GILEAD SCIENCES INC
Form 10-Q
November 04, 2015

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

FORM 10-Q

ý	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2015
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 No. 0-19731

GILEAD SCIENCES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	94-3047598
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer 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 ý 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 ý 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 ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No ý

Number of shares outstanding of the issuer's common stock, par value $0.001 per share, as of October 30, 2015: 1,441,180,186

GILEAD SCIENCES, INC.
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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®, HARVONI®, SOVALDI®, TRUVADA®, STRIBILD®, COMPLERA®, EVIPLERA®, VIREAD®, LETAIRIS®, RANEXA®, AMBISOME®, ZYDELIG®, EMTRIVA®, TYBOST®, HEPSERA®, VITEKTA®, CAYSTON®, VOLIBRIS® and RAPISCAN®. ATRIPLA® is a registered trademark belonging to Bristol-Myers Squibb & Gilead Sciences, LLC. LEXISCAN® is a registered trademark belonging to Astellas U.S. LLC. MACUGEN® is a registered trademark belonging to Eyetech, Inc. SUSTIVA® is a registered trademark of Bristol-Myers Squibb Pharma Company. TAMIFLU® is a registered trademark belonging to Hoffmann-La Roche Inc. This report also includes other trademarks, service marks and trade names of other companies.

PART I. FINANCIAL INFORMATION
Item I. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
GILEAD SCIENCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)
(in millions, except per share amounts)

	September 30, 2015	December 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$13,965	$10,027
Short-term marketable securities	1,749	101
Accounts receivable, net	6,105	4,635
Inventories	1,988	1,386
Deferred tax assets	894	508
Prepaid and other current assets	1,209	1,057
Total current assets	25,910	17,714
Property, plant and equipment, net	2,143	1,674
Long-term portion of prepaid royalties	409	466
Long-term deferred tax assets	291	236
Long-term marketable securities	9,400	1,598
Intangible assets, net	10,454	11,073
Goodwill	1,172	1,172
Other long-term assets	858	731
Total assets	$50,637	$34,664
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$1,239	$955
Accrued government and other rebates	4,713	2,316
Other accrued liabilities	2,721	1,873
Deferred revenues	356	134
Current portion of long-term debt and other obligations, net	331	483
Total current liabilities	9,360	5,761
Long-term debt, net	21,894	11,921
Long-term income taxes payable	1,027	562
Long-term deferred tax liabilities	30	51
Other long-term obligations	378	535
Commitments and contingencies (Note 9)		
Equity component of currently redeemable convertible notes	4	15
Stockholders’ equity:		
Preferred stock, par value $0.001 per share; 5 shares authorized; none outstanding	—	—
Common stock, par value $0.001 per share; shares authorized of 5,600 at September 30, 2015 and December 31, 2014; shares issued and outstanding of 1,449 at September 30, 2015 and 1,499 at December 31, 2014	1	2
Additional paid-in capital	285	2,391
Accumulated other comprehensive income	167	301
Retained earnings	16,961	12,732
Total Gilead stockholders’ equity	17,414	15,426
Noncontrolling interest	530	393

Total stockholders’ equity	17,944	15,819
Total liabilities and stockholders’ equity	$50,637	$34,664

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Product sales	$8,211	$5,968	$23,742	$17,252
Royalty, contract and other revenues	84	74	391	324
Total revenues	8,295	6,042	24,133	17,576
Costs and expenses:				
Cost of goods sold	1,064	987	2,944	2,725
Research and development expenses	743	630	2,257	1,809
Selling, general and administrative expenses	903	945	2,360	2,107
Total costs and expenses	2,710	2,562	7,561	6,641
Income from operations	5,585	3,480	16,572	10,935
Interest expense	(165)	(104)	(458)	(282)
Other income (expense), net	52	(5)	108	(27)
Income before provision for income taxes	5,472	3,371	16,222	10,626
Provision for income taxes	880	647	2,801	2,029
Net income	4,592	2,724	13,421	8,597
Net loss attributable to noncontrolling interest	(8)	(7)	(4)	(17)
Net income attributable to Gilead	$4,600	$2,731	$13,425	$8,614
Net income per share attributable to Gilead common stockholders - basic	$3.14	$1.80	$9.11	$5.64
Shares used in per share calculation - basic	1,463	1,514	1,474	1,528
Net income per share attributable to Gilead common stockholders - diluted	$3.06	$1.67	$8.73	$5.18
Shares used in per share calculation - diluted	1,503	1,637	1,538	1,662
Cash dividends declared per share	$0.43	$—	$0.86	$—

See accompanying notes.

