

GILEAD SCIENCES INC  
Form 10-Q  
November 05, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the quarterly period ended September 30, 2014  
or  
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File No. 0-19731

GILEAD SCIENCES, INC.

(Exact Name of Registrant as Specified in Its Charter)

|   |                                      |
|---|--------------------------------------|
| Delaware  | 94-3047598                           |
| (State or Other Jurisdiction of<br>Incorporation or Organization) | (IRS Employer<br>Identification No.) |

|   |            |
|---|------------|
| 333 Lakeside Drive, Foster City, California | 94404      |
| (Address of principal executive offices)    | (Zip Code) |

650-574-3000

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 ☒ 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ 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 ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☐  
(Do not check if a smaller reporting company)

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

Number of shares outstanding of the issuer's common stock, par value \$0.001 per share, as of October 31, 2014:  
1,508,664,333

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We own or have rights to various trademarks, copyrights and trade names used in our business, including the following: GILEAD®, GILEAD SCIENCES®, SOVALDI®, STRIBILD®, COMPLERA®, EVIPLERA®, TRUVADA®, VIREAD®, EMTRIVA®, TYBOST®, ZYDELIG®, HARVONI®, HEPSERA®, VITEKTA®,

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LETAIRIS<sup>®</sup>, RANEXA<sup>®</sup>, CAYSTON<sup>®</sup>, AMBISOME<sup>®</sup>, VOLIBRIS<sup>®</sup> and RAPISCAN<sup>®</sup>. ATRIPLA<sup>®</sup> is a registered trademark belonging to Bristol-Myers Squibb & Gilead Sciences, LLC. LEXISCAN<sup>®</sup> is a registered trademark belonging to Astellas U.S. LLC. MACUGEN<sup>®</sup> is a registered trademark belonging to Eyetech, Inc. SUSTIVA<sup>®</sup> is a registered trademark of Bristol-Myers Squibb Pharma Company. TAMIFLU<sup>®</sup> is a registered trademark belonging to Hoffmann-La Roche Inc. This report also includes other trademarks, service marks and trade names of other companies.

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## PART I. FINANCIAL INFORMATION

## ITEM I. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

## GILEAD SCIENCES, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)

(in thousands, except per share amounts)

|  | September 30,<br>2014 | December 31,<br>2013 |
|--|-----------------------|----------------------|
| Assets   |                       |                      |
| Current assets:  |                       |                      |
| Cash and cash equivalents  | \$6,209,060           | \$2,112,806          |
| Short-term marketable securities   | 107,266               | 18,756               |
| Accounts receivable, net   | 2,850,367             | 2,100,286            |
| Inventories  | 1,909,584             | 2,055,788            |
| Deferred tax assets  | 384,588               | 330,530              |
| Prepaid taxes  | 599,117               | 398,010              |
| Prepaid expenses   | 234,802               | 165,652              |
| Other current assets   | 267,247               | 91,925               |
| Total current assets   | 12,562,031            | 7,273,753            |
| Property, plant and equipment, net   | 1,509,796             | 1,166,181            |
| Long-term portion of prepaid royalties   | 487,852               | 198,766              |
| Long-term deferred tax assets  | 163,720               | 154,765              |
| Long-term marketable securities  | 1,375,400             | 439,028              |
| Intangible assets, net   | 11,306,547            | 11,900,106           |
| Goodwill   | 1,171,561             | 1,169,023            |
| Other long-term assets   | 267,486               | 195,163              |
| Total assets   | \$28,844,393          | \$22,496,785         |
| Liabilities and Stockholders' Equity   |                       |                      |
| Current liabilities:   |                       |                      |
| Accounts payable   | \$1,182,917           | \$1,255,914          |
| Accrued government rebates   | 1,741,829             | 983,490              |
| Accrued compensation and employee benefits   | 267,599               | 243,540              |
| Income taxes payable   | 43,781                | 10,855               |
| Other accrued liabilities  | 1,224,864             | 1,023,938            |
| Deferred revenues  | 116,880               | 110,640              |
| Current portion of long-term debt and other obligations, net   | 1,477,082             | 2,697,044            |
| Total current liabilities  | 6,054,952             | 6,325,421            |
| Long-term debt, net  | 7,933,040             | 3,938,708            |
| Long-term income taxes payable   | 417,434               | 162,412              |
| Long-term deferred tax liabilities   | 65,433                | 83,286               |
| Other long-term obligations  | 482,542               | 178,626              |
| Commitments and contingencies  |                       |                      |
| Equity component of currently redeemable convertible notes   | 27,382                | 63,831               |
| Stockholders' equity:  |                       |                      |
| Preferred stock, par value \$0.001 per share; 5,000 shares authorized; none outstanding  | —                     | —                    |
| Common stock, par value \$0.001 per share; shares authorized of 5,600,000; shares issued and outstanding of 1,513,593 at September 30, 2014 and 1,534,414 at | 1,514                 | 1,534                |

