GILEAD SCIENCES INC
Form 10-Q
May 07, 2014

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

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014

or

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission File No. 0-19731

GILEAD SCIENCES, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	94-3047598 (IRS Employer Identification No.)
333 Lakeside Drive, Foster City, California (Address of principal executive offices)	94404 (Zip Code)

650-574-3000
Registrant's Telephone Number, Including Area Code

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.
Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
(Do not check if a smaller reporting company)

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

Number of shares outstanding of the issuer's common stock, par value $0.001 per share, as of April 25, 2014: 1,535,682,107

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

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

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

	March 31, 2014 (unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$6,404,153	$2,112,806
Short-term marketable securities	64,877	18,756
Accounts receivable, net	3,236,195	2,100,286
Inventories	2,140,228	2,055,788
Deferred tax assets	348,942	330,530
Prepaid taxes	367,993	398,010
Prepaid expenses	207,230	165,652
Other current assets	201,011	91,925
Total current assets	12,970,629	7,273,753
Property, plant and equipment, net	1,303,029	1,166,181
Long-term portion of prepaid royalties	191,345	198,766
Long-term deferred tax assets	138,966	154,765
Long-term marketable securities	389,871	439,028
Intangible assets, net	11,707,830	11,900,106
Goodwill	1,171,561	1,169,023
Other long-term assets	204,461	195,163
Total assets	$28,077,692	$22,496,785
Liabilities and Stockholders’ Equity		
Current liabilities:		
Accounts payable	$1,234,507	$1,255,914
Accrued government rebates	1,139,093	983,490
Accrued compensation and employee benefits	181,799	243,540
Income taxes payable	152,953	10,855
Other accrued liabilities	1,222,821	1,023,938
Deferred revenues	111,792	110,640
Current portion of long-term debt and other obligations, net	1,871,811	2,697,044
Total current liabilities	5,914,776	6,325,421
Long-term debt, net	7,932,032	3,938,708
Long-term income taxes payable	226,018	162,412
Long-term deferred tax liabilities	81,960	83,286
Other long-term obligations	174,945	178,626
Commitments and contingencies		
Equity component of currently redeemable convertible notes	45,767	63,831
Stockholders’ equity:		
Preferred stock, par value $0.001 per share; 5,000 shares authorized; none outstanding	—	—
Common stock, par value $0.001 per share; shares authorized of 5,600,000; shares issued and outstanding of 1,537,642 and 1,534,414	1,538	1,534

Additional paid-in capital	5,746,574	5,386,735
Accumulated other comprehensive loss	(95,769)	(124,446)
Retained earnings	7,734,979	6,105,244
Total Gilead stockholders’ equity	13,387,322	11,369,067
Noncontrolling interest	314,872	375,434
Total stockholders’ equity	13,702,194	11,744,501
Total liabilities and stockholders’ equity	$28,077,692	$22,496,785

See accompanying notes.

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

	Three Months Ended March 31,	
	2014	2013
Revenues:		
Product sales	$4,870,974	$2,393,568
Royalty, contract and other revenues	127,982	138,067
Total revenues	4,998,956	2,531,635
Costs and expenses:		
Cost of goods sold	813,205	634,448
Research and development	594,978	497,632
Selling, general and administrative	548,123	374,296
Total costs and expenses	1,956,306	1,506,376
Income from operations	3,042,650	1,025,259
Interest expense	(76,269)	(81,787)
Other income (expense), net	(17,912)	(3,324)
Income before provision for income taxes	2,948,469	940,148
Provision for income taxes	725,882	222,438
Net income	2,222,587	717,710
Net loss attributable to noncontrolling interest	4,823	4,476
Net income attributable to Gilead	$2,227,410	$722,186
Net income per share attributable to Gilead common stockholders—basic	$1.45	$0.47
Shares used in per share calculation—basic	1,536,525	1,521,372
Net income per share attributable to Gilead common stockholders—diluted	$1.33	$0.43
Shares used in per share calculation—diluted	1,679,871	1,665,060

See accompanying notes.

