

ILLUMINA INC
Form 10-Q
November 05, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

**☐ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended October 3, 2010**

**☐ 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

33-0804655

(State or other Jurisdiction of Incorporation or
Organization)

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

9885 Towne Centre Drive, San Diego, CA

92121

(Address of Principal Executive Offices)

(Zip Code)

(858) 202-4500

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐

Smaller reporting company ☐

(Do not check if a smaller reporting company)

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

As of October 15, 2010, there were 125,043,975 shares of the Registrant's Common Stock outstanding.

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Illumina, Inc.
Condensed Consolidated Balance Sheets
(In thousands)

	October 3, 2010 (Unaudited)	January 3, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 210,767	\$ 144,633
Short-term investments	596,049	548,894
Accounts receivable, net	170,618	157,751
Inventory, net	130,029	92,776
Deferred tax assets, current portion	16,808	20,021
Prepaid expenses and other current assets	16,076	17,515
Total current assets	1,140,347	981,590
Property and equipment, net	126,269	117,188
Goodwill	278,112	213,452
Intangible assets, net	72,333	43,788
Deferred tax assets, long-term portion	37,538	47,371
Other assets	70,622	26,548
Total assets	\$ 1,725,221	\$ 1,429,937
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 59,792	\$ 52,781
Accrued liabilities	134,526	98,253
Long-term debt, current portion	306,106	290,202
Total current liabilities	500,424	441,236
Other long-term liabilities	32,783	24,656
Commitments and contingencies		
Conversion option subject to cash settlement	83,893	99,797
Stockholders' equity:		
Preferred stock		
Common stock	1,495	1,436
Additional paid-in capital	1,811,388	1,637,751
Accumulated other comprehensive income	2,565	2,830
Accumulated deficit	(193,779)	(280,226)
Treasury stock, at cost	(513,548)	(497,543)
Total stockholders' equity	1,108,121	864,248
Total liabilities and stockholders' equity	\$ 1,725,221	\$ 1,429,937

See accompanying notes to the condensed consolidated financial statements.

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Illumina, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	October 3,	September	October 3,	September
	2010	27,	2010	27,
		2009		2009
Revenue:				
Product revenue	\$ 224,668	\$ 150,306	\$ 596,885	\$ 459,708
Service and other revenue	12,641	8,054	44,558	26,052
Total revenue	237,309	158,360	641,443	485,760
Cost of revenue:				
Cost of product revenue	72,248	45,858	184,814	142,377
Cost of service and other revenue	5,621	3,706	15,705	10,024
Amortization of intangible assets	2,295	1,670	5,510	5,010
Total cost of revenue	80,164	51,234	206,029	157,411
Gross profit	157,145	107,126	435,414	328,349
Operating expenses:				
Research and development	44,804	34,406	132,146	100,248
Selling, general and administrative	55,006	42,096	158,956	126,866
Acquired in-process research and development		1,325	1,325	1,325
Total operating expenses	99,810	77,827	292,427	228,439
Income from operations	57,335	29,299	142,987	99,910
Other income (expense), net:				
Interest income	2,791	2,536	6,746	8,027
Interest expense	(6,190)	(5,964)	(18,279)	(17,361)
Other income, net	774	1,592	3,142	1,261
Total other expense, net	(2,625)	(1,836)	(8,391)	(8,073)
Income before income taxes	54,710	27,463	134,596	91,837
Provision for income taxes	19,263	10,386	48,145	31,261
Net income	\$ 35,447	\$ 17,077	\$ 86,451	\$ 60,576
Net income per basic share	\$ 0.28	\$ 0.14	\$ 0.70	\$ 0.49
Net income per diluted share	\$ 0.24	\$ 0.12	\$ 0.61	\$ 0.44

Shares used in calculating basic net income per share	124,684	124,557	122,816	123,274
Shares used in calculating diluted net income per share	145,205	139,874	140,854	137,438

See accompanying notes to the condensed consolidated financial statements.

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Illumina, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Nine Months Ended	
	October 3, 2010	September 27, 2009
Cash flows from operating activities:		
Net income	\$ 86,451	\$ 60,576
Adjustments to reconcile net income to net cash provided by operating activities:		
Acquired in-process research and development	1,325	1,325
Amortization of intangible assets	5,510	5,010
Amortization of debt discount	15,904	14,792
Gain on acquisition	(2,914)	
Depreciation expense	24,611	18,259
Stock-based compensation expense	51,804	44,334
Incremental tax benefit related to stock options exercised	(14,551)	(39,077)
Deferred income taxes	18,844	25,959
Other non-cash adjustments	4,567	308
Changes in operating assets and liabilities:		
Accounts receivable	(12,752)	(25,030)
Inventory	(36,463)	(6,455)
Prepaid expenses and other current assets	2,571	(3,455)
Other assets	(2,467)	(2,447)
Accounts payable	17,499	11,989
Accrued liabilities	32,719	2,136
Accrued income taxes	(1,431)	4,594
Other long-term liabilities	(564)	350
Unrealized loss on foreign exchange	429	(2,266)
Net cash provided by operating activities	191,092	110,902
Cash flows from investing activities:		
Purchases of available-for-sale securities	(663,430)	(563,290)
Sales and maturities of available-for-sale securities	558,128	356,281
Sales and maturities of trading securities	54,900	450
Net cash paid for acquisitions	(98,210)	(1,325)
Purchase of investments	(22,450)	(17,950)
Purchases of property and equipment	(37,434)	(46,288)
Cash paid for intangible assets	(6,500)	
Net cash used in investing activities	(214,996)	(272,122)
Cash flows from financing activities:		
Payments on current portion of long-term debt		(10,000)
Incremental tax benefit related to stock options exercised	14,551	39,077
Common stock repurchases	(16,006)	

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Proceeds from the exercise of warrants	9,587	7,576
Proceeds from issuance of common stock	81,798	35,634
Net cash provided by financing activities	89,930	72,287
Effect of exchange rate changes on cash and cash equivalents	108	437
Net increase (decrease) in cash and cash equivalents	66,134	(88,496)
Cash and cash equivalents at beginning of period	144,633	327,024
Cash and cash equivalents at end of period	\$ 210,767	\$ 238,528

See accompanying notes to the condensed consolidated financial statements.

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Illumina, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

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

1. Summary of Significant Accounting Principles

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. In management's opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited financial statements should be read in conjunction with the Company's audited financial statements and footnotes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 3, 2010 from which the balance sheet information herein was derived.

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

Fiscal Year

The Company's fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, and September 30. The three and nine months ended October 3, 2010 and September 27, 2009 were both 13 and 39 weeks, respectively.

