ILLUMINA INC
Form 10-K/A
March 29, 2005

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

AMENDMENT NO. 1

þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 2, 2005

OR

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, California (Address of Principal Executive Offices)	92121 (zip code)

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

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $.01 par value
(Title of class)

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule12b-2 of the Act).

Yes þ No o

As of January 31, 2005, there were 38,124,708 shares of the Registrant s Common Stock outstanding. The aggregate market value of the Common Stock held by non-affiliates of the Registrant (based on the closing price for the Common Stock on the Nasdaq National Market on June 30, 2004) was approximately $211,848,212. This amount excludes an aggregate of 4,291,431 shares of common stock held by officers and directors and each person known by the Registrant to own 10% or more of the outstanding common stock. Exclusion of shares held by any person should not be construed to indicate that such person possesses the power, direct or indirect, to direct or cause the direction of management or policies of the Registrant, or that such person is controlled by or under common control with the Registrant

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive proxy statement for the annual meeting of stockholders expected to be held on May 19, 2005 are incorporated by reference into Part III of this Report.

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Amendment No. 1 to the Annual Report on Form 10-K
For the Fiscal Year Ended January 2, 2005

EXPLANATORY NOTE

We are filing this Amendment No. 1 to our Annual Report Form 10-K for the fiscal year ended January 2, 2005 as filed on March 8, 2005 (the Annual Report) to correct a typographical error in the date of the report of Ernst & Young LLP, our independent registered public accounting firm.

The complete text of the report amended, as well as the consolidated financial statements and financial statement schedules filed under Part IV, Items 15(a)(1) and 15(a)(2), is included in the Amendment pursuant to Rule 12b-15 promulgated under the Securities Exchange Act of 1934. This Amendment amends and restates in their entirety only Part IV, Items 15(a)(1) and 15(a)(2), as well as Part IV, Item 15(a)(3), which contains the exhibit list. It does not affect any other Items and Exhibits in the Annual Report, and those unaffected Items or Exhibits are not included in this Amendment.

This Amendment continues to speak as of the date of the original Annual Report, and we have not updated the disclosure contained herein to reflect events that have occurred since the filing of the original Annual Report. Accordingly, this Form 10-K/A should be read in conjunction with our other filings made with the Securities and Exchange Commission subsequent to the filing of the original Annual Report, including any amendments to those filings.

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PART IV

ITEM 15. Exhibits, Financial Statement Schedules.

(a) The following documents are filed as a part of this report:

(1) CONSOLIDATED FINANCIAL STATEMENTS:

(2) FINANCIAL STATEMENT SCHEDULES:

(3) EXHIBITS:

EXHIBIT NUMBER	DESCRIPTION OF DOCUMENT
2.1(1)	Form of Merger Agreement between Illumina, Inc., a California corporation, and Illumina, Inc., a Delaware corporation.
3.1(2)	Amended and Restated Certificate of Incorporation.
3.2(1)	Bylaws.
3.3(5)	Certificate of Designation for Series A Junior Participating Preferred Stock (included as an exhibit to exhibit 4.3).
4.1(1)	Specimen Common Stock Certificate.
4.2(1)	Amended and Restated Investors Rights Agreement, dated November 5, 1999, by and among the Registrant and certain stockholders of the Registrant.

4.3(5)	Rights Agreement, dated as of May 3, 2001, between the Company and Equiserve Trust Company, N.A.
+10.1(1)	Form of Indemnification Agreement between the Registrant and each of its directors and officers.
+10.2(1)	1998 Incentive Stock Plan.

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EXHIBIT NUMBER	DESCRIPTION OF DOCUMENT
+10.3(2)	2000 Employee Stock Purchase Plan (Filed as Exhibit 99.2).
10.4(1)	Sublease Agreement dated August 1998 between Registrant and Gensia Sicor Inc. for Illumina s principal offices.
10.5(1)	Joint Development Agreement dated November 1999 between Registrant and PE Corporation (with certain confidential portions omitted).
10.6(1)	Asset Purchase Agreement dated November 1998 between Registrant and nGenetics, Inc. (with certain confidential portions omitted).
10.7(1)	Asset Purchase Agreement dated March 2000 between Registrant and Spyder Instruments, Inc. (with certain confidential portions omitted).
10.8(1)	License Agreement dated May 1998 between Tufts and Registrant (with certain confidential portions omitted).
10.9(1)	Master Loan and Security Agreement, dated March 6, 2000, by and between Registrant and FINOVA Capital Corporation.
+10.10(3)	2000 Stock Plan (Filed as Exhibit 99.1).
10.11(1)	Eastgate Pointe Lease, dated July 6, 2000, between Diversified Eastgate Venture and Registrant.
10.12(1)	Option Agreement and Joint Escrow Instructions, dated July 6, 2000, between Diversified Eastgate Venture and Registrant.
10.13(4)	First Amendment to Joint Development Agreement dated March 27, 2001 between Registrant and PE Corporation, now known as Applied Biosystems Group (with certain confidential portions omitted).
10.14(6)	First Amendment to Option Agreement and Escrow Instructions dated May 25, 2001 between Diversified Eastgate Venture and Registrant.
10.15(7)	Second Amendment to Option Agreement and Escrow Instructions dated July 18, 2001 between Diversified Eastgate Venture and Registrant.
10.16(7)	Third Amendment to Option Agreement and Escrow Instructions dated September 27, 2001 between Diversified Eastgate Venture and Registrant.
10.17(7)	First Amendment to Eastgate Pointe Lease dated September 27, 2001 between Diversified Eastgate Venture and Registrant.
10.18(8)	Replacement Reserve Agreement, dated as of January 10, 2002, between the Company and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund.
10.19(8)	

	Loan Assumption and Modification Agreement, dated as of January 10, 2002, between the Company, Diversified Eastgate Venture and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund.
10.20(8)	Tenant Improvement and Leasing Commission Reserve Agreement, dated as of January 10, 2002, between the Company and BNY Western Trust Company as Trustee for Washington Capital Joint Master Trust Mortgage Income Fund.
+10.21(8)	2000 Employee Stock Purchase Plan as amended on March 21, 2002.

EXHIBIT NUMBER	DESCRIPTION OF DOCUMENT
+10.22(8)	2000 Stock Plan as amended on March 21, 2002.
10.23(9)	License Agreement dated January 2002 between Amersham Biosciences Corp. and Registrant (with certain confidential portions omitted).
10.24(10)	License Agreement dated June 2002 between Dade Behring Marburg GmbH and Registrant (with certain confidential portions omitted).
10.25(11)	Purchase and Sale Agreement and Escrow Instructions dated June 18, 2004 between Bernardo Property Advisors, Inc. and Registrant.
10.26(12)	Single Tenant Lease dated August 18, 2004 between BioMed Realty Trust Inc. and Registrant.
10.27(12)	Settlement and Cross License Agreement dated August 18, 2004 between Applera Corporation and Registrant (with certain confidential portions omitted).
10.28(13)	Collaboration Agreement dated December 17, 2004 between Invitrogen Incorporated and Registrant (confidential treatment has been requested with respect to certain portions of this exhibit).
10.29(13)	Forms of Stock Option Agreement under 2000 Stock Plan.
14(10)	Code of Ethics.
21(13)	Subsidiaries of the Company.
23.1	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
24.1(13)	Power of Attorney (included on the signature page).
31.1	Certification of Jay T. Flatley pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Timothy M. Kish pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Jay T. Flatley pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Timothy M. Kish pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\+ Management contract or corporate plan or arrangement

(1) Incorporated by reference to the same numbered exhibit filed with our Registration Statement on Form S-1 (333-33922) filed April 3, 2000, as amended.

