

ILLUMINA INC
Form 10-Q
November 02, 2015
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 September 27, 2015

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the transition period from _____ to _____
Commission File Number 001-35406
Illumina, Inc.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

As of October 8, 2015, there were 146.4 million 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)

| | September 27, 2015 (Unaudited) | December 28, 2014 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$551,529 | \$636,154 |
| Short-term investments | 887,877 | 702,217 |
| Accounts receivable, net | 413,474 | 289,458 |
| Inventory | 233,781 | 191,144 |
| Deferred tax assets, current portion | 43,737 | 40,786 |
| Prepaid expenses and other current assets | 80,030 | 29,844 |
| Total current assets | 2,210,428 | 1,889,603 |
| Property and equipment, net | 308,722 | 265,264 |
| Goodwill | 756,687 | 724,904 |
| Intangible assets, net | 286,346 | 314,500 |
| Deferred tax assets, long-term portion | 86,827 | 49,848 |
| Other assets | 84,538 | 95,521 |
| Total assets | \$3,733,548 | \$3,339,640 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$123,432 | \$82,626 |
| Accrued liabilities | 358,259 | 335,276 |
| Long-term debt, current portion | 102,166 | 304,256 |
| Total current liabilities | 583,857 | 722,158 |
| Long-term debt | 1,007,935 | 986,780 |
| Other long-term liabilities | 173,061 | 167,904 |
| Redeemable noncontrolling interests | 32,128 | — |
| Stockholders' equity: | | |
| Common stock | 1,849 | 1,805 |
| Additional paid-in capital | 2,454,876 | 2,172,940 |
| Accumulated other comprehensive income (loss) | 1,040 | (1,080) |
| Retained earnings | 918,288 | 561,206 |
| Treasury stock, at cost | (1,439,486) | (1,272,073) |
| Total stockholders' equity | 1,936,567 | 1,462,798 |
| Total liabilities and stockholders' equity | \$3,733,548 | \$3,339,640 |
| See accompanying notes to the condensed consolidated financial statements. | | |

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

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Revenue: | | | | |
| Product revenue | \$470,824 | \$416,163 | \$1,392,711 | \$1,169,182 |
| Service and other revenue | 79,447 | 64,467 | 235,503 | 179,797 |
| Total revenue | 550,271 | 480,630 | 1,628,214 | 1,348,979 |
| Cost of revenue: | | | | |
| Cost of product revenue | 120,954 | 113,103 | 360,037 | 338,851 |
| Cost of service and other revenue | 29,590 | 23,909 | 94,289 | 68,598 |
| Amortization of acquired intangible assets | 12,188 | 9,677 | 34,957 | 28,757 |
| Total cost of revenue | 162,732 | 146,689 | 489,283 | 436,206 |
| Gross profit | 387,539 | 333,941 | 1,138,931 | 912,773 |
| Operating expense: | | | | |
| Research and development | 99,226 | 85,082 | 287,180 | 245,108 |
| Selling, general and administrative | 136,648 | 119,888 | 377,406 | 344,110 |
| Legal contingencies | 15,000 | 7,705 | 15,000 | 7,705 |
| Headquarter relocation | (5,226) |) 870 | (3,047) |) 4,357 |
| Acquisition related expense (gain), net | 1,109 | 903 | (6,449) |) (335) |
| Total operating expense | 246,757 | 214,448 | 670,090 | 600,945 |
| Income from operations | 140,782 | 119,493 | 468,841 | 311,828 |
| Other income (expense): | | | | |
| Interest income | 2,767 | 534 | 5,804 | 2,954 |
| Interest expense | (12,821) |) (10,987) |) (35,190) |) (30,652) |
| Cost-method investment gain, net | 2,900 | 4,427 | 15,482 | 4,427 |
| Other expense, net | (4,711) |) (1,024) |) (6,802) |) (31,860) |
| Total other expense, net | (11,865) |) (7,050) |) (20,706) |) (55,131) |
| Income before income taxes | 128,917 | 112,443 | 448,135 | 256,697 |
| Provision for income taxes | 13,296 | 18,954 | 93,609 | 56,626 |
| Consolidated net income | 115,621 | 93,489 | 354,526 | 200,071 |
| Add: Net loss attributable to noncontrolling interests | 2,556 | — | 2,556 | — |
| Net income attributable to Illumina stockholders | \$118,177 | \$93,489 | \$357,082 | \$200,071 |
| Earnings per share attributable to Illumina stockholders: | | | | |
| Basic | \$0.81 | \$0.66 | \$2.47 | \$1.50 |
| Diluted | \$0.79 | \$0.63 | \$2.39 | \$1.34 |
| Shares used in computing earnings per common share: | | | | |
| Basic | 145,349 | 141,142 | 144,447 | 133,290 |
| Diluted | 149,672 | 147,512 | 149,108 | 149,084 |

See accompanying notes to the condensed consolidated financial statements.

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

| | Three Months Ended | | Nine Months Ended | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Consolidated net income | \$115,621 | \$93,489 | \$354,526 | \$200,071 |
| Unrealized gain (loss) on available-for-sale securities, net of deferred tax | 441 | (972) | 2,120 | (873) |
| Total consolidated comprehensive income | 116,062 | 92,517 | 356,646 | 199,198 |
| Add: Comprehensive loss attributable to noncontrolling interests | 2,556 | — | 2,556 | — |
| Comprehensive income attributable to Illumina stockholders | \$118,618 | \$92,517 | \$359,202 | \$199,198 |

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 | |
|---|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 |
| Cash flows from operating activities: | | |
| Consolidated net income | \$354,526 | \$200,071 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation expense | 52,774 | 44,783 |
| Amortization of intangible assets | 40,884 | 37,839 |
| Share-based compensation expense | 97,104 | 114,089 |
| Accretion of debt discount | 29,828 | 27,989 |
| Loss on extinguishment of debt | 3,737 | 31,360 |
| Incremental tax benefit related to share-based compensation | (121,703) | (102,639) |
| Deferred income taxes | 83,679 | 30,428 |
| Change in fair value of contingent consideration | (6,449) | (2,958) |
| Change in estimated cease-use loss | (3,047) | 4,357 |
| Cost-method investment gain, net | (15,482) | (4,427) |
| Other | 5,488 | 6,369 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (121,309) | (37,733) |
| Inventory | (43,598) | (44,693) |
| Prepaid expenses and other current assets | (4,982) | (20,152) |
| Other assets | (428) | (5,262) |
| Accounts payable | 49,532 | 14,748 |
| Accrued liabilities | 8,884 | 40,598 |
| Accrued legal contingencies | 15,000 | 22,147 |
| Other long-term liabilities | (5,220) | 3,808 |
| Net cash provided by operating activities | 419,218 | 360,722 |
| Cash flows from investing activities: | | |
| Purchases of available-for-sale securities | (713,862) | (428,700) |
| Sales of available-for-sale securities | 335,351 | 324,554 |
| Maturities of available-for-sale securities | 189,929 | 118,229 |
| Net cash paid for acquisitions | (35,226) | (3,285) |
| Net sales proceeds from (purchases of) strategic investments | (4,100) | (6,755) |
| Purchases of property and equipment | (107,361) | (71,164) |
| Cash paid for intangible assets | (275) | (6,720) |
| Net cash used in investing activities | (335,544) | (73,841) |
| Cash flows from financing activities: | | |
| Payments on financing obligations | (216,207) | (29,880) |
| Payments on acquisition related contingent consideration liability | (1,500) | — |
| Proceeds from issuance of convertible notes | — | 1,132,378 |
| Repurchases of convertible notes | — | (1,244,721) |
| Incremental tax benefit related to share-based compensation | 121,703 | 102,639 |
| Common stock repurchases | (72,256) | (202,431) |
| Taxes paid related to net share settlement of equity awards | (95,157) | (9,668) |
| Proceeds from issuance of common stock | 65,668 | 84,733 |

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| | | | |
|--|-----------|------------|---|
| Contributions from noncontrolling interest owners | 32,128 | — | |
| Net cash used in financing activities | (165,621 |) (166,950 |) |
| Effect of exchange rate changes on cash and cash equivalents | (2,678 |) (1,673 |) |
| Net (decrease) increase in cash and cash equivalents | (84,625 |) 118,258 | |
| Cash and cash equivalents at beginning of period | 636,154 | 711,637 | |
| Cash and cash equivalents at end of period | \$551,529 | \$829,895 | |

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. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 28, 2014, from which the balance sheet information herein was derived. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expense, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

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

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

Redeemable Noncontrolling Interests

Noncontrolling interests represent the portion of equity (net assets) in an entity that is not wholly-owned by the Company that is not attributable, directly or indirectly, to the Company. Noncontrolling interests with embedded redemption features, such as put rights, that are not solely within the Company’s control are considered redeemable noncontrolling interests. Redeemable noncontrolling interests are presented outside of stockholders’ equity on the condensed consolidated balance sheets.