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

	Three Months Ended March 31,	
	2014	2013
Net income	$2,222,587	$717,710
Other comprehensive income:		
Change in foreign currency translation gain (loss), net of tax	5,783	(8,956)
Available-for-sale securities:		
Change in net unrealized gains (losses), net of tax impact of $82 and $(1,016)	147	1,785
Reclassifications to net income, net of tax impact of $(114) and $(9)	(199)	(17)
Net change	(52)	1,768
Cash flow hedges:		
Change in net unrealized gains (losses), net of tax impact of $1,732 and $(1,849)	1,265	74,060
Reclassifications to net income, net of tax impact of $(990) and $(11)	21,681	(451)
Net change	22,946	73,609
Other comprehensive income	28,677	66,421
Comprehensive income	2,251,264	784,131
Comprehensive loss attributable to noncontrolling interest	4,823	4,476
Comprehensive income attributable to Gilead	$2,256,087	$788,607

See accompanying notes.

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

	Three Months Ended March 31, 2014	2013
Operating Activities:		
Net income	$2,222,587	$717,710
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	24,510	23,973
Amortization expense	216,530	50,353
Stock-based compensation expense	82,181	61,767
Excess tax benefits from stock-based compensation	(156,695)	(40,746)
Tax benefits from employee stock plans	157,654	38,905
Deferred income taxes	(3,321)	39,301
Change in fair value of contingent consideration	2,678	6,024
Other	3,120	8,262
Changes in operating assets and liabilities:		
Accounts receivable, net	(1,117,620)	(231,781)
Inventories	(84,611)	(57,109)
Prepaid expenses and other assets	(169,380)	(187,304)
Accounts payable	(20,117)	30,792
Income taxes payable	240,973	12,056
Accrued liabilities	166,263	167,018
Deferred revenues	3,266	32,880
Net cash provided by operating activities	1,568,018	672,101
Investing Activities:		
Purchases of marketable securities	(94,340)	(62,604)
Proceeds from sales of marketable securities	83,224	65,985
Proceeds from maturities of marketable securities	13,666	6,862
Acquisitions, net of cash acquired	—	(378,645)
Capital expenditures	(163,490)	(38,854)
Net cash used in investing activities	(160,940)	(407,256)
Financing Activities:		
Proceeds from debt financing, net of issuance costs	3,967,914	—
Proceeds from convertible note hedges	601,591	100,771
Purchases of convertible note hedges	(26,249)	—
Proceeds from issuances of common stock	108,727	86,049
Repurchases of common stock	(450,087)	(82,239)
Repayments of debt and other long-term obligations	(1,418,716)	(347,916)
Excess tax benefits from stock-based compensation	156,695	40,746
Contributions from (distributions to) noncontrolling interest	(55,739)	3,588
Net cash provided by (used in) financing activities	2,884,136	(199,001)
Effect of exchange rate changes on cash	133	(5,566)
Net change in cash and cash equivalents	4,291,347	60,278
Cash and cash equivalents at beginning of period	2,112,806	1,803,694

Cash and cash equivalents at end of period	$6,404,153	$1,863,972

See accompanying notes.

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GILEAD SCIENCES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

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

Significant Accounting Policies, Estimates and Judgments

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

Concentrations of Risk

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

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

As of March 31, 2014, our accounts receivable in Southern Europe, specifically Greece, Italy, Portugal and Spain, totaled approximately $602.8 million, of which $156.8 million were greater than 120 days past due and $50.6 million were greater than 365 days past due. To date, we have not experienced significant losses with respect to the collection of our accounts receivable. We believe that our allowance for doubtful accounts was adequate at March 31, 2014.

Recent Accounting Pronouncements

There have been no new accounting pronouncements during the three months ended March 31, 2014 that we believe would have a material impact on our financial position or results of operations.

2. FAIR VALUE MEASUREMENTS

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

- Level 1 inputs which include quoted prices in active markets for identical assets or liabilities;
- Level 2 inputs which include observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability. For our marketable securities, we review trading activity and pricing as of the measurement date. When sufficient quoted pricing for identical securities is not available, we use market pricing and other observable market inputs for similar securities obtained from various third-party data providers. These inputs either represent quoted prices for similar assets in active markets or have been derived from observable market data; and
- Level 3 inputs which include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability. Our level 3 liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques and significant management judgment or estimation.

