ILLUMINA INC
Form 10-Q
October 25, 2017
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
þ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended October 1, 2017

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

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

(858) 202-4500
(Registrant's telephone number, including area code)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13a of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

As of October 20, 2017, there were 146 million shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.

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

	October 1, 2017 (Unaudited)	January 1, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,354	$ 735
Short-term investments	687	824
Accounts receivable, net	383	381
Inventory	327	300
Prepaid expenses and other current assets	54	78
Total current assets	2,805	2,318
Property and equipment, net	862	713
Goodwill	771	776
Intangible assets, net	185	243
Deferred tax assets	117	123
Other assets	306	108
Total assets	$ 5,046	$ 4,281
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 158	$ 138
Accrued liabilities	381	342
Build-to-suit lease liability	124	223
Long-term debt, current portion	2	2
Total current liabilities	665	705
Long-term debt	1,180	1,056
Other long-term liabilities	222	206
Redeemable noncontrolling interests	124	44
Stockholders' equity:		
Common stock	2	2
Additional paid-in capital	2,891	2,733
Accumulated other comprehensive loss	—	(1)
Retained earnings	2,188	1,485
Treasury stock, at cost	(2,226)	(2,022)
Total Illumina stockholders' equity	2,855	2,197
Noncontrolling interests	—	73
Total stockholders' equity	2,855	2,270
Total liabilities and stockholders' equity	$ 5,046	$ 4,281

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Revenue:				
Product revenue	$596	$ 514	$1,631	$ 1,506
Service and other revenue	118	93	344	273
Total revenue	714	607	1,975	1,779
Cost of revenue:				
Cost of product revenue	173	132	508	383
Cost of service and other revenue	50	38	153	117
Amortization of acquired intangible assets	9	11	30	32
Total cost of revenue	232	181	691	532
Gross profit	482	426	1,284	1,247
Operating expense:				
Research and development	134	126	409	374
Selling, general and administrative	167	139	499	438
Legal contingencies	—	—	—	(9)
Total operating expense	301	265	908	803
Income from operations	181	161	376	444
Other income (expense):				
Interest income	4	2	13	7
Interest expense	(10)	(9)	(26)	(25)
Other income, net	—	—	457	1
Total other (expense) income, net	(6)	(7)	444	(17)
Income before income taxes	175	154	820	427
Provision for income taxes	23	37	199	106
Consolidated net income	152	117	621	321
Add: Net loss attributable to noncontrolling interests	11	12	37	18
Net income attributable to Illumina stockholders	$163	$ 129	$658	$ 339
Net income attributable to Illumina stockholders for earnings per share	$163	$ 129	$657	$ 336
Earnings per share attributable to Illumina stockholders:				
Basic	$1.12	$ 0.88	$4.49	$ 2.29
Diluted	$1.11	$ 0.87	$4.45	$ 2.27
Shares used in computing earnings per common share:				
Basic	146	147	146	147
Diluted	148	148	148	148

See accompanying notes to the condensed consolidated financial statements.

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

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Consolidated net income	$152	$ 117	$621	$ 321
Unrealized gain (loss) on available-for-sale securities, net of deferred tax	1	(1)	1	1
Total consolidated comprehensive income	153	116	622	322
Add: Comprehensive loss attributable to noncontrolling interests	11	12	37	18
Comprehensive income attributable to Illumina stockholders	$164	$ 128	$659	$ 340

See accompanying notes to the condensed consolidated financial statements.

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

	Illumina Stockholders						
	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive (Loss) Income	Retained Earnings	Treasury Stock	Noncontrolling Interests	Total Stockholders' Equity
Balance as of January 1, 2017	$2	$ 2,733	$ (1)	$ 1,485	$ (2,022)	$ 73	$ 2,270
Net income (loss)	—	—	—	658	—	(7)	651
Unrealized gain on available-for-sale securities, net of deferred tax	—	—	1	—	—	—	1
Issuance of common stock, net of repurchases	—	63	—	—	(204)	—	(141)
Share-based compensation	—	123	—	—	—	—	123
Adjustment to the carrying value of redeemable noncontrolling interests	—	(30)	—	—	—	—	(30)
Vesting of redeemable equity awards	—	(12)	—	—	—	—	(12)
Cumulative-effect adjustment from adoption of ASU 2016-09	—	3	—	45	—	—	48
Deconsolidation of GRAIL	—	11	—	—	—	(66)	(55)
Balance as of October 1, 2017	$2	$ 2,891	$ —	$ 2,188	$ (2,226)	$ —	$ 2,855

See accompanying notes to condensed consolidated financial statements.

