

GILEAD SCIENCES, INC.**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of our deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	2010	2009
Deferred tax assets:		
Net operating loss carryforwards	\$ 308,854	\$ 377,058
Stock-based compensation	142,242	117,019
Reserves and accruals not currently deductible	109,806	90,760
Deferred revenue	49,194	67,389
Depreciation related	58,875	44,166
Research and other credit carryforwards	25,151	28,980
Capitalized intangibles	5,839	12,086
Other, net	88,669	64,881
Total deferred tax assets before valuation allowance	788,630	802,339
Valuation allowance	(13,040)	(1,078)
Total deferred tax assets	775,590	801,261
Deferred tax liabilities:		
Intangibles	(322,168)	(384,480)
Unremitted foreign earnings	(15,928)	(15,928)
Other	(20,774)	(17,053)
Total deferred tax liabilities	(358,870)	(417,461)
Net deferred tax assets	\$ 416,720	\$ 383,800

The valuation allowance increased (decreased) by \$11.9 million, \$1.1 million and \$(23.5) million for the years ended December 31, 2010, 2009 and 2008, respectively. We have concluded, based on the standard set forth in the FASB Accounting Standards Codification related to Income Taxes, that it is more likely than not that we will not realize any benefit from the deferred tax assets related to certain state net operating loss and credit carryforwards.

At December 31, 2010, we had U.S. federal net operating loss carryforwards of approximately \$732.5 million. The federal net operating loss carryforwards will start to expire in 2016, if not utilized. We also had federal tax credit carryforwards of approximately \$26.2 million which will start to expire in 2016, if not utilized. In addition, we had state net operating loss and tax credit carryforwards of approximately \$1.40 billion and \$3.3 million, respectively. The state net operating loss and tax credit carryforwards will start to expire in 2011 and 2016, respectively, if not utilized.

Utilization of net operating losses and tax credits may be subject to an annual limitation due to ownership change limitations provided in the Internal Revenue Code of 1986, as amended, and similar state provisions. This annual limitation may result in the expiration of the net operating losses (NOLs) and credits before utilization.

We file federal, state and foreign income tax returns in many jurisdictions in the United States and abroad. For federal income tax purposes, the statute of limitations is open for 2003 and onwards. For certain acquired entities, the statute of limitations is open for all years from inception due to our utilization of their NOLs and credits carried over from prior years. For California income tax purposes, the statute of limitations remains open for 2002 and onwards.

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Our income tax returns are audited by federal, state and foreign tax authorities. We are currently under examination by the Internal Revenue Service (IRS) for the 2005, 2006 and 2007 tax years and by various state and foreign jurisdictions. There are differing interpretations of tax laws and regulations, and as a result, significant disputes may arise with these tax authorities involving issues of the timing and amount of deductions and allocations of income among various tax jurisdictions. We periodically evaluate our exposures associated with our tax filing positions.

At December 31, 2010 and 2009, the total gross unrecognized tax benefits were \$126.5 million and \$106.5 million, respectively. Of the total unrecognized tax benefits, \$106.5 million and \$72.6 million at December 31, 2010 and 2009, respectively, if recognized, would reduce our effective tax rate in the period of recognition. We have continued to classify interest and penalties related to unrecognized tax benefits as part of our income tax provision in our Consolidated Statements of Income. As of December 31, 2010 and 2009, we had accrued interest and penalties related to unrecognized tax benefits of \$12.3 million and \$5.4 million, respectively.

As of December 31, 2010, we believe it is reasonably possible that our unrecognized tax benefits will decrease by approximately \$6.0 million in the next 12 months as we expect to have clarification from the tax authorities around certain of our uncertain tax positions. With respect to the remaining unrecognized tax benefits, we are currently unable to make a reasonable estimate as to the period of cash settlement, if any, with the respective tax authorities.

The following is a rollforward of our total gross unrecognized tax benefit liabilities for the years ended December 31, 2010 and 2009 (in thousands):

	December 31,		
	2010	2009	2008
Balance, beginning of period	\$ 106,506	\$ 121,424	\$ 115,087
Tax positions related to current year:			
Additions	24,320	25,036	37,495
Reductions	(3,303)	(8,380)	—
Tax positions related to prior years:			
Additions	25,581	37,014	4,298
Reductions	(23,474)	(36,277)	(23,307)
Settlements	(2,160)	(31,517)	(10,252)
Lapse of statute of limitations	(954)	(794)	(1,897)
Balance, end of period	<u>\$ 126,516</u>	<u>\$ 106,506</u>	<u>\$ 121,424</u>

18. DEFERRED COMPENSATION PLANS

We maintain a retirement savings plan under which eligible employees may defer compensation for income tax purposes under Section 401(k) of the Internal Revenue Code (Gilead Plan). Under the Gilead Plan, employees may contribute up to 60% of their eligible annual compensation, subject to IRS plan limits. We make matching contributions under the Gilead Plan. In 2010, 2009 and 2008, we contributed up to 50% of an employee's contributions up to an annual maximum match of \$5,000. Our total matching contribution expense under the Gilead Plan for the years ended December 31, 2010, 2009 and 2008 was \$11.2 million, \$10.2 million, and \$7.8 million, respectively.

We maintain a deferred compensation plan under which our directors and key employees may defer compensation for income tax purposes. The deferred compensation plan is a non-qualified deferred compensation

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plan which is not subject to the qualification requirements under Section 401(a) of the Internal Revenue Code. Compensation deferred after December 31, 2004 is subject to the requirements of Section 409A of the Internal Revenue Code. Under the plan, officers and other senior grade level employees may contribute up to 70% of their annual salaries and up to 100% of their annual bonus while directors may contribute up to 100% of their annual retainer fee. Amounts deferred by participants are deposited in a rabbi trust and are recorded in other noncurrent assets in our Consolidated Balance Sheets. Beginning in 2004, directors may also elect to receive all or a portion of their annual cash retainer in phantom shares, which gives the participant the right to receive an amount equal to the value of a specified number of shares over a specified period of time and which will be payable in shares of our common stock (with fractional shares paid out in cash) as established by the plan administrator. As of December 31, 2010, we had 31,682 phantom shares outstanding. Participants can elect one of several distribution dates available under the plan at which they will receive their deferred compensation payment.

