GILEAD SCIENCES INC
Form 10-Q
May 03, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2006

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 Number 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)	**(I.R.S. 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 x No ¨

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

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

Number of shares outstanding of the issuer s common stock, par value $0.001 per share, as of April 28, 2006: 455,016,054

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GILEAD SCIENCES, INC.

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PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

GILEAD SCIENCES, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share amounts)

	March 31, 2006 (unaudited)	December 31, 2005 (1)
Assets		
Current assets:		
Cash and cash equivalents	$ 268,677	$ 707,913
Marketable securities	2,270,944	1,603,120
Accounts receivable, net	433,633	396,125
Inventories	224,372	216,903
Deferred tax assets	97,905	84,839
Prepaid expenses	39,105	48,383
Other current assets	40,769	34,925
Total current assets	3,375,405	3,092,208
Property, plant and equipment, net	240,587	242,568
Noncurrent portion of prepaid royalties	328,332	333,582
Noncurrent deferred tax assets	60,163	66,893
Other noncurrent assets	32,047	29,400
	$ 4,036,534	$ 3,764,651
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 60,209	$ 61,083
Accrued clinical and preclinical expenses	10,260	10,514
Accrued compensation and employee benefits	52,604	59,927
Income taxes payable	73,710	95,739
Other accrued liabilities	151,865	149,516
Deferred revenue	12,881	18,353
Current portion of long-term debt	60,000	60,000
Current portion of other long-term obligations	374	206
Total current liabilities	421,903	455,338
Long-term deferred revenue	31,787	32,725
Long-term debt	184,000	240,000
Other long-term obligations	382	650
Minority interest in joint venture	10,049	8,160
Commitments and contingencies		
Stockholders equity:		
Common stock, par value $0.001 per share; 700,000 shares authorized; 462,850 and 459,726 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively	463	460
Additional paid-in capital	2,318,077	2,206,228
Accumulated other comprehensive income (loss)	(2,473)	11,578

Deferred stock compensation		(130)
Retained earnings	1,072,346	809,642
Total stockholders equity	3,388,413	3,027,778
	$ 4,036,534	$ 3,764,651

(1) The Condensed Consolidated Balance Sheet at December 31, 2005 has been derived from audited consolidated financial statements at that date but does not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statements.

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 March 31,	
	2006	**2005**
Revenues:		
Product sales	$ 559,353	$ 400,211
Royalty and contract revenue	133,525	30,203
Total revenues	692,878	430,414
Costs and expenses:		
Cost of goods sold	90,357	57,415
Research and development	88,400	70,434
Selling, general and administrative	142,469	79,088
Total costs and expenses	321,226	206,937
Income from operations	371,652	223,477
Interest and other income, net	28,525	7,319
Interest expense	(3,724)	(9)
Minority interest in joint venture	994	261
Income before provision for income taxes	397,447	231,048
Provision for income taxes	134,743	73,935
Net income	$ 262,704	$ 157,113
Net income per share basic	$ 0.57	$ 0.35
Net income per share diluted	$ 0.55	$ 0.34
Shares used in per share calculation basic	461,425	449,549
Shares used in per share calculation diluted	481,802	467,619

See accompanying notes.

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GILEAD SCIENCES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)

(in thousands)

	Three Months Ended March 31,	
	2006	**2005**
OPERATING ACTIVITIES:		
Net income	$ 262,704	$ 157,113
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	11,243	6,137
Stock-based compensation expense	29,632	151
Excess tax benefits from stock-based compensation	(37,380)	
Deferred tax assets	(626)	30,579
Asset disposal	7,883	
Write-down of inventory	6,820	
Minority interest in joint venture	1,889	115
Other non-cash transactions	4,881	455
Changes in operating assets and liabilities:		
Accounts receivable, net	(41,329)	(223)
Inventories	(13,104)	485
Prepaid expenses and other assets	(5,832)	(14,996)
Accounts payable	(874)	(11,690)
Income taxes payable	9,642	29,576
Accrued liabilities	(7,245)	25,758
Deferred revenue	(6,410)	(634)
Net cash provided by operating activities	221,894	222,826
INVESTING ACTIVITIES:		
Purchases of marketable securities	(1,044,377)	(491,449)
Proceeds from sales of marketable securities	278,201	203,970
Proceeds from maturities of marketable securities	90,440	73,247
Capital expenditures and other	(14,258)	(8,875)
Net cash used in investing activities	(689,994)	(223,107)
FINANCING ACTIVITIES:		
Proceeds from issuances of common stock	43,529	17,031
Repayments of long-term debt and other obligations	(56,132)	120
Excess tax benefits from stock-based compensation	37,380	
Net cash provided by financing activities	24,777	17,151
Effect of exchange rate changes on cash	4,087	(15,838)
Net increase (decrease) in cash and cash equivalents	(439,236)	1,032
Cash and cash equivalents at beginning of period	707,913	280,909
Cash and cash equivalents at end of period	$ 268,677	$ 281,941

See accompanying notes.

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GILEAD SCIENCES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2006

(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with United States 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, the Company or we) believes are necessary for a fair presentation of the periods presented. These interim financial results are not necessarily indicative of results to be expected for the full fiscal year.

Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. On an on-going basis, management evaluates its estimates, including those related to revenue recognition, allowance for doubtful accounts, inventories, prepaid royalties, clinical trial accruals, our income tax provision and stock-based compensation. Actual results may differ from these estimates. The accompanying condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and its joint venture with Bristol-Myers Squibb Company (BMS), for which Gilead is the primary beneficiary as determined under Financial Accounting Standards Board (FASB) Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46R). Minority interest is recorded for BMS s interest in the joint venture. Significant intercompany transactions have been eliminated.

