ILLUMINA INC
Form 10-Q
April 25, 2018
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
þQuarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended April 1, 2018

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

(858) 202-4500
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

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 filerþ	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13a of the Exchange Act. o

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 April 20, 2018, there were 147 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 millions)

	April 1, 2018 (Unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,560	$ 1,225
Short-term investments	813	920
Accounts receivable, net	400	411
Inventory	350	333
Prepaid expenses and other current assets	71	91
Total current assets	3,194	2,980
Property and equipment, net	983	931
Goodwill	775	771
Intangible assets, net	168	175
Deferred tax assets	100	88
Other assets	322	312
Total assets	$ 5,542	$ 5,257
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 151	$ 160
Accrued liabilities	388	432
Build-to-suit lease liability	21	144
Long-term debt, current portion	620	10
Total current liabilities	1,180	746
Long-term debt	710	1,182
Other long-term liabilities	364	360
Redeemable noncontrolling interests	215	220
Stockholders' equity:		
Common stock	2	2
Additional paid-in capital	2,897	2,833
Accumulated other comprehensive loss	(1)	(1)
Retained earnings	2,464	2,256
Treasury stock, at cost	(2,354)	(2,341)
Total Illumina stockholders' equity	3,008	2,749
Noncontrolling interests	65	—
Total stockholders' equity	3,073	2,749
Total liabilities and stockholders' equity	$ 5,542	$ 5,257

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Revenue:		
Product revenue	$628	$491
Service and other revenue	154	107
Total revenue	782	598
Cost of revenue:		
Cost of product revenue	174	166
Cost of service and other revenue	62	53
Amortization of acquired intangible assets	8	11
Total cost of revenue	244	230
Gross profit	538	368
Operating expense:		
Research and development	137	145
Selling, general and administrative	183	171
Total operating expense	320	316
Income from operations	218	52
Other income (expense):		
Interest income	5	4
Interest expense	(11)	(8)
Other income, net	9	455
Total other income, net	3	451
Income before income taxes	221	503
Provision for income taxes	24	155
Consolidated net income	197	348
Add: Net loss attributable to noncontrolling interests	11	19
Net income attributable to Illumina stockholders	$208	$367
Net income attributable to Illumina stockholders for earnings per share	$208	$366
Earnings per share attributable to Illumina stockholders:		
Basic	$1.42	$2.50
Diluted	$1.41	$2.48
Shares used in computing earnings per share:		
Basic	147	146
Diluted	148	147

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Total consolidated net income and comprehensive income	$197	$ 348
Add: Comprehensive loss attributable to noncontrolling interests	11	19
Comprehensive income attributable to Illumina stockholders	$208	$ 367

See accompanying notes to the condensed consolidated financial statements.

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ILLUMINA, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(Unaudited)
(In millions)

	Illumina Stockholders						
	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Noncontrolling Interests	Total Stockholders' Equity
Balance as of December 31, 2017	$ 2	$ 2,833	$ (1)	$ 2,256	$ (2,341)	$ —	$ 2,749
Net income (loss)	—	—	—	208	—	(1)	207
Issuance of common stock, net of repurchases	—	21	—	—	(13)	—	8
Share-based compensation	—	48	—	—	—	—	48
Adjustment to the carrying value of redeemable noncontrolling interests	—	(5)	—	—	—	—	(5)
Contributions from noncontrolling interest owners	—	—	—	—	—	61	61
Issuance of subsidiary shares	—	—	—	—	—	5	5
Balance as of April 1, 2018	$ 2	$ 2,897	$ (1)	$ 2,464	$ (2,354)	$ 65	$ 3,073

