CELGENE CORP /DE/
Form 10-Q
April 25, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark one)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2019

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 001-34912
CELGENE CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	22-2711928
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
86 Morris Avenue, Summit, NJ	07901
(Address of principal executive offices)	(Zip Code)

(908) 673-9000
(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 has submitted electronically every Interactive Data File required to be submitted 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 such files).
Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer X Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicated by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to

Section 13(a) of the Exchange Act.

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

As of April 22, 2019, 705,259,536 shares of Common Stock, par value $.01 per share, were outstanding.

CELGENE CORPORATION

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(Dollars in millions, except per share amounts)

	Three-Month Periods Ended March 31,	
	2019	2018
Revenue:		
Net product sales	$4,024	$3,531
Other revenue	1	7
Total revenue	4,025	3,538
Expenses:		
Cost of goods sold (excluding amortization of acquired intangible assets)	140	135
Research and development	1,216	2,203
Selling, general and administrative	773	864
Amortization of acquired intangible assets	109	87
Acquisition/integration related charges and restructuring, net	77	31
Total costs and expenses	2,315	3,320
Operating income	1,710	218
Other income and (expense):		
Interest and investment income, net	34	13
Interest (expense)	(192)	(166)
Other income, net	262	965
Income before income taxes	1,814	1,030
Income tax provision	269	184
Net income	$1,545	$846
Net income per common share:		
Basic	$2.20	$1.13
Diluted	$2.14	$1.10
Weighted average shares:		
Basic	702.4	748.3
Diluted	720.5	768.3

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(Dollars in millions)

	Three-Month Periods Ended March 31,	
	2019	2018
Net income	$1,545	$846
Other comprehensive income (loss):		
Foreign currency translation adjustments	(10)	16
Net unrealized gains (losses) related to cash flow hedges:		
Unrealized holding gains (losses)	51	(99)
Tax benefit	—	1
Unrealized holding gains (losses), net of tax	51	(98)
Reclassification adjustment for (gains) losses included in net income	(23)	27
Tax (benefit)	—	—
Reclassification adjustment for (gains) losses included in net income, net of tax	(23)	27
Excluded component related to cash flow hedges:		
Amortization of excluded component (gains)	(1)	(8)
Reclassification of realized excluded component losses to net income	1	11
Net reclassification adjustment included in net income	—	3
Net unrealized gains (losses) on debt securities available-for-sale:		
Unrealized holding (losses)	—	(9)
Tax benefit	—	2
Unrealized holding (losses), net of tax	—	(7)
Reclassification adjustment for losses included in net income	—	18
Tax (benefit)	—	(4)
Reclassification adjustment for losses included in net income, net of tax	—	14
Total other comprehensive income (loss)	18	(45)
Comprehensive income	$1,563	$801

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited)
(Dollars in millions, except per share amounts)

	March 31, 2019	December 31, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 5,433	$ 4,234
Debt securities available-for-sale	664	496
Equity investments with readily determinable fair values	1,594	1,312
Accounts receivable, net of allowances of $43 and $38 as of March 31, 2019 and December 31, 2018, respectively	2,327	2,066
Inventory	442	458
Other current assets	521	501
Total current assets	10,981	9,067
Property, plant and equipment, net	1,383	1,367
Intangible assets, net	16,101	16,213
Goodwill	8,003	8,003
Other non-current assets	1,171	830
Total assets	$ 37,639	$ 35,480
Liabilities and Stockholders' Equity		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	$ 500	$ 501
Accounts payable	340	418
Accrued expenses and other current liabilities	2,975	2,987
Income taxes payable	72	78
Current portion of deferred revenue	68	73
Total current liabilities	3,955	4,057
Deferred revenue, net of current portion	76	73
Income taxes payable	2,232	2,190
Deferred income tax liabilities	2,714	2,753
Other non-current liabilities	716	477
Long-term debt, net of discount	19,781	19,769
Total liabilities	29,474	29,319
Commitments and Contingencies (See Note 15)		
Stockholders' Equity		
Preferred stock, $.01 par value per share, 5.0 million shares authorized; none outstanding as of March 31, 2019 and December 31, 2018	—	—
Common stock, $.01 par value per share, 1,150.0 million shares authorized; issued 985.7 million and 981.5 million shares as of March 31, 2019 and December 31, 2018, respectively	10	10
Common stock in treasury, at cost; 280.9 million and 281.3 million shares as of March 31, 2019 and December 31, 2018, respectively	(26,298)	(26,336)
Additional paid-in capital	15,381	14,978
Retained earnings	19,104	17,559
Accumulated other comprehensive (loss)	(32)	(50)
Total stockholders' equity	8,165	6,161
Total liabilities and stockholders' equity	$ 37,639	$ 35,480

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in millions)

	Three-Month Periods Ended March 31, 2019	2018
Cash flows from operating activities:		
Net income	$1,545	$846
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	47	38
Amortization	110	88
Deferred income taxes	(41)	(52)
Change in value of contingent consideration and success payments	30	(30)
Net loss on sales of debt securities available-for-sale	—	18
Fair value adjustments on equity investments	(269)	(959)
Share-based compensation expense	257	208
Share-based employee benefit plan expense	—	9
Derivative instruments	8	(22)
Other, net	2	2
Change in current assets and liabilities, excluding the effect of acquisitions and disposals:		
Accounts receivable	(271)	(47)
Inventory	16	6
Other operating assets	50	(171)
Accounts payable and other operating liabilities	(28)	(219)
Income tax payable	35	(10)
Payment of contingent consideration	(13)	(22)
Deferred revenue	(2)	(8)
Net cash provided by (used in) operating activities	1,476	(325)
Cash flows from investing activities:		
Proceeds from sales of debt securities available-for-sale	261	3,203
Purchases of debt securities available-for-sale	(428)	(62)
Capital expenditures	(69)	(88)
Proceeds from sales of equity investment securities	2	55
Purchases of equity investment securities	(61)	(118)
Payments for acquisition of business, net of cash acquired	—	(8,648)
Net cash (used in) investing activities	(295)	(5,658)
Cash flows from financing activities:		
Payment for treasury shares	—	(2,700)
Proceeds from short-term borrowing	—	1,815
Principal repayments on short-term borrowing	—	(1,815)
Proceeds from issuance of long-term debt	—	4,452
Payment of contingent consideration	(58)	(40)
Net proceeds from share-based compensation arrangements	84	44
Net cash provided by financing activities	26	1,756
Effect of currency rate changes on cash and cash equivalents	(8)	33
Net increase (decrease) in cash and cash equivalents	1,199	(4,194)
Cash and cash equivalents at beginning of period	4,234	7,013

Cash and cash equivalents at end of period	$5,433	$2,819

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS - (Continued)
(Unaudited)
(Dollars in millions)

	Three-Month Periods Ended March 31,	
	2019	2018
Supplemental schedule of non-cash investing and financing activity:		
Change in net unrealized loss on debt securities available-for-sale	$ —	$ 9
Supplemental disclosure of cash flow information:		
Interest paid	281	190
Income taxes paid	275	387

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)
(Dollars in millions)

