ILLUMINA INC
Form 10-Q
October 29, 2012
Table of Contents

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

þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended September 30, 2012

¨ 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 (State or other jurisdiction of incorporation or organization)	33-0804655 (I.R.S. Employer Identification No.)
5200 Illumina Way, San Diego, CA (Address of principal executive offices)	92122 (Zip Code)

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

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

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 þ 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 þ		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 þ

As of October 12, 2012, there were 123,383,865 shares of the registrant's Common Stock outstanding.

Table of Contents

ILLUMINA, INC.
INDEX

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Condensed Consolidated Balance Sheets as of September 30, 2012 (Unaudited) and January 1, 2012	3
Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2012 and October 2, 2011 (Unaudited)	4
Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2012 and October 2, 2011 (Unaudited)	5
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and October 2, 2011 (Unaudited)	6
Notes to Condensed Consolidated Financial Statements (Unaudited)	8
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	23
Item 3. Quantitative and Qualitative Disclosures About Market Risk	31
Item 4. Controls and Procedures	31
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings	32
Item 1A. Risk Factors	32
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	32
Item 3. Defaults upon Senior Securities	33
Item 4. Mine Safety Disclosures	33
Item 5. Other Information	33
Item 6. Exhibits	33
SIGNATURES	34

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.

ILLUMINA, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	September 30, 2012 (Unaudited)	January 1, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$343,089	$302,978
Short-term investments	889,977	886,590
Accounts receivable, net	218,145	173,886
Inventory, net	147,684	128,781
Deferred tax assets, current portion	27,229	23,188
Prepaid expenses and other current assets	20,112	29,196
Total current assets	1,646,236	1,544,619
Property and equipment, net	154,869	143,483
Goodwill	370,189	321,853
Intangible assets, net	134,829	106,475
Deferred tax assets, long-term portion	54,410	19,675
Other assets	77,450	59,735
Total assets	$2,437,983	$2,195,840
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$74,971	$49,806
Accrued liabilities	191,821	177,115
Long-term debt, current portion	36,307	—
Total current liabilities	303,099	226,921
Long-term debt	797,162	807,369
Other long-term liabilities	111,690	80,613
Conversion option subject to cash settlement	3,818	5,722
Stockholders' equity:		
Preferred stock	—	—
Common stock	1,690	1,668
Additional paid-in capital	2,370,969	2,249,900
Accumulated other comprehensive income	2,447	2,117
Retained earnings (accumulated deficit)	10,640	(68,707)
Treasury stock, at cost	(1,163,532)	(1,109,763)
Total stockholders' equity	1,222,214	1,075,215
Total liabilities and stockholders' equity	$2,437,983	$2,195,840

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Revenue:				
Product revenue	$262,418	$220,296	$776,893	$756,884
Service and other revenue	23,456	15,203	62,358	48,580
Total revenue	285,874	235,499	839,251	805,464
Cost of revenue:				
Cost of product revenue	75,873	68,764	230,935	238,719
Cost of service and other revenue	10,540	6,585	28,761	19,178
Amortization of acquired intangible assets	3,588	3,035	9,674	9,055
Total cost of revenue	90,001	78,384	269,370	266,952
Gross profit	195,873	157,115	569,881	538,512
Operating expense:				
Research and development	54,056	50,399	174,118	151,400
Selling, general and administrative	69,791	66,031	206,276	200,925
Unsolicited tender offer related expense	3,956	—	18,742	—
Restructuring charges	138	—	3,434	—
Headquarter relocation expense	19,475	6,519	23,445	11,583
Acquisition related (gain) expense, net	(357)	(2,598)	2,460	2,442
Total operating expense	147,059	120,351	428,475	366,350
Income from operations	48,814	36,764	141,406	172,162
Other income (expense):				
Interest income	3,459	1,388	7,370	4,909
Interest expense	(9,483)	(8,797)	(28,193)	(25,605)
Other income (expense), net	855	(1,564)	(1,878)	(38,643)
Total other expense, net	(5,169)	(8,973)	(22,701)	(59,339)
Income before income taxes	43,645	27,791	118,705	112,823
Provision for income taxes	13,897	7,640	39,354	37,915
Net income	$29,748	$20,151	$79,351	$74,908
Net income per basic share	$0.24	$0.17	$0.65	$0.60
Net income per diluted share	$0.22	$0.15	$0.60	$0.52
Shares used in calculating basic net income per share	122,930	122,079	122,929	124,017
Shares used in calculating diluted net income per share	132,507	135,966	133,126	143,620

