

ILLUMINA INC  
Form 10-K  
February 26, 2008

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended December 30, 2007**
- 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: 000-30361**

**Illumina, Inc.**

*(Exact name of Registrant as Specified in Its Charter)*

**Delaware**

*(State or other Jurisdiction of  
Incorporation or Organization)*

**33-0804655**

*(I.R.S. Employer  
Identification No.)*

**9885 Towne Centre Drive,  
San Diego, California**  
*(Address of Principal Executive Offices)*

**92121**  
*(zip code)*

**Registrant's telephone number, including area code:**  
**(858) 202-4500**

**Securities registered pursuant to Section 12(b) of the Act:**  
**None**

**Securities registered pursuant to Section 12(g) of the Act:**

**Common Stock, \$0.01 par value**  
*(Title of class)*

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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. (Check one):

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 February 1, 2008, there were 55,545,039 shares (excluding 7,409,545 shares held in treasury) of the Registrant's Common Stock outstanding. The aggregate market value of the Common Stock held by non-affiliates of the Registrant as of June 29, 2007 (the last business day of the Registrant's most recently completed second fiscal quarter), based on the closing price for the Common Stock on The NASDAQ Global Select Market on that date, was \$2,112,729,064. This amount excludes an aggregate of 1,874,329 shares of Common Stock held by officers and directors and each person known by the Registrant to own 10% or more of the outstanding Common Stock. Exclusion of shares held by any person should not be construed to indicate that such person possesses the power, directly or indirectly, to direct or cause the direction of the management or policies of the Registrant, or that the Registrant is controlled by or under common control with such person.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant's definitive proxy statement for the annual meeting of stockholders expected to be held on May 16, 2008 are incorporated by reference into Items 10 through 14 of Part III of this Report.

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**ILLUMINA, INC.**  
**FORM 10-K**  
**FOR THE FISCAL YEAR ENDED DECEMBER 30, 2007**

**TABLE OF CONTENTS**

|                             |   | <b>Page</b> |
|-----------------------------|---|-------------|
| <b><u>PART I</u></b>        |   |             |
| <u>Item 1</u>               | <u>Business</u>   | 2           |
| <u>Item 1A</u>              | <u>Risk Factors</u>   | 15          |
| <u>Item 1B</u>              | <u>Unresolved Staff Comments</u>  | 22          |
| <u>Item 2</u>               | <u>Properties</u>   | 23          |
| <u>Item 3</u>               | <u>Legal Proceedings</u>  | 23          |
| <u>Item 4</u>               | <u>Submission of Matters to a Vote of Security Holders</u>  | 24          |
| <b><u>PART II</u></b>       |   |             |
| <u>Item 5</u>               | <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u> | 25          |
| <u>Item 6</u>               | <u>Selected Financial Data</u>  | 26          |
| <u>Item 7</u>               | <u>Management's Discussion and Analysis of Financial Condition and Results of Operation</u>                         | 28          |
| <u>Item 7A</u>              | <u>Quantitative and Qualitative Disclosures about Market Risk</u>   | 45          |
| <u>Item 8</u>               | <u>Financial Statements and Supplementary Data</u>  | 45          |
| <u>Item 9</u>               | <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>                         | 46          |
| <u>Item 9A</u>              | <u>Controls and Procedures</u>  | 46          |
| <u>Item 9B</u>              | <u>Other Information</u>  | 48          |
| <b><u>PART III</u></b>      |   |             |
| <u>Item 10</u>              | <u>Directors and Executive Officers of the Registrant</u>   | 48          |
| <u>Item 11</u>              | <u>Executive Compensation</u>   | 48          |
| <u>Item 12</u>              | <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>               | 48          |
| <u>Item 13</u>              | <u>Certain Relationships and Related Transactions</u>   | 49          |
| <u>Item 14</u>              | <u>Principal Accounting Fees and Services</u>   | 49          |
| <b><u>PART IV</u></b>       |   |             |
| <u>Item 15</u>              | <u>Exhibits and Financial Statement Schedule</u>  | 50          |
| <u>Signatures</u>           |   | 55          |
| <u>Financial Statements</u> |   | F-1         |
| <u>EXHIBIT 10.44</u>        |   |             |
| <u>EXHIBIT 21.1</u>         |   |             |
| <u>EXHIBIT 23.1</u>         |   |             |
| <u>EXHIBIT 31.1</u>         |   |             |
| <u>EXHIBIT 31.2</u>         |   |             |

EXHIBIT 32.1  
EXHIBIT 32.2

**Table of Contents**

**PART I**

**ITEM 1. *Business.***

This Annual Report on Form 10-K may contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance. We have attempted to identify forward-looking statements by terminology including anticipates, believes, can, continue, could, estimates, expects, intends, may, plans, or will or the negative of these terms or other comparable terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risks outlined under Item 1A. Risk Factors in this Annual Report, that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels or activity, performance or achievements expressed or implied by these forward-looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Annual Report. We are not under any duty to update any of the forward-looking statements after the date we file this Annual Report on Form 10-K or to conform these statements to actual results, unless required by law. You should, however, review the factors and risks we describe in the reports we file from time to time with the Securities and Exchange Commission.

Illumina®, Array of Arrays™, BeadArray™, BeadXpress™, CSPro®, DASL®, GoldenGate®, Infinium®, IntelliHyb®, iSelect®, Making Sense Out of Life®, Oligator®, Sentrix®, Solexa®, and VeraCode™ are our trademarks. This report also contains brand names, trademarks or service marks of companies other than Illumina, and these brand names, trademarks and service marks are the property of their respective holders.

**Available Information**

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge on our website, [www.illumina.com](http://www.illumina.com). The information on our website is not incorporated by reference into this report. Such reports are made available as soon as reasonably practicable after filing with, or furnishing to, the Securities and Exchange Commission. The SEC also maintains an Internet site at [www.sec.gov](http://www.sec.gov) that contains reports, proxy and information statements, and other information regarding issuers that electronically file with the SEC.

**Overview**

We are a leading developer, manufacturer and marketer of integrated systems for the large scale analysis of genetic variation and biological function. Using our proprietary technologies, we provide a comprehensive line of products and services that currently serve the sequencing, genotyping and gene expression markets. In the future, we expect to enter the market for molecular diagnostics. Our customers include leading genomic research centers, pharmaceutical companies, academic institutions, clinical research organizations and biotechnology companies. Our tools provide researchers around the world with the performance, throughput, cost effectiveness and flexibility necessary to perform the billions of genetic tests needed to extract valuable medical information from advances in genomics and proteomics. We believe this information will enable researchers to correlate genetic variation and biological function, which will enhance drug discovery and clinical research, allow diseases to be detected earlier and permit better choices of drugs for individual patients.

In April 2005, we completed the acquisition of CyVera Corporation (Cyvera). The aggregate consideration for the transaction was \$17.5 million, consisting of approximately 1.5 million shares of our common stock and payment of approximately \$2.3 million of CyVera's liabilities at the closing.

## **Table of Contents**

On January 26, 2007, we completed the acquisition of Solexa, Inc. (Solexa) for approximately 13.1 million shares of our common stock. Solexa develops and commercializes genetic analysis technologies used to perform a range of analyses, including whole genome resequencing, gene expression analysis and small RNA analysis. We believe our combined company is the only company with genome-scale technology for genotyping, gene expression and sequencing, the three cornerstones of modern genetic analysis.

We were incorporated in California in April 1998. We reincorporated in Delaware in July 2000. Our principal executive offices are located at 9885 Towne Centre Drive, San Diego, California 92121. Our telephone number is (858) 202-4500.

## **Industry Background**

### ***Genetic Variation and Biological Function***

Every person inherits two copies of each gene, one from each parent. The two copies of each gene may be identical, or they may be different. These differences are referred to as genetic variation. Examples of the physical consequences of genetic variation include differences in eye and hair color. Genetic variation can also have important medical consequences. Genetic variation affects disease susceptibility, including predisposition to cancer, diabetes, cardiovascular disease and Alzheimer's disease. In addition, genetic variation may cause people to respond differently to the same drug treatment. Some people may respond well, others may not respond at all, and still others may experience adverse side effects. A common form of genetic variation is a single-nucleotide polymorphism, or SNP. A SNP is a variation in a single position in a DNA sequence. It is estimated that the human genome contains over nine million SNPs.

While in some cases a single SNP will be responsible for medically important effects, it is now believed that combinations of SNPs may contribute to the development of most major diseases. Since there are millions of SNPs, it is important to investigate many representative, well-chosen SNPs simultaneously in order to discover medically valuable information.

Another contributor to disease and dysfunction is the over- or under-expression of genes within an organism's cells. A very complex network of genes interacts to maintain health in complex organisms. The challenge for scientists is to delineate the associated genes' expression patterns and their relationship to disease. Until recently, this problem was addressed by investigating effects on a gene-by-gene basis. This is time consuming, and difficulties exist when several pathways cannot be observed or controlled at the same time. With the advent of microarray technology, thousands of genes can now be tested at the same time.

### ***SNP Genotyping***

SNP genotyping is the process of determining which base (A, C, G or T) is present at a particular site in the genome within an individual or other organism. The use of SNP genotyping to obtain meaningful statistics on the effect of an individual SNP or a collection of SNPs, and to apply that information to clinical trials and diagnostic testing, requires the analysis of millions of SNP genotypes and the testing of large populations for each disease. For example, a single large clinical trial could involve genotyping 1,000,000 SNPs per patient in 1,000 patients, thus requiring 1 billion assays. Using previously available technologies, this scale of SNP genotyping was both impractical and prohibitively expensive.

Large-scale SNP genotyping can be used in a variety of ways, including studies designed to understand the genetic contributions to disease (disease association studies), genomics-based drug development, clinical trial analysis, disease predisposition testing, and disease diagnosis. SNP genotyping can also be used outside of healthcare, for



example in the development of plants and animals with desirable commercial characteristics. These markets will require billions of SNP genotyping assays annually.

**Table of Contents**

***Gene Expression Profiling***

Gene expression profiling is the process of determining which genes are active in a specific cell or group of cells and is accomplished by measuring mRNA, the intermediary messenger between genes (DNA) and proteins. Variation in gene expression can cause disease, or act as an important indicator of disease or predisposition to disease. By comparing gene expression patterns between cells from different environments, such as normal tissue compared to diseased tissue or in the presence or absence of a drug, specific genes or groups of genes that play a role in these processes can be identified. Studies of this type, often used in drug discovery, require monitoring thousands, and preferably tens of thousands, of mRNAs in large numbers of samples. Once a smaller set of genes of interest has been identified, researchers can then examine how these genes are expressed or suppressed across numerous samples, for example, within a clinical trial.

As gene expression patterns are correlated to specific diseases, gene expression profiling is becoming an increasingly important diagnostic tool. Diagnostic use of expression profiling tools is anticipated to grow rapidly with the combination of the sequencing of various genomes and the availability of more cost-effective technologies.

***Sequencing***

DNA sequencing is the process of determining the order of bases (A, C, G or T) in a DNA sample, which can be further divided into de novo sequencing, re-sequencing, and tag sequencing. In de novo sequencing, the goal is to determine the sequence of a representative sample from a species never before sequenced. Understanding the similarities and differences in DNA sequence between many species can help to improve our understanding of the function of the structures found in the DNA.

In re-sequencing, the sequence of samples from a given species is determined generally comparing each to a standard or reference sequence. This is an extremely comprehensive form of genotyping, in which every single base is characterized for possible mutations. In tag sequencing, short sequences, each representative of a larger molecule or genomic location, are detected and counted. In these applications, the number of times that each tag is seen provides quantification of an underlying biological process. As an example, in digital gene expression, one tag sequence may exist for each gene, and the number of copies of this tag which are detected in an experiment is a measure of how actively that gene is being expressed in the tissue sample being analyzed.

## **Table of Contents**

### **Our Technologies**

#### ***BeadArray Technology***

We have developed a proprietary array technology that enables the large-scale analysis of genetic variation and biological function. Our BeadArray technology combines microscopic beads and a substrate in a simple proprietary manufacturing process to produce arrays that can perform many assays simultaneously. Our BeadArray technology provides a unique combination of high throughput, cost effectiveness, and flexibility. We achieve high throughput with a high density of test sites per array and we are able to format arrays either in a pattern arranged to match the wells of standard microtiter plates or in various configurations in the format of standard microscope slides. We seek to maximize cost effectiveness by reducing consumption of expensive reagents and valuable samples, and through the low manufacturing costs associated with our technologies. Our ability to vary the size, shape and format of the well patterns and to create specific bead pools, or sensors, for different applications provides the flexibility to address multiple markets and market segments. We believe that these features have enabled our BeadArray technology to become a leading platform for the emerging high-growth market of SNP genotyping and expect they will enable us to become a key player in the gene expression market.

Our proprietary BeadArray technology combines microwells etched into a substrate and specially prepared beads that self-assemble into an array. We have deployed our BeadArray technology in two different array formats, the Array Matrix and the BeadChip. Our first bead-based product was the Array Matrix which incorporates fiber optic bundles. The fiber optic bundles, which we cut into lengths of less than one inch, are manufactured to our specifications. Each bundle is comprised of approximately 50,000 individual fibers and 96 of these bundles are placed into an aluminum plate, which forms an Array Matrix. BeadChips are fabricated in microscope slide-shaped sizes with varying numbers of sample sites per slide. Both formats are chemically etched to create tens to hundreds of thousands of wells for each sample site.

In a separate process, we create sensors by affixing a specific type of molecule to each of the billions of microscopic beads in a batch. We make different batches of beads, with the beads in a given batch coated with one particular type of molecule. The particular molecules on a bead define that bead's function as a sensor. For example, we create a batch of SNP sensors by attaching a particular DNA sequence, or oligo, to each bead in the batch. We combine batches of coated beads to form a pool specific to the type of array we intend to create. A bead pool one milliliter in volume contains sufficient beads to produce thousands of arrays.

To form an array, a pool of coated beads is brought into contact with the array surface where they are randomly drawn into the wells, one bead per well. The tens of thousands of beads in the wells comprise our individual arrays. Because the beads assemble randomly into the wells, we perform a final procedure called "decoding" in order to determine which bead type occupies which well in the array. We employ several proprietary methods for decoding, a process that requires only a few steps to identify all the beads in the array. One beneficial by-product of the decoding process is a validation of each bead in the array. This quality control test characterizes the performance of each bead and can identify and eliminate use of any empty wells. We ensure that each bead type on the array is sufficiently represented by including multiple copies of each bead type. Multiple bead type copies improve the reliability and accuracy of the resulting data by allowing statistical processing of the results of identical beads. We believe we are the only microarray company to provide this level of quality control in the industry.

An experiment is performed by preparing a sample, such as DNA from a patient, and introducing it to the array. The design features of our Array Matrix allow it to be simply dipped into a solution containing the sample, whereas our BeadChip allows processing of samples on a slide-sized platform. The molecules in the sample bind to their matching molecules on the coated bead. These molecules in either the sample or on the bead are labeled with a fluorescent dye either before or after the binding. The BeadArray Reader detects the fluorescent dye by shining a laser on the fiber

optic bundle or on the BeadChip. This allows the detection of the molecules resulting in a quantitative analysis of the sample.

**Table of Contents*****Sequencing Technology***

Our DNA sequencing technology, acquired as part of the Solexa merger that was completed on January 26, 2007, is based on the use of our sequencing-by-synthesis (SBS) biochemistry. In SBS, single stranded DNA is extended from a priming site, one base at a time, using reversible terminator nucleotides. These are DNA bases which can be added to a growing second strand, but which initially cannot be further extended. This means that at each cycle of the chemistry, only one base can be added. Each base which is added includes a fluorescent label which is specific to the particular base. Thus following incorporation, the fluorescence can be imaged, its color determined, and the base itself can be inferred. Once this is done, an additional step removes both the fluorescence and the block that had prevented further extension of the second strand. This allows another base to be added, and the cycle can be repeated. We have shown data in which this cycle is repeated up to 50 times, thus determining DNA sequences which are up to 50 bases long. This may well increase in the future as we further develop this technology. The reversible terminator bases which we use are novel synthetic molecules which we manufacture. They are not well incorporated by naturally occurring polymerases, so we have also developed proprietary enzymes for this purpose. Both the nucleotides and enzymes are the subject of significant intellectual property.

In our DNA sequencing systems, we apply the SBS biochemistry on microscopic islands of DNA. These are called DNA clusters. Each cluster starts as a single DNA molecule, typically a few hundred bases long, attached to the inside surface of a flow cell. We then use a proprietary amplification biochemistry to create copies of each starting molecule. As the copies are made, they are covalently linked to the surface, so they cannot diffuse away. After a number of cycles of amplification, each cluster might have 500 to 1,000 copies of the original starting molecule, but still be only about a micron (one-millionth of a meter) in diameter. By making so many copies, the fluorescent signal from each cluster is significantly increased. Because the clusters are so small though, tens of millions of clusters can be independently formed inside a single flow cell. This large number of clusters can then be sequenced simultaneously, by alternate cycles of SBS biochemistry and electronic imaging.

***VeraCode Technology***

The BeadArray technology is most effective in applications which require mid- to high levels of multiplexing from low to high levels of throughput. Multiplexing refers to the number of individual pieces of information that are simultaneously extracted from one sample. We believe the molecular diagnostics market will require systems which are extremely high throughput and cost effective in the mid- to low-multiplex range. To address this market, we acquired the VeraCode technology through our acquisition of CyVera Corporation in April 2005. Based on digitally encoded microbeads, VeraCode enables low-cost multiplexing from 1 to 384-plex in a single well. We began shipping the BeadXpress System, which uses the VeraCode technology, during the first quarter of 2007, along with several assays for the system. We believe that this system enables lower multiplex genotyping, gene expression and protein based assays. In the research market, we expect our customers to utilize our BeadArray technology for their higher multiplex projects and then move to our BeadXpress system for their lower multiplex projects utilizing the same assays.

***Oligator Technology***

Genomic applications require many different short pieces of DNA that can be made synthetically, called oligos. We have developed our proprietary Oligator technology for the parallel synthesis of many different oligos to meet the requirements of large-scale genomics applications. We believe that our Oligator technology is substantially more cost effective and provides significantly higher throughput than available commercial alternatives. Our synthesis machines are computer controlled and utilize many robotic processes to minimize the amount of labor used in the manufacturing process. In 2005, we implemented our fourth-generation Oligator technology, which is capable of manufacturing over 13,000 different oligos per run. This was an improvement over prior generations of technology where we could only

manufacture approximately 3,000 oligos per run. This increase in scale was necessary to enable us to

## **Table of Contents**

support the manufacture of oligos under our collaboration with Invitrogen as well as to support our increased internal need for oligos, a critical component of our BeadArray technology, for product sales and new product development.

### ***Key Advantages of Our Technology***

We believe that our technology provides distinct advantages, in a variety of applications, over competing technologies, by creating cost-effective, highly miniaturized arrays with the following characteristics:

*High Throughput.* The miniaturization of our BeadArray technology provides very high information content per unit area. To increase sample throughput, we have formatted our array matrix in a pattern arranged to match the wells of standard microtiter plates, allowing throughput levels of up to nearly 150,000 unique assays per microtiter plate, and we use laboratory robotics to speed process time. Similarly, we have patterned our whole-genome expression BeadChips to support up to 48,000 gene expression assays for six samples with each BeadChip, and our whole-genome genotyping BeadChips to support over 1,000,000 genotypes with each BeadChip. Our Infinium and GoldenGate assays are supported by full automation and LIMS to address high throughput laboratories. Our Genome Analyzer can analyze the DNA sequences of tens of millions of clusters at one time.

*Cost Effectiveness.* Our array products substantially reduce the cost of our customers' experiments as a result of our proprietary manufacturing process and our ability to capitalize on cost reductions generated by advances in fiber optics, plasma etching processes, digital imaging and bead chemistry. In addition, our products require smaller reagent volumes than other array technologies, thereby reducing reagent costs for our customers. Our Oligator technology further reduces reagent costs, as well as reducing our cost of coating beads used in our BeadArray and VeraCode technologies. We believe the Genome Analyzer allows DNA sequencing at 1/100th of the cost of conventional capillary instruments.

*Flexibility.* We are able to offer flexible solutions to our customers based on our ability to attach different kinds of molecules, including DNA, RNA, proteins and other chemicals, to our beads. In addition, we can have BeadChips manufactured in multiple shapes and sizes with wells organized in various arrangements to optimize them for different markets and market segments. In combination, the use of beads and etched wells provides the flexibility and scalability for our BeadArray technology to be tailored to perform many applications in many different market segments, from drug discovery to diagnostics. Our Oligator technology allows us to manufacture a wide diversity of lengths and quantities of oligos. DNA sequences determined with our Genome Analyzer can be used to identify larger DNA or RNA molecules from which the sequences have been derived, and can also be used for a series of applications based on tag sequencing, including digital gene expression analysis and microRNA discovery and quantification.

*Quality and Reproducibility.* The quality of our products is dependent upon each element in the system—the array, the assay used to perform the experiment and the instrumentation and software used to capture the results. Each array is manufactured with a high density of beads, which enables us to have multiple copies of each individual bead type. We measure the copies simultaneously and combine them into one data point. This allows us to make a comparison of each bead against its own population of identical beads, which permits the statistical calculation of a more reliable and accurate value for each data point. Finally, the manufacture of the array includes a proprietary decoding step that also functions as a quality control test of every bead on every array, improving the overall quality of the data. When we develop the assays used with our products, we focus on performance, cost and ease of use. By developing assays that are easy to use, we can reduce the potential for the introduction of error into the experiment. We believe that this enables researchers to obtain high quality and reproducible data from their experiments. Additionally, we manufacture substantially all of the reagents used in our assays, allowing us to control the quality of the product delivered to the customer.





## **Table of Contents**

### **Our Strategy**

Our goal is to make our BeadArray, BeadXpress and Genome Analyzer platforms the industry standard for products and services addressing the genetic analysis markets. We plan to achieve this by:

- focusing on emerging high-growth markets;
- seek out new and complimentary technologies;
- expanding our technologies into multiple product lines, applications and market segments; and
- strengthening our technological leadership.

### **Products and Services**

The first implementation of our BeadArray technology, the Array Matrix, is a disposable matrix with 96 fiber optic bundles arranged in a pattern that matches the standard 96-well microtiter plate. Each fiber optic bundle performs more than 1,500 unique assays. The BeadChip, introduced in 2003, is fabricated in multiple configurations to support multiple applications and scanning technologies.

We have provided genotyping services using our proprietary BeadArray technology since 2001. In addition, we have developed our first genotyping and gene expression products based on this technology. These products include disposable Array Matrices and BeadChips, GoldenGate and Infinium reagent kits for SNP genotyping, BeadArray Reader scanning instruments and an evolving portfolio of custom and standard gene expression products.

#### ***SNP Genotyping***

In 2001, we introduced the first commercial application of our BeadArray technology by launching our SNP genotyping services product line. Since this launch, we have had peak days in which we operated at 185 million genotypes per day. To our knowledge, no other genotyping platform can achieve comparable levels of throughput while delivering such high accuracy and low cost.

We designed our first consumable BeadArray product, the Array Matrix, for SNP genotyping. The Array Matrix uses a universal format that allows it to analyze any set of SNPs. We have also developed reagent kits based on GoldenGate assay protocols and the BeadArray Reader, a laser scanner, which is used to read our array products.

The BeadStation, a flexible and scalable system for performing genotyping, was initially commercialized in late 2003. The system currently includes our BeadArray Reader and genotyping and/or gene expression analysis software. Depending on throughput and automation requirements, our customers can select the system configuration to best meet their needs. For production-scale throughput, multiple BeadStations combined with LIMS, standard operating procedures, and analytical software and fluid handling robotics can be configured to produce millions of genotypes per day. Scientists and researchers can perform genotyping, gene expression, methylation, and copy number variation (CNV) analysis with these products.

In 2006, we introduced several new SNP genotyping products, including the HumanHap family of BeadChips, for genome-wide disease association studies. This family of BeadChips enables researchers to interrogate more than 1,000,000 SNP markers for associated studies. We believe our BeadChips provide the most comprehensive genomic coverage and highest data quality of any whole-genome genotyping product currently available. Through an application called Copy Number Polymorphisms, the HumanHap family of BeadChips also provides high-resolution

information on amplifications, deletions and loss of heterozygosity throughout the genome, abnormalities common in cancers and congenital diseases. In addition, we announced additional standard panels in the first quarter of 2006, including mouse linkage and cancer panels.

## **Table of Contents**

Also, in 2006, we began shipment of the iSelect Infinium genotyping product line used for focused content applications. With this product, customers can create a custom array of up to 60,000 SNP markers per sample with 12 samples per chip.

During the fourth quarter of 2006, we introduced and began shipping the HumanHap300-Duo and the HumanHap300-Duo+ Genotyping BeadChips, as well as the RatRef-12 Expression BeadChip. The HumanHap300-Duo allows researchers to analyze two samples simultaneously, with over 634,000 total tag SNPs on a single BeadChip. The HumanHap300-Duo+ allows for the addition of 60,000 custom SNP loci to the base product, enabling researchers to enrich that product with SNPs of interest in any genomic region. The RatRef-12 Expression BeadChip enables analysis of 12 samples in parallel on a single BeadChip. Content for this BeadChip is derived from the NCBI RefSeq database (Release 16), with over 22,000 rat transcripts represented. By allowing for multiple samples on the same BeadChip, we believe we have minimized chip to chip variability and enhanced data quality.

In 2007, we announced the following key new product developments associated with SNP Genotyping:

*Human 1M DNA Analysis BeadChip.* This product combines an unprecedented level of content for both whole-genome and CNV analysis, along with additional unique, high-value genomic regions of interest all on a single microarray chip. Shipments of the Human 1M DNA Analysis BeadChip began during the second quarter of 2007.

*HumanCNV370-Duo BeadChip.* The HumanCNV370-Duo enables researchers to analyze two samples simultaneously and access novel content for detecting disease-relevant CNV regions. Shipments of the HumanCNV370-Duo BeadChip began during the second quarter of 2007.

*HumanHap550-Duo BeadChip.* The HumanHap550-Duo provides the same content as our HumanHap550 BeadChip in a dual-format, resulting in significantly greater throughput and lower costs per sample. The HumanHap550-Duo contains more than 550,000 SNPs, selected based on a novel tag SNP approach. Shipments of the HumanHap550-Duo BeadChip began during the third quarter of 2007.

During 2008, we introduced two new products for DNA analysis: the Infinium High-Density (HD) Human1M-Duo (two samples per chip) and the Human610-Quad (four samples per chip), featuring up to 2.3 million SNPs per BeadChip. The new Infinium HD product line doubles sample throughput and reduces DNA input requirements by as much as 70 percent. The Infinium HD products also offer, what we believe is, enhanced signal discrimination and a new SNP calling algorithm. First customer shipments of the Human610-Quad and Human1M-Duo BeadChips are expected in the first and second quarter of 2008, respectively.

## ***Gene Expression Profiling***

With the addition of application specific accessory kits, our production-scale BeadStations are capable of performing a growing number of applications, including gene expression profiling.

In 2003, we introduced our focused set gene expression products on both the Array Matrix and BeadChip platforms. Our system includes a BeadArray Reader for imaging Array Matrices and BeadChips, a hybridization chamber and software for data extraction.

In 2005, we began shipment of the Human-6 and HumanRef-8 Expression BeadChip products. Both products allow large-scale expression profiling of multiple samples on a single chip and are imaged using our BeadArray Reader. The Human-6 BeadChip is designed to analyze six discrete whole-human-genome samples on one chip, interrogating in each sample approximately 48,000 transcripts from the estimated 30,000 genes in the human genome. The

HumanRef-8 BeadChip product analyzes eight samples in parallel against 24,000 transcripts from the roughly 22,000 genes represented in the consensus RefSeq database, a well-characterized whole-genome subset used broadly in genetic analysis. We believe these gene expression BeadChips have dramatically reduced the cost of whole-genome

## **Table of Contents**

expression analysis, allowing researchers to expand the scale and reproducibility of large-scale biological experimentation.

In 2006, we began shipment of the RatRef-12, which analyzes twelve samples in parallel against 22,226 transcripts from the roughly 21,910 genes represented in the RefSeq database, release 16.

In 2007, we launched the next versions of the Human and Mouse arrays, taking advantage of the updated content of the RefSeq and the UniGene databases could provide. We also expanded our product breadth and released our first microRNA arrays for both human and mouse. To keep up with the ever changing needs of the market, we have invested in the future with new, innovative technologies, acquired from the Solexa acquisition, to provide our customers with what we believe is the broadest portfolio of gene expression technologies available. We believe Digital Gene Expression (DGE) is a revolutionary approach to expression analysis. Driven by sequencing technology, DGE generates genome-wide expression profiles through sequencing, not hybridization. We believe this unique method provides 100 times the amount of data of other methods. It can provide more than one billion bases of data in a single run, at 1% of the cost of traditional Sanger sequencing. Using DGE, researchers can:

quickly discover novel RNAs in any species;

accurately quantify low-abundance RNA;

confidently analyze small and non-coding RNA, as well as transcriptomes; and

independently validate microarray data.

## ***Instrumentation***

The BeadArray Reader, an instrument we developed, is a key component of our BeadStation. This scanning equipment uses a laser to read the results of experiments that are captured on our arrays and was designed to be used in all areas of genetic analysis that use our Array Matrices and BeadChips. In the second quarter of 2006, we began shipment of the AutoLoader, which automates BeadChip loading and scanning and increases lab throughput. The Autoloader is designed to support up to two BeadArray Readers simultaneously for unattended operation.

During the first quarter of 2007, we began shipment of the Genome Analyzer. This product can generate more than one billion bases of data in a single run using a massively parallel sequencing approach. The system leverages Solexa sequencing-by-synthesis technology and novel reversible terminator chemistry, optimized to achieve what we believe are unprecedented levels of cost effectiveness and throughput.

Also, during the first quarter of 2007, we began shipment of the BeadXpress System. This system is a high-throughput, dual-color laser detection system developed using the VeraCode digital microbead technology. It enables scanning of a broad range of multiplexed assays and can take researchers from biomarker validation and focused studies to the development of molecular diagnostics.

## ***High-Throughput Oligo Synthesis***

We have put in place a state-of-the-art oligo manufacturing facility. This facility serves both the commercial needs under our collaboration with Invitrogen and our internal needs. In addition to their use to coat beads, these oligos are components of the reagent kits for our BeadArray products and are used for assay development. We manufacture oligos in a wide range of lengths and in several scales, with the ability to add many types of modifications. We offer a range of quality control options and have implemented a laboratory information management system (referred to as

LIMS) to control much of the manufacturing process. In 2005, we stopped selling oligos directly into the market and began shipping oligos under our collaboration with Invitrogen.