GILEAD SCIENCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)
(in millions)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$4,592	$2,724	$13,421	$8,597
Other comprehensive income (loss):				
Net foreign currency translation gains (losses), net of tax	3	(10)	(4)	(3)
Available-for-sale securities:				
Net unrealized gains, net of tax impact of $0, $0, $2 and $1	—	—	3	1
Net change	—	—	3	1
Cash flow hedges:				
Net unrealized gains, net of tax impact of $11, $6, $14 and $6	49	224	322	257
Reclassifications to net income, net of tax impact of $(5), $(1), $(14) and $(3)	(132)	2	(455)	44
Net change	(83)	226	(133)	301
Other comprehensive income (loss)	(80)	216	(134)	299
Comprehensive income	4,512	2,940	13,287	8,896
Comprehensive loss attributable to noncontrolling interest	(8)	(7)	(4)	(17)
Comprehensive income attributable to Gilead	$4,520	$2,947	$13,291	$8,913

See accompanying notes.

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

	Nine Months Ended September 30, 2015	2014
Operating Activities:		
Net income	$13,421	$8,597
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	116	94
Amortization expense	704	681
Stock-based compensation expense	285	265
Excess tax benefits from stock-based compensation	(498)	(358)
Tax benefits from exercise and vesting of stock-based awards	499	360
Deferred income taxes	(442)	(67)
Other	34	51
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,610)	(827)
Inventories	(659)	101
Prepaid expenses and other assets	(167)	(429)
Accounts payable	288	(75)
Income taxes payable	523	136
Accrued liabilities	2,617	1,256
Deferred revenues	344	12
Net cash provided by operating activities	15,455	9,797
Investing Activities:		
Purchases of marketable securities	(12,291)	(1,532)
Proceeds from sales of marketable securities	2,464	477
Proceeds from maturities of marketable securities	371	27
Capital expenditures	(581)	(390)
Net cash used in investing activities	(10,037)	(1,418)
Financing Activities:		
Proceeds from debt financing, net of issuance costs	9,902	3,965
Proceeds from convertible note hedges	600	1,629
Purchases of convertible note hedges	—	(26)
Repayments of debt and other obligations	(763)	(2,860)
Payment of contingent consideration	(2)	(98)
Payments to settle warrants	(3,865)	(4,093)
Proceeds from issuances of common stock	281	275
Repurchases of common stock	(6,951)	(3,348)
Payments of dividends	(1,260)	—
Excess tax benefits from stock-based compensation	498	358
Contributions from (distributions to) noncontrolling interest	141	(61)
Net cash used in financing activities	(1,419)	(4,259)
Effect of exchange rate changes on cash and cash equivalents	(61)	(24)
Net change in cash and cash equivalents	3,938	4,096

Cash and cash equivalents at beginning of period	10,027	2,113
Cash and cash equivalents at end of period	$13,965	$6,209

See accompanying notes.

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 certain variable interest entities for which we are the primary beneficiary. For consolidated entities where we own or are exposed to less than 100% of the economics, we record net income (loss) attributable to noncontrolling interests in our Condensed Consolidated Statements of Income equal to the percentage of the economic or ownership interest retained in such entities by the respective noncontrolling parties. 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, 2014, 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 and 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. Estimates are assessed each period and updated to reflect current information.

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, 2015, our accounts receivable in Southern Europe, specifically Greece, Italy, Portugal and Spain, totaled approximately $1.8 billion, of which $198 million were greater than 120 days past due, including $27 million 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, 2015.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB), 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 August 2015, the FASB issued an accounting standard update which defers the effective date of the new standard by one year.

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The standard will become effective for us beginning in the first quarter of 2018. Early application is permitted in 2017. 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.

In April 2015, the FASB issued an accounting standard update which requires presentation of debt issuance costs as a direct deduction from the carrying amount of a recognized debt liability on the balance sheet. The update does not change the guidance on the recognition and measurement of debt issuance costs. This guidance will become effective for us for annual periods beginning after December 15, 2015, and interim periods thereafter. At the time of adoption, we will reclassify debt issuance costs to a liability as a direct deduction from the carrying value of the debt, consistent with the presentation of a debt discount. We do not expect that the adoption of this update will have a material impact 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 Balance Sheets at amounts that approximate current fair values. There were no transfers between Level 1, Level 2 and Level 3 in the periods presented.

The following table summarizes the assets and liabilities measured at fair value on a recurring basis, by level, within the fair value hierarchy (in millions):

	September 30, 2015				December 31, 2014			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Money market funds	$12,029	$—	$—	$12,029	$7,926	$—	$—	$7,926
Corporate debt securities	—	4,824	—	4,824	—	938	—	938
U.S. treasury securities	3,378	—	—	3,378	363	—	—	363
Residential mortgage and asset-backed securities	—	1,306	—	1,306	—	269	—	269
U.S. government agencies securities	—	864	—	864	—	113	—	113
Certificates of deposit	—	489	—	489	—	—	—	—
Non-U.S. government securities	—	301	—	301	—	—	—	—
Foreign currency derivative contracts	—	267	—	267	—	349	—	349
Municipal debt securities	—	29	—	29	—	16	—	16
Deferred compensation plan	61	—	—	61	54	—	—	54
	$15,468	$8,080	$—	$23,548	$8,343	$1,685	$—	$10,028
Liabilities:								
Contingent consideration	$—	$—	$127	$127	$—	$—	$133	$133
Deferred compensation plan	61	—	—	61	54	—	—	54
Foreign currency derivative contracts	—	35	—	35	—	—	—	—
	$61	$35	$127	$223	$54	$—	$133	$187

Level 2 Inputs

We estimate the fair values of our corporate debt securities, residential mortgage and asset-backed securities, government related securities and certificates of deposit 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.