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Cash flows from operating activities:		
Consolidated net income	$197	$ 348
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on deconsolidation of GRAIL	—	(453)
Depreciation expense	30	26
Amortization of intangible assets	9	12
Share-based compensation expense	48	50
Accretion of debt discount	8	7
Deferred income taxes	(11)	86
Impairment of intangible assets	—	23
Other	(6)	(2)
Changes in operating assets and liabilities:		
Accounts receivable	11	16
Inventory	(17)	1
Prepaid expenses and other current assets	(2)	2
Other assets	(1)	(1)
Accounts payable	2	(3)
Accrued liabilities	(18)	52
Other long-term liabilities	5	4
Net cash provided by operating activities	255	168
Cash flows from investing activities:		
Purchases of available-for-sale securities	(598)	(61)
Sales of available-for-sale securities	288	40
Maturities of available-for-sale securities	415	48
Proceeds from sale of GRAIL securities	—	278
Deconsolidation of GRAIL cash	—	(52)
Net purchases of strategic investments	(3)	(7)
Purchases of property and equipment	(90)	(83)
Net cash provided by investing activities	12	163
Cash flows from financing activities:		
Payments on financing obligations	(2)	(1)
Common stock repurchases	—	(101)
Taxes paid related to net share settlement of equity awards	(13)	(22)
Proceeds from issuance of common stock	21	22
Contributions from noncontrolling interest owners	61	16
Net cash provided by (used in) financing activities	67	(86)
Effect of exchange rate changes on cash and cash equivalents	1	1
Net increase in cash and cash equivalents	335	246
Cash and cash equivalents at beginning of period	1,225	735
Cash and cash equivalents at end of period	$1,560	$ 981

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 audited consolidated financial statements and footnotes included in the Annual Report on Form 10-K for the fiscal year ended December 31, 2017, from which the prior year 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 our accounts, our wholly-owned subsidiaries, majority-owned or controlled companies, and variable interest entities (VIEs) for which we are 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.

We evaluate our ownership, contractual, and other interests in entities that are not wholly-owned to determine if these entities are VIEs, and, if so, whether we are the primary beneficiary of the VIE. In determining whether we are the primary beneficiary of a VIE and therefore required to consolidate the VIE, a qualitative approach is applied that determines whether we have 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. We continuously assess whether we are the primary beneficiary of a VIE as changes to existing relationships or future transactions may result in the consolidation or deconsolidation of such VIE. During the three months ended April 1, 2018, our consolidated VIE, Helix, received additional cash contributions from us and third-party investors in exchange for voting equity interests in Helix. Therefore, we reassessed and concluded that Helix continues to be a variable interest entity and that we remain the primary beneficiary. We have not provided financial or other support during the periods presented to our VIEs that we were not previously contractually required to provide.

The equity method is used to account for investments in which we have the ability to exercise significant influence, but not control, over the investee. Such investments are recorded within other assets, and the share of net income or losses of equity investments is recognized on a one quarter lag in other income, net.

Redeemable Noncontrolling Interests

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

Fiscal Year

Our fiscal year is the 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 months ended April 1, 2018 and April 2, 2017 were both 13 weeks.

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Reclassifications

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

Significant Accounting Policies

During the three months ended April 1, 2018, there have been no changes to our significant accounting policies as described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017, except as described below.

Recently Adopted Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard is based on the principle that revenue should be recognized in an amount that reflects the consideration to which we expect to be entitled in exchange for the transfer of promised goods or services. We adopted Topic 606 using the modified retrospective transition method. The cumulative effect of applying the new revenue standard to all incomplete contracts as of January 1, 2018 was not material and, therefore, did not result in an adjustment to retained earnings. There was no material difference to the consolidated financial statements for the period ended April 1, 2018 due to the adoption of Topic 606. Furthermore, we expect the impact to be immaterial to our consolidated financial statements going forward.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10), which requires equity investments (other than those accounted for under the equity method or those that result in consolidation) to be measured at fair value, with changes in fair value recognized in net income. This standard was effective for us beginning in the first quarter of 2018. Based on our elections, our strategic equity investments that do not have readily determinable fair values and do not qualify for the net asset value practical expedient for estimating fair value are measured at cost, less any impairments, plus or minus changes resulting from observable price changes in orderly transactions for identifiable or similar investments of the same issuer. The measurement alternative was applied prospectively and did not result in an adjustment to retained earnings.