	Common Stock	Treasury Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Stockholders' Equity
Balances as of December 31, 2018	$ 10	$(26,336)	$14,978	$17,559	$ (50)	$ 6,161
Net income	—	—	—	1,545	—	1,545
Other comprehensive income	—	—	—	—	18	18
Exercise of stock options and conversion of restricted stock units	—	(12)	164	—	—	152
Issuance of common stock for employee benefit plans	—	50	(18)	—	—	32
Expense related to share-based compensation	—	—	257	—	—	257
Balances as of March 31, 2019	$ 10	$(26,298)	$15,381	$19,104	$ (32)	$ 8,165
Balances as of December 31, 2017	$ 10	$(20,243)	$13,806	$13,061	$ 287	$ 6,921
Net income	—	—	—	846	—	846
Other comprehensive (loss)	—	—	—	—	(45)	(45)
Exercise of stock options and conversion of restricted stock units	—	(9)	60	—	—	51
Shares purchased under share repurchase program	—	(2,725)	—	—	—	(2,725)
Issuance of common stock for employee benefit plans	—	31	3	—	—	34
Expense related to share-based compensation	—	—	208	—	—	208
Adoption of ASU 2014-09, ASU 2016-01, ASU 2018-03, ASU 2018-02, ASU 2016-16 (Note 1)	—	—	—	452	(570)	(118)
Balances as of March 31, 2018	$ 10	$(22,946)	$14,077	$14,359	$ (328)	$ 5,172

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
(In all accompanying tables, amounts of dollars expressed in millions,
except per share amounts, unless otherwise indicated)

1. Nature of Business, Basis of Presentation and New Accounting Standards

Celgene Corporation, together with its subsidiaries (collectively "we," "our," "us," "Celgene" or the "Company"), is an integrated global biopharmaceutical company engaged primarily in the discovery, development and commercialization of innovative therapies for the treatment of cancer and inflammatory diseases through next-generation solutions in protein homeostasis, immuno-oncology, epigenetics, immunology and neuro-inflammation. Celgene Corporation was incorporated in the State of Delaware in 1986.

Our primary commercial stage products include REVLIMID®, POMALYST®/IMNOVID®, OTEZLA®, ABRAXANE®, and VIDAZA®. In addition, we earn revenue from other product sales and licensing arrangements.

Merger Agreement with Bristol-Myers Squibb Company

On January 2, 2019, we entered into a definitive merger agreement with Bristol-Myers Squibb Company (Bristol-Myers Squibb) under which Bristol-Myers Squibb will acquire Celgene in a cash and stock transaction with an equity value of approximately $74 billion, based on the closing price of Bristol-Myers Squibb shares of $52.43 on January 2, 2019 (Bristol-Myers Squibb - Celgene Merger). On April 12, 2019, the stockholders of each of Bristol-Myers Squibb and Celgene approved the Bristol-Myers Squibb - Celgene Merger. The transaction remains subject to the satisfaction of customary closing conditions and regulatory approvals. The Bristol-Myers Squibb - Celgene Merger is expected to close in the third quarter of 2019.

The definitive merger agreement includes restrictions on the conduct of our business prior to the completion of the merger or termination of the merger agreement, generally requiring us to conduct our business in the ordinary course consistent with past practice. Without limiting the generality of the foregoing, we are subject to a variety of specified restrictions. Unless we obtain Bristol-Myers Squibb's prior written consent (which consent may not be unreasonably withheld, conditioned or delayed) and except (i) as required or expressly contemplated by the merger agreement, (ii) as required by applicable law or (iii) as set forth in the confidential disclosure schedule delivered by Celgene to Bristol-Myers Squibb, we may not, among other things, incur additional indebtedness, issue additional shares of our common stock outside of our equity incentive plans, repurchase our common stock, pay dividends, acquire assets, securities or property (subject to certain exceptions, including without limitation, acquisitions up to a specified individual amount and an aggregate limitation), dispose of businesses or assets, enter into material contracts or make certain additional capital expenditures.

Based on the closing price of Bristol-Myers Squibb stock of $52.43 on January 2, 2019, the cash and stock consideration to be received by Celgene stockholders at closing is valued at $102.43 per Celgene share and one Contingent Value Right (Bristol-Myers Squibb CVR). The Bristol-Myers Squibb CVR will entitle its holder to receive a one-time potential payment of $9.00 in cash upon U.S. Food and Drug Administration (FDA) approval of all three of ozanimod (by December 31, 2020), liso-cel (JCAR017) (by December 31, 2020) and bb2121 (by March 31, 2021), in each case for a specified indication. When completed, Bristol-Myers Squibb stockholders are expected to own approximately 69% of the company, and Celgene stockholders are expected to own approximately 31%.

The transaction is not subject to a financing condition. The cash portion will be funded through a combination of cash on hand and debt financing. Bristol-Myers Squibb has obtained fully committed debt financing from Morgan Stanley Senior Funding, Inc. and MUFG Bank, Ltd.

On April 17, 2019, in connection with the Bristol-Myers Squibb - Celgene Merger, Bristol-Myers Squibb commenced an exchange offer for any and all outstanding notes issued by us (the “Celgene Notes”) for up to $19,850,000,000 aggregate principal amount of new notes to be issued by Bristol-Myers Squibb and cash. In conjunction with the exchange offer, Bristol-Myers Squibb is concurrently soliciting consents to adopt certain proposed amendments to each of the indentures governing the Celgene Notes to eliminate substantially all of the restrictive covenants in such indentures. The exchange offers and consent solicitations are conditioned upon, among other things, the closing of the Bristol-Myers Squibb - Celgene Merger. The exchange offers are expected to close on or about the closing date for the Bristol-Myers Squibb - Celgene Merger.

In connection with the Bristol-Myers Squibb - Celgene Merger, we have incurred, and will continue to incur, merger-related and integration-related preparation costs. A significant portion of those costs are contingent on the merger closing, such as investment banking fees, legal fees, and other employee related costs. We incurred $47 million of such costs during the three-month period ended March 31, 2019, which were recorded in Acquisition/integration related charges and restructuring, net within the Consolidated Statement of Income. We will incur approximately $171 million of professional fees due upon closing and approximately $205 million of employee-related costs, a portion of which is due upon closing with the remainder subject to satisfaction of a specified service period.

Basis of Presentation

The consolidated financial statements include the accounts of Celgene Corporation and its subsidiaries. Investments in limited partnerships and interests where we have an equity interest of 50% or less and do not otherwise have a controlling financial interest are accounted for by one of three methods: the equity method, as an investment without a readily determinable fair value or as an investment with a readily determinable fair value.

We operate in a single segment engaged in the discovery, development, manufacturing, marketing, distribution and sale of innovative therapies for the treatment of cancer and inflammatory diseases. Consistent with our operational structure, our Chief Executive Officer (CEO), as the chief operating decision maker, manages and allocates resources at the global corporate level. Our global research and development organization is responsible for discovery of new product candidates and supports development and registration efforts for potential future products. Our global supply chain organization is responsible for the manufacturing and supply of products. Regional/therapeutic area commercial organizations market, distribute and sell our products. The business is also supported by global corporate staff functions. Managing and allocating resources at the global corporate level enables our CEO to assess both the overall level of resources available and how to best deploy these resources across functions, therapeutic areas, regional commercial organizations and research and development projects in line with our overarching long-term corporate-wide strategic goals, rather than on a product or franchise basis. Consistent with this decision-making process, our CEO uses consolidated, single-segment financial information for purposes of evaluating performance, allocating resources, setting incentive compensation targets, as well as forecasting future period financial results.

The preparation of the consolidated financial statements requires management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. We are subject to certain risks and uncertainties related to, among other things, product development, regulatory approval, market acceptance, scope of patent and proprietary rights, competition, outcome of legal and governmental proceedings, credit risk, technological change and product liability.

Interim results may not be indicative of the results that may be expected for the full year. In the opinion of management, these unaudited consolidated financial statements include all normal and recurring adjustments considered necessary for a fair presentation of these interim unaudited consolidated financial statements. Certain prior year amounts have been reclassified to conform to the current year's presentation.
Our significant accounting policies are described in Note 1 of Notes to Consolidated Financial Statements included in our 2018 Annual Report on Form 10-K. Such significant accounting policies are applicable for periods prior to the adoption of the following new accounting standards. Effective January 1, 2019, we changed our approach to lease accounting in conjunction with our adoption of Accounting Standards Update No. 2016-02, "Leases" (ASU 2016-02) and subsequent amendments to ASU 2016-02, including Accounting Standards Update No. 2018-11 “Leases: Targeted Improvements” (ASU 2018-11 and, when taken together with ASU 2016-02, the “New Lease Accounting Standard”). As a result of the adoption of the New Lease Accounting Standard, we have updated our lease accounting policies as detailed below. There were no other changes to our significant accounting policies from those disclosed in our 2018 Annual Report on Form 10-K. See Note 16 for additional details related to our adoption of the New Lease Accounting Standard.

