# Baxter International

# 1997 Annual Report

## Blood Therapies

*1997 Sales: $1.8 billion*

Core Business: Baxter's Blood Therapies businesses are global leaders in products and therapies used in transfusion medicine. The company is a leading developer and processor of therapeutic proteins used to treat hemophilia, immune deficiencies and other blood-related disorders. It also is a leading manufacturer of plastic blood-collection containers and automated blood-separation and collection systems, used by blood and plasma centers to collect blood and its components for use in a variety of applications.

Key Products: Recombinate™ Anti-hemophilic factor (Recombinant) was the first genetically engineered clotting factor for the treatment of hemophilia A. Gammagard® S/D IGIV is a viral-inactivated plasma-based derivative that boosts weakened immune systems. The 1997 acquisition of Immuno International AG adds to the company's breadth of biopharmaceutical products, including vaccines and specialized blood-coagulation therapies. The Fenwal Blood-Pack® unit is the world's most widely used manual blood-collection container system. The company's Amicus™ separator is the most advanced automated instrument for the collection of platelets, a blood component essential for blood clotting.

Product Development: The company is conducting clinical trials of its hemoglobin therapeutic, or "blood substitute," which is an oxygen-carrying intravenous solution derived from human hemoglobin. Unlike a unit of blood, the product can be given to patients of any blood type, so it can be administered rapidly, potentially improving oxygen delivery to patients' vital organs. This may save lives and reduce complications for trauma patients and others with acute medical conditions. Baxter expects to launch the product in 2000. Meanwhile, the company continues to expand its capabilities in recombinant technologies to produce therapeutic proteins. Baxter also is developing pathogen-inactivation technologies for blood components to enhance the safety of transfusion products.

Global Strategy: To optimize its growth opportunities in transfusion medicine, in 1997 Baxter realigned its Blood Therapies businesses around three markets: biopharmaceuticals; products and systems for collecting, storing and separating blood and its components; and hemoglobin therapeutics. The company will grow its established businesses by introducing new products, by investing in recombinant and other technologies to enhance the safety and purity of its products, and by expanding globally. Today, more than half of these businesses' sales come from Europe. Growth there, as well as in North America and Japan, will come from new products. Growth in faster-growing, developing markets such as Asia and Latin America is fueled by established products such as blood-pack units and plasma-derived factor concentrates. In hemoglobin therapeutics, Baxter will continue to invest aggressively.

## I.V. Systems/Medical Products

*1997 Sales: $2.1 billion*

Core Business: Baxter's I.V. Systems/Medical Products business is a leading provider of medication-delivery products and systems that deliver fluids and drugs to patients. It is the world's leading manufacturer and marketer of intravenous (IV) products for use in hospitals and other health-care settings. Baxter manufactures about 800 different IV products, from IV fluids in plastic containers, to electronic infusion pumps, to ambulatory IV delivery systems. Additionally, the company sells select products of other companies in countries outside the United States.

Key Products: Baxter's Viaflex® container was the first flexible, plastic IV container and remains the standard for IV therapy worldwide. The company's Mini-Bag™ IV containers carry the industry's broadest line of premixed drugs for IV delivery. In 1997, Baxter introduced the Colleague™ volumetric infusion pump, which provides accurate, cost-effective electronic infusion for a broad range of therapeutic applications. The InterLink® IV access system was the first "needleless" system for IV therapy and is used by nearly 2,000 health-care facilities worldwide. Other products include compounding equipment for mixing IV nutrition solutions, ambulatory IV pumps, anesthesia products and automated dispensing systems for solid pharmaceuticals.

Product Development: Baxter continues to expand its industry-leading line of premixed drugs. The company also is advancing its compounding technology to meet pharmacists' needs for safety, efficiency and accuracy in preparing IV nutrition solutions. The acquisition of Bieffe Medital S.p.A. adds new low-cost technology for manufacturing IV solutions containers without plasticized polyvinyl chloride (PVC). This non-PVC container technology, which some customers prefer, complements Baxter's IV and renal product lines.

Global Strategy: The strategy of Baxter's I.V. Systems/Medical Products unit is twofold: in established markets, Baxter is using its position in basic IVs to introduce new, technologically advanced products and services that help customers increase productivity and reduce costs. In new markets, Baxter enters with products that meet its customers' current requirements, then broadens its product offerings as health-care spending increases. The company's acquisition of Bieffe will allow Baxter to provide IV solutions more cost-effectively in emerging markets, and to participate in markets in which non-PVC containers are required. The company also continues to form alliances or joint ventures to market or manufacture IV products in developing countries, such as Argentina, Chile, China, Hungary and Turkey.

## Renal

*1997 Sales: $1.4 billion*

Core Business: Baxter's Renal business is one of the world's leading providers of products and services for kidney dialysis, a treatment for end-stage renal disease, a life-threatening condition in which the kidneys fail. The company is a global leader in the manufacture of products for peritoneal dialysis (PD), a home-based therapy that Baxter pioneered in the late 1970s. Baxter also manufactures products for hemodialysis, which is administered at a hospital or clinic. Baxter pioneered hemodialysis in the 1950s.

Key Products: Baxter's Dianeal® solutions are the world's leading brand of PD solutions, which are administered by patients through a surgically implanted catheter in their peritoneum, or lining of the abdominal cavity. The peritoneum serves as the membrane through which waste products are filtered and later drained from the body. The company's Dianeal product line includes specially formulated solutions for specific patient needs. Baxter's Twin-Bag™ container system (also called the UltraBag™ system) combines infusion and drainage procedures in one system, simplifying solution exchanges and reducing the chance of infection. One of Baxter's most successful new products is the HomeChoice® automated PD machine. The lightweight, compact device cleanses the blood overnight while the patient sleeps. Hemodialysis products include hemodialysis machines, water-purification systems and dialyzers.

Product Development: Baxter continues to develop new PD solutions to manage specific patient conditions, new hardware systems to improve the quality of dialysis, and other products to reduce costs and improve patient convenience and quality of life. Baxter's Nextran unit is a leader in research on xenotransplantation, or animal-to-human transplants. Our researchers are developing genetically modified pig organs that someday could be transplanted safely into humans. This research extends beyond kidneys to livers, hearts and lungs.

Global Strategy: There are more than 800,000 dialysis patients worldwide. In many developing countries, thousands more go untreated. As the economies of these countries grow, so will dialysis treatment rates. Baxter's strategy is to increase PD penetration in developed countries and expand rapidly into less-developed nations, where PD is the preferred treatment due to its lower start-up costs. Baxter also is aggressively expanding its two renal-service businesses. In international markets, Baxter's Renal Therapy Services unit operates dialysis clinics in partnership with leading local physicians and hospitals to increase access to treatment, improve patient outcomes and reduce clinics' operating costs. In the United States, Baxter's Renal Management Strategies unit is partnering with nephrologists to use advanced disease-management techniques to improve the quality and reduce the cost of long-term renal care.