Recently Issued Accounting Pronouncements

In February 2016, the FASB issued Accounting Standard Update (ASU) 2016-02, Leases (Topic 842). The new standard requires lessees to recognize most leases on their balance sheet as lease liabilities with corresponding right-of-use assets. ASU 2016-02 is effective for us beginning in the first quarter of 2019. Currently, the standard will be adopted on a modified retrospective transition basis for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The FASB has proposed an alternative method to adopt the lease standard by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. While we are continuing to assess the effects of adoption, we believe the new standard will have a material effect on our consolidated financial statements and disclosures. We expect substantially all of our real-estate operating lease commitments will be recognized as lease liabilities with corresponding right-of-use assets upon adoption, resulting in a significant increase in the assets and liabilities on the consolidated balance sheet. We are currently evaluating the impact of Topic 842 on the consolidated financial statements as it relates to other aspects of our business.

In June 2016, the FASB issued Accounting Standards Update (ASU) 2016-13, Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments, which amends the impairment model by requiring entities to use a forward-looking approach based on expected losses to estimate credit losses on certain types of financial instruments, including trade receivables and available for sale debt securities. The standard is effective for us beginning in the first quarter of 2020, with early adoption permitted. We are currently evaluating the impact of ASU 2016-13 on the consolidated financial statements.

Revenue

Our revenue is generated primarily from the sale of products and services. Product revenue primarily consists of sales of instruments and consumables used in genetic analysis. Service and other revenue primarily consists of revenue generated from genotyping and sequencing services and instrument service contracts.

We recognize revenue when control of our products and services is transferred to our customers in an amount that reflects the consideration we expect to receive from our customers in exchange for those products and services. This process involves identifying the contract with a customer, determining the performance obligations in the contract, determining the contract

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price, allocating the contract price to the distinct performance obligations in the contract, and recognizing revenue when the performance obligations have been satisfied. A performance obligation is considered distinct from other obligations in a contract when it provides a benefit to the customer either on its own or together with other resources that are readily available to the customer and is separately identified in the contract. We consider a performance obligation satisfied once we have transferred control of a good or service to the customer, meaning the customer has the ability to use and obtain the benefit of the good or service. We recognize revenue for satisfied performance obligations only when we determine there are no uncertainties regarding payment terms or transfer of control.

Revenue from product sales is recognized generally upon delivery to the end customer, which is when control of the product is deemed to be transferred. Invoicing typically occurs upon shipment and the term between invoicing and when payment is due is not significant. In instances where right of payment or transfer of title is contingent upon the customer's acceptance of the product, revenue is deferred until all acceptance criteria have been met. Revenue from instrument service contracts is recognized as the services are rendered, typically evenly over the contract term. 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.

Revenue is recorded net of discounts, distributor commissions, and sales taxes collected on behalf of governmental authorities. Employee sales commissions are recorded as selling, general and administrative expenses when incurred as the amortization period would have been one year or less.

We regularly enter into contracts with multiple performance obligations. Such obligations are generally satisfied 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 separate, distinct performance obligations within the contract. We do not disclose the value of unsatisfied performance obligations for (i) contracts with an original expected length of one year or less, and (ii) contracts for which we recognize revenue at the amount to which we have the right to invoice for services performed.

The contract price is allocated to each performance obligation in proportion to its stand-alone selling price. We determine our best estimate of stand-alone 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, we rely upon prices set by our pricing committee, adjusted for applicable discounts.

Contract liabilities, which consists of deferred revenue and customer deposits, as of April 1, 2018 and December 31, 2017 were $184 million and $181 million, respectively, of which the short-term portions of $153 million and $150 million, respectively, were recorded in accrued liabilities and the remaining long-term portions were recorded in other long-term liabilities. Revenue recorded in the three months ended April 1, 2018 includes $68 million of previously deferred revenue that were included in contract liabilities as of December 31, 2017. Contract assets as of April 1, 2018 and December 31, 2017 were not material.

In certain markets, products and services are sold to customers through distributors. In most sales through distributors, the product is delivered directly to customers. The terms of sales transactions through distributors are consistent with the terms of direct sales to customers.

