ILLUMINA INC
Form 10-Q
May 03, 2007

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

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For Quarterly Period Ended April 1, 2007

o **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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

As of April 10, 2007, there were 53,605,794 shares of the Registrant s Common Stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	April 1, 2007 (unaudited)	December 31, 2006 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 123,529	$ 38,386
Short-term investments	203,292	92,418
Accounts receivable, net	53,127	39,984
Inventory, net	36,340	20,169
Prepaid expenses and other current assets	8,248	2,769
Total current assets	424,536	193,726
Property and equipment, net	32,807	25,634
Investment in Solexa		67,784
Goodwill	248,543	2,125
Acquired intangible assets, net	23,958	
Other assets, net	12,993	11,315
Total assets	$ 742,837	$ 300,584
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 66,661	$ 33,713
Current portion of long-term debt	67	63
Total current liabilities	66,728	33,776
Long-term debt, less current portion	400,006	
Other long-term liabilities	10,143	19,466
Commitments and contingencies		
Stockholders equity	265,960	247,342
Total liabilities and stockholders equity	$ 742,837	$ 300,584

(1) The Condensed Consolidated

Balance Sheet at December 31, 2006 has been derived from the audited financial statements as of that date.

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	
	April 1, 2007	**April 2, 2006**
Revenue:		
Product revenue	$ 61,266	$ 23,261
Service and other revenue	10,761	5,267
Research revenue	123	574
Total revenue	72,150	29,102
Costs and expenses:		
Cost of product revenue (including non-cash stock compensation expense of $883 and $198, respectively, and excluding amortization of acquired intangible assets)	21,815	7,676
Cost of service and other revenue (including non-cash stock compensation expense of $63 and $52, respectively)	3,305	1,617
Research and development (including non-cash stock compensation expense of $1,931 and $958, respectively)	15,956	8,216
Selling, general and administrative (including non-cash stock compensation expense of $4,801 and $1,923, respectively)	23,633	12,134
Amortization of acquired intangible assets	442	
Acquired in-process research and development	303,400	
Total costs and expenses	368,551	29,643
Loss from operations	(296,401)	(541)
Interest and other income, net	2,722	568
Income (loss) before income taxes	(293,679)	27
Provision for income taxes	4,397	131
Net loss	$ (298,076)	$ (104)
Net loss per basic and diluted share	$ (5.58)	$ (0.00)

Shares used in calculating basic and diluted net loss per share	53,422	41,475

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended	
	April 1, 2007	April 2, 2006
Operating activities:		
Net loss	$ (298,076)	$ (104)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Acquired in-process research and development	303,400	
Amortization of increase in inventory valuation	816	
Amortization of intangible assets	453	7
Amortization of debt issuance costs	165	
Depreciation expense	2,594	1,093
Loss on disposal of property and equipment	2	20
Stock-based compensation expense	7,678	3,131
Amortization of gain on sale of land and building	(60)	(94)
Changes in operating assets and liabilities:		
Accounts receivable	(8,209)	(3,742)
Inventory	(8,203)	(3,549)
Prepaid expenses and other current assets	(400)	(236)
Other assets	1,419	54
Accounts payable and accrued liabilities	9,583	2,961
Accrued income taxes	3,659	
Other long-term liabilities	(178)	2,819
Net cash provided by operating activities	14,643	2,360
Investing activities:		
Cash obtained in acquisition, net of cash paid for transaction costs	76,745	
Investment in secured convertible debentures		(3,036)
Purchases of available-for-sale securities	(157,550)	
Sales and maturities of available-for-sale securities	49,634	
Purchases of property and equipment	(3,239)	(4,192)
Net cash used in investing activities	(34,410)	(7,228)
Financing activities:		
Payments on long-term debt	(37)	(29)
Proceeds from issuance of convertible debt, net of issuance costs	390,745	
Purchase of convertible note hedges	(139,040)	
Sale of warrants	92,440	

Common stock repurchases		(250,889)		
Proceeds from issuance of common stock		11,731		3,131
Net cash provided by financing activities		104,950		3,102
Effect of foreign currency translation on cash and cash equivalents		(40)		(12)
Net increase (decrease) in cash and cash equivalents		85,143		(1,778)
Cash and cash equivalents at beginning of period		38,386		50,822
Cash and cash equivalents at end of period	$	123,529	$	49,044

See accompanying notes to the condensed consolidated financial statements.

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

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 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 U.S. generally accepted accounting principles 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 accruals, 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 2006 audited financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission (SEC) on February 28, 2007.

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 months ended April 1, 2007 and April 2, 2006 were both 13 weeks.

Revenue Recognition

The Company s revenue is generated primarily from the sale of products and services. Product revenue consists of sales of arrays, reagents, instrumentation, and oligonucleotides (oligos), which are short sequences of DNA. Service and other revenue consists of revenue received for performing genotyping services, extended warranty sales and revenue earned from milestone payments.