## CardioVascular

*1997 Sales: $0.9 billion*

Core Business: Baxter's CardioVascular Group is a global leader in the development and manufacture of products used to treat advanced heart disease and vascular disorders through conventional or minimally invasive surgical procedures. These include a complete line of heart-valve replacement and repair products; disposable medical devices, used to provide oxygen to the blood while the heart and lungs are stopped during open-heart surgery; vascular products, used to remove clots from peripheral blood vessels; cardiac-monitoring catheters; and contract perfusion services.

Key Products: The company's Carpentier-Edwards® pericardial heart valve, made from the tissue that surrounds a cow's heart, is the world's leading tissue heart valve due to its durability and performance. Baxter's SpiralGold® oxygenator, used in cardiopulmonary bypass, is one of a series of products coated with the company's patented Duraflo® heparin treatment, which reduces blood clotting and resulting complications. The company's Swan-Ganz® catheter, used to measure cardiac output and pressures inside the heart, and the Fogarty® embolectomy catheter, used in vascular surgery, have been industry standards for more than 25 years.

Product Development: Baxter is continuing to work with leading cardiovascular surgeons to develop new and enhanced heart-valve therapy products, both tissue and mechanical, for valve replacement and repair. The company also is investing in products and technologies for minimally invasive cardiac and vascular surgery, building off of its 1997 acquisition of Research Medical, Inc., and its continued work in endovascular grafts for treating abdominal aortic aneurysms. The company's Novacor® left-ventricular assist system is an implantable, electronic pump that aids circulation in patients awaiting heart transplantation. It has been approved in Europe as both a bridge and an alternative to transplant, and currently is under regulatory review in the United States in the bridge-to-transplant application.

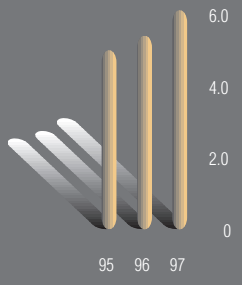
Global Strategy: Heart disease claims more lives and health-care dollars than any other medical ailment. Baxter's strategy is to be a leader in providing products and services to treat advanced heart disease, aiding patients with the most life-threatening and cost-intensive conditions. Significant opportunities for Baxter are in such established markets as North America, Europe and Japan, where growth is driven by technological advancement. An aging worldwide population and the progressive nature of heart disease also will contribute to market demand for Baxter's products. And, as the economies of developing countries such as Brazil, China and India grow and more money is spent treating chronic health conditions, they too, will represent significant growth markets for the company.

| | *(Dollars in millions, except per share data)* | 1997 | 1996 |
|---|---|---|---|
| OPERATING RESULTS | Net sales | $6,138 | $ 5,438 |
| | Income from continuing operations before acquired research-and-development (R&D) expense[1] | $ 652 | $ 575 |
| | Income from continuing operations | $ 300 | $ 575 |
| | Basic earnings per share from continuing operations before acquired R&D expense[1] | $ 2.35 | $ 2.11 |
| | Basic earnings per share from continuing operations | $ 1.08 | $ 2.11 |
| | Operational cash flow from continuing operations before net litigation payments | $ 432 | $ 587 |
| INVESTMENTS | Capital expenditures | $ 496 | $ 398 |
| | Research-and-development expenses | $ 392 | $ 340 |
| RETURNS | Total shareholder return | 25.9% | 14.1% |
| | Dividends per common share | $1.139 | $ 1.17 |
| OTHER | Total assets | $8,707 | $ 7,596 |
| | Net-debt-to-capital ratio | 46.9% | 33.8% |
| | Stockholders' equity | $2,619 | $ 2,504 |
| | Common stockholders of record at year-end | 62,900 | 65,400 |

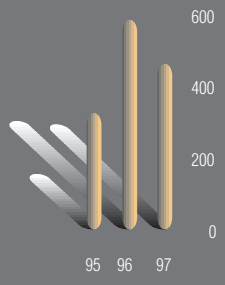
*See financial section for more information.*

*1. In 1997, the company recorded a $352 million charge for purchased R&D relating to the acquisitions of Immuno International AG and Research Medical, Inc.*

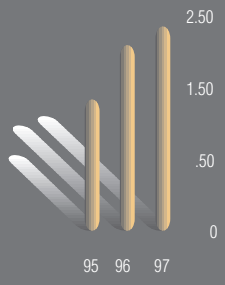
*2. Bar chart reflects basic earnings per share before R&D charge referenced above.*




*Net Sales (in billions of dollars)*




*Operational Cash Flow (in millions of dollars)*




*Basic Earnings Per Share from Continuing Operations [2] (in dollars)*

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*A Message from Chairman and Chief Executive Officer Vernon R. Loucks Jr.*

At Baxter International, we serve some of the world's most chronic and critical health-care needs. It is important work. Important to the patients and health-care professionals who use our products in 112 countries. Important to our employees, who know they are in the business of saving lives. And important to our shareholders, who invest in the opportunity to advance the frontiers of medicine worldwide. Baxter today is executing its strategies of global expansion and technological innovation in four businesses: blood therapies, intravenous (IV) therapy, renal therapy and cardiovascular medicine. These strategies enabled us to deliver attractive returns to our shareholders in 1997, and we are committed to doing so in 1998 and beyond.

**Key Accomplishments**

We made significant progress in 1997. We enhanced our technological superiority by introducing new products like our Amicus™ separator, an automated device that collects blood components, and the Colleague™ infusion pump, which is setting new standards for ease of use and accuracy in IV therapy. We expanded all of our businesses geographically, particularly in Asia and Latin America. And, our research-and-development initiatives made substantial progress in clinical testing. Additionally, several key acquisitions improved both our technology base and our global reach. They included:

- *Immuno International AG, a leading global manufacturer of therapeutic proteins. Baxter's and Immuno's strengths — both in terms of product lines and geographic markets — are extremely complementary, and we believe this will lead to greater gains for our customers and shareholders.*
- *Research Medical, Inc. (RMI), a leader in products used for minimally invasive heart and vascular surgery. The combination expands our product offerings in one of the fastest-growing segments of cardiovascular care.*
- *Bieffe Medital S.p.A., a leading dialysis, IV therapy and irrigation solutions business. Bieffe's flexible non-PVC container technology and cost-effective manufacturing processes enable our Renal and I.V. Systems businesses to enter emerging markets more quickly.*



Global expansion and technological innovation are the keys to our competitive edge. It's great to be first, best or biggest in any business. In medical specialties and markets where we operate, Baxter is often all three. That leadership drives growth and enables us to consistently meet our financial commitments to you.