During the three months ended March 31, 2006, we began reporting net foreign exchange transaction gains or losses as well as fair value changes on derivative instruments not designated as hedges, in interest and other income, net, in our Condensed Consolidated Statements of Income. These amounts, which were previously reported as selling, general and administrative (SG&A) expenses, were reclassified to conform to the current period presentation. Additionally, we began classifying interest receivable related to our marketable securities from marketable securities into other current assets in our Condensed Consolidated Balance Sheets to conform to the current period presentation. This reclassification had the effect of increasing other current assets and decreasing marketable securities by $12.9 million as of December 31, 2005. On our Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2005, this reclassification had the effect of decreasing net cash used in investing activities and decreasing net cash provided by operating activities by $4.4 million. This reclassification did not affect our Condensed Consolidated Statements of Income.

The accompanying financial information should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2005, included in our Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC).

Earnings Per Share

Basic earnings per share is calculated based on the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is calculated based on the weighted-average number of shares of common stock and other dilutive securities outstanding during the period. Potential dilutive shares of common stock resulting from the assumed exercise of outstanding stock options and equivalents are determined based on the treasury stock method.

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The following table is a reconciliation of the numerator and denominator used in the calculation of basic and diluted earnings per share (in thousands):

	Three Months Ended March 31,	
	2006	2005
Numerator:		
Net income used in calculation of diluted earnings per share	$ 262,704	$ 157,113
Denominator:		
Weighted-average shares of common stock outstanding used in calculation of basic earnings per share	461,425	449,549
Effect of dilutive securities:		
Stock options and equivalents	20,377	18,070
Weighted-average shares of common stock outstanding used in calculation of diluted earnings per share	481,802	467,619

Options to purchase approximately 4.9 million and 2.5 million shares of common stock were also outstanding during the three months ended March 31, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share because the options exercise prices were greater than the average market price of our common stock during these periods; therefore, their effect was antidilutive.

Stock-Based Compensation

In December 2004, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), which requires that all share-based payments to employees and directors, including grants of stock options, be recognized in the income statement based on their fair values, beginning with the first quarterly period after June 15, 2005, with early adoption permitted. SFAS 123R also requires the benefit of tax deductions in excess of recognized compensation cost to be reported in the statement of cash flows as a financing cash flow, rather than as an operating cash flow. SFAS 123R supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and amends SFAS No. 95, *Statement of Cash* Flows. On January 1, 2006, we adopted SFAS 123R using the modified prospective method, one of the adoption methods permitted under SFAS 123R (see Note 9).

2. INVENTORIES

Inventories are summarized as follows (in thousands):

	March 31, 2006	December 31, 2005
Raw materials	$ 138,802	$ 147,950
Work in process	31,132	25,061
Finished goods	54,438	43,892
Total inventories	$ 224,372	$ 216,903

Based on our current assessment of Gilead Access Program forecasted sales and existing pricing, we do not believe that we will fully recover the capitalized manufacturing costs associated with our existing Gilead Access Program inventory as of March 31, 2006. Accordingly, during the quarter ended March 31, 2006, we recorded $6.8 million in cost of goods sold to write-down this inventory to its estimated net realizable value.

3. ASSET DISPOSAL

In March 2006, we received local city approval to proceed with the demolition of two of our owned buildings in Foster City, California, and to begin construction. We included the charge associated with the write-off of these buildings, equal to their aggregate net book value of $7.9

million, in SG&A expenses.

4. EUROPEAN HEADQUARTERS RELOCATION

In June 2005, Gilead announced that the commercial, medical and administrative groups of its European headquarters, based in Paris, France, would be relocated to the London area in the United Kingdom. The European headquarters for our

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regulatory, safety and information technology groups are currently located in the Cambridge area in the United Kingdom. We believe that this relocation will enable us to achieve efficiencies through the closer proximity of the groups as Gilead positions itself to compete with the large pharmaceutical companies at a global level. Gilead s French subsidiary will continue to occupy Gilead s existing Paris facilities as we will continue to maintain and expand our sales and marketing presence in France.

In the third quarter of 2005, when the relocation plans were finalized, Gilead accrued a charge of $8.4 million, primarily consisting of employee severance costs and termination benefits, which was included in SG&A expenses. As of March 31, 2006, approximately $4.4 million has been charged against the accrual that is included in accrued compensation and employee benefits in the Condensed Consolidated Balance Sheet. The remaining payments are expected to be made during the second quarter of 2006. Additional costs relating to the new headquarters in the United Kingdom, including recruitment costs, legal expenses, capital expenditures and other related costs are being expensed as incurred. Based upon the most current information available, we believe that the aggregate severance, relocation and recruiting costs resulting from the relocation of our European headquarters continues to be in the range of $10 million to $13 million.

5. JAPAN TOBACCO

In March 2005, we entered into a licensing agreement with Japan Tobacco Inc. (Japan Tobacco), under which Japan Tobacco granted Gilead exclusive rights to develop and commercialize a novel HIV integrase inhibitor, GS 9137 (formerly called JTK-303), in all countries of the world, excluding Japan, where Japan Tobacco will retain such rights. Under the terms of the agreement, we incurred an upfront license fee of $15.0 million which was included in research and development (R&D) expenses in the first quarter of 2005 as there was no future alternative use for this technology. In March 2006, we recorded $5.0 million in R&D expenses related to a milestone we incurred as a result of dosing of the first patient in a Phase 2 clinical study. We are obligated to make additional payments upon the achievement of other milestones as well as pay royalties based on any future net product sales in the territories where we may market the drug.