Segment Information

The Company is organized in two business segments, Life Sciences and Diagnostics. The Life Sciences Business Unit includes all products and services that are primarily related to the research market, namely the product lines based on the Company's sequencing, BeadArray, and VeraCode technologies, and the Diagnostics Business Unit focuses on the emerging opportunity in molecular diagnostics. For the three and nine months ended October 3, 2010, the Company had limited activity related to the Diagnostics Business Unit. Accordingly, the Company operated in one reportable segment for the three and nine months ended October 3, 2010. The Company will begin reporting in two segments once revenues, operating profit or loss, or assets of the Diagnostics Business Unit exceed 10% of the consolidated amounts.

Revenue Recognition

The Company's revenue is generated primarily from the sale of products and services. Product revenue primarily consists of sales of instrumentation and consumables used in genetic analysis. Service and other revenue primarily consists of revenue received for performing genotyping and sequencing services, extended warranty sales, and amounts earned under research agreements with government grants, which are 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

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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 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 receivable is reasonably assured. Revenue for genotyping and sequencing services is recognized when earned, which is generally at the time the genotyping or sequencing analysis data is made available to the customer or agreed upon milestones are reached.

In order to assess whether the price is fixed or determinable, the Company evaluates whether refund rights exist. If there are refund rights or payment terms based on future performance, the Company defers revenue recognition until the price becomes fixed or 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 receipt of payment.

The Company regularly enters into contracts where revenue is derived from multiple deliverables including any mix of products or services. These products or services are generally delivered within a short time frame, approximately three to six months, of the contract execution date. Revenue recognition for contracts with multiple deliverables is based on the individual units of accounting determined to exist in the contract. A delivered item is considered a separate unit of accounting when the delivered item has value to the customer on a stand-alone basis. Items are considered to have stand-alone value when they are sold separately by any vendor or when the customer could resell the item on a stand-alone basis. Consideration is allocated at the inception of the contract to all deliverables based on their relative selling price. The relative selling price for each deliverable is determined using vendor specific objective evidence (VSOE) of selling price or third-party evidence of selling price if VSOE does not exist. If neither VSOE nor third-party evidence exists, the Company uses its best estimate of the selling price for the deliverable.

In order to establish VSOE of selling price, the Company must regularly sell the product or service on a standalone basis with a substantial majority priced within a relatively narrow range. VSOE of selling price is usually the midpoint of that range. If there is not a sufficient number of standalone sales and VSOE of selling price cannot be determined, then the Company considers whether third party evidence can be used to establish selling price. Due to the lack of similar products and services sold by other companies within the industry, the Company has rarely established selling price using third-party evidence. If neither VSOE nor third party evidence of selling price exists, the Company determines its best estimate of selling price using average selling prices over a rolling 12-month period coupled with an assessment of current market conditions. If the product or service has no history of sales or if the sales volume is not sufficient, the Company relies upon prices set by the Company's pricing committee adjusted for applicable discounts. The Company recognizes revenue for delivered elements only when it determines there are no uncertainties regarding customer acceptance.

In the first quarter of 2010, the Company offered an incentive with the launch of the HiSeq 2000 that enabled existing Genome Analyzer customers to trade-in their Genome Analyzer and receive a discount on the purchase of a HiSeq 2000. The incentive was limited to customers who had purchased a Genome Analyzer as of the date of the announcement and was the first significant trade-in program offered by the Company. The Company will account for HiSeq 2000 discounts related to the Genome Analyzer trade-in program in the period in which the HiSeq 2000 revenue is recognized.

Long-Lived Assets

The original assumptions and rationale utilized in establishing the carrying value and estimated lives of the Company's long-lived assets are periodically re-evaluated. The criteria used for these evaluations include management's estimate of the asset's continuing ability to generate income from operations and positive cash flow in future periods as well as the strategic significance of any intangible asset to the Company's business objectives. Impairment is reviewed at the lowest levels for which there are identifiable cash flows that are independent of the cash flows of other groups of assets. If assets are considered to be impaired, the impairment recognized is the amount by which the carrying value of the assets exceeds the fair value of the assets, which is determined by applicable market prices, when available. The Company did not recognize impairment during the three or nine months ended October 3, 2010.

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The Company determines the fair value of its assets and liabilities based on the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs. The Company uses a fair value hierarchy with three levels of inputs, of which the first two are considered observable and the last unobservable, to measure fair value:

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs, other than Level 1, that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following table presents the Company's fair value hierarchy for assets measured at fair value on a recurring basis as of October 3, 2010 (in thousands):

	Level 1	Level 2	Level 3	Total
Debt securities in government sponsored entities	\$	\$ 246,563	\$	\$ 246,563
Corporate debt securities		307,554		307,554
U.S. Treasury securities	41,932			41,932
Total assets measured at fair value	\$ 41,932	\$ 554,117	\$	\$ 596,049

The Company measures debt securities in government sponsored entities and corporate debt securities on a recurring basis primarily using quoted prices for similar assets in active markets.

Derivatives

The Company is exposed to foreign currency exchange rate risks in the normal course of business. To mitigate the risk associated with changes in foreign currency exchange rates, the Company enters into foreign currency forward contracts to hedge monetary assets and liabilities that are denominated in certain currencies other than the functional currency of its subsidiaries, which is currently the U.S. dollar. These foreign currency forward contracts are carried at fair value and are not designated as hedging instruments. As a result, changes in the value of the derivative are recognized in other income (expense), net, in the condensed consolidated statements of operations for the current period, along with an offsetting gain or loss on the underlying assets or liabilities.

As of October 3, 2010, the Company had foreign currency forward contracts in place to hedge exposures in the euro, Japanese yen, and the Australian dollar. As of October 3, 2010, the total notional amount of outstanding forward contracts in place for foreign currency purchases was approximately \$17.7 million. For the three and nine months ended October 3, 2010, non-designated foreign currency forward contracts resulted in losses of \$1.6 million and \$0.7 million, respectively.

Stock-Based Compensation

The Company uses the Black-Scholes-Merton option-pricing model to estimate the fair value of stock options granted and stock purchases under the Employee Stock Purchase Plan (ESPP). This model incorporates various assumptions including expected volatility, expected option life, expected dividends, and risk-free interest rates. The Company determines volatility 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 forfeiture experience, exercise activity, and its terms and conditions.

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

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
Interest rate - stock options	2.05%	N/A	2.05 - 2.73%	1.69 - 1.97%
Interest rate - stock purchases	0.17 - 0.48%	0.28 - 0.48%	0.17 - 0.51%	0.28 - 0.51%
Volatility - stock options	46%	N/A	46 - 48%	55-58%
Volatility - stock purchases	46 - 48%	48 - 58%	46 - 58%	48-58%
Expected life - stock options	6 years	N/A	6 years	5 years
Expected life - stock purchases	6-12 months	6-12 months	6-12 months	6-12 months
Expected dividend yield	0%	0%	0%	0%
Weighted average fair value per share of options granted	\$ 20.08	\$ N/A	\$ 18.82	\$ 14.79
Weighted average fair value per share of employee stock purchases	\$ 11.49	\$ 9.22	\$ 10.82	\$ 9.14

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The fair value of restricted stock units granted during the three and nine months ended October 3, 2010 and September 27, 2009 was based on the market price of our common stock on the date of grant.