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December 31, 2013

|   |              |              |
|---|--------------|--------------|
| Additional paid-in capital                    | 2,143,092    | 5,386,735    |
| Accumulated other comprehensive income (loss) | 173,962      | (124,446 )   |
| Retained earnings                             | 11,247,655   | 6,105,244    |
| Total Gilead stockholders' equity             | 13,566,223   | 11,369,067   |
| Noncontrolling interest                       | 297,387      | 375,434      |
| Total stockholders' equity                    | 13,863,610   | 11,744,501   |
| Total liabilities and stockholders' equity    | \$28,844,393 | \$22,496,785 |
| See accompanying notes.                       |              |              |

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GILEAD SCIENCES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(unaudited)  
(in thousands, except per share amounts)

|   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|-------------|------------------------------------|-------------|
|   | 2014                                | 2013        | 2014                               | 2013        |
| Revenues:   |                                     |             |                                    |             |
| Product sales   | \$5,968,208                         | \$2,709,652 | \$17,252,119                       | \$7,760,505 |
| Royalty, contract and other revenues                                    | 73,624                              | 73,181      | 323,612                            | 321,357     |
| Total revenues  | 6,041,832                           | 2,782,833   | 17,575,731                         | 8,081,862   |
| Costs and expenses:   |                                     |             |                                    |             |
| Cost of goods sold  | 987,306                             | 681,868     | 2,725,220                          | 2,000,979   |
| Research and development  | 630,466                             | 546,244     | 1,809,368                          | 1,567,778   |
| Selling, general and administrative                                     | 944,837                             | 406,860     | 2,106,515                          | 1,186,147   |
| Total costs and expenses  | 2,562,609                           | 1,634,972   | 6,641,103                          | 4,754,904   |
| Income from operations  | 3,479,223                           | 1,147,861   | 10,934,628                         | 3,326,958   |
| Interest expense  | (103,366 )                          | (73,949 )   | (281,639 )                         | (233,744 )  |
| Other income (expense), net   | (5,037 )                            | 5,777       | (26,594 )                          | 2,222       |
| Income before provision for income taxes                                | 3,370,820                           | 1,079,689   | 10,626,395                         | 3,095,436   |
| Provision for income taxes  | 646,557                             | 294,473     | 2,029,060                          | 824,892     |
| Net income  | 2,724,263                           | 785,216     | 8,597,335                          | 2,270,544   |
| Net loss attributable to noncontrolling interest                        | 7,011                               | 3,390       | 16,942                             | 12,853      |
| Net income attributable to Gilead                                       | \$2,731,274                         | \$788,606   | \$8,614,277                        | \$2,283,397 |
| Net income per share attributable to Gilead common stockholders—basic   | \$1.80                              | \$0.51      | \$5.64                             | \$1.50      |
| Shares used in per share calculation—basic                              | 1,513,899                           | 1,532,105   | 1,527,633                          | 1,526,847   |
| Net income per share attributable to Gilead common stockholders—diluted | \$1.67                              | \$0.47      | \$5.18                             | \$1.35      |
| Shares used in per share calculation—diluted                            | 1,636,530                           | 1,691,898   | 1,662,281                          | 1,689,647   |

See accompanying notes.