Leases: In accordance with the guidance pursuant to the New Lease Accounting Standard, the determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and includes considerations such as whether there is an identified asset, whether we have the right to obtain substantially all of the economic benefits from use of the identified asset and whether we have the right to direct the use of the identified asset. Leases are included in our Consolidated Balance Sheet as follows:

Asset/Liability	Operating Leases	Finance Leases[1]
Right of use (ROU) assets	Other non-current assets	Property, plant and equipment, net
Current lease liabilities	Accrued expenses and other current liabilities	Short-term borrowings and current portion of long-term debt
Non-current lease liabilities	Other non-current liabilities	Long-term debt, net of discount

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

[1] As of March 31, 2019, Celgene did not have any leases classified as finance leases.

ROU assets represent our right to use an underlying asset for the expected lease term and lease liabilities represent our obligation to make lease payments arising from the lease. ROU assets and related lease liabilities are recognized at commencement date based on the present value of lease payments over the expected lease term, including contractually specified annual rent increases. When determinable, we use the rate implicit in the lease to determine the present value of lease payments. As most of our leases do not provide an implicit rate, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise that option.

Our leasing portfolio is comprised entirely of operating leases, which we account for at the asset level. Additionally, our lease agreements may include both lease and non-lease components, which we account for as a single lease component when the payments are fixed. Lease expense for operating lease payments is recognized on a straight-line basis over the expected lease term.

We do not recognize ROU assets or related lease liabilities with a lease term of twelve months or less on our Consolidated Balance Sheet. Such lease payments are recorded in our Consolidated Statements of Income in the period in which the obligation for those payments was incurred. All of our leases are with unaffiliated parties.

New accounting standards which have been adopted

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02 and has subsequently issued a number of amendments to ASU 2016-02, including ASU 2018-11, which offers a transition option to entities adopting the New Lease Accounting Standard. Under the transition option, entities can elect to apply the new guidance using a modified retrospective approach at the beginning of the year in which New Lease Accounting Standard is adopted, rather than to the earliest comparative period presented in their financial statements. The New Lease Accounting Standard was effective for us as of January 1, 2019. The New Lease Accounting Standard provides accounting guidance for both lessee and lessor accounting models. Among other things, lessees will recognize on their balance sheet a ROU asset and a lease liability, based on the characterization of the lease as either an operating or finance lease. For income statement purposes, operating leases will result in the recognition of straight-line rent expense, while finance leases will result in a front-loaded expense pattern made up of both interest expense and amortization of the ROU asset.

We have elected to adopt the New Lease Accounting Standard using the modified retrospective method and, therefore, have not recast comparative periods presented in our unaudited consolidated financial statements. We have elected the package of transition practical expedients for our existing leases and therefore we have not reassessed the following: lease classification for existing leases, whether any existing contracts contained leases, if any initial direct costs were incurred and whether existing land easements should be accounted for as leases. As permitted under the New Lease Accounting Standard, we have elected as accounting policy elections to not recognize ROU assets and related lease liabilities for leases with terms of twelve months or less and to not separate lease and non-lease components, and instead account for the non-lease components together with the lease components as a single lease component.

The New Lease Accounting Standard had an impact on our Consolidated Balance Sheets as of January 1, 2019 and March 31, 2019, with the recognition of ROU assets in the amount of $293 million and $286 million, respectively, and the recognition of operating lease liabilities of $323 million and $313 million, respectively. However, the New Lease Accounting Standard did not have any significant impact on our Consolidated Statements of Income for any period. There was no material tax impact of adopting the New Lease Accounting Standard.

Accounting Standards Adopted in 2018

On January 1, 2018, we adopted several new accounting standards, including the following which required cumulative effect adjustments to Retained earnings and Accumulated Other Comprehensive Income (AOCI):

- ASU 2014-09 "Revenue from Contracts with Customers" (ASU 2014-09);
- ASU 2016-01 "Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" (ASU 2016-01);
- ASU 2018-03 "Technical Corrections and Improvements to Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities" (ASU 2018-03);
- ASU 2018-02 "Income Statement-Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" (ASU 2018-02); and
- ASU 2016-16 "Intra-Entity Transfers of Assets Other Than Inventory" (ASU 2016-16).

Additional information related to the adoption of these accounting standards is disclosed in Note 1 of Notes to Consolidated Financial Statements contained in our 2018 Annual Report on Form 10-K. The following table presents a summary of cumulative effect adjustments to Retained earnings and AOCI due to the adoption of new accounting standards on January 1, 2018 as noted above:

	Retained Earnings Increase / (Decrease)	AOCI (Decrease) / Increase
ASU 2014-09	$ 4	$ —
ASU 2016-01	687	(687)
ASU 2018-03	44	—
ASU 2018-02	(117)	117
ASU 2016-16	(166)	—
Net cumulative effect adjustments to Retained earnings and AOCI on January 1, 2018 due to the adoption of new accounting standards	$ 452	$ (570)

New accounting standards which have not yet been adopted

In June 2016, the FASB issued Accounting Standards Update No. 2016-13, "Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments" (ASU 2016-13). ASU 2016-13 requires that expected credit losses relating to financial assets measured on an amortized cost basis and available-for-sale debt securities be recorded through an allowance for credit losses. ASU 2016-13 limits the amount of credit losses to be recognized for available-for-sale debt securities to the amount by which carrying value exceeds fair value and also requires the reversal of previously recognized credit losses if fair value increases. The new standard will be effective for us on January 1, 2020. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

In November 2018, the FASB issued Accounting Standards Update No. 2018-18, “Collaboration Arrangements: Clarifying the Interaction between Topic 808 and Topic 606” (ASU 2018-18). The issuance of ASU 2014-09 raised questions about the interaction between the guidance on collaborative arrangements and revenue recognition. ASU 2018-18 addresses this uncertainty by (1) clarifying that certain transactions between collaborative arrangement participants should be accounted for as revenue under ASU 2014-09 when the collaboration arrangement participant is a customer, (2) adding unit of account guidance to assess whether the collaboration arrangement or a part of the arrangement is with a customer and (3) precluding a company from presenting transactions with collaboration arrangement participants that are not directly related to sales to third parties together with revenue from contracts with customers. The new standard will be effective for us on January 1, 2020 with early adoption permitted. We are currently evaluating the effect that the updated standard will have on our consolidated financial statements and related disclosures.

2. Revenue

The majority of our revenue is derived from product sales. Our primary commercial stage products include REVLIMID®, POMALYST®/IMNOVID®, OTEZLA®, ABRAXANE®, and VIDAZA®. In addition, we recognize revenue from other product sales and royalties based on licensees’ sales of our products or products using our technologies. We do not consider royalty revenue to be a material source of our consolidated revenue. As such, the following disclosure only relates to revenue associated with net product sales.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in the current revenue standard. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied.