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Net income	$29,748	$20,151	$79,351	$74,908
Unrealized gain (loss) on available-for-sale securities, net of deferred tax	244	(261)	330	321
Total comprehensive income	$29,992	$19,890	$79,681	$75,229

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

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

	Nine Months Ended	
	September 30, 2012	October 2, 2011
Cash flows from operating activities:		
Net income	$79,351	$74,908
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	35,564	40,303
Amortization of acquired intangible assets	10,130	9,501
Share-based compensation expense	70,148	70,276
Accretion of debt discount	26,100	23,673
Loss on extinguishment of debt	—	37,611
Cease-use loss	19,484	—
Contingent compensation expense	4,049	2,897
Incremental tax benefit related to stock options exercised	(12,463)	(40,387)
Deferred income taxes	(36,439)	6,209
Change in fair value of contingent consideration	1,713	(2,976)
Impairment of in-process research and development	21,438	—
Other non-cash adjustments	7,178	8,070
Changes in operating assets and liabilities:		
Accounts receivable	(37,045)	(2,544)
Inventory	(13,460)	9,315
Prepaid expenses and other current assets	(1,402)	(15,474)
Other assets	(2,717)	(3,110)
Accounts payable	18,434	(14,897)
Accrued liabilities	27,331	41,394
Other long-term liabilities	(1,107)	3,182
Unrealized (gain) loss on foreign exchange	(3,290)	1,889
Net cash provided by operating activities	212,997	249,840
Cash flows from investing activities:		
Purchases of available-for-sale securities	(802,353)	(1,076,674)
Sales of available-for-sale securities	666,579	715,377
Maturities of available-for-sale securities	128,346	124,730
Net cash paid for acquisitions	(83,156)	(58,302)
Purchases of strategic investments	(15,030)	(11,384)
Purchases of property and equipment	(51,680)	(50,686)
Cash paid for intangible assets	(11,329)	(1,100)
Net cash used in investing activities	(168,623)	(358,039)
Cash flows from financing activities:		
Payments on current portion of long-term debt	—	(349,874)
Cash paid in business combination milestones	(3,374)	—
Proceeds from issuance of convertible notes	—	903,492
Incremental tax benefit related to stock options exercised	12,463	40,387
Common stock repurchases	(52,509)	(570,406)
Proceeds from issuance of common stock	38,707	65,569
Net cash (used in) provided by financing activities	(4,713)	89,168

Effect of exchange rate changes on cash and cash equivalents	450	(70)
Net increase (decrease) in cash and cash equivalents	40,111	(19,101)
Cash and cash equivalents at beginning of period	302,978	248,947
Cash and cash equivalents at end of period	$343,089	$229,846

Table of Contents

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

	Nine Months Ended	
	September 30, 2012	October 2, 2011
Non-cash financing activities:		
Unsettled common stock repurchases	$(5,002)	$—

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

Illumina, Inc.
Notes to Consolidated Financial Statements
(Unaudited)
Unless the context requires otherwise, references in this report to “Illumina,” “we,” “us,” the “Company,” and “our” refer to Illumina, Inc. and its consolidated subsidiaries.