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

	Nine Months Ended	
	October 1, 2017	October 2, 2016
Cash flows from operating activities:		
Consolidated net income	$621	$ 321
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on deconsolidation of GRAIL	(453)	—
Depreciation expense	81	65
Amortization of intangible assets	36	38
Share-based compensation expense	123	102
Accretion of debt discount	23	22
Deferred income taxes	53	58
Impairment of intangible assets	23	—
Other	(2)	5
Changes in operating assets and liabilities:		
Accounts receivable	1	5
Inventory	(27)	(42)
Prepaid expenses and other current assets	14	3
Other assets	(3)	(6)
Accounts payable	12	(7)
Accrued liabilities	56	(57)
Other long-term liabilities	23	10
Net cash provided by operating activities	581	517
Cash flows from investing activities:		
Purchases of available-for-sale securities	(359)	(679)
Sales of available-for-sale securities	314	406
Maturities of available-for-sale securities	181	148
Net cash paid for acquisitions	—	(18)
Proceeds from sale of GRAIL securities	278	—
Deconsolidation of GRAIL cash	(52)	—
Net purchases of strategic investments	(25)	(9)
Purchases of property and equipment	(234)	(178)
Cash paid for intangible assets	(2)	(11)
Net cash provided by (used in) investing activities	101	(341)
Cash flows from financing activities:		
Payments on financing obligations	(7)	(71)
Payments on acquisition related contingent consideration liability	(3)	(29)
Proceeds from issuance of debt	5	5
Common stock repurchases	(176)	(113)
Taxes paid related to net share settlement of equity awards	(28)	(76)
Proceeds from issuance of common stock	63	47
Proceeds from early exercise of equity awards from a subsidiary	—	6
Contributions from noncontrolling interest owners	79	80
Net cash used in financing activities	(67)	(151)

Effect of exchange rate changes on cash and cash equivalents	4	1
Net increase in cash and cash equivalents	619	26
Cash and cash equivalents at beginning of period	735	769
Cash and cash equivalents at end of period	$1,354	$ 795

See accompanying notes to the condensed consolidated financial statements.

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

1. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Interim financial results are not necessarily indicative of results anticipated for the full year. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s audited consolidated financial statements and footnotes included in the Company’s Annual Report on Form 10-K for the fiscal year ended January 1, 2017, from which the balance sheet information herein was derived. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expense, and related disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

The unaudited condensed consolidated financial statements include the accounts of the Company, its wholly-owned subsidiaries, majority-owned or controlled companies, and variable interest entities (VIEs) for which the Company is the primary beneficiary. All intercompany transactions and balances have been eliminated in consolidation. Effective February 28, 2017, Illumina deconsolidated GRAIL, Inc.’s financial statements. In management’s opinion, the accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation of the results for the interim periods presented.

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

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

Redeemable Noncontrolling Interests

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

stockholders’ equity on the condensed consolidated balance sheets.

Fiscal Year

The Company’s fiscal year consists of 52 or 53 weeks ending the Sunday closest to December 31, with quarters of 13 or 14 weeks ending the Sunday closest to March 31, June 30, September 30, and December 31. The three and nine months ended October 1, 2017 and October 2, 2016 were both 13 and 39 weeks, respectively.

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Reclassifications

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

Significant Accounting Policies

During the three and nine months ended October 1, 2017, there have been no changes to the Company’s significant accounting policies as described in the Annual Report on Form 10-K for the fiscal year ended January 1, 2017.