## **Table of Contents**

### **Our Collaborative Partners**

#### *deCODE genetics*

In May 2006, we executed a Joint Development and Licensing Agreement (the Development Agreement) with deCODE genetics, ehf. (deCODE). Pursuant to the Development Agreement, the parties agreed to collaborate exclusively to develop, validate and commercialize specific diagnostic tests for variants in genes involved in three disease-related pathways: the gene-encoding leukotriene A4 hydrolase, linked to heart attack; the gene-encoding transcription factor 7-like 2 (TCF7L2), linked to type 2 diabetes; and the gene-encoding BARD1, linked to breast cancer. With deCODE, we are developing diagnostic tests based on these variants for use on our BeadXpress system.

Under the agreement, we are responsible for the manufacturing, marketing and selling of the diagnostic products. The companies share the development costs of these products and split the profits from sales of the diagnostics tests. The Development Agreement may be terminated as to a particular product under development if one party decides to discontinue funding the development of that product, and may be terminated in whole by either party if the other party commits an uncured material breach, files for bankruptcy or becomes insolvent. Under a separate supply agreement, we installed instrumentation at deCODE that enables deCODE to perform whole genome association studies on up to 100,000 samples using our HumanHap300 BeadChips and associated reagents.

### **Intellectual Property**

We have an extensive patent portfolio, including, as of February 1, 2008, ownership of, or exclusive licenses to, 119 issued U.S. patents and 153 pending U.S. patent applications, including five allowed applications that have not yet issued as patents, some of which derive from a common parent application. This portfolio includes patents acquired as part of our acquisition of Solexa on January 26, 2007. Our issued patents, which are directed at various aspects of our arrays, assays, oligo synthesis, sequencing technology, instruments and chemical detection technologies, expire between 2010 and 2025. We are seeking to extend the patents directed at the full range of our technologies. We have received or filed counterparts for many of these patents and applications in one or more foreign countries.

We also rely upon trade secrets, know-how, copyright and trademark protection, as well as continuing technological innovation and licensing opportunities to develop and maintain our competitive position. Our success will depend in part on our ability to obtain patent protection for our products and processes, to preserve our trade secrets, to enforce our patents, copyrights and trademarks, to operate without infringing the proprietary rights of third parties and to acquire licenses related to enabling technology or products.

We are party to various exclusive and non-exclusive license agreements and other arrangements with third parties, which grant us rights to use key aspects of our array and sequencing technologies, assay methods, chemical detection methods, reagent kits and scanning equipment. We have exclusive licenses from Tufts University to patents that are directed at our use of BeadArray technology. These patents were filed by Dr. David Walt, a member of our board of directors, the Chairman of our Scientific Advisory Board and one of our founders. Our exclusive licenses expire with the termination of the underlying patents, which will occur between 2010 and 2020. We also have additional nonexclusive licenses from various third parties for other components of our products. In most cases, the agreements remain in effect over the term of the underlying patents, may be terminated at our request without further obligation and require that we pay customary royalties while the agreement is in effect.

### **Research and Development**

We have made substantial investments in research and development since our inception. We have assembled a team of skilled engineers and scientists who are specialists in biology, chemistry, informatics, instrumentation, optical

systems, software, manufacturing and other related areas required to complete the development of our products. Our research and development efforts have focused primarily on the



## **Table of Contents**

tasks required to optimize our BeadArray, Oligator, VeraCode and sequencing technologies and to support commercialization of the products and services derived from these technologies. As of December 30, 2007, we had a total of 277 employees engaged in research and development activities.

Our research and development expenses for 2007, 2006, and 2005 (inclusive of charges relating to stock-based compensation of \$10.0 million, \$3.9 million, and \$0.1 million, respectively) were \$73.9 million, \$33.4 million, and \$27.8 million, respectively. Compared to 2007, we expect research and development expense to increase during 2008 as we continue to expand our research and product development efforts.

## **Marketing and Distribution**

Our current products address the genetic analysis portion of the life sciences market, in particular, experiments involving sequencing, SNP genotyping and gene expression profiling. These experiments may be involved in many areas of biologic research, including basic human disease research, pharmaceutical drug discovery and development, pharmacogenomics, toxicogenomics and agricultural research. Our potential customers include pharmaceutical, biotechnology, agrichemical, diagnostics and consumer products companies, as well as academic or private research centers. The genetic analysis market is relatively new and emerging and its size and speed of development will be ultimately driven by, among other items:

the ability of the research community to extract medically valuable information from genomics and to apply that knowledge to multiple areas of disease-related research and treatment;

the availability of sufficiently low cost, high-throughput research tools to enable the large amount of experimentation required to study genetic variation and biological function; and

the availability of government and private industry funding to perform the research required to extract medically relevant information from genomic analysis.

We market and distribute our products directly to customers in North America, major European markets, Japan, Singapore, and China. In each of these areas, we have dedicated sales, service and application support personnel responsible for expanding and managing their respective customer bases. In smaller markets in the Pacific Rim countries and Europe, we sell our products and provide services to customers through distributors that specialize in life science products. We expect to significantly increase our sales and distribution resources during 2008 and beyond as we launch a number of new products and expand the number of customers that can use our products.

## **Manufacturing**

We manufacture our array and sequencing platforms, reagent kits, scanning equipment and oligos. Our manufacturing capacity for BeadChips has increased 50% over the level as of January 1, 2007, despite the substantial increase in complexity associated with manufacturing these products. We intend to continue to increase capacity both domestically and internationally as needed to manufacture our products in sufficient quantity to meet our business plan for 2008. We expect to continue expanding our manufacturing capacity in Singapore. We have signed a lease agreement and plan to commence manufacturing operations in the latter half of 2008. We are focused on continuing to enhance the quality and manufacturing yield of our Array Matrices and BeadChips and are exploring ways to continue increasing the level of automation in the manufacturing process. In addition, we have implemented information management systems for many of our manufacturing and services operations to manage all aspects of material and sample use. We adhere to access and safety standards required by federal, state and local health ordinances, such as standards for the use, handling and disposal of hazardous substances.



## **Table of Contents**

### **Competition**

Although we expect that our products and services will provide significant advantages over products and services currently available from other sources, we expect to encounter intense competition from other companies that offer products and services for the SNP genotyping, gene expression and sequencing markets. These include companies such as Affymetrix, Agilent, Applied Biosystems, Beckman Coulter, Complete Genomics, Fluidigm, GE Corp., Luminex, Pacific Biosciences, Perlegen Sciences, Roche Diagnostics, Sequenom and Third Wave Technologies. Some of these companies have or will have substantially greater financial, technical, research, and other resources and larger, more established marketing, sales, distribution and service organizations than we do. In addition, they may have greater name recognition than we do in the markets we need to address and in some cases a larger installed base of systems. Each of these markets is very competitive and we expect new competitors to emerge and the intensity of competition to increase. In order to effectively compete with these companies, we will need to demonstrate that our products have superior throughput, cost and accuracy advantages over the competing products. Rapid technological development may result in our products or technologies becoming obsolete. Products offered by us could be made obsolete either by less expensive or more effective products based on similar or other technologies. Although we believe that our technology and products will offer advantages that will enable us to compete effectively with these companies, we cannot assure you that we will be successful.

### **Segment and Geographic Information**

We operate in one business segment for the development, manufacture and commercialization of tools for genetic analysis. Our operations are treated as one segment as we only report operating results on an aggregate basis to our chief operating decision maker, our Chief Executive Officer.

During 2007, \$159.1 million, or 43%, of our total revenue came from shipments to customers outside the United States, compared to \$81.5 million, or 44%, and \$28.0 million, or 38%, in 2006 and 2005, respectively. Sales to territories outside of the United States are generally denominated in U.S. dollars. We expect that sales to international customers will continue to be an important and growing source of revenue. We have sales support resources in Western Europe and direct sales offices in Japan, Singapore and China. In addition, we have distributor relationships in various countries in the Pacific Rim region and Europe. See Note 13 of Notes to Consolidated Financial Statements for further information concerning our foreign and domestic operations.

### **Seasonality**

Historically, customer purchasing patterns have not shown significant seasonal variation, although demand for our products is usually lowest in the first quarter of the calendar year and highest in the third quarter of the calendar year as academic customers spend unused budget allocations before the end of the government's fiscal year.

### **Environmental Matters**

We are dedicated to the protection of our employees and the environment. Our operations require the use of hazardous materials which subject us to a variety of federal, state and local environmental and safety laws and regulations. We believe we are in material compliance with current applicable laws and regulations; however, we could be held liable for damages and fines should contamination of the environment or individual exposures to hazardous substances occur. In addition, we cannot predict how changes in these laws and regulations, or the development of new laws and regulations, will affect our business operations or the cost of compliance.

During 2007, we entered into a lease agreement with BioMed Realty Trust, Inc. to expand into a new office building in San Diego, California. This new building will be LEED certified.



**Table of Contents****Employees**

As of December 30, 2007, we had a total of 1,041 employees, 195 of whom hold Ph.D. degrees. Ninety-seven of our employees with Ph.D. degrees are engaged in full-time research and development activities. None of our employees are represented by a labor union. We consider our employee relations to be positive.

**Executive Officers**

Our executive officers as of February 1, 2008, are as follows:

| <b>Name</b>              | <b>Age</b> | <b>Position</b>  |
|--------------------------|------------|--|
| Jay T. Flatley           | 55         | President, Chief Executive Officer and Director  |
| Christian O. Henry       | 39         | Senior Vice President, Chief Financial Officer, Acting General Manager of Sequencing                     |
| Christian G. Cabou       | 59         | Senior Vice President, General Counsel and Secretary   |
| Tristan B. Orpin         | 41         | Senior Vice President, Commercial Operations   |
| John R. Stuelpnagel, DVM | 50         | Co-Founder, Senior Vice President and General Manager, Microarrays, Chief Operating Officer and Director |

*Jay Flatley* is President and Chief Executive Officer of Illumina. Prior to his appointment in 1999, Mr. Flatley was the President and Chief Executive Officer of Molecular Dynamics, later acquired by Amersham Pharmacia Biotech in 1998 and now a part of GE Healthcare. Mr. Flatley, who was a founder and member of the board of directors for Molecular Dynamics, led the company to its initial public offering (IPO) in 1993, in addition to helping the company develop and launch over 15 major instrumentation systems, including the world's first capillary-based DNA sequencer. Prior to joining Molecular Dynamics, Mr. Flatley was Vice President of Engineering and Strategic Planning for Plexus Computers, a manufacturer of high-performance Unix super-microcomputers. Before his career at Plexus, Mr. Flatley was Executive Vice President for Manning Technologies and held various manufacturing positions while working for the Autolab division of Spectra Physics. Mr. Flatley received a bachelor of arts degree in economics from Claremont McKenna College (Claremont, CA) and a bachelor of science and master of science (summa cum laude) in industrial engineering from Stanford University (Stanford, CA). Currently, he serves as a member of the board of directors of both Illumina and GenVault Corporation.

*Christian Henry* is Senior Vice President, Chief Financial Officer and Acting General Manager of Sequencing of Illumina. Mr. Henry joined Illumina in June 2005 and is responsible for worldwide financial operations, controllership functions, facilities management and oversight of Illumina's DNA Sequencing business. Mr. Henry served previously as the Chief Financial Officer for Tickets.com, a publicly traded, online ticket provider that was recently acquired by Major League Baseball Advanced Media, LP. Prior to that, Mr. Henry was Vice President, Finance and Corporate Controller of Affymetrix, Inc., a publicly traded life sciences company, where he oversaw accounting, planning, SEC and management reporting, and treasury and risk management. He previously held a similar position at Nektar Therapeutics (formerly Inhale Therapeutic Systems, Inc.). Mr. Henry received a bachelor of administration degree in biochemistry and cell biology from the University of California, San Diego, and a master of business administration degree from the University of California, Irvine. He is a certified public accountant.

*Christian Cabou* is Senior Vice President, General Counsel and Secretary of Illumina. Mr. Cabou joined Illumina in May 2006 and has worldwide responsibility for all legal and intellectual property matters. Mr. Cabou is also Illumina's Code of Ethics Compliance Officer. Before joining Illumina, Mr. Cabou spent five years as General Counsel for GE Global Research and, before that, was Senior Counsel of Global Intellectual Property for GE Medical Systems. Prior

to his position at GE, Mr. Cabou spent seven years with the law firm Foley & Lardner where he was a partner. He had twenty years of experience in engineering design and management prior to his career in law and intellectual property.

## **Table of Contents**

Mr. Cabou received a J.D. from Northwestern University's School of Law (Chicago, IL.) in addition to a master of engineering management degree from Northwestern University. Mr. Cabou was awarded a MSEE (equivalent) degree from the Conservatoire National des Arts et Métiers (Paris, France) and a bachelor of science (equivalent) degree from the Lycée Technique d'Etat (Armentières, France).

*Tristan Orpin* is Senior Vice President, Commercial Operations of Illumina. He joined Illumina in December of 2002 in the role of Vice President of Worldwide Sales, and in January of 2007 was promoted to the position of Senior Vice President of Commercial Operations. Before joining Illumina, Mr. Orpin was Director of Sales and Marketing for Sequenom from September 1999 to August 2001. Later Mr. Orpin was elected Vice President of Sales and Marketing and held this position from August 2001 to November 2002. Prior to 2001, Mr. Orpin served in several senior sales and marketing positions at Bio-Rad Laboratories. Mr. Orpin received a bachelor of science in genetics and biochemistry with first class honors from the University of Melbourne (Melbourne, Australia).

*John Stuelpnagel, D.V.M.*, one of Illumina's co-founders, will serve as General Manager of Microarrays and Chief Operating Officer until April 1, 2008. Subsequent to that date, Dr. Stuelpnagel will have a continuing role with Illumina working on key projects as an Illumina Fellow. Additionally, as of April 1, 2008, he will step down from Illumina's Board of Directors. He has served as the Company's Chief Operating Officer since January 2005 and a Director since April 1998. From April 1998 to October 1999, he served as acting President and Chief Executive Officer and from April 1998 to April 2000 as acting Chief Financial Officer. Between October 1999 and January 2005, Dr. Stuelpnagel was Vice President of Business Development and later as Senior Vice President of Operations. While founding Illumina, Dr. Stuelpnagel was an associate with CW Group, a venture capital firm. Dr. Stuelpnagel received both a bachelor of science degree in biochemistry and a doctorate degree in veterinary medicine from the University of California (Davis, CA), and went on to receive a master of business administration degree from the University of California, Los Angeles.

### **ITEM 1A. Risk Factors.**

Our business is subject to various risks, including those described below. In addition to the other information included in this Form 10-K, the following issues could adversely affect our operating results or our stock price.

***We expect intense competition in our target markets, which could render our products obsolete, result in significant price reductions or substantially limit the volume of products that we sell. This would limit our ability to compete and maintain profitability. If we cannot continuously develop and commercialize new products, our revenue may not grow as intended.***

We compete with life sciences companies that design, manufacture and market instruments for analysis of genetic variation and biological function and other applications using technologies such as two-dimensional electrophoresis, capillary electrophoresis, mass spectrometry, flow cytometry, microfluidics, nanotechnology, next-generation DNA sequencing and mechanically deposited, inkjet and photolithographic arrays. We anticipate that we will face increased competition in the future as existing companies develop new or improved products and as new companies enter the market with new technologies. The markets for our products are characterized by rapidly changing technology, evolving industry standards, changes in customer needs, emerging competition, new product introductions and strong price competition. For example, prices per data point for genotyping have fallen significantly over the last two years and we anticipate that prices will continue to fall. One or more of our competitors may render our technology obsolete or uneconomical. Some of our competitors have greater financial and personnel resources, broader product lines, a more established customer base and more experience in research and development than we do. Furthermore, life sciences and pharmaceutical companies, which are our potential customers and strategic partners, could develop competing products. For example, during the third quarter of fiscal 2007, Applied Biosystems Group, a business segment of Applied Biosystems Corporation, launched the SOLID™ System, its next generation sequencing technology. If we are

unable



**Table of Contents**

to develop enhancements to our technology and rapidly deploy new product offerings, our business, financial condition and results of operations will suffer.

***Our manufacturing capacity may limit our ability to sell our products.***

We continue to ramp up our capacity to meet the anticipated demand for our products. Although we have significantly increased our manufacturing capacity and we believe we have plans in place sufficient to ensure we have adequate capacity to meet our business plan in 2008 and 2009, there are uncertainties inherent in expanding our manufacturing capabilities and we may not be able to increase our capacity in a timely manner. For example, manufacturing and product quality issues may arise as we increase production rates at our manufacturing facilities and launch new products. As a result, we may experience difficulties in meeting customer, collaborator and internal demand, in which case we could lose customers or be required to delay new product introductions, and demand for our products could decline. Additionally, in the past, we have experienced variations in manufacturing conditions that have temporarily reduced production yields. Due to the intricate nature of manufacturing products that contain DNA, we may encounter similar or previously unknown manufacturing difficulties in the future that could significantly reduce production yields, impact our ability to launch or sell these products, or to produce them economically, prevent us from achieving expected performance levels or cause us to set prices that hinder wide adoption by customers.

***We may encounter difficulties in managing our growth. These difficulties could impair our profitability.***

We have experienced and expect to continue to experience rapid and substantial growth in order to achieve our operating plans, which will place a strain on our human and capital resources. If we are unable to manage this growth effectively, our profitability could suffer. Our ability to manage our operations and growth effectively requires us to continue to expend funds to enhance our operational, financial and management controls, reporting systems and procedures and to attract and retain sufficient numbers of talented employees. If we are unable to scale up and implement improvements to our manufacturing process and control systems in an efficient or timely manner, or if we encounter deficiencies in existing systems and controls, then we will not be able to make available the products required to successfully commercialize our technology. Failure to attract and retain sufficient numbers of talented employees will further strain our human resources and could impede our growth.

***If we lose our key personnel or are unable to attract and retain additional personnel, we may be unable to achieve our goals.***

We are highly dependent on our management and scientific personnel, including Jay Flatley, our president and chief executive officer. The loss of their services could adversely impact our ability to achieve our business objectives. We will need to hire additional qualified personnel with expertise in molecular biology, chemistry, biological information processing, sales, marketing and technical support. We compete for qualified management and scientific personnel with other life science companies, universities and research institutions, particularly those focusing on genomics. Competition for these individuals, particularly in the San Diego and San Francisco area, is intense, and the turnover rate can be high. Failure to attract and retain management and scientific personnel would prevent us from pursuing collaborations or developing our products or technologies.

Our planned activities will require additional expertise in specific industries and areas applicable to the products developed through our technologies, including the life sciences and healthcare industries. Thus, we will need to add new personnel, including management, and develop the expertise of existing management. The failure to do so could impair the growth of our business.

**Table of Contents**

***If we are unable to develop and maintain operation of our manufacturing capability, we may not be able to launch or support our products in a timely manner, or at all.***

We currently manufacture in a limited number of locations. Our manufacturing facilities are located in San Diego and Hayward, California and Little Chesterford, United Kingdom. We are in the process of expanding our manufacturing operations into Singapore, a country in which we have no past manufacturing experience. These areas are subject to natural disasters such as earthquakes or floods. If a natural disaster were to significantly damage one of our facilities or if other events were to cause our operations to fail, these events could prevent us from developing and manufacturing our products and services.

Also, many of our manufacturing processes are automated and are controlled by our custom-designed Laboratory Information Management System (LIMS). Additionally, as part of the decoding step in our array manufacturing process, we record several images of each array to identify what bead is in each location on the array and to validate each bead in the array. This requires significant network and storage infrastructure. If either our LIMS system or our networks or storage infrastructure were to fail for an extended period of time, it may adversely impact our ability to manufacture our products on a timely basis and would prevent us from achieving our expected shipments in any given period.

***Our sales, marketing and technical support organization may limit our ability to sell our products.***

We currently have fewer resources available for sales and marketing and technical support services compared to some of our primary competitors. In order to effectively commercialize our sequencing, genotyping and gene expression systems and other products to follow, we will need to expand our sales, marketing and technical support staff both domestically and internationally. We may not be successful in establishing or maintaining either a direct sales force or distribution arrangements to market our products and services. In addition, we compete primarily with much larger companies that have larger sales and distribution staffs and a significant installed base of products in place, and the efforts from a limited sales and marketing force may not be sufficient to build the market acceptance of our products required to support continued growth of our business.

***Negative conditions in the global credit markets may impair the liquidity of a portion of our investment portfolio.***

Our investment securities consist of U.S. dollar-based short maturity mutual funds, commercial paper, corporate bonds, treasury notes, auction rate securities and municipal bonds. As of December 30, 2007, our short-term investments included \$14.7 million of high-grade (AAA rated) auction rate securities issued primarily by municipalities and universities. The recent negative conditions in the global credit markets have prevented some investors from liquidating their holdings, including their holdings of auction rate securities. In February 2008, we were informed that there was insufficient demand at auction for four of our high-grade auction rate securities, representing approximately \$10.7 million. As a result, these affected securities are currently not liquid, and we could be required to hold them until they are redeemed by the issuer or to maturity. We may experience a similar situation with our remaining auction rate securities. In the event we need to access the funds that are in an illiquid state, we will not be able to do so without a loss of principal, until a future auction on these investments is successful, the securities are redeemed by the issuer or they mature. At this time, management has not obtained sufficient evidence to conclude that these investments are impaired or that they will not be settled in the short term, although the market for these investments is presently uncertain. If the credit ratings of the security issuers deteriorate and any decline in market value is determined to be other-than-temporary, we would adjust the carrying value of the investment through an impairment charge.

**Table of Contents**

***We may encounter difficulties in integrating acquisitions that could adversely affect our business, specifically the effective launch and customer acceptance of new technology platforms.***

We acquired Solexa in January 2007 and CyVera in April 2005 and we may in the future acquire technology, products or businesses related to our current or future business. We have limited experience in acquisition activities and may have to devote substantial time and resources in order to complete acquisitions. Further, these potential acquisitions entail risks, uncertainties and potential disruptions to our business. For example, we may not be able to successfully integrate a company's operations, technologies, products and services, information systems and personnel into our business. An acquisition may further strain our existing financial and managerial resources, and divert management's attention away from our other business concerns.

In connection with these acquisitions, we assumed certain liabilities and hired certain employees, which is expected to continue to result in an increase in our research and development expenses and capital expenditures. There may also be unanticipated costs and liabilities associated with an acquisition that could adversely affect our operating results. To finance any acquisitions, we may choose to issue shares of our common stock as consideration, which could result in dilution to our stockholders. Additionally, an acquisition may have a substantial negative impact on near-term expected financial results.

The success of the Solexa acquisition depends, in part, on our ability to realize the anticipated synergies, growth opportunities and cost savings from integrating Solexa's businesses with our businesses. Our success in realizing these benefits and the timing of this realization depends upon the continued successful integration of the operations of Solexa. The integration of two independent companies is a complex, costly and time-consuming process. In addition, Solexa continues to operate at separate sites. Geographic integration in whole or in part could result in the loss of key employees, diversion of each company's management's attention, the disruption or interruption of, or the loss of momentum in, each company's ongoing businesses or inconsistencies in standards, controls, procedures and policies, any of which could adversely affect our ability to maintain relationships with customers and employees or our ability to achieve the anticipated benefits of the acquisition, or could reduce our earnings or otherwise adversely affect the business and financial results of the combined company.

***The combined company may fail to realize the anticipated benefits of the acquisition as a result of our failure to achieve anticipated revenue growth following the acquisition.***

For various reasons, including significant competition, low market acceptance or market growth, and lack of technology advantage, revenue recognized from the Solexa acquisition may not grow as anticipated and if so, we may not realize the expected value from this transaction.

***If we are unable to find third-party manufacturers to manufacture components of our products, we may not be able to launch or support our products in a timely manner, or at all.***

The nature of our products requires customized components that currently are available from a limited number of sources. For example, we currently use multiple components in our products that are single-sourced. If we are unable to secure a sufficient supply of those or other product components, we will be unable to meet demand for our products. We may need to enter into contractual relationships with manufacturers for commercial-scale production of some of our products, or develop these capabilities internally, and we cannot assure you that we will be able to do this on a timely basis, for sufficient quantities or on commercially reasonable terms. Accordingly, we may not be able to establish or maintain reliable, high-volume manufacturing at commercially reasonable costs.

***Changes in our effective income tax rate could impact our profitability.***

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgments based on interpretations of existing tax laws or regulations are required in

## **Table of Contents**

determining the provision for income taxes. Our effective income tax rate could be adversely affected by various factors including, but not limited to, changes in the mix of earnings in tax jurisdictions with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in existing tax laws or tax rates, changes in the level of non-deductible expenses including share-based compensation, changes in our future levels of research and development spending, mergers and acquisitions, and the result of examinations by various tax authorities.

### ***Any inability to adequately protect our proprietary technologies could harm our competitive position.***

Our success will depend in part on our ability to obtain patents and maintain adequate protection of our intellectual property in the United States and other countries. If we do not protect our intellectual property adequately, competitors may be able to use our technologies and thereby erode our competitive advantage. The laws of some foreign countries do not protect proprietary rights to the same extent as the laws of the United States, and many companies have encountered significant challenges in protecting their proprietary rights abroad. These challenges can be caused by the absence of rules and methods for the establishment and enforcement of intellectual property rights abroad.

The patent positions of companies developing tools for the life sciences and pharmaceutical industries, including our patent position, generally are uncertain and involve complex legal and factual questions. We will be able to protect our proprietary rights from unauthorized use by third parties only to the extent that our proprietary technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. We intend to apply for patents covering our technologies and products, as we deem appropriate. However, our patent applications may be challenged and may not result in issued patents or may be invalidated or narrowed in scope after they are issued. Questions as to inventorship may also arise. Any finding that our patents and applications are unenforceable could harm our ability to prevent others from practicing the related technology, and a finding that others have inventorship rights to our patents and applications could require us to obtain certain rights to practice related technologies, which may not be available on favorable terms, if at all.

In addition, our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products. There also is risk that others may independently develop similar or alternative technologies or design around our patented technologies. Also, our patents may fail to provide us with any competitive advantage. We may need to initiate additional lawsuits to protect or enforce our patents, or litigate against third party claims, which would be expensive and, if we lose, may cause us to lose some of our intellectual property rights and reduce our ability to compete in the marketplace. Furthermore, these lawsuits may divert the attention of our management and technical personnel.

We also rely upon trade secret protection for our confidential and proprietary information. We have taken security measures to protect our confidential information. These measures, however, may not provide adequate protection for our trade secrets or other confidential information. Among other things, we seek to protect our trade secrets and confidential information by entering into confidentiality agreements with employees, collaborators and consultants. Nevertheless, employees, collaborators or consultants may still disclose our confidential information, and we may not otherwise be able to effectively protect our trade secrets. Accordingly, others may gain access to our confidential information, or may independently develop substantially equivalent information or techniques.

### ***Litigation or other proceedings or third party claims of intellectual property infringement could require us to spend significant time and money and could prevent us from selling our products or services or impact our stock price.***

Our commercial success depends, in part, on our non-infringement of the patents or proprietary rights of third parties and on our ability to protect our own intellectual property. Third parties have asserted or may assert that we are employing their proprietary technology without authorization. As we



**Table of Contents**

enter new markets, we expect that competitors will likely assert that our products infringe their intellectual property rights as part of a business strategy to impede our successful entry into those markets. In addition, third parties may have obtained and may in the future obtain patents allowing them to claim that the use of our technologies infringes these patents. We could incur substantial costs and divert the attention of our management and technical personnel in defending ourselves against any of these claims. Any adverse ruling or perception of an adverse ruling in defending ourselves against these claims could have a material adverse impact on our stock price, which may be disproportionate to the actual import of the ruling itself. Furthermore, parties making claims against us may be able to obtain injunctive or other relief, which effectively could block our ability to develop further, commercialize and sell products, and could result in the award of substantial damages against us. In the event of a successful claim of infringement against us, we may be required to pay damages and obtain one or more licenses from third parties, or be prohibited from selling certain products. In addition, we may be unable to obtain these licenses at a reasonable cost, if at all. We could therefore incur substantial costs related to royalty payments for licenses obtained from third parties, which could negatively affect our gross margins. In addition, we could encounter delays in product introductions while we attempt to develop alternative methods or products. Defense of any lawsuit or failure to obtain any of these licenses on favorable terms could prevent us from commercializing products, and the prohibition of sale of any of our products could materially affect our ability to grow and maintain profitability.

***We have a significant amount of indebtedness. We may not be able to make payments on our indebtedness, and we may incur additional indebtedness in the future, which could adversely affect our operation and profitability.***

In February 2007, we issued \$400 million of 0.625% Convertible Senior Notes due February 2014. The notes bear interest semi-annually, mature on February 15, 2014 and obligate us to repurchase the notes at the option of the holders if a designated event (as defined in the indenture for the notes), such as certain merger transactions involving us, occurs. In addition, upon conversion of the notes, we must pay in cash the principal portion of the notes being converted. Our ability to make payments on the notes will depend on our future operating performance and our ability to generate cash and may also depend on our ability to obtain additional debt or equity financing. We may need to use our cash to pay principal and interest on our debt, which will reduce the funds available to fund our research and development programs, strategic initiatives and working capital requirements. Our ability to generate sufficient operating cash flow to service the notes and fund our operating requirements will depend on our continued ability to commercialize new products and expand our manufacturing capabilities. Our debt service obligations increase our vulnerabilities to competitive pressures, because our competitors may be less leveraged than we are. If we are unable to generate sufficient operating cash flow to service our indebtedness and fund our operating requirements, we may be forced to reduce our development programs or seek additional debt or equity financing, which may not be available to us on satisfactory terms, or at all, or may dilute the interests of our existing stockholders. Our level of indebtedness may make us more vulnerable to economic or industry downturns. If we incur new indebtedness, the risks relating to our business and our ability to service our indebtedness will intensify.

***We expect that our results of operations will fluctuate. This fluctuation could cause our stock price to decline.***

Our revenue is subject to fluctuations due to the timing of sales of high-value products and services projects, the impact of seasonal spending patterns, the timing and size of research projects our customers perform, changes in overall spending levels in the life sciences industry, and other unpredictable factors that may affect customer ordering patterns. Given the difficulty in predicting the timing and magnitude of sales for our products and services, we may experience quarter-to-quarter fluctuations in revenue resulting in the potential for a sequential decline in quarterly revenue. A large portion of our expenses are relatively fixed, including expenses for facilities, equipment and personnel. In addition, we expect operating expenses to continue to increase significantly in absolute dollars. Accordingly, if revenue does not grow as anticipated, we may not be able to maintain annual profitability. Any significant





## **Table of Contents**

delays in the commercial launch of our products, unfavorable sales trends in our existing product lines, or impacts from the other factors mentioned above, could adversely affect our future revenue growth or cause a sequential decline in quarterly revenue. Due to the possibility of fluctuations in our revenue and expenses, we believe that quarterly comparisons of our operating results are not a good indication of our future performance. If our operating results fluctuate or do not meet the expectations of stock market analysts and investors, our stock price could decline.