Fiscal Year

The Company’s fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine months ended September 27, 2015 and September 28, 2014 were both 13 and 39 weeks, respectively.

Significant Accounting Policies

During the three and nine months ended September 27, 2015, there have been no changes in to the Company's significant accounting policies as described in the Annual Report on Form 10-K for the fiscal year ended December 28, 2014.

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Recent Accounting Pronouncements

In February 2015, the Financial Accounting Standards Board issued Accounting Standard Update (ASU) 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The new standard modifies current guidance on consolidation under the variable interest model and the voting model. ASU 2015-02 will be effective for the Company beginning in the first quarter of 2016. The Company is currently evaluating the impact of ASU 2015-02 on its consolidated financial statements.

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

Earnings per Share

Basic earnings per share is computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed based on the sum of the weighted average number of common shares and potentially dilutive common shares outstanding during the period.

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

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

| | Three Months Ended | | Nine Months Ended | |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Weighted average shares outstanding | 145,349 | 141,142 | 144,447 | 133,290 |
| Effect of potentially dilutive common shares from: | | | | |
| Convertible senior notes | 1,670 | 1,972 | 2,013 | 3,967 |
| Equity awards | 2,653 | 4,124 | 2,648 | 4,367 |
| Warrants | — | 274 | — | 7,460 |
| Weighted average shares used in calculation of diluted earnings per share | 149,672 | 147,512 | 149,108 | 149,084 |
| Potentially dilutive shares excluded from calculation due to anti-dilutive effect | 13 | 54 | 7 | 112 |

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2. Balance Sheet Account Details

Short-Term Investments

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

| | September 27, 2015 | | | | December 28, 2014 | | | |
|--|--------------------|------------------------------|-------------------------------|-------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| Available-for-sale securities: | | | | | | | | |
| Debt securities in government sponsored entities | \$32,962 | \$12 | \$(1) | \$32,973 | \$51,308 | \$10 | \$(55) | \$51,263 |
| Corporate debt securities | 608,622 | 193 | (952) | 607,863 | 502,924 | 46 | (2,882) | 500,088 |
| U.S. Treasury securities | 246,671 | 374 | (4) | 247,041 | 151,255 | 5 | (394) | 150,866 |
| Total available-for-sale securities | \$888,255 | \$579 | \$(957) | \$887,877 | \$705,487 | \$61 | \$(3,331) | \$702,217 |

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

Contractual maturities of available-for-sale debt securities as of September 27, 2015 were as follows (in thousands):

| | |
|---------------------------------|-------------------------|
| | Estimated Fair Value |
| Due within one year | \$390,385 |
| After one but within five years | 497,492 |
| Total | \$887,877 |

Cost-Method Investments

As of September 27, 2015 and December 28, 2014, the aggregate carrying amounts of the Company's cost-method investments in non-publicly traded companies were \$54.7 million and \$37.2 million, respectively, included in other assets. Revenue recognized from transactions with such companies were \$16.1 million and \$47.3 million, respectively, for the three and nine months ended September 27, 2015 and \$14.7 million and \$31.4 million, respectively, for the three and nine months ended September 28, 2014.

During the nine months ended September 27, 2015, the Company recognized gains on dispositions of cost-method investments of \$18.0 million. During the nine months ended September 28, 2014, the Company recognized a gain of \$4.4 million associated with additional proceeds received for a cost-method investment sold in a prior period. The Company's cost-method investments are assessed for impairment quarterly. The Company determines that it is not practicable to estimate the fair value of its cost-method investments on a regular basis and does not reassess the fair value of cost-method investments if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. No material impairment loss was recorded during the three and nine months ended September 27, 2015 or September 28, 2014.

Inventory

Inventory consists of the following (in thousands):

| | September 27, 2015 | December 28, 2014 |
|-----------------|-----------------------|----------------------|
| Raw materials | \$84,136 | \$73,179 |
| Work in process | 114,848 | 94,102 |
| Finished goods | 34,797 | 23,863 |
| Total inventory | \$233,781 | \$191,144 |

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Goodwill

The Company tests the carrying value of goodwill in accordance with accounting rules on impairment of goodwill, which require the Company to estimate the fair value of the reporting unit annually, or when impairment indicators exist, and compare such amounts to their respective carrying values to determine if an impairment is required. The Company performed its annual assessment for goodwill impairment in the second quarter of 2015, noting no impairment.

Changes in the Company's goodwill balance during the nine months ended September 27, 2015 are as follows (in thousands):

| | Goodwill |
|----------------------------------|-----------|
| Balance as of December 28, 2014 | \$724,904 |
| Current period acquisitions | 31,783 |
| Balance as of September 27, 2015 | \$756,687 |

Derivatives

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

As of September 27, 2015, the Company had foreign exchange forward contracts in place to hedge exposures in the euro, Japanese yen, and Australian dollar. As of September 27, 2015 and December 28, 2014, the total notional amounts of outstanding forward contracts in place for foreign currency purchases were \$61.3 million and \$61.0 million, respectively.

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

| | September 27, 2015 | December 28, 2014 |
|---|-----------------------|----------------------|
| Accrued compensation expenses | \$107,209 | \$112,606 |
| Deferred revenue, current portion | 84,432 | 75,294 |
| Acquisition related contingent liability, current portion | 36,175 | 44,124 |
| Accrued taxes payable | 29,457 | 38,942 |
| Customer deposits | 28,783 | 20,274 |
| Reserve for product warranties | 17,933 | 15,616 |
| Accrued legal contingencies | 15,000 | — |
| Other | 39,270 | 28,420 |
| Total accrued liabilities | \$358,259 | \$335,276 |

Warranties

The Company generally provides a one-year warranty on instruments. Additionally, the Company provides a warranty on consumables through the expiration date, which generally ranges from six to twelve months after the manufacture date. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses based on

historical experience as well as anticipated product performance. The Company periodically reviews its warranty reserve for adequacy and adjusts the warranty accrual, if necessary, based on actual experience and estimated costs to be incurred. Warranty expense is recorded as a component of cost of product revenue.

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Changes in the Company's reserve for product warranties during the three and nine months ended September 27, 2015 and September 28, 2014 are as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Balance at beginning of period | \$16,365 | \$13,000 | \$15,616 | \$10,407 |
| Additions charged to cost of product revenue | 6,916 | 6,803 | 20,737 | 16,616 |
| Repairs and replacements | (5,348) | (5,370) | (18,420) | (12,590) |
| Balance at end of period | \$17,933 | \$14,433 | \$17,933 | \$14,433 |

Leases

Changes in the Company's facility exit obligation related to its former headquarters lease during the three and nine months ended September 27, 2015 and September 28, 2014 are as follows (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|--------------------|--------------------|--------------------|
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Balance at beginning of period | \$36,677 | \$38,480 | \$37,700 | \$38,218 |
| Adjustment to facility exit obligation | (5,935) | 57 | (5,278) | 2,065 |
| Accretion of interest expense | 590 | 666 | 1,926 | 1,948 |
| Cash payments | (1,539) | (1,153) | (4,555) | (4,181) |
| Balance at end of period | \$29,793 | \$38,050 | \$29,793 | \$38,050 |

On December 30, 2014, the Company entered into a lease agreement with an affiliate of Biomed Realty Trust, Inc. (BMR) for certain office buildings in Foster City, California. Minimum lease payments during the initial term of 16 years are estimated to be \$204.0 million. On June 25, 2015, the Company entered into a lease agreement with another affiliate of BMR for an office building near Cambridge, England. Minimum lease payments during the initial term of 20 years are estimated to be approximately \$147.9 million. One of our Board members also serves on the Board of BMR.