1. Summary of Significant Accounting 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. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation. In management’s opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited financial statements should be read in conjunction with the Company’s audited financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the fiscal year ended January 1, 2012, 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 expenses, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Fiscal Year

The Company’s fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine months ended September 30, 2012 and October 2, 2011 were both 13 and 39 weeks, respectively.

Reclassifications

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

Revenue Recognition

The Company's revenue is generated primarily from the sale of products and services. Product revenue primarily consists of sales of instrumentation and consumables used in genetic analysis. Service and other revenue primarily consists of revenue received for performing genotyping and sequencing services, instrument service contract sales, and amounts earned under research agreements with government grants, which are recognized in the period during which the related costs are incurred.

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

Revenue from product sales is recognized generally upon transfer of title to the customer, provided that no significant obligations remain and collection of the receivable is reasonably assured. Revenue from instrument service contracts is recognized as the services are rendered, typically evenly over the contract term, and revenue from genotyping and sequencing services is recognized when earned, which is generally at the time the genotyping or sequencing analysis data is made available to the customer or agreed upon milestones are reached.

In order to assess whether the price is fixed or determinable, the Company evaluates whether refund rights exist. If there are refund rights or payment terms based on future performance, the Company defers revenue recognition until the price becomes fixed or determinable. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. If the Company determines that collection of a payment is not reasonably assured, revenue recognition is deferred until receipt of payment.

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

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

During the fiscal year ended January 1, 2012, the Company completed its Genome Analyzer trade-in program that enabled certain Genome Analyzer customers to trade in their Genome Analyzer and receive a discount on the purchase of a HiSeq 2000. The incentive was limited to customers who had purchased a Genome Analyzer prior to the beginning of the incentive program in early 2010 and was the only significant trade-in program offered by the Company to date. The Company accounted for HiSeq 2000 discounts related to the Genome Analyzer trade-in program as reductions to revenue upon recognition of the HiSeq 2000 sales revenue, which is later than the date the trade-in program was launched.

In certain markets within Europe, the Asia-Pacific region, Latin America, the Middle East, and South Africa, the Company sells products and provides services to customers through distributors that specialize in life science products. In most sales through distributors, the product is delivered directly to customers. In cases where the product is delivered to a distributor, revenue recognition is deferred until acceptance is received from the distributor, and/or the end-user, if required by the applicable sales contract. The terms of sales transactions through distributors are consistent with the terms of direct sales to customers. These transactions are accounted for in accordance with the Company's revenue recognition policy described herein.

Fair Value Measurements

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

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Inputs, other than Level 1, that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 — Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The carrying amounts of financial instruments such as cash and cash equivalents, accounts receivable, prepaid expenses and other current assets, accounts payable, and accrued liabilities, excluding acquisition related contingent consideration liabilities, approximate the related fair values due to the short-term maturities of these instruments.

Table of Contents

Goodwill, Intangible Assets, and Other Long-Lived Assets

Goodwill represents the excess of cost over fair value of net assets acquired. The change in the carrying value of goodwill during the nine months ended September 30, 2012 was due to goodwill recorded in connection with the BlueGnome acquisition. The Company's identifiable intangible assets are typically comprised of acquired core technologies, licensed technologies, in-process research and development ("IPR&D"), customer relationships, and trade names.

The cost of all intangible assets with finite lives is amortized on a straight-line basis over the assets' estimated useful lives. The Company regularly performs reviews to determine if the carrying values of its long-lived assets are impaired. A review of intangible assets that have finite useful lives and other long-lived assets is performed when an event occurs indicating the potential for impairment. If indicators of impairment exist, the Company assesses the recoverability of the affected long-lived assets by determining whether the carrying amount of such assets exceeds the undiscounted expected future cash flows associated with such assets. If impairment is indicated, the Company compares the carrying amount to the estimated fair value of the affected assets and adjusts the value of such assets accordingly. Factors that would indicate potential impairment include a significant decline in the Company's stock price and market capitalization compared to its net book value, significant changes in the ability of a particular asset to generate positive cash flows, and significant changes in the Company's strategic business objectives and utilization of a particular asset. The Company performed quarterly reviews of its definite-lived assets and noted no indications of impairment for the three and nine months ended September 30, 2012.