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

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

		March 31, 2014		December 31, 2013	
Type of Borrowing	Description	Carrying Value	Fair Value	Carrying Value	Fair Value
Convertible Senior	May 2014 Notes	$208,471	$637,224	$234,217	$783,651
Convertible Senior	May 2016 Notes	913,478	2,947,013	1,113,043	3,871,516
Senior Unsecured	April 2021 Notes	993,996	1,096,750	993,781	1,075,480
Senior Unsecured	December 2014 Notes	749,789	759,983	749,710	762,637
Senior Unsecured	December 2016 Notes	699,384	737,961	699,326	740,705
Senior Unsecured	December 2021 Notes	1,247,788	1,358,275	1,247,716	1,336,738
Senior Unsecured	December 2041 Notes	997,904	1,148,870	997,885	1,118,660
Senior Unsecured[1]	April 2019 Notes	499,146	496,485	—	—
Senior Unsecured[1]	April 2024 Notes	1,747,201	1,763,825	—	—
Senior Unsecured[1]	April 2044 Notes	1,746,613	1,811,250	—	—

[1] See Note 8, Debt and Credit Facility for discussion of March 2014 financing.

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

	March 31, 2014				December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Debt securities:								
Money market funds	$5,056,350	$—	$—	$5,056,350	$1,490,964	$—	$—	$1,490,964
Corporate debt securities	—	221,734	—	221,734	—	220,025	—	220,025
U.S. treasury securities	105,291	—	—	105,291	85,403	—	—	85,403
U.S. government agencies securities	—	72,830	—	72,830	—	93,350	—	93,350
Residential mortgage and asset-backed securities	—	45,647	—	45,647	—	46,941	—	46,941
Municipal debt securities	—	9,246	—	9,246	—	12,065	—	12,065
Total debt securities	5,161,641	349,457	—	5,511,098	1,576,367	372,381	—	1,948,748
Deferred compensation plan	47,913	—	—	47,913	44,461	—	—	44,461
Derivatives	—	11,032	—	11,032	—	13,879	—	13,879
	$5,209,554	$360,489	$—	$5,570,043	$1,620,828	$386,260	$—	$2,007,088
Liabilities:								
Contingent consideration	$—	$—	$266,438	$266,438	$—	$—	$263,760	$263,760
Derivatives	—	72,366	—	72,366	—	99,057	—	99,057
Deferred compensation plan	47,913	—	—	47,913	44,461	—	—	44,461
	$47,913	$72,366	$266,438	$386,717	$44,461	$99,057	$263,760	$407,278

Level 2 Inputs

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

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

Level 3 Inputs
As of March 31, 2014 and December 31, 2013, the only assets or liabilities that were measured using Level 3 inputs were contingent consideration liabilities. Our policy is to recognize transfers into or out of Level 3 classification as of the actual date of the event or change in circumstances that caused the transfer.
Contingent Consideration Liabilities
In connection with certain acquisitions, we may be required to pay future consideration that is contingent upon the achievement of specified development, regulatory approval or sales-based milestone events. We estimate the fair value of the contingent consideration liabilities on the acquisition date and each reporting period thereafter using a probability-weighted income approach, which reflects the probability and timing of future payments. This fair value measurement is based on significant Level 3 inputs such as the anticipated timelines and probability of achieving development, regulatory approval or sales-based milestone events and projected revenues. The resulting probability-weighted cash flows are discounted using credit-risk adjusted interest rates.
Each reporting period thereafter, we revalue these obligations by performing a review of the assumptions listed above and record increases or decreases in the fair value of these contingent consideration obligations in research and development (R&D) expenses within our Condensed Consolidated Statements of Income until such time that the related product candidate receives marketing approval. In the absence of any significant changes in key assumptions, the quarterly determination of fair values of these contingent consideration obligations would primarily reflect the passage of time.
Significant judgment is employed in determining Level 3 inputs and fair value measurements as of the acquisition date and for each subsequent period. Updates to assumptions could have a significant impact on our results of operations in any given period and actual results may differ from estimates. For example, significant increases in the probability of achieving a milestone or projected revenues would result in a significantly higher fair value measurement while significant decreases in the estimated probability of achieving a milestone or projected revenues would result in a significantly lower fair value measurement. Significant increases in the discount rate or in the anticipated timelines would result in a significantly lower fair value measurement while significant decreases in the discount rate or anticipated timelines would result in a significantly higher fair value measurement.
The potential contingent consideration payments required upon achievement of development or regulatory approval-based milestones related to our CGI Pharmaceuticals, Inc. and Calistoga Pharmaceuticals, Inc. acquisitions range from no payment if none of the milestones are achieved to an estimated maximum of $254.0 million (undiscounted), of which we had accrued $221.6 million as of March 31, 2014 and $220.5 million as of December 31, 2013. The remainder of the contingent consideration liabilities accrual as of March 31, 2014 and December 31, 2013 relates to potential future payments resulting from the acquisition of Arresto Biosciences, Inc. for royalty obligations on future sales once specified sales-based milestones are achieved.
The following table provides a rollforward of our contingent consideration liabilities, which are recorded as part of other accrued liabilities and other long-term obligations in our Condensed Consolidated Balance Sheets (in thousands):