**1997 Financial Commitments**

- *Increase sales 20 percent, including acquisitions; or approximately 10 percent excluding acquisitions.* Sales grew 16 percent, including acquisitions and before the impact of foreign exchange. Sales rose 6 percent, excluding acquisitions.
- *Grow earnings in the low double digits.* Income from continuing operations increased 13 percent, excluding a charge for acquired research and development related to the Immuno and RMI acquisitions.
- *Generate $300 million to $400 million in operational cash flow before litigation payments, after investing approximately $1 billion for capital improvements and research and development.* Baxter generated $432 million in operational cash flow before litigation payments, after spending $392 million in research and development and $496 million in capital expenditures.

Overall, total return to shareholders (including reinvested dividends) for 1997 increased 26 percent. This was greater than the Dow Jones Industrial Average and the S&P Medical Products and Supplies Index. We also increased the dividend for the 41st consecutive year.

Contributing to this performance is our practice of directly aligning management's financial incentives with your interest as shareholders, through stock-purchase programs, stock options and bonus plans based both on the achievement of our financial commitments and on stock-price appreciation. Your board of directors also is compensated primarily in Baxter stock.

Our financial goals for 1998 are equally specific and ambitious. We expect to:

- *Increase sales approximately 10 percent, before acquisitions and the impact of foreign exchange.*
- *Grow earnings in the mid-teens, before the impact of foreign exchange, and in the low double digits after absorbing the impact of foreign exchange.*
- *Generate at least $500 million in operational cash flow. This will be after investing approximately $1 billion in capital improvements and research and development.*

We intend to achieve our goals in 1998 and beyond by building on our strengths and sticking to our strategies.

**Strategies and Strengths**

Our strategy of technological innovation stretches back through a long line of firsts: first flexible, plastic container for IV fluids; first artificial kidney machine; first implantable heart valve; first Factor VIII clotting concentrate to treat hemophilia, and many more. Today, Baxter's businesses are all based on expertise related to the blood and circulatory system. What's more, they share basic technologies. Our Blood Therapies, I.V. Systems and Renal businesses all use disposable plastic containers to deliver solutions. All four businesses rely on sophisticated instrumentation to control everything from IV pumps to heart-lung machines.



To make the most of the strengths we share, and to encourage ongoing innovation, Baxter's Technical Council brings together top scientists from throughout the company. We operate three corporate research centers in the United States, Belgium and Japan. We also maintain vast scientific databases that are available to all our businesses worldwide.

Despite this expertise, we have aggressively built on our internal strengths by accessing technology developed elsewhere. We have expanded our product portfolio in recent years by licensing and buying technology, acquiring companies and entering into joint ventures. This is one way we keep a new stream of ideas flowing into the company to complement our existing base of knowledge.

During 1997, we continued to advance our clinical trials, several of which are testing products that represent breakthroughs in medicine. We became the first company to begin Phase III clinical trials in trauma patients with a hemoglobin therapeutic, or "blood substitute." Called HemAssist™ (Hemoglobin Crosfumaril), this hemoglobin-derived solution is being tested for its ability to deliver oxygen to patients' vital organs, potentially reducing complications or saving the lives of patients with significant blood loss. We expect to bring this product to market in late 1999 or early 2000.

We also are pursuing potential breakthroughs in xenotransplantation, or animal-to-human transplants. Baxter added several sites to its clinical trial that uses transgenic pig livers as an extracorporeal (outside the body) perfusion device as a bridge to transplant for patients suffering from acute liver failure. We hope to complete this trial within the next year. Other trials, such as those for our Novacor® left-ventricular assist device, used to support patients with failing hearts; and for a pulmonary medication-delivery device, which potentially will deliver medication to patients' lungs more efficiently, are progressing well.

Besides being technologically adept, we also are committed to a strategy of global expansion. Our approach is market-by-market, developing and adapting products and services for the specific state of each market's medical system and economic infrastructure. We listen intently to our customers around the world, then design and deliver products and services that meet their requirements. That's what it means to be a truly global company.

These twin strategies of technological innovation and global expansion have proven very successful. Today, products that hold No. 1 market positions — many of which we were the first to introduce — account for about 70 percent of sales. Thirty-six percent of our sales are from products introduced within the last five years. At the same time, more than 50 percent of sales, and 75 percent of earnings, come from outside the United States.

Elsewhere in this report, sections on our core capabilities and individual businesses explain how we will pursue these strategies in 1998 and beyond.

- *Our Blood Therapies businesses will build on the Immuno acquisition to expand in Europe and elsewhere. They also will continue clinical trials for our hemoglobin therapeutic in the United States and Europe, and for our pathogen-inactivation technologies.*
- *Our I.V. Systems/Medical Products business will aggressively market its new Colleague™ pump worldwide, while using technology acquired from Bieffe to complement and expand its geographic base.*
- *Our Renal business will expand peritoneal dialysis and hemodialysis therapies into developed and emerging markets. It also will continue to expand its two service businesses: Renal Therapy Services, which operates dialysis clinics overseas, and Renal Management Strategies Inc., a disease-management organization focused on the U.S. market.*
- *Our CardioVascular business will build on its leadership in heart-valve therapy, as well as pursue opportunities in minimally invasive surgery and other developing treatments for late-stage cardiovascular disease.*



**Employees and Community**

Behind all these plans and strategies stand the people of Baxter. Our employees are exceptionally dedicated. They work here not just to make a living, but also to make a difference. To them, we pledge continued opportunity, support and respect. In 1997, we also reinforced our commitment to communities around the globe where we live and work. Through direct donations, including disaster relief, and through our support of The Baxter Allegiance Foundation, we worked to improve the availability and affordability of health care from Düsseldorf, Germany, to Cali, Colombia. It is a commitment that draws on our business skills as well as the caring and dedication of Baxter people everywhere.

At Baxter, we are driven and inspired by our strategies of technological innovation and global expansion; by the chance to save lives and alleviate suffering worldwide; by the opportunity to provide a challenging and rewarding work environment for our employees; and by the responsibility to generate outstanding returns for our shareholders. During 1998, we have the opportunity, and the obligation, to achieve those goals once again. We will meet the challenge.

On behalf of the entire Baxter team,

Vernon R. Loucks Jr., Chairman and Chief Executive Officer

February 13, 1998

**For more than 60 years, Baxter has achieved many medical breakthroughs we all take for granted today. Intravenous therapy. Kidney dialysis. Heart-valve replacement. Blood-component therapy. Building on this legacy of innovation, Baxter's businesses today share three core elements: expertise in technologies related to the blood and circulatory system, global leverage and superior manufacturing capabilities.**

Baxter is a global leader in technologies related to the blood and circulatory system. The company's blood therapies businesses make products that collect, separate and store blood, as well as therapeutic proteins derived from blood. Its renal products cleanse the blood. Cardiovascular products keep blood pumping through the body. Intravenous (IV) products infuse drugs and other solutions into the blood.