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## GILEAD SCIENCES, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(unaudited)

(in thousands)

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |             |
|---|-------------------------------------|-----------|------------------------------------|-------------|
|   | 2014                                | 2013      | 2014                               | 2013        |
| Net income  | \$2,724,263                         | \$785,216 | \$8,597,335                        | \$2,270,544 |
| Other comprehensive income:   |                                     |           |                                    |             |
| Change in foreign currency translation gain (loss), net of tax                                      | (10,031                             | ) 2,381   | (3,062                             | ) 5,155     |
| Available-for-sale securities:  |                                     |           |                                    |             |
| Change in net unrealized gains (losses), net of tax impact of \$(481), \$2,182, \$697 and \$2,310   | (831                                | ) 4,316   | 995                                | 4,082       |
| Reclassifications to net income, net of tax impact of \$(29), \$(38), \$(253) and \$(79)            | (51                                 | ) (65     | ) (437                             | ) (140      |
| Net change  | (882                                | ) 4,251   | 558                                | 3,942       |
| Cash flow hedges:   |                                     |           |                                    |             |
| Change in net unrealized gains (losses), net of tax impact of \$6,462, \$6,083, \$6,288 and \$2,504 | 223,886                             | (82,453   | ) 256,772                          | (3,371      |
| Reclassifications to net income, net of tax impact of \$(640), \$(358), \$(2,702) and \$(610)       | 2,449                               | 3,380     | 44,140                             | (2,181      |
| Net change  | 226,335                             | (79,073   | ) 300,912                          | (5,552      |
| Other comprehensive income (loss)   | 215,422                             | (72,441   | ) 298,408                          | 3,545       |
| Comprehensive income  | 2,939,685                           | 712,775   | 8,895,743                          | 2,274,089   |
| Comprehensive loss attributable to noncontrolling interest  | 7,011                               | 3,390     | 16,942                             | 12,853      |
| Comprehensive income attributable to Gilead   | \$2,946,696                         | \$716,165 | \$8,912,685                        | \$2,286,942 |

See accompanying notes.

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GILEAD SCIENCES, INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (unaudited)  
 (in thousands)

|   | Nine Months Ended<br>September 30, |             |
|---|------------------------------------|-------------|
|   | 2014                               | 2013        |
| Operating Activities:   |                                    |             |
| Net income  | \$8,597,335                        | \$2,270,544 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |             |
| Depreciation expense  | 93,669                             | 76,046      |
| Amortization expense  | 680,950                            | 140,699     |
| Stock-based compensation expense  | 264,583                            | 180,293     |
| Excess tax benefits from stock-based compensation                                 | (357,928)                          | (168,728)   |
| Tax benefits from exercise and vesting of stock-based awards                      | 360,336                            | 169,916     |
| Deferred income taxes   | (67,061)                           | (12,400)    |
| Change in fair value of contingent consideration                                  | (4,119)                            | 47,442      |
| Other   | 54,791                             | 45,116      |
| Changes in operating assets and liabilities:                                      |                                    |             |
| Accounts receivable, net  | (826,970)                          | (226,308)   |
| Inventories   | 100,828                            | (216,650)   |
| Prepaid expenses and other assets   | (428,969)                          | (111,199)   |
| Accounts payable  | (74,599)                           | 23,131      |
| Income taxes payable  | 135,672                            | (87,081)    |
| Accrued liabilities   | 1,256,505                          | 218,323     |
| Deferred revenues   | 12,310                             | 29,057      |
| Net cash provided by operating activities   | 9,797,333                          | 2,378,201   |
| Investing Activities:   |                                    |             |
| Purchases of marketable securities  | (1,532,426)                        | (254,657)   |
| Proceeds from sales of marketable securities                                      | 477,152                            | 226,291     |
| Proceeds from maturities of marketable securities                                 | 26,582                             | 57,556      |
| Acquisitions, net of cash acquired  | —                                  | (378,645)   |
| Capital expenditures  | (389,549)                          | (121,310)   |
| Net cash used in investing activities   | (1,418,241)                        | (470,765)   |
| Financing Activities:   |                                    |             |
| Proceeds from debt financing, net of issuance costs                               | 3,965,446                          | —           |
| Proceeds from convertible note hedges   | 1,629,483                          | 1,257,869   |
| Purchases of convertible note hedges  | (26,249)                           | —           |
| Proceeds from issuances of common stock   | 275,074                            | 240,671     |
| Repurchases of common stock   | (3,348,477)                        | (182,259)   |
| Repayments of debt and other long-term obligations                                | (2,859,872)                        | (2,224,782) |
| Payments to settle warrants   | (4,092,758)                        | (1,039,695) |
| Excess tax benefits from stock-based compensation                                 | 357,928                            | 168,728     |
| Payment of contingent consideration   | (98,346)                           | —           |
| Contributions from (distributions to) noncontrolling interest                     | (61,105)                           | 80,586      |
| Net cash used in financing activities   | (4,258,876)                        | (1,698,882) |
| Effect of exchange rate changes on cash and cash equivalents                      | (23,962)                           | (1,512)     |

