ILLUMINA INC
Form 10-Q
August 01, 2007

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

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

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the transition period from __________ to __________**

**Commission File Number 000-30361**

**Illumina, Inc.**

(Exact name of registrant as specified in its charter)

| Delaware | 33-0804655 |
|---|---|
| (State or other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| 9885 Towne Centre Drive, San Diego, CA | 92121 |
| (Address of Principal Executive Offices) | (Zip Code) |

(858) 202-4500

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

As of July 18, 2007, there were 53,952,776 shares of the Registrant s Common Stock outstanding.

**ILLUMINA, INC.**
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## PART I. FINANCIAL INFORMATION

**Item 1. Financial Statements.**

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

| | July 1, 2007 (unaudited) | December 31, 2006 (1) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 81,117 | $ 38,386 |
| Short-term investments | 262,145 | 92,418 |
| Accounts receivable, net | 57,441 | 39,984 |
| Inventory, net | 42,898 | 20,169 |
| Prepaid expenses and other current assets | 8,585 | 2,769 |
| Total current assets | 452,186 | 193,726 |
| Property and equipment, net | 36,683 | 25,634 |
| Investment in Solexa | | 67,784 |
| Goodwill | 248,778 | 2,125 |
| Acquired intangible assets, net | 23,296 | |
| Other assets, net | 12,631 | 11,315 |
| Total assets | $ 773,574 | $ 300,584 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 76,565 | $ 33,713 |
| Current portion of long-term debt | 42 | 63 |
| Total current liabilities | 76,607 | 33,776 |
| Long-term debt, less current portion | 400,000 | |
| Other long-term liabilities | 10,132 | 19,466 |
| Commitments and contingencies | | |
| Stockholders equity | 286,835 | 247,342 |
| Total liabilities and stockholders equity | $ 773,574 | $ 300,584 |

(1) The Condensed Consolidated

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

*See accompanying notes to the condensed consolidated financial statements.*

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

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 1, 2007 | July 2, 2006 | July 1, 2007 | July 2, 2006 |
| Revenue: | | | | |
| Product revenue | $ 74,297 | $ 36,403 | $ 135,562 | $ 59,664 |
| Service and other revenue | 10,086 | 4,795 | 20,847 | 10,062 |
| Research revenue | 152 | 379 | 276 | 953 |
| Total revenue | 84,535 | 41,577 | 156,685 | 70,679 |
| Costs and expenses: | | | | |
| Cost of product revenue (including non-cash stock compensation expense of $956, $300, $1,839 and $498, respectively, and excluding amortization of acquired intangible assets) | 27,036 | 11,912 | 48,850 | 19,588 |
| Cost of service and other revenue (including non-cash stock compensation expense of $77, $50, $140 and $102, respectively) | 3,105 | 1,664 | 6,412 | 3,281 |
| Research and development (including non-cash stock compensation expense of $2,497, $878, $4,428 and $1,836, respectively) | 18,184 | 8,587 | 34,140 | 16,803 |
| Selling, general and administrative (including non-cash stock compensation expense of $4,255, $2,099, $9,056 and $4,022, respectively) | 23,297 | 12,891 | 46,930 | 25,025 |
| Amortization of acquired intangible assets | 662 | | 1,104 | |
| Acquired in-process research and development | | | 303,400 | |
| Total costs and expenses | 72,284 | 35,054 | 440,836 | 64,697 |
| Income (loss) from operations | 12,251 | 6,523 | (284,151) | 5,982 |
| Interest and other income, net | 2,343 | 856 | 5,066 | 1,424 |
| Income (loss) before income taxes | 14,594 | 7,379 | (279,085) | 7,406 |
| Provision for income taxes | 5,330 | 611 | 9,727 | 742 |
| Net income (loss) | $ 9,264 | $ 6,768 | $ (288,812) | $ 6,664 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net income (loss) per basic share | $ | 0.17 | $ | 0.16 | $ | (5.39) | $ | 0.16 |
| Net income (loss) per diluted share | $ | 0.16 | $ | 0.14 | $ | (5.39) | $ | 0.14 |
| Shares used in calculating basic net income (loss) per share | | 53,778 | | 43,528 | | 53,604 | | 42,502 |
| Shares used in calculating diluted net income (loss) per share | | 58,061 | | 47,330 | | 53,604 | | 46,252 |