6. JOINT VENTURE WITH BRISTOL-MYERS SQUIBB

In December 2004, we entered into a collaboration with BMS to develop and commercialize the single tablet regimen of Gilead s Truvada and BMS s Sustiva® (efavirenz) in the United States. Structured as a joint venture, Gilead and BMS formed the limited liability company, Bristol-Myers Squibb & Gilead Sciences, LLC. Under the terms of the collaboration, Gilead and BMS granted royalty-free sublicenses to the joint venture for the use of their respective company-owned technologies and, in return, were granted a license by the joint venture to use any intellectual property that results from the collaboration. The ownership interests of the joint venture by Gilead and BMS, which reflect their respective economic interests, are based on the fraction of the estimated net selling price of the single tablet regimen attributable to Truvada and Sustiva, respectively, and will be adjusted on an annual basis. Since the net selling price for Truvada may change over time relative to the net selling price of Sustiva, both Gilead s and BMS s respective economic interests in the joint venture may vary annually.

Gilead has primary responsibility for clinical development activities and regulatory filings relating to any new products resulting from the collaboration, and BMS and Gilead will share marketing and sales efforts (both parties will provide equivalent sales force efforts for a minimum number of years). The daily operations of the joint venture are governed by four primary joint committees. Gilead is responsible for accounting, financial reporting and product distribution for the joint venture. Both parties agreed to provide their respective bulk active pharmaceutical ingredients to the joint venture at their approximate market values. As of March 31, 2006 and December 31, 2005, the joint venture held approximately $30.2 million and $26.5 million, respectively, of the active pharmaceutical ingredient in Sustiva which it purchased from BMS at BMS s estimated net selling price of Sustiva in the U.S. market. In April 2006, the joint venture filed a New Drug Application with the U.S. Food and Drug Administration for approval of the single tablet regimen.

The joint venture s total equity investment at risk is not expected to be sufficient to allow it to finance its operational activities without the ongoing funding of Gilead and BMS. Although we are the primary beneficiary, the legal structure of the joint venture limits the recourse that its creditors will have over the general credit or assets of Gilead. As explained in Note 1, our condensed consolidated financial statements include the results of our joint venture with BMS and reflect BMS s minority interest in the joint venture.

7. CREDIT FACILITIES

In December 2005, we entered into an agreement with a syndicate of banks, to provide for a five-year $500.0 million senior credit facility. The $500.0 million facility consisted of an uncollateralized $300.0 million term loan, which was entered into by Gilead Biopharmaceutics Ireland Corporation (GBIC), one of our wholly-owned Irish subsidiaries, and an

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uncollateralized $200.0 million revolving credit facility, which was entered into by the U.S. parent company, Gilead Sciences, Inc. The proceeds from the term loan were used by GBIC in December 2005 to facilitate a cash dividend distribution of $280.0 million to the parent company as part of the repatriation of our qualified foreign earnings under the provisions of the American Jobs Creation Act.

Under the terms of our term loan, the minimum amount of the principal payment that is required to be repaid at the end of each calendar quarter, beginning on March 31, 2006, is $15.0 million. Interest is accrued at a rate of LIBOR plus a tiered contractual rate of up to 62.5 basis points, and is payable in arrears at the end of each quarter. GBIC can prepay the term loan at any time in whole or in part, together with accrued interest on the prepaid principal, without penalty or premium. During the three months ended March 31, 2006, $56.0 million of the term loan was repaid. Any outstanding interest or principal at December 2010 is payable on demand. The U.S. parent company and another wholly-owned subsidiary, Gilead Vintage Park, LLC, are guarantors. As of March 31, 2006, the outstanding principal on the term loan was $244.0 million.

Under the terms of the revolving credit facility, interest is accrued and payable at a rate of LIBOR plus a tiered contractual rate of up to 50 basis points, and is payable in arrears at the end of each quarter. The parent company can prepay any outstanding borrowings at any time in whole or in part, together with accrued interest on the prepaid principal, without penalty or premium. Any outstanding interest or principal at December 2010 is payable on demand. The capacity of the revolving credit facility will increase to a maximum of $500.0 million as the term loan is repaid. We have the ability to irrevocably cancel any unutilized portion of the revolving credit facility, in whole or in part. Any proceeds obtained under the revolving credit facility are expected to be used for working capital, capital expenditures and other general corporate purposes, including the issuance of letters of credit up to $25.0 million. Gilead Vintage Park, LLC is the guarantor. In March 2006, the revolving credit facility was increased to $256.0 million as a result of a $56.0 million repayment we made under the term loan. As of March 31, 2006, we did not have any borrowings under the revolving credit facility.

8. CONTINGENCIES

Legal Proceedings

A number of states, counties and municipalities have filed complaints alleging that a large number of pharmaceutical defendants, including in some instances Gilead, reported inaccurate prices for their products, causing the governmental entity named as the plaintiff to overpay for pharmaceutical products furnished to participants in the Medicaid program. Separate actions filed by New York City and numerous New York counties were consolidated in a multi-district litigation proceeding before the United States District Court for the District of Massachusetts. On August 23, 2005, these cases were voluntarily dismissed with respect to Gilead. To its knowledge, Gilead has been named in three additional cases, (1) State of Alabama v. Abbott Laboratories, Inc. et al., currently pending in the Circuit Court of Montgomery County, Alabama; (2) County of Erie v. Abbott Laboratories, Inc. et al., currently pending in the Supreme Court of the State of New York, County of Erie and (3) State of Mississippi v. Abbott Laboratories, Inc., et al., currently pending in the Chancery Court of the First Judicial District of Hinds County, Mississippi. The complaints assert claims under state law and seek damages (and, in the State of Alabama case, treble damages) and attorneys fees. We intend to defend the cases vigorously. The cases are all at a preliminary stage and it is not possible to predict the outcome. As such, no amounts have been accrued related to the outcome of these cases.