Throughout its history, Baxter has capitalized on expertise in select core technologies to develop a steady stream of product innovations across businesses. Because many of these products are based on related technologies, they are produced in the same manufacturing plants. The company further leverages its expertise geographically, extending the reach of its life-saving products to patients around the world.



**History of Innovation**

When the company was founded in 1931, Baxter's first products were a line of five IV solutions supplied in glass containers. These products were the first commercially manufactured IV solutions, making life-saving IV therapy a reality. This technology led to the introduction of the first sterile, vacuum blood-collection containers, which made blood banks practical for the first time. When the company's Fenwal business developed the first flexible, plastic blood-collection system in the 1950s, it led directly to the creation of Baxter's Viaflex® product line of plastic IV bags, containers for peritoneal-dialysis (PD) solutions, and other Baxter products.

Baxter built on its expertise in basic IV solutions to develop IV nutrition, premixed and frozen drugs, dialysis solutions to cleanse the blood of kidney patients, plasma-based solutions to treat hemophilia and other diseases, and genetically manufactured therapeutic proteins. The company's hemoglobin-based "blood substitute"—now in clinical trials and targeted for release in the year 2000 pending regulatory approval—is the latest example of how Baxter uses its expertise in both blood derivatives and IV infusion technology to create potential breakthrough products.

***An estimated 3,000 patients die each year in the United States awaiting an organ transplant, and another 100,000 patients die never having qualified for a place on the donor-organ waiting list. Nextran's efforts to make porcine organs more acceptable for the human immune system may help to alleviate this critical shortage.***

Xenotransplantation also has potential application across Baxter's businesses—particularly for the company's Renal and CardioVascular units. This involves the genetic modification of animal organs for transplant into humans. The technology is being developed by Baxter's Nextran unit, which is conducting research with hearts, kidneys, livers and potentially other organs.

In 1997, the Smithsonian Institution recognized two Baxter products for their contribution to medical science. Baxter's Renal Link™ clinical software system, which helps physicians evaluate patients to achieve the best treatment, became part of the Smithsonian's collection of products depicting innovation in information technology. The Isolex® magnetic cell separator, currently used in clinical studies, was included in an exhibit commemorating the 25th anniversary of the National Cancer Act. The Isolex system collects stem cells, the "parents" of all other blood cells, for infusion into cancer patients to rebuild their immune systems following high-dose chemotherapy.

**Extending Expertise Across Borders**

Baxter's operating experience extends to nearly every type of political and health-care system in the world. This experience translates into tremendous global penetration—more than 50 percent of the company's sales come from outside the United States, and represent the company's fastest-growing markets. Many of Baxter's leading product lines—Recombinate™ Anti-hemophilic factor (Recombinant), Fenwal blood-collection systems, Swan-Ganz® catheters, Carpentier-Edwards® heart valves, Dianeal® PD solutions, and others—are leaders in the markets in which they are sold.

A key factor in the company's success in global markets is its practice of recruiting employees who understand the business culture, customs,

health-care system and practices, and government policies of the markets in which they work. This enables Baxter to more effectively tailor its leadership in key areas of technology to grow local markets. For example, Baxter is a global leader in PD products and services. Two years ago, the company decided to begin operating dialysis centers outside the United States, frequently partnering with local physicians. Baxter's Renal Therapy Services (RTS) unit now has nearly 70 centers in Asia, Latin America and Europe, and has more than doubled its patient base since 1996. Baxter expects RTS to continue its significant growth in 1998, particularly in Europe.

***Baxter's Renal Therapy Services (RTS) unit partners with nephrologists outside the United States to operate dialysis clinics dedicated to advancing the treatment of kidney disease. RTS provides clinical and administrative services that help nephrologists deliver quality care most cost-effectively, improve patient outcomes and expand patient access to a full range of therapies.***

To fully realize its global potential, Baxter last year created regional boards to direct the company's activities on a regional basis. These boards, representing Europe, Japan, Asia, North America and Intercontinental (Latin America, Eastern Europe, the Middle East, Australia, New Zealand and other countries), include individuals from all four Baxter business segments to capitalize on growth opportunities in specific markets. The boards work closely with Baxter's operating units to ensure an efficient, cohesive strategy for global growth that leverages all of the company's capabilities on a worldwide basis.

**Leveraging Manufacturing Excellence**

Every Baxter manufacturing plant around the world takes advantage of the expertise the company has developed over the years as a leading producer of critical health-care products. When Baxter establishes a PD solutions plant in a country, it is well along the road to being able to produce IV solutions, blood-collection containers and other products that use similar manufacturing technologies. Baxter plants share expertise in plastics extrusion, heat-sealing and filling, sterilization and many other processes.

The company's electron-beam sterilization system is one example. It was developed to sterilize a particular part on the disposable blood-collection kits used with Baxter's CS-3000® blood-cell separator. These kits are manufactured at Baxter's facility in Mountain Home, Arkansas, which also produces most of the plastic sheeting used in Baxter's IV, PD and blood-collection containers around the world. This "E-beam" technology, which provides a pinpoint stream of energy to sterilize specific plastic components, has several applications across the company.

Baxter manufacturing worldwide adheres to the highest standards of quality. In 1997, the company's operation in Singapore, which manufactures IV administration sets and electronic infusion pumps, won the Singapore Quality Award, that country's highest award for outstanding quality management systems. Other Baxter operations that have won national quality awards include those in Toongabbie, Australia, in 1991; Lessines, Belgium, in 1992; Cali, Colombia, in 1994; and Alliston, Canada, in 1996. Also in 1997, the company's IV sets plant in Sherbrooke, Canada, was chosen by the Province of Quebec as the first recipient of its Le Qualimètre Award, recognizing the facility's dedication to total quality. In Belgium, Baxter's Lessines plant was named factory of the year by a panel comprised of industrial representatives who assessed the manufacturing excellence of more than 200 companies.

Baxter's core capabilities will continue to drive the growth of the company. As new technologies come on board, the company will remain true to its mission of leveraging its technological expertise, its global presence and its manufacturing excellence to bring quality products and services to more and more patients around the world.

***In 1997, Baxter's manufacturing facility in Singapore earned the Singapore Quality Award, the country's highest recognition of quality excellence. The facility manufactures intravenous tubing and electronic infusion systems.***

John Bacich's most valuable time during his 30 years with Baxter's Hyland division has been spent with people with hemophilia. Baxter is the world's leading manufacturer of plasma-based and recombinant Factor VIII, the clotting factor missing from the blood of most people with hemophilia.

"I remember when parents had to drive long distances several times per month to get their children with hemophilia transfusions of fresh-frozen plasma, before there was factor concentrate," says Bacich, co-president, Hyland/Immuno. "I've seen Baxter pioneer countless technological advances to turn hemophilia from a debilitating disease to one which, while still requiring chronic therapy, enables more patients to live full, productive lives. That's what keeps me motivated and working at Baxter."

