingencies in Q3 2015 represent charges related to litigation matters.

Headquarter relocation in Q3 2015 consisted primarily of a net gain related to a change in a lease exit liability.

YTD 2016 vs. YTD 2015

Research and development expense increased by \$87.3 million, or 30%, in the first three quarters of 2016 compared to the first three quarters of 2015. Core Illumina R&D expense increased by \$58.9 million, or 21%, primarily due to increased headcount and outside services as we continue to invest in the development of new products as well as enhancements to existing products. Our consolidated VIEs contributed \$28.4 million to the increase, primarily due to employee related expenses for GRAIL and a full three quarters of operating results for Helix in 2016.

Selling, general and administrative expense increased by \$59.5 million, or 16%, in the first three quarters of 2016 compared to the first three quarters of 2015. Core Illumina SG&A expense increased by \$45.0 million, or 12%, primarily due to increased headcount and facilities investment to support the continued growth and scale of our operations, as well as outside services. Our consolidated VIEs contributed \$14.5 million to the increase, due to employee related expenses for GRAIL and a full three quarters of operating results for Helix in 2016.

Legal contingencies in the first three quarters of 2016 represent a reversal of previously recorded expense related to the settlement of patent litigation.

Acquisition related gain, net, in the first three quarters of 2015 consisted of changes in fair value of contingent consideration and transaction related costs for Core Illumina. The changes in the fair value of contingent consideration

were primarily due to changes in the estimated payments.

23

Table of Contents

Other Income (Expense), Net

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Interest income	\$2,056	\$2,767	\$(711)	(26)%	\$6,683	\$5,804	\$879	15 %
Interest expense	(8,208)	(12,821)	4,613	(36)	(24,880)	(35,190)	10,310	(29)
Cost-method investment gain, net	—	2,900	(2,900)	(100)	—	15,482	(15,482)	(100)
Other (expense) income, net	(186)	(4,711)	4,525	(96)	1,116	(6,802)	7,918	(116)
Total other expense, net	\$(6,338)	\$(11,865)	\$5,527	(47)%	\$(17,081)	\$(20,706)	\$3,625	(18)%

Other income (expense), net primarily relate to Core Illumina for all periods presented.

QTD 2016 vs. QTD 2015

Interest expense consisted primarily of accretion of discount on our convertible senior notes. The decrease in interest expense in Q3 2016 compared to Q3 2015 was due to a lower outstanding principal balance on the 2016 Notes, which matured in March 2016.

Other (expense) income, net in Q3 2015 primarily consists of a \$3.5 million loss on extinguishment of debt. There was no such loss in the same period of the current year.

YTD 2016 vs. YTD 2015

Interest expense consisted primarily of accretion of discount on our convertible senior notes. The decrease in interest expense in the first three quarters of 2016 compared to the first three quarters of 2015 was due to a lower outstanding principal balance on the 2016 Notes, which matured in March 2016.

Cost-method investment gain, net, during the first three quarters of 2015 consisted primarily of a gain on the sale of a cost-method investment.

Other (expense) income, net, in the first three quarters of 2016 primarily consisted of net foreign exchange gains and losses. Other (expense) income, net, in the first three quarters of 2015 consists of a \$3.5 million loss on extinguishment of debt and net foreign exchange gains and losses.

Table of Contents

Provision for Income Taxes

(Dollars in thousands)	Q3 2016	Q3 2015	Change	% Change	YTD 2016	YTD 2015	Change	% Change
Income before income taxes	\$154,364	\$128,917	\$25,447	20 %	\$426,935	\$448,135	\$(21,200)	(5)%
Provision for income taxes	37,429	13,296	24,133	182	106,387	93,609	12,778	14
Consolidated net income	\$116,935	\$115,621	\$1,314	1 %	\$320,548	\$354,526	\$(33,978)	(10)%
Effective tax rate	24.2	% 10.3	%		24.9	% 20.9	%	

QTD 2016 vs. QTD 2015

Our effective tax rate was 24.2% for Q3 2016 compared to 10.3% in Q3 2015. The variance from the U.S. federal statutory tax rate of 35% in Q3 2016 was primarily attributable to the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom, partially offset by the tax impact associated with the investments in our consolidated variable interest entities. The variance from the U.S. federal statutory tax rate of 35% in Q3 2015, was primarily attributable to a discrete tax benefit of \$24.8 million, related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a tax court opinion in which an unrelated third party was successful in challenging such charges. The decrease from the U.S. federal statutory tax rate also resulted from the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom.

YTD 2016 vs. YTD 2015

Our effective tax rate was 24.9% in the first three quarters of 2016. The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom, partially offset by the tax impact associated with the investments in our consolidated variable interest entities. For the first three quarters of 2015, our effective tax rate was 20.9%.