Balance at December 31, 2013	$263,760
Additions from new acquisitions	—
Net changes in valuation	2,678
Balance at March 31, 2014	$266,438

3. AVAILABLE-FOR-SALE SECURITIES

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

	March 31, 2014				December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Debt securities:								
Money market funds	$5,056,350	$—	$—	$5,056,350	$1,490,964	$—	$—	$1,490,964
Corporate debt securities	220,999	801	(66)	221,734	219,242	885	(102)	220,025
U.S. Treasury securities	105,330	75	(114)	105,291	85,337	94	(28)	85,403
U.S. government agencies securities	72,654	176	—	72,830	93,211	156	(17)	93,350
Residential mortgage and asset-backed securities	45,624	59	(36)	45,647	46,969	37	(65)	46,941
Municipal debt securities	9,175	71	—	9,246	12,009	56	—	12,065
Total	$5,510,132	$1,182	$(216)	$5,511,098	$1,947,732	$1,228	$(212)	$1,948,748

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

	March 31, 2014	December 31, 2013
Cash and cash equivalents	$5,056,350	$1,490,964
Short-term marketable securities	64,877	18,756
Long-term marketable securities	389,871	439,028
Total	$5,511,098	$1,948,748

Cash and cash equivalents in the table above exclude cash of $1.35 billion as of March 31, 2014 and $621.8 million as of December 31, 2013.

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

	March 31, 2014	
	Amortized Cost	Fair Value
Less than one year	$5,121,014	$5,121,227
Greater than one year but less than five years	383,960	384,741
Greater than five years but less than ten years	—	—
Greater than ten years	5,158	5,130
Total	$5,510,132	$5,511,098

The following table summarizes the gross realized gains and losses related to sales of marketable securities (in thousands):

	Three Months Ended March 31,

	2014	2013
Gross realized gains on sales	$338	$182
Gross realized losses on sales	$(25)	$(156)

The cost of securities sold was determined based on the specific identification method.
The following table summarizes our available-for-sale debt securities that were in a continuous unrealized loss position, but were not deemed to be other-than-temporarily impaired (in thousands):

	Less Than 12 Months		12 Months or Greater		Total	
	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value	Gross Unrealized Losses	Estimated Fair Value
March 31, 2014						
Debt securities:						
U.S. treasury securities	$(114)	$44,014	$—	$—	$(114)	$44,014
Corporate debt securities	(66)	37,719	—	—	(66)	37,719
Residential mortgage and asset-backed securities	(17)	15,248	(19)	3,655	(36)	18,903
U.S. government agencies securities	—	—	—	—	—	—
Total	$(197)	$96,981	$(19)	$3,655	$(216)	$100,636
December 31, 2013						
Debt securities:						
U.S. treasury securities	$(28)	$24,562	$—	$—	$(28)	$24,562
Corporate debt securities	(102)	37,076	—	1,505	(102)	38,581
Residential mortgage and asset-backed securities	(38)	19,563	(27)	6,731	(65)	26,294
U.S. government agencies securities	(17)	10,858	—	—	(17)	10,858
Total	$(185)	$92,059	$(27)	$8,236	$(212)	$100,295

We held a total of 40 securities as of March 31, 2014 and December 31, 2013 that were in an unrealized loss position. Based on our review of these securities, we believe we had no other-than-temporary impairments on these securities as of March 31, 2014 and December 31, 2013, because we do not intend to sell these securities and we believe it is not more likely than not that we will be required to sell these securities before the recovery of their amortized cost basis.