(2) Incorporated by reference to the same numbered exhibit filed with our Annual Report on Form 10-K for the year ended December 31, 2000.

(3) Incorporated by reference to the corresponding exhibit filed with our Registration Statement on Form S-8 filed March 29, 2001.

(4) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended March 31, 2001 filed May 8, 2001.

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(5) Incorporated by reference to the same numbered exhibit filed with our Registration Statement on Form 8-A (000-30361) filed May 14, 2001.

(6) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended June 30, 2001 filed August 13, 2001.

(7) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended September 30, 2001 filed November 14, 2001.

(8) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended March 31, 2002 filed May 13, 2002.

(9) Incorporated by reference to the same numbered exhibit filed with Amendment No. 1 to our Registration Statement on Form S-3 (333-111496) filed March 2, 2004.

(10) Incorporated by reference to the same numbered exhibit filed with our Annual Report on Form 10-K for the year ended December 28, 2003.

(11) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended June 27, 2004 filed August 6, 2004.

(12) Incorporated by reference to the same numbered exhibit filed with our Form 10-Q for the quarterly period ended October 3, 2004 filed November 12, 2004.

(13) Incorporated by reference to the same numbered exhibit filed with our original Form 10-K for the fiscal year ended January 2, 2005 filed March 8, 2005.

SUPPLEMENTAL INFORMATION

No Annual Report to stockholders or proxy materials has been sent to stockholders as of the date of this report. The Annual Report to stockholders and proxy material will be furnished to our stockholders subsequent to the filing of this report and we will furnish such material to the SEC at that time.

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SIGNATURES

Pursuant to the requirements of the Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 28, 2005.

ILLUMINA, INC.

/s/ JAY T. FLATLEY
By: Jay T. Flatley
President and Chief Executive Officer

March 28, 2005

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Illumina, Inc.

We have audited the accompanying consolidated balance sheets of Illumina, Inc. as of January 2, 2005 and December 28, 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for the years ended January 2, 2005, December 28, 2003 and December 29, 2002. Our audits also include the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Illumina, Inc. at January 2, 2005 and December 28, 2003, and the results of its operations and its cash flows for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Illumina, Inc. s internal control over financial reporting as of January 2, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 16, 2005 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

San Diego, California
February 16, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders
Illumina, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control over Financial Reporting, that Illumina, Inc. maintained effective internal control over financial reporting as of January 2, 2005, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Illumina Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that Illumina, Inc. maintained effective internal control over financial reporting as of January 2, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Illumina, Inc. maintained, in all material respects, effective internal control over financial reporting as of January 2, 2005, based on the COSO criteria**.**

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Illumina, Inc. as of January 2, 2005 and December 28, 2003, and the related consolidated statements of operations, stockholders equity, and cash flows for the years ended January 2, 2005, December 28, 2003 and December 29, 2002 of Illumina, Inc. and our report dated February 16, 2005 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

San Diego, California
February 16, 2005

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ILLUMINA, INC.

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	January 2, 2005	December 28, 2003
ASSETS		
Current assets:		
Cash and cash equivalents	$ 54,789	$ 12,465
Investments, available for sale		20,317
Restricted cash and investments	12,205	100
Accounts receivable, net	11,891	4,549
Inventory, net	3,807	2,022
Prepaid expenses and other current assets	999	965
Total current assets	83,691	40,418
Property and equipment, net	8,574	45,777
Long-term restricted investments		12,191
Intangible and other assets, net	2,642	848
Total assets	$ 94,907	$ 99,234
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 2,684	$ 2,030
Accrued liabilities	10,407	5,540
Litigation judgment	5,957	
Current portion of long-term debt		366
Current portion of equipment financing		253
Total current liabilities	19,048	8,189
Long-term debt, less current portion		24,999
Advance payment from former collaborator		10,000
Litigation judgment		8,658
Deferred gain on sale of land and building	3,218	
Other long term liabilities	379	
Commitments and contingencies		
Stockholders equity:		
Common stock, $.01 par value, 120,000,000 shares authorized, 38,120,685 shares issued and outstanding at January 2, 2005, 32,886,693 shares issued and outstanding at December 28, 2003	381	329
Additional paid-in capital	195,653	165,314
Deferred compensation	(156)	(1,103)
Accumulated other comprehensive income	96	335

Accumulated deficit	(123,712)	(117,487)
Total stockholders equity	72,262	47,388
Total liabilities and stockholders equity	$ 94,907	$ 99,234

See accompanying notes.

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ILLUMINA, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except per share amounts)

	Year ended January 2, 2005	Year ended December 28, 2003	Year ended December 29, 2002
Revenue			
Product revenue	$ 40,497	$ 18,378	$ 4,103
Service revenue	8,075	6,496	3,305
Research revenue	2,011	3,161	2,632
Total revenue	50,583	28,035	10,040
Costs and expenses:			
Cost of product revenue	11,572	7,437	1,815
Cost of service revenue	1,687	2,600	1,721
Research and development	21,114	22,511	26,848
Selling, general and administrative	25,080	18,899	9,099
Amortization of deferred compensation and other stock-based compensation charges	844	2,454	4,360
Litigation judgment (settlement)	(4,201)	756	8,052
Total costs and expenses	56,096	54,657	51,895
Loss from operations	(5,513)	(26,622)	(41,855)
Interest income	941	1,821	3,805
Interest and other expense	(1,653)	(2,262)	(2,281)
Net loss	$ (6,225)	$ (27,063)	$ (40,331)
Net loss per share, basic and diluted	$ (0.17)	$ (0.85)	$ (1.31)
Shares used in calculating net loss per share, basic and diluted	35,845	31,925	30,890
The composition of stock-based compensation is as follows:			
Research and development	$ 348	$ 1,289	$ 2,399
Selling, general and administrative	496	1,165	1,961
	$ 844	$ 2,454	$ 4,360

See accompanying notes.

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ILLUMINA, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(in thousands)

	Common stock		Additional paid-in	Deferred	Accumulated other comprehensive income	Accumulated	Total stockholders
	Shares	Amount	capital	compensation	(loss)	deficit	equity
Balance at December 30, 2001	32,234	322	163,896	(8,083)	749	(50,093)	106,791
Issuance of common stock for cash, net of repurchased shares	266	3	693				696
Amortization of deferred compensation				4,360			4,360
Reversal of deferred compensation related to unvested stock options and restricted stock of terminated employees			(106)	106			
Comprehensive loss:							
Unrealized gain on available-for-sale securities					228		228
Net loss						(40,331)	(40,331)
Comprehensive loss							(40,103)
Balance at December 29, 2002	32,500	325	164,483	(3,617)	977	(90,424)	71,744
Issuance of common stock for cash	408	4	899				903
Repurchase of restricted common stock	(21)		(8)				(8)
Amortization of deferred compensation			12	2,442			2,454
Reversal of deferred compensation related to unvested stock options and restricted stock of terminated employees			(72)	72			
Comprehensive loss:							
Unrealized gain on available-for sale securities					(702)		(702)
					60		60