The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to a discrete tax benefit of \$24.8 million, related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a tax court opinion in which an unrelated third party was successful in challenging such charges. The decrease from the U.S. federal statutory tax rate also resulted from the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom.

Liquidity and Capital Resources

At October 2, 2016, we had approximately \$794.7 million in cash and cash equivalents, of which approximately \$349.0 million were held by our foreign subsidiaries. Cash and cash equivalents held by our consolidated VIEs as of October 2, 2016 were \$103.6 million. Cash and cash equivalents increased by \$25.9 million from January 3, 2016, due to the factors described in the “Cash Flow Summary” below. Our primary source of liquidity, other than our holdings of cash, cash equivalents and investments, has been cash flows from operations. Our ability to generate cash from operations provides us with the financial flexibility we need to meet operating, investing, and financing needs. It is our intention to indefinitely reinvest all current and future foreign earnings in foreign subsidiaries.

Historically, we have liquidated our short-term investments or issued debt and equity securities to finance our business needs as a supplement to cash provided by operating activities. As of October 2, 2016, we had \$741.6 million in short-term investments. Short-term investments held by our foreign subsidiaries as of October 2, 2016 were approximately \$256.2 million. Our short-term investments include marketable securities consisting of U.S.

government-sponsored entities, corporate debt securities, and U.S. Treasury securities.

During the first three quarters of 2016, \$75.5 million in principal of the 2016 Notes were converted. The 2016 Notes became convertible on April 1, 2014 through, and including, March 11, 2016. All 2016 Notes were converted by March 11, 2016. The convertible senior notes due 2019 and 2021 were not convertible as of October 2, 2016.

Table of Contents

We anticipate that our current cash, cash equivalents and short-term investments, together with cash provided by operating activities are sufficient to fund our near term capital and operating needs for at least the next 12 months. Operating needs include the planned costs to operate our business, including amounts required to fund working capital and capital expenditures. Our primary short-term needs for capital, which are subject to change, include:

- support of commercialization efforts related to our current and future products, including expansion of our direct sales force and field support resources both in the United States and abroad;
- acquisitions of equipment and other fixed assets for use in our current and future manufacturing and research and development facilities;
- the continued advancement of research and development efforts;
- potential strategic acquisitions and investments;
- potential early repayment of debt obligations as a result of conversions;
- the expansion needs of our facilities, including costs of leasing and building out additional facilities; and
- repurchases of our outstanding common stock.

As of October 2, 2016, \$236.9 million remains under an authorized stock repurchase program.

Certain noncontrolling Helix investors may require Illumina to redeem all noncontrolling interests in cash at the then approximate fair market value. Such redemption right is exercisable at the option of certain noncontrolling interest holders after January 1, 2021, provided that a bona fide pursuit of the sale of Helix has occurred and an initial public offering of Helix has not been completed. The fair value of the redeemable noncontrolling interests related to Helix as of October 2, 2016 was \$33.1 million.

On April 14, 2016, we announced our commitment to invest \$100.0 million in a new venture capital investment fund established by Nicholas Naclerio, Ph.D., our former Senior Vice President, Corporate and Venture Development. The capital commitment is callable over ten years, and up to \$40.0 million can be drawn down during the first year. During the nine months ended October 2, 2016, the Company transferred \$3.2 million of its cost-method investments to the Fund and contributed \$4.4 million in cash.

We expect that our revenue and the resulting operating income, as well as the status of each of our new product development programs, will significantly impact our cash management decisions.

Our future capital requirements and the adequacy of our available funds will depend on many factors, including:

- our ability to successfully commercialize and further develop our technologies and create innovative products in our markets;
- scientific progress in our research and development programs and the magnitude of those programs;
- competing technological and market developments; and
- the need to enter into collaborations with other companies or acquire other companies or technologies to enhance or complement our product and service offerings.

Cash Flow Summary

(In thousands)

	YTD 2016	YTD 2015
Net cash provided by operating activities	\$407,085	\$419,218
Net cash used in investing activities	(341,247)	(335,544)
Net cash used in financing activities	(41,221)	(165,621)
Effect of exchange rate changes on cash and cash equivalents	1,310	(2,678)
Net increase (decrease) in cash and cash equivalents	\$25,927	\$(84,625)

Table of Contents

Operating Activities

Net cash provided by operating activities in the first three quarters of 2016 consisted of net income of \$320.5 million plus net adjustments of \$180.5 million partially offset by net changes in operating assets and liabilities of \$93.9 million. The primary non-cash expenses added back to net income included depreciation and amortization expenses of \$103.5 million, share-based compensation of \$101.8 million, deferred income tax of \$57.5 million, and accretion of debt discount of \$22.3 million. These non-cash add-backs were partially offset by \$109.9 million in incremental tax benefit related to share-based compensation. Cash flow impact from changes in net operating assets included increases in inventory and other assets, and decreases in accrued liabilities and accounts payable, partially offset by an increase in other long term liabilities, and decreases in accounts receivable and prepaid expenses.