4. DERIVATIVE FINANCIAL INSTRUMENTS

We operate in foreign countries, which exposes us to market risk associated with foreign currency exchange rate fluctuations between the U.S. dollar and various foreign currencies, the most significant of which is the Euro. In order to manage this risk, we may hedge a portion of our foreign currency exposures related to outstanding monetary assets and liabilities as well as forecasted product sales using foreign currency exchange forward or option contracts. In general, the market risk related to these contracts is offset by corresponding gains and losses on the hedged transactions. The credit risk associated with these contracts is driven by changes in interest and currency exchange rates and, as a result, varies over time. By working only with major banks and closely monitoring current market conditions, we seek to limit the risk that counterparties to these contracts may be unable to perform. We also seek to limit our risk of loss by entering into contracts that permit net settlement at maturity. Therefore, our overall risk of loss in the event of a counterparty default is limited to the amount of any unrecognized gains on outstanding contracts (i.e. those contracts that have a positive fair value) at the date of default. We do not enter into derivative contracts for trading purposes.

We hedge our exposure to foreign currency exchange rate fluctuations for certain monetary assets and liabilities of our foreign subsidiaries that are denominated in a non-functional currency. The derivative instruments we use to hedge this exposure are not designated as hedges, and as a result, changes in their fair value are recorded in other income (expense), net on our Condensed Consolidated Statements of Income.

We hedge our exposure to foreign currency exchange rate fluctuations for forecasted product sales that are denominated in a non-functional currency. The derivative instruments we use to hedge this exposure are designated as cash flow hedges and have maturity dates of 18 months or less. Upon executing a hedging contract and quarterly thereafter, we assess prospective hedge effectiveness using a regression analysis which calculates the change in cash flow as a result of the hedge instrument. On a monthly basis, we assess retrospective hedge effectiveness using a dollar offset approach. We exclude time value from our effectiveness testing and recognize changes in the time value of the hedge in other income (expense), net. The effective component of our hedge is recorded as an unrealized gain or loss on the hedging instrument in accumulated other comprehensive income (OCI) within stockholders' equity. When the hedged forecasted transaction occurs, the hedge is de-designated and the unrealized gains or losses are reclassified into product sales. The majority of gains and losses related to the hedged forecasted transactions reported in accumulated OCI at March 31, 2014 will be reclassified to product sales within 12 months.

The cash flow effects of our derivatives contracts for the three months ended March 31, 2014 and 2013 are included within net cash provided by operating activities in the Condensed Consolidated Statements of Cash Flows.

We had notional amounts on foreign currency exchange contracts outstanding of $4.04 billion at March 31, 2014 and $4.28 billion at December 31, 2013.

While all of our derivative contracts allow us the right to offset assets or liabilities, we have presented amounts on a gross basis. Under the International Swap Dealers Association, Inc. master agreements with the respective counterparties of the foreign currency exchange contracts, subject to applicable requirements, we are allowed to net settle transactions of the same currency with a single net amount payable by one party to the other. The following table summarizes the location and fair values of derivative instruments on our Condensed Consolidated Balance Sheets (in thousands):

	March 31, 2014			
	Asset Derivatives Classification	Fair Value	Liability Derivatives Classification	Fair Value
Derivatives designated as hedges:				
Foreign currency exchange contracts	Other current assets	$10,451	Other accrued liabilities	$65,965
Foreign currency exchange contracts	Other long-term assets	580	Other long-term obligations	6,321
Total derivatives designated as hedges		11,031		72,286
Derivatives not designated as hedges:				
Foreign currency exchange contracts	Other current assets	1	Other accrued liabilities	80
Total derivatives not designated as hedges		1		80
Total derivatives		$11,032		$72,366