Recently Adopted Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board issued Accounting Standard Update (ASU) 2016-09, Compensation - Stock Compensation (Topic 718), which aims to simplify the accounting for share-based payment transactions, including accounting for income taxes, classification on the statement of cash flows, accounting for forfeitures, and classification of awards as either liabilities or equity. This ASU was effective for the Company beginning in the first quarter of 2017.

Under the ASU, excess tax benefits from share-based payment arrangements are classified as discrete items within the provision for income taxes, rather than recognizing excess tax benefits in additional paid-in capital. Upon adoption in Q1 2017, the Company recorded $45 million, net, to retained earnings, primarily related to unrealized tax benefits associated with share-based compensation. During the three and nine months ended October 1, 2017, excess tax benefits of $12 million and $31 million, respectively, were reflected as a component of the provision for income taxes.

In addition, under the ASU, excess income tax benefits from share-based compensation arrangements are classified as cash flow from operations, rather than cash flow from financing activities. The Company has elected to apply the cash flow classification guidance retrospectively and reclassified $110 million from financing activity to operating activity for the nine months ended October 2, 2016.

Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606). The new standard is based on the principle that revenue should be recognized in an amount that reflects the consideration to which the entity expects to be entitled in exchange for the transfer of promised goods or services. Since its initial release, the FASB has issued several amendments to the standard, which include clarification of accounting guidance related to identification of performance obligations, intellectual property licenses, and principal vs. agent considerations.

ASU 2014-09 and all subsequent amendments (collectively, the “new standards”) will be effective for the Company beginning in the first quarter of 2018 and may be applied using either the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application.

The Company continues to work through steps in the implementation project plan, which include: finalizing new disclosures required by the new standards and implementing changes to business processes and reporting in support of the adoption of the new standards. The Company will adopt the new standards using the modified retrospective method with an adjustment to beginning retained earnings for the cumulative effect of the change, which is not expected to be material.

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In January 2016, the Financial Accounting Standards Board issued ASU 2016-01, Financial Instruments - Overall (Subtopic 825-10), which requires equity investments (other than those accounted for under the equity method or those that result in consolidation) to be measured at fair value, with changes in fair value recognized in net income. ASU 2016-01 will be effective for the Company beginning in the first quarter of 2018. The Company anticipates that the adoption of ASU 2016-01 may increase the volatility of other income and expense, net, as a result of the remeasurement of the Company's cost-method investments.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, Leases (Topic 842). The new standard requires lessees to recognize most leases on their balance sheets as lease liabilities with corresponding right-of-use assets and eliminates certain real estate-specific provisions. ASU 2016-02 will be effective for the Company beginning in the first quarter of 2019. ASU 2016-02 will be adopted on a modified retrospective transition basis for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial statements.

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

Earnings per Share

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

Potentially dilutive common shares consist of shares issuable under convertible senior notes and equity awards. Convertible senior notes have a dilutive impact when the average market price of the Company's common stock exceeds the applicable conversion price of the respective notes. Potentially dilutive common shares from equity awards are determined using the average share price for each period under the treasury stock method. In addition, proceeds from exercise of equity awards and the average amount of unrecognized compensation expense for equity awards are assumed to be used to repurchase shares. In loss periods, basic net loss per share and diluted net loss per share are identical because the otherwise dilutive potential common shares become anti-dilutive and are therefore excluded.

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

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Weighted average shares outstanding	146	147	146	147
Effect of potentially dilutive common shares from:				
Equity awards	2	1	2	1

Weighted average shares used in calculating diluted earnings per share	148	148	148	148
Potentially dilutive shares excluded from calculation due to anti-dilutive effect	—	—	—	1

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2. Balance Sheet Account Details

Short-Term Investments

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

	October 1, 2017			January 1, 2017		
	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value
Available-for-sale securities:						
Debt securities in government sponsored entities	$74	$ —	$ 74	$34	$ —	$ 34
Corporate debt securities	343	(1)	342	478	(2)	476
U.S. Treasury securities	272	(1)	271	316	(2)	314
Total available-for-sale securities	$689	$ (2)	$ 687	$828	$ (4)	$ 824

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

Contractual maturities of available-for-sale debt securities as of October 1, 2017 were as follows (in millions):

	Estimated Fair Value
Due within one year	$ 421
After one but within five years	266
Total	$ 687

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

Strategic Investments

As of October 1, 2017 and January 1, 2017, the aggregate carrying amounts of the Company’s cost-method investments in non-publicly traded companies included in other assets were $250 million and $57 million, respectively. Revenue recognized from transactions with such companies was $38 million and $96 million, respectively, for the three and nine months ended October 1, 2017 and $12 million and $42 million, respectively, for the three and nine months ended October 2, 2016.