At contract inception, we assess the goods promised in our contracts with customers and identify a performance obligation for each promise to transfer to the customer a good that is distinct. When identifying our performance obligations, we consider all goods promised in the contract regardless of whether explicitly stated in the customer contract or implied by customary business practices. Generally, our contracts with customers require us to transfer an individual distinct product, which would represent a single performance obligation. In limited situations, our contracts with customers will require us to transfer two or more distinct products, which would represent multiple performance obligations for each distinct product. For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation on a relative standalone selling price basis. In determining our standalone selling prices for our products, we utilize observable prices for our goods sold separately in similar circumstances and to customers in the same geographical region or market. Our performance obligations with respect to our product sales are satisfied at a point in time, which transfer control upon delivery of product to our customers. We consider control to have transferred upon delivery because the customer has legal title to the asset, we have transferred physical possession of the asset, the customer has significant risks and rewards of ownership of the asset, and in most instances we have a present right to payment at that time. The aggregate dollar value of unfulfilled orders as of March 31, 2019 was not material.

Distribution

REVLIMID® and POMALYST® are distributed in the United States primarily through contracted pharmacies under the REVLIMID Risk Evaluation and Mitigation Strategy (REMS) and POMALYST REMS® programs, respectively. These are proprietary risk-management distribution programs tailored specifically to provide for the safe and appropriate distribution and use of REVLIMID® and POMALYST®. Internationally, REVLIMID® and IMNOVID® are distributed under mandatory risk-management distribution programs tailored to meet local authorities' specifications to provide for the product's safe and appropriate distribution and use. These programs may vary by country and, depending upon the country and the design of the risk-management program, the product may be sold through hospitals or retail pharmacies. OTEZLA®, ABRAXANE® and VIDAZA® are distributed through the more traditional pharmaceutical industry supply chain and are not subject to the same risk-management distribution programs as REVLIMID® and POMALYST®/IMNOVID®.

Significant Payment Terms

Our contracts with our customers state the terms of the sale including the description, quantity, and price for each product purchased, as well as the payment and shipping terms. Our contractual payment terms vary by jurisdiction. In the United States, our contractual payment terms are typically due in no more than 30 days. Sales made outside the United States typically have payment terms that are greater than 60 days, thereby extending collection periods beyond those in the United States. The period between when we transfer control of the promised goods to a customer and when we receive payment from such customer is expected to be one year or less. Any exceptions to this are either not material or we collect interest from the customer for the time period between the invoice due date and the payment date. As such, we do not adjust the invoice amount for the effects of a significant financing component as the impact is not material to our consolidated financial statements.

Contract Balances

When the timing of our delivery of product is different from the timing of payments made by the customers, we recognize either a contract asset (performance precedes the contractual due date) or a contract liability (customer payment precedes performance). There were no significant changes in our contract asset or liability balances during the three-month periods ended March 31, 2019 and March 31, 2018 other than from transactions in the ordinary course of operating activities as described above.

Contract Assets

In limited situations, certain customer contractual payment terms require us to bill in arrears; thus, we satisfy some or all of our performance obligations before we are contractually entitled to bill the customer. In these situations, billing occurs subsequent to revenue recognition, which results in a contract asset. We reflect these contract assets as a component of Other current assets on the Consolidated Balance Sheet. For example, certain of our contractual arrangements do not permit us to bill until the product is sold through to the end-customer. As of March 31, 2019 and December 31, 2018, such contract assets were $36 million.

Contract Liabilities

In other limited situations, certain customer contractual payment terms allow us to bill in advance; thus, we receive customer cash payment before satisfying some or all of its performance obligations. In these situations, billing occurs in advance of revenue recognition, which results in contract liabilities. We reflect these contract liabilities as Deferred revenue on our Consolidated Balance Sheet. For example, certain of our contractual arrangements provide the customer with free product after the customer has purchased a contractual minimum amount of product. We concluded the free product represents a future performance obligation in the form of a contractual material right. As such, we defer a portion of the transaction price as a contract liability upon each sale of product until the contractual minimum volume is achieved. As we satisfy our remaining performance obligations, we release a portion of the deferred revenue balance. As of March 31, 2019 and December 31, 2018, such contract liabilities were $138 million and $137 million, respectively. Revenue recognized for the three-month period ended March 31, 2019 that was reflected in the deferred revenue balance as of December 31, 2018 was $12 million. Revenue recognized for the three-month period ended March 31, 2018 that was reflected in the deferred revenue balance at the beginning of 2018 was $16 million.

Gross-to-Net Sales Adjustments

We record gross-to-net sales accruals for government rebates, chargebacks, distributor service fees, other rebates and administrative fees, sales returns and allowances, and sales discounts. Provisions for discounts, early payments, rebates, sales returns, distributor service fees and chargebacks under terms customary in the industry are provided for in the same period the related sales are recorded. We record estimated reductions to revenue for volume-based discounts and rebates at the time of the initial sale based upon the sales terms, historical experience and trend analysis. We estimate these accruals using an expected value approach based primarily upon our historical rebate and discount payments made and the provisions included in current customer contracts and government regulations.

Government Rebates, including Medicaid and Medicare Rebates

Government rebate accruals are based on estimated payments due to governmental agencies for purchases made by third parties under various governmental programs. In the U.S., we participate in state government Medicaid programs and other Federal and state government programs, which require rebates to participating government entities. U.S. Medicaid rebate accruals are generally based on historical payment data and estimates of future Medicaid beneficiary utilization applied to the Medicaid unit rebate formula established by the Center for Medicaid and Medicare Services. The Medicaid rebate percentage was increased and extended to Medicaid Managed Care Organizations in March 2010. The accrual of the rebates associated with Medicaid Managed Care Organizations is calculated based on estimated historical patient data related to Medicaid Managed Care Organizations. We also analyze actual billings received from the states to further support the accrual rates. Effective in 2019, manufacturers of pharmaceutical products are responsible for 70% of the patient's cost of branded prescription drugs related to the Medicare Part D Coverage Gap, an increase of 20 percentage points from 2018. In order to estimate the cost to us of this coverage gap responsibility, we analyze data for eligible Medicare Part D patients against data for eligible Medicare Part D patients treated with our products, as well as the historical invoices. This expense is recognized throughout the year as costs are incurred. In certain international markets, government-sponsored programs require rebates to be paid based on program specific rules and, accordingly, the rebate accruals are determined primarily on estimated eligible sales.

Chargebacks, Distributor Service Fees, Other Rebates and Administrative Fees

Chargeback accruals are based on the differentials between product acquisition prices paid by wholesalers and lower government contract pricing paid by eligible customers covered under federally qualified programs. Distributor service fee accruals are based on contractual fees to be paid to the wholesale distributor for services provided. TRICARE is a health care program of the U.S. Department of Defense Military Health System that provides civilian health benefits for military personnel, military retirees and their dependents. TRICARE rebate accruals are included in chargeback accruals and are based on estimated Department of Defense eligible sales multiplied by the TRICARE rebate formula.

Rebates or administrative fees are offered to certain wholesale customers, group purchasing organizations and end-user customers, consistent with pharmaceutical industry practices. Settlement of rebates and administrative fees may generally occur from one to 15 months from the date of sale. We record a provision for rebates at the time of sale based on contracted rates and historical redemption rates. Assumptions used to establish the provision include level of wholesaler inventories, contract sales volumes and average contract pricing. We regularly review the information related to these estimates and adjust the provision accordingly.

Returns, Refunds and Warranties

We base our sales returns allowance on estimated on-hand retail/hospital inventories, measured end-customer demand as reported by third-party sources, actual returns history and other factors, such as the trend experience for lots where product is still being returned or inventory centralization and rationalization initiatives conducted by major pharmacy chains, as applicable. If the historical data we use to calculate these estimates do not properly reflect future returns, then a change in the allowance would be made in the period in which such a determination is made and revenues in that period could be materially affected. Under this methodology, we track actual returns by individual production lots. Returns on closed lots, that is, lots no longer eligible for return credits, are analyzed to determine historical returns experience. Returns on open lots, that is, lots still eligible for return credits, are monitored and compared with historical return trend rates. Any changes from the historical trend rates are considered in determining the current sales return allowance. We do not provide warranties on our products to our customers unless the product is defective as manufactured or damaged in transit within a reasonable period of time after receipt of the product by the customer.