As of October 3, 2010, approximately \$145.3 million of total unrecognized compensation cost related to stock options, restricted stock units and ESPP shares issued to date is expected to be recognized over a weighted-average period of approximately 2.41 years.

Total stock-based compensation expense for employee stock options, restricted stock, and stock purchases under the ESPP consists of the following (in thousands, except per share data):

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
Cost of product revenue	\$ 1,359	\$ 1,144	\$ 3,869	\$ 3,617
Cost of service and other revenue	137	112	394	397
Research and development	6,521	4,788	18,451	14,389
Selling, general and administrative	9,943	8,528	29,090	25,931
Share-based compensation expense before taxes	17,960	14,572	51,804	44,334
Related income tax benefits	(6,107)	(4,841)	(17,639)	(14,377)
Share-based compensation expense, net of taxes	\$ 11,853	\$ 9,731	\$ 34,165	\$ 29,957
Net share-based compensation expense per share of common stock:				
Basic	\$ 0.10	\$ 0.08	\$ 0.28	\$ 0.24
Diluted	\$ 0.08	\$ 0.07	\$ 0.24	\$ 0.22

Net Income (Loss) per Share

Basic net income or loss per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period increased to include dilutive potential common shares using the treasury stock method. Dilutive potential common shares consist of stock options with combined exercise prices and unrecognized compensation expense that are less than the average market price of the Company's common stock, restricted stock units with unrecognized compensation expense, convertible debt when the average market price of the Company's common stock is above the conversion price of \$21.83, and warrants with exercise prices that are less than the average market price of the Company's common stock. Under the treasury stock method, the amount that must be paid to exercise stock options and warrants, the amount of compensation expense for future services that the Company has not yet recognized for stock options and restricted stock units, and the amount of tax benefits that will be recorded in additional paid-in capital when the awards become deductible are assumed to be used to repurchase shares. In loss periods, basic net loss per share and diluted net loss per share are identical since the effect of dilutive potential common shares is anti-dilutive and therefore excluded.

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

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009

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	2010	2009	2010	2009
Weighted-average shares outstanding	124,684	124,557	122,816	123,274
Effect of dilutive potential common shares:				
Dilutive Convertible Senior Notes	9,292	7,035	8,381	6,531
Dilutive equity awards	4,734	4,468	4,407	4,432
Dilutive warrants sold in connection with the Convertible Senior Notes	5,662	2,329	4,316	1,625
Dilutive warrants assumed in an acquisition	833	1,485	934	1,576
Weighted-average shares used in calculating diluted net income per share	145,205	139,874	140,854	137,438
Weighted-average shares excluded from calculation due to anti-dilutive effect	2,518	4,526	2,350	4,772

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Total comprehensive income consisted of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	October 3, 2010	September 27, 2009	October 3, 2010	September 27, 2009
Net income	\$ 35,447	\$ 17,077	\$ 86,451	\$ 60,576
Unrealized (loss) gain on available-for-sale securities, net of deferred tax	(48)	399	(265)	814
Total comprehensive income	\$ 35,399	\$ 17,476	\$ 86,186	\$ 61,390

2. Balance Sheet Account Details***Short-Term Investments***

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

	October 3, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Debt securities in government sponsored entities	\$ 246,368	\$ 211	\$ (16)	\$ 246,563
Corporate debt securities	305,892	1,740	(78)	307,554
U.S. treasury securities	41,803	129		41,932
Total available-for-sale securities	\$ 594,063	\$ 2,080	\$ (94)	\$ 596,049

	January 3, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:				
Debt securities in government sponsored entities	\$ 289,101	\$ 702	\$ (102)	\$ 289,701
Corporate debt securities	190,949	2,039	(166)	192,822
U.S. treasury securities	11,487	12	(28)	11,471
Total available-for-sale securities	491,537	2,753	(296)	493,994
Trading securities:				
Auction rate securities	54,900		(6,129)	48,771
Put option		6,129		6,129
Total trading securities	54,900	6,129	(6,129)	54,900

Total short-term investments	\$ 546,437	\$ 8,882	\$ (6,425)	\$ 548,894
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Available-For-Sale Securities

As of October 3, 2010, the Company had 42 available-for-sale securities in a gross unrealized loss position, all of which had been in such position for less than twelve months. There were no unrealized losses due to credit issues for the periods presented. There were no impairments considered other-than-temporary as it is more likely than not the Company will hold the securities until maturity or a recovery of the cost basis. The following table shows the fair values and the gross unrealized losses of the Company's available-for-sale securities that were in an unrealized loss position as of October 3, 2010 and January 3, 2010 aggregated by investment category (in thousands):

	October , 2010		January 3, 2010	
	Fair	Gross	Fair	Gross
	Value	Unrealized	Value	Unrealized
		Losses		Losses
Debt securities in government sponsored entities	\$ 51,021	\$ (16)	\$ 73,783	\$ (102)
Corporate debt securities	71,228	(78)	26,488	(166)
U.S. treasury securities			4,471	(28)
Total	\$ 122,249	\$ (94)	\$ 104,742	\$ (296)

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Realized gains and losses are determined based on the specific identification method and are reported in other income, net in the condensed consolidated statements of operations. Gross realized gains for the three and nine months ended October 3, 2010 were \$1.1 million and \$1.6 million, respectively. Gross realized losses on sales of available-for-sale securities were immaterial for the three and nine months ended October 3, 2010. Gross realized gains and losses on sales of available-for-sale securities were immaterial for the three and nine months ended September 27, 2009.

Contractual maturities of available-for-sale securities as of October 3, 2010 were as follows (in thousands):

	Estimated Fair Value
Due within one year	\$ 208,877
After one but within five years	387,172
Total	\$ 596,049

Trading Securities

As of January 3, 2010, the Company's short-term investments included \$54.9 million (at cost) of auction rate securities issued primarily by municipalities and universities. The markets for auction rate securities effectively ceased when the vast majority of auctions failed in February 2008, preventing investors from selling these securities. Due to the auction failures and the lack of trading in the secondary market of these instruments, there was insufficient observable market information available to directly determine the fair value of the Company's auction rate securities. As a result, the value of these securities was determined using Level 3 hierarchical inputs. As of January 3, 2010, the fair value of the Company's auction rate securities was determined to be \$48.8 million.

In November 2008, the Company signed an agreement granting the Company an option to sell all of its auction rate securities at par value to UBS during the period of June 30, 2010 through July 2, 2012. To account for the option, the Company recorded a separate freestanding asset (put option) and recognized a corresponding gain in earnings during the fourth quarter of 2008. Subsequent to the initial recognition of the put option, the Company continued to recognize gains and losses in earnings approximating the changes in the fair value of the auction rate securities at each balance sheet date. At January 3, 2010, the fair value of the Company's put option was determined to be \$6.1 million. On July 1, 2010, the Company exercised its option to sell all of its remaining auction rate securities at par. From January 3, 2010 through July 1, 2010 the increase in the fair value of the auction rate securities was equal to the decrease in the fair value of the put option. As such, no gain or loss was recorded as a result of the exercise of the put option and the sale of the auction rate securities.