On March 12, 2015, the Company entered into an amendment of its headquarter lease for additional rental square footage, which is expected to increase its minimum lease payments by \$44.1 million over 15 years.

Investment in Helix

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

The assets and liabilities of Helix are not significant to the Company's financial position. Helix has an immaterial impact on the Company's consolidated statements of operations and cash flows.

The Company has not provided financing to Helix outside its contractual arrangements, which include the contributions of certain perpetual licenses, instruments, intangibles, initial laboratory setup, and discounted supply terms in exchange for voting equity interests in Helix. Such contributions are recorded at their historical basis as they remain within the control of the Company. Helix is financed through cash contributions made by the third party investors in exchange for voting equity interests in Helix.

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Redeemable Noncontrolling Interests

The noncontrolling interests in Helix contain a contingent put right exercisable by certain noncontrolling Helix investors that may require the Company to redeem all noncontrolling interests in cash at the then approximate fair market value. The fair value of the redeemable noncontrolling interests is considered a Level 3 instrument. Such redemption right is exercisable at the option of certain noncontrolling interest holders provided that a bona fide pursuit of the sale of Helix has occurred, and after the fifth anniversary of either January 1, 2016, or the date that Helix begins processing samples for commercial operations, whichever is earlier.

As such, the redeemable noncontrolling interests in Helix are classified outside of stockholders' equity on the consolidated balance sheet. The balance of the redeemable noncontrolling interests is reported at the greater of its carrying value after receiving its allocation of Helix's profits and losses or its estimated redemption value at each reporting date. As of September 27, 2015, the noncontrolling shareholders and Illumina each held 50% of Helix's outstanding equity interests.

The activity of the redeemable noncontrolling interests during the three months ended September 27, 2015 is as follows (in thousands):

| | Redeemable Noncontrolling Interests |
|---|---|
| Balance as of June 28, 2015 | \$— |
| Cash contributions | 54,167 |
| Amount held in escrow by third party | (22,039) |
| Net loss attributable to noncontrolling interests | (2,556) |
| Adjustment up to the redemption value | 2,556 |
| Balance as of September 27, 2015 | \$ 32,128 |

3. Fair Value Measurements

The following table presents the Company's hierarchy for assets and liabilities measured at fair value on a recurring basis as of September 27, 2015 and December 28, 2014 (in thousands):

| | September 27, 2015 | | | | December 28, 2014 | | | |
|--|--------------------|-----------|----------|-------------|-------------------|-----------|----------|-------------|
| | Level 1 | Level 2 | Level 3 | Total | Level 1 | Level 2 | Level 3 | Total |
| Assets: | | | | | | | | |
| Money market funds (cash equivalents) | \$185,885 | \$— | \$— | \$185,885 | \$431,172 | \$— | \$— | \$431,172 |
| Debt securities in government-sponsored entities | — | 32,973 | — | 32,973 | — | 51,263 | — | 51,263 |
| Corporate debt securities | — | 607,862 | — | 607,862 | — | 500,088 | — | 500,088 |
| U.S. Treasury securities | 247,041 | — | — | 247,041 | 150,866 | — | — | 150,866 |
| Deferred compensation plan assets | — | 25,382 | — | 25,382 | — | 23,486 | — | 23,486 |
| Total assets measured at fair value | \$432,926 | \$666,217 | \$— | \$1,099,143 | \$582,038 | \$574,837 | \$— | \$1,156,875 |
| Liabilities: | | | | | | | | |
| | \$— | \$— | \$36,175 | \$36,175 | \$— | \$— | \$44,124 | \$44,124 |

| | | | | | | | | |
|--|-----|----------|----------|----------|-----|----------|----------|----------|
| Acquisition related contingent consideration liabilities | | | | | | | | |
| Deferred compensation liability | — | 24,086 | — | 24,086 | — | 20,310 | — | 20,310 |
| Total liabilities measured at fair value | \$— | \$24,086 | \$36,175 | \$60,261 | \$— | \$20,310 | \$44,124 | \$64,434 |

The Company holds available-for-sale securities that consist of highly liquid, investment grade debt securities. The Company considers information provided by the Company's investment accounting and reporting service provider in the measurement of fair value of its debt securities. The investment service provider provides valuation information from an industry-recognized valuation service. Such valuations may be based on trade prices in active markets for identical assets or liabilities (Level 1 inputs) or valuation models using inputs that are observable either directly or indirectly (Level 2 inputs),

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such as quoted prices for similar assets or liabilities, yield curve, volatility factors, credit spreads, default rates, loss severity, current market and contractual prices for the underlying instruments or debt, broker and dealer quotes, as well as other relevant economic measures. The Company's deferred compensation plan assets consist primarily of investments in life insurance contracts carried at cash surrender value, which reflects the net asset value of the underlying publicly traded mutual funds. The Company performs control procedures to corroborate the fair value of its holdings, including comparing valuations obtained from its investment service provider to valuations reported by the Company's asset custodians, validation of pricing sources and models, and review of key model inputs if necessary.

At September 27, 2015, the fair value of the contingent consideration liabilities consisted primarily of amounts related to the 2013 Verinata Health, Inc. acquisition. The Company reassesses the fair value of contingent consideration to be settled in cash related to its acquisitions on a quarterly basis using the income approach. Assumptions used to estimate the acquisition date fair value of the contingent consideration include discount rates ranging from 6% to 20%, volatility of 50%, risk-free rate of 0.26%, revenue projections, and the probability of achieving regulatory milestones. This fair value measurement of the contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Level 3 instruments are valued based on unobservable inputs that are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value. The changes in the fair value of the contingent considerations during the three and nine months ended September 27, 2015 were due to changes in the estimated payments.

Changes in estimated fair value of contingent consideration liabilities during the nine months ended September 27, 2015 are as follows (in thousands):

| | Contingent Consideration Liability (Level 3 Measurement) |
|---|--|
| Balance as of December 28, 2014 | \$44,124 |
| Change in estimated fair value, recorded in acquisition related expense (gain), net | (6,449) |
| Cash payments | (1,500) |
| Balance as of September 27, 2015 | \$36,175 |

4. Convertible Senior Notes

As of September 27, 2015, the Company had outstanding \$104.2 million in principal amount of 0.25% convertible senior notes due March 15, 2016 (2016 Notes), \$632.5 million in principal amount of 0% convertible senior notes due June 15, 2019 (2019 Notes), and \$517.5 million in principal amount of 0.5% convertible senior notes due June 15, 2021 (2021 Notes).

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

In June 2014, the Company issued \$632.5 million aggregate principal amount of 2019 Notes and \$517.5 million aggregate principal amount of 2021 Notes. The Company used the net proceeds plus cash on hand to repurchase a portion of the outstanding 2016 Notes in privately negotiated transactions concurrently with the issuance of the 2019 and 2021 Notes. The 2019 Notes carry no coupon interest. The Company pays 0.5% interest per annum on the principal amount of the 2021 Notes, payable semiannually in arrears in cash on June 15 and December 15 of each year. The 2019 and 2021 Notes mature on June 15, 2019 and June 15, 2021, respectively, and the implied estimated effective rates of the liability components of the Notes were 2.9% and 3.5%, respectively, assuming no conversion. Assumptions used in the estimate represent what market participants would use in pricing the liability component, including market interest rates, credit standing, and yield curves, all of which are defined as Level 2 observable inputs.

The estimated implied interest rates were applied to the 2019 and 2021 Notes, which resulted in a fair value of the liability component in aggregate of \$971.5 million upon issuance, calculated as the present value of implied future payments based on the \$1,150.0 million aggregate principal amount. The \$161.2 million difference between the cash proceeds of \$1,132.7 million and the estimated fair value of the liability component was recorded in additional paid-in capital as the 2019 and 2021 Notes are not considered redeemable.

Both the 2019 and 2021 Notes will be convertible into cash, shares of common stock, or a combination of cash and shares of common stock, at the Company's election, based on an initial conversion rate, subject to adjustment, of 3.9318 shares per \$1,000 principal amount of the notes (which represents an initial conversion price of approximately \$254.34 per share), only in the following circumstances and to the following extent: (1) during the five business-day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per 2019 and 2021 Note for each day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the

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conversion rate on each such day; (2) during any calendar quarter (and only during that quarter) after the calendar quarter ending September 30, 2014, if the last reported sale price of the Company's common stock for 20 or more trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect on the last trading day of the immediately preceding calendar quarter; (3) upon the occurrence of specified events described in the indenture for the 2019 and 2021 Notes; and (4) at any time on or after March 15, 2019 for the 2019 Notes, or March 15, 2021 for the 2021 Notes, through the second scheduled trading day immediately preceding the maturity date.