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Sales Discounts

Sales discounts are based on payment terms extended to customers, which are generally offered as an incentive for prompt payment. We record our best estimate of sales discounts to which customers are likely to be entitled based on both historical information and current trends.

The reconciliation of gross product sales to net product sales by each significant category of gross-to-net adjustments was as follows:

	Three-Month Periods Ended March 31,	
	2019	2018
Gross Product Sales	$5,028	$4,247
Gross-to-Net Adjustments:		
Government Rebates	(383)	(291)
Chargebacks and Distributor Services Fees	(543)	(367)
Sales Discounts	(68)	(56)
Sales Returns and Allowances	(10)	(2)
Total Gross-to-Net Adjustments	(1,004)	(716)
Net Product Sales	$4,024	$3,531

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CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Total revenues from external customers by our franchises (Hematology / Oncology and Inflammation & Immunology), product and geography for the three-month periods ended March 31, 2019 and 2018 were as follows:

		Three-Month Periods Ended March 31, 2019	2018
Hematology / Oncology:			
REVLIMID®			
	U.S.	$1,686	$1,487
	International	891	747
	Worldwide	2,577	2,234
POMALYST®/IMNOVID®			
	U.S.	390	300
	International	167	153
	Worldwide	557	453
ABRAXANE®			
	U.S.	196	159
	International	90	103
	Worldwide	286	262
VIDAZA®			
	U.S.	3	2
	International	148	155
	Worldwide	151	157
All Other			
	U.S.	45	55
	International	19	17
	Worldwide	64	72
Total Hematology / Oncology:			
	U.S.	2,320	2,003
	International	1,315	1,175
	Worldwide	3,635	3,178
Inflammation & Immunology:			
OTEZLA®			
	U.S.	301	276
	International	88	77
	Worldwide	389	353
Total net product sales			
	U.S.	2,621	2,279
	International	1,403	1,252
	Worldwide	4,024	3,531
Other revenue		1	7
Total revenue		$4,025	$3,538

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3. Acquisitions and Divestitures

Acquisitions in Fiscal 2018:

Impact Biomedicines, Inc. (Impact): On February 12, 2018, we acquired all of the outstanding shares of Impact, a privately held biotechnology company which was developing fedratinib, a highly selective JAK2 kinase inhibitor, for myelofibrosis.

The consideration included an initial payment of approximately $1.1 billion. In addition, the sellers of Impact are eligible to receive contingent consideration based upon regulatory approvals of up to $1.4 billion and contingent consideration of up to $4.5 billion based upon the achievement of sales in any four consecutive calendar quarters between $1.0 billion and $5.0 billion. The acquisition of Impact was concentrated in one single identifiable asset and thus, for accounting purposes, we have concluded that the acquired assets do not meet the accounting definition of a business. The initial payment was allocated primarily to fedratinib, resulting in a $1.1 billion research and development asset acquisition expense and the balance of approximately $7 million was allocated to the remaining net assets acquired.

Juno Therapeutics, Inc. (Juno): On March 6, 2018, we acquired all of the outstanding shares of Juno (Juno Acquisition), resulting in Juno becoming our wholly-owned subsidiary. Juno is developing CAR (chimeric antigen receptor) T and TCR (T cell receptor) therapeutics with a broad, novel portfolio evaluating multiple targets and cancer indications. The acquisition added a novel scientific platform and scalable manufacturing capabilities including JCAR017 and JCARH125, both directed CAR T therapeutics currently in programs for relapsed and/or refractory diffuse large B-cell lymphoma and relapsed and/or refractory multiple myeloma, respectively.

Total consideration for the acquisition was approximately $10.4 billion, consisting of $9.1 billion for common stock outstanding, $966 million for the fair value of our investment in Juno and $367 million for the portion of equity compensation attributable to the pre-combination service period. In addition, the fair value of the awards attributed to post-combination service period was $666 million, which will be recognized as compensation expense over the requisite service period in our post-combination financial statements. We recognized $28 million and $250 million of post combination share-based compensation for the three-month periods ended March 31, 2019 and 2018, respectively.

The acquisition has been accounted for as a business combination using the acquisition method of accounting which requires that assets acquired and liabilities assumed be recognized at their fair values as of the acquisition date and requires the fair value of acquired in-process research and development (IPR&D) to be classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts.

The total consideration for the acquisition of Juno was $10.4 billion, which consisted of the following:

	Total Consideration
Cash paid for outstanding common stock at $87.00 per share	$ 9,101
Celgene investment in Juno at $87.00 per share [(1)]	966
Cash for equity compensation attributable to pre-combination service [(2)]	367
Total consideration	$ 10,434

[(1)] The Company recognized a gain of $458 million during the first quarter of 2018, as a result of remeasuring to fair value the equity interest in Juno held by us before the business combination, which was recorded in Other income, net within the Consolidated Statement of Income.

(2) All equity compensation attributable to pre-combination service was paid during the first quarter of 2018.

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The purchase price allocation resulted in the following amounts being allocated to the assets acquired and liabilities assumed on March 6, 2018 based upon their respective fair values summarized below. The determination of fair value was finalized in the fourth quarter of 2018.

	Amounts Recognized as of the acquisition date of March 6, 2018
Working capital [(1)]	$ 452
IPR&D	6,980
Technology platform intangible asset	1,260
Property, plant and equipment, net	144
Other non-current assets	32
Deferred tax liabilities, net	(1,530)
Other non-current liabilities	(41)
Total identifiable net assets	7,297
Goodwill	3,137
Total net assets acquired	$ 10,434

(1) Includes cash and cash equivalents, debt securities available-for-sale, accounts receivable, net of allowances, other current assets, accounts payable, accrued expenses and other current liabilities (including accrued litigation). See Note 17 for litigation matters related to Juno.

The fair value assigned to acquired IPR&D was based on the present value of expected after-tax cash flows attributable to JCAR017, which is in a pivotal phase II trial and JCARH125. The present value of expected after-tax cash flows attributable to JCAR017 and JCARH125 assigned to IPR&D was determined by estimating the after-tax costs to complete development of JCAR017 and JCARH125 into commercially viable products, estimating future revenue and ongoing expenses to produce, support and sell JCAR017 and JCARH125, on an after-tax basis, and discounting the resulting net cash flows to present value. The revenue and costs projections used were reduced based on the probability that products at similar stages of development will become commercially viable products. The rate utilized to discount the net cash flows to their present value reflects the risk associated with the intangible asset and is benchmarked to the cost of equity. Acquired IPR&D will be accounted for as indefinite-lived intangible assets until regulatory approvals for JCAR017 and JCARH125 in a major market or discontinuation of development.

The fair value of the technology platform intangible asset is equal to the present value of the expected after-tax cash flows attributable to the intangible asset, which was calculated based on the multi-period excess earnings method of the income approach. The multi-period excess earnings method of the income approach included estimating probability adjusted annual after-tax net cash flows through the cycle of development and commercialization of potential products generated by the technology platform then discounting the resulting probability adjusted net post-tax cash flows using a discount rate commensurate with the risk of our overall business operations to arrive at the net present value.

The excess of purchase price over the fair value amounts assigned to identifiable assets acquired and liabilities assumed represents the goodwill amount resulting from the acquisition. The goodwill recorded as part of the acquisition is primarily attributable to the broadening of our product portfolio and research capabilities in the hematology and oncology therapeutic area, the assembled workforce and the deferred tax consequences of the IPR&D asset recorded for financial statement purposes. We do not expect any portion of this goodwill to be deductible for tax purposes. The goodwill attributable to the acquisition has been recorded as a non-current asset in our Consolidated Balance Sheets and is not amortized, but is subject to review for impairment annually.