### ***We have only recently achieved annual operating profitability.***

Prior to 2006, we had incurred net losses each year since our inception, and in 2007 we reported a net loss of \$278.4 million, reflecting significant charges associated with our acquisition of Solexa in January 2007 and the settlement of our litigation with Affymetrix. As of December 30, 2007, our accumulated deficit was \$383.0 million. Our ability to regain and sustain annual profitability will depend, in part, on the rate of growth, if any, of our revenue and on the level of our expenses. Non-cash stock-based compensation expense and expenses related to our acquisition of Solexa are also likely to continue to adversely affect our future profitability. We expect to continue incurring significant expenses related to research and development, sales and marketing efforts to commercialize our products and the continued development of our manufacturing capabilities. In addition, we expect that our research and development and selling and marketing expenses will increase at a higher rate in the future as a result of the development and launch of new products. Even if we regain profitability, we may not be able to increase profitability on a quarterly basis.

### ***A significant portion of our sales are to international customers.***

Approximately 43%, 44% and 38% of our revenue for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively, was derived from shipments to customers outside the United States. We intend to continue to expand our international presence and export sales to international customers and we expect the total amount of non-U.S. sales to continue to grow. Export sales entail a variety of risks, including:

currency exchange fluctuations;

unexpected changes in legislative or regulatory requirements of foreign countries into which we import our products;

difficulties in obtaining export licenses or in overcoming other trade barriers and restrictions resulting in delivery delays; and

significant taxes or other burdens of complying with a variety of foreign laws.

In addition, sales to international customers typically result in longer payment cycles and greater difficulty in accounts receivable collection. We are also subject to general geopolitical risks, such as political, social and economic instability and changes in diplomatic and trade relations. One or more of these factors could have a material adverse effect on our business, financial condition and operating results.

### ***Our success depends upon the continued emergence and growth of markets for analysis of genetic variation and biological function.***

We design our products primarily for applications in the life sciences and pharmaceutical industries. The usefulness of our technology depends in part upon the availability of genetic data and its usefulness in identifying or treating disease. We are focusing on markets for analysis of genetic variation and biological function, namely sequencing, SNP genotyping and gene expression profiling. These markets are new and emerging, and they may not develop as

quickly as we anticipate, or reach their full potential. Other methods of analysis of genetic variation and biological function may emerge and displace the methods we are developing. Also, researchers may not seek or be able to convert raw genetic data into medically valuable information through the analysis of genetic variation and biological function. In

**Table of Contents**

addition, factors affecting research and development spending generally, such as changes in the regulatory environment affecting life sciences and pharmaceutical companies, and changes in government programs that provide funding to companies and research institutions, could harm our business. If useful genetic data is not available or if our target markets do not develop in a timely manner, demand for our products may grow at a slower rate than we expect, and we may not be able to sustain annual profitability.

***The accounting method for our convertible debt securities may be subject to change.***

A convertible debt security providing for share and/or cash settlement of the conversion value and meeting specified requirements under Emerging Issues Task Force (EITF) Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, including our outstanding convertible debt securities, is currently classified in its entirety as debt under U.S. generally accepted accounting principles. No portion of the carrying value of such a security related to the conversion option indexed to the issuer's stock is classified as equity. In addition, interest expense is recognized at the stated coupon rate. The coupon rate of interest for convertible debt securities, including our convertible debt securities, is typically lower than an issuer would be required to pay for nonconvertible debt with otherwise similar terms.

The EITF recently considered whether the accounting for cash settled convertible debt securities, which are convertible debt securities that require or permit settlement in cash either in whole or in part upon conversion should be changed, but was unable to reach a consensus and discontinued deliberations on this issue. Subsequently, in July 2007, the Financial Accounting Standards Board (FASB) voted unanimously to reconsider the current accounting for cash settled convertible debt securities, which includes our convertible debt securities. In August 2007, the FASB exposed for public comment a proposed FASB Staff Position (FSP) that would change the method of accounting for such securities and would require the proposed method to be retrospectively applied. The FASB began its redeliberations of the guidance in that proposed FSP in January 2008. The FSP, if issued as proposed, would likely become effective for companies like us in the first quarter of 2009. Under this proposed method of accounting, the debt and equity components of our convertible debt securities would be bifurcated and accounted for separately in a manner that would result in recognizing interest on these securities at effective rates more comparable to what we would have incurred had we issued nonconvertible debt with otherwise similar terms. The equity component of our convertible debt securities would be included in the paid-in-capital section of stockholders' equity on our balance sheet and, accordingly, the initial carrying values of these debt securities would be reduced. Our net income for financial reporting purposes would be reduced by recognizing the accretion of the reduced carrying values of our convertible debt securities to their face amounts as additional non-cash interest expense. Therefore, if the proposed method of accounting for cash settled convertible debt securities is adopted by the FASB as described above, it would have an adverse impact on our past and future reported financial results. As the final guidance has not been issued, we cannot predict its ultimate outcome.

We also cannot predict any other changes in GAAP that may be made affecting accounting for convertible debt securities, some of which could have an adverse impact on our past or future reported financial results.

**Item 1B. *Unresolved Staff Comments.***

None.

**Table of Contents****Item 2. *Properties.***

The following chart indicates the facilities we lease as of December 30, 2007, the location and size of each such facility and their designated use. During 2007, we expanded our facilities and leased additional space to accommodate growth in our business. We anticipate continuing to expand our facilities over the next several years as we continue to expand our worldwide commercial operations and our manufacturing capabilities.

| <b>Location</b>                    | <b>Approximate Square Feet</b> | <b>Operation</b>                   | <b>Lease Expiration</b> |
|------------------------------------|--------------------------------|------------------------------------|-------------------------|
| San Diego, CA                      | 116,000 sq. ft.                | R&D, Manufacturing, Administrative | 2023                    |
|                                    | 17,300 sq. ft.                 | Administrative                     | 2008                    |
|                                    | 9,200 sq. ft.                  | Administrative                     | 2008                    |
|                                    | 9,000 sq. ft.                  | Storage and Distribution           | 2011                    |
| Hayward, CA                        | 148,000 sq. ft.                | R&D, Manufacturing, Administrative | 2008                    |
| Wallingford, CT                    | 14,500 sq. ft.                 | R&D                                | 2008                    |
| Little Chesterford, United Kingdom | 23,000 sq. ft.                 | R&D, Manufacturing, Administrative | 2011                    |
|                                    | 5,500 sq. ft.                  | Administrative                     | 2009                    |
| Netherlands                        | 6,800 sq. ft.                  | Administrative and Distribution    | 2011                    |
| Tokyo, Japan                       | 3,300 sq. ft.                  | Administrative                     | 2009                    |
| Singapore                          | 3,200 sq. ft.                  | Administrative                     | 2009                    |

Additionally, on February 14, 2007, we entered into a lease agreement with BioMed Realty Trust, Inc. (BioMed) to expand into a new office building BioMed intends to build in San Diego, California. The new building will be used for research and development, manufacturing and administrative purposes. The lease covers approximately 84,000 square feet, which is to be occupied in three phases, the first of which is expected to be occupied by October 1, 2008. The lease expires 15 years from the date the first phase is occupied, subject to our right to extend the term for up to three additional five-year periods.

On October 3, 2007, we entered into a lease agreement with The Irvine Company, LLC (Irvine) to expand our manufacturing operations into an additional San Diego facility. The lease commences on March 1, 2008 and covers approximately 51,900 square feet. The lease expires in March 2015, subject to our right to extend the term for an additional five-year period.

On October 24, 2007, we also leased a manufacturing facility in Singapore that covers approximately 32,800 square feet. The lease commences on March 15, 2008 and is for a term of five years with the option to renew for an additional five-year period.

In February 2008, we agreed to lease an additional facility in Little Chesterford, United Kingdom that is in the process of being constructed for research and development, manufacturing and administrative purposes. This facility covers approximately 41,500 square feet. We expect to occupy this new building by the end of 2009.

**Item 3. *Legal Proceedings.***

In the recent past, we incurred substantial costs in defending ourselves against patent infringement claims and expect, going forward, to devote substantial financial and managerial resources to protect our intellectual property and to

defend against any future claims asserted against us.

**Affymetrix Litigation**

On January 9, 2008, we resolved all our outstanding litigations with Affymetrix, Inc. (Affymetrix) by entering into a settlement agreement in which we agreed, without admitting liability, to make a one-time payment to Affymetrix of \$90.0 million. In return, Affymetrix agreed to dismiss with prejudice all lawsuits it had brought against us, and we agreed to dismiss with prejudice our counterclaims in the relevant lawsuits. In exchange for the payment, Affymetrix agreed not to sue us or our affiliates or customers for making, using or selling any of our current products, evolutions of those products or services related to

## **Table of Contents**

those products. In addition, Affymetrix agreed that, for four years, it will not sue us for making, using or selling our products or services that are based on future technology developments. The covenant not to sue covers all fields other than photolithography, the process by which Affymetrix manufactures its arrays and a field in which we do not operate.

The January 2008 settlement resolved complaints Affymetrix had previously filed in the U.S. and abroad. Specifically, on July 26, 2004, Affymetrix had filed a complaint in the U.S. District Court for the District of Delaware alleging that the use, manufacture and sale of our BeadArray products and services, including our Array Matrix and BeadChip products, infringe six Affymetrix patents. At that time Affymetrix was also seeking an injunction against the sale of any products that would ultimately be determined to infringe these patents, unspecified monetary damages, interest and attorneys' fees. Subsequently, on October 24, 2007, Affymetrix had filed complaints in the U.S. District Court for the District of Delaware, in Regional Court in Düsseldorf (Germany), and in the High Court of Justice, Chancery Division Patents Court in London (United Kingdom) alleging that the use, manufacture and sale of certain of our BeadArray products and services, including our Array Matrix and BeadChip products, infringe three U.S. patents and three European patents of Affymetrix. In its U.S. complaint filed in 2007, Affymetrix had also alleged that our sequencing technology, including the Genome Analyzer, infringes two Affymetrix U.S. patents. Affymetrix also sought an injunction against the sale of any products that would ultimately be determined to infringe these patents, unspecified monetary damages, interest and attorneys' fees.

### ***Former Employee Claim***

On June 15, 2005, a former employee, filed suit against us in the U.S. District Court for the District of Delaware seeking an order requiring us and the U.S. Patent and Trademark Office to correct the inventorship of certain of our patents and patent applications by adding the former employee as an inventor, alleging that we committed inequitable conduct and fraud in not naming him as an inventor, and seeking a judgment declaring certain of our patents and patent applications unenforceable, unspecified monetary damages and attorney's fees. On January 30, 2008, this dispute was resolved to the mutual satisfaction of the parties by entering into a release and settlement agreement pursuant to which all claims pending in that litigation were dismissed with prejudice.

### ***Applied Biosystems Litigation***

On December 26, 2006, the Applied Biosystems Group of Applied Biosystems Corporation (Applied Biosystems) filed suit in California Superior Court, Santa Clara County against Solexa (which we acquired on January 26, 2007). This State Court action is about the ownership of several patents assigned in 1995 to Solexa's predecessor company (Lynx Therapeutics) by a former employee (Dr. Stephen Macevicz) who is the inventor of these patents and is named as a co-defendant in the suit. Lynx was originally a unit of Applied Biosystems but was spun out in 1992. On May 31, 2007, Applied Biosystems filed a second suit, this time against us, in the U.S. District Court for the Northern District of California. This second suit seeks a declaratory judgment of non-infringement of the Macevicz patents that are the subject of the State Court action mentioned above. Both suits were later consolidated in the U.S. District Court for the Northern District of California, San Francisco Division.

The Macevicz patents relate to methods for sequencing DNA using successive rounds of oligonucleotide probe ligation (Sequencing-by-Ligation). Our Genome Analyzer system uses a different technology called DNA Sequencing-by-Synthesis (SBS), which is not covered by any of these patents. In addition, the sequencing technology originally used by Lynx Therapeutics (called MPS<sup>®</sup>) is not based on the methods covered by the Macevicz patents. In any event, we have never used MPSS<sup>™</sup> in our sequencing platform. Furthermore, we have no plans to use any of the Sequencing-by-Ligation technologies covered by these patents. By these consolidated actions Applied Biosystems is seeking ownership of the Macevicz patents, unspecified costs and damages, and a declaration of non-infringement of these patents. Applied Biosystems is not asserting any claim for patent infringement against us.

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

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2007.

**Table of Contents****PART II****Item 5. *Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

Our common stock has been quoted on The NASDAQ Global Select Market under the symbol ILMN since July 28, 2000. Prior to that time, there was no public market for our common stock. The following table sets forth, for the periods indicated, the quarterly high and low sales prices per share of our common stock as reported on The NASDAQ Global Select Market. Our present policy is to retain earnings, if any, to finance future growth. We have never paid cash dividends and have no present intention to pay cash dividends in the foreseeable future. In addition, the indenture for our convertible senior notes due 2014, which are convertible into cash and, in certain circumstances, shares of our common stock, requires us to increase the conversion rate applicable to the notes if we pay any cash dividends.

|                | <b>2007</b> |            |
|----------------|-------------|------------|
|                | <b>High</b> | <b>Low</b> |
| First Quarter  | \$ 42.19    | \$ 28.11   |
| Second Quarter | 42.08       | 28.94      |
| Third Quarter  | 53.88       | 40.04      |
| Fourth Quarter | 63.38       | 50.34      |

|                | <b>2006</b> |            |
|----------------|-------------|------------|
|                | <b>High</b> | <b>Low</b> |
| First Quarter  | \$ 27.98    | \$ 13.75   |
| Second Quarter | 32.00       | 21.60      |
| Third Quarter  | 40.00       | 27.02      |
| Fourth Quarter | 45.87       | 32.20      |

At February 1, 2008, there were approximately 604 stockholders of record, and the closing price per share of our common stock, as reported on The NASDAQ Global Select Market on such date, was \$67.59.

**Sales of Unregistered Securities and Issuer Purchases of Equity Securities**

None during the fourth quarter of fiscal 2007.



**Table of Contents****Item 6. Selected Financial Data.**

The following table sets forth selected historical consolidated financial data for each of our last five fiscal years during the period ended December 30, 2007.

**Statement of Operations Data**

|  | <b>Year Ended<br/>December 30,<br/>2007<br/>(52 weeks)</b> | <b>Year<br/>Ended<br/>December 31<br/>2006<br/>(52 weeks)</b> | <b>Year<br/>Ended<br/>January 1,<br/>2006<br/>(52 weeks)</b> | <b>Year<br/>Ended<br/>January 2,<br/>2005<br/>(53 weeks)</b> | <b>Year Ended<br/>December 28,<br/>2003<br/>(52 weeks)</b> |
|--|--|---|--|--|--|
|  | <b>(In thousands, except per share data)</b>               |   |  |  |  |
| Revenue:   |  |   |  |  |  |
| Product revenue  | \$ 326,699   | \$ 155,811  | \$ 57,752  | \$ 40,497  | \$ 18,378  |
| Service and other revenue  | 40,100   | 28,775  | 15,749   | 10,086   | 9,657  |
| Total revenue  | 366,799  | 184,586   | 73,501   | 50,583   | 28,035   |
| Costs and expenses:  |  |   |  |  |  |
| Cost of product revenue (including non-cash stock compensation expense of \$4,045, \$1,289, \$0, \$0 and \$0, respectively)                      | 119,991  | 51,271  | 19,920   | 11,572   | 7,437  |
| Cost of service and other revenue (including non-cash stock compensation expense of \$279, \$235, \$0, \$0 and \$0, respectively)                | 12,445   | 8,073   | 3,261  | 1,687  | 2,600  |
| Research and development (including non-cash stock compensation expense of \$10,016, \$3,891, \$84, \$348 and \$1,289, respectively)             | 73,943   | 33,373  | 27,809   | 21,462   | 23,800   |
| Selling, general and administrative (including non-cash stock compensation expense of \$19,406, \$8,889, \$186, \$496 and \$1,165, respectively) | 101,256  | 54,057  | 28,158   | 25,576   | 20,064   |
| Amortization of acquired intangible assets   | 2,429  |   |  |  |  |
| Acquired in-process research and development(1)  | 303,400  |   | 15,800   |  |  |
| Litigation settlements (judgment), net(2)  | 54,536   |   |  | (4,201)  | 756  |
| Total costs and expenses   | 668,000  | 146,774   | 94,948   | 56,096   | 54,657   |
| Income (loss) from operations(1),(2)   | (301,201)  | 37,812  | (21,447)   | (5,513)  | (26,622)   |

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|   |              |           |             |            |             |
|---|--------------|-----------|-------------|------------|-------------|
| Interest income   | 16,026       | 5,368     | 1,404       | 941        | 1,821       |
| Interest and other expense, net                                   | (3,610)      | (560)     | (668)       | (1,518)    | (2,262)     |
| Income (loss) before income taxes                                 | (288,785)    | 42,620    | (20,711)    | (6,090)    | (27,063)    |
| Provision (benefit) for income taxes(5)                           | (10,426)     | 2,652     | 163         | 135        |             |
| Net income (loss)   | \$ (278,359) | \$ 39,968 | \$ (20,874) | \$ (6,225) | \$ (27,063) |
| Net income (loss) per basic share                                 | \$ (5.14)    | \$ 0.90   | \$ (0.52)   | \$ (0.17)  | \$ (0.85)   |
| Net income (loss) per diluted share                               | \$ (5.14)    | \$ 0.82   | \$ (0.52)   | \$ (0.17)  | \$ (0.85)   |
| Shares used in calculating basic net income (loss) per share(3)   | 54,154       | 44,501    | 40,147      | 35,845     | 31,925      |
| Shares used in calculating diluted net income (loss) per share(3) | 54,154       | 48,754    | 40,147      | 35,845     | 31,925      |

**Table of Contents****Balance Sheet Data**

|  | December 30,<br>2007 | December 31,<br>2006 | January 1,<br>2006<br>(In<br>thousands) | January 2,<br>2005 | December 28,<br>2003 |
|--|----------------------|----------------------|---|--------------------|----------------------|
| Cash, cash equivalents and short-term investments(2) | \$ 386,082           | \$ 130,804           | \$ 50,822                               | \$ 66,994          | \$ 33,882            |
| Working capital                                      | 397,040              | 159,950              | 57,992                                  | 64,643             | 32,229               |
| Total assets   | 987,732              | 300,584              | 100,610                                 | 94,907             | 99,234               |
| Long-term debt, less current portion(4)              | 400,000              |                      | 54                                      |                    | 24,999               |
| Accumulated deficit                                  | (382,977)            | (104,618)            | (144,586)                               | (123,712)          | (117,487)            |
| Total stockholders equity(1),(2),(4)                 | 411,678              | 247,342              | 72,497                                  | 72,262             | 47,388               |

In addition to the following notes, see Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations and Item 8, Financial Statements and Supplementary Data for further information regarding our consolidated results of operations and financial position for periods reported therein and for known factors that will impact comparability of future results.

- (1) The consolidated financial statements include results of operations of acquired companies commencing on their respective acquisition dates. In January 2007, we completed our acquisition of Solexa in a stock for stock merger transaction for a total purchase price of \$618.7 million. In April 2005, we completed our acquisition of Cyvera Corporation for a total purchase price of \$17.8 million. As part of the accounting for the acquisitions of Solexa in 2007 and Cyvera in 2005, we recorded charges to write-off acquired in-process research and development, or IPR&D of \$303.4 million and \$15.8 million, respectively. The IPR&D charge represents an estimate of the fair value of the in-process research and development for projects and technologies that, as of the acquisition date, had not reached technological feasibility and had no alternative future use. See Note 2 of Notes to Consolidated Financial Statements for further information regarding our Solexa acquisition.
- (2) The litigation settlements of \$54.5 million for the year ended December 30, 2007 are associated with two settlement agreements entered in January 2008. \$54.0 million relates to the settlement with Affymetrix. In January 2008, we paid Affymetrix \$90.0 million related to the Affymetrix settlement. See Note 8 of Notes to Consolidated Financial Statements for further information regarding these settlements. The \$4.2 million judgment, representing a gain recorded for the reversal of a prior accrual, and the \$0.8 million settlement for the years ended January 2, 2005 and December 28, 2003, respectively, are associated with a litigation judgment for a jury verdict in a termination-of-employment lawsuit.
- (3) For an explanation of the determination of the number of shares used to compute basic and diluted net income (loss) per share, see Note 1 of Notes to Consolidated Financial Statements.
- (4) In February 2007, we issued \$400.0 million principal amount of 0.625% Convertible Senior Notes (the Notes) due 2014, which included the full exercise of the initial purchasers' option to purchase up to an additional \$50.0 million aggregate principal amount of Notes. In connection with the offering of the Notes, we entered into convertible note hedge transactions entitling us to purchase up to 11,451,480 shares of our common stock

(subject to adjustment) at an initial strike price (subject to adjustment) of \$43.66 per share. Additionally, we sold warrants to the initial purchasers and/or their affiliates to acquire up to 18,322,320 shares of our common stock (subject to adjustment) at an initial strike price (subject to adjustment) of \$62.87 per share. See Note 5 of Notes to Consolidated Financial Statements for further information regarding the Notes.

- (5) For an explanation of the determination of the tax provision (benefit) recorded see Note 11 of Notes to Consolidated Financial Statements.

## **Table of Contents**

### **Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operation.***

The following discussion and analysis should be read with Item 6. Selected Financial Data and our consolidated financial statements and notes thereto included elsewhere in this Annual Report on Form 10-K. The discussion and analysis in this Annual Report on Form 10-K contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. Words such as anticipate, believe, continue, estimate, expect, intend, may, plan, potential, predict, project or similar words or phrases, or the negative 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 Solexa's and CyVera's technology with our existing technology, the commercial launch of new products, including products based on Solexa's and CyVera's technology, 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. Factors that could cause or contribute to these differences include those discussed in Item 1A. Risk Factors as well as those discussed elsewhere. The risk factors and other cautionary statements made in this Annual Report on Form 10-K should be read as applying to all related forward-looking statements wherever they appear in this Annual Report on Form 10-K.

#### **Overview**

We are a leading developer, manufacturer and marketer of integrated systems for the large scale analysis of genetic variation and biological function. Using our proprietary technologies, we provide a comprehensive line of products and services that currently serve the sequencing, genotyping and gene expression markets. In the future, we expect to enter the market for molecular diagnostics. Our customers include leading genomic research centers, pharmaceutical companies, academic institutions, clinical research organizations and biotechnology companies. Our tools provide researchers around the world with the performance, throughput, cost effectiveness and flexibility necessary to perform the billions of genetic tests needed to extract valuable medical information from advances in genomics and proteomics. We believe this information will enable researchers to correlate genetic variation and biological function, which will enhance drug discovery and clinical research, allow diseases to be detected earlier and permit better choices of drugs for individual patients.

In April 2005, we completed the acquisition of CyVera. The aggregate consideration for the transaction was \$14.5 million, consisting of approximately 1.5 million shares of our common stock and payment of approximately \$2.3 million of CyVera's liabilities at the closing.

On January 26, 2007, we completed the acquisition of Solexa for approximately 13.1 million shares of our common stock. Solexa develops and commercializes genetic analysis technologies used to perform a range of analyses including whole genome resequencing, gene expressing analysis and small RNA analysis. We believe our combined company is the only company with genome-scale technology for genotyping, gene expression and sequencing, the three cornerstones of modern genetic analysis.

Our revenue is subject to fluctuations due to the timing of sales of high-value products and service projects, the impact of seasonal spending patterns, the timing and size of research projects our customers perform, changes in overall spending levels in the life science industry and other unpredictable factors that may affect our customer ordering patterns. Any significant delays in the commercial launch or any lack or delay of commercial acceptance of new products, unfavorable sales trends in our existing product lines, or impacts from the other factors mentioned above,

could adversely affect our revenue growth or cause a sequential decline in quarterly revenue. Due to the possibility of fluctuations in our revenue and net income or loss, we believe quarterly comparisons of our operating results are not a good indication of our future performance.

## **Table of Contents**

As of December 30, 2007, our accumulated deficit was \$383.0 million and total stockholders' equity was \$411.7 million. Our losses have principally occurred as a result of acquired in-process research and development charges of \$303.4 million related to our acquisition of Solexa in 2007, the substantial resources required for the research, development and manufacturing scale-up effort required to commercialize our products and services, a charge of \$54.5 million in 2007 primarily related to settlement of our litigation with Affymetrix and \$15.8 million related to our acquisition of CyVera in 2005. We expect to continue to incur substantial costs for research, development and manufacturing scale-up activities over the next several years. We will also need to increase our selling, general and administrative costs as we build up our sales and marketing infrastructure to expand and support the sale of systems, other products and services.

## **Critical Accounting Policies and Estimates**

### ***General***

Our discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of financial statements requires that management make estimates, assumptions and judgments with respect to the application of accounting policies that affect the reported amounts of assets, liabilities, revenue and expenses, and the disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

Our significant accounting policies are described in Note 1 to our consolidated financial statements. Certain accounting policies are deemed critical if 1) they require an accounting estimate to be made based on assumptions that were highly uncertain at the time the estimate was made, and 2) changes in the estimate that are reasonably likely to occur, or different estimates that we reasonably could have used would have a material effect on our consolidated financial statements.

Management has discussed the development and selection of these critical accounting policies with the Audit Committee of our Board of Directors, and the Audit Committee has reviewed the disclosure. In addition, there are other items within our financial statements that require estimation, but are not deemed critical as defined above.

We believe the following critical accounting policies reflect our more significant estimates and assumptions used in the preparation of the consolidated financial statements.

### ***Revenue Recognition***

Our revenue is generated primarily from the sale of products and services. Product revenue consists of sales of arrays, reagents, flow cells, instrumentation and oligos. Service and other revenue consists of revenue received for performing genotyping and sequencing services, extended warranty sales and amounts earned under research agreements with government grants, which is recognized in the period during which the related costs are incurred.

We recognize revenue in accordance with the guidelines established by SEC Staff Accounting Bulletin (SAB) No. 104. Under SAB No. 104, revenue cannot be recorded until all of the following criteria have been met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured. All revenue is recorded net of any applicable allowances for returns or discounts.

Revenue for product sales is recognized generally upon shipment and transfer of title to the customer, provided no significant obligations remain and collection of the receivables is reasonably assured. Revenue from the sale of instrumentation is recognized when earned, which is generally upon shipment. Revenue for genotyping and

sequencing services is recognized when earned, which is generally at the time the genotyping and sequencing analysis data is delivered to the customer.



## **Table of Contents**

In order to assess whether the price is fixed and determinable, we ensure there are no refund rights. If payment terms are based on future performance or a right of return exists, we defer revenue recognition until the price becomes fixed and determinable. We assess collectibility based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. If we determine that collection of a payment is not reasonably assured, revenue recognition is deferred until the time collection becomes reasonably assured, which is generally upon receipt of payment. Changes in judgments and estimates regarding application of SAB No. 104 might result in a change in the timing or amount of revenue recognized.

Sales of instrumentation generally include a standard one-year warranty. We also sell separately priced maintenance (extended warranty) contracts, which are generally for one or two years, upon the expiration of the initial warranty. Revenue for extended warranty sales is recognized ratably over the term of the extended warranty period. Reserves are provided for estimated product warranty expenses at the time the associated revenue is recognized. If we were to experience an increase in warranty claims or if costs of servicing our warranted products were greater than our estimates, gross margins could be adversely affected.

While the majority of our sales agreements contain standard terms and conditions, we do enter into agreements that contain multiple elements or non-standard terms and conditions. Emerging Issues Task Force (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables*, provides guidance on accounting for arrangements that involve the delivery or performance of multiple products, services, or rights to use assets within contractually binding arrangements. Significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes, and if so, how the price should be allocated among the deliverable elements, when to recognize revenue for each element, and the period over which revenue should be recognized. We recognize revenue for delivered elements only when we determine that the fair values of undelivered elements are known and there are no uncertainties regarding customer acceptance.

### ***Allowance for Doubtful Accounts***

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We evaluate the collectibility of our accounts receivable based on a combination of factors. We regularly analyze customer accounts, review the length of time receivables are outstanding and review historical loss rates. If the financial condition of our customers were to deteriorate, additional allowances could be required.

### ***Inventory Valuation***

We record adjustments to inventory for potentially excess, obsolete or impaired goods in order to state inventory at net realizable value. We must make assumptions about future demand, market conditions and the release of new products that will supersede old ones. We regularly review inventory for excess and obsolete products and components, taking into account product life cycle and development plans, product expiration and quality issues, historical experience and our current inventory levels. If actual market conditions are less favorable than anticipated, additional inventory adjustments could be required.

### ***Contingencies***

We are subject to legal proceedings primarily related to intellectual property matters. Based on the information available at the balance sheet dates and through consultation with our legal counsel, we assess the likelihood of any adverse judgments or outcomes of these matters, as well as the potential ranges of probable losses. If losses are probable and reasonably estimable, we will record a liability in accordance with Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*.



**Table of Contents*****Goodwill and Intangible Asset Valuation***

Our goodwill represents the excess of the cost over the fair value of net assets acquired from our Solexa and Cyvera acquisitions. Our intangible assets are comprised primarily of acquired technology and customer relationships from the acquisition of Solexa and licensed technology from the Affymetrix settlement. We make significant judgments in relation to the valuation of goodwill and intangible assets resulting from (i) acquisitions; and (ii) litigation settlements.

In determining the carrying amount of our goodwill and intangible assets arising from acquisitions, we used the purchase method of accounting. The purchase method of accounting requires extensive use of accounting estimates and judgments to allocate the purchase price to the fair value of the net tangible and intangible assets acquired, including in-process research and development (IPR&D). Goodwill and intangible assets deemed to have indefinite lives are not amortized, but are subject to at least annual impairment tests. The amounts and useful lives assigned to other acquired intangible assets impact future amortization, and the amount assigned to IPR&D is expensed immediately.

Determining the fair values and useful lives of intangible assets acquired as part of litigation settlements also requires the exercise of judgment. While there are a number of different generally accepted valuation methods to estimate the value of intangible assets, we used the discounted cash flow method in determining the value of licensed technology associated with the settlement of our Affymetrix litigation. This method required significant management judgment to forecast the future operating results used in the analysis. In addition, other significant estimates were required such as residual growth rates and discount factors. The estimates we used to value and amortize intangible assets were consistent with the plans and estimates that we use to manage our business and based on available historical information and industry estimates and averages. These judgments can significantly affect our net operating results. In addition, we performed a sensitivity analysis to determine the effect a change in revenue projections of 10% would have on our intangible asset, noting the impact would be a reduction or increase in the value of the intangible asset of \$2.0 million.

