

CELGENE CORP /DE/
Form 10-Q
October 29, 2012

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

(Mark one)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2012

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
(State or other jurisdiction of incorporation
or organization)

86 Morris Avenue, Summit, NJ
(Address of principal executive offices)

22-2711928
(I.R.S. Employer Identification
Number)

07901
(Zip Code)

CELGENE CORPORATION

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PART I FINANCIAL INFORMATION**Item 1. Financial Statements.****CELGENE CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

(Unaudited)

(In thousands, except per share amounts)

	Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
	2012	2011	2012	2011
Revenue:				
Net product sales	\$ 1,388,013	\$ 1,219,118	\$ 3,970,102	\$ 3,457,055
Collaborative agreements and other revenue	2,362	3,766	8,223	16,468
Royalty revenue	28,876	26,853	80,978	84,650
Total revenue	1,419,251	1,249,737	4,059,303	3,558,173
Expenses:				
Cost of goods sold (excluding amortization of acquired intangible assets)	74,622	94,645	218,994	348,356
Research and development	441,595	356,839	1,250,737	1,163,837
Selling, general and administrative	354,644	303,303	1,003,449	911,207
Amortization of acquired intangible assets	46,157	75,044	132,065	214,181
Acquisition related (gains) charges and restructuring, net	649	(11,209)	28,864	(117,430)
Total costs and expenses	917,667	818,622	2,634,109	2,520,151
Operating income	501,584	431,115	1,425,194	1,038,022
Other income and expense:				
Interest and investment income, net	2,745	8,481	9,561	18,948
Interest (expense)	(17,793)	(10,292)	(40,652)	(31,460)
Other income (expense), net	(10,034)	(16,663)	(2,915)	(7,650)
Income before income taxes	476,502	412,641	1,391,188	1,017,860
Income tax provision	52,347	39,657	198,123	110,582
Net income	424,155	372,984	1,193,065	907,278
Net loss attributable to non-controlling interest	-	-	-	694
Net income attributable to Celgene	\$ 424,155	\$ 372,984	\$ 1,193,065	\$ 907,972
Net income per share attributable to Celgene:				
Basic	\$ 0.99	\$ 0.83	\$ 2.75	\$ 1.97
Diluted	\$ 0.97	\$ 0.81	\$ 2.69	\$ 1.94
Weighted average shares:				
Basic	427,209	452,019	434,062	460,161
Diluted	436,272	459,530	443,432	467,052

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See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)

	Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
	2012	2011	2012	2011
Net income	\$ 424,155	\$ 372,984	\$ 1,193,065	\$ 907,278
Other comprehensive income (loss):				
Foreign currency translation adjustments	4,664	(12,713)	6,746	6,108
Change in functional currency of a foreign subsidiary	-	-	13,144	-
Net unrealized gains (losses) related to cash flow hedges:				
Unrealized holding gains (losses), net of tax expense (benefit) of (\$1,263) and \$84 for the three-months ended September 30, 2012 and 2011, respectively, and (\$13,144) and \$79 for the nine-months ended September 30, 2012 and 2011, respectively	(26,728)	47,902	21,148	(9,269)
Reclassification adjustment for (gains) losses included in net income, net of tax (expense) benefit of \$552 and (\$514) for the three-months ended September 30, 2012 and 2011, respectively, and (\$2,470) and (\$1,631) for the nine-months ended September 30, 2012 and 2011, respectively	(24,880)	5,316	(59,893)	9,464
Net unrealized gains (losses) on marketable securities available for sale:				
Unrealized holding gains (losses), net of tax expense (benefit) of \$22 and (\$92) for the three-months ended September 30, 2012 and 2011, respectively, and (\$72) and \$1,418 for the nine-months ended September 30, 2012 and 2011, respectively	1,647	(301)	3,281	3,637
Reclassification adjustment for (gains) losses included in net income, net of tax (expense) benefit of \$5 and \$4 for the three-months ended September 30, 2012 and 2011, respectively, and \$50 and \$260 for the nine-months ended September 30, 2012 and 2011, respectively	412	(3,076)	108	(2,043)
Total other comprehensive income (loss)	(44,885)	37,128	(15,466)	7,897
Comprehensive income	379,270	410,112	1,177,599	915,175
Comprehensive loss attributable to non-controlling interest	-	-	-	694
Comprehensive income attributable to Celgene	\$ 379,270	\$ 410,112	\$ 1,177,599	\$ 915,869

See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands, except per share amounts)