As noted in the indentures for the 2019 and 2021 Notes, it is the Company's intent and policy to settle conversions through combination settlement, which essentially involves repayment of an amount of cash equal to the "principal portion" and delivery of the "share amount" in excess of the conversion value over the principal portion in shares of common stock. As a policy election under applicable guidance related to the calculation of diluted net income per share, the Company elected the combination settlement method as its stated settlement policy and applied the treasury stock method in the calculation of the potential dilutive impact of the 2019 and 2021 Notes. Neither the 2019 nor the 2021 Notes were convertible as of September 27, 2015 and had no dilutive impact during the three and nine months ended September 27, 2015. If the 2019 and 2021 Notes were converted as of September 27, 2015, the if-converted value would not exceed the principal amount.

0.25% Convertible Senior Notes due 2016

In 2011, the Company issued \$920.0 million aggregate principal amount of 2016 Notes. The Company pays 0.25% interest per annum on the principal amount of the 2016 Notes semiannually in arrears in cash on March 15 and September 15 of each year. The 2016 Notes mature on March 15, 2016. The effective rate of the liability component was estimated to be 4.5%.

The 2016 Notes are convertible into cash, shares of common stock, or a combination of cash and shares of common stock, at the Company's election, based on an initial conversion rate, subject to adjustment, of 11.9687 shares per \$1,000 principal amount of the 2016 Notes (which represents an initial conversion price of approximately \$83.55 per share), only in the following circumstances and to the following extent: (1) during the five business-day period after any 10 consecutive trading day period (the "measurement period") in which the trading price per 2016 Note for each day of such measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such day; (2) during any calendar quarter (and only during that quarter) after the calendar quarter ending March 31, 2011, if the last reported sale price of the Company's common stock for 20 or more trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter exceeds 130% of the applicable conversion price in effect on the last trading day of the immediately preceding calendar quarter; (3) upon the occurrence of specified events described in the indenture for the 2016 Notes; and (4) at any time on or after December 15, 2015 through the second scheduled trading day immediately preceding the maturity date. Based upon meeting the stock trading price conversion requirement during the three months ended March 30, 2014, the 2016 Notes became convertible on April 1, 2014 and will continue to be convertible through March 11, 2016.

In conjunction with the issuance of the 2019 and 2021 Notes, the Company used the net proceeds from the issuance plus cash on hand to repurchase \$600.0 million in principal amount of the outstanding 2016 Notes in privately negotiated transactions. The aggregate cash used for the repurchase was \$1,244.7 million. The repurchase is accounted for as an extinguishment of debt and resulted in a \$31.4 million loss for the difference between the \$588.8 million fair value of debt component and the carrying value of the repurchased 2016 Notes. The \$655.9 million of the repurchase price allocated to the equity component was recorded as a reduction of additional paid-in capital.

As noted in the indenture for the 2016 Notes, it is the Company's intent and policy to settle conversions through combination settlement, which essentially involves repayment of an amount of cash equal to the "principal portion" and delivery of the "share amount" in excess of the conversion value over the principal portion in shares of common stock. As a policy election under applicable guidance related to the calculation of diluted net income per share, the Company elected the combination settlement method as its stated settlement policy and applied the treasury stock method in the calculation of the dilutive impact of the 2016 Notes. The calculation of dilutive potential common shares outstanding for the three and nine months ended September 27, 2015 reflects the dilutive impact from the 2016 Notes. If the remaining 2016 Notes were converted as of September 27, 2015, the if-converted value would exceed the principal amount by \$141.2 million.

During the nine months ended September 27, 2015, the Company recorded a loss on extinguishment of debt calculated as the difference between the estimated fair value of the debt and the carrying value of the notes as of the settlement date. To measure the fair value of the converted notes as of the settlement date, the applicable interest rate was estimated using Level 2 observable inputs and applied to the converted notes using the same methodology as in the issuance date valuation.

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The following table summarizes information about the conversion of the 2016 Notes during the nine months ended September 27, 2015 (in thousands, except percentage):

| | |
|---|-------------|
| | 2016 Notes |
| Cash paid for principal of notes converted | \$215,859 |
| Conversion value over principal amount paid in shares of common stock | \$320,868 |
| Number of shares of common stock issued upon conversion | 1,564 |
| Loss on extinguishment of debt | \$3,737 |
| Effective interest rate used to measure fair value of converted notes upon conversion | 1.2% - 1.4% |

Summary of Convertible Senior Notes

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

| | | |
|---|-----------------------|----------------------|
| | September 27, 2015 | December 28, 2014 |
| Principal amount of convertible notes outstanding | \$1,254,168 | \$1,470,027 |
| Unamortized discount of liability component | (144,067) | (178,991) |
| Net carrying amount of liability component | 1,110,101 | 1,291,036 |
| Less: current portion | (102,166) | (304,256) |
| Long-term debt | \$1,007,935 | \$986,780 |
| Carrying value of equity component, net of debt issuance cost | \$213,897 | \$215,283 |
| Fair value of outstanding notes | \$1,506,257 | \$2,021,750 |
| Weighted-average remaining amortization period of discount on the liability component | 4.8 years | 5.2 years |

5. Share-based Compensation Expense

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

| | | | | |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 27, 2015 | September 28, 2014 | September 27, 2015 | September 28, 2014 |
| Cost of product revenue | \$2,567 | \$2,572 | \$7,012 | \$6,816 |
| Cost of service and other revenue | 498 | 311 | 1,243 | 880 |
| Research and development | 9,098 | 14,589 | 31,152 | 39,043 |
| Selling, general and administrative | 20,066 | 27,197 | 57,697 | 67,350 |
| Share-based compensation expense before taxes | 32,229 | 44,669 | 97,104 | 114,089 |
| Related income tax benefits | (9,876) | (14,852) | (28,304) | (37,103) |
| Share-based compensation expense, net of taxes | \$22,353 | \$29,817 | \$68,800 | \$76,986 |

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The assumptions used for the specified reporting periods and the resulting estimates of weighted-average fair value per share for stock purchased under the Employee Stock Purchase Plan (ESPP) during the nine months ended September 27, 2015 are as follows:

| | |
|---------------------------------------|--------------------------------------|
| | Employee Stock Purchase Rights |
| Risk-free interest rate | 0.07% - 0.33% |
| Expected volatility | 29% - 38% |
| Expected term | 0.5 - 1.0 year |
| Expected dividends | — |
| Weighted-average fair value per share | \$53.92 |

As of September 27, 2015, approximately \$198.8 million of unrecognized compensation cost related to stock options, restricted stock, and ESPP shares granted to date is expected to be recognized over a weighted-average period of approximately 2.3 years.

6. Stockholders' Equity

During the nine months ended September 27, 2015, the Company's stockholders approved the 2015 Stock and Incentive Compensation Plan (the 2015 Stock Plan), which replaced both the 2005 Stock and Incentive Plan and the 2008 Verinata Health Stock Plan, and increased the maximum number of shares of common stock authorized for issuance by 2.7 million shares. As of September 27, 2015, approximately 8.3 million shares remained available for future grants under the 2015 Stock Plan and the 2005 Solexa Equity Plan.

Restricted Stock

The Company's restricted stock activity and related information for the nine months ended September 27, 2015 is as follows (units in thousands):

| | Restricted Stock Awards (RSA) | Restricted Stock Units (RSU) | Performance Stock Units (PSU)(1) | Weighted-Average Grant-Date Fair Value per Share | | |
|--------------------------------------|--|------------------------------------|--|---|----------|----------|
| | | | | RSA | RSU | PSU |
| Outstanding at December 28, 2014 | 108 | 2,841 | 1,257 | \$56.62 | \$92.35 | \$96.21 |
| Awarded | — | 119 | 12 | — | \$202.45 | \$204.44 |
| Vested | (76 |) (488 |) — | \$60.21 | \$72.71 | — |
| Cancelled | — | (222 |) (123 |) — | \$96.97 | \$97.24 |
| Outstanding at September 27, 2015 | 32 | 2,250 | 1,146 | \$47.93 | \$101.98 | \$97.24 |

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

Stock Options

The Company's stock option activity under all stock option plans during the nine months ended September 27, 2015 is as follows:

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

| | (in thousands) | Exercise Price |
|-----------------------------------|----------------|----------------|
| Outstanding at December 28, 2014 | 3,211 | \$ 34.74 |
| Exercised | (1,338 |) \$ 28.32 |
| Cancelled | (77 |) \$ 10.65 |
| Outstanding at September 27, 2015 | 1,796 | \$ 40.55 |

At September 27, 2015, outstanding options to purchase 1.8 million shares were exercisable with a weighted-average exercise price per share of \$40.92.