SFAS No. 142, *Goodwill and Other Intangible Assets*, requires that goodwill and certain intangible assets be assessed for impairment using fair value measurement techniques. If the carrying amount of a reporting unit exceeds its fair value, then a goodwill impairment test is performed to measure the amount of the impairment loss, if any. The goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. The implied fair value of goodwill is determined in the same manner as in a business combination. Determining the fair value of the implied goodwill is judgmental in nature and often involves the use of significant estimates and assumptions. These estimates and assumptions could have a significant impact on whether or not an impairment charge is recognized and also the magnitude of any such charge. Estimates of fair value are primarily determined using discounted cash flows and market comparisons. These approaches use significant estimates and assumptions, including projection and timing of future cash flows, discount rates reflecting the risk inherent in future cash flows, perpetual growth rates, determination of appropriate market comparables, and determination of whether a premium or discount should be applied to comparables. It is reasonably possible that the plans and estimates used to value these assets may be incorrect. If our actual results, or the plans and estimates used in future impairment analyses, are lower than the original estimates used to assess the recoverability of these assets, we could incur additional impairment charges. We have performed our annual test of goodwill as of May 1, 2007, noting no impairment, and have determined there has been no impairment of goodwill through December 30, 2007.

***Stock-Based Compensation***

We account for stock-based compensation in accordance with SFAS No. 123R, *Share-Based Payment*. Under the provisions of SFAS No. 123R, stock-based compensation cost is estimated at the grant date based on the award's fair-value as calculated by the Black-Scholes-Merton (BSM) option-pricing model and is recognized as expense over

the requisite service period. The BSM model requires various highly judgmental assumptions including volatility, forfeiture rates, and expected option life. If any of

**Table of Contents**

these assumptions used in the BSM model change significantly, stock-based compensation expense may differ materially in the future from that recorded in the current period.

***Income Taxes***

In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for the expected future tax benefit to be derived from tax loss and credit carryforwards. Deferred tax assets and liabilities are determined using the enacted tax rates in effect for the years in which those tax assets are expected to be realized. A valuation allowance is established when it is more likely than not the future realization of all or some of the deferred tax assets will not be achieved. The evaluation of the need for a valuation allowance is performed on a jurisdiction by jurisdiction basis, and includes a review of all available positive and negative evidence. As of December 30, 2007, we have maintained a valuation allowance only against certain U.S. and foreign deferred tax assets that we concluded have not met the more likely than not threshold required under SFAS No. 109.

Due to the adoption of SFAS No. 123R, we recognize excess tax benefits associated with share-based compensation to stockholders' equity only when realized. When assessing whether excess tax benefits relating to share-based compensation have been realized, we follow the with-and-without approach, excluding any indirect effects of the excess tax deductions. Under this approach, excess tax benefits related to share-based compensation are not deemed to be realized until after the utilization of all other tax benefits available to us.

Effective January 1, 2007, we adopted FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN No. 48 requires that we recognize the impact of a tax position in our financial statements only if that position is more likely than not of being sustained upon examination by taxing authorities, based on the technical merits of the position. Any interest and penalties related to uncertain tax positions will be reflected in income tax expense.

**Table of Contents****Results of Operations**

To enhance comparability, the following table sets forth audited consolidated statement of operations data for the years ended December 30, 2007, December 31, 2006, and January 1, 2006 stated as a percentage of total revenue.

|  | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year<br/>Ended<br/>January 1,<br/>2006</b> |
|--|---|---|---|
| Revenue                                      |   |   |   |
| Product revenue                              | 89%   | 84%   | 79%   |
| Service and other revenue                    | 11  | 16  | 21  |
| Total revenue                                | 100   | 100   | 100   |
| Costs and expenses:                          |   |   |   |
| Cost of product revenue                      | 33  | 28  | 27  |
| Cost of service and other revenue            | 3   | 5   | 4   |
| Research and development                     | 20  | 18  | 38  |
| Selling, general and administrative          | 27  | 29  | 38  |
| Amortization of acquired intangible assets   | 1   |   |   |
| Acquired in-process research and development | 83  |   | 22  |
| Litigation settlements                       | 15  |   |   |
| Total costs and expenses                     | 182   | 80  | 129   |
| Income (loss) from operations                | (82)  | 20  | (29)  |
| Interest income                              | 4   | 3   | 2   |
| Interest and other expense, net              | (1)   |   | (1)   |
| Income (loss) before income taxes            | (79)  | 23  | (28)  |
| Provision (benefit) for income taxes         | (3)   | 1   |   |
| Net income (loss)                            | (76)%                                       | 22%   | (28)%   |

**Comparison of Years Ended December 30, 2007 and December 31, 2006**

Our fiscal year is 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, and September 30. The years ended December 30, 2007 and December 31, 2006 were both 52 weeks.

**Revenue**

| <b>Year Ended<br/>December 30,</b> | <b>Year Ended<br/>December 31,</b> | <b>Percentage</b> |
|------------------------------------|------------------------------------|-------------------|
|------------------------------------|------------------------------------|-------------------|

|                           | <b>2007</b>           | <b>2006</b>       | <b>Change</b> |
|---------------------------|-----------------------|-------------------|---------------|
|                           | <b>(In thousands)</b> |                   |               |
| Product revenue           | \$ 326,699            | \$ 155,811        | 110%          |
| Service and other revenue | 40,100                | 28,775            | 39            |
| <b>Total revenue</b>      | <b>\$ 366,799</b>     | <b>\$ 184,586</b> | <b>99%</b>    |

Total revenue for the years ended December 30, 2007 and December 31, 2006 was \$366.8 million and \$184.6 million, respectively. This represents an increase of \$182.2 million for 2007, or 99%, compared to 2006.

Product revenue increased to \$326.7 million for the year ended December 30, 2007 from \$155.8 million for the year ended December 31, 2006. Consumable products and instruments

**Table of Contents**

constituted 59% and 37% of product revenue for the year ended December 30, 2007, respectively, compared to 64% and 28% for the year ended December 31, 2006, respectively. The change in sales associated with our product mix is due to increased sales in instruments primarily attributable to the Genome Analyzer, which was introduced during the first quarter of 2007. Growth in consumable revenue was primarily attributable to strong demand for our Infinium products. We expect to see continued growth in product revenue, which can be mainly attributed to the launch of several new products, sales of existing products and the growth of our installed base of instruments.

Service and other revenue increased to \$40.1 million for the year ended December 30, 2007 from \$28.8 million for the year ended December 31, 2006. Service and other revenue includes revenue generated from genotyping and sequencing service contracts and extended warranty contracts. In 2007, service and other revenue also includes research revenue. Historically, research revenue was included in a separate line item on the Consolidated Statements of Operations. The increase in service and other revenue is primarily due to the completion of several significant Infinium and iSelect custom SNP genotyping service contracts and sequencing services contracts. We expect sales from SNP genotyping and sequencing services contracts to fluctuate on a yearly and quarterly basis, depending on the mix and number of contracts that are completed. The timing of completion of SNP genotyping and sequencing services contracts are highly dependent on the customers' schedules for delivering the SNPs and samples to us.

*Cost of Product and Service and Other Revenue*

|   | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 30,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|---|---|---|------------------------------|
|   | <b>(In thousands)</b>                       |   |                              |
| Cost of product revenue                             | \$ 119,991                                  | \$ 51,271                                   | 134%                         |
| Cost of service and other revenue                   | 12,445                                      | 8,073                                       | 54                           |
| Total cost of product and service and other revenue | \$ 132,436                                  | \$ 59,344                                   | 123%                         |

Cost of product and service and other revenue represents manufacturing costs incurred in the production process, including component materials, assembly labor and overhead, installation, warranty, packaging and delivery costs, as well as costs associated with performing genotyping and sequencing services on behalf of our customers. Cost of product revenue increased to \$120.0 million for the year ended December 30, 2007, compared to \$51.3 million for the year ended December 31, 2006, primarily driven by higher consumable and instrument sales. Cost of product revenue for the years ended December 30, 2007 and December 31, 2006 included non-cash stock-based compensation expense of \$4.0 million and \$1.3 million, respectively. Gross margin on product revenue decreased to 63.3% for the year ended December 30, 2007, compared to 67.1% for the year ended December 31, 2006. The decrease in the gross margin percentage is primarily due to the shift in product mix towards instruments. In addition, the gross margin percentage was adversely impacted by the increase in non-cash stock-based compensation expense as well as \$0.7 million associated with the amortization of inventory revaluation costs related to our acquisition of Solexa in January 2007. The impact of non-cash stock-based compensation charges decreased our gross margin by 41 basis points for the year ended December 30, 2007 compared to the year ended December 31, 2006. The inventory revaluation costs decreased our gross margin by 24 basis points for the year ended December 30, 2007, compared to the year ended December 31, 2006.

Cost of service and other revenue increased to \$12.4 million for the year ended December 30, 2007, compared to \$8.1 million for the year ended December 31, 2006, primarily due to higher service revenue. Gross margin on service



and other revenue decreased to 69.0% for the year ended December 30, 2007, compared to 71.9% for the year ended December 31, 2006. The decrease in the gross margin percentage is primarily driven by unfavorable product mix.

**Table of Contents**

We expect product mix to continue to affect our future gross margins. We expect price competition to continue in our market, and our margins may fluctuate from year to year and quarter to quarter as a result.

*Research and Development Expenses*

|                          | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|--------------------------|---|---|------------------------------|
|                          | <b>(In thousands)</b>                       |   |                              |
| Research and development | \$ 73,943                                   | \$ 33,373                                   | 122%                         |

Our research and development expenses consist primarily of salaries and other personnel-related expenses, laboratory supplies and other expenses related to the design, development, testing and enhancement of our products. We expense our research and development expenses as they are incurred.

Research and development expenses increased to \$73.9 million for the year ended December 30, 2007, compared to \$33.4 million for the year ended December 31, 2006. Research and development expenses as a percentage of total revenue were 20.2% for the year ended December 30, 2007, compared to 18.1% for the year ended December 31, 2006. Approximately \$27.0 million of the increase for the year ended December 30, 2007 was due to higher research and development expenses associated with our acquisition of Solexa in January 2007. Costs to support our BeadArray technology research activities increased approximately \$8.5 million for the year ended December 30, 2007, compared to the year ended December 31, 2006, primarily due to an overall increase in personnel-related expenses and increased lab and material expenses. Several new Infinium chip products, including the Human 1M DNA Analysis BeadChip, HumanCNV370-Duo BeadChip and HumanHap550-Duo BeadChip, have been introduced to the market in 2007. In addition, non-cash stock-based compensation expense increased approximately \$6.1 million compared to the year ended December 31, 2006. These increases were partially offset by a \$1.0 million decrease in research and development expenses related to the VeraCode technology, compared to the year ended December 31, 2006. We began shipping our BeadXpress System, which is based on our VeraCode technology, during the first quarter of 2007. As a result of completing the development of this product, the related research and development expenses have decreased.

We believe a substantial investment in research and development is essential to remaining competitive and expanding into additional markets. Accordingly, we expect our research and development expenses to increase in absolute dollars as we expand our product base.

*Selling, General and Administrative Expenses*

|                                     | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|-------------------------------------|---|---|------------------------------|
|                                     | <b>(In thousands)</b>                       |   |                              |
| Selling, general and administrative | \$ 101,256                                  | \$ 54,057                                   | 87%                          |

Our selling, general and administrative expenses consist primarily of personnel costs for sales and marketing, finance, human resources, business development, legal and general management, as well as professional fees, such as expenses

for legal and accounting services. Selling, general and administrative expenses increased to \$101.3 million for the year ended December 30, 2007, compared to \$54.1 million for the year December 31, 2006.

Sales and marketing expenses increased \$24.5 million during the year ended December 30, 2007, compared to the year ended December 31, 2006. The increase is primarily due to increases of \$18.6 million attributable to personnel-related expenses to support the growth of our business, \$3.3 million of non-cash stock-based compensation expense and \$2.6 million attributable to other non-personnel-related expenses consisting mainly of sales and marketing activities for our existing and new products. General and administrative expense increased \$22.7 million during the year ended

**Table of Contents**

December 30, 2007, compared to the year ended December 30, 2006, due to increases of \$8.7 million in personnel-related expenses associated with the growth of our business, \$7.2 million of non-cash stock-based compensation expense, \$3.4 million in outside legal fees, \$3.3 million in other outside service expenses, primarily due to increases in consulting fees and increased tax, audit, and other public company costs.

We expect our selling, general and administrative expenses to increase in absolute dollars as we expand our staff, add sales and marketing infrastructure and incur additional costs to support the growth in our business.

*Amortization of Acquired Intangible Assets*

|  | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|--|---|---|------------------------------|
|  | <b>(In thousands)</b>                       |   |                              |
| Amortization of acquired intangible assets | \$ 2,429                                    | \$  | N/A                          |

Amortization of acquired intangible assets totaled \$2.4 million for the year ended December 30, 2007. There was no amortization of acquired intangibles for the year ended December 31, 2006. The amount amortized in 2007 represents the amortization of our intangible assets acquired from Solexa in January 2007.

*Acquired In-Process Research and Development*

|  | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 30,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|--|---|---|------------------------------|
|  | <b>(In thousands)</b>                       |   |                              |
| Acquired in-process research and development | \$ 303,400                                  | \$  | N/A                          |

During the year ended December 30, 2007, we recorded \$303.4 million of acquired IPR&D resulting from the Solexa acquisition. At the acquisition date, Solexa's ongoing research and development initiatives were primarily involved with the development of its genetic analysis platform for sequencing and expression profiling. These in-process research and development projects are comprised of Solexa's reversible terminating nucleotide biochemistry platform, referred to as sequencing-by-synthesis (SBS) biochemistry, as well as Solexa's reagent, analyzer and sequencing services related technologies, which were valued at \$237.2 million, \$44.2 million, \$19.1 million and \$2.9 million, respectively, at the acquisition date. Although these projects were approximately 95% complete at the acquisition date, they had not reached technological feasibility and had no alternative future use. Accordingly, the amounts allocated to those projects were written off in the first quarter of 2007, the period the acquisition was consummated. Acquisitions of businesses, products or technologies by us in the future may result in substantial charges for acquired IPR&D that may cause fluctuations in our interim or annual operating results. There were no charges resulting from any acquisitions during the same period in fiscal 2006.

*Litigation Settlements*

| <b>Year Ended</b> | <b>Year Ended</b> |
|-------------------|-------------------|
|-------------------|-------------------|

|                        | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|------------------------|------------------------------|------------------------------|------------------------------|
|                        | <b>(In thousands)</b>        |                              |                              |
| Litigation settlements | \$ 54,536                    | \$                           | N/A                          |

During the year ended December 30, 2007, we recorded a charge of \$54.5 million associated with two settlement agreements entered into subsequent to year-end. The total charge is comprised primarily of \$54.0 million related to a \$90.0 million settlement with Affymetrix entered into on January 9, 2008 for certain patent litigation between the parties. See Note 8 of Notes to Consolidated Financial Statements for further information regarding this settlement.

**Table of Contents***Interest Income*

|                 | <b>Year Ended<br/>December 30,<br/>2007<br/>(In thousands)</b> | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Percentage<br/>Change</b> |
|-----------------|--|--|------------------------------|
| Interest income | \$ 16,026  | \$ 5,368   | 199%                         |

Interest income on our cash and cash equivalents and investments was \$16.0 million and \$5.4 million for the years ended December 30, 2007 and December 31, 2006, respectively. The increase in interest income over the prior year was primarily driven by higher cash balances from the proceeds of our February 2007 convertible debt offering, cash acquired as part of the Solexa acquisition, and improved operating cash flow. In addition, we experienced higher effective interest rates on our cash equivalents and short-term investments.

*Interest and Other Expense, Net*

|                                 | <b>Year Ended<br/>December 30,<br/>2007<br/>(In thousands)</b> | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Percentage<br/>Change</b> |
|---------------------------------|--|--|------------------------------|
| Interest and other expense, net | \$ (3,610)   | \$ (560)   | 545%                         |

Interest and other expense, net, consists of interest expense and other income and expenses related to net foreign currency exchange transaction gains and losses. Interest and other expense, net, increased to \$3.6 million for the year ended December 30, 2007, compared to \$0.6 million for the year ended December 31, 2006.

Interest expense was \$3.6 million for the year ended December 30, 2007, compared to \$11,000 for the year ended December 31, 2006. The increase is primarily related to our convertible debt offering in February 2007. For the years ended December 30, 2007 and December 31, 2006, we recorded approximately \$0.5 million and \$0.4 million, respectively, in net foreign currency transaction losses, respectively. In 2007, these foreign currency exchange losses were offset by \$0.5 million of foreign currency exchange gains associated with the sale of our secured convertible debentures with Genizon BioSciences, Inc. (Genizon) in the fourth quarter of 2007. See Note 10 of Notes to Consolidated Financial Statements for further information regarding the sale of our debentures with Genizon.

*Provision (benefit) for Income Taxes*

|                                      | <b>Year Ended<br/>December 30,<br/>2007<br/>(In thousands)</b> | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Percentage<br/>Change</b> |
|--------------------------------------|--|--|------------------------------|
| Provision (benefit) for income taxes | \$ (10,426)  | \$ 2,652   | (493%)                       |

The provision (benefit) for income taxes was approximately (\$10.4) million and \$2.7 million for the years ended December 30, 2007 and December 31, 2006, respectively. The provision consists of federal, state, and foreign income tax expense, offset in 2007 by the release of the valuation allowance against a significant portion of our U.S. deferred tax assets.

During the year ended December 30, 2007, we utilized approximately \$72.9 million and \$10.8 million of our federal and state net operating loss carryforwards, respectively, to reduce our federal and state income taxes. As of December 30, 2007, we had net operating loss carryforwards for federal and state tax purposes of approximately \$28.7 million and \$99.1 million, respectively, which begin to expire in 2025 and 2015, respectively, unless previously utilized. In addition, we also had U.S. federal and state research and development tax credit carryforwards of approximately \$9.2 million and \$9.3 million respectively, which begin to expire in 2018 and 2019 respectively, unless previously utilized.

Pursuant to Section 382 and 383 of the Internal Revenue Code, utilization of our net operating losses and credits may be subject to annual limitations in the event of any significant future changes in our

**Table of Contents**

ownership structure. These annual limitations may result in the expiration of net operating losses and credits prior to utilization. Previous limitations due to Section 382 and 383 have been reflected in the deferred tax assets as of December 30, 2007.

As of December 30, 2007, we concluded that it is more likely than not that a significant portion of our deferred tax assets will be realized and, accordingly we released a portion of our valuation allowance, approximately \$17.1 million of which was recorded as a reduction to the tax provision. In addition, we established current and long term deferred tax assets on the Consolidated Balance Sheets of approximately \$26.8 million and \$80.1 million, respectively, and decreased the goodwill balances recorded in conjunction with the CyVera and Solexa acquisitions by approximately \$2.1 million and \$18.4 million, respectively. Based upon the available evidence as of December 30, 2007, we are not able to conclude it is more likely than not certain U.S. and foreign deferred tax assets will be realized. Therefore, we have recorded a valuation allowance of approximately \$2.9 million and \$25.4 million against certain U.S. and foreign deferred tax assets, respectively.

***Comparison of Years Ended December 31, 2006 and January 1, 2006***

Our fiscal year is 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, and September 30. The years ended December 31, 2006 and January 1, 2006 were both 52 weeks.

*Revenue*

|                           | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|---------------------------|---|---|------------------------------|
|                           | <b>(In thousands)</b>                       |   |                              |
| Product revenue           | \$ 155,811                                  | \$ 57,752                                 | 170%                         |
| Service and other revenue | 28,775                                      | 15,749                                    | 83                           |
| Total revenue             | \$ 184,586                                  | \$ 73,501                                 | 151%                         |

Total revenue for the years ended December 31, 2006 and January 1, 2006 was \$184.6 million and \$73.5 million, respectively. This represents an increase of \$111.1 million for 2006, or 151%, compared to 2005.

Product revenue increased to \$155.8 million for the year ended December 31, 2006 from \$57.8 million for the year ended January 1, 2006. The increase in 2006 resulted primarily from higher consumable and BeadStation sales. Growth in consumable revenue was primarily attributable to the launch and shipment of our whole genome genotyping products, the HumanHap300 and HumanHap550 BeadChips. In addition, growth in consumable revenue can be attributed to the growth in our installed base of BeadArray Readers, which has nearly doubled since January 1, 2006. Consumable products constituted 66% of product revenue for year ended December 31, 2006, compared to 47% in the year ended January 1, 2006. We expect to see continued growth in product revenue, which can be partially attributed to the launch of several new products, as well as the growth of our installed base of instruments.

Service and other revenue increased to \$28.8 million for the year ended December 31, 2006 from \$15.7 million for the year ended January 1, 2006. The increase in service and other revenue is primarily due to the completion of several significant Infinium and GoldenGate SNP genotyping service contracts. We introduced our Infinium services in early



2006. We expect sales from SNP genotyping services contracts to fluctuate on a yearly and quarterly basis, depending on the mix and number of contracts that are completed. The timing of completion of a SNP genotyping services contract is highly dependent on the customer's schedule for delivering the SNPs and samples to us. This increase in service revenue was partially offset by a decrease in government grants and other research funding of \$0.5 million over the prior year due primarily to the completion of several projects funded by grants from the National

**Table of Contents**

Institutes of Health. We do not expect research revenue to be a material component of our revenue going forward.

*Cost of Product and Service and Other Revenue*

|   | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|---|--|---|------------------------------|
| Cost of product revenue                             | \$ 51,271  | \$ 19,920                                 | 157%                         |
| Cost of service and other revenue                   | 8,073  | 3,261                                     | 148                          |
| Total cost of product and service and other revenue | \$ 59,344  | \$ 23,181                                 | 156%                         |

Cost of product and service and other revenue represents manufacturing costs incurred in the production process, including component materials, assembly labor and overhead, installation, warranty, packaging and delivery costs, as well as costs associated with performing genotyping services on behalf of our customers. Costs related to research revenue are included in research and development expense. Cost of product revenue increased to \$51.3 million for the year ended December 31, 2006, compared to \$19.9 million for the year ended January 1, 2006, primarily driven by higher consumable and instrument sales. Cost of product revenue for the year ended December 31, 2006 included stock-based compensation expenses resulting from the adoption of SFAS No. 123R totaling \$1.3 million. Gross margin on product revenue increased to 67.1% for the year ended December 31, 2006, compared to 65.5% for the year ended January 1, 2006. The increase in gross margin percentage is primarily due to the impact of favorable product mix, as well as decreased manufacturing costs. A higher percentage of our revenue in 2006 was generated from the sale of consumables, which generally have a more favorable gross margin than other products. The decrease in manufacturing costs is primarily due to reduced raw material costs as a result of more favorable negotiated contracts with our vendors and improvements in our manufacturing processes. This increase in gross margin was offset, in part, by the impact of stock-based compensation charges, which decreased our gross margin by 83 basis points in 2006 compared to 2005.

Cost of service and other revenue increased to \$8.1 million for the year ended December 31, 2006, compared to \$3.3 million for the year ended January 1, 2006, primarily due to higher service revenue. Cost of service and other revenue for the year ended December 31, 2006 included stock-based compensation expenses resulting from the adoption of SFAS No. 123R totaling \$0.2 million. Gross margin on service and other revenue decreased to 71.9% for the year ended December 31, 2006, compared to 79.3% for the year ended January 1, 2006. The decrease is due primarily to a change in the mix of projects, as well as the impact of stock-based compensation charges, the latter having decreased our service and other revenue gross margin by 85 basis points in 2006 compared to 2005.

We expect product mix to continue to affect our future gross margins. However, we expect our market to become increasingly price competitive and our margins may fluctuate from year to year and quarter to quarter.

*Research and Development Expenses*

|  | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|--|---|---|------------------------------|
|--|---|---|------------------------------|

**(In thousands)**

|                          |    |        |    |        |     |
|--------------------------|----|--------|----|--------|-----|
| Research and development | \$ | 33,373 | \$ | 27,809 | 20% |
|--------------------------|----|--------|----|--------|-----|

Our research and development expenses consist primarily of salaries and other personnel-related expenses, laboratory supplies and other expenses related to the design, development, testing and enhancement of our products. We expense our research and development expenses as they are incurred.

**Table of Contents**

Research and development expenses increased to \$33.4 million for the year ended December 31, 2006, compared to \$27.8 million for the year ended January 1, 2006. Research and development expenses for the years ended December 31, 2006 and January 1, 2006 included stock-based compensation expenses primarily resulting from the adoption of SFAS No. 123R totaling \$3.9 million and \$0.1 million, respectively. Exclusive of these stock-based compensation charges, the increase in research and development expenses for the year ended December 31, 2006 is primarily due to the development of our recently-acquired VeraCode technology purchased in conjunction with our acquisition of CyVera in April 2005. We launched the first products resulting from this acquisition during the first quarter of 2007. Research and development expenses related to the VeraCode technology increased \$2.7 million for the year ended December 31, 2006, compared to the year ended January 1, 2006. In addition, costs to support our Oligator technology platform and BeadArray research activities decreased \$1.0 million for the year ended December 31, 2006, compared to the year ended January 1, 2006.

We believe a substantial investment in research and development is essential to remaining competitive and expanding into additional markets. Accordingly, we expect our research and development expenses to increase in absolute dollars as we expand our product base and integrate the operations of Solexa into our business.

*Selling, General and Administrative Expenses*

|                                     | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|-------------------------------------|---|---|------------------------------|
|                                     | <b>(In thousands)</b>                       |   |                              |
| Selling, general and administrative | \$ 54,057                                   | \$ 28,158                                 | 92%                          |

Our selling, general and administrative expenses consist primarily of personnel costs for sales and marketing, finance, human resources, business development, legal and general management, as well as professional fees, such as expenses for legal and accounting services. Selling, general and administrative expenses increased to \$54.1 million for the year ended December 31, 2006, compared to \$28.2 million for the year ended January 1, 2006. Selling, general and administrative expenses for the years ended December 31, 2006 and January 1, 2006 included stock-based compensation expenses primarily resulting from the adoption of SFAS No. 123R totaling \$8.9 million and \$0.2 million, respectively.

Sales and marketing expenses increased \$10.6 million during the year ended December 31, 2006, compared to the year ended January 1, 2006. The increase is primarily due to increases of \$6.5 million attributable to personnel-related expenses, \$3.2 million of stock-based compensation expense and \$0.9 million attributable to other non-personnel-related costs, mainly sales and marketing activities for our existing and new products. General and administrative expenses increased \$15.3 million during the year ended December 31, 2006, compared to the year ended January 1, 2006, due to increases of \$5.5 million of stock-based compensation expense, \$5.3 million in outside legal costs related to the Affymetrix litigation, \$3.1 million in personnel-related expenses associated with the growth of our business and \$1.4 million in outside consulting costs. Outside consulting costs primarily include tax and audit fees and general legal expenses not associated with the Affymetrix litigation.

We expect our selling, general and administrative expenses to increase in absolute dollars as we expand our staff, add sales and marketing infrastructure, incur increased litigation costs and incur additional costs to support the growth in our business.

*Interest Income*

|                 | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|-----------------|---|---|------------------------------|
| Interest income | \$ 5,368                                    | \$ 1,404                                  | 282%                         |

40

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**Table of Contents**

Interest income on our cash and cash equivalents and investments was \$5.4 million and \$1.4 million for the years ended December 31, 2006 and January 1, 2006, respectively. The increase was due to higher average cash balances and higher effective interest rates compared to the prior year.

*Interest and Other Expense, Net*

|                                 | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|---------------------------------|--|---|------------------------------|
| Interest and other expense, net | \$ (560)   | \$ (668)                                  | (16%)                        |

Interest and other expense, net, consists of interest expense, other income and expenses related to foreign exchange transaction costs and gains and losses on disposals of assets. Interest and other expense, net, decreased to \$0.6 million for the year ended January 1, 2006, compared to \$0.7 million for the year ended January 2, 2005.

Interest expense was \$11,000 for the year ended December 31, 2006, compared to \$7,000 for the year ended January 1, 2006. For the years ended December 31, 2006 and January 1, 2006, we recorded approximately \$0.4 million in losses due to foreign currency transactions. In addition in 2006, we recorded \$0.1 million related to losses on disposal of assets, compared to \$0.3 million of losses in 2005.

*Provision for Income Taxes*

|                            | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Year Ended<br/>January 1,<br/>2006</b> | <b>Percentage<br/>Change</b> |
|----------------------------|--|---|------------------------------|
| Provision for income taxes | \$ 2,652   | \$ 163                                    | 1,527%                       |

The provision for income taxes was approximately \$2.7 million in 2006, up from \$0.2 million in 2005. In 2006, the provision principally consists of federal and state alternative minimum tax and income tax expense related to foreign operations. In 2005, the provision for income taxes consisted of income tax expense related to foreign operations.

During the year ended December 31, 2006, we utilized approximately \$25.9 million and \$16.6 million of our federal and state net operating loss carryforwards, respectively, to reduce our federal and state income taxes. As of December 31, 2006, we had net operating loss carryforwards for federal and state tax purposes of approximately \$76.4 million and \$39.1 million, respectively, which begin to expire in 2022 and 2013, respectively, unless previously utilized. In addition, we also had U.S. federal and state research and development tax credit carryforwards of approximately \$6.4 million and \$6.3 million respectively, which begin to expire in 2018 and 2019 respectively, unless previously utilized.

Pursuant to Section 382 and 383 of the Internal Revenue Code, utilization of our net operating losses and credits may be subject to annual limitations in the event of any significant future changes in our ownership structure. These annual limitations may result in the expiration of net operating losses and credits prior to utilization. Previous limitations due to Section 382 and 383 have been reflected in the deferred tax assets as of December 31, 2006.

Based upon the available evidence as of December 31, 2006, we are not able to conclude it is more likely than not the remaining deferred tax assets in the U.S. will be realized. Therefore, we have recorded a full valuation allowance against the U.S. deferred tax assets of approximately \$36.5 million.

**Table of Contents****Liquidity and Capital Resources*****Cashflow***

|  | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|--|---|--|---|
| Net cash provided by (used in) operating activities  | \$ 56,294                                   | \$ 39,000  | \$ (9,008)                                |
| Net cash used in investing activities                | (67,686)                                    | (160,735)  | (1,535)                                   |
| Net cash provided by financing activities            | 148,292                                     | 109,296  | 5,963                                     |
| Effect of foreign currency translation               | (345)                                       | 3  | 613                                       |
| Net increase (decrease) in cash and cash equivalents | \$ 136,555                                  | \$ (12,436)  | \$ (3,967)                                |

Historically, our sources of cash have included:

issuance of equity and debt securities, including cash generated from the exercise of stock options and participation in our Employee Stock Purchase Plan (ESPP);

cash generated from operations, primarily from the collection of accounts receivable resulting from product sales; and

interest income.