	September 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$ 2,715,534	\$ 1,859,464
Marketable securities available for sale	1,117,402	788,690
Accounts receivable, net of allowances of \$36,485 and \$18,855 at September 30, 2012 and December 31, 2011, respectively	957,453	945,531
Inventory	235,866	189,573
Deferred income taxes	134,920	116,751
Other current assets	224,494	395,094
Assets held for sale	-	58,122
Total current assets	5,385,669	4,353,225
Property, plant and equipment, net	547,396	506,042
Intangible assets, net	3,188,303	2,844,698
Goodwill	2,042,837	1,887,220
Other assets	444,622	414,725
Total assets	\$ 11,608,827	\$ 10,005,910
Liabilities and Stockholders Equity		
Current liabilities:		
Short-term borrowings	\$ 324,895	\$ 526,684
Accounts payable	110,394	121,525
Accrued expenses	744,065	701,707
Income taxes payable	2,006	30,042
Current portion of deferred revenue	12,100	14,346
Other current liabilities	157,849	138,424
Liabilities of disposal group	-	7,244
Total current liabilities	1,351,309	1,539,972
Deferred revenue, net of current portion	15,388	12,623
Income taxes payable	178,369	616,465
Deferred income taxes	1,083,197	775,022
Other non-current liabilities	482,541	273,516
Long-term debt, net of discount	2,769,313	1,275,585
Total liabilities	5,880,117	4,493,183
Commitments and Contingencies (Note 15)		
Stockholders Equity:		
Preferred stock, \$.01 par value per share, 5,000,000 shares authorized; none outstanding at September 30, 2012 and December 31, 2011	-	-
Common stock, \$.01 par value per share, 575,000,000 shares authorized; issued 495,171,932 and 487,381,255 shares at September 30, 2012 and December 31, 2011, respectively	4,952	4,874
Common stock in treasury, at cost; 71,201,387 and 49,889,078 shares at September 30, 2012 and December 31, 2011, respectively	(4,241,425)	(2,760,705)
Additional paid-in capital	7,283,505	6,764,479
Retained earnings	2,759,481	1,566,416
Accumulated other comprehensive income (loss)	(77,803)	(62,337)
Total stockholders equity	5,728,710	5,512,727

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Total liabilities and stockholders' equity	\$	11,608,827	\$	10,005,910
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See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine-Month Periods Ended September 30,	
	2012	2011
Cash flows from operating activities:		
Net income	\$ 1,193,065	\$ 907,278
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	59,853	53,051
Amortization	133,022	215,961
Allocation of prepaid royalties	1,370	16,214
Provision for accounts receivable allowances	14,626	3,375
Deferred income taxes	143,565	(101,510)
Impairment charges	64,866	118,000
Change in value of contingent consideration	26,287	(122,547)
Share-based compensation expense	171,041	162,958
Share-based employee benefit plan expense	15,125	14,567
Reclassification adjustment for cash flow hedges included in net income	(62,363)	7,833
Unrealized change in value of derivative instruments	47,903	(37,837)
Realized (gains) losses on marketable securities available for sale	158	(1,616)
Other, net	(93)	(994)
Change in current assets and liabilities, excluding the effect of acquisitions:		
Accounts receivable	(34,558)	(188,503)
Inventory	(46,298)	73,776
Other operating assets	182,806	48,113
Assets held for sale, net	(1,176)	2,647
Accounts payable and other operating liabilities	88,359	90,344
Income tax payable	(469,129)	80,119
Deferred revenue	(267)	(2,756)
Net cash provided by operating activities	1,528,162	1,338,473
Cash flows from investing activities:		
Proceeds from sales of marketable securities available for sale	1,188,657	1,814,974
Purchases of marketable securities available for sale	(1,517,460)	(1,327,244)
Payments for acquisition of business, net of cash acquired	(352,245)	(180,000)
Proceeds from the sale of assets, net	15,782	93,185
Capital expenditures	(81,883)	(90,559)
(Purchases) refunds of investment securities	(29,988)	6,597
Other investing activities	(1,010)	(4,949)
Net cash provided by (used in) investing activities	(778,147)	312,004
Cash flows from financing activities:		
Payment for treasury shares	(1,470,365)	(1,574,415)
Proceeds from short-term borrowing	3,874,416	404,843
Principal repayments on short-term borrowing	(4,075,374)	(135,750)
Proceeds from the issuance of long-term debt	1,486,682	-
Net proceeds from exercise of common stock options and warrants	321,064	92,258
Excess tax benefit from share-based compensation arrangements	19,867	15,734
Net cash provided by (used in) financing activities	156,290	(1,197,330)
Effect of currency rate changes on cash and cash equivalents	(50,235)	(9,348)
Net increase in cash and cash equivalents	856,070	443,799
Cash and cash equivalents at beginning of period	1,859,464	1,351,128

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Cash and cash equivalents at end of period	\$	2,715,534	\$	1,794,927
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See accompanying Notes to Unaudited Consolidated Financial Statements

CELGENE CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - (Continued)

(Unaudited)

(Dollars in thousands)

	Nine-Month Periods Ended September 30,	
	2012	2011
Supplemental schedule of non-cash investing and financing activity:		
Change in net unrealized (gain) loss on marketable securities available for sale	\$ (3,209)	\$ (4,928)
Matured shares tendered in connection with stock option exercises	\$ (156)	\$ (16)
Supplemental disclosure of cash flow information:		
Interest paid	\$ 25,001	\$ 26,179
Income taxes paid	\$ 369,619	\$ 79,159

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 thousands,
except per share amounts, unless otherwise indicated)**

1. Nature of Business and Basis of Presentation

Celgene Corporation, together with its subsidiaries (collectively we, our, us, Celgene or the Company) is a global biopharmaceutical company primarily engaged in the discovery, development and commercialization of innovative therapies designed to treat cancer and immune-inflammatory diseases. We are dedicated to innovative research and development which is designed to bring new therapies to market and are involved in research in several scientific areas that may deliver proprietary next-generation therapies, targeting areas such as intracellular signaling pathways in cancer and immune cells, immunomodulation in cancer and autoimmune diseases, and therapeutic application of cell therapies.