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Employee Stock Purchase Plan

The price at which common stock is purchased under the ESPP is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. During the nine months ended September 27, 2015, approximately 0.2 million shares were issued under the ESPP. As of September 27, 2015, there were approximately 14.5 million shares available for issuance under the ESPP.

Share Repurchases

In January 2014, the Company's Board of Directors authorized up to \$250.0 million to repurchase shares of the Company's common stock on a discretionary basis. In addition, on May 1, 2015, the Company's Board of Directors authorized \$150.0 million of repurchases under a Rule 10b5-1 plan. During the three months ended September 27, 2015, 0.2 million shares for \$37.5 million were repurchased. During the nine months ended September 27, 2015, the Company repurchased approximately 0.4 million shares for \$72.2 million. Authorizations to repurchase up to an additional \$208.1 million of the Company's common stock remained available as of September 27, 2015. On October 29, 2015, the Company's Board of Directors authorized a new discretionary share repurchase program of \$250.0 million.

7. Income Taxes

The Company's effective tax rate may vary from the U.S. federal statutory tax rate due to the change in the mix of earnings in tax jurisdictions with different statutory rates, benefits related to tax credits, and the tax impact of non-deductible expenses and other permanent differences between income before income taxes and taxable income. The effective tax rates for the three and nine months ended September 27, 2015 were 10.3% and 20.9%, respectively. For the three and nine months ended September 27, 2015, the variance from the U.S. federal statutory tax rate of 35% was primarily attributable to a discrete tax benefit of \$24.8 million related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a recent tax court opinion in which an unrelated third party was successful in challenging such charges. The variance from the U.S. federal statutory tax rate of 35% was also attributable to the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom.

8. Legal Proceedings

The Company is involved in various lawsuits and claims arising in the ordinary course of business, including actions with respect to intellectual property, employment, and contractual matters. In connection with these matters, the Company assesses, on a regular basis, the probability and range of possible loss based on the developments in these matters. A liability is recorded in the financial statements if it is believed to be probable that a loss has been incurred and the amount of the loss can be reasonably estimated. As of September 27, 2015, the Company had \$15.0 million in accrued legal contingencies. Because litigation is inherently unpredictable and unfavorable results could occur, assessing contingencies is highly subjective and requires judgments about future events. The Company regularly reviews outstanding legal matters to determine the adequacy of the liabilities accrued and related disclosures. The amount of ultimate loss may differ from these estimates. Each matter presents its own unique circumstances, and prior litigation does not necessarily provide a reliable basis on which to predict the outcome, or range of outcomes, in any individual proceeding. Because of the uncertainties related to the occurrence, amount, and range of loss on any pending litigation or claim, the Company is currently unable to predict their ultimate outcome, and, with respect to any pending litigation or claim where no liability has been accrued, to make a meaningful estimate of the reasonably possible loss or range of loss that could result from an unfavorable outcome. In the event that opposing litigants or claims ultimately succeed at trial and any subsequent appeals on their claims, any potential loss or charges in excess of any established accruals, individually or in the aggregate, could have a material adverse effect on the Company's

business, financial condition, results of operations, and/or cash flows in the period in which the unfavorable outcome occurs or becomes probable, and potentially in future periods.

On November 14, 2014, the Company entered into a Settlement and License Agreement with Syntrix Biosystems, Inc. and its sole shareholders, John A. Zebala and Amy Zebala, that settled all claims in the litigation brought against the Company. On December 2, 2014, the Company and its subsidiary Verinata Health, Inc. entered into a series of agreements with Sequenom, Inc. and several other parties that, among other items, settled a patent litigation among the parties involved. For more detailed discussions on these matters, refer to note “10. Legal Proceedings” in Part II, Item 8 of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014.

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

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

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

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

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

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

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

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

This MD&A discussion contains forward-looking statements that involve risks and uncertainties. Please see "Consideration Regarding Forward-Looking Statements" at the end of this MD&A section for additional factors relating to such statements. This MD&A should be read in conjunction with our condensed consolidated financial statements and accompanying notes included in this report and our Annual Report on Form 10-K for the fiscal year ended December 28, 2014. Operating results are not necessarily indicative of results that may occur in future periods.

Business Overview and Outlook

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

About Illumina

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

Our portfolio of integrated systems, consumables, and analysis tools is designed to accelerate and simplify genetic analysis. This portfolio addresses a range of genomic complexity, price points, and throughput, enabling customers to select the best solution for their research or clinical challenge. Our leading-edge sequencing instruments can efficiently perform a broad range of nucleic-acid (DNA, RNA) analyses across a wide range of sample sizes.

Our financial results have been, and will continue to be, impacted by several significant trends, which are described below. While these trends are important to understanding and evaluating our financial results, this discussion should be read in conjunction with our condensed consolidated financial statements and the notes thereto in Item 1, Part I of this report, and the other transactions, events, and trends discussed in “Risk Factors” in Item 1A, Part II of this report and Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014.

Next-Generation Sequencing

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

Arrays

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

Financial Overview

Financial highlights for the first three quarters of 2015 include the following:

Net revenue increased by 20.7% during the first three quarters of 2015 to \$1,628.2 million compared to the first three quarters of 2014. Our sales increased across our portfolio of sequencing products, including consumables, instruments, and services.

Gross profit as a percentage of revenue (gross margin) was 69.9% in the first three quarters of 2015 compared to 67.7% in the first three quarters of 2014. In the first three quarters of 2015, gross margins increased due to efficiencies and leverage in manufacturing operations, as well as a positive shift in product mix to sequencing consumables, offset in part by unfavorable foreign exchange fluctuations. In addition, gross profit and gross margin in the first three quarters of 2014 were negatively affected by legal contingency charges associated with Syntrix patent litigation subsequently settled in November 2014. See details on this matter in note “8. Legal Proceedings” in Part I, Item 1 of this Form 10-Q. We believe our gross margin in future periods will depend on several factors, including: market conditions that may impact our pricing power; sales mix changes among consumables, instruments, and services; product mix changes between established products and new products; our cost structure for manufacturing operations; royalties; and our ability to create innovative and high premium products that meet or stimulate customer demand.

Income from operations increased by \$157.0 million in the first three quarters of 2015 compared to the first three quarters of 2014, as a result of higher revenue, despite the increase in research and development and selling, general and administrative expenses, which we expect will continue to grow.

Our effective tax rate was 20.9% in the first three quarters of 2015, compared to 22.1% in the first three quarters of 2014. The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to a discrete tax benefit

of \$24.8 million, related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a recent tax court opinion in which an unrelated third party was successful in challenging such charges. If this tax court opinion is overturned, our tax rate will be adversely impacted by the reversal of the discrete tax benefit recorded this quarter and any stock compensation that should have been included in the cost-sharing charges from this year going forward. The decrease from the U.S. federal statutory tax rate also resulted from the mix of earnings in jurisdictions with lower statutory tax rates from the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom. Our future effective tax rate may vary from the U.S. federal statutory tax rate due to the mix of earnings in tax jurisdictions with different statutory tax rates and the other factors discussed in the risk factor “We are subject to risks related to taxation in multiple jurisdictions” in Part I Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014. We anticipate that our effective tax rate will trend lower than the U.S. federal statutory tax rate in the future due to the portion of our earnings that will be subject to lower statutory tax rates.

Cash, cash equivalents, and short-term investments were \$1.4 billion as of September 27, 2015.