Today, the biggest concern of the hemophilia population, Bacich says, is product safety. "A close second is always having a steady supply of product." Baxter's acquisition of Immuno International AG enhances the company's capabilities in both of these areas, while adding many products to treat a host of other conditions.

In 1997, Baxter completed its acquisition of Immuno, a leading global manufacturer of therapeutic proteins. This acquisition increases Baxter's global reach, allowing the company to serve more patients. The greatest expansion is in Europe, where Immuno derives more than three-quarters of its sales. "It also opens up opportunities for Immuno's products in the United States, Latin America, Japan and Asia, where Baxter has a stronger presence," says Tim Anderson, Baxter group vice president.

The acquisition greatly broadens Baxter's line of therapeutic proteins derived from human blood plasma. Hyland, in addition to producing Factor VIII, processes albumin, a blood-volume expander for burn victims and other critically ill patients, and intravenous gamma globulins, used to treat patients with immune deficiencies. Immuno processes numerous other plasma derivatives, including albumin and additional factor concentrates, immunoglobulins targeted at specific diseases, and a fibrin sealant used to stop patients' bleeding.

Hyland and Immuno also combine their industry-leading plasma-screening and viral-inactivation technologies for increased product safety, and their research and production capacity. Baxter can now process more than three million liters of plasma a year. Additionally, the company's recombinant manufacturing facility in Thousand Oaks, California, will provide significant potential for the future.

Anderson says that no company has more expertise in blood therapies than Baxter. "Burn victims go home from the hospital more quickly. Hemophilia patients lead more productive lives. Cancer patients recover from treatment with less-serious side effects. That's why our expertise in blood therapies is critical."

Elsewhere in Baxter's Blood Therapies businesses, the company's HemAssist™ (Hemoglobin Crosfumaril) hemoglobin therapeutic progressed to final-stage clinical testing. The Amicus™ separator, used for the collection of blood components, was introduced to U.S. customers. Finally, Baxter combined the assets of its Immunotherapy division with VIMRX Pharmaceuticals Inc. to form a new company to develop cellular therapies to fight cancer and other diseases.

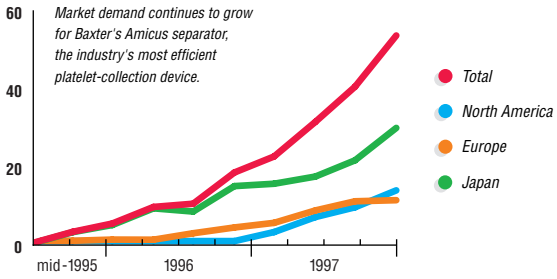
***Marilène, a cancer patient and mother of two, had Tisseel® fibrin sealant applied to help heal wounds resulting from radiation therapy to her face. By promoting fast, safe and effective wound healing, the therapy enabled her to eat normally again in a relatively short period of time, further aiding her recovery.***

Transfusio

***A surgeon in France prepares to administer Tisseel® fibrin sealant, which is used to control intraoperative bleeding in surgical procedures. It consists of fibrinogen and thrombin, two blood proteins that, when mixed, form a natural clotting substance called fibrin to stop bleeding and seal internal wounds. Developed by Immuno International AG, Tisseel is one of a number of wound-management products Baxter plans to introduce in the coming years.***

n Medicine

***Market Demand for Amicus™ Kits***
*(number of kits in thousands)*




*Market demand continues to grow for Baxter's Amicus separator, the industry's most efficient platelet-collection device.*

*One kit is used for each platelet-collection procedure.*

The neonatal intensive-care unit (ICU) of the Children's Hospital of Illinois in Peoria, treats about 700 high-risk and premature infants a year—from babies born with complex heart problems to premature infants weighing as little as 10 ounces. As one of the nation's leading neonatal ICUs, the hospital served as a test site for Baxter's Colleague™ volumetric infusion pump.

Introduced in 1997, the Colleague pump is an electronic infusion pump that provides more precise flow rates, can be used for all types of patients and is easier to use than existing devices when infusing intravenous (IV) solutions into patients. The pump can deliver flow rates as low as 0.1 milliliters an hour and as high as 1,200 milliliters an hour. This wide range allows it to be used in virtually any clinical setting—from the neonatal ICU, where the smallest dosages must be delivered with the highest degree of accuracy, to the emergency room, where trauma victims may require large volumes of fluid.

"We had one baby on the Colleague who weighed less than a pound and required seven IV lines running simultaneously," says Cheryl Colgan, clinical educator for the neonatal ICU at Children's Hospital. "For cases this complex, we have not found any other pump that meets our needs as well as the Colleague pump."

Following the pump's successful trial in the neonatal ICU, it was brought back in for trials in the pediatric ICU. "They loved it as well," Colgan says. The hospital, which previously employed three different types of IV pumps, now plans to replace all of its pumps with the Colleague pump.

"It satisfies the one need that hadn't previously been met for patients, and that is a very accurate pump that can be used in a wide range of applications throughout the hospital," says Jack McGinley, group vice president, I.V. Systems/Medical Products.

Customers played a key role in the product's development, according to Dave Drohan, president, I.V. Systems, who led the crusade to acquire the core technology for the Colleague pump from a European company in 1993. "We listened to our customers and gave them the product they were asking for."

In addition to its clinical benefits, the Colleague pump also can be used with standard Baxter IV sets rather than more expensive IV administration cassettes. "This cost-effectiveness is a significant competitive advantage," Drohan says. "Colleague offers the economic benefits of a standard-set pump, yet it is as accurate as pumps that require expensive cassettes."

Drohan estimates that the Colleague pump will represent 90 percent of Baxter's IV pump sales by year-end 1998. "This pump positions us for continued leadership in the electronic flow-control marketplace."

Elsewhere in the I.V. Systems/Medical Products business, the acquisition of Bieffe Medital S.p.A. broadens Baxter's ability to serve the global IV market. Bieffe adds new, low-cost non-PVC container technology that gives Baxter a strong competitive position in several international markets. Other acquisitions and joint ventures outside the United States also were completed in 1997 as part of the company's initiative to globalize its IV business. A main area of emphasis is Latin America, where sales of the company's IV products grew 11 percent in 1997.

***Nathan Denault, with his parents Steve and Crystal, was the first patient to be treated with the Colleague™ pump in clinical trials last spring. Because he was born 12 weeks prematurely and weighed only two pounds, he could receive only an extremely small amount of fluids. Nathan benefited from the Colleague pump's ability to deliver flow rates as low as 0.1 milliliters an hour.***



Medicati

*The Colleague™ pump is manufactured in Baxter's Singapore plant. The facility, which also manufactures solution-administration sets and components for the company's InterLink® "needleless" intravenous (IV) access system, is the largest IV pump manufacturing plant in the world. Baxter introduced the Colleague pump in 1997.*

***Global IV Manufacturing Presence***

# on Delivery

Fifty-year-old jewelry craftsman Antonio Romero of Mexico City was diagnosed with end-stage renal disease (ESRD), or kidney failure, in September 1994.