*See accompanying notes to the condensed consolidated financial statements.*

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

| | Six Months Ended | |
|---|---|---|
| | **July 1, 2007** | **July 2, 2006** |
| Operating activities: | | |
| Net income (loss) | $ (288,812) | $ 6,664 |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Acquired in-process research and development | 303,400 | |
| Amortization of increase in inventory valuation | 942 | |
| Amortization of intangible assets | 1,126 | 14 |
| Amortization of debt issuance costs | 501 | |
| Depreciation expense | 5,438 | 2,545 |
| Gain on disposal of property and equipment | (22) | 20 |
| Stock-based compensation expense | 15,463 | 6,458 |
| Amortization of gain on sale of land and building | (102) | (187) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (12,536) | (5,031) |
| Inventory | (14,869) | (7,991) |
| Prepaid expenses and other current assets | (760) | (1,229) |
| Other assets | 1,524 | 145 |
| Accounts payable and accrued liabilities | 20,282 | 11,512 |
| Accrued income taxes | 7,712 | 1,133 |
| Other long-term liabilities | (161) | 3,210 |
| Net cash provided by operating activities | 39,126 | 17,263 |
| Investing activities: | | |
| Cash obtained in acquisition, net of cash paid for transaction costs | 72,532 | |
| Investment in secured convertible debentures | | (3,036) |
| Purchases of available-for-sale securities | (296,879) | (4,529) |
| Proceeds from sale of fixed assets | 40 | |
| Sales and maturities of available-for-sale securities | 130,308 | |
| Cash paid for intangible assets | | (15) |
| Purchases of property and equipment | (9,925) | (9,149) |
| Net cash used in investing activities | (103,924) | (16,729) |
| Financing activities: | | |
| Payments on long-term debt | (69) | |
| Proceeds from issuance of convertible debt, net of issuance costs | 390,296 | (58) |

| | | |
|---|---|---|
| Purchase of convertible note hedges | (139,040) | |
| Sale of warrants | 92,440 | |
| Common stock repurchases | (251,622) | |
| Proceeds from issuance of common stock | 15,410 | 101,088 |
| Net cash provided by financing activities | 107,415 | 101,030 |
| Effect of foreign currency translation on cash and cash equivalents | 114 | (136) |
| Net increase in cash and cash equivalents | 42,731 | 101,428 |
| Cash and cash equivalents at beginning of period | 38,386 | 50,822 |
| Cash and cash equivalents at end of period | $ 81,117 | $ 152,250 |

*See accompanying notes to the condensed consolidated financial statements.*

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

**1. Summary of Significant Accounting Principles**

***Basis of Presentation***

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

Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited financial statements should be read in conjunction with the Company s 2006 audited financial statements and footnotes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2006, as filed with the Securities and Exchange Commission (SEC) on February 28, 2007.

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

***Fiscal Year***

The Company s fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, and September 30. The three and six months ended July 1, 2007 and July 2, 2006 were both 13 and 26 weeks, respectively.

***Revenue Recognition***

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

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

Revenue for product sales is recognized generally upon shipment and transfer of title to the customer, provided no significant obligations remain and collection of the receivables is reasonably assured. Revenue from the sale of instrumentation is recognized when earned, which is generally upon shipment. However, in the case of BeadLabs, revenue is recognized upon the completion of installation, training and the receipt of customer acceptance. Revenue for genotyping and sequencing services is recognized when earned, which is generally at the time the genotyping and sequencing analysis data is delivered to the customer or as specific milestones are achieved.

In order to assess whether the price is fixed and determinable, the Company ensures there are no refund rights. If payment terms are based on future performance, the Company defers revenue recognition until the price becomes fixed and determinable. The Company assesses collectibility based on a number of factors, including past transaction history with the customer and the creditworthiness of the customer. If the Company determines that collection of a payment is not reasonably assured, revenue recognition is deferred until the time collection becomes reasonably assured, which is generally upon receipt of payment.