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Results of Operations

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

| | Q3 2015 | Q3 2014 | YTD 2015 | YTD 2014 | |
|--|---------|---------|----------|----------|---|
| Revenue: | | | | | |
| Product revenue | 85.6 | % 86.6 | % 85.5 | % 86.7 | % |
| Service and other revenue | 14.4 | 13.4 | 14.5 | 13.3 | |
| Total revenue | 100.0 | 100.0 | 100.0 | 100.0 | |
| Cost of revenue: | | | | | |
| Cost of product revenue | 22.0 | 23.5 | 22.1 | 25.1 | |
| Cost of service and other revenue | 5.4 | 5.0 | 5.8 | 5.1 | |
| Amortization of acquired intangible assets | 2.2 | 2.0 | 2.2 | 2.1 | |
| Total cost of revenue | 29.6 | 30.5 | 30.1 | 32.3 | |
| Gross profit | 70.4 | 69.5 | 69.9 | 67.7 | |
| Operating expense: | | | | | |
| Research and development | 18.0 | 17.7 | 17.6 | 18.2 | |
| Selling, general and administrative | 24.8 | 24.9 | 23.2 | 25.5 | |
| Legal contingencies | 2.7 | 1.6 | 0.9 | 0.6 | |
| Headquarter relocation | (0.9) |) 0.2 | (0.2) |) 0.3 | |
| Acquisition related expense (gain), net | 0.2 | 0.2 | (0.4) |) — | |
| Total operating expense | 44.8 | 44.6 | 41.1 | 44.6 | |
| Income from operations | 25.6 | 24.9 | 28.8 | 23.1 | |
| Other income (expense): | | | | | |
| Interest income | 0.5 | 0.1 | 0.4 | 0.3 | |
| Interest expense | (2.3) |) (2.3) |) (2.2) |) (2.3) |) |
| Cost-method investment gain, net | 0.5 | 0.9 | 1.0 | 0.3 | |
| Other expense, net | (0.9) |) (0.2) |) (0.5) |) (2.4) |) |
| Total other expense, net | (2.2) |) (1.5) |) (1.3) |) (4.1) |) |
| Income before income taxes | 23.4 | 23.4 | 27.5 | 19.0 | |
| Provision for income taxes | 2.4 | 3.9 | 5.7 | 4.2 | |
| Consolidated net income | 21.0 | 19.5 | 21.8 | 14.8 | |
| Add: Net loss attributable to noncontrolling interests | 0.5 | — | 0.1 | — | |
| Net income attributable to Illumina stockholders | 21.5 | % 19.5 | % 21.9 | % 14.8 | % |

Our fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine month periods ended September 27, 2015 and September 28, 2014 were both 13 and 39 weeks, respectively.

Revenue

| (Dollars in thousands) | Q3 2015 | Q3 2014 | Change | % Change | YTD 2015 | YTD 2014 | Change | % Change |
|---------------------------|-----------|-----------|----------|----------|---------------|-------------|-----------|----------|
| Product revenue | \$470,824 | \$416,163 | \$54,661 | 13 | % \$1,392,711 | \$1,169,182 | \$223,529 | 19 |
| Service and other revenue | 79,447 | 64,467 | 14,980 | 23 | 235,503 | 179,797 | 55,706 | 31 |
| Total revenue | \$550,271 | \$480,630 | \$69,641 | 14 | % \$1,628,214 | \$1,348,979 | \$279,235 | 21 |

Product revenue consists primarily of revenue from the sale of consumables and instruments. Service and other revenue consists primarily of sequencing and genotyping service revenue as well as instrument service contract revenue.

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QTD 2015 vs. QTD 2014

Revenue increased \$69.6 million, or 14%, to \$550.3 million in Q3 2015 compared to \$480.6 million in Q3 2014.

Consumables revenue increased \$59.8 million, or 23%, to \$321.1 million in Q3 2015 compared to \$261.3 million in Q3 2014, driven by growth in the sequencing instrument installed base.

Instrument revenue decreased \$4.9 million, or 3%, to \$145.4 million in Q3 2015 compared to \$150.3 million in Q3 2014, due to decreases in HiSeq X and MiSeq shipments.

Service and other revenue increased \$15.0 million, or 23%, to \$79.4 million in Q3 2015 compared to \$64.5 million in Q3 2014, driven primarily by the growth in NIPT services resulting from higher test volumes. Also contributing to the increase was revenue from genotyping services and extended instrument service contracts as our sequencing instrument installed base continues to grow.

Overall, these increases were negatively impacted by the foreign exchange fluctuations in the comparative periods. Absent these fluctuations, revenues would have grown 18% on a constant currency basis from Q3 2014 to Q3 2015.

YTD 2015 vs. YTD 2014

Revenue increased \$279.2 million, or 21%, to \$1,628.2 million in the first three quarters of 2015 compared to \$1,349.0 million in the first three quarters of 2014.

Consumables revenue increased \$182.2 million, or 24%, to \$932.8 million in the first three quarters of 2015 compared to \$750.6 million in the first three quarters of 2014, driven by growth in the sequencing instrument installed base.

Instrument revenue increased \$40.8 million, or 10%, to \$447.1 million in the first three quarters of 2015 compared to \$406.3 million in the first three quarters of 2014, driven by shipments of our high-throughput platforms.

Service and other revenue increased \$55.7 million, or 31%, to \$235.5 million in the first three quarters of 2015 compared to \$179.8 million in the first three quarters of 2014, driven by the growth in NIPT services resulting from higher test volumes. Revenue from extended instrument service contracts also contributed to the increase as our sequencing instrument installed base continues to grow.

Overall, these increases were negatively impacted by the foreign exchange fluctuations in the comparative periods. Absent these fluctuations, revenues would have grown 25% on a constant currency basis from the first three quarters of 2014 to the first three quarters of 2015.

Gross Margin

| (Dollars in thousands) | Q3 2015 | Q3 2014 | Change | % Change | YTD 2015 | YTD 2014 | Change | % Change |
|------------------------|-----------|-----------|----------|----------|-------------|-----------|-----------|----------|
| Gross profit | \$387,539 | \$333,941 | \$53,598 | 16% | \$1,138,931 | \$912,773 | \$226,158 | 25% |
| Gross margin | 70.4 | % 69.5 | % | | 69.9 | % 67.7 | % | |

QTD 2015 vs. QTD 2014

Gross margin increased to 70.4% in Q3 2015 from 69.5% in Q3 2014. In Q3 2014, gross margin was negatively affected by legal contingency charges associated with Syntrix patent litigation subsequently settled in November

2014. See details on this matter in note “8. Legal Proceedings” in Part I, Item 1 of this Form 10-Q. Gross margin was further affected by a positive shift in product mix to sequencing consumables, which carry a higher margin, partially offset by an unfavorable shift in foreign exchange rates.

YTD 2015 vs. YTD 2014

Gross margin increased to 69.9% in the first three quarters of 2015 compared to 67.7% in the first three quarters of 2014, primarily due to efficiencies and leverage in manufacturing operations and a positive shift in product mix to sequencing consumables, partially offset by unfavorable foreign exchange fluctuations. In addition, gross margin in the first three quarters

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of 2014 was negatively affected by legal contingency charges associated with Syntrix patent litigation subsequently settled in November 2014. See details on this matter in note “8. Legal Proceedings” in Part I, Item 1 of this Form 10-Q.

| Operating Expense (Dollars in thousands) | Q3 2015 | Q3 2014 | Change | % Change | YTD 2015 | YTD 2014 | Change | % Change |
|---|-----------|-----------|----------|----------|-----------|-----------|----------|----------|
| Research and development | \$99,226 | \$85,082 | \$14,144 | 17 | \$287,180 | \$245,108 | \$42,072 | 17 |
| Selling, general and administrative | 136,648 | 119,888 | 16,760 | 14 | 377,406 | 344,110 | 33,296 | 10 |
| Legal contingencies | 15,000 | 7,705 | 7,295 | 95 | 15,000 | 7,705 | 7,295 | 95 |
| Headquarter relocation | (5,226) | 870 | (6,096) | (701) | (3,047) | 4,357 | (7,404) | (170) |
| Acquisition related expense (gain), net | 1,109 | 903 | 206 | 23 | (6,449) | (335) | (6,114) | 1,825 |
| Total operating expense | \$246,757 | \$214,448 | \$32,309 | 15 | \$670,090 | \$600,945 | \$69,145 | 12 |

QTD 2015 vs. QTD 2014

Research and development expense increased by \$14.1 million, or 17%, in Q3 2015 from Q3 2014, primarily due to increased headcount as we continue to invest in the development of our products as well as enhancements to existing products.