The Company’s cost-method investments are assessed for impairment quarterly. The Company determines that it is not practicable to estimate the fair value of its cost-method investments on a regular basis and does not reassess the fair value of cost-method investments unless there are identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investments. No material impairment losses were recorded during the three and nine months ended October 1, 2017 or October 2, 2016.

The Company invests in a venture capital investment fund (the Fund) with a capital commitment of $100 million that is callable over ten years. The Company’s investment in the Fund is accounted for as an equity method investment. The carrying amounts included in other assets were $14 million and $10 million as of October 1, 2017 and January 1, 2017, respectively.

Inventory

Inventory consists of the following (in millions):

	October 1, 2017	January 1, 2017
Raw materials	$ 90	$ 102
Work in process	192	161
Finished goods	45	37
Total inventory	$ 327	$ 300

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Property and Equipment

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

	October 1, 2017	January 1, 2017
Leasehold improvements	$ 320	$ 270
Machinery and equipment	301	274
Computer hardware and software	178	156
Furniture and fixtures	34	24
Building	147	9
Construction in progress	273	307
Total property and equipment, gross	1,253	1,040
Accumulated depreciation	(391)	(327)
Total property and equipment, net	$ 862	$ 713

Property and equipment, net included non-cash expenditures of $94 million and $194 million for the nine months ended October 1, 2017 and October 2, 2016, respectively, which were excluded from the condensed consolidated statements of cash flows. Such non-cash expenditures included $60 million and $169 million recorded under build-to-suit lease accounting for the nine months ended October 1, 2017 and October 2, 2016, respectively.

Intangible Assets and Goodwill

The Company tests the carrying value of goodwill in accordance with accounting rules on impairment of goodwill, which require the Company to estimate the fair value of the reporting unit annually, or when impairment indicators exist, and compare such amounts to their respective carrying values to determine if an impairment is required. The Company performed its annual assessment for goodwill impairment in the second quarter of 2017, noting no impairment.

Changes to the Company’s goodwill balance during the nine months ended October 1, 2017 are as follows (in millions):

	Goodwill
Balance as of January 1, 2017	$ 776
GRAIL deconsolidation	(5)
Balance as of October 1, 2017	$ 771

The Company regularly performs reviews to determine if any event has occurred that may indicate its identifiable intangible assets are potentially impaired. During the nine months ended October 1, 2017, the Company performed a recoverability test when the planned use of a finite-lived acquired intangible asset changed, resulting in an impairment charge of $18 million recorded in cost of product revenue. Also during the nine months ended October 1, 2017, the Company recorded a $5 million impairment charge of in-process research and development as it was determined the project had no future alternative use.

Derivatives

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

assets or liabilities.

As of October 1, 2017, the Company had foreign exchange forward contracts in place to hedge exposures in the euro, Japanese yen, Australian dollar, and Canadian dollar. As of October 1, 2017 and January 1, 2017, the total notional amounts of outstanding forward contracts in place for foreign currency purchases were $79 million and $69 million, respectively.

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Accrued Liabilities

Accrued liabilities consist of the following (in millions):

	October 1, 2017	January 1, 2017
Accrued compensation expenses	$ 138	$ 112
Deferred revenue, current portion	131	121
Accrued taxes payable	41	32
Customer deposits	18	20
Other	53	57
Total accrued liabilities	$ 381	$ 342

Warranties

The Company generally provides a one-year warranty on instruments. Additionally, the Company provides a warranty on consumables through the expiration date, which generally ranges from six to twelve months after the manufacture date. At the time revenue is recognized, the Company establishes an accrual for estimated warranty expenses based on historical experience as well as anticipated product performance. The Company periodically reviews its warranty reserve for adequacy and adjusts the warranty accrual, if necessary, based on actual experience and estimated costs to be incurred. Warranty expense is recorded as a component of cost of product revenue.