A purported class action complaint was filed on November 10, 2003, in the United States District Court for the Northern District of California against Gilead and our Company s Chief Executive Officer, Chief Financial Officer, former Executive Vice President of Operations (and current Senior Business Advisor), Executive Vice President of Research and Development, Senior Vice President of Manufacturing and Senior Vice President of Research. The complaint alleges that the defendants violated federal securities laws, specifically Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended, and Rule 10b-5 of the Securities and Exchange Commission, by making certain alleged false and misleading statements. The plaintiffs seek unspecified damages on behalf of a purported class of purchasers of Gilead s securities during the period from July 14, 2003 through October 28, 2003. Other similar actions were subsequently filed and the court issued an order consolidating the lawsuits into a single action on December 22, 2003. On February 9, 2004, the court issued an order appointing lead plaintiffs in the consolidated action. On April 30, 2004, the lead plaintiffs, on behalf of the purported class, filed their consolidated amended complaint. On June 21, 2004, the Company and individual defendants filed their motion to dismiss the consolidated amended complaint. On January 4, 2005, the court granted the defendants motion to dismiss with leave to amend. Plaintiffs filed a second amended complaint on February 25, 2005 and a third amended complaint on March 11, 2005. On October 11, 2005, the court granted the defendants notion to dismiss the third amended complaint with leave to amend. On December 2, 2005, the plaintiffs filed a fourth consolidated amended complaint. The court heard defendants motion to dismiss on February 21, 2006, took the matter under submission and has yet to render its decision. We intend to defend the cases vigorously. As the outcome cannot be predicted at this time, no amount has been accrued related to the outcome of this matter.

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We are also a party to various other legal actions that arose in the ordinary course of our business. We do not believe that any of these other legal actions will have a material adverse impact on our business, results of operations or financial position.

Other Matters

In March 2006, as part of an initiative to evaluate our European distribution framework outside of our five largest European markets, we began contacting certain of our European distributors regarding our current distribution terms with them and our intent to ultimately terminate these distribution relationships. This process will entail lengthy negotiations between us and these distributors. Although it is probable that we will incur contract termination costs, we are currently unable to reasonably estimate such costs in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* and as such, no amount has been accrued related to the outcome of these negotiations.

9. STOCK-BASED COMPENSATION

On January 1, 2006, we adopted the provisions of SFAS 123R which requires that the fair value of all share-based payments to employees and directors, including grants of stock options, be recognized in our Condensed Consolidated Statements of Income. We applied the modified prospective method, one of the adoption methods permitted under SFAS 123R, which requires that compensation expense be recorded for all nonvested stock options and other stock-based awards at the beginning of the first quarter of adoption of SFAS 123R. In accordance with the modified prospective method, no prior period amounts have been restated to reflect our adoption of SFAS 123R.

Pro Forma Information Under SFAS 123

Prior to the adoption of SFAS 123R, in accordance with the provisions of SFAS 123, as amended by SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure*, we elected to follow APB 25, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB Opinion No. 25*, in accounting for our employee stock-based plans. Under APB 25, if the exercise price of Gilead s employee and director stock options was equal to or greater than the fair value of the underlying stock on the date of grant, no compensation expense was recognized in our Condensed Consolidated Statements of Income.

The table below presents net income and basic and diluted net income per share as if compensation cost for the Company s stock option plans and employee stock purchase plan (ESPP) had been determined based on the estimated fair value of awards under those plans on the grant or purchase date in accordance with SFAS 123 (in thousands, except per share amounts):

	Three Months Ended March 31, 2005
Net income as reported	$ 157,113
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	92
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of related tax effects	(19,433)
Pro forma net income	$ 137,772
Net income per share:	
Basic - as reported	$ 0.35
Basic - pro forma	$ 0.31
Diluted - as reported	$ 0.34
Diluted - pro forma	$ 0.29

Adoption of SFAS 123R

Stock-based compensation is recognized as expense over the requisite service periods in our Condensed Consolidated Statements of Income using a graded vesting expense attribution approach for unvested stock option awards granted prior to the adoption of SFAS 123R and using the straight-line expense attribution approach for stock option awards granted after the adoption of SFAS 123R. As stock-based compensation expense related to stock option awards recognized on adoption of SFAS 123R is based on awards ultimately expected to vest, gross expense has been reduced for estimated forfeitures. SFAS 123R requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We estimated forfeitures based on our historical experience. Prior to the adoption of SFAS 123R, pro forma information required under SFAS 123 included forfeitures as they occurred.

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In November 2005, the FASB issued FASB Staff Position No. 123R-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*. We adopted the simplified method to calculate the beginning balance of the additional paid-in-capital (APIC) pool of the excess tax benefit, and to determine the subsequent impact on the APIC pool and Condensed Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that were outstanding upon our adoption of SFAS 123R.