Our primary commercial stage products include REVLIMID®, VIDAZA®, ABRAXANE®, THALOMID® and ISTODAX®. Additional sources of revenue include a licensing agreement with Novartis, which entitles us to royalties on FOCALIN XR® and the entire RITALIN® family of drugs, the sale of services through our Cellular Therapeutics subsidiary and other licensing agreements.

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 either the equity or cost method. We record net income (loss) attributable to non-controlling interest, if any, in our Consolidated Statements of Income equal to the percentage of ownership interest retained in the respective operations by the non-controlling parties.

The preparation of these unaudited 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 product development, regulatory approval, market acceptance, scope of patent and proprietary rights, competition, European 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.

2. Summary of Significant Accounting Policies

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Our significant accounting policies are described in Note 1 of the Notes to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2011, or the 2011 Annual Report on Form 10-K.

New Accounting Pronouncements: In July 2012, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2012-02, Intangibles—Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment, or ASU 2012-02. ASU 2012-02 allows a company the option to first assess qualitative factors to determine whether it is necessary to perform a quantitative impairment test. Under that option, a company would no longer be required to calculate the fair value of an indefinite-lived intangible asset unless the company determines, based on that qualitative assessment, that it is more likely than not that the fair value of the indefinite-lived intangible asset is less than its carrying amount. ASU 2012-02 is effective for annual and interim indefinite-lived intangible asset impairment tests performed for periods beginning after September 15, 2012. Early adoption is permitted and we intend to adopt this standard in the fourth quarter of 2012. The adoption of ASU 2012-02 is not expected to have a material impact on our financial position or results of operations.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Divestitures

Avila Acquisition

On March 7, 2012, or the Acquisition Date, we acquired all of the outstanding common stock of Avila Therapeutics, Inc., subsequently renamed Celgene Avilomics Research, herein referred to as Avila. The acquisition resulted in Avila becoming our wholly-owned subsidiary. The results of operations for Avila are included in our consolidated financial statements from the Acquisition Date and the assets and liabilities of Avila have been recorded at their respective fair values on the Acquisition Date and consolidated with our other assets and liabilities. Avila's results of operations prior to the Acquisition Date were determined to be immaterial to us; therefore, *pro forma* financial statements are not required to be presented.

We paid \$352.2 million in cash, net of cash acquired, and may make additional payments of up to an estimated maximum of \$595.0 million in contingent developmental and regulatory milestone payments.

Avila is a clinical-stage biotechnology company focused on the design and development of targeted covalent drugs to achieve best-in class outcomes. Avila's product pipeline has been created using its proprietary Avilomics platform for developing targeted covalent drugs that treat diseases through protein silencing. Avila's most advanced product candidate, CC-292, formerly AVL-292, a potential treatment for cancer and autoimmune diseases, is currently in phase I clinical testing. We acquired Avila to enhance our portfolio of potential therapies for patients with life-threatening illnesses worldwide.

Our potential contingent consideration payments are classified as liabilities, which were measured at fair value as of the Acquisition Date. The range of potential milestone payments is from no payment if none of the milestones are achieved to an estimated maximum of \$595.0 million if all milestones are achieved. The potential milestones consist of developmental and regulatory achievements, including milestones for the initiation of phase II and phase III studies, investigational new drug, or IND, filings, and other regulatory events.

We estimated the fair value of potential contingent consideration using a probability-weighted income approach, which reflects the probability and timing of future potential payments. This fair value measurement is based on significant input not observable in the market and thus represents a Level 3 liability within the fair value hierarchy. The resulting probability-weighted cash flows were discounted using a discount rate based on a market participant assumption.

Subsequent to the acquisition date, we measure the contingent consideration arrangements at fair value each period with changes in fair value recognized in operating earnings unless changes pertain to facts and circumstances that existed as of the Acquisition Date, in which case changes are recognized as adjustments to goodwill. Changes in fair value reflect new information about the in-process research and development, or IPR&D, assets and the passage of time. In the absence of new information, changes in fair value only reflect the passage of time as development

work towards the achievement of the milestones progresses and are accrued based on an accretion schedule.

Fair value amounts allocated to contingent consideration and certain assets have been adjusted during the three-month period ended September 30, 2012 based on analysis of facts and circumstances that existed as of the Acquisition Date. These measurement period adjustments were not significant and did not have a significant impact on our financial condition, results of operations or cash flows in any interim period in 2012 and, therefore, we did not retrospectively adjust our interim financial statements for prior periods.