Changes in the fair value of the Company's auction rate securities and put option from January 3, 2010 through October 3, 2010 are as follows (in thousands):

Fair value of auction rate securities and put option as of January 3, 2010	54,900
Auction rate securities redeemed by issuer	(32,100)
Auction rate securities sold upon the exercise of put option on July 1, 2010	(22,800)
Fair value as of October 3, 2010	\$

Inventory

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

	October 3, 2010	January 3, 2010
Raw materials	\$ 53,551	\$ 37,979
Work in process	62,642	44,663

Finished goods	13,836	10,134
Total inventory, net	\$ 130,029	\$ 92,776

Table of Contents***Accrued Liabilities***

Accrued liabilities consist of the following (in thousands):

	October 3, 2010	January 3, 2010
Short-term deferred revenue	\$ 43,740	\$ 27,445
Compensation	43,482	32,487
Customer deposits	13,614	6,121
Reserve for product warranties	11,291	10,215
Taxes	9,562	12,109
Accrued royalties	1,858	2,552
Other	10,979	7,324
Total accrued liabilities	\$ 134,526	\$ 98,253

3. Acquisitions

Under the acquisition method of accounting, the Company allocates the fair value of the total consideration transferred to the tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values on the date of acquisition. The fair values assigned to identifiable intangible assets acquired are based on estimates and assumptions determined by management. The Company records the excess consideration over the aggregate fair value of tangible and intangible assets as goodwill. Pro forma results of operations have not been presented for acquisitions completed in 2010 because the effects of these acquisitions were not material.

Helixis, Inc.

On April 30, 2010, the Company completed the acquisition of Helixis, Inc., a company developing a high-performance, low-cost, real-time polymerase chain reaction system used for nucleic acid analysis. Total consideration for the acquisition at the closing date was approximately \$86.7 million, including \$70.0 million in cash (net of \$2.6 million of cash acquired) and \$14.1 million for the estimated fair value of contingent consideration payments that may range from \$0 to \$35 million based on the achievement of certain revenue-based milestones by December 31, 2011. The operations of Helixis have been included in the Company's condensed consolidated financial statements since the acquisition date of April 30, 2010. Using information available at the close of the acquisition, the Company allocated approximately \$2.3 million of the consideration to tangible assets and liabilities and approximately \$28.0 million to identified intangible assets that will be amortized over a useful life of 10 years. The Company also recorded a \$2.0 million net deferred tax liability to reflect the tax impact of the identified intangible assets that will not generate tax deductible amortization expense net of the future tax benefit of acquired net operating loss carryforwards. The Company recorded the excess consideration of approximately \$58.4 million as goodwill, which is not deductible for income tax purposes. Goodwill is attributable to estimated synergies arising from the acquisition and other intangible assets that do not qualify for separate recognition.

Prior to the acquisition, the Company had an equity interest in Helixis with a cost basis of \$2.0 million that was accounted for under the cost method. As a result of revaluing the Company's equity interest in Helixis on the acquisition date, the Company recognized a gain of \$2.9 million, which was included in other income, net, in its condensed consolidated statement of operations in the second quarter of 2010.

Avantome, Inc.

On August 1, 2008, the Company completed the acquisition of Avantome, Inc., a development-stage company creating a low cost, long-read sequencing technology. At the time of the acquisition, the Company paid \$25.8 million in cash, including transaction costs, and recorded a charge of \$24.7 million for purchased in-process research and development (IPR&D). As part of the acquisition agreement, the Company agreed to pay Avantome's former shareholders up to an additional \$35.0 million in contingent cash consideration based on the achievement of certain milestones. For the nine months ended October 3, 2010, the Company recorded IPR&D of \$1.3 million and compensation expense of \$2.8 million associated with these milestones. Compensation expense associated with the

Avantome acquisition is included in research and development in the consolidated statements of operations.

Table of Contents**4. Warranties**

The Company generally provides a one-year warranty on genotyping, gene expression and sequencing systems. Additionally, the Company provides a warranty on its consumable sales through the expiry date, which generally ranges from six to twelve months after the manufacture date. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses based on historical experience as well as anticipated product performance. This expense is recorded as a component of cost of product revenue. Warranty expenses associated with extended maintenance contracts for systems are recorded as cost of service and other revenue as incurred.

Changes in the Company's reserve for product warranties from January 3, 2010 through October 3, 2010 are as follows (in thousands):

Balance as of January 3, 2010	\$ 10,215
Additions charged to cost of revenue	15,054
Repairs and replacements	(13,978)
Balance as of October 3, 2010	\$ 11,291

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 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 interest payments of \$1.2 million on February 15, 2010 and August 15, 2010. The notes mature on February 15, 2014.

The notes will be convertible into cash and, if applicable, shares of the Company's common stock based on a conversion rate, subject to adjustment, of 45.8058 shares per \$1,000 principal amount of notes (which represents a conversion price of approximately \$21.83 per share), only in the following circumstances and to the following extent: (1) during the five business-day period after any five consecutive trading-day 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, 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) at any time on or after November 15, 2013 through the third scheduled trading day immediately preceding the maturity date. As of October 3, 2010, notes in an aggregate principal amount of \$10.0 million have been converted.

The Company entered into a hedge transaction upon issuance of the convertible senior notes with the initial purchasers and/or their affiliates (the hedge counterparties), which entitles the Company to purchase up to 18,322,320 shares of the Company's common stock at a strike price of approximately \$21.83 per share, subject to adjustment. In addition, the Company sold to these hedge counterparties warrants exercisable, on a cashless basis, for up to 18,322,320 shares of the Company's common stock at a strike price of \$31.435 per share, subject to adjustment. The cost of the hedge transaction that was not covered by the proceeds from the sale of the warrants was approximately \$46.6 million and was reflected as a reduction of additional paid-in capital. The hedge transaction is expected to reduce the potential equity dilution upon conversion of the notes to the extent the Company exercises the hedge to purchase shares from the hedge counterparties to deliver to converting noteholders. However, the warrants could have a dilutive effect on the Company's earnings per share to the extent that the price of the Company's common stock exceeds the strike price of the warrants.