Juno's actual operating results represent a partial quarter in fiscal 2018, from the acquisition date of March 6, 2018 through the end of the quarter on March 31, 2018. There were no revenues reported for such period. However, a net loss of $304 million was included in such period, including share-based compensation charges of $250 million and $22 million of acquisition related charges.

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Pro Forma Financial Information for the Juno Acquisition:

The following table provides unaudited pro forma financial information for the three-month period ended March 31, 2018 as if the Juno Acquisition had occurred on January 1, 2017.

	Three-Month Period Ended March 31, 2018
Total revenue	$ 3,548
Net income	609
Net income per common share: basic	$ 0.81
Net income per common share: diluted	$ 0.79

The unaudited pro forma financial information was prepared using the acquisition method of accounting and was based on the historical financial information of Celgene and Juno. The supplemental pro forma financial information reflects primarily the following pro forma adjustments:

- Elimination of research related cost sharing transactions between Celgene and Juno;
- The pro forma financial information assumes that the acquisition related transaction fees and costs, including post combination share-based compensation related to the acquisition, were removed from the three-month period ended March 31, 2018 and were assumed to have been incurred during the first quarter of 2017;
- The pro forma financial information assumes that the gain recognized as a result of remeasuring to fair value the equity interest we held in Juno prior to the business combination was removed from the three-month period ended March 31, 2018 and was assumed to have been recognized during the first quarter of 2017;
- Additional interest expense and amortization of debt issuance costs for a portion of the $4.5 billion of debt that was issued in February 2018 to partially finance the acquisition;
- Additional amortization expense on the acquired technology platform asset; and
- Statutory tax rates were applied, as appropriate, to each pro forma adjustment based on the jurisdiction in which the adjustment occurred.

The unaudited pro forma results do not reflect any operating efficiencies or potential cost savings that may result from the combined operations of Celgene and Juno. Accordingly, these unaudited pro forma results are presented for illustrative purposes and are not intended to represent or be indicative of the actual results of operations of the combined company that would have been achieved had the acquisition occurred at the beginning of the periods presented, nor are they intended to represent or be indicative of future results of operations.

4. Earnings Per Share

	Three-Month Periods Ended March 31,	
(Amounts in millions, except per share)	2019	2018
Net income	$1,545	$846
Weighted-average shares:		

Basic	702.4	748.3
Effect of dilutive securities:		
Options, restricted stock units, performance stock units and other	18.1	20.0
Diluted	720.5	768.3
Net income per share:		
Basic	$2.20	$1.13
Diluted	$2.14	$1.10

The total number of potential shares of common stock excluded from the diluted earnings per share computation because their inclusion would have been anti-dilutive was 41.7 million and 35.7 million shares for the three-month periods ended March 31, 2019 and 2018, respectively.

Share Repurchase Program: As of March 31, 2019, we had remaining availability under our authorized common stock share repurchase program of $2.8 billion. We did not repurchase any shares of our common stock during the three-month period ended March 31, 2019.

5. Accumulated Other Comprehensive (Loss) Income

The components of other comprehensive (loss) income consist of changes in pension liability, changes in net unrealized gains (losses) on debt securities available-for-sale, changes in net unrealized gains (losses) related to cash flow hedges, the amortization of the excluded component related to cash flow hedges and changes in foreign currency translation adjustments.

The accumulated balances related to each component of other comprehensive (loss) income, net of tax, are summarized as follows:

	Pension Liability Adjustment	Net Unrealized Gains (Losses) On Debt Securities Available-for-Sale[1]	Net Unrealized Gains (Losses) Related to Cash Flow Hedges	Amortization of Excluded Component Related to Cash Flow Hedges	Foreign Currency Translation Adjustments	Accumulated Other Comprehensive (Loss) Income
Balance as of December 31, 2018	$ (28)	$ 3	$ 42	$ (7)	$ (60)	$ (50)
Other comprehensive income (loss) before reclassifications, net of tax	—	—	51	(1)	(10)	40
Reclassified (gains) losses from accumulated other comprehensive income (loss), net of tax	—	—	(23)	1	—	(22)
Net current-period other comprehensive income (loss), net of tax	—	—	28	—	(10)	18
Balance as of March 31, 2019	$ (28)	$ 3	$ 70	$ (7)	$ (70)	$ (32)
Balance as of December 31, 2017	$ (22)	$ 562	$ (206)	$ (15)	$ (32)	$ 287
Cumulative effect adjustment for the adoption of ASU 2016-01 and ASU 2018-02	—	(566)	(4)	—	—	(570)
Other comprehensive (loss) income before reclassifications, net of tax	—	(7)	(98)	(8)	16	(97)
Reclassified losses from accumulated other comprehensive income (loss), net of tax	—	14	27	11	—	52
Net current-period other comprehensive income (loss), net of tax	—	7	(71)	3	16	(45)
Balance as of March 31, 2018	$ (22)	$ 3	$ (281)	$ (12)	$ (16)	$ (328)

[1] Balances as of December 31, 2017 are prior to the adoption of ASU 2016-01 and, as such, include equity securities with readily determinable fair values. Upon adoption of ASU 2016-01, we recorded a cumulative effect adjustment for our net unrealized gains related to our equity securities with readily determinable fair values as of January 1, 2018. Therefore, the unrealized gains (losses) position as of March 31, 2018 solely relate to debt securities available-for-sale.

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Accumulated Other Comprehensive (Loss) Income Components	Classification in the Consolidated Statements of Income	Gains (Losses) Reclassified Out of Accumulated Other Comprehensive (Loss) Income Three-Month Periods Ended March 31,	
		2019	2018
(Losses) gains related to cash-flow hedges:			
Foreign exchange contracts	Net product sales	$ 24	$ (26)
Treasury rate lock agreements	Interest (expense)	(1)	(1)
Excluded component related to cash-flow hedges:			
Foreign exchange contracts	Net product sales	—	(3)
(Losses) gains on debt securities available-for-sale:			
Realized gain (loss) on sales of debt securities available-for-sale	Interest and investment income, net[1]	—	(18)
	Income tax provision - (expense) benefit[1]	—	4
Total reclassification, net of tax		$ 23	$ (44)

[1] We use a specific identification approach to release the realized gain (loss) on sales of debt securities available-for-sale and income tax effects into Accumulated other comprehensive (loss).

6. Financial Instruments and Fair Value Measurement

The tables below present information about assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018 and the valuation techniques we utilized to determine such fair value.

- Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Our level 1 assets consist of equity investments with readily determinable fair values. Our level 1 liability relates to our publicly traded Abraxis contingent value rights (Abraxis CVRs). See Note 19 of Notes to Consolidated Financial Statements included in our 2018 Annual Report on Form 10-K for a description of the Abraxis CVRs.
- Level 2 inputs utilize observable quoted prices for similar assets and liabilities in active markets and observable quoted prices for identical or similar assets in markets that are not very active. From time to time, our level 2 assets consist primarily of U.S. Treasury securities, U.S. government-sponsored agency securities, U.S. government-sponsored agency mortgage-backed securities (MBS), global corporate debt securities, asset backed securities, ultra short income fund investments, time deposits and repurchase agreements with original maturities of greater than three months. We also have derivative instruments including foreign currency forward contracts, purchased currency options, zero-cost collar currency contracts and interest rate swap contracts, which may be in an asset or liability position.
- Level 3 inputs utilize unobservable inputs and include valuations of assets or liabilities for which there is little, if any, market activity. We do not have any level 3 assets. Our level 3 liabilities consist of contingent consideration related to undeveloped product rights and technology platforms resulting from the acquisitions of Gloucester

Pharmaceuticals, Inc. (Gloucester), Nogra Pharma Limited (Nogra), Avila Therapeutics, Inc. (Avila) and Quanticel Pharmaceuticals, Inc. (Quanticel). In addition, in connection the Juno Acquisition, we assumed Juno's contingent consideration and success payment liabilities.