Sales of instrumentation generally include a standard one-year warranty. The Company also sells separately priced maintenance (extended warranty) contracts, which are generally for one or two years, upon the expiration of the initial warranty. Revenue for extended warranty sales is recognized ratably over the term of the extended warranty period. Reserves are provided for estimated product warranty expenses at the time the associated revenue is recognized. If the Company were to experience an increase in warranty claims or if costs of servicing its warrantied products were greater than its estimates, gross margins could be adversely affected.

While the majority of its sales agreements contain standard terms and conditions, the Company does enter into agreements that contain multiple elements or non-standard terms and conditions. Emerging Issues Task Force (EITF) No. 00-21, *Revenue Arrangements with Multiple Deliverables,* provides guidance on accounting for arrangements that involve the delivery or performance of multiple products, services, or rights to use assets within contractually binding arrangements. Significant contract interpretation is sometimes required to determine the appropriate accounting, including whether the deliverables specified in a multiple element arrangement should be treated as separate units of accounting for revenue recognition purposes, and if so, how the price should be allocated among the deliverable elements, when to recognize revenue for each element, and the period over which revenue should be recognized. The Company recognizes revenue for delivered elements only when it determines that the fair values of undelivered elements are known and there are no uncertainties regarding customer acceptance.

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

***Cash and Cash Equivalents***

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

***Investments***

The Company applies Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, to its investments. Under SFAS No. 115, the Company classifies its investments as available-for-sale and records such assets at estimated fair value in the balance sheet, with unrealized gains and losses, if any, reported in stockholders equity. As of July 1, 2007, the Company s excess cash balances were primarily invested in marketable debt securities, including commercial paper, auction rate certificates and corporate bonds and notes, with strong credit ratings or short maturity mutual funds providing similar financial returns. The Company limits the amount of investment exposure as to institutions, maturity and investment type.

***Stock-Based Compensation***

On January 2, 2006, the Company adopted SFAS No. 123 (revised 2004), *Share-Based Payment*, which addresses the accounting for stock-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise s equity instruments or that may be settled by the issuance of such equity instruments. The Company uses the Black-Scholes-Merton option-pricing model to determine the fair-value of stock-based awards under SFAS No. 123R. As of July 1, 2007, approximately $109.5 million of total unrecognized compensation cost related to stock options, restricted stock and ESPP shares issued to date is expected to be recognized over a weighted-average period of approximately two and a half years.

The Company has elected to use the Black-Scholes-Merton option-pricing model, which incorporates various assumptions including volatility, expected life, and interest rates. The expected volatility is based on the historical volatility of the Company s common stock over the most recent period generally commensurate with the estimated expected life of the Company s stock options, adjusted for the impact of unusual fluctuations not reasonably expected to recur and other relevant factors. The expected life of an award is based on historical experience and on the terms and conditions of the stock awards granted to employees.

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

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| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 1, 2007 | July 2, 2006 | July 1, 2007 | July 2, 2006 |
| Interest rate stock options | 4.61 - 4.68% | 4.92 - 5.02% | 4.61 - 4.75% | 4.36 - 5.02% |
| Interest rate stock purchases | 4.83 - 4.86% | 4.85 - 4.86% | 4.83 - 4.86% | 4.85 - 4.86% |
| Volatility stock options | 66 - 68% | 75% | 66 - 70% | 75 - 77% |
| Volatility stock purchases | 75 - 76% | 76% | 75 - 76% | 76% |
| Expected life stock options | 6 years | 6 years | 6 years | 6 years |
| Expected life stock purchases | 6 -12 months | 6-12 months | 6-12 months | 6-12 months |
| Expected dividend yield | 0% | 0% | 0% | 0% |
| Weighted average fair value per share of options granted | $ 21.29 | $ 18.33 | $ 25.02 | $ 16.03 |
| Weighted average fair value per share of employee stock purchases | $ 11.84 | $ 8.12 | $ 11.84 | $ 8.12 |