Our historical cash outflows have primarily been associated with:

cash used for operating activities such as the purchase and growth of inventory, expansion of our sales and marketing and research and development infrastructure and other working capital needs;

cash used for our stock repurchases;

expenditures related to increasing our manufacturing capacity and improving our manufacturing efficiency; and

interest payments on our debt obligations.

Other factors that impact our cash inflow and outflow include:

significant increases in our product and services revenue, leading to gross margins greater than 63% in each of the last three fiscal years. As our product sales have increased significantly since 2001, our gross profit and operating income have increased significantly as well, providing us with an increased source of cash to finance the expansion of our operations; and

fluctuations in our working capital.



As of December 30, 2007, we had cash, cash equivalents and short-term investments of \$386.1 million, compared to \$130.8 million as of December 31, 2006. We currently invest our funds in U.S. dollar-based short maturity mutual funds, commercial paper, corporate bonds, treasury notes, auction rate securities and municipal bonds. We do not hold securities backed by mortgages. As of December 30, 2007, our short-term investments included \$14.7 million of high-grade (AAA rated) auction rate securities issued primarily by municipalities and universities. See Part I Item 1A:

**Risk Factors** Negative conditions in the global credit markets may impair the liquidity of a portion of our investment portfolio.

The primary inflows of cash during the year ended December 30, 2007 were approximately \$390.3 million from the net proceeds of our convertible debt offering in February 2007, \$479.4 million from the sale and maturity of our investments in available-for-sale securities, and \$92.4 million generated from the sale of warrants in February 2007. In addition, on January 26, 2007, we completed the merger

**Table of Contents**

with Solexa, which resulted in net cash acquired of \$72.1 million. The primary cash outflows during the year ended December 30, 2007 were attributable to the purchase of available-for-sale securities for approximately \$598.4 million, the repurchase of an aggregate of 7.4 million shares of our common stock for approximately \$251.6 million, as well as approximately \$139.0 million for the purchase of a convertible note hedge. These convertible note transactions and our stock repurchase program are discussed in detail below.

On February 16, 2007, we issued \$400.0 million principal amount of 0.625% Convertible Senior Notes due 2014 (the Notes). The net proceeds from the offering, after deducting the initial purchasers' discount and offering expenses, were approximately \$390.3 million. We used approximately \$201.6 million of the net proceeds to purchase approximately 5.8 million shares of our common stock in privately negotiated transactions concurrently with the offering. We used \$46.6 million of the net proceeds of this offering to pay the net cost of convertible note hedge and warrant transactions, which are designed to reduce the potential dilution upon conversion of the notes. We are using the balance of the net proceeds for other general corporate purposes, which may include acquisitions and additional repurchases of our common stock. The notes mature on February 15, 2014 and bear interest semi-annually at a rate of 0.625% per year, payable on February 15 and August 15 of each year, beginning on August 15, 2007. In addition, we may in certain circumstances be obligated to pay additional interest. If a designated event, as defined in the indenture for the notes, occurs, holders of the notes may require us to repurchase all or a portion of their notes for cash at a repurchase price equal to the principal amount of the notes to be repurchased, plus accrued and unpaid interest. In addition, upon conversion of the notes, we must pay the principal portion in cash. The notes will become convertible only in certain circumstances based on conditions relating to the trading price of the notes and our common stock or upon the occurrence of specified corporate events, and we expect the notes to become convertible beginning in the second quarter of 2008 if the trading price of our common stock does not decline from current levels. The notes also will, by their terms, become convertible at any time from, and including, November 15, 2013 through the third scheduled trading day immediately preceding February 15, 2014.

On February 20, 2007, we executed a Rule 10b5-1 trading plan to repurchase up to \$75.0 million of our outstanding common stock over a period of six months. We repurchased approximately 1.6 million shares of our common stock under this plan for approximately \$50.0 million in cash. As of December 30, 2007, this plan had expired.

Our primary short-term needs for capital, which are subject to change, include expenditures related to:

the \$90.0 million liability recorded at December 30, 2007 for the one-time payment made to Affymetrix on January 25, 2008, in accordance with the settlement agreement entered on January 9, 2008;

our facilities expansion needs, including costs of leasing additional facilities;

the acquisition of equipment and other fixed assets for use in our current and future manufacturing and research and development facilities;

support of our 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;

the continued advancement of research and development efforts; and

improvements in our manufacturing capacity and efficiency.

Approximately \$24.3 million of our net cash generated from operations for the year ended December 30, 2007 was used on capital expenditures, primarily for manufacturing and research and development equipment, furniture, fixtures and computer equipment. We expect that our product 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.

**Table of Contents**

We anticipate that our current cash and cash equivalents and income from operations will be sufficient to fund our 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. At the present time, we have no material commitments for capital expenditures. Due to expansion of our facilities and manufacturing operations, we anticipate spending approximately \$25.0 million in capital expenditures during 2008. Our future capital requirements and the adequacy of our available funds will depend on many factors, including:

our ability to successfully commercialize our sequencing and VeraCode technologies and to expand our SNP genotyping and sequencing services product lines;

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.

As a result of the factors listed above, we may require additional funding in the future. Our failure to raise capital on acceptable terms, when needed, could have a material adverse effect on our business.

***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 (SPEs), which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. During the fiscal year ended December 30, 2007, we were not involved in any off balance sheet arrangements within the meaning of the rules of the Securities and Exchange Commission.

***Contractual Obligations***

Contractual obligations represent future cash commitments and liabilities under agreements with third parties, and exclude orders for goods and services entered into in the normal course of business that are not enforceable or legally binding and contingent liabilities for which we cannot reasonably predict future payment. Additionally, the table excludes uncertain tax positions of \$21.4 million. The expected timing of payment of the obligations presented below is estimated based on current information. Timing of payments and actual amounts paid may be different depending on changes to agreed-upon terms or amounts for some obligations.

The following chart represents our contractual obligations as of December 30, 2007, aggregated by type (amounts in thousands):

| <b>Contractual Obligation</b> | <b>Total</b> | <b>Payments Due by Period</b> |                      |                      |            | <b>More Than<br/>5 Years</b> |
|-------------------------------|--------------|-------------------------------|----------------------|----------------------|------------|------------------------------|
|                               |              | <b>Less Than<br/>1 Year</b>   | <b>1<br/>3 Years</b> | <b>3<br/>5 Years</b> |            |                              |
| Long-term debt obligations(1) | \$ 416,250   | \$ 2,500                      | \$ 5,000             | \$ 5,000             | \$ 403,750 |                              |
| Operating leases(2)           | 120,435      | 10,329                        | 15,036               | 15,412               | 79,658     |                              |
| Other(3)                      | 90,536       | 90,536                        |                      |                      |            |                              |

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|       |            |            |           |           |            |
|-------|------------|------------|-----------|-----------|------------|
| Total | \$ 627,221 | \$ 103,365 | \$ 20,036 | \$ 20,412 | \$ 483,408 |
|-------|------------|------------|-----------|-----------|------------|

- (1) The long-term debt obligations in the above table include the principal amount of our Convertible Senior Notes and interest payments totaling 0.625% per annum. See Note 5 of Notes to Consolidated Financial Statements for further discussion of the terms of the Convertible Senior Notes.
- (2) See Note 6 of Notes to Consolidated Financial Statements for discussion of our operating leases.

**Table of Contents**

- (3) Other in the above table includes amounts owed as a result of our litigation settlements occurring subsequent to December 30, 2007. See Note 8 of Notes to Consolidated Financial Statements for further discussion of the related settlement.

***Recent Accounting Pronouncements***

Information with respect to recent accounting pronouncements is included in Note 1 of Notes to Consolidated Financial Statements.

**Item 7A. *Quantitative and Qualitative Disclosures about Market Risk.***

***Interest Rate Sensitivity***

Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. The fair market value of fixed rate securities may be adversely impacted by fluctuations in interest rates while income earned on floating rate securities may decline as a result of decreases in interest rates. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We attempt to ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We mitigate default risk by investing in investment grade securities. We have historically maintained a relatively short average maturity for our investment portfolio, and we believe a hypothetical 100 basis point adverse move in interest rates along the entire interest rate yield curve would not materially affect the fair value of our interest sensitive financial instruments.

***Market Price Sensitive Instruments***

In order to reduce the potential equity dilution, we entered into a convertible note hedge contract entitling us to purchase a maximum of 11,451,480 shares of our common stock (subject to adjustment) at an initial strike price of \$43.66 per share (subject to adjustment). Upon conversion of our Convertible Senior Notes, this hedge contract is expected to reduce the equity dilution if the daily volume-weighted average price per share of our common stock exceeds the strike price of the hedge. We also entered into warrant transactions with the counterparties of the convertible note hedge transactions entitling them to acquire a maximum of 18,322,320 shares of our common stock (subject to adjustment) at an initial strike price of \$62.87 per share (subject to adjustment). The warrant transactions could have a dilutive effect on our earnings per share to the extent that the price of our common stock during the measurement period at maturity of the warrants exceeds the strike price of the warrants. We did not hold any material derivative financial instruments for the year ended December 31, 2006.

***Foreign Currency Exchange Risk***

Although most of our revenue is realized in U.S. dollars, some portions of our revenue are realized in foreign currencies. As a result, our financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in foreign markets. The functional currencies of our subsidiaries are their respective local currencies. Accordingly, the accounts of these operations are translated from the local currency to the U.S. dollar using the current exchange rate in effect at the balance sheet date for the balance sheet accounts, and using the average exchange rate during the period for revenue and expense accounts. The effects of translation are recorded in accumulated other comprehensive income as a separate component of stockholders' equity.

**Item 8. *Financial Statements and Supplementary Data.***

The Report of Independent Registered Public Accounting Firm, Financial Statements and Notes to Financial Statements begin on page F-1 immediately following the signature page and are incorporated herein by reference.

**Table of Contents**

**Item 9. *Changes In and Disagreements with Accountants on Accounting and Financial Disclosure.***

None.

**Item 9A. *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.

We have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of 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, or the Securities Exchange Act), as of December 30, 2007. Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of December 30, 2007, our disclosure controls and procedures were effective to ensure that (a) the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and (b) such information is accumulated and communicated to our management, including our principal executive officer and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management have concluded that the disclosure controls and procedures are effective at the reasonable assurance level. Because of inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected.

An evaluation was also performed under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of any change in our internal control over financial reporting that occurred during the fourth quarter of 2007 and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. Other than completing the integration of Solexa, Inc.'s internal controls over financial reporting into our financial reporting systems during the fourth quarter of 2007, that evaluation did not identify any such change.

**MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control – Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 30, 2007. The effectiveness of our internal control over financial reporting as of December 30, 2007 has been audited by Ernst & Young LLP, an independent registered accounting firm, as stated in their report which is included herein.





**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of  
Illumina, Inc.

We have audited Illumina, Inc.'s internal control over financial reporting as of December 30, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Illumina, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Illumina, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 30, 2007, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Illumina, Inc. as of December 30, 2007 and December 31, 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 30, 2007 of Illumina, Inc. and our report dated February 22, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California  
February 22, 2008



**Table of Contents**

**Item 9B. *Other Information.***

None.

**PART III**

**Item 10. *Directors and Executive Officers of the Registrant.***

(a) Identification of Directors. Information concerning our directors is incorporated by reference from the section entitled *Proposal One: Election of Directors* to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

(b) Identification of Executive Officers. Information concerning our executive officers is set forth under *Executive Officers* in Part I of this Annual Report on Form 10-K and is incorporated herein by reference.

(c) Compliance with Section 16(a) of the Exchange Act. Information concerning compliance with Section 16(a) of the Securities Exchange Act of 1934 is incorporated by reference from the section entitled *Compliance with Section 16(a) of the Securities Exchange Act* to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

(d) Information concerning the audit committee financial expert as defined by the SEC rules adopted pursuant to the Sarbanes-Oxley Act of 2002 is incorporated by reference from our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

**Code of Ethics**

We have adopted a code of ethics for our directors, officers and employees, which is available on our website at [www.illumina.com](http://www.illumina.com) in the Investor Information section under *Corporate*. The information on, or that can be accessed from, our website is not incorporated by reference into this report.

**Item 11. *Executive Compensation.***

Information concerning executive compensation is incorporated by reference from the sections entitled *Executive Compensation and Other Information* to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

**Item 12. *Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.***

Information concerning the security ownership of certain beneficial owners and management is incorporated by reference from the section entitled *Ownership of Securities* to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

**Table of Contents****Equity Compensation Plan Information**

The following table presents information about our common stock that may be issued upon the exercise of options, warrants and rights under our existing equity compensation plans as of December 30, 2007: the 2000 Employee Stock Purchase Plan, the 2005 Stock and Incentive Plan (which replaced the 2000 Stock Plan) and the Solexa, Inc. 2005 Equity Incentive Plan. Prior to our initial public offering, we granted options under our 1998 Incentive Stock Plan. All of these plans have been approved by our stockholders. Options outstanding include options granted under the 1998 Incentive Stock Plan, the 2000 Stock Plan, the 2005 Stock and Incentive Plan, the Solexa, Inc. 2005 Equity Incentive Plan, and the Solexa, Inc. 1992 Plan.

| <b>Plan Category</b>                                       | <b>(a) Number of Securities to be Issued Upon Exercise of Outstanding Options</b> | <b>(b) Weighted-Average Exercise Price per Share of Outstanding Options</b> | <b>(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))</b> |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 10,423,934  | \$ 24.26  | 5,869,564(1)(2)  |
| Equity compensation plans not approved by security holders |   |   |  |
| <b>Total</b>   | <b>10,423,934</b>   | <b>\$ 24.26</b>   | <b>5,869,564</b>   |

Please refer to Note 7 to the consolidated financial statements included in this Annual Report on Form 10-K for a description of our equity compensation plans.

- (1) Includes 1,834,384 shares available for grant under our 2005 Stock Incentive Plan and our 2005 Solexa Equity Incentive Plan. The 2005 Stock Incentive Plan provides for an automatic annual increase in the shares reserved for issuance by the lesser of (1) five percent of outstanding shares of our common stock on the last day of the immediately preceding fiscal year, (2) 1,200,000 shares, or (3) a lesser amount as determined by our board of directors.
- (2) Includes 4,035,180 shares available for grant under our 2000 Employee Stock Purchase Plan. The 2000 Employee Stock Purchase Plan provides for an automatic annual increase in the shares reserved for issuance by the lesser of (1) three percent of outstanding shares of our common stock on the last day of the immediately preceding fiscal year or (2) 1,500,000 shares.

**Item 13. *Certain Relationships and Related Transactions.***

Information concerning certain relationships and related transactions is incorporated by reference from the sections entitled Proposal One: Election of Directors, Executive Compensation and Other Information and Certain Transactions to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

**Item 14. *Principal Accounting Fees and Services.***

Information concerning principal accounting fees and services is incorporated by reference from the sections entitled Proposal Two: Ratification of Independent Registered Public Accounting Firm to be contained in our definitive Proxy Statement with respect to our 2008 Annual Meeting of Stockholders to be filed with the SEC no later than April 28, 2008.

**PART IV****Item 15. Exhibits, Financial Statement Schedules.**

(a) The following documents are filed as a part of this report:

(1) *Consolidated Financial Statements:*

|   | <b>Page</b> |
|---|-------------|
| Index to Consolidated Financial Statements  | F-1         |
| Report of Independent Registered Public Accounting Firm   | F-2         |
| Consolidated Balance Sheets as of December 30, 2007 and December 31, 2006   | F-3         |
| Consolidated Statements of Operations for the years ended December 30, 2007, December 31, 2006, and January 1, 2006 | F-4         |
| Consolidated Statements of Stockholders' Equity for the period from January 2, 2005 to December 30, 2007            | F-5         |
| Consolidated Statements of Cash Flows for the years ended December 30, 2007, December 31, 2006, and January 1, 2006 | F-6         |
| Notes to Consolidated Financial Statements  | F-7         |

(2) *Financial Statement Schedule:*

|   |      |
|---|------|
| Valuation and Qualifying Account and Reserves for the three years ended December 30, 2007 | F-37 |
|---|------|

(3) *Exhibits:*

| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 2.1(16)               | Agreement and Plan of Merger, dated as of November 12, 2006, among Solexa, Inc., Callisto Acquisition Corp. and the Registrant.                                |
| 3.1(2)                | Corrected Amended and Restated Certificate of Incorporation.   |
| 3.2(30)               | Amended Bylaws.  |
| 3.3(5)                | Certificate of Designation for Series A Junior Participating Preferred Stock (included as an exhibit to exhibit 4.3).  |
| 4.1(1)                | Specimen Common Stock Certificate.   |
| 4.2(1)                | Second Amended and Restated Stockholders Rights Agreement, dated November 5, 1999, by and among the Registrant and certain stockholders of the Registrant.     |
| 4.3(5)                | Rights Agreement, dated as of May 3, 2001, between the Registrant and Equiserve Trust Company, N.A.  |
| 4.4(35)               | Indenture related to the 0.625% Convertible Senior Notes due 2014, dated as of February 16, 2007, between the Registrant and the Bank of New York, as trustee. |
| 4.5(36)               | Registration Rights Agreement, dated as of February 16, 2007, between the Registrant and the Purchasers named therein.   |
| +10.1(1)              | Form of Indemnification Agreement between the Registrant and each of its directors and officers.   |

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- +10.2(1) 1998 Incentive Stock Plan.
- +10.3(7) 2000 Employee Stock Purchase Plan, as amended and restated through July 20, 2006.
- 10.4(1) Sublease Agreement dated August 1998 between Registrant and Gensia Sicor Inc. for the Registrant's principal offices.
- 10.5(37) License Agreement dated May 1998 between Tufts and Registrant.
- 10.6(1) Master Loan and Security Agreement, dated March 6, 2000, by and between Registrant and FINOVA Capital Corporation.
- +10.7(20) 2000 Stock Plan, as amended and restated through March 21, 2002.
- 10.8(1) Eastgate Pointe Lease, dated July 6, 2000, between Diversified Eastgate Venture and Registrant.



**Table of Contents**

| <b>Exhibit<br/>Number</b> | <b>Description of Document</b>  |
|---------------------------|---|
| 10.9(1)                   | Option Agreement and Joint Escrow Instructions, dated July 6, 2000, between Diversified Eastgate Venture and Registrant.  |
| 10.10(4)                  | First Amendment to Joint Development Agreement dated March 27, 2001 between Registrant and PE Corporation, now known as Applied Biosystems Group (with certain confidential portions omitted).  |
| 10.11(6)                  | First Amendment to Option Agreement and Escrow Instructions dated May 25, 2001 between Diversified Eastgate Venture and Registrant.   |
| 10.12(13)                 | Second Amendment to Option Agreement and Escrow Instructions dated July 18, 2001 between Diversified Eastgate Venture and Registrant.   |
| 10.13(14)                 | Third Amendment to Option Agreement and Escrow Instructions dated September 27, 2001 between Diversified Eastgate Venture and Registrant.   |
| 10.14(15)                 | First Amendment to Eastgate Pointe Lease dated September 27, 2001 between Diversified Eastgate Venture and Registrant.  |
| 10.15(8)                  | Replacement Reserve Agreement, dated as of January 10, 2002, between the Registrant and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund.  |
| 10.16(17)                 | Loan Assumption and Modification Agreement, dated as of January 10, 2002, between the Registrant, Diversified Eastgate Venture and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund. |
| 10.17(18)                 | Tenant Improvement and Leasing Commission Reserve Agreement, dated as of January 10, 2002, between the Registrant and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund.              |
| +10.18(42)                | Solexa Share Option Plan for Consultants.   |
| +10.19(43)                | Solexa Enterprise Management Incentive Plan.  |
| 10.20(21)                 | Non-exclusive License Agreement dated January 2002 between Amersham Biosciences Corp. and Registrant (with certain confidential portions omitted).  |
| 10.21(22)                 | License Agreement dated June 2002 between Dade Behring Marburg GmbH and Registrant (with certain confidential portions omitted).  |
| 10.22(23)                 | Purchase and Sale Agreement and Escrow Instructions dated June 18, 2004 between Bernardo Property Advisors, Inc. and Registrant.  |
| 10.23(24)                 | Single Tenant Lease dated August 18, 2004 between BMR-9885 Towne Centre Drive LLC and Registrant.   |
| 10.24(25)                 | Settlement and Cross License Agreement dated August 18, 2004 between Applera Corporation and Registrant (with certain confidential portions omitted).   |
| 10.25(39)                 | Solexa 2005 Equity Incentive Plan   |
| 10.26(40)                 | Solexa 1992 Stock Option Plan   |
| 10.27(41)                 | Solexa Unapproved Company Share Option Plan   |
| 10.28(26)                 | Collaboration Agreement dated December 17, 2004 between Invitrogen Incorporated and Registrant (with certain confidential portions omitted).  |
| 10.29(27)                 | Offer letter for Christian O. Henry dated April 26, 2005.   |
| 10.30(28)                 | Forms of Stock Option Agreement under 2000 Stock Plan.  |
| 10.31(29)                 | Secured Convertible Debenture Indenture between Genizon BioSciences Inc., Computershare Trust Company of Canada and the Registrant, dated March 24, 2006.   |
| 10.32(30)                 | Joint Development and Licensing Agreement dated May 15, 2006 between deCODE genetics, ehf. and Registrant (with certain confidential portions omitted).   |

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- 10.33(31) Form of Change in Control Severance Agreement between the Registrant and Jay T. Flatley.
- 10.34(31) Form of Change in Control Severance Agreement between the Registrant and Christian O. Henry.
- 10.35(31) Form of Change in Control Severance Agreement between the Registrant and Tristan B. Orpin.
- 10.36(31) Form of Change in Control Severance Agreement between the Registrant and John R. Stuelpnagel.

**Table of Contents**

| <b>Exhibit<br/>Number</b> | <b>Description of Document</b>  |
|---------------------------|---|
| 10.37(31)                 | Form of Change in Control Severance Agreement between the Registrant and Arthur L. Holden.  |
| 10.38(31)                 | Form of Change in Control Severance Agreement between the Registrant and Christian G. Cabou.  |
| 10.39(34)                 | Securities Purchase Agreement, dated as of November 12, 2006, between Solexa, Inc. and the Registrant.  |
| 10.40(50)                 | Lease between The Irvine Company LLC and the Registrant, dated September 29, 2006.  |
| 10.41(37)                 | Amended and Restated Lease between BMR-9885 Towne Centre Drive LLC and the Registrant for the 9885 Towne Centre Drive property, dated January 26, 2007. |
| 10.42(37)                 | Lease between BMR-9885 Towne Centre Drive LLC and the Registrant for the 9865 Towne Centre Drive property, dated January 26, 2007.                      |
| 10.43(38)                 | Amended and Restated 2005 Stock and Incentive Plan.   |
| 10.44                     | Settlement and Release Agreement between Affymetrix, Inc. and the Registrant, dated January 9, 2008.  |
| 10.45(44)                 | Confirmation of Convertible Bond Hedge Transaction, dated February 12, 2007, by and between the Registrant and Goldman, Sachs & Co.                     |
| 10.46(45)                 | Confirmation of Convertible Bond Hedge Transaction, dated February 12, 2007, by and between the Registrant and Deutsche Bank AG London.                 |
| 10.47(46)                 | Confirmation Issuer Warrant Transaction, dated February 12, 2007, by and between the Registrant and Goldman, Sachs & Co.                                |
| 10.48(47)                 | Confirmation Issuer Warrant Transaction, dated February 12, 2007, by and between the Registrant and Deutsche Bank AG London.                            |
| 10.49(48)                 | Amendment to the Confirmation of Issuer Warrant Transaction, dated February 13, 2007, by and between the Registrant and Goldman, Sachs & Co.            |
| 10.50(49)                 | Amendment to the Confirmation of Issuer Warrant Transaction, dated February 13, 2007, by and between the Registrant and Deutsche Bank AG London.        |
| 14(10)                    | Code of Ethics.   |
| 21.1                      | Subsidiaries of the Registrant.   |
| 23.1                      | Consent of Independent Registered Public Accounting Firm.   |
| 24.1                      | Power of Attorney (included on the signature page).   |
| 31.1                      | Certification of Jay T. Flatley pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2                      | Certification of Christian O. Henry pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1                      | Certification of Jay T. Flatley 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 Christian O. Henry pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.           |

+ Management contract or corporate plan or arrangement

- (1) Incorporated by reference to the same numbered exhibit filed with our Registration Statement on Form S-1 (333-33922) filed April 3, 2000, as amended.
- (2) Incorporated by reference to the same numbered exhibit filed with our Annual Report on Form 10-K (File No. 000-30361) for the year ended December 31, 2000 filed March 29, 2001.
- (3) [reserved]

- (4) Incorporated by reference to exhibit 10.13 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended March 31, 2001 filed May 8, 2001.
- (5) Incorporated by reference to the same numbered exhibit filed with our Registration Statement on Form 8-A (File No. 000-30361) filed May 14, 2001.
- (6) Incorporated by reference to exhibit 10.15 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended June 30, 2001 filed August 13, 2001.

**Table of Contents**

- (7) Incorporated by reference to exhibit 10.3 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended October 1, 2006 filed October 30, 2006.
- (8) Incorporated by reference to exhibit 10.18 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended March 31, 2002 filed May 13, 2002.
- (9) [reserved]
- (10) Incorporated by reference to the same numbered exhibit filed with our Annual Report on Form 10-K (File No. 000-30361) for the year ended December 28, 2003 filed March 12, 2004.
- (11) [reserved]
- (12) [reserved]
- (13) Incorporated by reference to exhibit 10.16 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended September 30, 2001 filed November 14, 2001.
- (14) Incorporated by reference to exhibit 10.17 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended September 30, 2001 filed November 14, 2001.
- (15) Incorporated by reference to exhibit 10.18 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended September 30, 2001 filed November 14, 2001.
- (16) Incorporated by reference to exhibit 2.1 filed with our Form 8-K (File No. 000-30361) filed November 13, 2006.
- (17) Incorporated by reference to exhibit 10.19 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended March 31, 2002 filed May 13, 2002.
- (18) Incorporated by reference to the exhibit 10.20 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended March 31, 2002 filed May 13, 2002.
- (19) [reserved]
- (20) Incorporated by reference to the exhibit 10.22 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended March 31, 2002 filed May 13, 2002.
- (21) Incorporated by reference to exhibit 10.24 filed with Amendment No. 1 to our Registration Statement on Form S-3 (File No. 333-111496) filed March 2, 2004.
- (22) Incorporated by reference to exhibit 10.23 filed with our Amendment No. 1 to our Registration Statement on Form S-3 (File No. 333-111496) filed March 2, 2004.
- (23) Incorporated by reference to exhibit 10.25 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended June 27, 2004 filed August 6, 2004.
- (24)

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Incorporated by reference to exhibit 10.26 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended October 3, 2004 filed November 12, 2004.

- (25) Incorporated by reference to exhibit 10.27 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended October 3, 2004 filed November 12, 2004.
- (26) Incorporated by reference to exhibit 10.28 filed with our Form 10-K (File No. 000-30361) for the year ended January 2, 2005 filed March 8, 2005.
- (27) Incorporated by reference to exhibit 10.33 filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended July 3, 2005 filed August 8, 2005.
- (28) Incorporated by reference to exhibit 10.29 filed with our Form 10-K (File No. 000-30361) for the year ended January 2, 2005 filed March 8, 2005.
- (29) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended April 2, 2006 filed May 8, 2006.
- (30) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended July 2, 2006 filed August 2, 2006.
- (31) Incorporated by reference to the same numbered exhibit filed with our Form 8-K (File No. 000-30361) filed August 23, 2006.
- (32) [reserved]

**Table of Contents**

- (33) [reserved]
- (34) Incorporated by reference to exhibit 10.1 filed with our Form 8-K (File No. 000-30361) filed November 13, 2006.
- (35) Incorporated by reference to exhibit 4.1 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (36) Incorporated by reference to exhibit 4.2 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (37) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q (File No. 000-30361) for the quarterly period ended April 1, 2007 filed May 3, 2007.
- (38) Incorporated by reference to exhibit 10.1 filed with our Form 8-K (File No. 000-30361) filed on July 30, 2007.
- (39) Incorporated by reference to exhibit 99.1 filed with our Form 8-K (File No. 000-30361) filed November 26, 2007.
- (40) Incorporated by reference to exhibit 99.2 filed with our Form 8-K (File No. 000-30361) filed November 26, 2007.
- (41) Incorporated by reference to exhibit 99.3 filed with our Form 8-K (File No. 000-30361) filed November 26, 2007.
- (42) Incorporated by reference to exhibit 99.4 filed with our Form 8-K (File No. 000-30361) filed November 26, 2007.
- (43) Incorporated by reference to exhibit 99.5 filed with our Form 8-K (File No. 000-30361) filed November 26, 2007.
- (44) Incorporated by reference to exhibit 10.1 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (45) Incorporated by reference to exhibit 10.2 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (46) Incorporated by reference to exhibit 10.3 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (47) Incorporated by reference to exhibit 10.4 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (48) Incorporated by reference to exhibit 10.5 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (49) Incorporated by reference to exhibit 10.6 filed with our Form 8-K (File No. 000-30361) filed February 16, 2007.
- (50)

Incorporated by reference to the same numbered exhibit filed with our Annual Report on Form 10-K (File No. 000-30361) for the year ended December 31, 2006 filed February 28, 2007.

**Supplemental Information**

No Annual Report to stockholders or proxy materials has been sent to stockholders as of the date of this report. The Annual Report to stockholders and proxy material will be furnished to our stockholders subsequent to the filing of this Annual Report on Form 10-K and we will furnish such material to the SEC at that time.



**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on February 26, 2008.

Illumina, Inc.