The acquisition has been accounted for using the acquisition method of accounting which requires that most assets acquired and liabilities assumed be recognized at their fair values as of the Acquisition Date and

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

requires the fair value of acquired IPR&D to be classified as indefinite-lived assets until the successful completion or abandonment of the associated research and development efforts.

The fair value of consideration transferred in the acquisition of Avila is shown in the table below:

	Fair Value at the Acquisition Date
Cash	\$ 363,405
Contingent consideration	171,654
Total fair value of consideration transferred	\$ 535,059

The purchase price allocation resulted in the following amounts being allocated to the assets acquired and liabilities assumed at the Acquisition Date based upon their respective fair values summarized below:

	Amounts Recognized as of Acquisition Date
Working capital (1)	\$ 11,987
Property, plant and equipment	2,559
Platform technology intangible asset (2)	330,800
In-process research and development product rights	198,400
Net deferred tax liability (3)	(164,993)
Total identifiable net assets	378,753
Goodwill	156,306
Net assets acquired	\$ 535,059

(1) Includes cash and cash equivalents, accounts receivable, other current assets, accounts payable and other current liabilities.

(2) Platform technology related to the Avilomics discovery platform which is being amortized over a useful life of seven years based on the estimated useful life of the platform.

(3) Includes current deferred income tax asset of \$14.7 million and non-current deferred tax liability of \$179.7 million.

The fair values of current assets, current liabilities and property, plant and equipment were determined to approximate their book values.

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The fair value of the platform technology intangible asset was based primarily on expected cash flows from future product candidates to be developed from the Avilomics platform and the fair value assigned to acquired IPR&D was primarily based on expected cash flows from the CC-292 product candidate which is in phase I testing. The values assigned to the platform technology intangible asset and the IPR&D asset were determined by estimating the costs to develop CC-292 and future product candidates into commercially viable products, estimating the resulting revenue from the potential products, and discounting the net cash flows to present value. The revenue and cost projections used were reduced based on the probability of developing new drugs. Additionally, the projections considered the relevant market sizes, growth factors and the nature and expected timing of new product introductions. The resulting net cash flows from such potential products are based on our estimates of cost of sales, operating expenses, and income taxes. The rates utilized to discount the net cash flows to their present value were commensurate with the stage of development of the projects and uncertainties in the economic estimates used in the projections described above. Acquired IPR&D will be accounted for as an indefinite-lived intangible asset until regulatory approval in specified markets or discontinuation of CC-292.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The excess of purchase price over the fair value amounts assigned to the assets acquired and liabilities assumed represents the goodwill amount resulting from the acquisition. The goodwill recorded as part of the acquisition is largely attributable to full ownership rights to the Avilomics platform. 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.

Prior to the acquisition, Avila had a number of collaboration agreements in place which we are now party to. These agreements entitle us to receive potential milestone payments and reimbursement of expenses for research and development expenses incurred under the collaborations and our collaboration partners may receive intellectual property rights or options to purchase such rights related to products developed under the collaborations. We do not consider these collaboration arrangements to be significant.

Sale of Facilities

Two manufacturing and research facilities located in Melrose Park, Illinois, and the equipment associated with operations at those facilities, were sold in June 2012 to APP Pharmaceuticals, Inc. (now known as Fresenius Kabi USA, LLC), or APP, a subsidiary of Fresenius Kabi AG. APP manufactures ABRAXANE® at one of the facilities. In exchange for the facilities, we received rights to free and reduced cost manufacturing of specified quantities of ABRAXANE®, which we recorded as current or non-current assets based on anticipated timing of delivery, a five-year rent-free lease of a portion of one of the facilities, and a net cash payment of \$1.8 million. The transaction did not result in any gain or loss.

4. Earnings Per Share

<i>(Amounts in thousands, except per share)</i>	Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
	2012	2011	2012	2011
Net income attributable to Celgene	\$ 424,155	\$ 372,984	\$ 1,193,065	\$ 907,972
Weighted-average shares:				
Basic	427,209	452,019	434,062	460,161
Effect of dilutive securities:				
Options, restricted stock units, warrants and other incentives	9,063	7,511	9,370	6,891
Diluted	436,272	459,530	443,432	467,052
Net income per share:				
Basic	\$ 0.99	\$ 0.83	\$ 2.75	\$ 1.97
Diluted	\$ 0.97	\$ 0.81	\$ 2.69	\$ 1.94

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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 11,588,987 and 21,682,141 shares for the three-month periods ended September 30, 2012 and 2011, respectively. The total number of potential common shares excluded for the nine-month periods ended September 30, 2012 and 2011 was 11,462,879 and 26,846,063, respectively.

Since April 2009, our Board of Directors has approved repurchases of up to an aggregate of \$6.5 billion of our common stock, including \$2.5 billion approved by our Board of Directors during their June 2012 meeting. As of September 30, 2012, an aggregate of 67,008,026 shares of common stock were repurchased under the program, including 10,766,077 shares of common stock repurchased during the three-month period

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

ended September 30, 2012. As of September 30, 2012, we had a remaining open-ended repurchase authorization of \$2.417 billion.