Foreign currency translation adjustment							
Net loss						(27,063)	(27,063)
Comprehensive loss							(27,705)
Balance at December 28, 2003	32,887	329	165,314	(1,103)	335	(117,487)	47,388
Issuance of common stock for cash	5,278	53	30,454				30,507
Repurchase of restricted common stock	(44)	(1)	(12)				(13)
Amortization of deferred compensation				844			844
Reversal of deferred compensation related to unvested stock options and restricted stock of terminated employees			(103)	103			
Comprehensive loss:							
Unrealized loss on available-for-sale securities					(305)		(305)
Unrealized loss on hedging contracts					(46)		(46)
Foreign currency translation adjustment					112		112
Net loss						(6,225)	(6,225)
Comprehensive loss							(6,464)
Balance at January 2, 2005	38,121	$ 381	$ 195,653	$ (156)	$ 96	$ (123,712)	$ 72,262

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ILLUMINA, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Year ended January 2, 2005	Year ended December 28, 2003	Year ended December 29, 2002
Cash flows from operating activities			
Net loss	$ (6,225)	$ (27,063)	$ (40,331)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	3,956	4,545	4,531
Loss on disposal of property and equipment		175	
Amortization of premium on investments	354	432	609
Amortization of deferred compensation and other stock-based compensation charges	844	2,454	4,360
Amortization of gain on sale of land and building	(156)		
Changes in operating assets and liabilities:			
Accounts receivable	(7,202)	(1,296)	(2,878)
Inventory	(1,785)	277	(1,328)
Prepaid expenses and other current assets	(29)	8	155
Other assets	(2,041)	(151)	211
Accounts payable	697	260	(205)
Accrued liabilities	1,958	1,742	1,262
Accrued litigation judgment	567	606	8,052
Other long term liabilities	(512)	(245)	(31)
Advance payment from former collaborator	(10,000)		
Net cash used in operating activities	(19,574)	(18,256)	(25,593)
Cash flows from investing activities			
Purchases of available-for-sale securities	(6,603)	(1,940)	(116,568)
Sales and maturities of available-for-sale securities	26,348	32,456	141,551
Proceeds from sale of land and building, net of fees	40,667		
Purchase of property and equipment	(3,355)	(2,032)	(26,830)
Acquisition of intangible assets	(35)	(16)	(794)
Net cash provided by (used in) investing activities	57,022	28,468	(2,641)
Cash flows from financing activities			
Proceeds from long-term debt			26,000
Payments on long-term debt	(25,387)	(342)	(293)
Payments on equipment financing	(232)	(337)	(297)
Proceeds from issuance of common stock	30,507	904	696

Repurchase of common stock	(13)	(9)	
Net cash provided by financing activities	4,875	216	26,106
Effect of foreign currency translation on cash and cash equivalents	1		
Net increase (decrease) in cash and cash equivalents	42,324	10,428	(2,128)
Cash and cash equivalents at beginning of the year	12,465	2,037	4,165
Cash and cash equivalents at end of the year	$ 54,789	$ 12,465	$ 2,037
Supplemental disclosures of cash flow information:			
Cash paid during the year for interest	$ 1,368	$ 2,222	$ 2,263

See accompanying notes.

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ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Summary of Significant Accounting Policies

Organization and Business

Illumina, Inc. (the Company) was incorporated on April 28, 1998. The Company develops and markets next-generation tools for the large-scale analysis of genetic variation and function. Using the Company s technologies, it has developed a comprehensive line of products that are designed to provide the throughput, cost effectiveness and flexibility necessary to enable researchers in the life sciences and pharmaceutical industries to perform the billions of tests necessary to extract medically valuable information from advances in genomics. This information is expected to correlate genetic variation and gene function with particular disease states, enhancing drug discovery, allowing diseases to be detected earlier and more specifically, and permitting better choices of drugs for individual patients.

Basis of Presentation

The consolidated financial statements of the Company have been prepared in conformity with accounting principles generally accepted in the United States and include the accounts of the Company and its wholly-owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation.

Fiscal Year

The Company s fiscal year is 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 years ended January 2, 2005 and December 28, 2003 are 53 and 52 weeks, respectively.

Use of Estimates

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.

Cash and Cash Equivalents

Cash and cash equivalents are comprised of highly liquid investments with a remaining maturity of less than three months from the date of purchase.

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. The Company invests its excess cash balances in marketable debt securities, primarily government securities 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. The cost of securities sold is determined based on the specific identification method. Gross realized gains totaled $453,750, $342,693 and $810,201 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively. Gross realized losses totaled $891, $141 and $27,467 for the years ended January 2, 2005, December 28, 2003, and December 29, 2002, respectively.

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Restricted Cash and Investments

At January 2, 2005, restricted cash and investments consist of corporate debt securities that are used as collateral against a letter of credit and a $100,000 bond deposit with the San Diego Superior Court related to the Applied Biosystems litigation (see Note 7). At December 28, 2003, the restricted investments used as collateral against the letter of credit were classified as long term.

Fair Value of Financial Instruments

The carrying amounts of certain of the Company s financial instruments including cash and cash equivalents, accounts and notes receivable, accounts payable and accrued liabilities approximate fair value. The Company enters into foreign currency exchange forward contracts to minimize its exposure to foreign currency exchange fluctuations and accounts for these derivatives in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities* as described more fully in Note 3.

Accounts and Notes Receivable

Trade accounts receivable are recorded at net invoice value and notes receivable are recorded at contractual value plus earned interest. Interest income on notes receivable is recognized according to the terms of each related agreement. The Company considers receivables past due based on the contractual payment terms. The Company reviews its exposure to amounts receivable and reserves specific amounts if collectibility is no longer reasonably assured. The Company also reserves a percentage of the net trade receivable balance based on collection history. The Company re-evaluates such reserves on a regular basis and adjusts its reserves as needed.

Concentrations of Risk

Cash equivalents, investments and accounts receivable are financial instruments that potentially subject the Company to concentrations of credit risk. Most of the Company s cash and cash equivalents as of January 2, 2005 are deposited with financial institutions in the United States and Company policy restricts the amount of credit exposure to any one issuer and to any one type of investment, other than securities issued by the U.S. Government. The Company has historically not experienced significant credit losses from accounts receivable. The Company performs a regular review of customer activity and associated credit risks and generally does not require collateral. The Company maintains an allowance for doubtful accounts based upon the expected collectibility of accounts receivable.

The Company s products require customized components that currently are available from a limited number of sources. The Company obtains certain key components included in its products from single vendors. No assurance can be given that these or other product components will be available in sufficient quantities at acceptable costs in the future.

Approximately 52% of the Company s revenues for the year ended January 2, 2005 were derived from customers outside the United States. International sales entail a variety of risks, including currency exchange fluctuations, longer payment cycles and greater difficulty in accounts receivable collection. The Company is also subject to general geopolitical risks, such as political, social and economic instability and changes in diplomatic and trade relations. The risks of international sales are mitigated in part by the extent to which sales are geographically distributed and the Company s foreign currency hedging program.

Inventories

Inventories are stated at the lower of standard cost (which approximates actual cost) or market. Inventory includes raw materials and finished goods that may be used in the research and development process and such items are expensed as consumed. Provisions for slow moving, excess and obsolete inventories are provided based on product life cycle and development plans, product expiration and quality issues, historical experience and inventory levels.