Goodwill, which has an indefinite useful life, is reviewed for impairment at least annually during the second fiscal quarter, or more frequently if an event occurs indicating the potential for impairment. The first step of the goodwill impairment test involves comparing the estimated fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of loss, which involves comparing the implied fair value of the goodwill to the carrying value of the goodwill. The Company performed its annual assessment for goodwill impairment in the second fiscal quarter of 2012, noting no impairment. In its impairment test, the Company concluded that it has a single reporting unit and that its fair value exceeded its book value, using market capitalization as a reference for the Company's fair value. Therefore, the first step recoverability test was passed and the second step analysis was not required.

The IPR&D impairment test requires the Company to assess the fair value of the asset as compared to its carrying value, and if the carrying value exceeds the fair value, record an impairment charge. The Company performed its annual impairment test of its IPR&D in the second fiscal quarter of 2012 and recorded $21.4 million in impairment charges within research and development expenses in the condensed consolidated statements of income. Resources previously assigned to the research project were re-directed with no plans for additional investments to be made to the project in the foreseeable future.

Derivatives

The Company is exposed to foreign exchange rate risks in the normal course of business. To manage a portion of the accounting exposure resulting from changes in foreign currency exchange rates, the Company enters into foreign exchange contracts to hedge monetary assets and liabilities that are denominated in currencies other than the U.S. dollar. These foreign exchange contracts are carried at fair value and are not designated as hedging instruments. Changes in the value of the derivative are recognized in other expense, net, in the consolidated statements of income for the current period, along with an offsetting remeasurement gain or loss on the underlying foreign currency denominated assets or liabilities.

As of September 30, 2012, the Company had foreign exchange forward contracts in place to hedge exposures in the euro, Japanese yen, and Australian dollar. As of September 30, 2012 and January 1, 2012, the total notional amount of outstanding forward contracts in place for foreign currency purchases were approximately $34.2 million and $25.5 million, respectively. Gains and losses related to the non-designated foreign exchange forward contracts for the three and nine months ended September 30, 2012 and October 2, 2011 were immaterial.

Leases

Leases are reviewed and classified as capital or operating at their inception. For leases that contain rent escalations, the Company records rent expense on a straight-line basis over the lease term, which includes the construction build-out period and lease extension periods, if appropriate. The difference between rent payments and straight-line rent expense is recorded as deferred rent in accrued and other long-term liabilities. Landlord allowances and rent abatements are recorded as a reduction to rent expense over the lease term. The Company capitalizes leasehold improvements and amortizes them over the shorter of the lease term or their expected useful lives.

Table of Contents

During the third quarter of 2012, the Company completed the relocation of its headquarters that started in 2011. In relation to this move, the Company recorded and continues to record headquarter relocation expenses consisting primarily of cease-use loss, accelerated depreciation expense, moving expenses, and additional rent expense during the transition period when both the new and former headquarters facilities are occupied. Cease-use loss and a corresponding facility exit obligation for vacating certain buildings of the Company's former facilities are calculated as the present value of the remaining lease obligation offset by estimated sublease rental receipts during the remaining lease period, adjusted for deferred items, estimated lease incentives, and the risk-adjusted discount rate. Accelerated depreciation expense is recorded for leasehold improvements based on the reassessed useful lives of less than a year.

Restructuring Charges

In late 2011, the Company announced and executed a restructuring plan to reduce the Company's workforce and consolidate certain facilities. The Company measured and accrued the liabilities associated with employee separation costs at fair value as of the date the plan was announced and terminations were communicated to employees, which primarily included severance pay and other separation costs such as outplacement services and benefits. If a terminated employee was retained for a period of time beyond the announcement date, any retention related costs are accrued over the retention period. The Company measures and accrues the facilities exit costs at fair value upon its exit. Facilities exit costs primarily consist of cease-use losses to be recorded upon vacating the facilities, asset impairment, and accelerated depreciation expenses.