5. Accumulated Other Comprehensive Income (Loss)

The components of other comprehensive income (loss) consist of changes in pension liability, changes in net unrealized gains (losses) on marketable securities classified as available-for-sale, net unrealized gains (losses) related to cash flow hedges and changes in foreign currency translation adjustments, which includes changes in a subsidiary's functional currency and net asset transfers of common control subsidiaries.

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

	Pension Liability	Net Unrealized Gains (Losses) From Marketable Securities	Net Unrealized Gains (Losses) From Hedges	Foreign Currency Translation Adjustment	Total Accumulated Other Comprehensive Income (Loss)
Balance December 31, 2011	\$ (5,382)	\$ 4,707	\$ 5,713	\$ (67,375)	\$ (62,337)
Other comprehensive income (loss)	-	3,389	(38,745)	19,890	(15,466)
Balance September 30, 2012	\$ (5,382)	\$ 8,096	\$ (33,032)	\$ (47,485)	\$ (77,803)
Balance December 31, 2010	\$ (3,836)	\$ 3,102	\$ (15,556)	\$ (57,477)	\$ (73,767)
Other comprehensive income (loss)	-	3,145	(1,356)	6,108	7,897
Balance September 30, 2011	\$ (3,836)	\$ 6,247	\$ (16,912)	\$ (51,369)	\$ (65,870)

6. Financial Instruments and Fair Value Measurement

The table below presents information about assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2012 and the valuation techniques we utilized to determine such fair value. Fair values determined based on Level 1 inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities. Our Level 1 assets consist of marketable equity securities. Fair values determined based on 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. 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, non-U.S. government, agency and Supranational securities, global corporate debt securities, foreign currency forward contracts, purchased foreign currency options and interest rate swap contracts. Fair values determined based on 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 1 liability relates to our publicly traded contingent value rights, or CVRs. Our Level 2 liability relates to written foreign currency options. The Level 3 liability consists of contingent consideration related to undeveloped product rights resulting from the acquisition of Gloucester Pharmaceuticals, Inc., or Gloucester, and contingent consideration related to the undeveloped product rights and the technology platform acquired from the Avila acquisition. The estimated maximum potential payments related to the contingent consideration from the acquisitions of Gloucester and Avila are \$120.0 million and \$595.0 million, respectively.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Balance at September 30, 2012	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities	\$ 1,117,402	\$ 485	\$ 1,116,917	\$ -
Cash equivalents	83,098	-	83,098	-
Interest rate swaps	639	-	639	-
Forward currency contracts	8,626	-	8,626	-
Purchased currency options	6,274	-	6,274	-
Total assets	\$ 1,216,039	\$ 485	\$ 1,215,554	\$ -
Liabilities:				
Contingent value rights	\$ (122,465)	\$ (122,465)	\$ -	\$ -
Written currency options	(6,388)	-	(6,388)	-
Other acquisition related contingent consideration	(212,950)	-	-	(212,950)
Total liabilities	\$ (341,803)	\$ (122,465)	\$ (6,388)	\$ (212,950)

	Balance at December 31, 2011	Quoted Price in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Available-for-sale securities	\$ 788,690	\$ 560	\$ 788,130	\$ -
Forward currency contracts	48,561	-	48,561	-
Total assets	\$ 837,251	\$ 560	\$ 836,691	\$ -
Liabilities:				
Contingent value rights	\$ (60,583)	\$ (60,583)	\$ -	\$ -
Other acquisition related contingent consideration	(76,890)	-	-	(76,890)
Total liabilities	\$ (137,473)	\$ (60,583)	\$ -	\$ (76,890)

There were no security transfers between Levels 1 and 2 in the nine-month period ended September 30, 2012. The following tables represent a roll-forward of the fair value of Level 3 instruments (significant unobservable inputs):

	Nine-Month Periods Ended September 30,	
	2012	2011
Assets:		
Balance at beginning of period	\$ -	\$ 23,372
Amounts acquired or issued	-	-
Net realized and unrealized gains	-	1,182
Settlements	-	(22,477)
Transfers in and/or out of Level 3	-	-
Balance at end of period	\$ -	\$ 2,077

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Settlements of \$22.5 million during the nine-month period ended September 30, 2011 consisted of Level 3 instruments that were considered non-core assets acquired in the acquisition of Abraxis BioScience, Inc., or Abraxis, and were included in the sale of the non-core assets in April 2011.

	Nine-Month Periods Ended September 30,	
	2012	2011
Liabilities:		
Balance at beginning of period	\$ (76,890)	\$ (252,895)
Amounts acquired or issued	(171,654)	-
Net change in fair value	35,594	(14,198)
Settlements	-	-
Transfers in and/or out of Level 3	-	180,000
Balance at end of period	\$ (212,950)	\$ (87,093)

Level 3 liabilities issued during the nine-month period ended September 30, 2012 consist of contingent consideration related to the acquisition of Avila. Transfers out of Level 3 during the nine-month period ended September 30, 2011 consisted of a \$180.0 million milestone that was part of the contingent consideration in the Gloucester acquisition. This milestone was valued based on the contractually defined amount of the milestone and paid in July 2011.