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The Company accounts separately for the liability and equity components of the notes in accordance with authoritative guidance for convertible debt instruments that may be settled in cash upon conversion. The guidance requires the carrying amount of the liability component to be estimated by measuring the fair value of a similar liability that does not have an associated conversion feature. Because the Company was unable to find any other comparable companies in industry and size with outstanding non-convertible public debt, the Company determined that senior, unsecured corporate bonds represent a similar liability to the convertible senior notes without the conversion option. To measure the fair value of the similar liability at February 16, 2007, the Company estimated an interest rate using assumptions that market participants would use in pricing the liability component, including market interest rates, credit standing, yield curves and volatilities, all of which are defined as Level 2 Observable Inputs. The estimated interest rate of 8.27% was applied to the convertible senior notes and coupon interest using a present value technique to arrive at the fair value of the liability component. The difference between the cash proceeds associated with the convertible debt and this estimated fair value of the liability component is recorded as an equity component. The Company classified a portion of the equity component as temporary equity measured as the excess of a) the amount of cash that would be required to be paid upon conversion over b) the current carrying amount of the liability-classified component. The amount is reflected within conversion option subject to cash settlement in the condensed consolidated balance sheets.

As of January 3, 2010, the principal amount of the convertible senior notes was \$390.0 million and the unamortized discount was \$99.8 million resulting in a net carrying amount of the liability component of \$290.2 million. As of October 3, 2010, the principal amount of the convertible senior notes was \$390.0 million and the unamortized discount was \$83.9 million resulting in a net carrying amount of the liability component of \$306.1 million. The remaining period over which the discount on the liability component will be amortized is 3.37 years.

6. Stockholders' Equity***Stock Options***

The Company's stock option activity under all stock option plans during the nine months ended October 3, 2010 is as follows:

	Options	Weighted-Average Exercise Price
Outstanding at January 3, 2010	16,089,438	\$ 18.59
Granted	2,045,489	\$ 39.11
Exercised	(4,398,243)	\$ 16.38
Cancelled	(676,127)	\$ 21.85
Outstanding at October 3, 2010	13,060,557	\$ 22.37

The aggregate intrinsic value of options outstanding and options exercisable as of October 3, 2010 was \$348.9 million and \$234.7 million, respectively. Aggregate intrinsic value represents the difference between the Company's closing stock price per share on the last trading day of the fiscal period, which was \$49.09 as of October 1, 2010, and the exercise price multiplied by the number of options outstanding. Total intrinsic value of options exercised was \$110.4 million and \$63.6 million for the nine months ended October 3, 2010 and September 27, 2009, respectively.

The weighted average remaining life of options outstanding and options exercisable as of October 3, 2010 was 6.67 years and 5.78 years, respectively.

Employee Stock Purchase Plan

The price at which stock is purchased under the ESPP 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. Shares totaling 372,544 were issued under the ESPP during the nine months ended October 3, 2010. As of October 3, 2010, there were 16,061,905 shares available for issuance under the ESPP.

Table of Contents***Restricted Stock Units***

A summary of the Company's restricted stock unit activity and related information for the nine months ended October 3, 2010 is as follows:

	Restricted Stock Units (1)
Outstanding at January 3, 2010	2,508,708
Awarded	624,018
Vested	(220,104)
Cancelled	(174,787)
Outstanding at October 3, 2010	2,737,835

- (1) Each stock unit represents the fair market value of one share of common stock.

The weighted average grant-date fair value per share for the restricted stock units was \$40.34 for the nine months ended October 3, 2010.

Based on the closing price of the Company's common stock of \$49.09 on October 1, 2010, the total intrinsic value of all outstanding restricted stock units on that date was \$134.4 million.

Warrants

In conjunction with an acquisition in January 2007, the Company assumed 4,489,686 warrants. During the nine months ended October 3, 2010, there were 986,982 warrants exercised, resulting in cash proceeds to the Company of approximately \$9.6 million.

A summary of all warrants outstanding as of October 3, 2010 is as follows:

Number of Shares	Exercise Price	Expiration Date
293,714	\$ 10.91	11/23/2010
802,458	\$ 10.91	1/19/2011
18,322,320(1)	\$ 31.44	2/15/2014
19,418,492		

- (1) Represents warrants sold in connection with the offering of the Company's convertible senior notes (see Note 5).

7. Legal Proceedings

From time to time, we are party to litigation and other legal proceedings in the ordinary course, and incidental to the conduct, of our business. While the results of any litigation or other legal proceedings are uncertain, management does not believe the ultimate resolution of any pending legal matters is likely to have a material adverse effect on our financial position or results of operations.

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

This discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and the financial statements, notes thereto and related Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended January 3, 2010 included in our Annual Report on Form 10-K. Operating results are not necessarily indicative of results that may occur in future periods.

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

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Forward-looking statements are subject to known and unknown risks and uncertainties and are based on potentially inaccurate assumptions that could cause actual results to differ materially from those expected or implied by the forward-looking statements. Among the important factors that could cause actual results to differ materially from those in any forward-looking statements are (i) our ability to develop and commercialize further our BeadArray[®], VeraCode[®], and Solexa[®] technologies and to deploy new sequencing, gene expression, and genotyping products and applications for our technology platforms, (ii) our ability to manufacture robust instrumentation and reagents, and (iii) reductions in the funding levels to our primary customers, including as the result of timing and amount of funding provided by the American Recovery and Reinvestment Act of 2009, together with other factors detailed in our filings with the Securities and Exchange Commission, including our most recent filings on Forms 10-K and 10-Q, or in information disclosed in public conference calls, the date and time of which are released beforehand. We undertake no obligation, and do not intend, to update these forward-looking statements, to review or confirm analysts' expectations, or to provide interim reports or updates on the progress of the current financial quarter. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q.

Business Overview

We are a leading developer, manufacturer, and marketer of integrated systems for the analysis of genetic variation and function. We provide innovative sequencing and array-based solutions for genotyping, copy number variation analysis, methylation studies, gene expression profiling, and low-multiplex analysis of DNA, RNA, and protein. Our customers include leading genomic research centers, pharmaceutical companies, academic institutions, clinical research organizations, and biotechnology companies.

We develop and commercialize sequencing technologies used to perform a range of analyses, including de novo sequencing, whole genome re-sequencing, gene expression analysis, and small RNA analysis. Our product and service offerings also include leading-edge solutions for single-nucleotide polymorphism (SNP) genotyping, copy number variation (CNV), DNA methylation studies, gene expression profiling, and low-multiplex analysis of DNA, RNA, and protein. We believe we are the only company with genome-scale technology for sequencing, genotyping, and gene expression—the three cornerstones of modern genetic analysis.

Our tools provide researchers around the world with the performance, throughput, cost effectiveness, and flexibility necessary to determine and analyze the billions of bits of genetic information 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.

Our analysis presented below is organized to provide the information we believe will be useful for understanding the relevant trends going forward. However, this discussion should be read in conjunction with our consolidated financial statements and the notes thereto in Item 1 of this report.

Business Trends and Outlook

Our financial results have been, and will continue to be, impacted by several significant trends, which are described below. While these trends are important to understanding and evaluating our financial results, the other transactions, events, and trends discussed in *Risk Factors* in Item 1A of this report and Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010 may also materially impact our business operations and financial results.