Changes in the Company's reserve for product warranties during the three and nine months ended October 1, 2017 and October 2, 2016 are as follows (in millions):

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Balance at beginning of period	$ 14	$ 16	$ 13	$ 17
Additions charged to cost of product revenue	7	4	18	17
Repairs and replacements	(5)	(6)	(15)	(20)
Balance at end of period	$ 16	$ 14	$ 16	$ 14

Leases

Changes in the Company's facility exit obligation related to its former headquarters lease during the three and nine months ended October 1, 2017 and October 2, 2016 are as follows (in millions):

	Three Months Ended		Nine Months Ended	
	October 1, 2017	October 2, 2016	October 1, 2017	October 2, 2016
Balance at beginning of period	$ 18	$ 21	$ 19	$ 22
Accretion of interest expense	—	—	—	1
Cash payments	(1)	(1)	(2)	(3)
Balance at end of period	$ 17	$ 20	$ 17	$ 20

On February 22, 2017, the Company entered into a lease agreement for a building under construction in Madison, Wisconsin. Minimum lease payments during the initial 15-year term are estimated to be $46 million.

Investments in Consolidated Variable Interest Entities

GRAIL, Inc.

In January 2016, the Company obtained a majority equity ownership interest in GRAIL, a company formed with unrelated third party investors to develop a blood test for early-stage cancer detection. The Company determined that GRAIL

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was a variable interest entity as the entity lacked sufficient equity to finance its activities without additional support. Additionally, the Company determined that it had (a) control of GRAIL's board of directors, which had unilateral power over the activities that most significantly impacted the economic performance of GRAIL and (b) the obligation to absorb losses of and the right to receive benefits from GRAIL that were potentially significant to GRAIL. As a result, the Company was deemed to be the primary beneficiary of GRAIL and was required to consolidate GRAIL.

In January 2016, GRAIL completed its Series A convertible preferred stock financing, raising $120 million, of which the Company invested $40 million. Additionally, the Company and GRAIL executed a long-term supply agreement in which the Company contributed certain perpetual licenses, employees, and discounted supply terms in exchange for 113 million shares of GRAIL's Class B common stock. Such contributions were recorded at their historical basis as they remained within the control of the Company. The $80 million received by GRAIL from unrelated third party investors upon issuance of its Series A convertible preferred stock was classified as noncontrolling interests in stockholders' equity on the Company's condensed consolidated balance sheet.

In June 2016, GRAIL authorized for issuance 98 million shares of Series A-1 convertible preferred stock, all of which were issued to Illumina in exchange for Illumina's 98 million shares of GRAIL Class B common stock. As a result of the exchange, Illumina recorded a $10 million deemed dividend, net of tax of $10 million, through equity, which was eliminated in consolidation.

Deconsolidation of GRAIL, Inc.

On February 28, 2017, GRAIL completed the initial close of its Series B preferred stock financing, raising over $900 million, in which the Company did not participate. Concurrent with the financing, GRAIL repurchased from the Company 35 million shares of its Series A preferred stock and approximately 34 million shares of its Series A-1 preferred stock for an aggregate purchase price of $278 million. At this time, the Company ceased to have a controlling financial interest in GRAIL and the Company's equity ownership was reduced from 52% to 19%. Additionally, the Company's voting interest was reduced to 13%, and the Company no longer has representation on GRAIL's board of directors. As a result, the Company deconsolidated GRAIL's financial statements effective February 28, 2017 and accounts for the remaining retained investment as a cost method investment. During the three months ended July 2, 2017, the Company purchased approximately 3 million Series B preferred shares for $14 million resulting in an ownership of approximately 17% of GRAIL's outstanding stock and a 12% voting interest. As of October 1, 2017, the Company holds $185 million in other assets related to this investment, which consists of 5 million Series A preferred shares, and approximately 3 million Series B preferred shares and 78 million Class A common shares of GRAIL.