The most common treatment for ESRD in most parts of the world is hemodialysis, a therapy pioneered by Baxter in the 1950s, in which the patient's blood is filtered through a machine outside the body to eliminate waste normally removed by healthy kidneys. Like an increasing number of nephrologists, however, Romero's doctor instead prescribed peritoneal dialysis (PD), a newer, faster-growing therapy introduced by Baxter in 1978.

Unlike hemodialysis, PD is a home-based therapy. It uses the body's peritoneal membrane as a filter to cleanse the blood rather than external pumping and filtering equipment, offering significant cost and lifestyle advantages. "Being a home therapy, with flexible scheduling of solution exchanges, PD makes it easier for patients to work and lead a normal home life," says Dr. Mario Matos Martínez of the Centro Médico "La Raza." "It represents a better quality of life for patients."

Baxter is the world's leading provider of products for PD. The therapy is growing fastest in developing markets, where patients lack access to dialysis centers or kidney transplants. "Without treatment, patients with ESRD will die. In some countries, PD is the patient's only option," says Don Joseph, group vice president, Renal.

To enhance the therapy, Baxter continues to introduce new products. The company's Dianeal® product line of PD nutritional solutions has evolved to include specially formulated solutions for specific patient needs. These include low-calcium solutions for patients who have problems managing their calcium level; Extraneal™, a polyglucose solution for patients who require a higher fluid-removal rate; and Nutrineal™, an amino-acid-based solution that provides nutrition for patients who suffer from malnutrition.

Baxter also has begun to introduce its Twin-Bag™ PD solution container in developing markets. The product combines infusion and drainage in one system, simplifying solution exchanges and reducing infection rates.

In developed markets, automated peritoneal dialysis (APD) is the fastest-growing form of therapy. Baxter has fueled much of this growth with its HomeChoice® APD machine. The lightweight, compact device cleanses the blood overnight while the patient sleeps.

Elsewhere in Baxter's Renal business, the company's acquisition of Bieffe Medital S.p.A. will broaden its position in the global renal market. Baxter also continued to expand its Renal Therapy Services (RTS) business, which operates dialysis centers in partnership with local physicians in a number of countries outside the United States. RTS doubled the number of patients it served in 1997 to more than 5,200, and plans to aggressively expand in Europe in 1998. In the United States, Baxter's Renal Management Strategies unit and Humana Inc. signed the industry's first national managed-care agreement for kidney-disease patients, designed to improve patient outcomes while reducing costs. In 1998, Baxter plans to introduce a new hemodialysis instrument with advanced features to improve its position in the hemodialysis market.

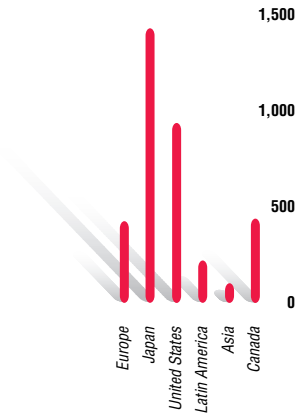


***Mexico City student Alma Lilia Martínez is able to lead an active life thanks to peritoneal dialysis (PD), a home-based therapy introduced by Baxter in the late 1970s. The therapy is particularly popular in developing markets due to its low start-up costs compared to hemodialysis. Baxter is the world's leading provider of products and services for PD.***

Kidney

# Dialysis

***Each month, Baxter Renal Service Specialist Martín Ramírez delivers peritoneal-dialysis (PD) solutions to kidney-disease patient Antonio Romero of Mexico City. More than 90 percent, or 15,000, of Mexico's dialysis patients are on PD, which is the second-largest number of PD patients in the world after the United States. Baxter introduced home delivery of PD solutions in Mexico in 1996.***




***Dialysis Patients Worldwide***
*(patients per million population)*

*The number of patients being treated for kidney disease varies dramatically by geography. Baxter's strategy is to increase access to dialysis worldwide.*

*Source: Baxter estimates and national registries.*

When Sandra Austhof's heart valve began to fail, this mother of two young sons and nutritionist at the Cleveland Clinic Foundation had three treatment options: replace it with a tissue valve, made from human or animal tissue; replace it with a mechanical valve, made from carbon, titanium or other substances; or repair it with an annuloplasty product. Austhof's surgeon opted to implant Baxter's Cosgrove Edwards® annuloplasty system, which is used to reshape and repair defective heart valves.

Baxter is a world leader in heart-valve therapy, providing every treatment option for patients undergoing heart-valve procedures, including replacement valves—tissue (bovine and porcine), mechanical and human—and repair rings, like the one that Austhof received.

Austhof had been hoping that her heart valve could be repaired, which would permit many of the quality-of-life benefits also associated with tissue valves. Had a mechanical valve been implanted, Austhof would have been required to take life-long blood-thinning medications, eliminating her ability to have more children.

"I felt shocked and frightened when I first learned about the seriousness of my condition," Austhof said. "Once the surgery was over, I was so relieved. I knew I made it and was going to survive."

Cardiovascular disease is among the top three diseases in terms of health-care spending worldwide. Baxter's CardioVascular business focuses on late-stage cardiovascular disease, the fastest-growing segment of this marketplace.

Nearly a quarter-million heart-valve procedures will be performed worldwide in 1998. Baxter estimates that over the next five years, its valves and valve-repair products will be used in half of such procedures performed in the United States.

Also contributing to growth in Baxter's CardioVascular business is the trend toward minimally invasive surgery. Baxter is developing products for both "beating" and "stopped" heart minimally invasive procedures, drawing from the company's well-established franchises in heart-valve therapy, cardiac access and support, perfusion technologies and services, and critical-care monitoring systems. The 1997 acquisition of Research Medical, Inc. adds a number of other products for both conventional and minimally invasive cardiac surgery to Baxter's portfolio.

"Our goal is to provide products to surgeons that enable them to use the therapeutic approach that best suits their patients' needs, whether this means using conventional or minimally invasive methods," says Mike Mussallem, group vice president, CardioVascular.

To broaden its heart-valve portfolio, in 1997 Baxter signed an agreement with the American Red Cross to market human-tissue valves that have been cryopreserved. Baxter also received European regulatory clearance to market its Edwards MIRA™ bileaflet mechanical heart valve, and plans to initiate U.S. clinical trials in 1998.

The company also continued its work with leading clinicians to fight cardiovascular disease. Baxter signed a multiyear agreement with the Lerner Research Institute of the Cleveland Clinic Foundation to jointly develop new products and processes to treat late-stage cardiovascular disease.