Next Generation Sequencing

Strong demand for next generation sequencing applications continues to drive both sequencing instrument and consumable sales. During Q1 2010, we began customer shipments of the HiSeq 2000, our next generation sequencing instrument that allows customers to sequence whole human genomes for less than \$10,000 in reagent costs. During the first nine months of 2010, we significantly increased our manufacturing capacity for the HiSeq 2000. Given the strong demand for the instrument, our goal is to continue to increase our HiSeq 2000 production capacity in Q4 2010, which we believe will begin to reduce the amount of time between the placement of customer orders and shipments.

Table of Contents***MicroArrays***

We experienced a slowdown in the sales of our microarray products during 2009 that was largely attributable to researchers reducing or suspending the initiation of new studies as they waited for rare variant content emerging from the 1000 Genomes Project, an international research effort launched in 2008 to establish the most detailed catalog of human genetic variation. Despite advances in sequencing technology, we believe microarrays remain a cheaper, faster, and more accurate technology for use when genetic content is known. The information content of specific microarrays is fixed and reproducible. As such, specific microarrays provide repeatable, standardized assays for certain subsets of nucleotide bases within the overall genome. During Q3 2010, microarray product sales increased on a year over year and sequential basis, led by the Omni 2.5, a four sample BeadChip with approximately 2.5 million markers per sample launched in Q2 2010. This product includes new rare variant content from the 1000 Genomes Project. As additional new rare variant content becomes available from the 1000 Genomes Project, we plan to launch a microarray that will feature approximately 5.0 million markers per sample. The launch of this product will depend on the timing of the release of new content from the 1000 Genomes Project. We believe the launch of these microarrays will continue to increase the demand in the microarray market.

American Recovery and Reinvestment Act of 2009 (the Recovery Act)

The Recovery Act was enacted in February 2009 to provide stimulus to the U.S. economy in the wake of the economic downturn. As part of the Recovery Act legislation, over \$10.0 billion in funding was provided to the National Institutes of Health (NIH) through September 2010 to support the advancement of scientific research. While it is not possible to quantify the net impact of orders resulting from the Recovery Act due to the uncertainty surrounding orders that would have been received in absence of stimulus, we believe approximately \$64.4 million in orders during the first nine months of 2010 were directly related to Recovery Act grants. We believe Recovery Act funds will continue to be spent by our customers through 2012.

Gross Margin

Our gross profit as a percentage of revenue (gross margin) increased during 2009 as compared to 2008 from the realization of cost efficiencies in manufacturing and an improved sales mix of sequencing consumables driven by growth in the installed base of our sequencing systems. During the first nine months of 2010, gross margin was relatively flat as compared to the first nine months of 2009 due to improved margins on sequencing consumables offset by lower margins on our newer products, such as the HiSeq 2000, and the effects of discounts on the sales of HiSeq 2000 associated with the Genome Analyzer trade-in program. We expect gross margins to be in the mid 60s in Q4 2010 as we continue shipments of discounted HiSeq 2000s purchased through the Genome Analyzer trade-in program. We also expect changes in our product mix and price competition to continue to affect our gross margins.

Operating Expenses

We expect to incur increased operating expenses to support the expected growth of our business. However, in Q3 2010 revenue grew faster than operating expenses and as a result, operating expenses as a percentage of revenue were lower as compared to the first half of 2010. We believe a substantial investment in research and development is essential to remaining competitive and launching products into new 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 are also expected to increase in absolute dollars as we continue to expand our staff and add sales and marketing infrastructure.

Income Taxes

The provision for income taxes is dependent on the mix of earnings in tax jurisdictions with different statutory tax rates and the other factors discussed in the risk factor We are subject to risks related to taxation in multiple jurisdictions and the possible loss of the tax deduction on our outstanding convertible notes in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010. For 2010 and beyond, we anticipate increased earnings in higher tax jurisdictions, which may adversely impact the provision for income taxes.

Due to the expected utilization of the majority of our net operating loss carryforwards and U.S. federal research and development tax credit carryforwards, we anticipate significant income tax payments in 2010 and beyond.

Table of Contents**Results of Operations**

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

	Q3 2010	Q3 2009	YTD 2010	YTD 2009
Revenue:				
Product revenue	95%	95%	93%	95%
Service and other revenue	5	5	7	5
Total revenue	100	100	100	100
Cost of revenue:				
Cost of product revenue	31	29	29	29
Cost of service and other revenue	2	2	2	2
Amortization of intangible assets	1	1	1	1
Total cost of revenue	34	32	32	32
Gross profit	66	68	68	68
Operating expenses:				
Research and development	19	22	21	21
Selling, general and administrative	23	27	25	26
Acquired in-process research and development		1		
Total operating expenses	42	50	46	47
Income from operations	24	18	22	21
Other income (expense), net:				
Interest income	1	2	1	2
Interest expense	(2)	(4)	(3)	(4)
Other income, net		1	1	
Total other expense, net	(1)	(1)	(1)	(2)
Income before income taxes	23	17	21	19
Provision for income taxes	8	7	8	6
Net income	15%	10%	13%	13%

Our fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30 and September 30. The three and nine months ended October 3, 2010 and September 27, 2009 were both 13 and 39 weeks, respectively.

Third Quarter of 2010 Compared to Third Quarter of 2009

(in thousands)	Q3 2010	Q3 2009	Change	% Change
Product revenue	\$ 224,668	\$ 150,306	\$ 74,362	49%

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Service and other revenue	12,641	8,054	4,587	57
Total revenue	\$ 237,309	\$ 158,360	\$ 78,949	50%
Total gross profit	\$ 157,145	\$ 107,126	\$ 50,019	47%
Total gross margin	66.2%	67.6%		

Revenue

Product revenue consists primarily of sales of consumables and instruments.

Consumable revenue increased \$46.0 million, or 53%, to \$133.0 million for Q3 2010 compared to \$87.0 million for Q3 2009. Microarray consumable revenue, which constituted more than half of our total consumable revenue, increased \$26.4 million primarily attributable to growth in sales of whole-genome genotyping and focused content arrays. Sales volume of our Infinium BeadChip products, which constituted a majority of our microarray consumable sales, increased on a per sample basis during Q3 2010 compared to Q3 2009. The average selling price per sample, however, declined due to a change in product mix primarily attributable to growth in sales of our focused content arrays and a number of large sample volume purchase orders that incurred higher discounts. Revenue from sequencing consumables increased \$19.7 million due to growth in the installed base of our sequencing systems.

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Revenue from the sale of instruments increased \$27.1 million, or 45%, to \$87.8 million for Q3 2010 compared to \$60.7 million for Q3 2009. The change was due to increases of \$25.1 million and \$2.0 million in sales of our sequencing and microarray systems respectively. We experienced increases in both the number of units sold and average selling prices per unit for our sequencing systems during Q3 2010 compared to Q3 2009 due to increased demand for next generation sequencing systems and the launch of the HiSeq 2000 in Q1 2010.