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. However, in the case of BeadLabs, revenue is recognized upon the completion of installation, training and the receipt of customer acceptance. Revenue for genotyping services is recognized when earned, which is generally at the time the genotyping analysis data is delivered to the customer or as specific milestones are achieved.

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

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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 warrantied 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. 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. 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.

A third source of revenue, research revenue, consists of amounts performed under government grants, which is recognized in the period during which the related costs are incurred. All revenue is recorded net of any applicable allowances for returns or discounts.

Cash and Cash Equivalents

Cash and cash equivalents are comprised of short-term, highly liquid investments primarily consisting of commercial paper and money market-type funds.

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 balance sheet, with unrealized gains and losses, if any, reported in stockholders equity. As of April 1, 2007, the Company s excess cash balances were primarily invested in marketable debt securities, including commercial paper, auction rate certificates 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.

Restricted Cash

As of April 1, 2007, restricted cash, included in cash and cash equivalents, consisted of bank guarantees totaling approximately $2.8 million primarily associated with two sales contracts entered into during 2006 and 2007. Both guarantees are scheduled to be released during 2007. There was no restricted cash as of April 2, 2006.

Stock-Based Compensation

On January 2, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment*, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The Company uses the Black-Scholes-Merton option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R.

Net loss per basic and diluted share was increased by $0.14 for the three months ended April 1, 2007 as a result of the adoption of SFAS No. 123R. Stock-based compensation expense capitalized as part of inventory as of April 1, 2007 was approximately $0.3 million. As of April 1, 2007, approximately $107.5 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 and a half years.

The Company has elected to use the Black-Scholes-Merton option-pricing model, which incorporates various assumptions including volatility, expected life, and interest rates. The expected volatility is based on the historical volatility of the Company s

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common stock over the most recent period 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 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 granted and for stock purchases under the ESPP during those periods are as follows:

	Three Months Ended	
	April 1, 2007	April 2, 2006
Interest rate stock options	4.71 4.75%	4.36 4.57%
Interest rate stock purchases	4.83 4.86%	4.85 4.86%
Volatility stock options	69 70%	76 77%
Volatility stock purchases	75 76%	76%
Expected life stock options	6 years	6 years
Expected life stock purchases	6-12 months	6 12 months
Expected dividend yield	0%	0%
Weighted average fair value per share of options granted	$ 25.82	$ 14.91
Weighted average fair value per share of employee stock purchases	$ 11.84	$ 8.11

Net Loss per Share

Basic and diluted net loss per share is presented in conformity with SFAS No. 128, *Earnings per Share*, for all periods presented. In accordance with SFAS No. 128, basic net 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 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. However, for all periods presented, diluted net loss per share is the same as basic net loss per share because the Company reported a net loss and therefore the inclusion of weighted average shares of common stock issuable upon the exercise of stock options and warrants would be anti-dilutive. The following table presents the calculation of weighted-average shares used to calculate basic and diluted net loss per share (in thousands):

	Three Months Ended	
	April 1, 2007	April 2, 2006
Weighted-average shares outstanding	53,455	41,515
Less: Weighted-average shares of common stock subject to repurchase	(33)	(40)
Weighted-average shares used in calculating basic and diluted net loss per share	53,422	41,475

The total number of shares excluded from the calculation of diluted net loss per share, prior to application of the treasury stock method, was 9,210,422 and 8,189,566 for the three months ended April 1, 2007 and April 2, 2006, respectively. The total number of warrants excluded from the calculation of diluted net loss per share was 1,894,560 for the three months ended April 1, 2007. These warrants were assumed as part of the Company s merger with Solexa, Inc. on January 26, 2007.

Comprehensive Income (Loss)

Comprehensive income (loss) is comprised of net 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 components of other comprehensive income (loss) are as follows (in thousands):

	Three Months Ended	
	April 1, 2007	April 2, 2006
Net loss	$ (298,076)	$ (104)
Foreign currency translation adjustments	136	285
Unrealized loss on investments	(10,824)	(42)
Total other comprehensive income (loss)	$ (308,764)	$ 139

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 generally accepted accounting principles and expands disclosures about fair value measurements. This Statement applies only to fair value measurements that are already required or permitted by other accounting standards. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after December 15, 2007. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on its consolidated results of operations and financial position.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS No. 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. Under SFAS No. 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees and issued debt. Other eligible items include firm commitments for financial instruments that otherwise would not be recognized at inception and non-cash warranty obligations where a warrantor is permitted to pay a third party to provide the warranty goods or services. If the use of fair value is elected, any upfront costs and fees related to the item must be recognized in earnings and cannot be deferred, *e.g.*, debt issue costs. The fair value election is irrevocable and generally made on an instrument-by-instrument basis, even if a company has similar instruments that it elects not to measure based on fair value. At the adoption date, unrealized gains and losses on existing items for which fair value has been elected are reported as a cumulative adjustment to beginning retained earnings. Subsequent to the adoption of SFAS No. 159, changes in fair value are recognized in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company in the first quarter of fiscal 2008. The Company is currently determining whether fair value accounting is appropriate for any of its eligible items and cannot estimate the impact, if any, which SFAS No. 159 will have on its consolidated results of operations and financial condition.