***Net Income (Loss) per Share***

Basic and diluted net income (loss) per share is presented in conformity with SFAS No. 128, *Earnings per Share*, for all periods presented. In accordance with SFAS No. 128, basic net income (loss) per share is computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase. Diluted net income (loss) per share is typically computed using the weighted average number of common and dilutive common equivalent shares from stock options using the treasury stock method. The following table presents the calculation of weighted-average shares used to calculate basic and diluted net income (loss) per share (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | July 1, 2007 | July 2, 2006 | July 1, 2007 | July 2, 2006 |
| Weighted-average shares outstanding | 53,802 | 43,567 | 53,628 | 42,541 |
| Less: Weighted-average shares of common stock subject to repurchase | (24) | (39) | (24) | (39) |
| Weighted-average shares used in calculating basic net income (loss) per share | 53,778 | 43,528 | 53,604 | 42,502 |
| Plus: Effect of dilutive potential common shares | 4,283 | 3,802 | | 3,750 |
| Weighted-average shares used in calculating diluted net income (loss) per share | 58,061 | 47,330 | 53,604 | 46,252 |

The total number of shares excluded from the calculation of diluted net loss per share, prior to application of the treasury stock method, was 9,234,451 for the six months ended July 1, 2007. The total number of warrants excluded from the calculation of diluted net loss per share was 1,894,560 for the three and six months ended July 1, 2007. These warrants were assumed as part of the Company s merger with Solexa, Inc. on January 26, 2007.

***Comprehensive Income (Loss)***

Comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). Other comprehensive income (loss) includes unrealized gains and losses on the Company s available-for-sale securities, changes in the fair value of derivatives designated as effective cash flow hedges, and foreign currency translation adjustments.

The components of other comprehensive income (loss) are as follows (in thousands):

| | Three Months Ended | Six Months Ended |
|---|---|---|

| | July 1, 2007 | July 2, 2006 | July 1, 2007 | July 2, 2006 |
|---|---|---|---|---|
| Net income (loss) | $ 9,264 | $ 6,768 | $ (288,812) | $ 6,664 |
| Foreign currency translation adjustments | 66 | 123 | 201 | 160 |
| Unrealized gain (loss) on investments | 97 | 123 | (10,728) | 81 |
| Unrealized loss on cash flow hedges | | | | (10) |
| Total other comprehensive income (loss) | $ 9,427 | $ 7,014 | $ (299,339) | $ 6,895 |

***Recent Accounting Pronouncements***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement applies only to fair value measurements that are already required or permitted by other accounting standards. Accordingly, this Statement does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years

beginning after December 15, 2007. The Company is currently evaluating the impact, if any, the adoption of SFAS No. 157 will have on its consolidated results of operations and financial position.

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

***Recently Adopted Accounting Pronouncements***

Effective January 1, 2007, the Company adopted FASB Interpretation (FIN) No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109*, which clarifies the accounting for uncertainty in tax positions. FIN No. 48 requires that the Company recognize the impact of a tax position in its financial statements only if that position is more likely than not to be sustained on audit, based on the technical merits of the position. The adoption of FIN No. 48 did not result in an adjustment to the Company s opening retained earnings since there was no cumulative effect from the change in accounting principle due to the Company maintaining a full valuation allowance against its U.S. deferred tax assets. At the date of adoption, the Company reduced its deferred tax assets and related valuation allowance by approximately $5.1 million for uncertain tax positions. As of July 1, 2007 we have reduced our deferred tax assets and related valuation allowance by approximately $6.9 million for uncertain tax positions. Interest and penalties related to uncertain tax positions will be reflected in income tax expense. All of the Company s tax years remain subject to future examination by the major tax jurisdictions in which it is subject to tax.

**2. Acquisition of Solexa, Inc.**

On January 26, 2007, the Company completed its acquisition of Solexa, Inc. (Solexa), a Delaware corporation, in a stock-for-stock merger transaction. The Company issued approximately 13.1 million shares of its common stock as consideration for this merger. The results of Solexa s operations have been included in the Company s consolidated financial statements since the acquisition date of January 26, 2007.