Net cash provided by operating activities in the first three quarters of 2015 consisted of net income of \$354.5 million plus net adjustments of \$166.8 million partially offset by net changes in operating assets and liabilities of \$102.1 million. The primary non-cash expenses added back to net income included share-based compensation of \$97.1 million, depreciation and amortization expenses of \$93.7 million, deferred income taxes of \$83.7 million, and accretion of debt discount of \$29.8 million. These non-cash add-backs were partially offset by \$121.7 million in incremental tax benefit related to share-based compensation, \$15.5 million in cost-method investment gain, net, and \$6.4 million in change in fair value of contingent consideration. Cash flow impact from changes in net operating assets included increases in accounts receivable and inventory, partially offset by increases in accounts payable and accrued liabilities.

Investing Activities

Net cash used in investing activities totaled \$341.2 million for the first three quarters of 2016. We purchased \$679.1 million of available-for-sale securities and \$554.6 million of our available-for-sale securities matured or were sold during the period. We also paid net cash of \$17.8 million for acquisitions and invested \$178.4 million in capital expenditures primarily associated with facilities and the purchase of manufacturing, research and development equipment.

Net cash used in investing activities totaled \$335.5 million for the first three quarters of 2015. We purchased \$713.9 million of available-for-sale securities and \$525.3 million of our available-for-sale securities matured or were sold during the period. We invested \$107.4 million in capital expenditures primarily associated with machinery and equipment, facilities and information technology equipment and systems primarily related to our enterprise resource planning implementation.

Financing Activities

Net cash used in financing activities totaled \$41.2 million for the first three quarters of 2016. We used \$113.1 million to repurchase our common stock, \$76.4 million to pay taxes related to net share settlement of equity awards, and \$29.2 million to pay acquisition related contingent consideration. We used \$70.5 million to repay financing obligations. We received \$109.9 million in incremental tax benefit related to share-based compensation, \$47.2 million in proceeds from issuance of common stock through the exercise of stock options and the sale of shares under our employee stock purchase plan, \$5.0 million in proceeds from issuance of debt related to an outstanding line of credit held by Helix, and \$5.9 million in proceeds from early exercises of equity awards from a subsidiary. Contributions from noncontrolling interest owners were \$80.0 million.

Net cash used in financing activities totaled \$165.6 million for the first three quarters of 2015. We used \$95.2 million to pay taxes related to net share settlement of equity awards and \$72.3 million to repurchase our common stock. We used \$216.2 million to repay financing obligations. We received \$121.7 million in incremental tax benefit related to

share-based compensation and \$65.7 million in proceeds from issuance of common stock through the exercise of stock options and the sale of shares under our employee stock purchase plan. Contributions from noncontrolling interest owners were \$32.1 million.

Off-Balance Sheet Arrangements

We do not participate in any transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. During the first three quarters of 2016, we were not involved in any “off-balance sheet arrangements” within the meaning of the rules of the Securities and Exchange Commission.

Table of Contents

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements, we make estimates, assumptions and judgments that can have a significant impact on our net revenue, operating income and net income, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in the accounting policies described in Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. There were no material changes to our critical accounting policies and estimates during the first three quarters of 2016.

Recent Accounting Pronouncements

For summary of recent accounting pronouncements applicable to our condensed consolidated financial statements, see note "1. Summary of Significant Accounting Policies" in Part I, Item 1, Notes to Condensed Consolidated Financial Statements, which is incorporated herein by reference.

Consideration Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, strategies, objectives, expectations, intentions, and adequacy of resources. Words such as "anticipate," "believe," "continue," "estimate," "expect," "intend," "may," "plan," "potential," "predict," "project," or similar phrases, or the negatives of these words, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward looking. Examples of forward-looking statements include, among others, statements regarding the integration of our acquired technologies with our existing technology, the commercial launch of new products, the entry into new business segments or markets, and the duration which our existing cash and other resources is expected to fund our operating activities.

Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Among the important factors that could cause actual results to differ materially from those in any forward-looking statements include the following:

- our ability to develop and commercialize our instruments and consumables, to deploy new products, services, and applications, and expand the markets for our technology platforms;
- our ability to manufacture robust instrumentation and consumables;
- our ability to identify and integrate acquired technologies, products, or businesses successfully;
- our expectations and beliefs regarding prospects and growth for the business and its markets;
- the assumptions underlying our critical accounting policies and estimates;
- our assessments and estimates that determine our effective tax rate;
- our assessments and beliefs regarding the outcome of pending legal proceedings and any liability that we may incur as a result of those proceedings;
- uncertainty, or adverse economic and business conditions, including as a result of slowing or uncertain economic growth in the United States or worldwide; and
- other factors detailed in our filings with the SEC, including the risks, uncertainties, and assumptions described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016, or in information disclosed in public conference calls, the date and time of which are released beforehand.

The foregoing factors should be considered together with other factors detailed in our filings with the Securities and Exchange Commission, including our most recent filings on Forms 10-K and 10-Q, or in information disclosed in

public conference calls, the date and time of which are released beforehand. We undertake no obligation, and do not intend to update these forward-looking statements, to review or confirm analysts' expectations, or to provide interim reports or updates on the

28

Table of Contents

progress of the current financial quarter. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There were no substantial changes to our market risks in the nine months ended October 2, 2016, when compared to the disclosures in Item 7A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016.

Item 4. Controls and Procedures.

We design our internal controls to provide reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported in conformity with U.S. generally accepted accounting principles. We also maintain internal controls and procedures to ensure that we comply with applicable laws and our established financial policies.

Based on management's evaluation (under the supervision and with the participation of our chief executive officer (CEO) and chief financial officer (CFO)), as of the end of the period covered by this report, our CEO and CFO concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), are effective to provide reasonable assurance that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and is accumulated and communicated to management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

During Q3 2016, we continued to monitor and evaluate the operating effectiveness of key controls related to process enhancements arising out of our enterprise resource planning system implementation in 2015. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that materially affected or are reasonably likely to materially affect internal control over financial reporting.

Table of Contents

PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved in various lawsuits and claims arising in the ordinary course of business, including actions with respect to intellectual property, employment, and contractual matters. In connection with these matters, we assesses, on a regular basis, the probability and range of possible loss based on the developments in these matters. A liability is recorded in the financial statements if it is believed to be probable that a loss has been incurred and the amount of the loss can be reasonably estimated. Because litigation is inherently unpredictable and unfavorable results could occur, assessing contingencies is highly subjective and requires judgments about future events. We regularly review outstanding legal matters to determine the adequacy of the liabilities accrued and related disclosures. The amount of ultimate loss may differ from these estimates. Each matter presents its own unique circumstances, and prior litigation does not necessarily provide a reliable basis on which to predict the outcome, or range of outcomes, in any individual proceeding. Because of the uncertainties related to the occurrence, amount, and range of loss on any pending litigation or claim, we are currently unable to predict their ultimate outcome, and, with respect to any pending litigation or claim where no liability has been accrued, to make a meaningful estimate of the reasonably possible loss or range of loss that could result from an unfavorable outcome. In the event that opposing litigants or claims ultimately succeed at trial and any subsequent appeals on their claims, any potential loss or charges in excess of any established accruals, individually or in the aggregate, could have a material adverse effect on our business, financial condition, results of operations, and/or cash flows in the period in which the unfavorable outcome occurs or becomes probable, and potentially in future periods.

Item 1A. Risk Factors.

Our business is subject to various risks, including those described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2016, which we strongly encourage you to review. There have been no material changes from the risk factors disclosed in Item 1A of our Form 10-K.

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

Unregistered Sales of Equity Securities

None during the quarterly period ended October 2, 2016.

Purchases of Equity Securities by the Issuer

On July 28, 2016, the Company's Board of Directors authorized a new share repurchase program, which supersedes all prior and available repurchase authorizations, to repurchase \$250.0 million of outstanding common stock. The following table summarizes shares repurchased pursuant to these programs during the three months ended October 2, 2016.

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs

Edgar Filing: ILLUMINA INC - Form 10-Q

July 4, 2016 - July 31, 2016	29,384	164.18	29,384	\$245,175,663
August 1, 2016 - August 28, 2016	50,058	\$ 164.78	50,058	\$236,926,941
August 29, 2016 - October 2, 2016	—	\$—	—	\$236,926,941
Total	79,442	\$ 164.56	79,442	\$236,926,941

(1) All shares purchased during the three months ended October 2, 2016, were made in open-market transactions.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Table of Contents

Item 5. Other Information.

None.

Item 6. Exhibits.

Exhibit Number Description of Document

31.1	Certification of Francis A. deSouza pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Marc A. Stapley pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Francis A. deSouza pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Marc A. Stapley pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase

31

Table of Contents

SIGNATURES

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.

ILLUMINA, INC.
(registrant)

Date: November 7, 2016 /s/ MARC A. STAPLEY

Marc A. Stapley

Executive Vice President, Chief Administrative Officer and Chief Financial Officer