The fair value measurement of restructuring related liabilities requires certain assumptions and estimates to be made by the Company, such as the retention period of certain employees, the timing and amount of sublease income on properties to be vacated, and the operating costs to be paid until lease termination. It is the Company's policy to use the best estimates based on facts and circumstances available at the time of measurement, review the assumptions and estimates periodically, and adjust the liabilities when necessary.

Net Income per Share

Basic net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period. Diluted net income per share is computed by dividing net income by the weighted average number of common shares outstanding during the reporting period increased to include dilutive potential common shares calculated using the treasury stock method. Diluted net income per share reflects the potential dilution from outstanding stock options, restricted stock units and awards, performance stock units, employee stock purchase plan (ESPP) obligations, warrants, shares subject to forfeiture, and convertible senior notes. Under the treasury stock method, convertible senior notes will have a dilutive impact when the average market price of the Company’s common stock is above the applicable conversion price of the respective notes. In addition, the following amounts are assumed to be used to repurchase shares: the amount that must be paid to exercise stock options and warrants and purchase shares under the ESPP; the amount of compensation expense for future services that the Company has not yet recognized for stock options, restricted stock units and awards, performance stock units, ESPP shares, and shares subject to forfeiture; and the amount of tax benefits that will be recorded in additional paid-in capital when the expenses related to respective awards become deductible.

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Weighted average shares outstanding	122,930	122,079	122,929	124,017

Effect of dilutive potential common shares from:				
Convertible senior notes	906	1,292	941	4,885
Equity awards	3,719	4,549	3,812	5,315
Warrants sold in connection with convertible senior notes	4,952	8,046	5,444	9,403
Weighted average shares used in calculation of diluted net income per share	132,507	135,966	133,126	143,620
Potentially dilutive shares excluded from calculation due to anti-dilutive effect	2,727	1,543	2,871	1,189

Table of Contents

2. Balance Sheet Account Details

Short-Term Investments

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

	September 30, 2012				January 1, 2012			
	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	$296,579	$269	$(13)	$296,835	$393,759	$428	$(148)	$394,039
Corporate debt securities	459,773	1,378	(43)	461,108	432,550	1,293	(461)	433,382
U.S. Treasury securities	131,771	263	—	132,034	58,955	214	—	59,169
Total available-for-sale securities	$888,123	$1,910	$(56)	$889,977	$885,264	$1,935	$(609)	$886,590

As of September 30, 2012, the Company had 28 available-for-sale securities in a gross unrealized loss position, all of which had been in such position for less than twelve months except for one security. Such security in a gross unrealized loss position for greater than twelve months had a fair value of $2.5 million and an immaterial gross unrealized loss as of September 30, 2012. There were no impairments considered other-than-temporary as it is more likely than not the Company will hold the securities until maturity or until the cost basis is recovered.

The following table shows the fair values and the gross unrealized losses of the Company's available-for-sale securities that were in an unrealized loss position for less than twelve months as of September 30, 2012 and January 1, 2012 aggregated by investment category (in thousands):

	September 30, 2012		January 1, 2012	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Debt securities in government sponsored entities	$34,983	$(14)	$133,904	$(148)
Corporate debt securities	49,337	(41)	138,326	(461)
Total	$84,320	$(55)	$272,230	$(609)

Realized gains and losses are determined based on the specific identification method and are reported in interest income in the consolidated statements of income. Gross realized gains on sales of available-for-sale securities for the three and nine months ended September 30, 2012 were $1.2 million and $1.6 million, respectively. Gross realized losses on sales of available-for-sale securities for the three and nine months ended September 30, 2012 and gross realized gains and losses on sales of available-for-sale securities for the three and nine months ended October 2, 2011 were immaterial.