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 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.

Foreign Currency Risk Management

We have established revenue hedging and balance sheet risk management programs to mitigate volatility in future foreign currency cash flows and changes in fair value caused by volatility in foreign exchange rates.

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. We manage our anticipated transaction exposure principally with foreign currency forward contracts and occasionally foreign currency put and call options.

Foreign Currency Forward Contracts: We use foreign currency forward contracts to hedge specific forecasted transactions denominated in foreign currencies and to reduce exposures to foreign currency fluctuations of certain assets and liabilities denominated in foreign currencies.

We enter into 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 at September 30, 2012 and December 31, 2011 had settlement dates within 36 months. These foreign currency forward contracts are designated as cash flow hedges and, to the extent effective, any unrealized gains or losses on them are reported in other comprehensive income (loss), or OCI, and reclassified to operations in the same periods during which the underlying hedged transactions

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

affect operations. Any ineffectiveness on these foreign currency forward contracts is reported in other income (expense), net. Foreign currency forward contracts entered into to hedge forecasted revenue and expenses were as follows at September 30, 2012 and December 31, 2011:

Foreign Currency	Notional Amount	
	September 30, 2012	December 31, 2011
Australian Dollar	\$ 11,483	\$ 17,169
British Pound	94,407	53,764
Canadian Dollar	163,078	67,281
Euro	389,452	714,446
Japanese Yen	504,668	606,538
Swiss Franc	337	49,182
Total	\$ 1,163,425	\$ 1,508,380

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 September 30, 2012, credit risk did not materially change the fair value of our foreign currency forward contracts.

We also enter into foreign currency forward contracts to reduce exposures to foreign currency fluctuations of certain recognized assets and liabilities denominated in foreign currencies. 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 (expense), net in the current period. The aggregate notional amount of the foreign currency forward non-designated hedging contracts outstanding at September 30, 2012 and December 31, 2011 were \$947.9 million and \$916.9 million, respectively.

Foreign Currency Option Contracts: During the three-month period ended September 30, 2012, we hedged 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 euros. Specifically, we sell (or write) a local currency call option and purchase a local currency put option with the same expiration dates and amounts but with different strike prices; this combination of transactions is generally referred to as a collar. The expiration dates and notional amounts correspond to the amount and timing of forecasted future foreign currency sales. 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. The premium collected from the call option partially offsets the premium paid for the purchased put option. At the same time, in order to offset the upfront cost of this collar, a local currency put option is sold with a lower strike price and the same expiration dates and amounts as the option contracts that are used to hedge sales. The written put is not designated as a hedging instrument and gains and losses associated with the written put option are recorded on the income statement as other income (expense), net. If the U.S. dollar strengthens relative to the currency of the hedged foreign currency sales to levels that reduce the exchange rate of the foreign currency below the strike price of this written put option, the put option would increase in value, resulting in losses to us equal to the difference between the strike price and the actual exchange rate multiplied by the notional amount of the hedged foreign currency sales.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign currency option contracts entered into to hedge forecasted revenue and expenses were as follows at September 30, 2012 and December 31, 2011:

Foreign Currency Option	Notional Amount*	
	September 30, 2012	December 31, 2011
Designated as hedging activity:		
Purchased Put	\$ 228,779	\$ -
Written Call	\$ 235,920	\$ -
Not designated as hedging activity:		
Written Put	\$ 215,952	\$ -

* U.S. Dollar notional amounts are calculated as the hedged local currency amount multiplied times the strike value of the foreign currency option. The local currency notional amounts of our purchased put, written call, and written put options are equal to each other.

Interest Rate Risk Management

Treasury Rate Lock Agreements: During the nine-month period ended September 30, 2012, we entered into treasury rate lock agreements, or treasury rate locks, in anticipation of issuing fixed-rate notes that were issued in August 2012. With the exception of a short period in June when certain outstanding treasury rate locks were not designated as hedges, our treasury rate locks were designated as cash flow hedges and, to the extent effective, any realized or unrealized gains or losses on them were reported in OCI and will be recognized in income over the life of the anticipated fixed-rate notes. Treasury rate locks were settled during the nine-month period ended September 30, 2012 which resulted in losses of \$35.3 million that were recorded to OCI. During the short period in June when we had outstanding treasury rate locks that were not considered hedging instruments, we recorded the change in fair value of \$3.7 million in other income (expense), net. No material amounts were recorded in income during the nine-month periods ended September 30, 2012 or 2011 as a result of hedge ineffectiveness or hedge components excluded from the assessment of effectiveness. At September 30, 2012 we had no outstanding 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 interest rates. Since the specific terms and notional amount of the swap are intended to match those of the debt being hedged, it is assumed to be a highly effective hedge and all changes in fair value of the swap is recorded on the Consolidated Balance Sheets with no net impact recorded in income. Any net interest payments made or received on interest rate swap contracts are recognized as interest expense.