Selling, general and administrative expense increased by \$16.8 million, or 14%, in Q3 2015 from Q3 2014, primarily driven by increased headcount to support our continued growth, investments in scaling our operations, and start-up costs related to our Helix joint venture.

Legal contingencies in Q3 2015 and Q3 2014 represent charges related to litigation matters.

Headquarter relocation costs for Q3 2015 include a net gain related to a change in a lease exit liability, partially offset by accretion of interest on such liability.

YTD 2015 vs. YTD 2014

Research and development expense increased by \$42.1 million, or 17%, in the first three quarters of 2015 compared to the first three quarters of 2014, primarily due to increased headcount and outside services as we continue to invest in the development of new products as well as enhancements to existing products.

Selling, general and administrative expense increased by \$33.3 million, or 10%, in the first three quarters of 2015 compared to the first three quarters of 2014, primarily driven by increased headcount to support our continued growth, investments in scaling our operations, and start-up costs related to our Helix joint venture.

Legal contingencies for the first three quarters of 2015 and 2014 represent charges related to litigation matters.

Headquarter relocation costs for the first three quarters of 2015 include a net gain related to a change in a lease exit liability recorded in Q3, partially offset by accretion of interest on such liability.

| Other Expense, Net (Dollars in thousands) | Q3 2015 | Q3 2014 | Change | % Change | YTD 2015 | YTD 2014 | Change | % Change |
|--|---------|---------|---------|----------|----------|----------|---------|----------|
| Interest income | \$2,767 | \$534 | \$2,233 | 418 | \$5,804 | \$2,954 | \$2,850 | 96 |

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| | | | | | | | | |
|-------------------------------------|-------------|------------|------------|-------|---------------|-------------|----------|--------|
| Interest expense | (12,821) | (10,987) | (1,834) | 17 | (35,190) | (30,652) | (4,538) | 15 |
| Cost-method investment gain, net | 2,900 | 4,427 | (1,527) | (34) | 15,482 | 4,427 | 11,055 | 250 |
| Other expense, net | (4,711) | (1,024) | (3,687) | 360 | (6,802) | (31,860) | 25,058 | (79) |
| Total other expense, net | \$(11,865) | \$(7,050) | \$(4,815) | 68 | % \$(20,706) | \$(55,131) | \$34,425 | (62)% |

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QTD 2015 vs. QTD 2014

Interest expense consisted primarily of accretion of discount on our convertible senior notes. The increase in interest expense in Q3 2015 compared to Q3 2014 was due to the issuance in June 2014 of our 2019 and 2021 Notes, partially offset by the impact from the concurrent repurchase of \$600.0 million in principal amount of our 2016 Notes.

Other expense, net, in Q3 2015 primarily consists of a \$3.5 million loss on extinguishment of debt. There were no such losses in the same period of the prior year.

YTD 2015 vs. YTD 2014

Interest expense consisted primarily of accretion of discount on our convertible senior notes. The increase in interest expense in the first three quarters of 2015 compared to the first three quarters of 2014 was due to the issuance in June 2014 of our 2019 and 2021 Notes, partially offset by the impact from the concurrent repurchase of \$600.0 million in principal amount of our 2016 Notes.

Cost-method investment gain, net, during the first three quarters of 2015 consisted primarily of gains on dispositions of cost-method investments partially offset by impairment charges on other investments.

Other expense, net, in the first three quarters of 2014 was negatively impacted by \$31.4 million loss on extinguishment of debt recorded as a result of the repurchase of \$600.0 million in principal amount of our 2016 Notes.

Provision for Income Taxes

| (Dollars in thousands) | Q3 2015 | Q3 2014 | Change | % Change | YTD 2015 | YTD 2014 | Change | % Change |
|----------------------------|------------|------------|-----------|----------|------------|------------|------------|----------|
| Income before income taxes | \$ 128,917 | \$ 112,443 | \$ 16,474 | 15 % | \$ 448,135 | \$ 256,697 | \$ 191,438 | 75 % |
| Provision for income taxes | 13,296 | 18,954 | (5,658) | (30) | 93,609 | 56,626 | 36,983 | 65 |
| Consolidated net income | \$ 115,621 | \$ 93,489 | \$ 22,132 | 24 % | \$ 354,526 | \$ 200,071 | \$ 154,455 | 77 % |
| Effective tax rate | 10.3 % | 16.9 % | | | 20.9 % | 22.1 % | | |

QTD 2015 vs. QTD 2014

Our effective tax rate was 10.3% for Q3 2015 compared to 16.9% in Q3 2014. The variance from the U.S. federal statutory tax rate of 35% in Q3 2015 was primarily attributable to a discrete tax benefit of \$24.8 million, related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a recent tax court opinion in which an unrelated third party was successful in challenging such charges. In addition, we generated a higher mix of foreign earnings, such as earnings from Singapore and the United Kingdom, which were taxed at rates lower than the U.S. federal statutory tax rate. The variance from the U.S. federal statutory tax rate of 35% in Q3 2014 was primarily attributable to the reversal of the valuation allowance on foreign tax credits and the removal of uncertain tax positions associated with statute expirations, which were recorded as discrete items in the quarter. In addition, we generated a higher mix of foreign earnings, such as earnings from Singapore and the United Kingdom, which were taxed at rates lower than the U.S. federal statutory tax rate.

YTD 2015 vs. YTD 2014

Our effective tax rate was 20.9% in the first three quarters of 2015. The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to a discrete tax benefit of \$24.8 million, related to the exclusion of stock compensation from prior period cost-sharing charges as a result of a recent tax court opinion in which an unrelated third party was successful in challenging such charges. The decrease from the U.S. federal statutory tax rate also resulted from the mix of earnings in jurisdictions with lower statutory tax rates than the U.S. federal statutory tax rate, such as in Singapore and the United Kingdom. In the first nine months of 2014, our effective tax rate was 22.1%. The variance from the U.S. federal statutory tax rate of 35% was primarily attributable to the reversal of the valuation allowance on foreign tax credits and the removal of uncertain tax positions associated with statute expirations, which were recorded as discrete items. The difference from the statutory rate also resulted from a higher mix of foreign earnings, such as earnings in Singapore and the United Kingdom, which were taxed at rates lower than the U.S federal statutory tax rate and the tax treatment of the loss on extinguishment of debt.

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Liquidity and Capital Resources

At September 27, 2015, we had approximately \$551.5 million in cash and cash equivalents, of which approximately \$325 million were held by our foreign subsidiaries. Cash and cash equivalents decreased by \$84.6 million from last year, due to the factors described in the “Cash Flow Summary” below. Our primary source of liquidity, other than our holdings of cash, cash equivalents and investments, has been cash flows from operations. Our ability to generate cash from operations provides us with the financial flexibility we need to meet operating, investing, and financing needs. It is our intention to indefinitely reinvest all current and future foreign earnings in foreign subsidiaries.

Historically, we have liquidated our short-term investments or issued debt and equity securities to finance our business needs as a supplement to cash provided by operating activities. As of September 27, 2015, we had \$887.9 million in short-term investments. Short-term investments held by our foreign subsidiaries as of September 27, 2015 were approximately \$468 million. Our short-term investments include marketable securities consisting of U.S. government-sponsored entities, corporate debt securities, and U.S. Treasury securities.

As of September 27, 2015, \$104.2 million in principal amount of our 2016 Notes remained outstanding, with a maturity date of March 15, 2016. Based upon meeting the stock trading price conversion requirement during the three months ended March 30, 2014, the 2016 Notes became convertible on April 1, 2014 and will continue to be convertible through March 11, 2016. During the first three quarters of 2015, \$215.9 million in principal of the 2016 Notes were converted. It is our intent and policy to settle conversions of the 2016 Notes through combination settlement, which essentially involves repayment of an amount of cash equal to the principal amount and delivery of the excess of conversion value over principal amount in shares of common stock. The convertible senior notes due 2019 and 2021 were not convertible as of September 27, 2015.

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

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

As of September 27, 2015, we had \$36.2 million in fair value of contingent consideration liabilities associated with prior acquisitions to be settled in future periods.