Property and Equipment

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Property and equipment are stated at cost, subject to review of impairment, and depreciated over the estimated useful lives of the assets (generally three to seven years for equipment) using the straight-line method. Amortization of leasehold improvements is computed over the shorter of the lease term or the estimated useful life of the related assets.

Intangible Assets

Intangible assets consist of license agreements and acquired technology. In accordance with Accounting Principles Board (APB) Opinion No. 17, *Accounting for Intangible Assets*, intangible assets are recorded at cost. The rights related to one of the license agreements are amortized over its estimated useful life (five years) and will be fully amortized in fiscal year 2008. The rights related to other license agreements are amortized based on sales of related product and are expected to be fully amortized by the end of fiscal 2005. The cost of these license agreements was $844,450 and the Company has amortized $493,333 through January 2, 2005. Amortization expense related to license agreements for the years ending January 2, 2005, December 28, 2003 and December 29, 2002 was $300,000, $185,000 and $8,333, respectively.

Long-Lived Assets

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, if indicators of impairment exist, the Company annually assesses the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, the Company measures the future discounted cash flows associated with the use of the asset and adjusts the value of the asset accordingly. While the Company s current and historical operating and cash flow losses are indicators of impairment, the Company believes the future cash flows to be received from the long-lived assets recorded at January 2, 2005 will exceed the assets carrying value, and accordingly the Company has not recognized any impairment losses through January 2, 2005.

Reserve for Product Warranties

The Company generally provides a one year warranty on genotyping and gene expression systems. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with system sales. This expense is recorded as a component of cost of revenue.

Revenue Recognition

The Company records revenue in accordance with the guidelines established by SEC Staff Accounting Bulletin No. 104 (SAB 104). Under SAB 104, revenue cannot be recorded until all the following criteria are met: 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. Product revenue consists of sales of oligonucleotides, arrays, assay reagents, genotyping systems and gene expression systems. Service revenue consists of revenue received for performing SNP genotyping services and for extended warranty sales.

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. BeadLab revenue is recognized when earned, which is generally upon shipment, installation, training and fulfillment of contractually defined acceptance criteria. Reserves are provided for anticipated product warranty expenses at the time the associated revenue is recognized. Revenue for extended warranty sales is recognized ratably over the term of the extended warranty. Revenue for genotyping services is recognized generally at the time the genotyping analysis data is delivered to the customer. The Company has been awarded $9.1 million from the National Institutes of Health to perform genotyping services in connection with the first phase of the International HapMap Project. A portion of the revenue from this project is earned at the time the related costs are incurred while the remainder of the revenue is earned upon the delivery of genotyping data. Research revenue consists of amounts earned under research agreements with government grants, which is recognized in the period during which the related costs are incurred. Some contracts entered into by the Company qualify as multiple element arrangements as defined by Emerging Issues Task Force Issue No. 00-21 (EITF 00-21), *Revenue Arrangements with Multiple Deliverables*.

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

The Company recognizes revenue for delivered elements only when the delivered element has stand-alone value, the fair values of undelivered elements are known, and there are no uncertainties regarding customer acceptance. All revenues are recognized net of applicable allowances for returns or discounts.

Shipping and Handling Expenses

Shipping and handling expenses are included in cost of product revenue and totaled $180,208, $143,423 and $45,809 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

Research and Development

Expenditures relating to research and development are expensed in the period incurred.

Software Development Costs

The Company applies Statement of Financial Accounting Standards No. 86, *Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed*, to capitalize costs related to marketed software. To date, the Company has only marketed software that is an incidental component to its SNP genotyping and gene expression systems. Accordingly, the Company capitalizes software costs that are incurred after the later of 1) the establishment of technological feasibility of the software or 2) the completion of all research and development activities for the other components of the product. Through January 2, 2005, the period between achieving either of these milestones and the general release date of the products has been very brief and software development costs thereafter were not significant. Accordingly, the Company has not capitalized any qualifying software development costs in the accompanying consolidated financial statements. The costs of developing routine enhancements are expensed as research and development costs as incurred because of the short time between the determination of technological feasibility and the date of general release of the related products.

The Company applies Statement of Position (SOP) No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. For the years ended January 2, 2005 and December 28, 2003, the Company capitalized $26,650 and $93,693, respectively, in costs incurred to acquire and develop software associated with the implementation of its Enterprise Resource Planning and Laboratory Information Management systems. These costs are amortized over the estimated useful life of the software of seven years, beginning when the software is ready for its intended use.

Advertising Costs

The Company expenses advertising costs as incurred. Advertising costs were $792,508, $439,710 and $267,338 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

Income Taxes

A deferred income tax asset or liability is computed for the expected future impact of differences between the financial reporting and tax bases of assets and liabilities, as well as the expected future tax benefit to be derived from tax loss and credit carryforwards. Deferred income tax expense is generally the net change during the year in the deferred income tax asset or liability. Valuation allowances are established when realizability of deferred tax assets is uncertain. The effect of tax rate changes is reflected in tax expense during the period in which such changes are enacted.

Foreign Currency Translation

The functional currencies of the Company s wholly owned subsidiaries are their respective local currencies. Accordingly, all balance sheet accounts of these operations are translated to U.S. dollars using the exchange rates in effect at the balance sheet date, and revenues and expenses are translated using the average exchange rates in effect during the period. The gains and losses from foreign currency translation of these subsidiaries financial statements

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

are recorded directly as a separate component of stockholders equity under the caption Accumulated other comprehensive income.

Stock-Based Compensation

At January 2, 2005, the Company has three stock-based employee and non-employee director compensation plans, which are described more fully in Note 6. As permitted by SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company accounts for common stock options granted, and restricted stock sold, to employees, founders and directors using the intrinsic value method and, thus, recognizes no compensation expense for options granted, or restricted stock sold, with exercise prices equal to or greater than the fair value of the Company s common stock on the date of the grant. The Company has recorded deferred stock compensation related to certain stock options, and restricted stock, which were granted prior to the Company s initial public offering with exercise prices below estimated fair value (see Note 6), which is being amortized on an accelerated amortization methodology in accordance with Financial Accounting Standards Board Interpretation Number (FIN) 28.

Pro forma information regarding net loss is required by SFAS No. 123 and has been determined as if the Company had accounted for its employee stock options and employee stock purchases under the fair value method of that statement. The fair value for these options was estimated at the dates of grant using the fair value option pricing model (Black Scholes) with the following weighted-average assumptions for 2004, 2003 and 2002:

	Year ended January 2, 2005	Year ended December 28, 2003	Year ended December 29, 2002
Weighted average risk-free interest rate	3.25%	3.03%	3.73%
Expected dividend yield	0%	0%	0%
Weighted average volatility	97%	103%	104%
Estimated life (in years)	5	5	5
Weighted average fair value of options granted	$ 5.25	$ 3.31	$ 4.39

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the vesting period. The Company s pro forma information is as follows (in thousands except per share amounts):

	Year ended January 2, 2005	Year ended December 28, 2003	Year ended December 29, 2002
Net loss as reported	$ (6,225)	$ (27,063)	$ (40,331)
Add: Stock-based compensation expense recorded	844	2,454	4,360
Less: Assumed stock compensation expense	(9,217)	(8,576)	(8,479)

Pro forma net loss	$	(14,598)	$	(33,185)	$	(44,450)
Basic and Diluted net loss per share:						
As reported	$	(0.17)	$	(0.85)	$	(1.31)
Pro forma	$	(0.41)	$	(1.04)	$	(1.44)

The pro forma effect on net loss presented is not likely to be representative of the pro forma effects on reported net income or loss in future years because these amounts reflect less than five years of vesting.