Contractual maturities of available-for-sale debt securities as of September 30, 2012 were as follows (in thousands):

	Estimated Fair Value
Due within one year	$320,885
After one but within five years	569,092
Total	$889,977

Cost-Method Investments

As of September 30, 2012 and January 1, 2012, the aggregate carrying amounts of the Company's cost-method investments in non-publicly traded companies were $60.3 million and $45.3 million, respectively, which were included in other assets in the consolidated balance sheets. The Company assesses all cost-method investments for impairment quarterly. No

Table of Contents

impairment loss was recorded during the three and nine months ended September 30, 2012 or October 2, 2011. The Company 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.

Headquarters Facility Exit Obligation

During the three and nine months ended September 30, 2012, the Company recorded additional facility exit obligation of $22.8 million as it completed the relocation of its headquarters that started in 2011. Changes in the Company's facility exit obligation related to its former headquarters lease during the nine months ended September 30, 2012 are as follows (in thousands):

Balance as of January 1, 2012	$25,049	
Additional facility exit obligation accrued	22,817	
Accretion of interest expense	1,306	
Cash payments	(4,308	)
Balance as of September 30, 2012	$44,864	

Inventory

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

	September 30, 2012	January 1, 2012
Raw materials	$56,199	$58,340
Work in process	72,372	53,412
Finished goods	19,113	17,029
Total inventory, net	$147,684	$128,781

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2012	January 1, 2012
Deferred revenue, current portion	$58,828	$52,573
Accrued compensation expenses	55,947	52,035
Accrued taxes payable	22,252	19,339
Customer deposits	17,739	17,958
Reserve for product warranties	11,640	11,966
Facility exit obligation, current portion	7,497	4,408
Acquisition related contingent consideration liability, current portion	4,847	2,335
Accrued royalties	2,610	5,682
Other accrued expenses	10,461	10,819
Total accrued liabilities	$191,821	$177,115

3. Restructuring Activities

In late 2011, the Company implemented a cost reduction initiative that included workforce reductions and the consolidation of certain facilities. In total, the Company notified approximately 200 employees of their involuntary termination.

Table of Contents

A summary of the pre-tax charge and estimated total costs associated with the initiative is as follows (in thousands):

	Employee Separation Costs	Facilities Exit Costs	Other Costs	Total
Amount recorded in accrued liabilities as of January 1, 2012	$3,496	$—	$30	$3,526
Activities recorded during the nine months ended September 30, 2012:				
Additional expenses	2,692	221	521	3,434
Cash paid	(5,859)	(196)	(547)	(6,602)
Amount recorded in accrued liabilities as of September 30, 2012	$329	$25	$4	$358
Cumulative expense recorded since inception	$10,375	$221	$974	$11,570
Estimated total restructuring costs to be incurred	$10,478	$221	$974	$11,673

4. Acquisitions

BlueGnome

On September 19, 2012, the Company announced the acquisition of BlueGnome Ltd ("BlueGnome"), a provider of cytogenetics and in vitro fertilization screening products. Total consideration for the acquisition was $95.5 million, which included $88.0 million in initial cash payments and $7.5 million in fair value of contingent cash consideration of up to $20.0 million based on the achievement by December 28, 2014 of certain revenue based milestones.

The Company estimated the fair value of contingent cash consideration using a probability weighted discounted cash flow approach, a Level 3 measurement 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 Company used a discount rate of 30% in the assessment of the acquisition date fair value for the contingent cash consideration. Future changes in significant inputs such as the discount rate and estimated probabilities of milestone achievements could have a significant effect on the fair value of the contingent consideration.

In conjunction with the purchase transaction, the Company also agreed to pay up to $20.0 million to BlueGnome shareholders contingent upon the retention of certain key employees and certain other criteria. Such contingent payments will be recognized as contingent compensation expense over the retention period through December 28, 2014.