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|  |             |             |
|--|-------------|-------------|
| Net change in cash and cash equivalents          | 4,096,254   | 207,042     |
| Cash and cash equivalents at beginning of period | 2,112,806   | 1,803,694   |
| Cash and cash equivalents at end of period       | \$6,209,060 | \$2,010,736 |

See accompanying notes.

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GILEAD SCIENCES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. The financial statements include all adjustments (consisting only of normal recurring adjustments) that the management of Gilead Sciences, Inc. (Gilead, we or us) believes are necessary for a fair presentation of the periods presented. These interim financial results are not necessarily indicative of results expected for the full fiscal year or for any subsequent interim period.

The accompanying Condensed Consolidated Financial Statements include the accounts of Gilead, our wholly-owned subsidiaries and our joint ventures with Bristol-Myers Squibb Company (BMS), for which we are the primary beneficiary. We record a noncontrolling interest in our Condensed Consolidated Financial Statements to reflect BMS's interest in the joint ventures. All intercompany transactions have been eliminated. The Condensed Consolidated Financial Statements include the results of companies acquired by us from the date of each acquisition for the applicable reporting periods.

The accompanying Condensed Consolidated Financial Statements and related Notes to Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and the related notes thereto for the year ended December 31, 2013, included in our Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

Significant Accounting Policies, Estimates and Judgments

The preparation of these Condensed Consolidated Financial Statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures. On an ongoing basis, management evaluates its significant accounting policies or estimates. We base our estimates on historical experience and on various market-specific and other relevant assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates.

Concentrations of Risk

We are subject to credit risk from our portfolio of cash equivalents and marketable securities. Under our investment policy, we limit amounts invested in such securities by credit rating, maturity, industry group, investment type and issuer, except for securities issued by the U.S. government. We are not exposed to any significant concentrations of credit risk from these financial instruments. The goals of our investment policy, in order of priority, are as follows: safety and preservation of principal and diversification of risk; liquidity of investments sufficient to meet cash flow requirements; and a competitive after-tax rate of return.

We are also subject to credit risk from our accounts receivable related to our product sales. The majority of our trade accounts receivable arises from product sales in the United States and Europe.

As of September 30, 2014, our accounts receivable in Southern Europe, specifically Greece, Italy, Portugal and Spain, totaled approximately \$587.2 million, of which \$154.5 million were greater than 120 days past due and \$52.0 million were greater than 365 days past due. To date, we have not experienced significant losses with respect to the collection of our accounts receivable. We believe that our allowance for doubtful accounts was adequate at September 30, 2014.