Our contingent consideration obligations are recorded at their estimated fair values and we revalue these obligations each reporting period until the related contingencies are resolved. The fair value measurements are estimated using probability-weighted discounted cash flow approaches that are based on significant unobservable inputs related to product candidates acquired in business combinations and are reviewed quarterly. These inputs include, as applicable, estimated probabilities and timing of achieving specified development and regulatory milestones, estimated annual sales and the discount rate used to calculate the present value of estimated future payments. Significant changes which increase or decrease the probabilities of achieving the related development and regulatory events, shorten or lengthen the time required to achieve such events, or increase or decrease estimated annual sales would result in corresponding increases or decreases in the fair values of these obligations. The fair value of our contingent consideration as of March 31, 2019 and December 31, 2018 was calculated using the following significant unobservable inputs:

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Inputs	Ranges (weighted average) utilized as of:	
	March 31, 2019	December 31, 2018
Discount rate	3.6% to 4.8% (4.3%)	3.6% to 4.8% (4.3%)
Probability of payment	0% to 68% (5%)	0% to 68% (5%)
Projected year of payment for development and regulatory milestones	2020 to 2029 (2024)	2020 to 2029 (2024)
Projected year of payment for sales-based milestones and other amounts calculated as a percentage of annual sales	N/A	N/A

The maximum remaining potential payments related to the contingent consideration from the acquisitions of Gloucester, Avila, Quanticel and those assumed in the Juno Acquisition are estimated to be $120 million, $475 million, $214 million and $283 million, respectively, and $1.8 billion plus other amounts calculated as a percentage of annual sales pursuant to the license agreement with Nogra.

Success payment obligations assumed through the Juno Acquisition are also recorded at their estimated fair values and are revalued quarterly. Changes in the fair value of contingent consideration and success payment obligations are recognized in Acquisition/integration related charges and restructuring, net in the Consolidated Statements of Income.

The following tables present the Company's hierarchy for its assets and liabilities measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018:

		Fair Value Measurements as of March 31, 2019		
	Balance as of March 31, 2019	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Debt securities available-for-sale	$664	$—	$ 664	$ —
Equity investments with readily determinable fair values	1,594	1,594	—	—
Forward currency contracts	83	—	83	—
Zero-cost collar currency contracts	17	—	17	—
Interest rate swaps	2	—	2	—
Total assets	$2,360	$1,594	$ 766	$ —
Liabilities:				
Contingent value rights	$(48)	$(48)	$ —	$ —
Other acquisition related contingent consideration and success payments	(162)	—	—	(162)
Total liabilities	$(210)	$(48)	$ —	$ (162)

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

	Balance as of December 31, 2018	Fair Value Measurements as of December 31, 2018 Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Debt securities available-for-sale	$ 496	$—	$ 496	$ —
Equity investments with readily determinable fair values	1,312	1,312	—	—
Forward currency contracts	78	—	78	—
Total assets	$ 1,886	$1,312	$ 574	$ —
Liabilities:				
Contingent value rights	$ (19)	$(19)	$ —	$ —
Interest rate swaps	(10)	—	(10)	—
Zero-cost collar currency contracts	(1)	—	(1)	—
Other acquisition related contingent consideration and success payments	(163)	—	—	(163)
Total liabilities	$ (193)	$(19)	$ (11)	$ (163)

We measure equity investments without a readily determinable fair value at cost, less any impairment, plus or minus changes resulting from observable price changes in orderly transactions for an identical or similar investment of the same issuer or at net asset value, as a practical expedient, if available. We record upward adjustments, downward adjustments and impairments of equity investments without readily determinable fair values within Other income, net on the Consolidated Statements of Income. The following table represents a roll-forward of equity investments without readily determinable fair values:

	Three-Month Period Ended March 31, 2019
Balance as of December 31, 2018	$ 545
Purchases	25
Upward adjustments	15
Downward adjustments and impairments	(1)
Balance as of March 31, 2019	$ 584

	Three-Month Period Ended March 31, 2018

Balance as of December 31, 2017	$ 513
Cumulative effect adjustment for the adoption of ASU 2018-03	59
Purchases	16
Upward adjustments	21
Sales	(3)
Downward adjustments and impairments	(1)
Transfer to readily determinable fair value	(10)
Balance as of March 31, 2018	$ 595

For equity investments without a readily determinable fair value held as of March 31, 2019, cumulative upward adjustments and downward adjustments and impairments since the adoption of ASU 2016-01 for the period January 1, 2018 through March 31, 2019 were $81 million and $135 million, respectively.

For equity investments with and without readily determinable fair values held as of March 31, 2019 and 2018, we recorded a net unrealized gain of $268 million and $449 million within Other income, net on the Consolidated Statements of Income for the three-month periods ended March 31, 2019 and 2018, respectively.

CELGENE CORPORATION AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

There were no security transfers between levels 1, 2 and 3 during the three-month periods ended March 31, 2019 and 2018. The following tables represent a roll-forward of the fair value of level 3 instruments:

	Three-Month Period Ended March 31, 2019
Liabilities:	
Balance as of December 31, 2018	$ (163)
Net change in fair value	—
Balance as of March 31, 2019	$ (163)

	Three-Month Period Ended March 31, 2018
Liabilities:	
Balance as of December 31, 2017	$ (80)
Amounts acquired from Juno	(122)
Net change in fair value	1
Balance as of March 31, 2018	$ (201)

7. Derivative Instruments and Hedging Activities

Our revenue and earnings, cash flows and fair values of assets and liabilities can be impacted by fluctuations in foreign exchange rates and interest rates. We actively manage the impact of foreign exchange rate and interest rate movements through operational means and through the use of various financial instruments, including derivative instruments such as foreign currency option contracts, foreign currency forward contracts, treasury rate lock agreements and interest rate swap contracts. In instances where these financial instruments are accounted for as cash flow hedges or fair value hedges we may from time to time terminate the hedging relationship. If a hedging relationship is terminated, we generally either settle the instrument or enter into an offsetting instrument.

Foreign Currency Risk Management

We maintain a foreign exchange exposure management program to mitigate the impact of volatility in foreign exchange rates on future foreign currency cash flows, translation of foreign earnings and changes in the fair value of assets and liabilities denominated in foreign currencies.

Through our revenue hedging program, we endeavor to reduce the impact of possible unfavorable changes in foreign exchange rates on our future U.S. Dollar cash flows that are derived from foreign currency denominated sales. To achieve this objective, we hedge a portion of our forecasted foreign currency denominated sales that are expected to occur in the foreseeable future, typically within the next three years, with a maximum of five years. We manage our anticipated transaction exposure principally with foreign currency forward contracts, a combination of foreign currency zero-cost collars, and occasionally purchased foreign currency put options.

Foreign Currency Forward Contracts: We use foreign currency forward contracts to hedge specific forecasted transactions denominated in foreign currencies, manage exchange rate volatility in the translation of foreign earnings, and reduce exposures to foreign currency fluctuations of certain assets and liabilities denominated in foreign currencies.