The table below summarizes the impact of adopting SFAS 123R effective January 1, 2006 (in thousands, except per share amounts):

	Three Months Ended March 31, 2006
Cost of goods sold	$ 3,187
Research and development expenses	11,949
Selling, general and administrative expenses	14,496
Stock-based compensation expense included in total costs and expenses	29,632
Tax benefit related to stock-based compensation expense	6,129
Stock-based compensation expense included in net income	$ 23,503
Stock-based compensation expense included in net income per share:	
Basic	$ 0.05
Diluted	$ 0.05

During the three months ended March 31, 2006, we capitalized $2.5 million of stock-based compensation costs into inventory. The total fair value of stock options that vested during the three months ended March 31, 2006 was $36.6 million. As of March 31, 2006, we had stock-based compensation expense of $245.8 million related to nonvested stock option awards not yet recognized, which is expected to be recognized over an estimated weighted average period of 2.5 years.

Valuation Assumptions

Fair values of awards granted under the stock option plans and ESPP were estimated at grant or purchase dates using a Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected volatility and expected life. In connection with our adoption of SFAS 123R, we refined the methodologies used to derive our valuation model assumptions. To calculate the estimated fair value of the awards, we used the following assumptions:

	Three Months Ended March 31,	
	2006	2005
Expected Volatility:		
Stock options	39%	47%
ESPP	34%	47%
Expected life in years:		
Stock options	5.3	4.8
ESPP	1.3	1.4
Risk-free interest rate:		
Stock options	4.6%	3.7%
ESPP	4.7%	2.5%
Expected dividend yield	0%	0%

The fair value of stock option awards granted prior to the adoption of SFAS 123R was calculated using the multiple option approach while the fair value of stock option awards granted beginning January 1, 2006 was calculated using the single option approach.

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Prior to the adoption of SFAS 123R, we used historical stock price volatility. In connection with our adoption of SFAS 123R, we determined that a blend of historical volatility along with implied volatility for traded options on Gilead s stock is a better reflection of market activity and expected volatility.

The expected life of stock-based awards represents the weighted-average period the stock awards are expected to remain outstanding. We estimate the weighted-average expected life based on historical cancellation and historical exercise data related to our stock option awards as well as the contractual term and vesting terms of the awards.

The risk-free interest rate is based upon observed interest rates appropriate for the term of the stock-based awards. The dividend yield is based on our history and expectation of dividend payouts.

Other Stock-Based Compensation Information

In May 2004, Gilead s stockholders approved and we adopted the 2004 Equity Incentive Plan (2004 Plan). Stock options under the NeXstar and Triangle stock option plans, which we assumed as a result of the merger with NeXstar and the acquisition of Triangle, have been converted into Gilead options effective with the merger or acquisition. The 2004 Plan is a broad-based, incentive plan that allows for the awards to be granted to employees, directors and consultants of Gilead. Generally, few grants have been made to consultants and currently there are no grants outstanding to consultants. The 2004 Plan provides for option grants designated as either nonqualified or incentive stock options. Prior to January 1, 2006, Gilead granted both nonqualified and incentive stock options while after January 1, 2006, all stock options granted are nonqualified stock options. Under the 2004 Plan, employee stock options generally vest over five years, are exercisable over a period not to exceed the contractual term of ten years from the date the stock options are issued and are granted at prices not less than the fair value of our common stock on the grant date. Stock option exercises are settled with newly issued common stock from the plan s previously authorized and available pool of shares. As of March 31, 2006, there were 14,873,616 shares remaining and available for future grant under the 2004 Plan.

Under Gilead s ESPP, employees can purchase shares of Gilead common stock based on a percentage of their compensation. The purchase price per share is equal to the lower of 85% of the fair value of our common stock on the offering date or the purchase date. A two-year look-back feature in our ESPP causes the offering period to reset if the fair value of our common stock on the purchase date is less than that on the original offering date. ESPP purchases by employees are settled with newly issued common stock from the plan s previously authorized and available pool of shares. As of March 31, 2006, there were 1,725,683 shares remaining and available for issuance under the ESPP.

The following table summarizes activity under all Gilead, NeXstar and Triangle stock option plans. All option grants presented in the table had exercise prices not less than the fair value of the underlying stock on the grant date (shares in thousands):

	Three Months Ended March 31, 2006		Year Ended December 31, 2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	45,920	$22.60	49,413	$18.10
Granted	5,714	$58.17	8,930	$36.39
Forfeited	(817)	$28.14	(1,997)	$26.05
Exercised	(3,123)	$13.94	(10,426)	$12.45
Outstanding, end of period	47,694	$27.33	45,920	$22.60
Exercisable, end of period	22,037	$17.06	22,237	$15.56
Weighted average grant-date fair value		$24.93		$15.79

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The following is a summary of Gilead stock options outstanding and stock options exercisable at March 31, 2006 (options and aggregate intrinsic value in thousands):

	Options Outstanding				Options Exercisable			
Range of Exercise Prices	Options Outstanding	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value	Options Exercisable	Weighted Average Remaining Contractual Life in Years	Weighted Average Exercise Price	Aggregate Intrinsic Value
$ 2.25 - $16.43	9,834	4.0	$8.03	$ 532,946	9,454	3.9	$7.79	$ 514,586
$16.44 - $17.89	9,934	6.4	$17.12	448,049	6,140	6.3	$17.06	277,275
$17.90 - $30.53	9,913	7.8	$28.53	333,956	3,659	7.7	$28.19	124,520
$30.84 - $38.87	9,888	8.5	$33.01	288,812	2,623	8.3	$33.04	76,550
$39.15 - $70.47	8,125	9.6	$54.79	60,433	161	3.4	$48.63	2,286
Total	47,694	7.2	$27.33	$ 1,664,196	22,037	5.7	$17.06	$ 995,217