By /s/ Jay T. Flatley  
 Jay T. Flatley  
*President and Chief Executive Officer*

February 26, 2008

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENT, that each person whose signature appears below constitutes and appoints Jay T. Flatley and Christian O. Henry, and each or any one of them, his true and lawful attorney-in-fact and agent, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments to this Annual Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitutes or substitute, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Annual Report on Form 10-K has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

|                          |  |                   |
|--------------------------|--|-------------------|
| /s/ Jay T. Flatley       | President, Chief Executive Officer and<br>Director (Principal Executive Officer)                     | February 26, 2008 |
| Jay T. Flatley           |  |                   |
| /s/ Christian O. Henry   | Senior Vice President and Chief Financial<br>Officer (Principal Financial and<br>Accounting Officer) | February 26, 2008 |
| Christian O. Henry       |  |                   |
| /s/ William H. Rastetter | Chairman of the Board of Directors   | February 26, 2008 |
| William H. Rastetter     |  |                   |
| /s/ Daniel M. Bradbury   | Director   | February 26, 2008 |

Daniel M. Bradbury

/s/ A. Blaine Bowman

Director

February 26, 2008

A. Blaine Bowman

/s/ Karin Eastham

Director

February 26, 2008

Karin Eastham

**Table of Contents**

|                         |  |                   |
|-------------------------|--|-------------------|
| /s/ Jack Goldstein      | Director   | February 26, 2008 |
| Jack Goldstein          |  |                   |
| /s/ Paul Grint          | Director   | February 26, 2008 |
| Paul Grint              |  |                   |
| /s/ John R. Stuelpnagel | Senior Vice President and General<br>Manager, Microarrays, Chief Operating<br>Officer and Director | February 26, 2008 |
| John R. Stuelpnagel     |  |                   |
| /s/ David R. Walt       | Director   | February 26, 2008 |
| David R. Walt           |  |                   |
| /s/ Roy Whitfield       | Director   | February 26, 2008 |
| Roy Whitfield           |  |                   |

**Table of Contents**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

|  |     |
|--|-----|
| <u>Report of Independent Registered Public Accounting Firm</u>   | F-2 |
| <u>Consolidated Balance Sheets as of December 30, 2007 and December 31, 2006</u>   | F-3 |
| <u>Consolidated Statements of Operations for the years ended December 30, 2007, December 31, 2006, and January 1, 2006</u> | F-4 |
| <u>Consolidated Statements of Stockholders' Equity for the period from January 2, 2005 to December 30, 2007</u>            | F-5 |
| <u>Consolidated Statements of Cash Flows for the years ended December 30, 2007, December 31, 2006, and January 1, 2006</u> | F-6 |
| <u>Notes to Consolidated Financial Statements</u>  | F-7 |

F-1

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**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors and Stockholders of  
Illumina, Inc.

We have audited the accompanying consolidated balance sheets of Illumina, Inc. as of December 30, 2007 and December 31, 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 30, 2007. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Illumina, Inc., at December 30, 2007 and December 31, 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 30, 2007, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, Illumina, Inc. changed its method of accounting for share-based payments in accordance with Statement of Financial Accounting Standards No. 123R, Share-Based Payment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Illumina, Inc.'s internal control over financial reporting as of December 30, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2008 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California  
February 22, 2008

**Table of Contents****ILLUMINA, INC.****CONSOLIDATED BALANCE SHEETS**

|  | <b>December 30,<br/>2007</b>                    | <b>December 31,<br/>2006</b> |
|--|---|------------------------------|
|  | <b>(In thousands, except share<br/>amounts)</b> |                              |
| <b>ASSETS</b>  |   |                              |
| Current assets:  |   |                              |
| Cash and cash equivalents  | \$ 174,941                                      | \$ 38,386                    |
| Short-term investments   | 211,141   | 92,418                       |
| Accounts receivable, net   | 83,119  | 39,984                       |
| Inventory, net   | 53,980  | 20,169                       |
| Deferred tax assets - current portion  | 26,934  | 259                          |
| Prepaid expenses and other current assets  | 12,640  | 2,510                        |
| <b>Total current assets</b>  | <b>562,755</b>                                  | <b>193,726</b>               |
| Property and equipment, net  | 46,274  | 25,634                       |
| Investment in Solexa   |   | 67,784                       |
| Goodwill   | 228,734   | 2,125                        |
| Intangible assets, net   | 58,116  | 108                          |
| Deferred tax assets - long term portion  | 80,245  | 294                          |
| Other assets, net  | 11,608  | 10,913                       |
| <b>Total assets</b>  | <b>\$ 987,732</b>                               | <b>\$ 300,584</b>            |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |   |                              |
| Current liabilities:   |   |                              |
| Accounts payable   | \$ 24,311                                       | \$ 9,853                     |
| Litigation settlements payable   | 90,536  |                              |
| Accrued liabilities  | 50,852  | 23,860                       |
| Current portion of long-term debt  | 16  | 63                           |
| <b>Total current liabilities</b>   | <b>165,715</b>                                  | <b>33,776</b>                |
| Long-term debt, less current portion   | 400,000   |                              |
| Deferred gain on sale of land and building   | 2,485   | 2,468                        |
| Deferred income tax liabilities  |   | 6,987                        |
| Other long-term liabilities  | 7,854   | 10,011                       |
| Commitments and contingencies  |   |                              |
| Stockholders' equity:  |   |                              |
| Preferred stock, \$0.01 par value, 10,000,000 shares authorized, no shares issued and outstanding at December 30, 2007 and December 31, 2006 | 628   | 469                          |

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|   |            |    |           |
|---|------------|----|-----------|
| Common stock, \$0.01 par value, 120,000,000 shares authorized,<br>62,803,677 shares issued and outstanding at December 30, 2007,<br>46,857,512 shares issued and outstanding at December 31, 2006 |            |    |           |
| Additional paid-in capital  | 1,044,302  |    | 340,197   |
| Accumulated other comprehensive income  | 1,347      |    | 11,294    |
| Accumulated deficit   | (382,977)  |    | (104,618) |
| Treasury stock, at cost (7,409,545 shares at December 30, 2007 and no shares at<br>December 31, 2006)   | (251,622)  |    |           |
| Total stockholders' equity  | 411,678    |    | 247,342   |
| Total liabilities and stockholders' equity  | \$ 987,732 | \$ | 300,584   |

See accompanying notes to consolidated financial statements

F-3

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**Table of Contents****ILLUMINA, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

|   | <b>Year<br/>Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|---|---|---|---|
|   | <b>(In thousands, except per share amounts)</b> |   |   |
| Revenue   |   |   |   |
| Product revenue   | \$ 326,699                                      | \$ 155,811                                  | \$ 57,752                                 |
| Service and other revenue   | 40,100  | 28,775                                      | 15,749                                    |
| Total revenue   | 366,799   | 184,586                                     | 73,501                                    |
| Costs and expenses:   |   |   |   |
| Cost of product revenue (including non-cash stock compensation expense of \$4,045, \$1,289, and \$0, respectively)                | 119,991   | 51,271                                      | 19,920                                    |
| Cost of service and other revenue (including non-cash stock compensation expense of \$279, \$235, and \$0, respectively)          | 12,445  | 8,073                                       | 3,261                                     |
| Research and development (including non-cash stock compensation expense of \$10,016, \$3,891, and \$84, respectively)             | 73,943  | 33,373                                      | 27,809                                    |
| Selling, general and administrative (including non-cash stock compensation expense of \$19,406, \$8,889, and \$186, respectively) | 101,256   | 54,057                                      | 28,158                                    |
| Amortization of acquired intangible assets  | 2,429   |   |   |
| Acquired in-process research and development  | 303,400   |   | 15,800                                    |
| Litigation settlements  | 54,536  |   |   |
| Total costs and expenses  | 668,000   | 146,774                                     | 94,948                                    |
| Income (loss) from operations   | (301,201)                                       | 37,812                                      | (21,447)                                  |
| Interest income   | 16,026  | 5,368                                       | 1,404                                     |
| Interest and other expense, net   | (3,610)   | (560)                                       | (668)                                     |
| Income (loss) before income taxes   | (288,785)                                       | 42,620                                      | (20,711)                                  |
| Provision (benefit) for income taxes  | (10,426)  | 2,652                                       | 163                                       |
| Net income (loss)   | \$ (278,359)                                    | \$ 39,968                                   | \$ (20,874)                               |
| Net income (loss) per basic share   | \$ (5.14)                                       | \$ 0.90                                     | \$ (0.52)                                 |
| Net income (loss) per diluted share   | \$ (5.14)                                       | \$ 0.82                                     | \$ (0.52)                                 |
| Shares used in calculating basic net income (loss) per share  | 54,154  | 44,501                                      | 40,147                                    |



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|  |        |        |        |
|--|--------|--------|--------|
| Shares used in calculating diluted net income (loss) per share | 54,154 | 48,754 | 40,147 |
|--|--------|--------|--------|

See accompanying notes to consolidated financial statements

F-4

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**Table of Contents****ILLUMINA, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

|  | <b>Common Stock<br/>Shares</b> | <b>Common Stock<br/>Amount</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Deferred<br/>Compensation</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income<br/>(In thousands)</b> | <b>Accumulated<br/>Deficit</b> | <b>Treasury Stock<br/>Shares</b> | <b>Treasury Stock<br/>Amount</b> | <b>Total<br/>Stockholders'<br/>Equity</b> |
|--|--------------------------------|--------------------------------|---|----------------------------------|--|--------------------------------|----------------------------------|----------------------------------|---|
| Balance as of January 2, 2015  | 38,121                         | \$ 381                         | \$ 195,653                                | \$ (156)                         | \$ 96  | \$ (123,712)                   |                                  |                                  | \$ 72,209                                 |
| Issuance of common stock for cash  | 1,592                          | 16                             | 6,030                                     |                                  |  |                                |                                  |                                  | 6,042                                     |
| Issuance of common stock in conjunction with an acquisition                      | 1,580                          | 16                             | 14,812                                    |                                  |  |                                |                                  |                                  | 14,828                                    |
| Deferred compensation related to unvested restricted stock options assumed       |                                |                                |   | (197)                            |  |                                |                                  |                                  | (197)                                     |
| Compensation expense related to acceleration of options for terminated employees |                                |                                | 79  |                                  |  |                                |                                  |                                  | 79  |
| Deferred compensation related to a restricted stock award                        | 1                              |                                | 192                                       | (192)                            |  |                                |                                  |                                  |   |
| Amortization of deferred compensation  |                                |                                |   | 191                              |  |                                |                                  |                                  | 191                                       |
| Other comprehensive income (loss):   |                                |                                |   |                                  |  |                                |                                  |                                  |   |
| Realized gain on available-for-sale securities                                   |                                |                                |   |                                  | 29   |                                |                                  |                                  | 29  |
| Realized gain on foreign currency exchange contracts                             |                                |                                |   |                                  | 56   |                                |                                  |                                  | 56  |
| Translation adjustment   |                                |                                |   |                                  | 77   |                                |                                  |                                  | 77  |
| Other comprehensive loss   |                                |                                |   |                                  |  | (20,874)                       |                                  |                                  | (20,874)                                  |
| Balance as of January 1, 2016  | 41,294                         | 413                            | 216,766                                   | (354)                            | 258  | (144,586)                      |                                  |                                  | 72,491                                    |
| Issuance of common stock   | 5,563                          | 56                             | 114,440                                   |                                  |  |                                |                                  |                                  | 114,496                                   |

|                              |        |     |           |     |          |           |           |
|------------------------------|--------|-----|-----------|-----|----------|-----------|-----------|
| 2006 offering costs          |        |     | (6,530)   |     |          |           | (6,530)   |
| stock-based                  |        |     |           |     |          |           |           |
| compensation expense         |        |     | 14,082    | 354 |          |           | 14,436    |
| deductible tax benefit       |        |     |           |     |          |           |           |
| related to stock options     |        |     |           |     |          |           |           |
| exercised                    |        |     | 1,439     |     |          |           | 1,439     |
| comprehensive income         |        |     |           |     |          |           |           |
| (continued):                 |        |     |           |     |          |           |           |
| realized gain on             |        |     |           |     |          |           |           |
| available-for-sale           |        |     |           |     |          |           |           |
| securities, net of           |        |     |           |     |          |           |           |
| deferred tax                 |        |     |           |     | 10,693   |           | 10,693    |
| realized gain on             |        |     |           |     |          |           |           |
| foreign contracts            |        |     |           |     | (10)     |           | (10)      |
| foreign currency             |        |     |           |     |          |           |           |
| translation adjustment       |        |     |           |     | 353      |           | 353       |
| income                       |        |     |           |     |          | 39,968    | 39,968    |
| comprehensive income         |        |     |           |     |          |           | 51,000    |
| Balance as of                |        |     |           |     |          |           |           |
| December 31, 2006            | 46,857 | 469 | 340,197   |     | 11,294   | (104,618) | 247,300   |
| Balance of common            |        |     |           |     |          |           |           |
| stock                        | 2,327  | 23  | 30,067    |     |          |           | 30,067    |
| Balance of common            |        |     |           |     |          |           |           |
| stock for the acquisition    |        |     |           |     |          |           |           |
| of Solexa, Inc.              | 13,221 | 132 | 530,592   |     |          |           | 530,745   |
| Fair value of options        |        |     |           |     |          |           |           |
| acquired from Solexa,        |        |     |           |     |          |           |           |
|                              |        |     | 75,334    |     |          |           | 75,334    |
| Convertible note hedge       |        |     | (139,040) |     |          |           | (139,040) |
| Warrants issued in           |        |     |           |     |          |           |           |
| connection with the          |        |     |           |     |          |           |           |
| issuance of convertible debt |        |     |           |     |          |           |           |
| Balance                      |        |     | 92,440    |     |          |           | 92,440    |
| Warrants exercised           | 399    | 4   | 6,071     |     |          |           | 6,071     |
| stock-based                  |        |     |           |     |          |           |           |
| compensation expense         |        |     | 33,926    |     |          |           | 33,926    |
| deductible tax benefit       |        |     |           |     |          |           |           |
| related to stock options     |        |     |           |     |          |           |           |
| exercised                    |        |     | 20,086    |     |          |           | 20,086    |
| deductible tax benefit       |        |     |           |     |          |           |           |
| related to convertible       |        |     |           |     |          |           |           |
| debt issuance                |        |     | 54,629    |     |          |           | 54,629    |
| Purchases of common          |        |     |           |     |          |           |           |
| stock                        |        |     |           |     | (7,410)  | (251,622) | (251,622) |
| comprehensive income         |        |     |           |     |          |           |           |
| (continued):                 |        |     |           |     |          |           |           |
| realized loss on             |        |     |           |     | (10,529) |           | (10,529)  |
| available-for-sale           |        |     |           |     |          |           |           |
| securities, net of           |        |     |           |     |          |           |           |

|                   |        |        |              |    |          |              |           |              |    |        |
|-------------------|--------|--------|--------------|----|----------|--------------|-----------|--------------|----|--------|
| ferred tax        |        |        |              |    |          |              |           |              |    |        |
| ign currency      |        |        |              |    |          |              |           |              |    |        |
| lation adjustment |        |        |              |    | 582      |              |           |              |    | 5      |
| income            |        |        |              |    |          |              | (278,359) |              |    | (278,3 |
| prehensive loss   |        |        |              |    |          |              |           |              |    | (288,3 |
| nce as of         |        |        |              |    |          |              |           |              |    |        |
| ember 30, 2007    | 62,804 | \$ 628 | \$ 1,044,302 | \$ | \$ 1,347 | \$ (382,977) | (7,410)   | \$ (251,622) | \$ | 411,6  |

See accompanying notes to consolidated financial statements

F-5

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**Table of Contents****ILLUMINA, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | <b>Year<br/>Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006<br/>(In thousands)</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|--|---|--|---|
| Cash flows from operating activities:  |   |  |   |
| Net income (loss)  | \$ (278,359)                                    | \$ 39,968  | \$ (20,874)                               |
| Adjustments to reconcile net income (loss) to net cash used in operating activities: |   |  |   |
| Acquired in-process research and development   | 303,400   |  | 15,800                                    |
| Amortization of increase in inventory valuation                                      | 942   |  |   |
| Amortization of acquired intangible assets   | 2,429   |  |   |
| Amortization of debt issuance costs  | 1,176   |  |   |
| Depreciation expense   | 11,464  | 6,032  | 3,824                                     |
| Loss on disposal of property and equipment   | 15  | 116  | 293                                       |
| Amortization of premium on investments   |   |  | (14)                                      |
| Stock-based compensation expense   | 33,746  | 14,304   | 270                                       |
| Incremental tax benefit related to stock options exercised                           | (20,086)  | (1,439)  |   |
| Amortization of gain on sale of land and building                                    | (187)   | (375)  | (375)                                     |
| Changes in operating assets and liabilities:   |   |  |   |
| Accounts receivable  | (37,060)  | (21,733)   | (7,039)                                   |
| Inventory  | (27,130)  | (9,728)  | (6,502)                                   |
| Prepaid expenses and other current assets  | (6,127)   | (1,591)  | 290                                       |
| Deferred income taxes  | (11,408)  | (548)  |   |
| Other assets   | 2,612   | (5,212)  | 687                                       |
| Accounts payable   | 12,262  | 2,438  | 3,193                                     |
| Litigation settlements payable   | 54,536  |  |   |
| Accrued income taxes   | 1,586   | 1,809  | 144                                       |
| Accrued liabilities  | 15,901  | 9,066  | 4,070                                     |
| Litigation judgment  |   |  | (5,957)                                   |
| Other long-term liabilities  | (3,418)   | 5,893  | 3,182                                     |
| Net cash provided by (used in) operating activities                                  | 56,294  | 39,000   | (9,008)                                   |
| Cash flows from investing activities:  |   |  |   |
| Net cash obtained from (paid for) acquisitions                                       | 72,075  |  | (2,388)                                   |
| Investment in secured convertible debentures   |   | (3,036)  |   |
| Sale of secured convertible debentures   | 3,593   |  |   |
| Investment in Solexa   |   | (50,000)   |   |
| Purchases of available-for-sale securities   | (598,383)                                       | (236,331)  |   |
| Sales and maturities of available-for-sale securities                                | 479,415   | 143,846  | 12,248                                    |
| Proceeds from sale of fixed assets   | 42  |  |   |

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|   |            |           |           |
|---|------------|-----------|-----------|
| Purchase of property and equipment                                  | (24,343)   | (15,114)  | (11,395)  |
| Cash paid for intangible assets                                     | (85)       | (100)     |           |
| Net cash used in investing activities                               | (67,686)   | (160,735) | (1,535)   |
| Cash flows from financing activities:                               |            |           |           |
| Payments on long-term debt  | (95)       | (109)     | (83)      |
| Proceeds from issuance of convertible debt, net of issuance costs   | 390,269    |           |           |
| Purchase of convertible note hedges                                 | (139,040)  |           |           |
| Sale of warrants  | 92,440     |           |           |
| Proceeds from warrant exercises                                     | 6,075      |           |           |
| Common stock repurchases  | (251,622)  |           |           |
| Proceeds from issuance of common stock                              | 30,179     | 107,966   | 6,046     |
| Incremental tax benefit related to stock options exercised          | 20,086     | 1,439     |           |
| Net cash provided by financing activities                           | 148,292    | 109,296   | 5,963     |
| Effect of foreign currency translation on cash and cash equivalents | (345)      | 3         | 613       |
| Net increase (decrease) in cash and cash equivalents                | 136,555    | (12,436)  | (3,967)   |
| Cash and cash equivalents at beginning of the year                  | 38,386     | 50,822    | 54,789    |
| Cash and cash equivalents at end of the year                        | \$ 174,941 | \$ 38,386 | \$ 50,822 |
| Supplemental disclosures of cash flow information:                  |            |           |           |
| Cash paid during the year for interest                              | \$ 1,378   | \$ 11     | \$ 15     |
| Cash paid during the year for income taxes                          | \$ 2,581   | \$ 1,392  | \$ 33     |

See accompanying notes to consolidated financial statements

**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Organization and Summary of Significant Accounting Policies**

***Organization and Business***

Illumina, Inc. (the Company) was incorporated on April 28, 1998. The Company is a leading developer, manufacturer and marketer of integrated systems for the large-scale analysis of genetic variation and biological function. Using the Company's proprietary technologies, the Company provides a comprehensive line of products and services that currently serve the sequencing, genotyping and gene expression markets. The Company also expects to enter the market for molecular diagnostics. The Company's tools provide researchers around the world with the performance, throughput, cost effectiveness and flexibility necessary to perform the billions of genetic tests needed to extract valuable medical information from advances in genomics and proteomics. The Company believes this information will enable researchers to correlate genetic variation and biological function, which will enhance drug discovery and clinical research, allow diseases to be detected earlier and permit better choices of drugs for individual patients.

***Basis of Presentation***

The consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

***Fiscal Year***

The Company's fiscal year is 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, and September 30. The years ended December 30, 2007, December 31, 2006 and January 1, 2006 were all 52 weeks.

***Reclassifications***

Certain prior year amounts have been reclassified to conform to current year presentation. During the fourth quarter of 2007, the Company classified research revenue as part of service and other revenue. Research revenue consists of government grants and other research funding. For the years ended December 30, 2007, December 31, 2006, and January 1, 2006, research revenue represented approximately \$0.5 million, \$1.3 million, and \$1.8 million, respectively.

***Use of Estimates***

The preparation of financial statements requires that management make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, goodwill and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

***Cash and Cash Equivalents***

Cash and cash equivalents are comprised of short-term, highly liquid investments with maturities of 90 days or less from the date of purchase.

***Investments***

The Company applies Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, to its investments. Under SFAS No. 115, the Company classifies its investments as available-for-sale and records such assets at estimated fair value in the

F-7

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**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

balance sheet, with unrealized gains and losses, if any, reported in stockholders' equity. As of December 30, 2007, the Company's excess cash balances were primarily invested in marketable debt securities, including commercial paper and corporate bonds and notes, with strong credit ratings or short maturity mutual funds providing similar financial returns. The Company limits the amount of investment exposure as to institutions, maturity and investment type. The cost of securities sold is determined based on the specific identification method.

***Restricted Cash***

As of December 30, 2007, restricted cash, included in cash and cash equivalents, consisted of bank guarantees totaling approximately \$720,000 primarily associated with various sales contracts. These guarantees are scheduled to be released during 2008. As of December 31, 2006, restricted cash consisted of two bank guarantees totaling approximately \$250,000. Both guarantees were released during 2007.

***Fair Value of Financial Instruments***

The carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, accounts and notes receivable, accounts payable, accrued liabilities, and convertible senior notes approximate fair value.

***Accounts and Notes Receivable***

Trade accounts receivable are recorded at net invoice value and notes receivable are recorded at contractual value plus earned interest. Interest income on notes receivable is recognized according to the terms of each related agreement. The Company considers receivables past due based on the contractual payment terms. The Company reviews its exposure to amounts receivable and reserves specific amounts if collectibility is no longer reasonably assured. The Company also reserves a percentage of its trade receivable balance based on collection history. The Company re-evaluates such reserves on a regular basis and adjusts its reserves as needed.

***Concentrations of Risk***

Cash equivalents, investments and accounts receivable are financial instruments that potentially subject the Company to concentrations of credit risk. Most of the Company's cash and cash equivalents as of December 30, 2007 were deposited with financial institutions in the United States and the Company's investment policy restricts the amount of credit exposure to any one issuer and to any one type of investment, other than securities issued by the U.S. government. The Company has historically not experienced significant credit losses from investments and accounts receivable. The Company performs a regular review of customer activity and associated credit risks and generally does not require collateral. The Company maintains an allowance for doubtful accounts based upon a percentage of its trade receivable balance based on collection history and re-evaluates such reserves on a regular basis.

The Company's products require customized components that currently are available from a limited number of sources. The Company obtains certain key components included in its products from single vendors. No assurance can be given that these or other product components will be available in sufficient quantities at acceptable costs in the future.

Approximately 43%, 44%, and 38% of the Company's revenue for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively, was derived from shipments to customers outside the United States.

Approximately 46% and 39% of the Company's net accounts receivable

F-8

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**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

balance as of December 30, 2007 and December 31, 2006, respectively, was related to customers outside the United States. Sales to territories outside of the United States are generally denominated in U.S. dollars. International sales entail a variety of risks, including currency exchange fluctuations, longer payment cycles and greater difficulty in accounts receivable collection. The Company is also subject to general geopolitical risks, such as political, social and economic instability and changes in diplomatic and trade relations. The risks of international sales are mitigated in part by the extent to which sales are geographically distributed.

***Inventories***

Inventories are stated at the lower of standard cost (which approximates actual cost) or market. Inventory includes raw materials and finished goods that may be used in the research and development process and such items are expensed as consumed. Provisions for slow moving, excess and obsolete inventories are provided based on product life cycle and development plans, product expiration and quality issues, historical experience and inventory levels.

***Property and Equipment***

Property and equipment are stated at cost, subject to review of impairment, and depreciated over the estimated useful lives of the assets (generally three to seven years) using the straight-line method. Amortization of leasehold improvements is computed over the shorter of the lease term or the estimated useful life of the related assets.

***Goodwill***

Goodwill represents the excess of the cost over the fair value of net assets acquired. SFAS No. 142, *Goodwill and Other Intangible Assets*, requires that goodwill be tested annually for impairment or more frequently if events and circumstances warrant, utilizing a test that begins with an estimate of the fair value of the reporting unit or intangible asset. The Company tests goodwill annually and whenever events or circumstances occur indicating that goodwill might be impaired. The Company performed its annual impairment test of goodwill as of May 1, 2007, noting no impairment, and has determined there has been no impairment of goodwill through December 30, 2007.

***Intangible Assets***

Intangible assets include acquired technology, customer relationships, other license agreements, and licensed technology, which are being amortized over their estimated useful lives ranging from three to 10 years (see Note 3). The amortization of the Company's acquired technology and customer relationships is excluded from cost of product revenue and is separately classified as amortization of acquired intangible assets on the Consolidated Statements of Operations. The Company will begin amortizing licensed technology, representing the balance capitalized as part of the Affymetrix litigation, in January 2008.

***Long-Lived Assets***

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, if indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the future discounted cash flows associated with the use of the asset and adjusts the value of the asset accordingly. While the Company's historical operating and cash flow losses are indicators of

impairment, the Company believes the current and future cash flows to be received from the long-lived assets recorded at December 30, 2007 will

F-9

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**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

exceed the assets' carrying value, and accordingly the Company has not recognized any impairment losses through December 30, 2007.

***Reserve for Product Warranties***

The Company generally provides a one-year warranty on instrumentation. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with system sales. This expense is recorded as a component of cost of revenue.

***Revenue Recognition***

The Company's revenue is generated primarily from the sale of products and services. Product revenue consists of sales of arrays, reagents, flow cells, instrumentation, and oligonucleotides (oligos), which are short sequences of DNA. Service and other revenue consists of revenue received for performing genotyping and sequencing services, extended warranty sales and amounts earned under research agreements with government grants, which is recognized in the period during which the related costs are incurred.

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the seller's price to the buyer is fixed or determinable and collectibility is reasonably assured. In instances where final acceptance of the product or system is required, revenue is deferred until all the acceptance criteria have been met. All revenue is recorded net of any applicable allowances for returns or discounts.

Revenue for product sales is recognized generally upon shipment and transfer of title to the customer, provided no significant obligations remain and collection of the receivables is reasonably assured. Revenue from the sale of instrumentation is recognized when earned, which is generally upon shipment. Revenue for genotyping and sequencing services is recognized when earned, which is generally at the time the genotyping and sequencing analysis data is delivered to the customer.

In order to assess whether the price is fixed and determinable, the Company ensures there are no refund rights. If payment terms are based on future performance, the Company defers revenue recognition until the price becomes fixed and determinable. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. If the Company determines that collection of a payment is not reasonably assured, revenue recognition is deferred until the time collection becomes reasonably assured, which is generally upon receipt of payment.

Sales of instrumentation generally include a standard one-year warranty. The Company also sells separately priced maintenance (extended warranty) contracts, which are generally for one or two years, upon the expiration of the initial warranty. Revenue for extended warranty sales is recognized ratably over the term of the extended warranty period. Reserves are provided for estimated product warranty expenses at the time the associated revenue is recognized. If the Company were to experience an increase in warranty claims or if costs of servicing its warranted products were greater than its estimates, gross margins could be adversely affected.

While the majority of its sales agreements contain standard terms and conditions, the Company does enter into agreements that contain multiple elements or non-standard terms and conditions. Emerging Issues Task Force (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables*, provides guidance on accounting for arrangements that

involve the delivery or performance of multiple products, services, or rights to use assets within contractually binding arrangements. For arrangements with multiple elements, revenue recognition is based on the individual units of accounting determined to exist in the arrangement. A delivered item is considered a separate unit of accounting when the delivered

F-10

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

item has value to the customer on a stand-alone basis, there is objective and reliable evidence of the fair value of the undelivered items and, if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered items is considered probable and substantially in the Company's control. Items are considered to have stand-alone value when they are sold separately by any vendor or the customer could resell the item on a stand-alone basis. Fair value of an item is generally the price charged for the product when regularly sold on a stand-alone basis. When objective and reliable evidence of fair value exists for all units of accounting in an arrangement, arrangement consideration is generally allocated to each unit of accounting based upon their relative fair values. In those instances when objective and reliable evidence of fair value exists for the undelivered items but not for the delivered items, the residual method is used to allocate arrangement consideration. Under the residual method, the amount of arrangement consideration allocated to the delivered items equals the total arrangement consideration less the aggregate fair value of the undelivered items. When the Company is unable to establish stand-alone value for delivered items or when fair value of undelivered items has not been established, revenue is deferred until all elements are delivered and services have been performed, or until fair value can objectively be determined for any remaining undelivered elements. The Company recognizes revenue for delivered elements only when it determines that the fair values of undelivered elements are known and there are no uncertainties regarding customer acceptance.

***Shipping and Handling Expenses***

Shipping and handling expenses are included in cost of product revenue and totaled \$2.2 million, \$1.8 million, and \$1.3 million for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively.

***Research and Development***

Research and development expenses consist of costs incurred for internal and grant-sponsored research and development. Research and development expenses include salaries, contractor fees, facilities costs, utilities and allocations of benefits. Expenditures relating to research and development are expensed in the period incurred.

***Advertising Costs***

The Company expenses advertising costs as incurred. Advertising costs were \$2.8 million, \$1.9 million and \$1.2 million for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively.

***Income Taxes***

In accordance with SFAS No. 109, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for the expected future tax benefit to be derived from tax loss and credit carryforwards. Deferred tax assets and liabilities are determined using the enacted tax rates in effect for the years in which those tax assets are expected to be realized. A valuation allowance is established when it is more likely than not the future realization of all or some of the deferred tax assets will not be achieved. The evaluation of the need for a valuation allowance is performed on a jurisdiction by jurisdiction basis, and includes a review of all available positive and negative evidence. As of December 30, 2007, the Company maintained a valuation allowance only against certain U.S. and





**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

foreign deferred tax assets that the Company concluded did not meet the more likely than not threshold required under SFAS No. 109.

Due to the adoption of SFAS No. 123R, the Company recognizes excess tax benefits associated with share-based compensation to stockholders' equity only when realized. When assessing whether excess tax benefits relating to share-based compensation have been realized, the Company follows the with-and-without approach excluding any indirect effects of the excess tax deductions. Under this approach, excess tax benefits related to share-based compensation are not deemed to be realized until after the utilization of all other tax benefits available to the Company.

Effective January 1, 2007, the Company adopted FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN No. 48 requires recognition of the impact of a tax position in the Company's financial statements only if that position is more likely than not of being sustained upon examination by taxing authorities, based on the technical merits of the position. Any interest and penalties related to uncertain tax positions will be reflected in income tax expense.