In December 2004, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 123 (revised 2004), *Share Based Payment* (SFAS 123R), which is a revision of FASB Statement No. 123, *Accounting for Stock-Based Compensation* (SFAS 123). This statement supercedes APB Opinion 25, *Accounting for Stock Issued to Employees* (APB 25), and amends FASB Statement No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS 123R is similar to the approach described in SFAS 123; however, SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

SFAS 123R permits companies to adopt its requirements using either a modified prospective method or a modified retrospective method. Under the modified prospective method, compensation cost is recognized in the financial statements beginning with the effective date, based on the requirements of SFAS 123R for all share-based payments granted after that date, and based on the requirements for SFAS 123 for all unvested awards granted prior to the effective date of SFAS 123R. Under the modified retrospective method, the requirements are the same as under the modified prospective method, but also permits companies to restate financial statements of previous periods based on proforma disclosures made in accordance with SFAS 123. The Company currently utilizes the Black-Scholes model to measure the fair value of stock options granted to employees under the pro forma disclosure requirements if FAS 123. While SFAS 123R permits companies to continue to use such model, it also permits the use of a lattice model. The Company has not yet determined which method or model it will use to measure the fair value of employee stock options under the adoption for SFAS 123R. The new standard is effective for periods beginning after June 15, 2005, and the Company expects to adopt SFAS 123R on July 4, 2005.

The Company currently accounts for share-based payments to employees using APB 25 s intrinsic value method and, as such, recognizes no compensation cost for employee stock options granted with exercise prices equal to or greater than the fair value of the Company s common stock on the date of the grant. Accordingly, the adoption of SFAS 123R s fair value method is expected to result in significant non-cash charges which will increase the Company s reported operating expenses, however, it will have no impact on its cash flows. The impact of adoption of SFAS 123R cannot be predicted at this time because it will depend on the level of share-based payments granted in the future and the model the Company chooses to use. However, had the Company adopted SFAS 123R in prior periods, the impact of that standard would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net income and earnings above.

Deferred compensation for options granted, and restricted stock sold, to consultants has been determined in accordance with SFAS No. 123 and Emerging Issues Task Force 96-18 as the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measured. Deferred charges for options granted, and restricted stock sold, to consultants are periodically remeasured as the underlying options vest.

Comprehensive Loss

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

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

	Year ended January 2, 2005	Year ended December 28, 2003
Foreign currency translation adjustments	$ 171	$ 60
Unrealized loss on available-for-sale securities	(29)	275

Unrealized loss on cash flow hedges		(46)		
Accumulated other comprehensive loss	$	96	$	335

Net Loss per Share

Basic and diluted net loss per common share are presented in conformity with SFAS No. 128, *Earnings per Share,* for all periods presented. In accordance with SFAS No. 128, basic and net loss per share is computed using the weighted-average number of shares of common stock outstanding during the period, less shares subject to repurchase. Diluted net loss per share is typically computed using the weighted average number of common and dilutive common equivalent shares from stock options using the treasury stock method. However, for all periods presented, diluted net loss per share is the same as basic net loss per share because the Company reported a net loss

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

and therefore the inclusion of weighted average shares of common stock issuable upon the exercise of stock options would be antidilutive.

	Year ended January 2, 2005	Year ended December 28, 2003	Year ended December 29, 2002
		(in thousands)	
Weighted-average shares outstanding	36,165	32,733	32,390
Less: Weighted-average shares of common stock subject to repurchase	(320)	(808)	(1,500)
Weighted-average shares used in computing net loss per share, basic and diluted	35,845	31,925	30,890

The total number of shares excluded from the calculation of diluted net loss per share, prior to application of the treasury stock method for options and warrants, was 6,360,023, 5,809,649 and 5,556,455 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

2. Balance Sheet Account Details

Investments, including restricted investments, consist of the following (in thousands):

	January 2, 2005			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
Restricted corporate debt securities	$ 12,134	$	$ (29)	$ 12,105
Total	$ 12,134	$	$ (29)	$ 12,105

	December 28, 2003			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Market Value
US Treasury securities	$ 6,340	$ 253	$	$ 6,593
Corporate debt securities	13,480	244		13,724

	19,820	497		20,317
Restricted corporate debt securities	12,413		(222)	12,191
Total	$ 32,233	$ 497	$ (222)	$ 32,508

As of January 2, 2005, all investments mature within one year.

Accounts receivable consist of the following (in thousands):

	January 2, 2005	**December 28, 2003**
Accounts receivable from product and service sales	$ 11,182	$ 4,388
Notes receivable from product sales	464	
Accounts receivable from government grants	108	260
Other receivables	283	79
	12,037	4,727
Allowance for doubtful accounts	(146)	(178)
Total	$ 11,891	$ 4,549

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ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

Inventory consists of the following (in thousands):

	January 2, 2005	December 28, 2003
Raw materials	$ 1,487	$ 829
Work in process	1,714	931
Finished goods	606	262
Total	$ 3,807	$ 2,022

Property and equipment consist of the following (in thousands):

	January 2, 2005	December 28, 2003
Land	$	$ 10,361
Buildings		29,479
Leasehold improvements	347	174
Laboratory and manufacturing equipment	11,067	9,221
Computer equipment and software	6,116	5,130
Furniture and fixtures	2,095	1,966
	19,625	56,331
Accumulated depreciation and amortization	(11,051)	(10,554)
Total	$ 8,574	$ 45,777

Depreciation expense was $3.7 million, $4.4 million and $4.5 million for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

Accrued liabilities consist of the following (in thousands):

	January 2, 2005	December 28, 2003
Compensation	$ 3,798	$ 2,608
Professional fees	1,488	1,437
Taxes	928	523
Reserve for product warranties	577	230

Customer deposits	1,671	253
Short-term deferred revenue	915	
Short-term deferred gain on sale of building	375	
Other	655	489
Total	$ 10,407	$ 5,540

3. Derivative Financial Instruments

SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, requires that all derivatives be recognized on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. We assess, both at its inception and on an on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting the changes in cash flows of hedged items. We also assess hedge ineffectiveness on a quarterly basis and record the gain or loss related to the ineffective portion to current earnings to the extent significant.

The Company has a foreign exchange hedging program principally designed to mitigate the potential impact due to changes in foreign currency exchange rates. The Company does not hold any derivative financial instruments for trading or speculative purposes. The Company primarily uses forward exchange contracts to hedge foreign currency exposures and they generally have terms of one year or less. These contracts have been designated as cash flow hedges and accordingly, to the extent effective, any unrealized gains or losses on these foreign currency forward contracts are reported in other comprehensive income. Realized gains and losses for the effective portion are recognized with the underlying hedge transaction. The notional settlement amount of the foreign currency forward contracts outstanding at January 2, 2005 was approximately $4.0 million. These contracts had a fair value of approximately $249,443 and were included in other current liabilities at January 2, 2005.