19. SUBSEQUENT EVENTS

Stock Repurchase Program

In January 2011, our Board authorized an additional three-year, \$5.00 billion stock repurchase program which will commence upon the completion of our existing program authorized in May 2010.

Acquisition of Arresto Biosciences, Inc.

In December 2010, we entered into an agreement to acquire Arresto Biosciences, Inc. (Arresto) for \$225 million plus potential future payments based on achievement of certain sales levels. This transaction closed on January 14, 2011, at which time Arresto became a wholly-owned subsidiary. Arresto was a privately-held, development-stage biotechnology company based in Palo Alto, California, focused on developing antibodies for the potential treatment of fibrotic diseases and cancer. The company's lead product is GS 6224 (formerly AB0024), a humanized monoclonal antibody (mAb) targeting the human lysyl oxidase-like-2 (LOXL2) protein. In addition to an ongoing Phase 1 study of GS 6224 in patients with advanced solid tumors, a Phase 1 study had also been initiated to evaluate GS 6224 in patients with idiopathic pulmonary fibrosis. We believe that Arresto's pipeline and research and development expertise are well aligned with Gilead's areas of focus. Given the timing of the closing of this acquisition, we are currently in the process of valuing the assets acquired and liabilities assumed in the business combination. As a result, we are unable to provide the amounts recognized as of the acquisition date for the major classes of assets acquired and liabilities assumed and certain disclosures pertaining to contingent consideration.

Acquisition of Calistoga Pharmaceuticals, Inc.

In February 2011, we entered into an agreement to acquire Calistoga Pharmaceuticals, Inc. (Calistoga) for \$375 million plus potential payments of up to \$225 million based on the achievement of certain milestones. This transaction is expected to close in the second quarter of 2011. Calistoga is a privately-held, biotechnology company based in Seattle, Washington, focused on the development of medicines to treat cancer and inflammatory diseases. The company has a portfolio of proprietary compounds that selectively target isoforms of phosphoinositide-3 kinase (P13K). Calistoga's lead product candidate, CAL-101, is a first-in-class specific inhibitor of the P13K delta isoform. P13K delta is preferentially expressed in leukocytes involved in a variety of inflammatory and autoimmune diseases and hematological cancers.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

20. QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

The following amounts are in thousands, except per share amounts:

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
<i>2010</i> ⁽¹⁾				
Total revenues	\$2,085,853	\$1,927,224	\$1,937,656	\$1,998,687
Gross profit on product sales	\$1,347,633	\$1,350,536	\$1,387,975	\$1,433,901
Net income	\$ 852,094	\$ 709,127	\$ 702,163	\$ 626,365
Net income attributable to Gilead	\$ 854,901	\$ 712,061	\$ 704,876	\$ 629,419
Net income per share attributable to Gilead common stockholders				
—basic	\$ 0.95	\$ 0.81	\$ 0.85	\$ 0.78
Net income per share attributable to Gilead common stockholders				
—diluted	\$ 0.92	\$ 0.79	\$ 0.83	\$ 0.76
<i>2009</i>				
Total revenues	\$1,530,460	\$1,647,155	\$1,801,389	\$2,032,379
Gross profit on product sales	\$1,118,166	\$1,185,333	\$1,239,255	\$1,330,999
Net income	\$ 586,576	\$ 569,145	\$ 670,478	\$ 799,393
Net income attributable to Gilead	\$ 589,112	\$ 571,398	\$ 673,033	\$ 802,212
Net income per share attributable to Gilead common stockholders				
—basic	\$ 0.65	\$ 0.63	\$ 0.75	\$ 0.89
Net income per share attributable to Gilead common stockholders				
—diluted	\$ 0.63	\$ 0.61	\$ 0.72	\$ 0.87

⁽¹⁾ During 2010, we recorded \$136.0 million of impairment charges in R&D expense, related to certain IPR&D assets acquired from CV Therapeutics. See Notes 5 and 9.

GILEAD SCIENCES, INC.
Schedule II: Valuation and Qualifying Accounts

	<u>Balance at Beginning of Period</u>	<u>Additions/ Charged to Expense</u>	<u>Deductions</u>	<u>Balance at End of Period</u>
Year ended December 31, 2010:				
Accounts receivable allowances ⁽¹⁾	\$ 132,810	\$818,132	\$800,000	\$150,942
Valuation allowance for deferred tax assets ⁽²⁾	\$ 1,078	\$ 12,127	\$ 165	\$ 13,040
Year ended December 31, 2009:				
Accounts receivable allowances ⁽¹⁾	\$ 90,694	\$606,504	\$564,388	\$132,810
Valuation allowance for deferred tax assets ⁽²⁾	\$ —	\$ 15,103	\$ 14,025	\$ 1,078
Year ended December 31, 2008:				
Accounts receivable allowances ⁽¹⁾	\$ 72,217	\$500,037	\$481,560	\$ 90,694
Valuation allowance for deferred tax assets	\$ 23,498	\$ 965	\$ 24,463	\$ —

⁽¹⁾ Allowances are for doubtful accounts, sales returns, cash discounts and chargebacks.

⁽²⁾ Valuation allowance for deferred tax assets includes \$9.9 million and \$1.1 million as of December 31, 2010 and 2009, respectively, related to our acquisitions.

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