The operations of GRAIL from January 2, 2017 up to the date of deconsolidation are included in the accompanying condensed consolidated statements of income for the nine months ended October 1, 2017. During this period, the Company absorbed approximately 50% of GRAIL's losses based upon its proportional ownership of GRAIL's common stock.

On February 28, 2017, the Company recorded a pretax gain of $453 million included in other income, net, of which $159 million relates to the remeasurement of the Company's retained equity interest to its fair value. The pretax gain on deconsolidation includes (i) the consideration received from GRAIL for its repurchase of a portion of the Company's ownership interest, (ii) the derecognition of the carrying amounts of GRAIL's assets and liabilities, (iii) the derecognition of the noncontrolling interest related to GRAIL, and (iv) the recording of the Company's remaining interest in GRAIL at fair value. This fair value measurement of the Company's remaining interest was derived using the market approach. Significant estimates and assumptions required for this valuation included, but were not limited to, various Black-Scholes option-pricing model assumptions as of the date of deconsolidation and estimated discounts for lack of marketability related to the equity securities. These unobservable inputs, which represent a Level 3

measurement, are supported by little or no market activity and reflect the Company's own assumptions in measuring fair value.

In connection with the deconsolidation of GRAIL, the parties amended their long-term supply agreement, including the discounted supply terms. The repurchase and supply arrangements, which were entered into concurrently, contain various elements and, as such, are deemed to be an arrangement with multiple deliverables as defined under the respective authoritative accounting guidance. The Company determined that each of the elements, which include the purchase obligation, the purchase right, and services to be provided in accordance with the long-term supply agreement, were at, or approximated, fair value on a standalone basis, and therefore, there was no discount to allocate among the deliverables. As such, none of the deconsolidation gain was allocated to these elements.

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Helix Holdings I, LLC

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

As contractually committed, the Company contributed certain perpetual licenses, instruments, intangibles, initial laboratory setup, and discounted supply terms in exchange for voting equity interests in Helix. Such contributions are recorded at their historical basis as they remain within the control of the Company. Helix is financed through cash contributions made by the third party investors in exchange for voting equity interests in Helix.

Certain noncontrolling Helix investors may require the Company to redeem all noncontrolling interests in cash at the then approximate fair market value. Such redemption right is exercisable at the option of certain noncontrolling interest holders after January 1, 2021, provided that a bona fide pursuit of the sale of Helix has occurred and an initial public offering of Helix has not been completed. The fair value of the redeemable noncontrolling interests is considered a Level 3 instrument.

As the contingent redemption is outside of the control of Illumina, the redeemable noncontrolling interests in Helix are classified outside of stockholders’ equity on the accompanying condensed consolidated balance sheets. The balance of the redeemable noncontrolling interests is reported at the greater of its carrying value after receiving its allocation of Helix’s profits and losses or its estimated redemption value at each reporting date. As of October 1, 2017, the noncontrolling shareholders and Illumina each held 50% of Helix’s outstanding voting equity interests.

The assets and liabilities of Helix are not significant to the Company’s financial position as of October 1, 2017. Helix has an immaterial impact on the Company’s condensed consolidated statements of income and cash flows for the three and nine months ended October 1, 2017.

As of October 1, 2017, the accompanying condensed consolidated balance sheet includes $32 million of cash and cash equivalents attributable to Helix that will be used to settle their respective obligations and will not be available to settle obligations of the Company.

Redeemable Noncontrolling Interests

The activity of the redeemable noncontrolling interests during the nine months ended October 1, 2017 is as follows (in millions):

	Redeemable Noncontrolling Interests	
Balance as of January 1, 2017	$ 44	
Amount released from escrow	79	
Vesting of redeemable equity awards	12	
Net loss attributable to noncontrolling interests	(30	)

Adjustment up to the redemption value	30
Deconsolidation of GRAIL	(11)
Balance as of October 1, 2017	$ 124

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3. Fair Value Measurements

The following table presents the Company's hierarchy for assets and liabilities measured at fair value on a recurring basis as of October 1, 2017 and January 1, 2017 (in millions):