The following is a summary of the activity relating to Gilead s nonvested stock options for the three months ended March 31, 2006 (shares in thousands):

	Shares	Weighted Average Grant-Date Fair Value
Nonvested, January 1, 2006	23,683	$14.32
Granted	5,714	$24.93
Forfeited	(817)	$14.04
Vested	(2,923)	$12.53
Nonvested, March 31, 2006	25,657	$16.89

10. STOCKHOLDERS EQUITY

Stock Repurchase Program

In March 2006, Gilead s Board of Directors authorized a program for the repurchase of Gilead common stock in an amount up to $1.0 billion over a two-year period. Stock repurchases under this program may be made through open market and private block transactions pursuant to Rule 10b5-1 plans or privately negotiated purchases or other means, including accelerated share repurchase transactions or similar arrangements. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate and regulatory requirements and other market conditions. During the three months ended March 31, 2006, we did not repurchase any common stock under this program.

In April 2006, Gilead repurchased and retired 8.4 million shares of Gilead common stock at $65.13 per share, or $545.0 million. The remaining authorized amount of stock repurchases that may be made under this program which terminates in March 2008 is $455.0 million.

Comprehensive Income

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

	Three Months Ended March 31,	
	2006	2005
Net income	$ 262,704	$ 157,113
Net foreign currency translation loss	(109)	(1,861)
Net unrealized gain (loss) on cash flow hedges, net of related tax effects	(6,263)	22,089
Net unrealized loss on available-for-sale securities, net of related tax effects	(7,679)	(2,042)
Comprehensive income	$ 248,653	$ 175,299

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11. SEGMENT INFORMATION

Gilead operates in one business segment, which primarily focuses on the development and commercialization of human therapeutics for infectious diseases. All products are included in one segment because our major products have similar economic and other characteristics, including the nature of the products and production processes, type of customers, distribution methods and regulatory environment.

Product sales consist of the following (in thousands):

	Three Months Ended March 31,	
	2006	2005
HIV Products:		
Truvada	$ 248,946	$ 91,167
Viread	191,775	197,843
Emtriva	9,962	12,446
Total HIV products	450,683	301,456
AmBisome	53,800	54,214
Hepsera	52,655	42,665
Vistide	1,794	1,595
DaunoXome	421	281
Total product sales	$ 559,353	$ 400,211

Product sales and product-related contract revenue are attributed to countries based on ship-to location. Royalty and non-product related contract revenue are attributed to countries based on the location of the collaboration partner. Certain revenue amounts for 2005 have been reclassified between geographic regions to conform to the current period presentation. The following table summarizes total revenues from external customers and collaboration partners by geographic region (in thousands):

	Three Months Ended March 31,	
	2006	2005
United States	$ 300,594	$ 229,547
Outside of the United States:		
Switzerland	118,945	14,959
France	48,315	39,112
Italy	35,215	25,652
Spain	35,145	30,365
United Kingdom	35,043	23,938
Germany	28,914	26,401
Other European countries	48,055	25,177
Other countries	42,652	15,263
Total revenues outside of the United States	392,284	200,867
Total revenues	$ 692,878	$ 430,414

The following table summarizes revenues from our customers who individually account for 10% or more of our total revenues (as a % of total revenues):

	Three Months Ended March 31,	
	2006	2005
Cardinal Health, Inc.	16%	20%
McKesson Corp.	11%	12%
AmerisourceBergen Corp.	10%	12%

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12. SUBSEQUENT EVENTS

Convertible Senior Notes

In April 2006, we issued $650.0 million principal amount of convertible senior notes due in 2011 (2011 Notes) and $650.0 million principal amount of convertible senior notes due in 2013 (2013 Notes) (collectively, the Notes) in a private placement pursuant to Rule 144A. The 2011 Notes and the 2013 Notes were issued at par bearing interest rates of 0.50% and 0.625%, respectively. The aggregate principal amount of the Notes sold reflects the full exercise by the initial purchasers of their option to purchase additional Notes to cover over-allotments. The 2011 Notes may be convertible based on an initial conversion rate of 12.9024 shares per $1,000 principal amount of notes (which represents an initial conversion price of approximately $77.50 per share). The 2013 Notes may be convertible based on an initial conversion rate of 13.1230 shares per $1,000 principal amount of notes (which represents an initial conversion price of approximately $76.20 per share). The Notes may be converted, subject to adjustment, only under the following circumstances: 1) during any calendar quarter beginning after September 30, 2006 if the closing price of our common stock for at least 20 trading days in the 30 consecutive trading days of the previous quarter is more than 130% of the applicable conversion price per share, 2) if we make specified distributions to holders of our common stock or specified corporate transactions occur, or 3) during the last month prior to maturity of the applicable Notes. Upon conversion, a holder would receive an amount in cash equal to the lesser of (i) the principal amount of the Note or (ii) the conversion value, as defined. If the conversion value exceeds $1,000, we will also deliver, at our option, cash or common stock or a combination of cash and common stock for the conversion value in excess of $1,000. If the Notes are converted in connection with a change in control, as defined, we may be required to provide a make-whole premium in the form of an increase in the conversion rate, subject to a stated maximum amount. In addition, in the event of a change in control, the holders may require us to purchase all or a portion of their Notes at a purchase price equal to 100% of the principal amount of Notes, plus accrued and unpaid interest, if any.