The following table represents revenue by source (in millions):

	Three Months Ended					
	April 1, 2018			April 2, 2017		
	Sequencing	Microarray	Total	Sequencing	Microarray	Total
Consumables	$417	$ 87	$504	$318	$ 69	$387
Instruments	112	6	118	95	5	100

Other product	5	1	6	4	—	4
Total product revenue	534	94	628	417	74	491
Service and other	96	58	154	78	29	107
Total revenue	$630	$ 152	$782	$495	$ 103	$598

Revenue related to our Consolidated VIEs is included in sequencing services and other revenue.

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The following table represents revenue by geographic area, based on region of destination (in millions):

	Three Months Ended	
	April 1, 2018	April 2, 2017
United States	$416	$ 325
Europe	184	126
Greater China (1)	78	56
Asia-Pacific (1)	70	67
Other markets	34	24
Total revenue	$782	$ 598

(1) Revenue for the Greater China region, which consists of China, Taiwan, and Hong Kong, is reported separately from the Asia-Pacific region.

Earnings per Share

Basic earnings per share attributable to Illumina stockholders is computed based on the weighted average number of common shares outstanding during the period. Diluted earnings per share attributable to Illumina stockholders is computed based on the sum of the weighted average number of common shares and potentially dilutive common shares outstanding during the period. Per-share earnings of our VIEs are included in the consolidated basic and diluted earnings per share computations based on our share of the VIE's securities.

Potentially dilutive common shares consist of shares issuable under convertible senior notes and equity awards. Convertible senior notes have a dilutive impact when the average market price of our common stock exceeds the applicable conversion price of the respective notes. Potentially dilutive common shares from equity awards are determined using the average share price for each period under the treasury stock method. In addition, proceeds from exercise of equity awards and the average amount of unrecognized compensation expense for equity awards are assumed to be used to repurchase shares.

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

	Three Months Ended	
	April 1, 2018	April 2, 2017
Weighted average shares outstanding	147	146
Effect of potentially dilutive common shares from:		
Equity awards	1	1
Weighted average shares used in calculating diluted earnings per share	148	147
Potentially dilutive shares excluded from calculation due to anti-dilutive effect	—	1

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2. Balance Sheet Account Details

Short-Term Investments

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

	April 1, 2018			December 31, 2017		
	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale debt securities:						
Debt securities in government sponsored entities	$38	$ —	$ 38	$67	$ —	$ 67
Corporate debt securities	375	(2)	373	423	(2)	421
U.S. Treasury securities	403	(1)	402	433	(1)	432
Total available-for-sale debt securities	$816	$ (3)	$ 813	$923	$ (3)	$ 920

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 April 1, 2018 were as follows (in millions):

	Estimated Fair Value
Due within one year	$ 353
After one but within five years	460
Total	$ 813

We have the ability, if necessary, to liquidate any of our cash equivalents and short-term investments to meet our liquidity needs in the next 12 months. Accordingly, those investments with contractual maturities greater than one year from the date of purchase are classified as short-term on the accompanying condensed consolidated balance sheets.

Strategic Investments

The carrying amounts of our strategic equity investments without readily determinable fair values are initially measured at cost and are remeasured for impairment and observable price changes in orderly transactions for identifiable or similar investments of the same issuer.

As of April 1, 2018 and December 31, 2017, the aggregate carrying amounts of our strategic equity investments without readily determinable fair values were $256 million and $250 million, respectively, included in other assets. Revenue recognized from transactions with such companies for the three months ended April 1, 2018 and April 2, 2017 was $36 million and $23 million, respectively.

We invest in a venture capital investment fund (the Fund) with a capital commitment of $100 million that is callable over ten years, of which $80 million remains as of April 1, 2018. Our investment in the Fund is accounted for as an equity-method investment. The carrying amounts of the Fund included in other assets were $19 million and $16 million as of April 1, 2018 and December 31, 2017, respectively.

Inventory

Inventory consists of the following (in millions):

	April 1, 2018	December 31, 2017
Raw materials	$ 95	$ 93
Work in process	209	188
Finished goods	46	52
Total inventory	$ 350	$ 333

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Property and Equipment

Property and equipment, net consists of the following (in millions):

	April 1, 2018	December 31, 2017
Leasehold improvements	$ 477	$ 331
Machinery and equipment	331	316
Computer hardware and software	207	185
Furniture and fixtures	40	34
Buildings	269	