At September 30, 2012, we were party to pay-floating, receive-fixed interest rate swap contracts designated as fair value hedges of fixed-rate notes in which the notional amounts matched the amount of the hedged fixed-rate notes. Our swap contracts outstanding at September 30, 2012 will mature in 2022, with an aggregate notional amount of \$200.0 million, which effectively converts a portion of our \$1.0 billion, 3.25% fixed-rate notes due in 2022 to a floating rate. In August 2011, we settled outstanding interest rate swap contracts we entered into with respect to our \$500.0 million, 2.45% fixed-rate notes due in 2015 resulting in the receipt of \$34.3 million. The proceeds from the settlements are being accounted for as a reduction of current and future interest expense associated with these notes.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the fair value and presentation in the Consolidated Balance Sheets for derivative instruments as of September 30, 2012 and December 31, 2011:

Instrument	Asset Derivatives		September 30, 2012		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<i>Derivatives designated as hedging instruments:</i>						
Foreign exchange contracts*	Other current assets	\$ 25,278	Other current assets	\$ 14,199		
	Other current liabilities	16,689	Other current liabilities	24,628		
	Other non-current assets	5,375	Other non-current assets	3,249		
	Other non-current liabilities	3,859	Other non-current liabilities	6,221		
Interest rate swap agreements	Other current assets	151	Other current assets	-		
	Other non-current assets	489	Other non-current assets	-		
<i>Derivatives not designated as hedging instruments:</i>						
Foreign exchange contracts*	Other current assets	52,015	Other current assets	39,713		
	Other current liabilities	796	Other current liabilities	8,166		
	Other non-current assets	10,857	Other non-current assets	9,790		
	Other non-current liabilities	-	Other non-current assets	392		
Total	\$ 115,509		\$ 106,358			

Instrument	Asset Derivatives		December 31, 2011		Liability Derivatives	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<i>Derivatives designated as hedging instruments:</i>						
Foreign exchange contracts*	Other current assets	\$ 68,889	Other current assets	\$ 32,430		
	Other current liabilities	129	Other current liabilities	3,940		
	Other non-current liabilities	-	Other non-current liabilities	24,832		
<i>Derivatives not designated as hedging instruments:</i>						
Foreign exchange contracts*	Other current assets	66,639	Other current assets	10,395		
	Other current liabilities	2,462	Other current liabilities	22,289		

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	Other non-current assets	36,684	Other non-current assets	32,356
Total		\$ 174,803		\$ 126,242

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

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following tables summarize the effect of derivative instruments designated as cash flow hedging instruments on the Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2012 and 2011, respectively:

Instrument	Three-Month-Period Ended September 30, 2012				
	Amount of Gain/(Loss) Recognized in OCI on Derivative (1)	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
	<i>(Effective Portion)</i>	<i>(Effective Portion)</i>	<i>(Effective Portion)</i>	<i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>	<i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>
Foreign exchange contracts	\$ (24,500)	Net product sales	\$ 24,784	Other income, net	\$ (1,681)(2)
Treasury rate lock agreements	\$ (3,492)	Interest expense	\$ (457)		

(1) Net gains of \$1,983 are expected to be reclassified from Accumulated OCI into income in the next 12 months.

(2) The amount of net losses recognized in income represents \$2,230 in losses related to the ineffective portion of the hedging relationships and \$549 of gains related to amounts excluded from the assessment of hedge effectiveness.

Instrument	Three-Month-Period Ended September 30, 2011				
	Amount of Gain/(Loss) Recognized in OCI on Derivative	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income	Location of Gain/(Loss) Recognized in Income on Derivative	Amount of Gain/(Loss) Recognized in Income on Derivative
	<i>(Effective Portion)</i>	<i>(Effective Portion)</i>	<i>(Effective Portion)</i>	<i>(Ineffective Portion and Amount Excluded)</i>	<i>(Ineffective Portion and Amount Excluded)</i>

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					<i>From Effectiveness Testing)</i>		<i>From Effectiveness Testing)</i>
Foreign exchange contracts	\$	47,987	Net product sales	\$	(4,802)	Other income, net	\$ (6,256)(1)

(1) The amount of net losses recognized in income represents \$2,125 in gains related to the ineffective portion of the hedging relationships and \$8,381 of losses related to amounts excluded from the assessment of hedge effectiveness.

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Nine-Month Period Ended September 30, 2012					
Instrument	Amount of Gain/(Loss) Recognized in OCI on Derivative (1) <i>(Effective Portion)</i>	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income <i>(Effective Portion)</i>	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income <i>(Effective Portion)</i>	Location of Gain/(Loss) Recognized in Income on Derivative <i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>	Amount of Gain/(Loss) Recognized in Income on Derivative <i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>
Foreign exchange contracts	\$ 43,258	Net product sales	\$ 62,820	Other income, net	\$ (3,422)(2)
Treasury rate lock agreements	\$ (35,255)	Interest Expense	\$ (457)		

(1) Net gains of \$1,983 are expected to be reclassified from Accumulated OCI into income in the next 12 months.