Concurrent with the issuance of the Notes, we purchased convertible note hedges in private transactions at a cost of $379.1 million to cover, subject to customary anti-dilution adjustments, 16.9 million shares of our common stock at strike prices which correspond to the initial conversion prices of the Notes. If the market value per share of our common stock at the time of conversion of the Notes is above the strike price of the applicable convertible note hedges, we are entitled to receive from the counterparties of the transactions cash or common stock or a combination of cash and common stock for the excess of the then current market price of the common stock over the strike price of the convertible note hedges. We also sold warrants in private transactions and received net proceeds of $235.5 million to acquire 16.9 million shares of our common stock, subject to customary anti-dilution adjustments. If the market value of our common stock at the time of the exercise of the applicable warrants exceeds their respective strike prices, we will be required to net settle with the respective counterparties for the value of the warrants in excess of the warrant strike prices. The warrants have strike prices of $101.60 per share (for the warrants expiring in 2011) and $107.79 per share (for the warrants expiring in 2013) and are exercisable only on the respective expiration dates. Taken together, the convertible note hedges and warrants are intended to reduce the potential dilution upon future conversions of the Notes by effectively increasing the initial conversion price to $101.60 per share for the 2011 Notes and $107.79 per share for the 2013 Notes. The net cost of $143.7 million of the convertible note hedge and warrant transactions will be recorded in stockholders equity. We will also record a tax benefit of approximately $147 million in stockholders equity from the deferred tax assets that we will recognize related to the convertible note hedges.

Contemporaneously with the closing of the sale of the Notes, a portion of the net proceeds from the Notes issuances and the proceeds of the warrant transactions were used to repurchase $544.9 million or 8.4 million shares of our common stock under our stock repurchase program.

Investment in Corus Pharma

In April 2006, we purchased $25.0 million of Series C preferred stock of Corus Pharma, Inc. (Corus), a privately-held Seattle, Washington-based company focused on the development of novel drugs for respiratory diseases. The Series C preferred stock is convertible into Corus s common stock on a one-to-one basis, which may be adjusted for future stock issuances by Corus and certain other events. In connection with the purchase of Corus Series C preferred stock, we also entered into an agreement whereby we will have an exclusive option to acquire all of Corus remaining stock at a pre-specified price through December 31, 2006. We will record our investment in Corus in other noncurrent assets and currently do not expect to consolidate Corus.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Executive Summary

We are a biopharmaceutical company that discovers, develops and commercializes therapeutics to advance the care of patients suffering from life-threatening diseases. We are a multinational company, with revenues from nine approved products and marketing operations in eleven countries. We focus our research and clinical programs on anti-infectives. Currently, we market Viread® (tenofovir disoproxil fumarate), Truvada® (tenofovir disoproxil fumarate and emtricitabine) and Emtriva® (emtricitabine) for the treatment of human immunodeficiency virus (HIV) infection; Hepsera® (adefovir dipivoxil) for the treatment of chronic hepatitis B; AmBisome® (amphotericin B) liposome for injection for the treatment of fungal infection; and Vistide® (cidofovir injection) for the treatment of cytomegalovirus (CMV) retinitis. F. Hoffmann-La Roche Ltd (Roche) currently markets Tamiflu® (oseltamivir phosphate) for the treatment and prevention of influenza under a royalty-paying development and license agreement with us. Eyetech Pharmaceuticals, Inc. (Eyetech) markets Macugen® (pegaptanib sodium injection) in the United States for the treatment of neovascular age-related macular degeneration under a royalty-paying collaborative agreement with us. We began recording royalties from Eyetech during the second quarter of 2005.

Our operating results for the first quarter of 2006 were led by strong net product sales of $559.4 million including HIV product sales (Viread, Truvada and Emtriva) of $450.7 million. A 50% increase in HIV product sales in the first quarter of 2006 over the first quarter of 2005 served as a key driver in increasing total product sales by 40% over the comparable period in 2005. In the United States, Truvada sales were up 20% sequentially from the fourth quarter of 2005 and represented 69% of our U.S. HIV product sales. Outside of the United States, higher HIV product sales as compared to the first quarter of 2005 were primarily because the launch of Truvada in certain European countries began in the first three months of 2005. Additionally, Viread sales volume continued to increase, particularly in Europe, Australia and Canada, as well as in Brazil, where individual orders tend to be large and ordering patterns tend to be unpredictable. AmBisome product sales in the first quarter of 2006 decreased by 1% compared to the first quarter of 2005, as a result of the dynamics of the competitive European antifungal market. Hepsera product sales for the first quarter of 2006 increased 23% from the first quarter of 2005 driven primarily by significant volume growth in both the United States and Europe, which increased by 15% and 30%, respectively, compared to the same quarter last year. On the collaborative front, the Company recognized $129.4 million in royalty revenue of which $115.3 million related to royalties received from fourth quarter 2005 sales of Tamiflu by F. Hoffmann-La Roche Ltd (Roche). Tamiflu royalties increased due to strong sales of Tamiflu by Roche as well as the elimination of the contractual cost of goods adjustment.

During the first quarter of 2006, we adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R) and began expensing the fair value of stock-based compensation cost. As a result, stock-based compensation expense is a significant component of the increase in our operating expenses for the quarter ended March 31, 2006 as compared to the prior year. Further discussion is included in Critical Accounting Policies and Estimates below.