Using information available at the close of the acquisition, the Company allocated approximately $9.8 million of the total consideration to tangible assets, net of liabilities, and $49.2 million to identified intangible assets, including additional developed technologies of $25.0 million, customer relationships of $17.1 million, and a trade name of $7.1 million with average useful lives of seven, seven, and ten years, respectively. The Company also recorded an $11.8 million deferred tax liability to reflect the tax impact of the identified intangible assets that will not generate tax deductible amortization expense. The Company recorded the excess consideration of approximately $48.3 million as goodwill. The purchase price allocation for the acquisition set forth above is preliminary and subject to change as more detailed analysis is completed and additional information with respect to the fair value of the assets and liabilities acquired becomes available.

Prior Acquisitions

On January 10, 2011, the Company acquired Epicentre Technologies Corporation ("Epicentre"), a provider of nucleic acid sample preparation reagents and specialty enzymes used in sequencing and microarray applications. Total consideration for the acquisition was $71.4 million, which included $59.4 million in net cash payments made at closing, $4.6 million in the fair value of contingent consideration settled in stock that is subject to forfeiture if certain non-revenue based milestones are not met, and $7.4 million in the fair value of contingent cash consideration of up to $15.0 million based on the achievement of certain revenue based milestones by January 10, 2013.

Table of Contents

The Company estimated the fair value of contingent stock consideration based on the closing price of its common stock as of the acquisition date. Approximately 229,000 shares of common stock were issued to Epicentre shareholders in connection with the acquisition, which shares are subject to forfeiture if certain non-revenue-based milestones are not met. One third of these shares issued with an assessed fair value of $4.6 million were determined to be part of the purchase price. The remaining shares with an assessed fair value of $10.1 million were determined to be compensation for post-acquisition service, the cost of which will be recognized as contingent compensation expense over a period of two years in research and development expense or selling, general and administrative expense.

The Company estimated the fair value of contingent cash consideration using a probability weighted discounted cash flow approach, a Level 3 measurement 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 Company used a discount rate of 21% in the assessment of the acquisition date fair value for the contingent cash consideration. Future changes in significant inputs such as the discount rate and estimated probabilities of milestone achievements could have a significant effect on the fair value of the contingent consideration.

The Company allocated $0.9 million of the total consideration to tangible assets, net of liabilities, and $26.9 million to identified intangible assets, including additional developed technologies of $23.3 million, a trade name of $2.5 million, and customer relationships of $1.1 million, with weighted average useful lives of approximately nine, ten, and three years, respectively. The Company recorded the excess consideration of $43.6 million as goodwill.

As of September 30, 2012, the Company's remaining gross milestone obligations related to prior acquisitions other than Epicentre and BlueGnome consisted of potential employment-related milestone payments of $1.4 million. Employment-related contingent compensation expense is recorded in operating expense.
Adjustments related to contingent compensation recorded as a result of all acquisitions consist of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Contingent compensation, included in research and development expense	$754	$775	$2,218	$4,067
Contingent compensation, included in selling, general and administrative expense	742	(279)	2,586	1,259
Total contingent compensation expense	$1,496	$496	$4,804	$5,326
IPR&D, included in acquisition related (gain) expense, net	$—	$—	$—	$5,425

Table of Contents

5. 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 30, 2012 and January 1, 2012 (in thousands):

	September 30, 2012				January 1, 2012			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds (cash equivalent)	$131,783	$—	$—	$131,783	$166,898	$—	$—	$166,898
Debt securities in government sponsored entities	—	296,835	—	296,835	—	394,039	—	394,039
Corporate debt securities	—	461,108	—	461,108	—	433,382	—	433,382
U.S. Treasury securities	132,034	—	—	132,034	59,169	—	—	59,169
Deferred compensation plan assets	—	13,568	—	13,568	—	10,800	—	10,800
Total assets measured at fair value	$263,817	$771,511	$—	$1,035,328				