Gross Margin

The decrease in gross margin was primarily attributable to the effects of discounts on the sales of HiSeq 2000 associated with the Genome Analyzer trade-in program. This impact was partially offset by improved margins on microarray and sequencing consumables.

Operating Expenses

(in thousands)	Q3 2010	Q3 2009	Change	% Change
Research and development	\$ 44,804	\$ 34,406	\$ 10,398	30%
Selling, general and administrative	55,006	42,096	12,910	31
Acquired in-process research and development		1,325	(1,325)	(100)
Total operating expenses	\$ 99,810	\$ 77,827	\$ 21,983	28%

The increase in research and development expenses was due to a \$7.0 million increase in personnel expenses associated with the growth of our business and an increase in other non-personnel expenses of \$3.4 million comprised mostly of lab and production supplies expenses.

The increase in selling, general and administrative expenses was primarily attributable to an \$8.1 million increase in personnel expenses associated with the growth of our business and an increase in outside service expenses of \$3.3 million comprised mostly of legal expenses for litigation related activities.

During Q3 2009 we recorded acquired in-process research and development charges of \$1.3 million related to milestone payments made to the former shareholders of Avantome, Inc. During 2010 the same expense was recorded in Q2.

Other Income (Expense), Net

(in thousands)	Q3 2010	Q3 2009	Change	% Change
Interest income	\$ 2,791	\$ 2,536	\$ 255	10%
Interest expense	(6,190)	(5,964)	(226)	4
Other income, net	774	1,592	(818)	(51)
Total other expense, net	\$ (2,625)	\$ (1,836)	\$ (789)	43%

Interest income increased \$0.3 million due to a \$1.1 million realized gain recorded on the sale of securities partially offset by a decline in interest rates. Interest expense increased \$0.2 million due to the amortization of the discount on our convertible senior notes. Other income, net, decreased due to a \$0.8 million decrease in net foreign currency transaction gains.

Provision for Income Taxes

(in thousands)	Q3 2010	Q3 2009	Change	% Change
Income before income taxes	\$ 54,710	\$ 27,463	\$ 27,247	99%
Provision for income taxes	\$ 19,263	\$ 10,386	\$ 8,877	85%
Effective tax rate	35.2%	37.8%		

The decrease in the effective tax rate was primarily attributable to tax adjustments discovered during the preparation of prior year tax returns that resulted in an increase to the tax provision recorded in Q3 2009. Return provision adjustments did not materially change the provision for income taxes in Q3 2010.

Table of Contents***Nine Months Ended October 3, 2010 Compared to Nine Months Ended September 27, 2009***

(in thousands)	YTD 2010	YTD 2009	Change	% Change
Product revenue	\$ 596,885	\$ 459,708	\$ 137,177	30%
Service and other revenue	44,558	26,052	18,506	71
Total revenue	\$ 641,443	\$ 485,760	\$ 155,683	32%
Total gross profit	\$ 435,414	\$ 328,349	\$ 107,065	33%
Total gross margin	67.9%	67.6%		

Revenue

Product revenue consists primarily of sales of consumables and instruments.

Consumable revenue increased \$86.2 million, or 30%, to \$372.8 million for the first nine months of 2010 compared to \$286.6 million for the first nine months of 2009. Microarray consumable revenue, which constituted more than half of our total consumable revenue, increased \$25.7 million primarily attributable to growth in sales of focused content, custom, and methylation arrays. Sales volume of our Infinium BeadChip products, which constituted a majority of our microarray consumable sales, increased on a sample basis during the first nine months of 2010 compared to the first nine months of 2009. The average selling price per sample, however, declined due to a change in product mix primarily attributable to growth in sales of our focused content arrays and a number of large sample volume purchase orders that incurred higher discounts. Revenue from sequencing consumables increased \$60.5 million due to growth in the installed base of our sequencing systems.

Revenue from the sale of instruments increased \$50.0 million, or 30%, to \$215.0 million for the first nine months of 2010 compared to \$165.0 million for the first nine months of 2009 primarily due to an increase in sales of our sequencing systems. We experienced increases in both the number of units sold and average selling prices per unit for our sequencing systems during the first nine months of 2010 compared to the same period in the prior year. The increase in units sold was due to increased demand for next generation sequencing systems. The increase in average selling prices was primarily attributable to the launch of the HiSeq 2000 in Q1 2010.

Gross Margin

Gross margin was relatively flat during the first nine months of 2010 as compared to the first nine months of 2009 primarily due to improved margins on sequencing consumables offset by lower margins on our newer products, such as the HiSeq 2000, and the effects of discounts on the sales of HiSeq 2000 associated with the Genome Analyzer trade-in program.

Operating Expenses

(in thousands)	YTD 2010	YTD 2009	Change	% Change
Research and development	\$ 132,146	\$ 100,248	\$ 31,898	32%
Selling, general and administrative	158,956	126,866	32,090	25
Acquired in-process research and development	1,325	1,325		
Total operating expenses	\$ 292,427	\$ 228,439	\$ 63,988	28%

The increase in research and development expenses was due to a \$20.5 million increase in personnel expenses associated with the growth of our business and an increase in other non-personnel expenses of \$11.4 million comprised mostly of lab and production supplies expenses.

The increase in selling, general and administrative expenses was primarily attributable to a \$23.6 million increase in personnel expenses associated with the growth of our business and an increase in outside service expenses of

\$7.2 million comprised mostly of legal expenses for litigation related activities and marketing expenses.

Table of Contents*Other Income (Expense), Net*

(in thousands)	YTD 2010	YTD 2009	Change	% Change
Interest income	\$ 6,746	\$ 8,027	\$ (1,281)	(16)%
Interest expense	(18,279)	(17,361)	(918)	(5)
Other income, net	3,142	1,261	1,881	149
Total other expense, net	\$ (8,391)	\$ (8,073)	\$ (318)	4%

Interest income decreased \$1.3 million due to an overall decline in interest rates partially offset by a \$1.6 million realized gain recorded on the sale of securities. Interest expense increased \$0.9 million due to the amortization of the discount on our convertible senior notes. Other income, net, increased due to a \$2.9 million gain recognized in Q2 2010 on the acquisition of Helixis, Inc., which represented the difference between the carrying value of our cost method investment in Helixis prior to acquisition and the fair value of that investment at the time of acquisition. This increase was partially offset by a gain of \$0.8 million on the extinguishment of debt recorded in Q1 2009 for which there was no similar gain recognized in 2010 and a \$0.3 million decrease in net foreign currency transaction gains.