For the year ended January 2, 2005, there were no amounts recognized in earnings due to hedge ineffectiveness and we settled foreign exchange contracts of $283,721. The Company did not hold any derivative financial instruments prior to fiscal 2004.

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ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

4. Warranties and Maintenance Contracts

The Company generally provides a one year warranty on genotyping and gene expression systems. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses associated with system sales. This expense is recorded as a component of cost of product revenue. Estimated warranty expenses associated with extended maintenance contracts are recorded as cost of revenue ratably over the term of the maintenance contract.

Changes in the Company s warranty liability during the two years ended January 2, 2005 are as follows (in thousands):

Balance at December 29, 2002	$	
Additions charged to cost of revenue		230
Balance at December 28, 2003		230
Additions charged to cost of revenue		976
Repairs and replacements		(629)
Balance at January 2, 2005	$	577

5. Commitments and Long-term Debt

Building Loan

In July 2000, the Company entered into a 10-year lease to rent space in two newly constructed buildings in San Diego that are now occupied by the Company. That lease contained an option to purchase the buildings together with certain adjacent land that has been approved for construction of an additional building. The Company exercised that option and purchased the properties in January 2002 and assumed a $26 million, 10-year mortgage on the property at a fixed interest rate of 8.36%. The Company made monthly payments of $208,974, representing interest and principal, through August 2004. Interest expense was $1.4 million, $2.2 million and $2.3 million for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

In June, 2004, the Company entered into a conditional agreement to sell its land and buildings for $42.0 million and to lease back such property for an initial term of ten years. The sale was completed in August 2004 at which time the lease was signed. After the repayment of the remaining $25.2 million debt and other related transaction expenses, the Company received $15.5 million in net cash proceeds. The Company removed the land and net book value of the buildings of $36.9 million from its balance sheet, deferred the resulting $3.7 million gain on the sale of the property, and is amortizing the deferred gain over the ten year lease term in accordance with SFAS 13, *Accounting for Leases*.

The Company leased a portion of the space to a tenant under a lease which expired in June 2004. Rental income was recorded as an offset to the Company s facility costs. Rental income was $409,517, $695,282 and $679,468 for the years ended January 2, 2005, December 28, 2003, and December 29, 2002, respectively.

Capital Leases

In April 2000, the Company entered into a $3,000,000 loan arrangement to be used at its discretion to finance purchases of capital equipment. The loan was secured by the capital equipment financed. As of January 2, 2005, all loan payments were made, the underlying equipment was purchased and the loan arrangement was closed. Cost and accumulated depreciation of equipment under capital leases at December 28, 2003 was $1,287,789 and $1,060,278, respectively. Depreciation of equipment under capital leases was included in depreciation expense. Interest expense related to capital leases was $10,500, $56,661 and $97,265 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

Operating Leases

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

In August 2004, the Company entered into a ten year lease for its San Diego facility after the land and building were sold (as discussed above). Under the terms of the lease, the Company made a $1.9 million security deposit and is paying monthly rent of $318,643 for the first year with an annual increase of 3% in each subsequent year. The lease contains an option to renew for three additional periods of five years each. The Company also leases office space under non-cancelable operating leases that expire at various times through January 2007. These leases contain renewal options ranging from 2 to 3 years. At January 2, 2005, annual future minimum payments under these operating leases are as follows (in thousands):

2005	$ 4,251
2006	4,371
2007	4,131
2008	4,225
2009	4,351
2010 and thereafter	21,896
Total	$ 43,225

Rent expense, net of amortization of the deferred gain on sale of property, was $1,794,234, $238,065 and $141,361 for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

6. Stockholders Equity

Common stock

As of January 2, 2005, the Company had 38,120,685 shares of common stock outstanding, of which 4,844,072 shares were sold to employees and consultants subject to restricted stock agreements. The restricted common shares vest in accordance with the provisions of the agreements, generally over five years. All unvested shares are subject to repurchase by the Company at the original purchase price. As of January 2, 2005, 154,003 shares of common stock were subject to repurchase.

Stock Options

In June 2000, the Company s board of directors and stockholders adopted the 2000 Stock Plan. The 2000 Stock Plan amended and restated the 1998 Incentive Stock Plan and increased the shares reserved for issuance by 4,000,000 shares. In addition, the 2000 Stock Plan provides for an automatic annual increase in the shares reserved for issuance by the lesser of 5% of outstanding shares of the Company s common stock on the last day of the immediately preceding fiscal year, 1,500,000 shares or such lesser amount as determined by the Company s board of directors.

In 1998, the Company adopted the 1998 Incentive Stock Plan (the Plan) and had reserved 5,750,000 shares of common stock for grants under the Plan. The Plan provided for the grant of incentive and nonstatutory stock options, stock bonuses and rights to purchase stock to employees, directors or consultants of the Company. The Plan provided that incentive stock options to be granted only to employees at no less than the fair value of the Company s common stock, as determined by the board of directors at the date of the grant. Options generally vest 20% one year from the date of grant and ratably each month thereafter for a period of 48 months and expire ten years from date of grant. In December 1999, the Company modified the plan to allow for acceleration of vesting in the event of an acquisition or merger.

A summary of the Company s stock option activity from December 30, 2001 through January 2, 2005 follows:

	Options	**Weighted-Average Exercise Price**
Outstanding at December 30, 2001	3,380,796	$ 8.97
Granted	1,467,500	$ 5.62
Exercised	(137,727)	$ 0.46
Cancelled	(287,788)	$ 11.81

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

	Options	Weighted-Average Exercise Price
Outstanding at December 29, 2002	4,422,781	$ 7.94
Granted	1,241,175	$ 3.31
Exercised	(102,590)	$ 1.25
Cancelled	(331,492)	$ 8.36
Outstanding at December 28, 2003	5,229,874	$ 6.95
Granted	1,453,400	$ 7.08
Exercised	(139,768)	$ 1.98
Cancelled	(337,486)	$ 8.80
Outstanding at January 2, 2005	6,206,020	$ 6.99

At January 2, 2005, options to purchase approximately 2,653,581 shares were exercisable and 5,964,649 shares remain available for future grant.

Following is a further breakdown of the options outstanding as of January 2, 2005:

Range of exercise prices	Options outstanding	Weighted average remaining life in years	Weighted average exercise price	Options exercisable	Weighted average exercise price of options exercisable
$ 0.03 - 3.06	1,046,528	7.05	$ 2.00	557,690	$ 1.43
$ 3.20 - 4.64	1,084,251	8.08	$ 4.14	393,768	$ 4.15
$ 4.87 - 5.99	1,225,679	7.54	$ 5.78	315,639	$ 5.63
$ 6.00 - 7.90	1,312,994	8.56	$ 7.27	339,664	$ 7.05
$ 7.94 - 11.55	1,043,316	6.72	$ 9.11	650,475	$ 9.14
$11.56 - 45.00	493,252	5.94	$ 21.64	396,345	$ 21.92
	6,206,020	7.50	$ 6.99	2,653,581	$ 8.00

2000 Employee Stock Purchase Plan

In February 2000, the board of directors and stockholders adopted the 2000 Employee Stock Purchase Plan (the Purchase Plan). A total of 2,445,547 shares of the Company s common stock have been reserved for issuance under the Purchase Plan. The Purchase Plan permits eligible employees to purchase common stock at a discount, but only through payroll deductions, during defined offering periods. The price at which stock is purchased under the Purchase

Plan is equal to 85% of the fair market value of the common stock on the first or last day of the offering period, whichever is lower. The initial offering period commenced in July 2000. In addition, the Purchase Plan provides for annual increases of shares available for issuance under the Purchase Plan beginning with fiscal 2001. 585,855, 304,714 and 128,721 shares were issued under the 2000 Employee Stock Purchase Plan during fiscal 2004, 2003 and 2002, respectively.