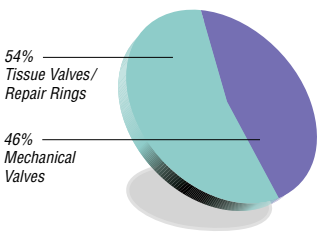


***Sandra Austhof, shown here with her husband Joel and their sons, Bradley and Jared, is one of a growing number of people who have opted to have their heart valves repaired rather than replaced. Austhof received Baxter's Cosgrove Edwards® annuloplasty system. Baxter is a world leader in both replacement heart valves and valve-repair products.***

Cardiovasc

***Dr. Delos M. Cosgrove, chairman of the department of thoracic and cardiovascular surgery at the Cleveland Clinic Foundation, performs minimally invasive surgery to repair a patient's defective heart valve. Baxter heart valves and valve-repair products are used in the majority of these procedures. The Cleveland Clinic is the world's largest cardiovascular center, providing care to more cardiovascular patients than any other hospital.***

***U.S. Heart-Valve Procedures, 1996***




*The U.S. market continues to shift to tissue products used in heart-valve replacement and repair.*

*Source: Baxter estimates.*

# ular Therapy

**Baxter and its employees play a vital role in producing life-saving products and services for patients around the world. The company also plays an important role in the communities in which it does business. From product donations and health-related grants, to environmental stewardship, volunteerism and support of women- and minority-owned businesses, Baxter is making a positive and far-reaching impact.**

### Worldwide Philanthropy

The Baxter Allegiance Foundation's grant-making initiatives extend across international borders, helping to improve access to health care on three continents. In 1997, the foundation provided millions of dollars in philanthropic gifts in the United States, Europe, Latin America and Mexico. Next year, the foundation will further expand its geographic reach to include Japan and Asia.

In 1997, the foundation continued to strengthen its community ties through several collaborative partnerships with local institutions and community groups, and by providing grants to 190 programs, including:

- *Care for the homeless, Düsseldorf, Germany.* Germany's high unemployment rate, coupled with the growing number of refugees from the war in Bosnia, have created a homeless population of nearly one million people, many critically in need of health care. The foundation's grant supports a mobile clinic that offers medical care to homeless people living in the streets of Düsseldorf. The German Medical Society has since registered the clinic as an official medical facility, qualifying it for government funding and eliminating the need for future foundation grants.

- *Community health, Los Angeles, California.* South Central Los Angeles (L.A.) has the highest concentration of medically uninsured people in the United States, nearly one-third of whom are under age 15. Additionally, it has the highest incidence of poverty in L.A. County. A foundation grant is enabling the Charles R. Drew University of Medicine and Science to reopen public health clinics in the area that had been closed due to county fiscal constraints, and to extend its ambulatory care training program to prepare the next generation of health professionals to work in medically underserved and indigent communities.

***Medizinische Hilfe für Wohnungslose Düsseldorf, a mobile clinic providing care to the homeless, was one of numerous organizations that received grants from The Baxter Allegiance Foundation.***

### Providing a Lifeline During Crises

Through the international relief organization, AmeriCares, last year Baxter and Allegiance Corporation donated nearly $5 million in medical supplies to people around the world coping with inadequate medical care and supplies, natural disasters and the effects of war. Since 1987, Baxter and Allegiance together have donated nearly $100 million in medical supplies through AmeriCares.

### Making a Difference in Our Communities

Reflecting Baxter's commitment to community service, Baxter employees across the globe were active in a variety of volunteer activities. They helped renovate homes for the elderly, staffed homeless shelters and raised funds for medical research. In Northern Illinois, hundreds of Baxter employees participated in the Y-ME campaign against breast cancer. Baxter employees from Europe and the United States volunteered as camp counselors at the Barretstown Gang Camp in County Kildare, Ireland, where seriously ill children learn and play together in a nurturing environment.

To support education, Baxter sponsored four teams in the FIRST national robot tournament. FIRST (For Inspiration and Recognition of Science and Technology) is a non-profit organization that establishes business, community and student partnerships dedicated to inspiring and encouraging youth to learn about science and technology through participative and competitive activities.

***Many Baxter employees volunteer their time to worthy causes in their local communities. Ricky Bartlett, a sterilizer operator at Baxter's manufacturing plant in Marion, North Carolina, is a volunteer for the McDowell County Rescue Squad.***

Many of Baxter's employee volunteer efforts led to additional support through the company's Dollars

for Doers program. Funded by The Baxter Allegiance Foundation, the program provides grants to organizations in the United States where employees volunteer. The foundation also matches employee donations to qualifying health and educational organizations.

**Focusing on Safety and the Environment**

Baxter has set aggressive health, safety and environmental goals in an effort to provide a safe workplace for its employees, and to respect the environment in the communities in which it operates.

In health and safety, Baxter continues to make strides. The company's Renal business received the U.S. Occupational Safety and Health Administration's highest honor in the agency's Voluntary Protection Program for its outstanding management of health and safety. Additionally, more than half of Baxter's facilities worldwide reported no lost workdays due to work-related injuries or illness in 1997.

Baxter's efforts to cut air toxic emissions, reduce energy consumption, improve packaging and reduce the amount of waste going to landfills are paying off. Over the last three years, Baxter's environmental initiatives have yielded more than $100 million in savings and cost-avoidance. Other environmental milestones for the company include:

- *Achieving 100 percent compliance with the company's state-of-art environmental management standards by all company facilities worldwide.*
- *Reducing air toxic and chlorofluorocarbon emissions by 94 percent between 1988 and 1996.*
- *Recycling 58 million pounds of materials, including more than two million pounds of paper, in 1996.*
- *Cutting hazardous and other regulated waste disposal 1.2 million pounds worldwide between 1989 and 1996.*
- *Reducing product packaging by 39 million pounds between 1990 and 1996.*

Baxter subscribes to a number of voluntary environmental, health and safety initiatives worldwide. These currently include the U.S. Environmental Protection Agency's *WasteWi$e* waste-reduction program and the International Chamber of Commerce's Business Charter for Sustainable Development. The company also is a member of the Coalition for Environmentally Responsible Economies (CERES), the Health Resources Conservation Coalition and numerous other organizations.

***Baxter employees have reduced waste, cut air emissions and implemented many other environmental initiatives in company facilities around the world. Baxter received more than 20 awards in 1997 for its environmental efforts.***

**Valuing Employees**

Shared Values—Respect, Responsiveness and Results—are the principles by which Baxter employees conduct themselves on a daily basis. They define our responsibilities to customers, shareholders, suppliers, the community and each other.