Provision for Income Taxes

(in thousands)	YTD 2010	YTD 2009	Change	% Change
Income before income taxes	\$ 134,596	\$ 91,837	\$42,759	47%
Provision for income taxes	\$ 48,145	\$ 31,261	\$16,884	54%
Effective tax rate	35.8%	34.0%		

The increase in the effective tax rate was primarily attributable to the expiration of the federal research and development credit on December 31, 2009, which has not yet passed for fiscal 2010. We anticipate this measure passing during Q4 2010 with retroactive application for the current year, which would be recorded on a cumulative basis during the quarter in which the measure becomes law. Increased earnings in higher tax jurisdictions also contributed to the increase in the effective tax rate.

Liquidity and Capital Resources*Cash flow summary*

(in thousands)	YTD 2010	YTD 2009
Net cash provided by operating activities	\$ 191,092	\$ 110,902
Net cash used in investing activities	(214,996)	(272,122)
Net cash provided by financing activities	89,930	72,287
Effect of exchange rate changes on cash and cash equivalents	108	437
Net increase (decrease) in cash and cash equivalents	\$ 66,134	\$ (88,496)

Operating Activities

Cash provided by operating activities for the nine months ended October 3, 2010 consists of net income of \$86.5 million plus net non-cash adjustments of \$105.1 million and a \$0.5 million increase in net operating assets. The primary non-cash expenses added back to net income included share based compensation of \$51.8 million and depreciation and amortization expense related to property and equipment, intangibles and the debt discount on our convertible notes totaling \$46.0 million.

Investing Activities

Cash used in investing activities totaled \$215.0 million for the nine months ended October 3, 2010. During the first nine months of 2010, we:

purchased and sold available-for-sale securities totaling \$663.4 million and \$558.1 million, respectively;

paid net cash of \$98.2 million for acquisitions;

sold trading securities totaling \$54.9 million;

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used \$37.4 million for capital expenditures primarily associated with the purchase of manufacturing equipment and infrastructure for additional production capacity and rental and loaner instruments; and

made strategic investments totaling \$22.5 million.

Financing Activities

Cash provided by financing activities totaled \$89.9 million for the first nine months of 2010. We received \$91.4 million in proceeds from the exercise of stock options and warrants and the sale of shares under our Employee Stock Purchase Plan and \$14.6 million in incremental tax benefit related to stock options exercised. These increases were partially offset by common stock repurchases of \$16.0 million.

Liquidity

We manage our business to maximize operating cash flows as the primary source of our liquidity. Our ability to generate cash from operations provides us with the financial flexibility we need to meet operating, investing, and financing needs. Historically, we have issued debt and equity securities to finance our requirements to the extent that cash provided by operating activities was not sufficient to fund our needs. We may require additional funding in the future and our failure to raise capital on acceptable terms, when needed, could have a material adverse effect on our business.

At October 3, 2010, we had approximately \$806.8 million in cash and short-term investments. Short-term investments include marketable securities consisting of debt securities in government sponsored entities, corporate debt securities, and U.S. treasury notes. We do not hold securities backed by mortgages.

On February 16, 2007, the Company issued \$400.0 million principal of convertible senior notes that mature February 15, 2014. The Company pays 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 notes are convertible into cash and, if applicable, shares of our common stock under certain circumstances as described in Note 5 of Notes to Consolidated Financial Statements. As of October 3, 2010, the principal amount of the notes was \$390.0 million due to the conversion of \$10.0 million of the notes during the first quarter of 2009.

Our primary short-term needs for capital, which are subject to change, include expenditures related to:
potential strategic acquisitions and investments;

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 repurchase of our outstanding common stock;

the continued advancement of research and development efforts;

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

the expansion needs of our facilities, including costs of leasing additional facilities.

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.

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

- our ability to successfully commercialize and further develop our technologies and create innovative products in our markets;

- scientific progress in our research and development programs and the magnitude of those programs;

- competing technological and market developments; and

- the need to enter into collaborations with other companies or acquire other companies or technologies to enhance or complement our product and service offerings.

Off-Balance Sheet Arrangements

There were no substantial changes to our off-balance sheet arrangements or contractual commitments in the nine months ended October 3, 2010, when compared to the disclosures in Item 7 of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

Critical Accounting Policies and Estimates

There were no material changes to our critical accounting policies and estimates during the nine months ended October 3, 2010. For further information on our critical accounting policies and estimates, refer to our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

Recent Accounting Pronouncements

There were no accounting pronouncements adopted by the Company or issued during the nine months ended October 3, 2010 that had a material effect on the Company's condensed consolidated financial statements or that are reasonably certain to have a material impact on the condensed consolidated financial statements in future periods.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There were no substantial changes to our market risks in the nine months ended October 3, 2010, when compared to the disclosures in Item 7A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010.

Item 4. Controls and Procedures.

We design our internal controls to provide reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported in conformity with GAAP. 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 Exchange Act), as of October 3, 2010. Based upon that evaluation, our principal executive officer and principal financial officer concluded that, as of October 3, 2010, our disclosure controls and procedures are effective to provide reasonable assurance that (a) the information required to be disclosed by us in the reports that we file or submit under the 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

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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 third quarter of 2010 and that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. That evaluation did not identify any such change.

PART II OTHER INFORMATION**Item 1. Legal Proceedings.**

From time to time, we are party to litigation and other legal proceedings in the ordinary course, and incidental to the conduct, of our business. While the results of any litigation or other legal proceedings are uncertain, management does not believe the ultimate resolution of any pending legal matters is likely to have a material adverse effect on our financial position or results of operations.

Item 1A. Risk Factors.

Our business is subject to various risks, including those described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended January 3, 2010, which we strongly encourage you to review. There have been no material changes from the risk factors disclosed in Item 1A of our Form 10-K.

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

In July 2010, our board of directors authorized a \$200 million stock repurchase program, with \$100 million allocated to repurchasing Company common stock under a 10b5-1 plan over the next 12 months and \$100 million allocated to repurchasing Company common stock at management's discretion during open trading windows. The following table summarizes shares repurchased pursuant to these programs during the quarter ended October 3, 2010:

		Total Number of Shares Purchased as Part of Publicly Announced Programs(1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs(1)
Period	Total Number of Shares Purchased(1)	Average Price Paid per Share(1)	
July 5, 2010 – August 1, 2010		\$	\$ 200,000,000
August 2, 2010 – August 29, 2010	178,198	44.95	192,000,025
August 30, 2010 – October 3, 2010	168,914	47.48	184,002,071
Total	347,112	\$ 46.21	\$ 184,002,071

(1) All shares purchased during the quarter ended October 3, 2010 were in connection with

our stock
repurchase
program
authorized by
our board of
directors in
July 2010. All
stock
repurchases
were made
under a 10b5-1
trading program
or in
open-market
transactions.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

None.

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Item 6. Exhibits.

Exhibit

Number

Description of Document

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.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase

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SIGNATURES

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

Illumina, Inc.
(registrant)

Date: November 5, 2010

/s/ CHRISTIAN O. HENRY

Christian O. Henry
Senior Vice President and Chief Financial
Officer
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