Recently Adopted Accounting Pronouncements

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 that the Company recognize the impact of a tax position in its financial statements only if that position is more likely than not to be sustained on audit, 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 retained earnings since there was no cumulative effect from the change in accounting principle due to the Company maintaining a full valuation allowance against its U.S. deferred tax assets. At the date of adoption, the Company reduced its deferred tax assets and related valuation allowance by approximately $5.1 million for uncertain tax positions. As of April 1, 2007, the Company has reduced its deferred tax assets and related valuation allowance by approximately $6.8 million for uncertain tax positions. Interest and penalties related to uncertain tax positions will be reflected in income tax expense. All of the Company s tax years remain subject to future examination by the major tax jurisdictions in which it is subject to tax.

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 results of Solexa s operations have been included in the Company s consolidated financial statements since the acquisition date of January 26, 2007.

Solexa develops genetic analysis technologies primarily in the United States and the United Kingdom. The combined Company has recently commercialized the Illumina Genome Analyzer System (renamed from the Solexa 1G Analyzer post-merger), which performs DNA sequencing based on Solexa s proprietary reversible terminator Sequencing-by-Synthesis (SBS) chemistry and Clonal Single Molecule Array technology.

Pursuant to the merger agreement, Solexa shareholders received 0.344 of a share of the Company s common stock in exchange for each share of Solexa common stock held. The Company issued approximately 13.1 million shares of its common stock as consideration for this merger. In addition, certain executives at Solexa received change in control bonuses totaling approximately $7.9 million upon consummation of the merger. These bonuses were paid both in cash and in shares of Illumina common stock and were based on a percentage of the amount by which the consideration

received by Solexa stockholders as a direct result of the

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change in control exceeded the sum of $150 million plus the aggregate gross proceeds received by Solexa through sales of equity securities after the effective date of such bonus arrangement. The total number of shares issued in connection with such change in control bonuses was approximately 0.1 million shares of the Company s common stock.

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 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	7,902
Fair market value of vested stock options, warrants and restricted stock assumed	75,334
Total purchase price	$ 618,485

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, including 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 $40.1425 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.

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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	$ 51,665
Property, plant and equipment, net	6,515
Other assets	786
Current liabilities	(13,244)
Other long-term liabilities	(1,455)
Net tangible assets acquired	44,267
Identifiable intangible assets (core technology and customer relationships)	24,400
In-process research and development	303,400
Goodwill	246,418
Total net assets acquired	$ 618,485

The Company s fair value estimates for the purchase price allocation may change during the allowable allocation period, which is up to one year from the acquisition date, if additional information becomes available.

In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* the goodwill is not amortized, but will be subject to a periodic assessment for impairment by applying a fair-value-based test. None of this goodwill is expected to be deductible for tax purposes. The Company performs its annual test for impairment of goodwill in May of each year. The Company is required to perform a periodic assessment between annual tests in certain circumstances. The Company has determined there was no impairment of the Solexa goodwill during the first quarter of 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 genomic 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.

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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 U.S. 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. The remaining useful lives of the core technology and customer relationships are ten and three years, respectively.

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):

	Three Months Ended April 1, 2007	Three Months Ended April 2, 2006
Revenue	$ 72,205	$ 29,870
Net loss	$ (2,329)	$ (12,279)
Basic and diluted net loss per share	$ (0.04)	$ (0.22)

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.

3. Segment Information

The Company has determined that, in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*, it operates in one segment as it only reports operating results on an aggregate basis to its chief operating decision maker of the Company.

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4. 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. The components of net inventories are as follows (in thousands):

	April 1, 2007	December 31, 2006
Raw materials	$ 16,725	$ 8,365
Work in process	14,640	8,907
Finished goods	4,975	2,897
	$ 36,340	$ 20,169

5. Goodwill and Intangible Assets

The Company accounts for goodwill and intangibles under SFAS No. 142, *Goodwill and Other Intangible Assets*. As such, goodwill and other indefinite-lived intangible assets are not amortized, but are subject to annual impairment reviews, or more frequent reviews if events or circumstances indicate there may be an impairment. The Company performs its test of goodwill annually in May.

The carrying amount of goodwill was $248.5 million as of April 1, 2007, compared to $2.1 million at December 31, 2006. The increase in goodwill was due to the acquisition of Solexa in January 2007. The $2.1 million balance at December 31, 2006 was related to the acquisition of CyVera in April 2005. This balance is included in goodwill as of April 1, 2007 and there has been no impairment of goodwill as of that date.

Intangible assets other than goodwill are required to be separated into two categories: finite-lived and indefinite-lived. Intangible assets with finite useful lives are amortized over their estimated useful life, while intangible assets with indefinite useful lives are not amortized. The Company currently has no intangible assets with indefinite lives.