### Branded Prescription Drug Fee

We, along with other pharmaceutical manufacturers of branded drug products, are required to pay a portion of the Branded Prescription Drug (BPD) Fee, which is calculated based on select government sales during each calendar year as a percentage of total industry government sales. During the third quarter of 2014, the IRS issued final regulations which required manufacturers to recognize an additional year of expense, which for us resulted in a cumulative catch-up of \$337 million within the quarter. The IRS is expected to communicate the final BPD fee amounts due for 2013 sales during the third quarter of 2015 and for 2014 sales during the third quarter of 2016. As of September 30, 2014, our BPD fee accrual totaled \$343 million, of which \$304 million was included in other long-term obligations on our Condensed Consolidated Balance Sheet.

### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, jointly with the International Accounting Standards Board, issued a comprehensive new standard on revenue recognition from contracts with customers. The standard's core principle is that a reporting entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In applying this new guidance to contracts within its scope, an entity will: (1) identify the contract(s) with a customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, and (5) recognize revenue when (or as) the entity satisfies a performance obligation. Additionally, this new guidance will require significantly expanded revenue recognition disclosures. This guidance will become effective for us beginning in the first quarter of 2017. Early application is not permitted. Entities have the option of using either a full retrospective or a modified retrospective approach to adopt this new guidance. We are currently evaluating the impact of our pending adoption of this standard on our Condensed Consolidated Financial Statements.

### 2. FAIR VALUE MEASUREMENTS

We determine the fair value of financial and non-financial assets and liabilities using the fair value hierarchy, which establishes three levels of inputs that may be used to measure fair value, as follows:

Level 1 inputs which include quoted prices in active markets for identical assets or liabilities;

Level 2 inputs which include observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

For our marketable securities, we review trading activity and pricing as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from various third-party data providers. These inputs either represent quoted prices for similar assets in active markets or have been derived from observable market data; and

Level 3 inputs which include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability. Our Level 3 liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques and significant management judgment or estimation.

Our financial instruments consist principally of cash and cash equivalents, marketable securities, accounts receivable, foreign currency exchange contracts, accounts payable and short-term and long-term debt. Cash and cash equivalents, marketable securities and foreign currency exchange contracts that hedge accounts receivable and forecasted sales are reported at their respective fair values on our Condensed Consolidated Balance Sheets. Short-term and long-term debt are reported at their amortized cost on our Condensed Consolidated Balance Sheets. The remaining financial instruments are reported on our Condensed Consolidated Balances Sheets at amounts that approximate current fair values.

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The fair values of our convertible senior notes and senior unsecured notes were determined using Level 2 inputs based on their quoted market values. The following table summarizes the carrying values and fair values of our convertible senior notes and senior unsecured notes (in thousands):

| Type of Borrowing  | Description         | September 30, 2014 |            | December 31, 2013 |            |
|--------------------|---------------------|--------------------|------------|-------------------|------------|
|                    |                     | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
| Convertible Senior | May 2014 Notes      | \$—                | \$—        | \$234,217         | \$783,651  |
| Convertible Senior | May 2016 Notes      | 727,072            | 3,517,174  | 1,113,043         | 3,871,516  |
| Senior Unsecured   | April 2021 Notes    | 994,425            | 1,093,710  | 993,781           | 1,075,480  |
| Senior Unsecured   | December 2014 Notes | 749,947            | 752,820    | 749,710           | 762,637    |
| Senior Unsecured   | December 2016 Notes | 699,499            | 729,603    | 699,326           | 740,705    |
| Senior Unsecured   | December 2021 Notes | 1,247,933          | 1,358,813  | 1,247,716         | 1,336,738  |
| Senior Unsecured   | December 2041 Notes | 997,942            | 1,186,550  | 997,885           | 1,118,660  |
| Senior Unsecured   | April 2019 Notes    | 499,232            | 496,065    | —                 | —          |
| Senior Unsecured   | April 2024 Notes    | 1,747,340          | 1,782,900  | —                 | —          |
| Senior Unsecured   | April 2044 Notes    | 1,746,669          | 1,848,333  | —                 | —          |