(2) The amount of net losses recognized in income represents \$7,472 in losses related to the ineffective portion of the hedging relationships and \$4,050 of gains related to amounts excluded from the assessment of hedge effectiveness.

Nine-Month Period Ended September 30, 2011					
Instrument	Amount of Gain/(Loss) Recognized in OCI on Derivative <i>(Effective Portion)</i>	Location of Gain/(Loss) Reclassified from Accumulated OCI into Income <i>(Effective Portion)</i>	Amount of Gain/(Loss) Reclassified from Accumulated OCI into Income <i>(Effective Portion)</i>	Location of Gain/(Loss) Recognized in Income on Derivative <i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>	Amount of Gain/(Loss) Recognized in Income on Derivative <i>(Ineffective Portion and Amount Excluded From Effectiveness Testing)</i>
Foreign exchange contracts	\$ (9,190)	Net product sales	\$ (7,833)	Other income, net	\$ (6,021)(1)

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(1) The amount of net losses recognized in income represents \$566 in losses related to the ineffective portion of the hedging relationships and \$5,455 of losses related to amounts excluded from the assessment of hedge effectiveness.

The following table summarizes the effect of derivative instruments designated as fair value hedging instruments on the Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2012 and 2011:

Instrument	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative			
		Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
		2012	2011	2012	2011
Interest rate swaps	Interest Expense	\$ 1,959	\$ 2,620	\$ 5,561	\$ 6,356

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes the effect of derivative instruments not designated as hedging instruments on the Consolidated Statements of Income for the three- and nine-month periods ended September 30, 2012 and 2011:

Instrument	Location of Gain (Loss) Recognized in Income on Derivative	Amount of Gain (Loss) Recognized in Income on Derivative			
		Three-Month Periods Ended September 30,		Nine-Month Periods Ended September 30,	
		2012	2011	2012	2011
Foreign exchange contracts	Other income, net	\$ (11,457)	\$ (46,586)	\$ 4,470	\$ (11,666)
Treasury rate lock agreements	Other income, net	\$ -	\$ -	\$ 3,718	\$ -

The impact of gains and losses on derivatives not designated as hedging instruments are generally offset by net foreign exchange gains and losses, which are also included in other income (expense), net for all periods presented.

8. Cash, Cash Equivalents and Marketable Securities Available-for-Sale

Money market funds of \$1.445 billion and \$738.7 million at September 30, 2012 and December 31, 2011, respectively, were recorded at cost, which approximates fair value and are included in cash and cash equivalents.

The amortized cost, gross unrealized holding gains, gross unrealized holding losses and estimated fair value of available-for-sale securities by major security type and class of security at September 30, 2012 and December 31, 2011 were as follows:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
September 30, 2012				
U.S. Treasury securities	\$ 452,083	\$ 374	\$ (8)	\$ 452,449

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U.S. government-sponsored agency securities	239,470	247	(19)	239,698
U.S. government-sponsored agency MBS	261,620	1,884	(1,067)	262,437
Non-U.S. government, agency and Supranational securities	5,535	25	-	5,560
Corporate debt - global	155,756	1,025	(8)	156,773
Marketable equity securities	407	78	-	485
Total available-for-sale marketable securities	\$ 1,114,871	\$ 3,633	\$ (1,102)	\$ 1,117,402

CELGENE CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2011	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Estimated Fair Value
U.S. Treasury securities	\$ 228,996	\$ 58	\$ (38)	\$ 229,016
U.S. government-sponsored agency securities	196,833	81	(69)	196,845
U.S. government-sponsored agency MBS	256,440	600	(1,901)	255,139
Non-U.S. government, agency and Supranational securities	2,666	19	-	2,685
Corporate debt - global	104,181	497	(233)	104,445
Marketable equity securities	407	153	-	560
Total available-for-sale marketable securities	\$ 789,523	\$ 1,408	\$ (2,241)	\$ 788,690

U.S. government-sponsored agency securities include general unsecured obligations either issued directly by or guaranteed by U.S. Government Sponsored Enterprises. U.S. government-sponsored agency mortgage-backed securities, or MBS, include mortgage-backed securities issued by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation and the Government National Mortgage Association. Non-U.S. government, agency and Supranational securities consist of direct obligations of highly rated governments of nations other than the United States and obligations of sponsored agencies and other entities that are guaranteed or supported by highly rated governments of nations other than the United States. Corporate debt - global includes obligations issued by investment-grade corporations, including some issues that have been guaranteed by governments and government agencies. Net unrealized gains in the marketable debt securities primarily reflect the impact of decreased interest rates at September 30, 2012.

Duration periods of available-for-sale debt securities at September 30, 2012 were as follows:

	Amortized Cost	Fair Value
Duration of one year or less	\$ 449,266	\$ 450,044
Duration of one through three years	600,905	602,095
Duration of three through five years	64,293	64,778
Total	\$ 1,114,464	\$ 1,116,917

9. Inventory

A summary of inventories by major category at September 30, 2012 and December 31, 2011 follows:

September 30, December 31,

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	2012		2011
Raw materials	\$ 67,767	\$	50,533
Work in process	105,680		115,170