During the first three quarters of 2015, we used \$72.2 million to repurchase our outstanding shares under the stock repurchase programs authorized by our Board of Directors. On May 1, 2015, our Board of Directors authorized \$150.0 million of additional repurchases under a Rule 10b5-1 plan. As of September 27, 2015, \$208.1 million remained available under the authorized programs in aggregate. On October 29, 2015, the Company’s Board of Directors authorized a new discretionary share repurchase program of \$250.0 million.

The noncontrolling interests in Helix contain a contingent put right exercisable by certain noncontrolling Helix investors that may require Illumina to redeem all noncontrolling interests in cash at the then approximate fair market value. Such redemption right is exercisable at the option of certain noncontrolling interest holders provided that a bona fide pursuit of the sale of Helix has occurred, and after the fifth anniversary of either January 1, 2016, or the date that Helix begins processing samples for commercial operations, whichever is earlier. The fair value of the redeemable noncontrolling interests as of September 27, 2015 was \$32.1 million.

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

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

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

Cash Flow Summary

| (In thousands) | YTD 2015 | YTD 2014 |
|--|-------------|------------|
| Net cash provided by operating activities | \$419,218 | \$360,722 |
| Net cash used in investing activities | (335,544) | (73,841) |
| Net cash used in financing activities | (165,621) | (166,950) |
| Effect of exchange rate changes on cash and cash equivalents | (2,678) | (1,673) |
| Net (decrease) increase in cash and cash equivalents | \$(84,625) | \$118,258 |

Operating Activities

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

Net cash provided by operating activities in the first three quarters of 2014 consisted of net income of \$200.1 million plus net adjustments of \$187.2 million partially offset by net changes in operating assets and liabilities of \$26.5 million. The primary non-cash expenses added back to net income included share-based compensation of \$114.1 million, depreciation and amortization expenses of \$82.6 million, loss on extinguishment of debt of \$31.4 million, deferred income taxes of \$30.4 million, and accretion of debt discount of \$28.0 million. These non-cash add-backs were partially offset by \$102.6 million in incremental tax benefit related to share-based compensation. The main drivers for the change in net operating assets were increases in inventory, accounts receivable, and prepaid and other assets, partially offset by increases in accrued liabilities, and accrued legal contingencies.

Investing Activities

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

Net cash used in investing activities totaled \$73.8 million for the first three quarters of 2014. We purchased \$428.7 million of available-for-sale securities and \$442.8 million of our available-for-sale securities matured or were sold during the period. We also invested \$71.2 million in capital expenditures primarily associated with the purchase of manufacturing, research, and development equipment, leasehold improvements, and information technology equipment and systems.

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Financing Activities

Net cash used in financing activities totaled \$165.6 million for the first three quarters of 2015. We used \$95.2 million to pay taxes related to net share settlement of equity awards and \$72.3 million to repurchase our common stock. We used \$216.2 million to repay financing obligations. We received \$121.7 million in incremental tax benefit related to share-based compensation and \$65.7 million in proceeds from issuance of common stock through the exercise of stock options and the sale of shares under our employee stock purchase plan. Contributions from noncontrolling owners were \$32.1 million.

Net cash used in financing activities totaled \$167.0 million for the first three quarters of 2014. We received \$1,132.4 million in proceeds from the issuance of \$1,150.0 million of our convertible senior notes due 2019 and 2021, net of issuance costs paid in the period. We used \$1,244.7 million to repurchase \$600.0 million in principal of our 2016 Notes and paid \$29.9 million in conversions of our convertible senior notes due 2014. We used \$202.4 million to repurchase our common stock. We received \$102.6 million in incremental tax benefit related to share-based compensation and \$84.7 million in proceeds from the issuance of our common stock through the exercise of stock options and the sale of shares under our employee stock purchase plan.

Off-Balance Sheet Arrangements

We do not participate in any transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. During the first three quarters of 2015, we were not involved in any “off-balance sheet arrangements” within the meaning of the rules of the Securities and Exchange Commission.

Critical Accounting Policies and Estimates

In preparing our condensed consolidated financial statements, we make estimates, assumptions and judgments that can have a significant impact on our net revenue, operating income and net income, as well as on the value of certain assets and liabilities on our balance sheet. We believe that the estimates, assumptions and judgments involved in the accounting policies described in Management’s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014 have the greatest potential impact on our financial statements, so we consider them to be our critical accounting policies and estimates. There were no material changes to our critical accounting policies and estimates during the first three quarters of 2015.

Recent Accounting Pronouncements

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

Consideration Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, strategies, objectives, expectations, intentions, and adequacy of resources. Words such as “anticipate,” “believe,” “continue,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “predict,” “project,” or similar phrases, or the negatives of these words, may identify forward-looking statements, but the absence of these words does not necessarily mean that a statement is not forward looking. Examples of forward-looking statements include,

among others, statements regarding the integration of our acquired technologies with our existing technology, the commercial launch of new products, the entry into new business segments or markets, and the duration which our existing cash and other resources is expected to fund our operating activities.

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

- our ability to develop and commercialize our instruments and consumables, to deploy new products, services, and applications, and expand the markets for our technology platforms;

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our ability to manufacture robust instrumentation and consumables;
our ability to identify and integrate acquired technologies, products, or businesses successfully;
our expectations and beliefs regarding prospects and growth for the business and its markets;
the assumptions underlying our critical accounting policies and estimates;
our assessments and estimates that determine our effective tax rate;
• our assessments and beliefs regarding the outcome of pending legal proceedings and any liability, that we may incur as a result of those proceedings; and
other factors detailed in our filings with the SEC, including the risks, uncertainties, and assumptions described in Item 4A of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014, or in information disclosed in public conference calls, the date and time of which are released beforehand.
The foregoing factors should be considered together with other factors detailed in our filings with the Securities and Exchange Commission, including our most recent filings on Forms 10-K and 10-Q, or in information disclosed in public conference calls, the date and time of which are released beforehand. We undertake no obligation, and do not intend to update these forward-looking statements, to review or confirm analysts' expectations, or to provide interim reports or updates on the progress of the current financial quarter. Accordingly, you should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

There were no substantial changes to our market risks in the nine months ended September 27, 2015, when compared to the disclosures in Item 7A of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014.

Item 4. Controls and Procedures.

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

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

During Q3 2015, we transitioned to a new enterprise resource planning system (ERP) and, accordingly, modified our existing internal controls infrastructure, as well as added other processes and internal controls, to adapt to our new ERP system. We believe that the new ERP system and related changes to processes and internal controls will enhance our internal control over financial reporting while providing us with the ability to scale our business. We have taken the necessary steps to monitor and maintain appropriate internal control over financial reporting during Q3 2015 and will continue to evaluate the operating effectiveness of related key controls during subsequent periods.

There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that materially affected or are reasonably likely to materially affect internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors.

Our business is subject to various risks, including those described in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 28, 2014, which we strongly encourage you to review. There have been no material changes from the risk factors disclosed in Item 1A of our Form 10-K.

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

Unregistered Sales of Equity Securities

None during the quarterly period ended September 27, 2015.

Purchases of Equity Securities by the Issuer

In January 2014, the Company's Board of Directors authorized up to \$250.0 million to repurchase shares of the Company's common stock on a discretionary basis. In addition, on May 1, 2015, the Company's Board of Directors authorized \$150.0 million of additional repurchases under a Rule 10b5-1 plan. The following table summarizes shares repurchased pursuant to these programs during the three months ended September 27, 2015.

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Programs | Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs |
|--------------------------------------|--------------------------------------|------------------------------|---|---|
| June 29, 2015 - July 26, 2015 | — | — | — | \$245,620,362 |
| July 27, 2015 - August 23, 2015 | 28,742 | \$208.75 | 28,742 | \$239,620,537 |
| August 24, 2015 - September 27, 2015 | 159,271 | \$197.77 | 159,271 | \$208,121,681 |

| | | | | |
|-------|---------|-----------|---------|---------------|
| Total | 188,013 | \$ 199.45 | 188,013 | \$208,121,681 |
|-------|---------|-----------|---------|---------------|

(1) All shares purchased during the three months ended September 27, 2015, were made in open-market transactions under a Rule 10b5-1 plan.

Item 3. Defaults Upon Senior Securities.

None.

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Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

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

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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 2, 2015

/s/ MARC A. STAPLEY
Marc A. Stapley
Senior Vice President and Chief Financial Officer