The following table summarizes, for assets or liabilities recorded at fair value, the respective fair value and the classification by level of input within the fair value hierarchy previously defined (in thousands):

|  | September 30, 2014 |             |          |             | December 31, 2013 |           |           |             |
|--|--------------------|-------------|----------|-------------|-------------------|-----------|-----------|-------------|
|  | Level 1            | Level 2     | Level 3  | Total       | Level 1           | Level 2   | Level 3   | Total       |
| <b>Assets:</b>                                   |                    |             |          |             |                   |           |           |             |
| <b>Debt securities:</b>                          |                    |             |          |             |                   |           |           |             |
| Money market funds                               | \$5,049,683        | \$—         | \$—      | \$5,049,683 | \$1,490,964       | \$—       | \$—       | \$1,490,964 |
| Corporate debt securities                        | —                  | 675,745     | —        | 675,745     | —                 | 220,025   | —         | 220,025     |
| U.S. treasury securities                         | 520,208            | —           | —        | 520,208     | 85,403            | —         | —         | 85,403      |
| U.S. government agencies securities              | —                  | 131,417     | —        | 131,417     | —                 | 93,350    | —         | 93,350      |
| Residential mortgage and asset-backed securities | —                  | 151,287     | —        | 151,287     | —                 | 46,941    | —         | 46,941      |
| Municipal debt securities                        | —                  | 9,209       | —        | 9,209       | —                 | 12,065    | —         | 12,065      |
| Total debt securities                            | 5,569,891          | 967,658     | —        | 6,537,549   | 1,576,367         | 372,381   | —         | 1,948,748   |
| Deferred compensation plan                       | 52,261             | —           | —        | 52,261      | 44,461            | —         | —         | 44,461      |
| Foreign currency derivative contracts            | —                  | 215,911     | —        | 215,911     | —                 | 13,879    | —         | 13,879      |
|  | \$5,622,152        | \$1,183,569 | \$—      | \$6,805,721 | \$1,620,828       | \$386,260 | \$—       | \$2,007,088 |
| <b>Liabilities:</b>                              |                    |             |          |             |                   |           |           |             |
| Contingent consideration                         | \$—                | \$—         | \$94,899 | \$94,899    | \$—               | \$—       | \$263,760 | \$263,760   |
| Foreign currency derivative contracts            | —                  | 3,696       | —        | 3,696       | —                 | 99,057    | —         | 99,057      |

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|                            |          |         |          |           |          |          |           |           |
|----------------------------|----------|---------|----------|-----------|----------|----------|-----------|-----------|
| Deferred compensation plan | 52,261   | —       | —        | 52,261    | 44,461   | —        | —         | 44,461    |
|                            | \$52,261 | \$3,696 | \$94,899 | \$150,856 | \$44,461 | \$99,057 | \$263,760 | \$407,278 |

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## Level 2 Inputs

We estimate the fair values of our government agency securities, corporate debt, residential mortgage and asset-backed securities by taking into consideration valuations obtained from third-party pricing services. The pricing services utilize industry standard valuation models, including both income- and market-based approaches, for which all significant inputs are observable, either directly or indirectly, to estimate fair value. These inputs include reported trades of and broker/dealer quotes on the same or similar securities; issuer credit spreads; benchmark securities; prepayment/default projections based on historical data and other observable inputs.

Substantially all of our foreign currency derivative contracts have maturities primarily over an 18-month time horizon and all are with counterparties that have a minimum credit rating of A- or equivalent by Standard & Poor's, Moody's Investors Service, Inc. or Fitch, Inc. We estimate the fair values of these contracts by taking into consideration valuations obtained from a third-party valuation service that utilizes an income-based industry standard valuation model for which all significant inputs are observable, either directly or indirectly. These inputs include foreign currency rates, London Interbank Offered Rates (LIBOR) and swap rates. These inputs, where applicable, are at commonly quoted intervals.