Deferred Stock Compensation

Since the inception of the Company, in connection with the grant of certain stock options and sales of restricted stock to employees, founders and directors through July 25, 2000, the Company has recorded deferred stock compensation totaling approximately $17.6 million, representing the difference between the exercise or purchase price and the fair value of the Company s common stock as estimated by the Company s management for financial reporting purposes on the date such stock options were granted or restricted common stock was sold. Deferred compensation is included as a reduction of stockholders equity and is being amortized to expense over the vesting period of the options and restricted stock. During the years ended January 2, 2005, December 28, 2003 and December 29, 2002, the Company recorded amortization of deferred stock compensation expense of approximately $0.8 million, $2.5 million and $4.4 million, respectively.

Shares Reserved for Future Issuance

At January 2, 2005, the Company has reserved shares of common stock for future issuance as follows (in thousands):

ILLUMINA, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - (Continued)

2000 Stock Plan	12,171
2000 Employee Stock Purchase Plan	1,364
	13,535

Stockholder Rights Plan

On May 3, 2001, the Board of Directors of the Company declared a dividend of one preferred share purchase right (a Right) for each outstanding share of common stock of the Company. The dividend was payable on May 14, 2001 (the Record Date) to the stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one unit consisting of one-thousandth of a share of its Series A Junior Participating Preferred Stock at a price of $100 per unit. The Rights will be exercisable if a person or group hereafter acquires beneficial ownership of 15% or more of the outstanding common stock of the Company or announces an offer for 15% or more of the outstanding common stock. If a person or group acquires 15% or more of the outstanding common stock of the Company, each Right will entitle its holder to purchase, at the exercise price of the right, a number of shares of common stock having a market value of two times the exercise price of the right. If the Company is acquired in a merger or other business combination transaction after a person acquires 15% or more of the Company s common stock, each Right will entitle its holder to purchase, at the Right s then-current exercise price, a number of common shares of the acquiring company which at the time of such transaction have a market value of two times the exercise price of the right. The Board of Directors will be entitled to redeem the Rights at a price of $0.01 per Right at any time before any such person acquires beneficial ownership of 15% or more of the outstanding common stock. The rights expire on May 14, 2011 unless such date is extended or the rights are earlier redeemed or exchanged by the Company.

7. Legal Proceedings

The Company has incurred substantial costs in defending itself against patent infringement claims, and expects to devote substantial financial and managerial resources to protect its intellectual property and to defend against the claims described below as well as any future claims asserted against it.

Termination-of-Employment Lawsuit

In June 2002, the Company recorded a $7.7 million charge to cover total damages and estimated expenses awarded by a jury related to a termination-of-employment lawsuit. The Company appealed the decision, and in December 2004, the Fourth Appellate District Court of Appeal, in San Diego, California, reduced the amount of the award. The Company recorded interest expense during the appeal based on the statutory rate. For the years ended January 2, 2005 and December 28, 2003, the Company recorded litigation expense of $567,000 and $756,000, respectively, for interest. As a result of the revised judgment, the Company reduced the $9.2 million liability recorded on its balance sheet to $5.9 million and recorded a gain of $3.3 million as a litigation judgment in the statement of operations for the year ended January 2, 2005.

As a result of the Company s decision to appeal the ruling, the Company filed a surety bond with the court equal to 1.5 times the judgment amount or approximately $11.3 million. Under the terms of the bond, the Company is required to maintain a letter of credit for 90% of the bond amount to secure the bond. Further, the Company was required to deposit approximately $12.5 million of marketable securities as collateral for the letter of credit and accordingly, these funds were restricted from use for general corporate purposes until the appeal process was completed. A judgment was rendered in December 2004 and payment was made in early 2005 at which time the restricted funds, recorded as restricted investments, were released.

Litigation with Applera Corporation s Applied Biosystems Group

In November 1999, the Company entered into a joint development agreement with Applied Biosystems Group (Applied Biosystems), an operating group of Applera Corporation (Applera), under which the companies would jointly develop a SNP genotyping system that would combine the Company s BeadArray technology with Applied Biosystems assay chemistry and scanner technology. In conjunction with the agreement, Applied Biosystems

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agreed to provide the Company with non-refundable research and development support of $10.0 million, all of which was provided by December 2001. As of December 28, 2003 this amount was recorded as a liability on the Company s balance sheet.

In December 2002, Applied Biosystems initiated a patent infringement suit and sought to compel arbitration of an alleged breach of the joint development agreement. In December 2002, the Company filed a suit alleging breach of contract, breach of the implied covenant of good faith and fair dealing, unfair competition and other allegations against Applied Biosystems in San Diego Superior Court, and moved to prevent the arbitration of the joint development agreement sought by Applied Biosystems. In January 2004, the Company notified Applied Biosystems that it was terminating the joint development agreement.

In August 2004, the Company and Applera entered into a settlement and cross-license agreement. Under the terms of the agreement, the Company paid Applera a one-time payment of $8.5 million. The settlement agreement also provided for an exchange of royalty-free cross-licenses to certain intellectual property rights, termination of the joint development agreement, dismissal of the federal patent infringement action brought by Applied Biosystems, termination of the arbitration proceeding, and dismissal of the Company s state court action against Applied Biosystems.

As a result of the settlement, the Company removed the $10.0 million liability from its balance sheet, made a payment of $8.5 million to Applera and recorded a gain of $1.5 million as a litigation settlement in the statement of operations for the year ended January 2, 2005.

Affymetrix Litigation

In July 2004, Affymetrix, Inc. (Affymetrix) filed a complaint in the U.S. District Court for the District of Delaware alleging that certain of the Company s products infringe six Affymetrix patents. The suit seeks an unspecified amount of monetary damages and a judgment enjoining the sale of products, if any, that are determined to be infringing these patents. In September 2004, the Company filed its answer and counterclaims to Affymetrix complaint, seeking declaratory judgments from the court that it does not infringe the Affymetrix patents, and that such patents are invalid, and filed counterclaims against Affymetrix for unfair competition and interference with actual and prospective economic advantage. The Company believes it has meritorious defenses against each of the infringement claims alleged by Affymetrix and intends to vigorously defend itself against this suit. However, the Company cannot be sure it will prevail in this matter. Any unfavorable determination, and in particular, any significant cash amounts required to be paid by the Company or prohibition of the sale of the Company s products and services, could result in a material adverse effect on its business, financial condition and results of operations. While the parties have pending motions before the court, no trial date has yet been set for this case.

8. Collaborative Agreements

International HapMap Project

The Company is the recipient of a grant from the National Institutes of Health covering its participation in the first phase of the International HapMap Project, which is a $100 million, internationally funded successor project to the Human Genome Project that will help identify a map of genetic variations that may be used to perform disease-related research. The Company could receive up to $9.1 million of funding for this project which covers basic research activities, the development of SNP assays and the genotyping to be performed on those assays. As of January 2, 2005, the Company had approximately $0.7 million of funding remaining related to this project which is expected to be received in early 2005.