***Foreign Currency Translation***

The functional currencies of the Company's wholly-owned subsidiaries are their respective local currencies. Accordingly, all balance sheet accounts of these operations are translated to U.S. dollars using the exchange rates in effect at the balance sheet date, and revenues and expenses are translated using the average exchange rates in effect during the period. The gains and losses from foreign currency translation of these subsidiaries' financial statements are recorded as a separate component of stockholders' equity under the caption accumulated other comprehensive income.

***Stock-Based Compensation***

Prior to the beginning of fiscal 2006, the Company measured compensation expense for its employee stock-based compensation plans using the intrinsic value method prescribed by APB Opinion No. 25. The Company applied the disclosure provisions of SFAS No. 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation Transition and Disclosure*, as if the fair-value-based method had been applied in measuring stock-based compensation expense. Under APB Opinion No. 25, when the exercise price of the Company's employee stock options was not less than the market price of the underlying stock on the date of the grant, no compensation expense was recognized.

Effective January 2, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123R, *Share-Based Payment*, using the modified prospective transition method. The modified prospective transition method requires that stock-based compensation expense be recorded for all new and unvested stock options, restricted stock and employee stock purchase plan (ESPP) shares that are ultimately expected to vest as the requisite service is rendered. As of December 30, 2007, approximately \$122.9 million of total unrecognized compensation cost related to stock options, restricted stock and ESPP shares issued to date is expected to be recognized over a weighted-average period of approximately two years.

**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table illustrates the effect on net loss and basic and diluted net loss per share as if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation during the year ended January 1, 2006 (in thousands, except per share data):

|  | <b>Year Ended<br/>January 1,<br/>2006</b> |
|--|---|
| Net loss as reported                           | \$ (20,874)                               |
| Add: Stock-based compensation expense recorded | 270                                       |
| Less: Assumed stock-based compensation expense | (8,393)                                   |
| Pro forma net loss                             | \$ (28,997)                               |
| Basic and diluted net loss per share:          |   |
| As reported                                    | \$ (0.52)                                 |
| Pro forma                                      | \$ (0.72)                                 |

The Company uses the Black-Scholes-Merton option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R. This model incorporates various assumptions including volatility, expected life, and interest rates. Historically, the Company used an expected stock-price volatility assumption that was primarily based on historical realized volatility of the underlying stock during a period of time. Beginning the third quarter of 2007, volatility was determined by equally weighing the historical and implied volatility of the Company's common stock. The historical volatility of the Company's common stock over the most recent period is generally commensurate with the estimated expected life of the Company's stock options, adjusted for the impact of unusual fluctuations not reasonably expected to recur and other relevant factors. The implied volatility is calculated from the implied market volatility of exchange-traded call options on the Company's common stock. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees.

The assumptions used for the specified reporting periods and the resulting estimates of weighted-average fair value per share of options and restricted stock units granted and for stock purchases under the ESPP during those periods are as follows:

|                                 | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|---------------------------------|---|---|---|
| Interest rate - stock options   | 3.68 - 4.90%                                | 4.73%                                       | 4.08%                                     |
| Interest rate - stock purchases | 4.71 - 4.86%                                | 4.08 - 4.85%                                | 3.25 - 4.08%                              |
| Volatility - stock options      | 55 - 70%                                    | 76%   | 90%                                       |
| Volatility - stock purchases    | 69 - 76%                                    | 76 - 90%                                    | 90 - 103%                                 |

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|   |               |               |               |
|---|---------------|---------------|---------------|
| Expected life stock options   | 6 years       | 6 years       | 5 years       |
| Expected life stock purchases   | 6 - 12 months | 6 - 12 months | 6 - 24 months |
| Expected dividend yield   | 0%            | 0%            | 0%            |
| Weighted average fair value per share of options granted                | \$25.71       | \$18.88       | \$7.38        |
| Weighted average fair value per share of restricted stock units granted | \$51.37       |               |               |
| Weighted average fair value per share of employee stock purchases       | \$14.66       | \$4.76        | \$1.81        |

F-13

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Net Income ( Loss) per Share***

Basic and diluted net income (loss) per common share is presented in conformity with SFAS No. 128, *Earnings per Share*, for all periods presented. In accordance with SFAS No. 128, basic net income (loss) per share is computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase. Diluted net income (loss) per share is typically computed using the weighted average number of common and dilutive common equivalent shares from stock options using the treasury stock method. The following table presents the calculation of weighted-average shares used to calculate basic and diluted net income (loss) per share (in thousands):

|   | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|---|---|---|---|
| Weighted-average shares outstanding   | 54,164                                      | 44,537                                      | 40,199                                    |
| Less: Weighted-average shares of common stock subject to repurchase             | (10)  | (36)  | (52)                                      |
| Weighted-average shares used in calculating basic net income (loss) per share   | 54,154                                      | 44,501                                      | 40,147                                    |
| Plus: Effect of dilutive potential common shares                                |   | 4,253                                       |   |
| Weighted-average shares used in calculating diluted net income (loss) per share | 54,154                                      | 48,754                                      | 40,147                                    |

The total number of shares excluded from the calculation of diluted net loss per share, prior to application of the treasury stock method, was 10,560,182 and 7,368,181 for the year ended December 30, 2007 and January 1, 2006, respectively, as their effect was antidilutive. The total number of warrants excluded from the calculation of diluted net loss per share was 1,719,446 for the year ended December 30, 2007. These warrants were assumed as part of the Company's merger with Solexa, Inc. on January 26, 2007. In addition, the warrants sold to the initial purchasers of the Convertible Senior Notes and/or their affiliates to acquire up to 18,322,320 shares of the Company's common stock (subject to adjustment) were excluded from the calculation of diluted net income (loss) per share for the year ended December 30, 2007 since the average fair market value of the Company's stock during the year was below the strike price of \$62.87 per share.

***Comprehensive Income***

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on the Company's available-for-sale securities, changes in the fair value of derivatives designated as effective cash flow hedges, and foreign currency translation adjustments. The Company has disclosed comprehensive income as a component of stockholders' equity.

The components of accumulated other comprehensive income are as follows (in thousands):

|   | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> |
|---|---|---|
| Foreign currency translation adjustments                              | \$ 1,183                                    | \$ 601                                      |
| Unrealized gain on available-for-sale securities, net of deferred tax | 164   | 10,693                                      |
| Total other comprehensive income                                      | \$ 1,347                                    | \$ 11,294                                   |

F-14

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Recent Accounting Pronouncements***

In September 2006 the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this pronouncement will have on the Company's consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows companies to elect to measure certain assets and liabilities at fair value and is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this pronouncement will have on the Company's consolidated financial statements.

In June 2007, the FASB ratified EITF No. 07-3, *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*. EITF No. 07-3 requires that nonrefundable advance payments for goods and services that will be used or rendered in future research and development activities pursuant to executory contractual arrangements be deferred and recognized as an expense in the period that the related goods are delivered or services are performed. EITF No. 07-3 is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact, if any, the adoption of this pronouncement will have on the Company's consolidated financial statements.

SFAS No. 141(R), *Business Combinations*, was issued in December of 2007. SFAS No. 141(R) established principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. SFAS No. 141(R) also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The guidance will become effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact, if any, the adoption of this pronouncement will have on the Company's consolidated financial statements.

**2. Acquisition of Solexa, Inc.**

On January 26, 2007, the Company completed its acquisition of Solexa, Inc. (Solexa), a Delaware corporation, in a stock-for-stock merger transaction. The Company issued approximately 13.1 million shares of its common stock as consideration for this merger. The results of Solexa's operations have been included in the Company's consolidated financial statements since the acquisition date of January 26, 2007.

Upon the closing of the merger on January 26, 2007, there were approximately 3.7 million shares of the Company's restricted stock and shares issuable upon the exercise of outstanding options and warrants assumed as part of the acquisition. Total estimated merger consideration also includes approximately \$75.3 million, which represents the fair market value of the vested options, warrants and restricted stock assumed. The Company also expects to recognize approximately \$14.7 million of non-cash stock-based compensation expense related to unvested stock options and restricted stock at the acquisition date. This expense will be recognized beginning from the acquisition date over a



**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

weighted-average period of approximately two years. These awards were valued using the following assumptions as of January 25, 2007 (the measurement date, as discussed below):

|                         |                   |
|-------------------------|-------------------|
| Interest rate           | 4.56 - 5.05%      |
| Volatility              | 54.26%            |
| Expected life           | 0.35 - 3.98 years |
| Expected dividend yield | 0%                |

The purchase price of the acquisition is as follows (in thousands):

|  |            |
|--|------------|
| Fair market value of securities issued   | \$ 527,067 |
| Fair market value of change of control bonuses and related taxes                 | 8,182      |
| Transaction costs not included in Solexa net tangible assets acquired            | 8,138      |
| Fair market value of vested stock options, warrants and restricted stock assumed | 75,334     |
| Total purchase price   | \$ 618,721 |

The fair value of the Company's shares used in determining the purchase price was based on the average of the closing price of the Company's common stock for a range of four trading days, comprising of the two days prior to and two days subsequent to January 25, 2007, the measurement date. The measurement date was determined per the guidance in EITF No. 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*. Based on these closing prices, the Company estimated the fair value of its common stock to be \$40.14 per share, which equates to a total fair value of common stock issued of \$527.1 million.

***Purchase Price Allocation***

The Solexa purchase price was allocated to tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date (January 26, 2007). The excess of the purchase price over the fair value of net assets acquired was allocated to goodwill.

The Company believes the fair values assigned to the assets acquired and liabilities assumed were based on reasonable assumptions. The following table summarizes the estimated fair values of net assets acquired (in thousands):

|                                    |           |
|------------------------------------|-----------|
| Current assets                     | \$ 51,444 |
| Property, plant and equipment, net | 6,515     |
| Other assets                       | 786       |
| Deferred tax assets                | 18,360    |
| Current liabilities                | (13,463)  |
| Other long-term liabilities        | (1,455)   |
| Net tangible assets acquired       | 62,187    |



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|   |            |
|---|------------|
| Identifiable intangible assets (core technology and customer relationships) | 24,400     |
| In-process research and development   | 303,400    |
| Goodwill  | 228,734    |
| Total net assets acquired   | \$ 618,721 |

The Company's purchase price allocation changed during the fourth quarter of 2007, due to the release of the valuation allowance initially recorded in conjunction with the acquisition of Solexa against

F-16

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

certain deferred tax assets. As a result, the Company decreased the goodwill balance by approximately \$18.4 million from the balance as of September 30, 2007 and recorded a deferred tax asset as of December 30, 2007.

***In-Process Research and Development***

The Company allocated \$303.4 million of the purchase price to in-process research and development projects. In-process research and development (IPR&D) represents the valuation of acquired, to-be-completed research projects. At the acquisition date, Solexa's ongoing research and development initiatives were primarily involved with the development of its genetic analysis platform for sequencing and expression profiling. These in-process research and development projects are composed of Solexa's reversible terminating nucleotide biochemistry platform, referred to as sequencing-by-synthesis (SBS) biochemistry, as well as Solexa's reagent, analyzer and sequencing services related technologies, which were valued at \$237.2 million, \$44.2 million, \$19.1 million and \$2.9 million, respectively, at the acquisition date. Although these projects were approximately 95% complete at the acquisition date, they had not reached technological feasibility and had no alternative future use. Accordingly, the amounts allocated to those projects were written off in the first quarter of 2007, the period the acquisition was consummated.

The values of the research projects were determined by estimating the costs to develop the acquired technology into commercially viable products, estimating the resulting net cash flows from the projects, and discounting the net cash flows to their present value. These cash flows were estimated by forecasting total revenue expected from these products and then deducting appropriate operating expenses, cash flow adjustments and contributory asset returns to establish a forecast of net cash flows arising from the in-process technology. These cash flows were substantially reduced to take into account the time value of money and the risks associated with the inherent difficulties and uncertainties given the projected stage of development of these projects at closing. Due to the nature of the forecast and the risks associated with the projected growth and profitability of the developmental projects, discount rates of 19.5% were considered appropriate for valuation of the IPR&D. The Company believes that these discount rates were commensurate with the projects' stage of development and the uncertainties in the economic estimates described above.

If these projects are not successfully developed, the sales and profitability of the combined company may be adversely affected in future periods. The Company believes that the foregoing assumptions used in the IPR&D analysis were reasonable at the time of the acquisition. No assurance can be given, however, that the underlying assumptions used to estimate expected project sales, development costs or profitability, or the events associated with such projects, will transpire as estimated.

***Identifiable Intangible Assets***

Acquired identifiable assets include various patents that are separate and distinct from the intellectual property surrounding the SBS biochemistry platform (core technology) as well as customer relationships. These patents are held in both the United States and Europe. The Company valued the patents and developed technology utilizing a discounted cash flow model which uses forecasts of future royalty savings and expenses related to the intangible assets. The Company utilized a discount rate of 19.5% when preparing this model. The value of the customer relationships is the benefit derived, based upon estimated cash flows, from having a customer in place versus having to incur the time, cost and foregone cash flow required to develop or replace the customer. The amounts assigned to the core technology and customer relationships are \$23.5 million and \$0.9 million, respectively.



**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Goodwill***

Goodwill represents the excess of the Solexa purchase price over the sum of the amounts assigned to assets acquired less liabilities assumed. The Company believes that the acquisition of Solexa will produce the following significant benefits:

*Increased Market Presence and Opportunities.* The combination of the Company and Solexa should increase the combined Company's market presence and opportunities for growth in revenue, earnings and stockholder return. The Company believes that the Solexa technology is highly complementary to the Company's own portfolio of products and services and will enhance the Company's capabilities to service its existing customers, as well as accelerate the development of additional technologies, products and services. The Company believes that integrating Solexa's capabilities with the Company's technologies will better position the Company to address the emerging biomarker research and development and in-vitro and molecular diagnostic markets. The Company began to recognize revenue from products shipped as a result of this acquisition during the first quarter of 2007.

*Operating Efficiencies.* The combination of the Company and Solexa provides the opportunity for potential economies of scale and cost savings.

The Company believes that these primary factors support the amount of goodwill recognized as a result of the purchase price paid for Solexa, in relation to other acquired tangible and intangible assets, including in-process research and development.

The following unaudited pro forma information shows the results of the Company's operations for the specified reporting periods as though the acquisition had occurred as of the beginning of that period (in thousands, except per share data):

|                                      | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> |
|--------------------------------------|---|---|
| Revenue                              | \$ 366,854                                  | \$ 187,103                                  |
| Net income (loss)                    | \$ 17,388                                   | \$ (38,957)                                 |
| Net income (loss) per share, basic   | \$ 0.32                                     | \$ (0.68)                                   |
| Net income (loss) per share, diluted | \$ 0.29                                     | \$ (0.68)                                   |

The pro forma results have been prepared for comparative purposes only and are not necessarily indicative of the actual results of operations had the acquisition taken place as of the beginning of the periods presented, or the results that may occur in the future. The pro forma results exclude the \$303.4 million non-cash acquired IPR&D charge recorded upon the closing of the acquisition during the first quarter of 2007.

***Investment in Solexa***

On November 12, 2006, the Company entered into a definitive securities purchase agreement with Solexa in which the Company invested approximately \$50 million in Solexa in exchange for 5,154,639 newly issued shares of Solexa common stock in conjunction with the merger of the two companies. This investment was valued at \$67.8 million as of December 31, 2006, which represented a market value of \$13.15 per share of Solexa common stock. This investment was eliminated as part of the Company's purchase accounting upon the closing of the merger on January 26, 2007.

F-18

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Balance Sheet Account Details**

The following is a summary of short-term investments as of December 30, 2007 (in thousands):

|  | <b>Amortized<br/>Cost</b> | <b>Gross<br/>Unrealized<br/>Gains</b> | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Estimated<br/>Fair Value</b> |
|--|---------------------------|---------------------------------------|--|---------------------------------|
| U.S. Treasury securities and obligations of U.S. government agencies                               | \$ 42,648                 | \$ 108                                | \$                                     | \$ 42,756                       |
| Debt securities issued by the states of the United States and political subdivisions of the states | 14,675                    |                                       |  | 14,675                          |
| Corporate debt securities  | 153,547                   | 252                                   | (89)                                   | 153,710                         |
| Total  | \$ 210,870                | \$ 360                                | \$ (89)                                | \$ 211,141                      |

Gross realized losses on sales of available-for-sale securities totaled approximately \$0, \$35,000 and \$0 for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively. Gross realized gains on sales of available-for-sale securities totaled approximately \$8,000, \$0, and \$0 for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively. As of December 30, 2007, all of the Company's investments in a gross unrealized loss position had been in such position for less than 12 months. Impairments are not considered other than temporary as the Company has the intent and ability to hold these investments until maturity.

The Company also recorded an unrealized gain, net of tax, of \$10.8 million as of December 31, 2006, related to the investment in common stock of Solexa (see Note 2). The net unrealized gain is classified as a part of accumulated other comprehensive income in the stockholders' equity section of the consolidated balance sheet as of December 31, 2006. This unrealized gain was eliminated as part of the Company's purchase accounting upon the closing of the merger on January 26, 2007.

Contractual maturities of short-term investments at December 30, 2007 were as follows (in thousands):

|                                 | <b>Estimated<br/>Fair Value</b> |
|---------------------------------|---------------------------------|
| Due within one year             | \$ 14,675                       |
| After one but within five years | 196,466                         |
| Total                           | \$ 211,141                      |

Accounts receivable consist of the following (in thousands):

|  | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|------------------------------|------------------------------|
| Accounts receivable from product and service sales | \$ 82,144                    | \$ 39,627                    |
| Notes receivable from product sales                |                              | 112                          |
| Accounts receivable from government grants         | 15                           | 167                          |
| Other receivables                                  | 1,500                        | 416                          |
|  | 83,659                       | 40,322                       |
| Allowance for doubtful accounts                    | (540)                        | (338)                        |
| Total  | \$ 83,119                    | \$ 39,984                    |

F-19

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Inventory, net, consists of the following (in thousands):

|                 | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|-----------------|------------------------------|------------------------------|
| Raw materials   | \$ 27,098                    | \$ 8,365                     |
| Work in process | 20,321                       | 8,907                        |
| Finished goods  | 6,561                        | 2,897                        |
| Total           | \$ 53,980                    | \$ 20,169                    |

Property and equipment consist of the following (in thousands):

|   | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|---|------------------------------|------------------------------|
| Leasehold improvements                    | \$ 4,531                     | \$ 1,760                     |
| Manufacturing and laboratory equipment    | 50,384                       | 30,523                       |
| Computer equipment and software           | 18,772                       | 10,383                       |
| Furniture and fixtures                    | 3,691                        | 3,114                        |
|   | 77,378                       | 45,780                       |
| Accumulated depreciation and amortization | (31,104)                     | (20,146)                     |
| Total                                     | \$ 46,274                    | \$ 25,634                    |

Depreciation expense was \$11.5 million, \$6.0 million and \$3.8 million for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively.

Intangible assets consist of the following (in thousands):

|                             | <b>December 30, 2007</b>             |                                     | <b>December 31, 2006</b>             |                                     |
|-----------------------------|--------------------------------------|-------------------------------------|--------------------------------------|-------------------------------------|
|                             | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> | <b>Gross<br/>Carrying<br/>Amount</b> | <b>Accumulated<br/>Amortization</b> |
| Acquired intangible assets: |                                      |                                     |                                      |                                     |
| Core technology             | \$ 23,500                            | \$ (2,154)                          | \$                                   | \$                                  |
| Customer relationships      | 900                                  | (275)                               |                                      |                                     |



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|                                  |           |            |        |          |
|----------------------------------|-----------|------------|--------|----------|
| Total acquired intangible assets | 24,400    | (2,429)    |        |          |
| Other intangible assets:         |           |            |        |          |
| License agreements               | 1,029     | (884)      | 944    | (836)    |
| Licensed technology              | 36,000    |            |        |          |
| Total intangible assets          | \$ 61,429 | \$ (3,313) | \$ 944 | \$ (836) |

Amortization expense associated with the acquired intangible assets was \$2.4 million for the year ended December 30, 2007. There was no amortization of acquired intangibles for the years ended December 31, 2006 and January 1, 2006, respectively.

F-20

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The estimated annual amortization of intangible assets for the next five years is shown in the following table (in thousands). Actual amortization expense to be reported in future periods could differ from these estimates as a result of acquisitions, divestitures, asset impairments and other factors.

|                     |                  |
|---------------------|------------------|
| 2008                | \$ 7,194         |
| 2009                | 7,193            |
| 2010                | 6,905            |
| 2011                | 6,870            |
| 2012                | 6,858            |
| 2013 and thereafter | 23,096           |
| <b>Total</b>        | <b>\$ 58,116</b> |

Accrued liabilities consist of the following (in thousands):

|  | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|------------------------------|------------------------------|
| Compensation                                 | \$ 17,410                    | \$ 8,239                     |
| Taxes  | 8,298                        | 1,804                        |
| Short-term deferred revenue                  | 7,541                        | 3,382                        |
| Customer deposits                            | 5,266                        | 3,703                        |
| Legal and other professional fees            | 4,276                        | 3,831                        |
| Reserve for product warranties               | 3,716                        | 996                          |
| Short-term deferred rent                     | 1,251                        |                              |
| Short-term deferred gain on sale of building | 171                          | 375                          |
| Other  | 2,923                        | 1,530                        |
| <b>Total</b>                                 | <b>\$ 50,852</b>             | <b>\$ 23,860</b>             |

**4. Warranties**

The Company generally provides a one-year warranty on genotyping and gene expression systems. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with system sales. This expense is recorded as a component of cost of product revenue. Estimated warranty expenses associated with extended maintenance contracts are recorded as cost of revenue ratably over the term of the maintenance contract.

**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Changes in the Company's reserve for product warranties during the three years ended December 30, 2007 are as follows (in thousands):

|                                      |          |
|--------------------------------------|----------|
| Balance as of January 2, 2005        | \$ 387   |
| Additions charged to cost of revenue | 1,094    |
| Repairs and replacements             | (730)    |
| Balance as of January 1, 2006        | 751      |
| Additions charged to cost of revenue | 1,379    |
| Repairs and replacements             | (1,134)  |
| Balance as of December 31, 2006      | 996      |
| Additions charged to cost of revenue | 4,939    |
| Repairs and replacements             | (2,219)  |
| Balance as of December 30, 2007      | \$ 3,716 |

**5. Convertible Senior Notes**

On February 16, 2007, the Company issued \$400.0 million principal amount of 0.625% Convertible Senior Notes due 2014 (the Notes), which included the exercise of the initial purchasers' option to purchase up to an additional \$50.0 million aggregate principal amount of Notes. The net proceeds from the offering, after deducting the initial purchasers' discount and offering expenses, were approximately \$390.3 million. The Company will pay 0.625% interest per annum on the principal amount of the Notes, payable semi-annually in arrears in cash on February 15 and August 15 of each year. The Company made an interest payment of approximately \$1.2 million on August 15, 2007. The Notes mature on February 15, 2014.

The Notes will be convertible into cash and, if applicable, shares of the Company's common stock, \$0.01 par value per share, based on an initial conversion rate, subject to adjustment, of 22.9029 shares per \$1,000 principal amount of Notes (which represents an initial conversion price of approximately \$43.66 per share), only in the following circumstances and to the following extent: (1) during the five business-day period after any five consecutive trading period (the measurement period) in which the trading price per note for each day of such measurement period was less than 97% 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 after the calendar quarter ending March 31, 2007, if the last reported sale price of the Company's common stock for 20 or more trading days in a 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; and (4) the notes will be convertible at any time on or after November 15, 2013 through the third scheduled trading day immediately preceding the maturity date.

In connection with the offering of the notes, the Company entered into convertible note hedge transactions (the hedge) with the initial purchasers and/or their affiliates (the counterparties) entitling the Company to purchase up to 11,451,480 shares of the Company's common stock, subject to adjustment, at an initial strike price of \$43.66 per share,

subject to adjustment. In addition, the Company sold to these counterparties warrants to acquire up to 18,322,320 shares of the Company's common stock (the warrants), subject to adjustment, at an initial strike price of \$62.87 per share, subject to adjustment. The cost of the hedge that was not covered by the proceeds from the sale of the warrants was approximately \$46.6 million and is reflected as a reduction of additional paid-in capital as of December 30, 2007. The hedge is expected to reduce the potential equity dilution upon conversion of the notes if the daily volume-weighted average price per share of the Company's common stock exceeds the strike price of the hedge. The warrants could have a dilutive effect on the Company's earnings per share to the extent

F-22

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

that the price of the Company's common stock during a given measurement period exceeds the strike price of the warrants.

**6. Commitments*****Deferred Gain/Building Loan***

In August 2004, the Company completed a sale-leaseback transaction of its land and buildings located in San Diego. The sale of this property resulted in a \$3.7 million gain. Effective upon the closing of the sale, the Company leased the property back from the buyer for an initial term of ten years, which was extended in February 2007 to 19 years. In accordance with SFAS No. 13, *Accounting for Leases*, the Company has deferred the gain and is amortizing it over the 19-year lease term.

***Operating Leases***

The Company leases office and manufacturing facilities under various noncancellable operating lease agreements. Facilities leases generally provide for periodic rent increases and many contain escalation clauses and renewal options. Certain leases require the Company to pay property taxes and routine maintenance. The Company is headquartered in San Diego, California and leases facilities in Hayward, California, Wallingford, Connecticut, the United Kingdom, the Netherlands, Japan, and Singapore.

Annual future minimum payments under these operating leases as of December 30, 2007 were as follows (in thousands):

|                     |            |
|---------------------|------------|
| 2008                | \$ 10,329  |
| 2009                | 7,550      |
| 2010                | 7,486      |
| 2011                | 7,669      |
| 2012                | 7,743      |
| 2013 and thereafter | 79,658     |
| Total               | \$ 120,435 |

Rent expense, net of amortization of the deferred gain on sale of property, was \$7.7 million, \$4.7 million and \$4.7 million for the years ended December 30, 2007, December 31, 2006 and January 1, 2006, respectively.

**7. Stockholders Equity*****Common Stock***

As of December 30, 2007, 4,848,395 shares were sold to employees and consultants subject to restricted stock agreements. The restricted common shares vest in accordance with the provisions of the agreements, generally over five years. As of December 30, 2007, 10,417 shares of common stock were subject to repurchase. In addition, during

2005, the Company also issued 12,000 shares for a restricted stock award to an employee under the Company's 2005 Stock and Incentive Plan based on service performance. These shares vest monthly over a three-year period. As part of the Solexa acquisition, the Company assumed 53,664 shares of restricted stock issued to an employee under the 2005 Solexa Equity Incentive Plan. These shares vest and become exercisable at the rate of 25% on the first anniversary of the date of grant and ratably on a quarterly basis over a period of 36 months thereafter.

F-23

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Stock Options******2005 Stock and Incentive Plan***

In June 2005, the stockholders of the Company approved the 2005 Stock and Incentive Plan (the 2005 Stock Plan). Upon adoption of the 2005 Stock Plan, issuance of options under the Company's existing 2000 Stock Plan ceased. Additionally, in connection with the acquisition of Solexa, the Company assumed stock options granted under the 2005 Solexa Equity Incentive Plan (the 2005 Solexa Equity Plan). As of December 30, 2007, an aggregate of up to 13,485,619 shares of the Company's common stock were reserved for issuance under the 2005 Stock Plan and the 2005 Solexa Equity Plan. The 2005 Stock Plan provides for an automatic annual increase in the shares reserved for issuance by the lesser of 5% of outstanding shares of the Company's common stock on the last day of the immediately preceding fiscal year, 1,200,000 shares or such lesser amount as determined by the Company's board of directors. As of December 30, 2007, options to purchase 1,834,384 shares remained available for future grant under the 2005 Stock Plan and 2005 Solexa Equity Plan.

The Company's stock option activity under all stock option plans from January 2, 2005 through December 30, 2007 is as follows:

|  | <b>Options</b> | <b>Weighted-<br/>Average<br/>Exercise Price</b> |
|--|----------------|---|
| Outstanding at January 2, 2005               | 6,205,020      | \$ 6.99   |
| Granted                                      | 2,992,300      | \$ 10.02  |
| Exercised                                    | (869,925)      | \$ 4.66   |
| Cancelled                                    | (1,001,964)    | \$ 11.00  |
| Outstanding at January 1, 2006               | 7,325,431      | \$ 7.96   |
| Granted                                      | 2,621,050      | \$ 27.24  |
| Exercised                                    | (1,273,119)    | \$ 7.28   |
| Cancelled                                    | (314,242)      | \$ 12.44  |
| Outstanding at December 31, 2006             | 8,359,120      | \$ 13.94  |
| Options assumed through business combination | 1,424,332      | \$ 21.37  |
| Granted                                      | 3,784,508      | \$ 40.64  |
| Exercised                                    | (2,179,286)    | \$ 12.06  |
| Cancelled                                    | (964,740)      | \$ 22.38  |
| Outstanding at December 30, 2007             | 10,423,934     | \$ 24.26  |

**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Following is a further breakdown of the options outstanding as of December 30, 2007:

| <b>Range of<br/>Exercise Prices</b> | <b>Options<br/>Outstanding</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Life<br/>in Years</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Options<br/>Exercisable</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>of Options<br/>Exercisable</b> |
|-------------------------------------|--------------------------------|---|--|--------------------------------|---|
| \$0.03-5.99                         | 1,243,927                      | 4.89  | \$ 4.48  | 788,144                        | \$ 3.84   |
| \$6.00-8.52                         | 1,213,703                      | 6.30  | \$ 7.87  | 643,821                        | \$ 7.65   |
| \$8.60-12.28                        | 1,052,123                      | 6.46  | \$ 9.49  | 597,737                        | \$ 9.43   |
| \$12.30-20.97                       | 1,714,245                      | 7.62  | \$ 17.90   | 712,249                        | \$ 17.51  |
| \$21.31-30.54                       | 1,094,170                      | 8.28  | \$ 26.89   | 353,553                        | \$ 26.28  |
| \$30.55-35.68                       | 1,070,526                      | 9.02  | \$ 34.24   | 121,149                        | \$ 34.93  |
| \$35.82-39.22                       | 907,327                        | 8.75  | \$ 38.95   | 140,801                        | \$ 39.09  |
| \$39.42-40.08                       | 1,267,250                      | 9.08  | \$ 40.07   | 212,128                        | \$ 40.08  |
| \$40.23-640.99(1)                   | 860,049                        | 9.60  | \$ 49.93   | 15,576                         | \$ 81.16  |
| \$3,123.55(1)                       | 614                            | 2.15  | \$ 3,123.55  | 614                            | \$ 3,123.55   |
| \$0.03-3,123.55                     | 10,423,934                     | 7.68  | \$ 24.26   | 3,585,772                      | \$ 15.83  |

(1) Adjusted for reverse split of securities underlying options assumed with Solexa acquisition.