Upon the closing of the merger on January 26, 2007, there were approximately 3.7 million shares of the Company s restricted stock and shares issuable upon the exercise of outstanding options and warrants assumed as part of the acquisition. Total estimated merger consideration also includes approximately $75.3 million, which represents the fair market value of the vested options, warrants and restricted stock assumed. The Company also expects to recognize approximately $14.7 million of non-cash stock-based compensation expense related to unvested stock options and restricted stock at the acquisition date. This expense will be recognized beginning from the acquisition date over a weighted-average period of approximately two years. These awards were valued using the following assumptions as of January 25, 2007 (the measurement date, as discussed below):

| | |
|---|---|
| Interest rate | 4.56 5.05% |
| Volatility | 54.26% |
| Expected life | 0.35 3.98 years |
| Expected dividend yield | 0% |

The purchase price of the acquisition is as follows (in thousands):

| | |
|---|---|
| Fair market value of securities issued | $ 527,067 |
| Fair market value of change of control bonuses and related taxes | 8,182 |
| Transaction costs not included in Solexa net tangible assets acquired | 8,137 |
| Fair market value of vested stock options, warrants and restricted stock assumed | 75,334 |
| Total purchase price | $ 618,720 |

The fair value of the Company s shares used in determining the purchase price was based on the average of the closing price of the Company s common stock for a range of four trading days, including two days prior to and two days subsequent to January 25, 2007, the measurement date. The measurement date was determined per the guidance in EITF No. 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*. Based on these closing prices, the Company estimated the fair value of its common stock to be $40.1425 per share, which equates to a total fair value of common stock issued of $527.1 million.

***Purchase Price Allocation***

The Solexa purchase price was allocated to tangible and intangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date (January 26, 2007). The excess of the purchase price over the fair value of net assets acquired was allocated to goodwill.

The Company believes the fair values assigned to the assets acquired and liabilities assumed were based on reasonable assumptions. The following table summarizes the estimated fair values of net assets acquired (in thousands):

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

| | |
|---|---|
| Goodwill | 246,653 |
| Total net assets acquired | $ 618,720 |

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

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In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets,* the goodwill is not amortized, but will be subject to a periodic assessment for impairment by applying a fair-value-based test. None of this goodwill is expected to be deductible for tax purposes. The Company performs its annual test for impairment of goodwill in May of each year. The Company is required to perform a periodic assessment between annual tests in certain circumstances. The Company has determined there was no impairment of the Solexa goodwill through the second quarter of 2007.

***In-Process Research and Development***

The Company allocated $303.4 million of the purchase price to in-process research and development projects. In-process research and development (IPR&D) represents the valuation of acquired, to-be-completed research projects. At the acquisition date, Solexa s ongoing research and development initiatives were primarily involved with the development of its genetic analysis platform for sequencing and expression profiling. These in-process research and development projects are composed of Solexa s reversible terminating nucleotide biochemistry platform, referred to as sequencing-by-synthesis (SBS) biochemistry, as well as Solexa s reagent, analyzer and sequencing services related technologies, which were valued at $237.2 million, $44.2 million, $19.1 million and $2.9 million, respectively, at the acquisition date. Although these projects were approximately 95% complete at the acquisition date, they had not reached technological feasibility and had no alternative future use. Accordingly, the amounts allocated to those projects were written off in the first quarter of 2007, the period the acquisition was consummated.

The values of the research projects were determined by estimating the costs to develop the acquired technology into commercially viable products, estimating the resulting net cash flows from the projects, and discounting the net cash flows to their present value. These cash flows were estimated by forecasting total revenue expected from these products and then deducting appropriate operating expenses, cash flow adjustments and contributory asset returns to establish a forecast of net cash flows arising from the in-process technology. These cash flows were substantially reduced to take into account the time value of money and the risks associated with the inherent difficulties and uncertainties given the projected stage of development of these projects at closing. Due to the nature of the forecast and the risks associated with the projected growth and profitability of the developmental projects, discount rates of 19.5% were considered appropriate for valuatio