Invitrogen Corporation

In December 2004, the Company entered into a strategic collaboration with Invitrogen Corporation. The collaboration is expected to expand the Company s Oligator DNA synthesis technology and combine that capability with Invitrogen s sales, marketing and distribution channels. Under the terms of the agreement, Invitrogen has agreed to pay the Company up to $3.4 million, which the Company plans to invest in its San Diego facility to enable implementation of fourth-generation Oligator technology and extend the technology into tube-based oligo products.

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In addition, the agreement provides for the transfer of the Company s Oligator technology into two Invitrogen facilities outside North America. Profit from the sale of collaboration products will be divided equally between the two companies.

9. Income Taxes

The Company s provision for income taxes for the years ended January 2, 2005 and December 28, 2003 consisted of $135,000 of income tax expense related to its foreign operations. This expense is included with interest and other expense in the statement of operations.

At January 2, 2005, the Company has federal and state tax net operating loss carryforwards of approximately $86.5 million and $39.1 million, respectively. The federal and state tax loss carryforwards will begin expiring in fiscal year 2018 and 2006 respectively, unless previously utilized. The Company also has federal and state research and development tax credit carryforwards of approximately $3.1 million and $1.9 million, repectively, which will begin to expire in fiscal year 2018, unless previously utilized.

Pursuant to Sections 382 and 383 of the Internal Revenue Code, annual use of the Company s net operating loss and credit carryforwards may be limited in the event of a cumulative ownership change of more than 50 percentage points within a three-year period.

Significant components of the Company s deferred tax assets as of January 2, 2005 and December 28, 2003 are shown below (in thousands). A valuation allowance has been established as of January 2, 2005 and December 28, 2003 to offset the net deferred tax assets, as realization of such assets has not met the more likely than not threshold required under FAS 109.

	January 2, 2005	December 28, 2003
Deferred tax assets:		
Net operating loss carryforwards	$ 32,161	$ 25,869
Research and other credit carryforwards	5,076	5,111
Advance payment from former collaborator		4,074
Capitalized research and development	1,857	1,348
Other	6,433	6,795
Total deferred tax assets	45,527	43,197
Valuation allowance for deferred tax assets	(45527)	(43,197)
Net deferred taxes	$	$

Deferred tax assets of approximately $0.4 million and $0.2 million at January 2, 2005 and December 28, 2003, respectively, resulted from the exercise of employee stock options. When recognized, the tax benefit of these assets will be accounted for as a credit to additional paid-in capital rather than a reduction of the income tax provision.

Reconciliation of the statutory federal income tax to the Company s effective tax (in thousands):

	Year Ended January 2, 2005	Year Ended December 28, 2003	Year Ended December 29, 2002
Tax at federal statutory rate	$ (2,179)	$ (9,472)	$ (14,116)
State, net of federal benefit	(336)	(1,434)	(2,115)
Research and development credits	34	(1,374)	(1,239)
Change in valuation allowance	2,330	12,130	14,241
Permanent differences	(264)	738	1,234
Other	550	(588)	1,995
Tax expense	$ 135	$	$

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Act). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. The deduction

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is subject to a number of limitations and, as of today, uncertainty remains as to how to interpret numerous provisions in the Act. Based on our analysis of the Act, although not yet finalized, it is possible that under the repatriation provision of the Act we may repatriate some amount of our undistributed foreign earnings. We expect to finalize our assessment in 2005.

10. Retirement Plan

The Company has a 401(k) savings plan covering substantially all of its employees. Company contributions to the plan are discretionary and no such contributions were made during the years ended January 2, 2005, December 28, 2003 and December 29, 2002.

11. Segment Information, Geographic Data and Significant Customers

The Company has determined that, in accordance with SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information* it operates in one segment as it only reports operating results on an aggregate basis to chief operating decision makers of the Company. The Company had sales in the following regions for the years ended January 2, 2005, December 28, 2003 and December 29, 2002 (in thousands):

	January 2, 2005	**December 28, 2003**	**December 29, 2002**
United States	$ 24,166	$ 13,666	$ 8,731
Europe	12,528	5,909	1,047
Asia	9,703	5,557	246
Other	4,186	2,903	16
Total	$ 50,583	$ 28,035	$ 10,040

Exclusive of revenue recorded from the National Institutes of Health, the Company had one customer that provided approximately 14% of total revenue in the year ended January 2, 2005 and approximately 18% of total revenue in the year ended December 28, 2003 and one other customer that contributed approximately 22% of revenue in the year ended December 29, 2002. Revenue from the National Institutes of Health accounted for approximately 13%, 21% and 19% of total revenue for the years ended January 2, 2005, December 28, 2003 and December 29, 2002, respectively.

12. Subsequent Events

In February 2005, the Company signed a definitive agreement and plan of merger with CyVera Corporation, a privately-held Connecticut-based company, pursuant to which CyVera will become a wholly-owned subsidiary of the Company. CyVera s technology is highly complementary to our portfolio of products and services and upon closing of the transaction will become an integral part of our technology. The aggregate consideration for the transaction is $17.5 million, consisting of approximately 1.5 million shares of the Company s common stock and the payment of approximately $2.3 million of CyVera s liabilities at the closing. The closing is subject to customary conditions and is expected to occur by the end of March 2005. The Company expects the first products based on CyVera s technology to be available in the second half in 2006.

13. Quarterly Financial Information (unaudited)

The following financial information reflects all normal recurring adjustments, except as noted below, which are, in the opinion of management, necessary for a fair statement of the results of interim periods. Summarized quarterly data for fiscal 2004 and 2003 are as follows (in thousands except per share data):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2004:				
Total revenues	$ 10,803	$ 11,486	$ 13,512	$ 14,782
Total cost of revenue	2,802	3,067	3,517	3,873
Net income (loss)	(3,931)	(3,516)	(2,026)	3,248
Historical net loss per share, basic	(0.12)	(0.10)	(0.05)	0.09

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	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Historical net loss per share, diluted	(0.12)	(0.10)	(0.05)	0.08
2003:				
Total revenues	$ 4,276	$ 4,769	$ 8,249	$ 10,741
Total cost of revenue	1,910	2,026	2,681	3,420
Net loss	(8,960)	(8,592)	(5,511)	(4,000)
Historical net loss per share, basic and diluted	(0.28)	(0.27)	(0.17)	(0.12)

In the third quarter of 2004 the Company recorded a $1.5 million reduction in expense for a legal settlement and in the fourth quarter of 2004, the Company recorded a $3.3 million reduction in expense related to the reduction of a legal judgment (see Note 7).

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SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS AND RESERVES FOR THE THREE YEARS ENDED JANUARY 2, 2005

	Allowance for doubtful accounts	Reserve for obsolete and excess inventory	Reserve for product warranty
		(thousands)	
Balance at December 30, 2001	$ 32	$	$
Charged to expense	115	73	
Utilizations	(2)		
Balance at December 29, 2002	145	73	
Charged to expense	118	466	230
Utilizations	(85)	(73)	
Balance at December 28, 2003	178	466	230
Charged to expense	49	543	976
Utilizations	(81)	(407)	(629)
Balance at January 2, 2005	$ 146	$ 602	$ 577

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