## Level 3 Inputs

As of September 30, 2014 and December 31, 2013, the only assets or liabilities that were measured using Level 3 inputs were contingent consideration liabilities. Our policy is to recognize transfers into or out of Level 3 classification as of the actual date of the event or change in circumstances that caused the transfer.

### Contingent Consideration Liabilities

In connection with certain acquisitions, we may be required to pay future consideration that is contingent upon the achievement of specified development, regulatory approval or sales-based milestone events. We estimate the fair value of the contingent consideration liabilities on the acquisition date and each reporting period thereafter using a probability-weighted income approach, which reflects the probability and timing of future payments. This fair value measurement is based on significant Level 3 inputs such as the anticipated timelines and probability of achieving development, regulatory approval or sales-based milestone events and projected revenues. The resulting probability-weighted cash flows are discounted using credit-risk adjusted interest rates.

Each reporting period thereafter, we revalue these obligations by performing a review of the assumptions listed above and record increases or decreases in the fair value of these contingent consideration obligations in research and development (R&D) expenses within our Condensed Consolidated Statements of Income until such time that the related product candidate receives marketing approval. In the absence of any significant changes in key assumptions, the quarterly determination of fair values of these contingent consideration obligations would primarily reflect the passage of time.

Significant judgment is employed in determining Level 3 inputs and fair value measurements as of the acquisition date and for each subsequent period. Updates to assumptions could have a significant impact on our results of operations in any given period and actual results may differ from estimates. For example, significant increases in the probability of achieving a milestone or projected revenues would result in a significantly higher fair value measurement while significant decreases in the estimated probability of achieving a milestone or projected revenues would result in a significantly lower fair value measurement. Significant increases in the discount rate or in the anticipated timelines would result in a significantly lower fair value measurement while significant decreases in the discount rate or anticipated timelines would result in a significantly higher fair value measurement.

The potential contingent consideration payments required upon achievement of development or regulatory approval-based milestones related to our CGI Pharmaceuticals, Inc. and Calistoga Pharmaceuticals, Inc. (Calistoga) acquisitions range from no payment if none of the milestones are achieved to an estimated maximum of \$254.0 million (undiscounted), of which we had accrued \$47.4 million as of September 30, 2014 and \$220.5 million as of December 31, 2013. In July 2014, upon receiving U.S. Food and Drug Administration (FDA) approval of Zydrelig, certain regulatory approval-based milestones related to our Calistoga acquisition were met and as a result, we made contingent consideration payments totaling \$175.0 million in the third quarter of 2014. The remainder of the contingent consideration liabilities as of September 30, 2014 and December 31, 2013 relate to potential future payments resulting from the acquisition of Arresto Biosciences, Inc. for royalty obligations on future sales once

specified sales-based milestones are achieved.

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The following table provides a rollforward of our contingent consideration liabilities, which are recorded as part of other accrued liabilities and other long-term obligations in our Condensed Consolidated Balance Sheets (in thousands):

|                               |            |
|-------------------------------|------------|
| Balance at December 31, 2013  | \$263,760  |
| Milestone payments            | (175,000 ) |
| Net changes in valuation      | 6,139      |
| Balance at September 30, 2014 | \$94,899   |

### 3. AVAILABLE-FOR-SALE SECURITIES

Estimated fair values of available-for-sale securities are generally based on prices obtained from commercial pricing services. The following table is a summary of available-for-sale debt securities recorded in cash and cash equivalents or marketable securities in our Condensed Consolidated Balance Sheets (in thousands):

| September 30, 2014 |                              |                               |                         | December 31, 2013 |                              |                               |                         |
|--------------------|------------------------------|-------------------------------|-------------------------|-------------------|------------------------------|-------------------------------|-------------------------|
| Amortized<br>Cost  | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Estimated<br>Fair Value |