During the quarter, we continued to make progress in our HIV, hepatitis B virus (HBV) and hepatitis C virus (HCV) programs. We achieved bioequivalence on a formulation of the single tablet regimen of Truvada and Bristol-Myers Squibb Company s (BMS) Sustiva (the single tablet regimen) earlier this year, and filed a New Drug Application (NDA) in April 2006. In our integrase inhibitor programs, we dosed our first patient in a Phase 2 clinical study related to our novel integrase inhibitor for HIV, GS 9137, which we licensed from Japan Tobacco. This event triggered a $5.0 million milestone payment which we recorded in research and development expenses. Our internally developed integrase inhibitor, GS 9160, did not demonstrate a desired level of bioavailability and therefore, we decided to discontinue development of GS 9160 and turn our focus to a back-up integrase inhibitor, GS 9224. In the HBV area, we continued to enroll patients into our two pivotal Phase 3 studies of Viread for chronic hepatitis B and in HCV, and we are expecting to begin Phase 1/2 viral dynamics clinical studies in the second or third quarters of 2006 on GS 9132 in collaboration with Achillion Pharmaceuticals.

In April 2006, our exploration into new therapeutic areas was marked by a $25.0 million Series C preferred stock investment in Corus Pharma, Inc., a privately-held Seattle, Washington-based company focused on the development of novel drugs for respiratory diseases. Concurrent with the investment, we also have an exclusive option to purchase all of the remaining shares of Corus at a pre-specified price through December 31, 2006.

Our cash, cash equivalents and marketable securities continued to grow by $228.6 million primarily funded by our first quarter operating cash flows. In April 2006, we issued $1.30 billion principal amount of convertible senior notes and concurrently we repurchased $544.9 million of our common stock under our stock repurchase program, purchased convertible note hedges at a cost of $379.1 million as well as sold warrants for proceeds of $235.5 million. Together with our existing cash, cash equivalents and marketable securities, the net proceeds of these transactions of $587.6 million, after deducting the initial purchasers discount and the estimated offering expenses, will allow us to further our corporate development initiatives, including licensing opportunities and potential acquisitions, as well as to meet our ongoing working capital and infrastructure needs.

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Critical Accounting Policies and Estimates

Reference is made to Critical Accounting Policies and Estimates included in our Annual Report on Form 10-K for the year ended December 31, 2005.

Stock-based Compensation

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123R, a revision of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), which requires that all share-based payments to employees and directors, including grants of stock options be recognized in the income statement based on their fair values. SFAS 123R supersedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and amends SFAS No. 95, *Statement of Cash Flows*. On January 1, 2006, we adopted SFAS 123R using the modified prospective method of adoption as permitted under SFAS 123R which requires that compensation expense be recorded for all nonvested stock options and other stock-based awards as of the beginning of the first quarter of adoption. In accordance with the modified prospective method, no prior period amounts have been restated to reflect the provisions of SFAS 123R.

Prior to the adoption of SFAS 123R, in accordance with the provisions of SFAS 123, we elected to follow APB 25, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation an Interpretation of APB Opinion No. 25*, in accounting for our employee stock-based plans. Under APB 25, if the exercise price of Gilead s employee and director stock options was equal to or greater than the fair value of the underlying stock on the date of grant, no compensation expense was recognized. However, as required by SFAS 123, the pro forma impact of expensing the fair value of our stock option awards and employee stock purchase plan was disclosed in the notes to our condensed consolidated financial statements.

In connection with our adoption of SFAS 123R, we refined our valuation assumptions and the methodologies used to derive those assumptions; however, we elected to continue using the Black-Scholes option valuation model. The fair value of stock option awards granted prior to the adoption of SFAS 123R was calculated using the multiple option approach while the fair value of stock option awards granted beginning January 1, 2006 was calculated using the single option approach. Concurrent with our adoption of SFAS 123R, we determined that a blend of historical volatility along with implied volatility for traded options on Gilead s stock would be a better measure of market conditions and expected volatility. Previously, we used historical stock price volatility as it was the most reliable source of volatility data. We estimate the weighted-average expected life of our stock-option awards based on historical cancellation and exercise data related to our stock-based awards as well as the contractual term and vesting terms of the awards. We allocate stock-based compensation expense using a graded vesting expense attribution approach for unvested stock option awards granted prior to the adoption of SFAS 123R consistent with the expense attribution approach used in our historical SFAS 123 disclosures and using a straight-line expense attribution approach for stock-based awards granted after the adoption of SFAS 123R. We currently believe that the straight-line expense attribution approach better reflects the level of service to be provided over the vesting period of our awards. Stock-based compensation expense related to stock options is recognized net of estimated forfeitures. We estimated forfeitures based on our historical experience.

During the quarter ended March 31, 2006, we recognized stock-based compensation expense of $23.5 million, net of tax, and capitalized $2.5 million into inventory. As of March 31, 2006, we had unrecognized stock-based compensation of $245.8 million related to nonvested stock options awards, which is expected to be recognized over an estimated weighted average period of 2.5 years.

Results of Operations

Total Revenues

We had total revenues of $692.9 million for the quarter ended March 31, 2006 compared with $430.4 million for the quarter ended March 31, 2005. Included in total revenues are product sales and royalty and contract revenue, including revenue earned from manufacturing collaborations.

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Product Sales

Product sales consisted of the following (in thousands):

	Three Months Ended March 31,		
	2006	2005	Change
HIV Products:			
Truvada	$ 248,946	$ 91,167	173%
Viread	191,775	197,843	(3)%
Emtriva	9,962	12,446	(20)%