The weighted average remaining life in years of options exercisable is 6.57 years as of December 30, 2007.

The aggregate intrinsic value of options outstanding and options exercisable as of December 30, 2007 was \$376.0 million and \$161.2 million, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price on the last trading day of the fiscal period, which was \$60.09 as of December 28, 2007, and the exercise price multiplied by the number of options outstanding. Total intrinsic value of options exercised was \$72.1 million and \$34.0 million for the years ended December 30, 2007 and December 31, 2006, respectively.

#### *2000 Employee Stock Purchase Plan*

In February 2000, the board of directors and stockholders adopted the 2000 Employee Stock Purchase Plan (the Purchase Plan). A total of 6,233,713 shares of the Company's common stock have been reserved for issuance under the Purchase Plan. The Purchase Plan permits eligible employees to purchase common stock at a discount, but only through payroll deductions, during defined offering periods.



The price at which stock is purchased under the Purchase Plan is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. The initial offering period commenced in July 2000. In addition, beginning with fiscal 2001, the Purchase Plan provides for annual increases of shares available for issuance by the lesser of 3% of the number of outstanding shares of the Company's common stock on the last day of the immediately preceding fiscal year, 1,500,000 shares or such lesser amount as determined by the Company's board of directors. 133,481, 266,394 and 717,164 shares were issued under the Purchase Plan during fiscal 2007, 2006 and 2005, respectively. As of December 30, 2007, there were 4,035,180 shares available for issuance under the Purchase Plan.

F-25

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Restricted Stock Units***

In 2007 the Company began granting restricted stock units pursuant to its 2005 Stock and Incentive Plan as part of its regular annual employee equity compensation review program. Restricted stock units are share awards that, upon vesting, will deliver to the holder shares of the Company's common stock. Generally, restricted stock units granted in the year ended December 30, 2007, vest over four years as follows: 15% of the shares will vest one year from the date of grant, 15% will vest two years from the date of grant, 30% will vest three years from the date of grant, and 40% will vest four years from the date of grant.

A summary of the Company's restricted stock unit activity and related information in the fiscal year ended December 30, 2007 is as follows:

|                                  | <b>Restricted Stock Units</b> |
|----------------------------------|-------------------------------|
| Outstanding at December 31, 2006 |                               |
| Awarded                          | 197,750                       |
| Vested                           |                               |
| Cancelled                        | (500)                         |
| Outstanding at December 30, 2007 | 197,250                       |

The weighted average grant-date fair value per share for the restricted stock units was \$51.37 for the year ended December 30, 2007.

Based on the closing price of the Company's common stock of \$60.09 on December 28, 2007, the total pretax intrinsic value of all outstanding restricted stock units on that date was \$11,852,752.

No restricted stock units were outstanding as of December 31, 2006.

***Warrants***

In conjunction with its acquisition of Solexa, Inc. on January 26, 2007, the Company assumed 2,244,843 warrants issued by Solexa prior to the acquisition. During the year ended December 30, 2007, there were 399,315 warrants exercised, resulting in cash proceeds to the Company of approximately \$6.1 million. As of December 30, 2007, 126,082 of the assumed warrants had expired.

A summary of all warrants outstanding as of December 30, 2007 is as follows:

| <b>Number of Shares</b> | <b>Exercise Price</b> | <b>Expiration Date</b> |
|-------------------------|-----------------------|------------------------|
| 31,989                  | \$ 57.62              | 9/24/2008              |
| 119,255                 | \$ 14.54              | 4/25/2010              |

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|               |    |       |            |
|---------------|----|-------|------------|
| 526,619       | \$ | 14.54 | 7/12/2010  |
| 404,623       | \$ | 21.81 | 11/23/2010 |
| 636,960       | \$ | 21.81 | 1/19/2011  |
| 18,322,320(1) | \$ | 62.87 | 2/15/2014  |
| 20,041,766    |    |       |            |

(1) Represents warrants sold in connection with the offering of the Company's Convertible Senior Notes (See Note 5).

No warrants were outstanding as of December 31, 2006.

F-26

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**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Treasury Stock***

In conjunction with its issuance of \$400 million principal amount of 0.625% Convertible Senior Notes due 2014 on February 16, 2007, the Company repurchased 5.8 million shares of its outstanding common stock for approximately \$201.6 million in privately negotiated transactions concurrently with the offering.

On February 20, 2007, the Company executed a Rule 10b5-1 trading plan to repurchase up to \$75.0 million of its outstanding common stock over a period of six months. The Company repurchased approximately 1.6 million shares of its common stock under this plan for approximately \$50.0 million. As of December 30, 2007, this plan had expired.

***Stockholder Rights Plan***

On May 3, 2001, the Board of Directors of the Company declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock of the Company. The dividend was payable on May 14, 2001 (the Record Date) to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one unit consisting of one-thousandth of a share of its Series A Junior Participating Preferred Stock at a price of \$100 per unit. The Rights will be exercisable if a person or group hereafter acquires beneficial ownership of 15% or more of the outstanding common stock of the Company or announces an offer for 15% or more of the outstanding common stock. If a person or group acquires 15% or more of the outstanding common stock of the Company, each Right will entitle its holder to purchase, at the exercise price of the right, a number of shares of common stock having a market value of two times the exercise price of the right. If the Company is acquired in a merger or other business combination transaction after a person acquires 15% or more of the Company's common stock, each Right will entitle its holder to purchase, at the Right's then-current exercise price, a number of common shares of the acquiring company which at the time of such transaction have a market value of two times the exercise price of the right. The Board of Directors will be entitled to redeem the Rights at a price of \$0.01 per Right at any time before any such person acquires beneficial ownership of 15% or more of the outstanding common stock. The rights expire on May 14, 2011 unless such date is extended or the rights are earlier redeemed or exchanged by the Company.

**8. Litigation Settlements**

In the recent past, the Company incurred substantial costs in defending against patent infringement claims and expects, going forward, to devote substantial financial and managerial resources to protect the Company's intellectual property and to defend against any future claims asserted against the Company.

***Affymetrix Litigation***

On January 9, 2008, we resolved all our outstanding litigations with Affymetrix, Inc. (Affymetrix) by entering into a settlement agreement in which we agreed, without admitting liability, to make a one-time payment to Affymetrix of \$90.0 million. In return, Affymetrix agreed to dismiss with prejudice all lawsuits it had brought against us, and we agreed to dismiss with prejudice our counterclaims in the relevant lawsuits. In exchange for the payment, Affymetrix agreed not to sue us or our affiliates or customers for making, using or selling any of our current products, evolutions of those products or services related to those products. In addition, Affymetrix agreed that, for four years, it will not sue us for making, using or selling our products or services that are based on future technology developments. The covenant not to sue covers all fields other than photolithography, the process by which Affymetrix manufactures its arrays and a field in which we do not operate.



**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The January 2008 settlement resolved complaints Affymetrix had previously filed in the U.S. and abroad. Specifically, on July 26, 2004, Affymetrix had filed a complaint in the U.S. District Court for the District of Delaware alleging that the use, manufacture and sale of our BeadArray products and services, including our Array Matrix and BeadChip products, infringe six Affymetrix patents. At that time Affymetrix was also seeking an injunction against the sale of any products that would ultimately be determined to infringe these patents, unspecified monetary damages, interest and attorneys' fees. Subsequently, on October 24, 2007, Affymetrix had filed complaints in the U.S. District Court for the District of Delaware, in Regional Court in Düsseldorf (Germany), and in the High Court of Justice, Chancery Division Patents Court in London (United Kingdom) alleging that the use, manufacture and sale of certain of our BeadArray products and services, including our Array Matrix and BeadChip products, infringe three U.S. patents and three European patents of Affymetrix. In its U.S. complaint filed in 2007, Affymetrix had also alleged that our sequencing technology, including the Genome Analyzer, infringes two Affymetrix U.S. patents. Affymetrix also sought an injunction against the sale of any products that would ultimately be determined to infringe these patents, unspecified monetary damages, interest and attorneys' fees.

As of December 30, 2007, the Company accrued for the total \$90.0 million payment as a result of the settlement, of which \$36.0 million was recorded as licensed technology and classified as an intangible asset. The remaining \$54.0 million was charged to expense during the fourth quarter of 2007 and is included in income (loss) from operations on the Consolidated Statements of Operations. This allocation was determined in accordance with SFAS No. 5, *Accounting for Contingencies*, and EITF 00-21 using the concepts of fair value based on the past and estimated future revenue streams related to the products covered by the patents previously under dispute. The value of the licensed technology is the benefit derived, calculated using estimated discounted cash flows and future revenue projections, from the perpetual covenant not to sue for damages related to the sale of the Company's current products. The Company utilized a discount rate of 9.25% when preparing this model. The effective life and related amortization will be based on the higher of the percentage of usage or the straight-line method. This percentage of usage will be determined using the revenues generated from products covered by the patents previously under dispute. These patents expire at various times through 2015.

***Former Employee Claim***

On June 15, 2005, a former employee of the Company filed suit against the Company in the U.S. District Court for the District of Delaware seeking an order requiring the Company and the U.S. Patent and Trademark Office to correct the inventorship of certain of the Company's patents and patent applications by adding the former employee as an inventor, alleging that the Company committed inequitable conduct and fraud in not naming him as an inventor, and seeking a judgment declaring certain of the Company's patents and patent applications unenforceable, unspecified monetary damages and attorney's fees. On January 30, 2008, this dispute was resolved to the mutual satisfaction of the parties by entering into a release and settlement agreement pursuant to which all claims pending in that litigation were dismissed with prejudice. As a result of the settlement, the Company recognized a charge of \$0.5 million for the year ended December 30, 2007 in income (loss) from operations on the Consolidated Statements of Operations.

***Applied Biosystems Litigation***

On December 26, 2006, the Applied Biosystems Group of Applera Corporation (Applied Biosystems) filed suit in California Superior Court, Santa Clara County against Solexa (which was acquired by the Company on January 26, 2007). This State Court action is about the ownership of several patents assigned in 1995 to Solexa's predecessor company (Lynx Therapeutics) by a former employee (Dr. Stephen Macevicz) who is the inventor of these patents and

is named as a co-defendant in the suit. Lynx was originally a unit of Applied Biosystems but was spun out in 1992. On May 31, 2007, Applied

F-28

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Biosystems filed a second suit, this time against the Company, in the U.S. District Court for the Northern District of California. This second suit seeks a declaratory judgment of non-infringement of the Macevicz patents that are the subject of the State Court action mentioned above. Both suits were later consolidated in the U.S. District Court for the Northern District of California, San Francisco Division.

The Macevicz patents relate to methods for sequencing DNA using successive rounds of oligonucleotide probe ligation (Sequencing-by-Ligation). The Company's Genome Analyzer system uses a different technology called DNA Sequencing-by-Synthesis (SBS), which is not covered by any of these patents. In addition, the sequencing technology originally used by Lynx Therapeutics (called MPS<sup>®</sup>) is not based on the methods covered by the Macevicz patents. In any event, the Company has never used MPSS<sup>™</sup> in the Company's sequencing platform. Furthermore, the Company has no plans to use any of the Sequencing-by-Ligation technologies covered by these patents. By these consolidated actions Applied Biosystems is seeking ownership of the Macevicz patents, unspecified costs and damages, and a declaration of non-infringement of these patents. Applied Biosystems is not asserting any claim for patent infringement against the Company.

**9. Collaborative Agreements*****deCODE genetics***

In May 2006, the Company and deCODE genetics, ehf. (deCODE) executed a Joint Development and Licensing Agreement (the Development Agreement). Pursuant to the Development Agreement, the parties agreed to collaborate exclusively to develop, validate and commercialize specific diagnostic tests for variants in genes involved in three disease-related pathways: the gene-encoding leukotriene A4 hydrolase, linked to heart attack; the gene-encoding transcription factor 7-like 2 (TCF7L2), linked to type 2 diabetes; and the gene-encoding BARD1, linked to breast cancer. The Company and deCODE are developing diagnostic tests based on these variants for use on the Company's BeadXpress system.

Under the agreement, the Company will be responsible for the manufacturing, marketing and selling of the diagnostic products. The companies will share the development costs of these products and split the profits from sales of the diagnostics tests. The Development Agreement may be terminated as to a particular product under development if one party decides to discontinue funding the development of that product, and may be terminated in whole by either party if the other party commits an uncured material breach, files for bankruptcy or becomes insolvent. Under a separate supply agreement, the Company installed instrumentation at deCODE that will enable deCODE to perform whole genome association studies on up to 100,000 samples using the Company's Sentrix HumanHap300 BeadChips and associated reagents. The Company has deferred approximately \$2.0 million of revenue for instruments installed during the third quarter of 2006 under guidance provided by SFAS No. 48, *Revenue Recognition When Right of Return Exists*. This amount is classified as a long-term liability as of December 30, 2007. The Company has also deferred approximately \$1.3 million of costs related to product shipments to deCODE, which are classified as a long-term asset as of December 30, 2007.

**10. Investment in Genizon BioSciences Inc.**

In January 2006, Genizon BioSciences Inc. (Genizon), a Canadian company focused on gene discovery, purchased from the Company approximately \$1.9 million in equipment and committed to purchase an additional \$4.3 million in consumables. The Company understands that Genizon is using the Company's products to perform whole-genome and



targeted association studies involving thousands of members of the Quebec Founder Population. The goal of the studies is to provide understanding of the genetic origins and mechanisms of common diseases which may then lead to possible drug targets.

F-29

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2006, the Company entered into a Subscription Agreement for Secured Convertible Debentures with Genizon. Pursuant to the agreement, the Company purchased a Secured Convertible Debenture (the Debenture) of Genizon and certain warrants for CDN \$3.5 million (approximately U.S. \$3.0 million). The Debenture matures two years from issuance and bears interest, payable semiannually, at a rate of 5% per annum for the first year and 12.5% per annum for the second year. Unless the Debenture is converted before maturity, 112.5% of the principal amount of the Debenture is due upon maturity. The Company also received warrants to purchase 226,721 shares of Genizon Class H Preferred Shares at an exercise price of \$1.54 per share.

The Company concluded that the purchase of the Debenture and the concurrent purchase by Genizon of the Company's products are linked transactions under guidance contained in EITF No. 00-21. Since the transactions are considered linked, the Company deferred approximately \$3.0 million of revenue (the face value of the Debentures) in the first quarter of 2006, related to the Genizon product shipments. During the fourth quarter of 2007, the Company sold the Debenture and warrants to third party investors for the face value of the Debenture (CDN \$3.5 million or approximately U.S. \$3.0 million) plus accrued interest, at which time the associated deferred revenue was recognized. Deferred costs of approximately \$1.1 million related to product shipments to Genizon were also recognized in the fourth quarter of 2007, as well as approximately \$0.5 million of foreign exchange gain due to the appreciation of the Canadian dollar versus the U.S. dollar between the debenture purchase and sale dates.

**11. Income Taxes**

The provision (benefit) for income taxes consists of the following (in thousands):

|                               | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|-------------------------------|---|---|---|
| Current:                      |   |   |   |
| Federal                       | \$ 18,564                                   | \$ 1,125                                    | \$  |
| State                         | 4,801                                       | 1,177                                       |   |
| Foreign                       | (2,172)                                     | 903   | 105                                       |
| Total current provision       | 21,193                                      | 3,205                                       | 105                                       |
| Deferred:                     |   |   |   |
| Federal                       | (20,254)                                    |   |   |
| State                         | (11,622)                                    |   |   |
| Foreign                       | 257   | (553)                                       | 58  |
| Total deferred provision      | (31,619)                                    | (553)                                       | 58  |
| Total tax provision (benefit) | \$ (10,426)                                 | \$ 2,652                                    | \$ 163                                    |

**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The provision (benefit) for income taxes reconciles to the amount computed by applying the federal statutory rate to income (loss) before taxes as follows (in thousands):

|  | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|--|---|---|---|
| Tax at federal statutory rate              | \$ (101,075)                                | \$ 14,945                                   | \$ (7,043)                                |
| State, net of federal benefit              | (174)                                       | 767   | 633                                       |
| Alternative minimum tax                    |   | 1,125                                       |   |
| Research and other credits                 | (4,981)                                     | (1,900)                                     | (1,239)                                   |
| Acquired in-process research & development | 106,190                                     |   | 5,372                                     |
| Adjustments to deferred tax balances       | (690)                                       | (3,509)                                     | 2,952                                     |
| Change in valuation allowance              | (17,125)                                    | (10,038)                                    | (1,138)                                   |
| Permanent differences                      | 1,229                                       | 818   | (226)                                     |
| Foreign rate adjustments                   | 6,426                                       | 3   | (28)                                      |
| Other                                      | (226)                                       | 441   | 880                                       |
| Total tax provision (benefit)              | \$ (10,426)                                 | \$ 2,652                                    | \$ 163                                    |

The income (loss) before income taxes summarized by region is as follows (in thousands):

|   | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|---|---|---|---|
| United States                           | \$ 58,445                                   | \$ 42,612                                   | \$ (21,365)                               |
| Foreign                                 | (347,230)                                   | 8   | 654                                       |
| Total income (loss) before income taxes | \$ (288,785)                                | \$ 42,620                                   | \$ (20,711)                               |

**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Significant components of the Company's deferred tax assets and liabilities are as follows (in thousands):

|  | <b>December 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|------------------------------|------------------------------|
| Deferred tax assets:                         |                              |                              |
| Net operating losses                         | \$ 34,277                    | \$ 13,728                    |
| Tax credits                                  | 11,465                       | 10,831                       |
| Deferred revenue                             | 2,236                        | 2,859                        |
| Capitalized research and development costs   | 2,018                        | 1,290                        |
| Accrued litigation settlements               | 21,427                       |                              |
| Other accruals and reserves                  | 6,326                        | 2,491                        |
| Stock compensation                           | 8,166                        | 4,736                        |
| Convertible debt                             | 49,137                       |                              |
| Other, net                                   | 8,068                        | 2,592                        |
| <b>Total deferred tax assets</b>             | <b>143,120</b>               | <b>38,527</b>                |
| Valuation allowance on deferred tax assets   | (28,343)                     | (36,458)                     |
| <b>Net deferred tax assets</b>               | <b>114,777</b>               | <b>2,069</b>                 |
| Deferred tax liabilities:                    |                              |                              |
| Property and equipment                       | (408)                        | (1,516)                      |
| Net unrealized gain on investments           | (106)                        | (6,987)                      |
| Purchased intangible amortization            | (7,084)                      |                              |
| <b>Total deferred tax liabilities</b>        | <b>(7,598)</b>               | <b>(8,503)</b>               |
| <b>Net deferred tax assets (liabilities)</b> | <b>\$ 107,179</b>            | <b>\$ (6,434)</b>            |

A valuation allowance is established when it is more likely than not the future realization of all or some of the deferred tax assets will not be achieved. The evaluation of the need for a valuation allowance is performed on a jurisdiction by jurisdiction basis, and includes a review of all available positive and negative evidence. As of December 30, 2007, the Company has concluded that it is more likely than not that a significant portion of its deferred tax assets will be realized and, accordingly the Company released a portion of its valuation allowance, approximately \$17.1 million of which was recorded as a reduction to the tax provision. Based upon the available evidence as of December 30, 2007, the Company is not able to conclude it is more likely than not certain U.S. and foreign deferred tax assets will be realized. Therefore, the Company has recorded a valuation allowance of approximately \$2.9 million and \$25.4 million against certain U.S. and foreign deferred tax assets, respectively.

As of December 30, 2007, the Company had net operating loss carryforwards for federal and state tax purposes of approximately \$28.7 million and \$99.1 million respectively, which begin to expire in 2025 and 2015 respectively, unless previously utilized. In addition, the Company also had U.S. federal and state research and development tax

credit carryforwards of approximately \$9.2 million and \$9.3 million respectively, which begin to expire in 2018 and 2019 respectively, unless previously utilized.

As of December 30, 2007, the valuation allowance includes approximately \$20.2 million of pre-acquisition deferred tax assets of Solexa. To the extent any of these assets are recognized, the adjustment will be applied first to reduce to zero any goodwill related to the acquisition, and then as a reduction to the tax provision. During 2007, the Company recorded approximately \$2.1 million as a

F-32

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

reduction to goodwill related to pre-acquisition deferred tax assets that previously had a valuation allowance recorded against them and were recognized during the year.

Pursuant to Section 382 and 383 of the Internal Revenue Code, utilization of the Company's net operating losses and credits may be subject to annual limitations in the event of any significant future changes in its ownership structure. These annual limitations may result in the expiration of net operating losses and credits prior to utilization. Previous limitations due to Section 382 and 383 have been reflected in the deferred tax assets as of December 30, 2007.

Due to the adoption of SFAS No. 123R, the Company recognizes excess tax benefits associated with share-based compensation to stockholders' equity only when realized. When assessing whether excess tax benefits relating to share-based compensation have been realized, the Company follows the with-and-without approach excluding any indirect effects of the excess tax deductions. Under this approach, excess tax benefits related to share-based compensation are not deemed to be realized until after the utilization of all other tax benefits available to the Company. During 2007, the Company realized approximately \$20.1 million of such excess tax benefits, and accordingly recorded a corresponding credit to additional paid in capital. As of December 30, 2007, the Company has approximately \$11.2 million of unrealized excess tax benefits associated with share-based compensation. These tax benefits will be accounted for as a credit to additional paid-in capital, if and when realized, rather than a reduction of the tax provision.

Residual United States income taxes have not been provided on approximately \$1.7 million of undistributed earnings of foreign subsidiaries as of December 30, 2007, since the earnings are considered to be permanently invested in the operations of such subsidiaries.

Effective January 1, 2007, the Company adopted FIN No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN No. 48 requires recognition of the impact of a tax position in the Company's financial statements only if that position is more likely than not of being sustained upon examination by taxing authorities, based on the technical merits of the position. The adoption of FIN No. 48 did not result in an adjustment to the Company's opening stockholders' equity since there was no cumulative effect from the change in accounting principle.

The following table summarizes the gross amount of the Company's uncertain tax positions (in thousands):

|   |           |
|---|-----------|
| Balance at January 1, 2007  | \$ 5,381  |
| Increases related to current year tax positions                       | 1,619     |
| Increase of uncertain tax positions resulting from Solexa acquisition | 14,376    |
| Balance at December 30, 2007  | \$ 21,376 |

As of December 30, 2007, approximately \$5.8 million of the Company's uncertain tax positions would reduce the Company's annual effective tax rate, if recognized.

The Company does not expect its uncertain tax positions to change significantly over the next 12 months. Any interest and penalties related to uncertain tax positions will be reflected in income tax expense. As of December 30, 2007, no

interest or penalties have been accrued related to the Company's uncertain tax positions. Tax years 1998 to 2007 remain subject to future examination by the major tax jurisdictions in which the Company is subject to tax.

F-33

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. Retirement Plan**

The Company has a 401(k) savings plan covering substantially all of its employees. Company contributions to the plan are discretionary. During the years ended December 30, 2007, December 31, 2006, and January 1, 2006, the Company made matching contributions of \$1.4 million, \$0.4 million, and \$0, respectively.

**13. Segment Information, Geographic Data and Significant Customers**

Subsequent to December 30, 2007, the Company reorganized its operating structure to further leverage the synergies between its sequencing and genotyping businesses. Under the new structure, a newly created Life Sciences Business Unit will include all products and services related to the research market, namely the BeadArray, BeadXpress and Sequencing product lines. The Company has also created a Diagnostics Business Unit to put more focus on the emerging opportunity in molecular diagnostics. The Diagnostics Business Unit plans to develop diagnostic content for the BeadXpress system, and ultimately for the Company's sequencing products. For the fiscal year ended December 30, 2007, the Company had no activity related to the Diagnostics Business Unit and operating results were reported on an aggregate basis to the chief operating decision maker of the Company, the chief executive officer. In accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, the Company operated in one segment for the fiscal year ended December 30, 2007. Beginning January 2008, the Company will have two reportable segments including the Life Sciences Business Unit and the Diagnostics Business Unit.

The Company had revenue in the following regions for the years ended December 30, 2007, December 31, 2006 and January 1, 2006 (in thousands):

|               | <b>Year Ended<br/>December 30,<br/>2007</b> | <b>Year Ended<br/>December 31,<br/>2006</b> | <b>Year Ended<br/>January 1,<br/>2006</b> |
|---------------|---|---|---|
| United States | \$ 207,692                                  | \$ 103,043                                  | \$ 45,480                                 |
| Europe        | 109,556                                     | 55,440                                      | 17,551                                    |
| Asia          | 35,155                                      | 15,070                                      | 6,850                                     |
| Other         | 14,396                                      | 11,033                                      | 3,620                                     |
| Total         | \$ 366,799                                  | \$ 184,586                                  | \$ 73,501                                 |

The Company had no customers that provided more than 10% of total revenue in the years ended December 30, 2007, December 31, 2006 and January 1, 2006.

Long-lived assets include property and equipment, net, goodwill and intangible assets, net. The Company had long-lived assets in the following regions as of December 30, 2007 and December 31, 2006 (in thousands):

| <b>Year Ended<br/>December 30,</b> | <b>Year Ended<br/>December 31,</b> |
|------------------------------------|------------------------------------|
|------------------------------------|------------------------------------|



|               | <b>2007</b> | <b>2006</b> |
|---------------|-------------|-------------|
| United States | \$ 311,686  | \$ 27,505   |
| Europe        | 21,175      | 133         |
| Asia          | 263         | 229         |
| Other         |             |             |
| Total         | \$ 333,124  | \$ 27,867   |

F-34

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**Table of Contents****ILLUMINA, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The increase in long-lived assets located in the United States and Europe at December 30, 2007 compared to December 31, 2006 was primarily due to the Solexa acquisition and the settlement of the Affymetrix litigation.

**14. Quarterly Financial Information (unaudited)**

The following financial information reflects all normal recurring adjustments, except as noted below, which are, in the opinion of management, necessary for a fair statement of the results of interim periods. Summarized quarterly data for fiscal 2007 and 2006 are as follows (in thousands except per share data):

|   | <b>First<br/>Quarter(1)</b> | <b>Second<br/>Quarter</b> | <b>Third<br/>Quarter</b> | <b>Fourth<br/>Quarter(2),(3)</b> |
|---|-----------------------------|---------------------------|--------------------------|----------------------------------|
| 2007:                                   |                             |                           |                          |                                  |
| Total revenue                           | \$ 72,150                   | \$ 84,535                 | \$ 97,510                | \$ 112,604                       |
| Total cost of revenue                   | 25,120                      | 30,141                    | 37,078                   | 40,097                           |
| Net income (loss)                       | (298,076)                   | 9,264                     | 14,503                   | (4,050)                          |
| Net income (loss) per share,<br>basic   | (5.58)                      | 0.17                      | 0.27                     | (0.07)                           |
| Net income (loss) per share,<br>diluted | (5.58)                      | 0.16                      | 0.24                     | (0.07)                           |
| 2006:                                   |                             |                           |                          |                                  |
| Total revenue                           | \$ 29,102                   | \$ 41,577                 | \$ 53,472                | \$ 60,435                        |
| Total cost of revenue                   | 9,293                       | 13,576                    | 16,356                   | 20,119                           |
| Net income (loss)                       | (104)                       | 6,768                     | 16,162                   | 17,142                           |
| Net income (loss) per share,<br>basic   | (0.00)                      | 0.16                      | 0.35                     | 0.37                             |
| Net income (loss) per share,<br>diluted | (0.00)                      | 0.14                      | 0.32                     | 0.34                             |

The sum of the net income (loss) per share for each of the four quarters within each fiscal year presented may not equate to the net income (loss) per share reported for the full fiscal year because different numbers of shares were outstanding during the periods presented.

- (1) During the first quarter of 2007, the Company recorded a \$303.4 million charge related to acquired in-process research and development from the Solexa acquisition.
- (2) During the fourth quarter of 2007, the Company recorded a \$54.0 million charge related to the settlement of its Affymetrix litigation.
- (3) During the fourth quarter of 2007, the Company recorded a \$11.1 million benefit related to the release of the valuation allowance recorded against certain U.S. deferred tax assets.

**15. Subsequent Events**

***Litigation Settlements***

Subsequent to year-end, the Company entered into two settlement agreements. On January 9, 2008, the Company entered into a settlement agreement with Affymetrix to resolve its patent litigation (see Note 8). The cash settlement of \$90.0 million was paid on January 25, 2008. On January 30, 2008 a dispute with a former employee was resolved regarding the inventorship of certain of the Company's patents. All claims pending in that litigation were dismissed with prejudice in accordance with the release and settlement agreement (see Note 8). The cash settlement of \$0.5 million was paid on February 6, 2008.

F-35

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**Table of Contents**

**ILLUMINA, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Investments***

At February 19, 2008, the Company held approximately \$55.9 million of auction rate securities issued primarily by municipalities and universities. In February 2008, auctions failed for \$10.7 million of these auction rate securities and there is no assurance that currently successful auctions on the other auction rate securities in the Company's investment portfolio will continue to succeed and as a result its ability to liquidate its investment and fully recover the carrying value of the Company's investment in the near term may be limited or not exist. All of the Company's auction rate securities, including those subject to the failure, are currently rated AAA, the highest rating, by a rating agency. If the issuers are unable to successfully close future auctions and their credit ratings deteriorate, the Company may in the future be required to record an impairment charge on these investments. The Company believes it will be able to liquidate its investment without significant loss within the next year, and currently believes these securities are not significantly impaired, primarily due to the government guarantee of the underlying securities. However, it could take until the final maturity of the underlying notes (up to 30 years) to realize these investments' recorded value. Based on the Company's expected operating cash flows, and its other sources of cash, the Company does not anticipate the potential lack of liquidity on these investments will affect its ability to execute its current business plan.

**Table of Contents**

**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES  
FOR THE THREE YEARS ENDED DECEMBER 30, 2007**

|                                       | <b>Allowance<br/>for<br/>Doubtful<br/>Accounts</b> | <b>Reserve for<br/>Inventory</b> |
|---------------------------------------|--|----------------------------------|
|                                       | <b>(In thousands)</b>                              |                                  |
| Balance as of January 2, 2005         | \$ 146   | \$ 1,038                         |
| Charged to expense                    | 167  | 304                              |
| Utilizations                          |  | (247)                            |
| Balance as of January 1, 2006         | 313  | 1,095                            |
| Charged to expense                    | 179  | 127                              |
| Utilizations                          | (154)  | (372)                            |
| Balance as of December 31, 2006       | 338  | 850                              |
| Acquired through business acquisition |  | 439                              |
| Charged to expense                    | 237  | 1,863                            |
| Utilizations                          | (35)   | (1,063)                          |
| Balance as of December 30, 2007       | \$ 540   | \$ 2,089                         |

F-37