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 millions):

		September 30, 2015		December 31, 2014	
Type of Borrowing	Description	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible Senior	May 2016 Notes	$331	$1,434	$483	$2,097
Senior Unsecured	April 2021 Notes	995	1,090	995	1,108
Senior Unsecured	December 2016 Notes	700	717	700	727
Senior Unsecured	December 2021 Notes	1,248	1,356	1,248	1,377
Senior Unsecured	December 2041 Notes	998	1,145	998	1,229
Senior Unsecured	April 2019 Notes	499	503	499	500
Senior Unsecured	April 2024 Notes	1,748	1,798	1,747	1,836
Senior Unsecured	April 2044 Notes	1,747	1,767	1,747	1,954
Senior Unsecured	February 2020 Notes	499	504	499	504
Senior Unsecured	February 2025 Notes	1,748	1,766	1,748	1,797
Senior Unsecured	February 2045 Notes	1,740	1,693	1,740	1,872
Senior Unsecured	September 2018 Notes	1,000	1,008	—	—
Senior Unsecured	September 2020 Notes	1,996	2,014	—	—
Senior Unsecured	September 2022 Notes	999	1,011	—	—
Senior Unsecured	March 2026 Notes	2,739	2,767	—	—
Senior Unsecured	September 2035 Notes	997	1,007	—	—
Senior Unsecured	March 2046 Notes	2,241	2,263	—	—

Level 3 Inputs

As of September 30, 2015 and December 31, 2014, the only assets or liabilities that were measured using Level 3 inputs were contingent consideration liabilities of $127 million and $133 million, respectively. 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.

The contingent consideration liabilities primarily included the potential future contingent consideration payments resulting from the acquisition of Arresto Biosciences, Inc. for royalty obligations on future sales once specified sales-based milestones are achieved, and the acquisitions of CGI Pharmaceuticals, Inc. and Calistoga Pharmaceuticals, Inc. upon achievement of development or regulatory approval-based milestones.

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 securities recorded in cash and cash equivalents or marketable securities in our Condensed Consolidated Balance Sheets (in millions):

	September 30, 2015				December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	$12,029	$—	$—	$12,029	$7,926	$—	$—	$7,926
Corporate debt securities	4,832	5	(13)	4,824	941	—	(3)	938
U.S. treasury securities	3,370	8	—	3,378	363	—	—	363
Residential mortgage and asset-backed securities	1,305	2	(1)	1,306	269	—	—	269
Certificates of deposit	489	—	—	489	—	—	—	—
U.S. government agencies securities	863	1	—	864	113	—	—	113

Non-U.S. government securities	301	—	—	301	—	—	—	—
Municipal debt securities	29	—	—	29	16	—	—	16
Total	$23,218	$ 16	$ (14)	$23,220	$9,628	$ —	$ (3)	$9,625

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The following table summarizes the classification of the available-for-sale securities on our Condensed Consolidated Balance Sheets (in millions):

	September 30, 2015	December 31, 2014
Cash and cash equivalents	$12,071	$7,926
Short-term marketable securities	1,749	101
Long-term marketable securities	9,400	1,598
Total	$23,220	$9,625

Cash and cash equivalents in the table above exclude cash of $1.9 billion as of September 30, 2015 and $2.1 billion as of December 31, 2014.

The following table summarizes our portfolio of available-for-sale securities by contractual maturity (in millions):

	September 30, 2015	
	Amortized Cost	Fair Value
Less than one year	$13,821	$13,820
Greater than one year but less than five years	9,254	9,257
Greater than five years but less than ten years	118	118
Greater than ten years	25	25
Total	$23,218	$23,220

The following table summarizes our available-for-sale debt securities that were in a continuous unrealized loss position, but were not deemed to be other-than-temporarily impaired (in millions):

	Less Than 12 Months		12 Months or Greater		Total	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
September 30, 2015						
Corporate debt securities	$(13)	$2,343	$—	$58	$(13)	$2,401
Residential mortgage and asset-backed securities	(1)	527	—	17	(1)	544
Non-U.S. government securities	—	188	—	—	—	188
U.S. government agencies securities	—	52	—	—	—	52
U.S. treasury securities	—	42	—	—	—	42
Municipal debt securities	—	5	—	—	—	5
Total	$(14)	$3,157	$—	$75	$(14)	$3,232

December 31, 2014