We manage a portfolio of foreign currency forward contracts to protect against changes in anticipated foreign currency cash flows resulting from changes in foreign currency exchange rates, primarily associated with non-functional currency denominated revenues and expenses of foreign subsidiaries. The foreign currency forward hedging contracts outstanding as of March 31, 2019 and December 31, 2018 had settlement dates within 27 months and 30 months, respectively. The spot rate components of these foreign currency forward contracts are designated as cash flow hedges and any unrealized gains or losses are reported in Other Comprehensive Income (OCI) and reclassified to the Consolidated Statements of Income in the same periods during which the underlying hedged transactions affect earnings. If a hedging relationship is terminated with respect to a foreign currency forward contract, accumulated gains or losses associated with the contract remain in OCI until the hedged forecasted transaction occurs and are reclassified to operations in the same periods during which the underlying hedged transactions affect earnings. We recognize

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in earnings the initial value of the forward point components on a straight-line basis over the life of the derivative instrument within the same line item in the Consolidated Statements of Income that is used to present the earnings effect of the hedged item.

Foreign currency forward contracts entered into to hedge forecasted revenue and expenses were as follows as of March 31, 2019 and December 31, 2018:

	Notional Amount	
Foreign Currency	March 31, 2019	December 31, 2018
Australian Dollar	$31	$ 46
British Pound	49	82
Canadian Dollar	112	158
Euro	887	1,381
Japanese Yen	320	424
Total	$1,399	$ 2,091

We consider the impact of our own and the counterparties' credit risk on the fair value of the contracts as well as the ability of each party to execute its obligations under the contract on an ongoing basis. As of March 31, 2019, credit risk did not materially change the fair value of our foreign currency forward contracts.

We also manage a portfolio of foreign currency contracts to reduce exposures to foreign currency fluctuations of certain recognized assets and liabilities denominated in foreign currencies and, from time to time, we enter into foreign currency contracts to manage exposure related to translation of foreign earnings. These foreign currency forward contracts have not been designated as hedges and, accordingly, any changes in their fair value are recognized on the Consolidated Statements of Income in Other income, net in the current period. The aggregate notional amount of the foreign currency forward non-designated hedging contracts outstanding as of March 31, 2019 and December 31, 2018 were $398 million and $347 million, respectively.

Foreign Currency Option Contracts: From time to time, we may hedge a portion of our future foreign currency exposure by utilizing a strategy that involves both a purchased local currency put option and a written local currency call option that are accounted for as hedges of future sales denominated in that local currency. Specifically, we sell (or write) a local currency call option and purchase a local currency put option with the same expiration dates and local currency notional amounts but with different strike prices. The premium collected from the sale of the call option is equal to the premium paid for the purchased put option, resulting in no net premium being paid. This combination of transactions is generally referred to as a "zero-cost collar." The expiration dates and notional amounts correspond to the amount and timing of forecasted foreign currency sales. The foreign currency zero-cost collar contracts outstanding as of March 31, 2019 and December 31, 2018 had settlement dates within 21 months and 24 months, respectively. If the U.S. Dollar weakens relative to the currency of the hedged anticipated sales, the purchased put option value reduces to zero and we benefit from the increase in the U.S. Dollar equivalent value of our anticipated foreign currency cash flows; however, this benefit would be capped at the strike level of the written call, which forms the upper end of the collar.

Outstanding foreign currency zero-cost collar contracts entered into to hedge forecasted revenue were as follows as of March 31, 2019 and December 31, 2018:

Notional Amount (1)

	March 31, 2019	December 31, 2018
Foreign currency zero-cost collar contracts designated as hedging activity:		
Purchased Put	$1,893	$ 1,933
Written Call	2,171	2,216

(1) U.S. Dollar notional amounts are calculated as the hedged local currency amount multiplied by the strike value of the foreign currency option. The local currency notional amounts of our purchased put and written call that are designated as hedging activities are equal to each other.

We previously entered into foreign currency purchased put option contracts to hedge forecasted revenue which were not part of a collar strategy. Such purchased put option contracts had a notional value of nil as of March 31, 2019 and December 31, 2018. We de-designated all of our purchased put option contracts prior to March 31, 2019.

Interest Rate Risk Management
Forward Starting Interest Rate Swaps and Treasury Rate Locks: In anticipation of issuing fixed-rate debt, we may use forward starting interest rate swaps (forward starting swaps) or treasury rate lock agreements (treasury rate locks) that are designated as cash flow hedges to hedge against changes in interest rates that could impact expected future issuances of debt. To the extent these hedges of cash flows related to anticipated debt are effective, any realized or unrealized gains or losses on the forward starting swaps or treasury rate locks are reported in OCI and are recognized in income over the life of the anticipated fixed-rate notes. As of March 31, 2019 and December 31, 2018, we did not have any outstanding forward starting swaps or treasury rate locks.

Interest Rate Swap Contracts: From time to time we hedge the fair value of certain debt obligations through the use of interest rate swap contracts. The interest rate swap contracts are designated hedges of the fair value changes in the notes attributable to changes in benchmark interest rates. Gains or losses resulting from changes in fair value of the underlying debt attributable to the hedged benchmark interest rate risk are recorded on the Consolidated Statements of Income within Interest (expense) with an associated offset to the carrying value of the notes recorded on the Consolidated Balance Sheets. Since the specific terms and notional amount of the swap are intended to match those of the debt being hedged all changes in fair value of the swap are recorded on the Consolidated Statements of Income within Interest (expense) with an associated offset to the derivative asset or liability on the Consolidated Balance Sheets. Consequently, there is no net impact recorded in income. Any net interest payments made or received on interest rate swap contracts are recognized as interest expense on the Consolidated Statements of Income. If a hedging relationship is terminated for an interest rate swap contract, accumulated gains or losses associated with the contract are measured and recorded as a reduction or increase of current and future interest expense associated with the previously hedged debt obligations.

The following table summarizes the notional amounts of our outstanding interest rate swap contracts as of March 31, 2019 and December 31, 2018:

	Notional Amount March 31, 2019	December 31, 2018
Interest rate swap contracts entered into as fair value hedges of the following fixed-rate senior notes:		
3.875% senior notes due 2025	$200	$ 200
3.450% senior notes due 2027	450	450
3.900% senior notes due 2028	—	200
Total	$650	$ 850

We have entered into swap contracts that were designated as hedges of certain of our fixed rate notes in 2019 and 2018, and also terminated the hedging relationship by settling certain of those swap contracts during 2019 and 2018. In 2019, we settled $200 million notional amount of certain swap contracts. The settlement of swap contracts resulted in the receipt of net proceeds of $5 million during the three-month period ended March 31, 2019, which are accounted for as a reduction of current and future interest expense associated with these notes. During 2018, we settled $250 million notional amount of certain swap contracts. The settlement of swap contracts resulted in the receipt of net proceeds of $2 million during the year ended December 31, 2018, which were accounted for as a reduction of current and future interest expense associated with these notes. See Note 11 for additional details related to reductions of current and future interest expense.

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The following tables summarize the fair value and presentation in the Consolidated Balance Sheets for derivative instruments as of March 31, 2019 and December 31, 2018:

Instrument	Balance Sheet Location	March 31, 2019 Fair Value Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments:			
Foreign exchange contracts [1]	Other current assets	$ 58	$ 7
	Other non-current assets	49	10
Interest rate swap agreements	Other current assets	6	—
	Other non-current assets	2	—
	Other non-current liabilities	2	8
Derivatives not designated as hedging instruments:			
Foreign exchange contracts [1]	Other current assets	21	1
	Accrued expenses and other current liabilities	1	11
Interest rate swap agreements	Other non-current assets	3	3
Total		$ 142	$ 40

[1] Derivative instruments in this category are subject to master netting arrangements and are presented on a net basis in the Consolidated Balance Sheet in accordance with ASC 210-20.

Instrument	Balance Sheet Location	December 31, 2018 Fair Value Asset Derivatives	Liability Derivatives
Derivatives designated as hedging instruments:			
Foreign exchange contracts [1]	Other current assets	$ 63	$ 18
	Other non-current assets	45	16
	Other non-current liabilities	12	15
Interest rate swap agreements	Other current assets	7	—