The company's efforts to provide a supportive environment for its employees was recognized by *BusinessWeek* magazine when it named Baxter as one of the top 30 family-friendly companies in the United States. *BusinessWeek* cited a corporate culture that strongly supports a balance between the demands of work and family life. During the year, Baxter published a seminal study on work-and-life conflicts that has become an industrywide guide for work-and-life issues. Additionally, for the second consecutive year, Baxter was named to *HISPANIC* magazine's Hispanic Corporate 75.

Baxter is committed to helping its employees develop to their full potential, regardless of cultural background, gender or position. In 1997, the company continued to invest in programs that recognize employee contributions and acknowledge the diversity of their needs. Forty-four percent of Baxter's management and professional positions in the United States are held by women, and nearly 18 percent by minorities. Women and minorities make up 36 percent of the company's board of directors.

The annual reports of The Baxter Allegiance Foundation and Corporate Environmental, Health and Safety are available by writing either group at:

**Baxter International Inc.**
**One Baxter Parkway**
**Deerfield, Illinois 60015-4633**

## FINANCIAL INFORMATION

This discussion and analysis presents the factors that had a material effect on Baxter International Inc.'s (Baxter, or, together with its consolidated subsidiaries, the company) cash flows and results of operations during the three years ended December 31, 1997, and the company's financial position at that date. This discussion and analysis should be read in conjunction with the Consolidated Financial Statements of the company and related notes.

## KEY FINANCIAL OBJECTIVES AND RESULTS

| 1997 OBJECTIVES | RESULTS |
|---|---|
| • Generate $300 million in operational cash flow, before litigation payments. | • The company generated $432 million of operational cash flow in 1997, before litigation payments. |
| • Increase net sales approximately 10% before the impact of 1997 acquisitions and 20% including 1997 acquisitions. | • Net sales increased 3% before the impact of acquisitions and increased 13% including acquisitions. Excluding the effect of a stronger U.S. dollar, net sales increased 6% before acquisitions and 16% including acquisitions. |
| • Achieve growth in income from continuing operations in the low double digits. | • Income from continuing operations increased 13%, excluding the in-process research and development charge relating to the acquisitions discussed below. |



## COMPANY AND INDUSTRY OVERVIEW

Baxter is a global developer, manufacturer and marketer of products and technologies related to the blood and circulatory system. The company has market-leading positions in four businesses within this segment of the medical products and services industry: *Blood Therapies*, which develops biopharmaceutical and blood-collection and separation products and technologies; *I.V. Systems/Medical Products*, which develops technologies and systems to improve intravenous medication delivery, and distributes medical products; *Renal*, which develops products and services to treat kidney disease; and *CardioVascular*, which develops products and provides services to treat late-stage heart disease and vascular disorders.

The company generates more than 50% of its revenues outside the United States. While health-care cost containment continues to be a focus around the world, demand for health-care products and services continues to be strong worldwide, particularly in developing markets such as Latin America and Asia. The company's strategies emphasize global expansion and technological innovation to advance medical care worldwide.

The health-care marketplace continues to be competitive. There has been consolidation in the company's customer base and by its competitors, which has resulted in pricing and market-share pressures. These industry trends are expected to continue. The company will continue to manage these issues by capitalizing on its market-leading positions, developing new products and services, leveraging its cost structure and making acquisitions.

The company has experienced increases in its labor and material costs, which are partly influenced by general inflationary trends. Competitive market conditions have minimized the impact of inflation on the selling prices of the company's products and services. Management expects these trends to continue.

## RESULTS OF CONTINUING OPERATIONS

### NET SALES TRENDS

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 | Percent increase **1997** | 1996 |
|---|---|---|---|---|---|
| Global businesses: | | | | | |
| Blood Therapies | **$1,765** | $1,284 | $1,131 | **37%** | 14% |
| I.V. Systems/Medical Products | **2,110** | 1,956 | 1,893 | **8%** | 3% |
| Renal | **1,384** | 1,343 | 1.294 | **3%** | 4% |
| CardioVascular | **879** | 855 | 730 | **3%** | 17% |
| **Total net sales** | **$6,138** | $5,438 | $5,048 | **13%** | 8% |

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 | Percent increase **1997** | 1996 |
|---|---|---|---|---|---|
| United States | **$2,887** | $2,665 | $2,492 | **8%** | 7% |
| International | **3,251** | 2,773 | 2,556 | **17%** | 9% |
| **Total net sales** | **$6,138** | $5,438 | $5,048 | **13%** | 8% |



The U.S. dollar has strengthened relative to other currencies over the last two years. As a result, the company's sales denominated in foreign currencies are lower when translated into U.S. dollars. Excluding the effect of a stronger U.S. dollar, international sales growth would have been 24% and 13% in 1997 and 1996, respectively.

**Blood Therapies**

Strong demand for the company's therapeutic proteins, especially Recombinate™ Anti-hemophilic factor (Recombinant), generated worldwide growth in the Blood Therapies businesses in 1997 and 1996, particularly outside the United States. This trend is expected to continue as the company increases its manufacturing capacity for genetically engineered proteins to meet the strong demand for these blood therapies. The acquisition of Immuno International AG (Immuno), a global manufacturer of biopharmaceutical products, was a strong contributor to sales growth in 1997. The Immuno acquisition strengthens the businesses' presence in Europe and enhances the company's position in several emerging markets. Sales of Gammagard® S/D immunoglobulin intravenous, a viral-inactivated plasma derivative that boosts immune systems, strongly contributed to the 1996 sales growth of the Blood Therapies businesses. Sales levels in 1997 in the automated and manual blood-collection businesses decreased slightly from those in the prior year primarily due to pricing pressures and supply issues, partially offset by continued penetration of basic blood-collection products into developing markets. Sales in the automated and manual blood-collection businesses increased modestly from 1995 to 1996, as penetration into developing markets more than offset pricing pressures in the businesses.

**I.V. Systems/Medical Products**

Contributing to 1997 sales growth were increased sales due to the acquisition of the Clintec parenteral-nutrition business (Clintec) after the dissolution of the company's joint venture with Nestlé S.A. Excluding the effect of the acquisition of Clintec, worldwide sales of intravenous and other medical products increased moderately in both 1997 and 1996. Sales in the United States and Western Europe were unfavorably affected by competitive pricing pressures and cost pressures from health-care providers. Offsetting these factors were increased penetration and new product introductions in Latin America, increased sales as a result of a multiyear agreement entered into in late 1996 with Premier, a major U.S. group of customers, and the 1997 introduction of the Colleague™ volumetric infusion pump in the United States. Also, as discussed in Note 4 to the Consolidated Financial Statements, in early 1998, the company acquired Bieffe Medital S.p.A. (Bieffe), a European manufacturer of dialysis and intravenous solutions and containers, and entered into a definitive agreement to aquire the Pharmaceutical Products Division of the Ohmeda business from the BOC Group (Ohmeda), a manufacturer of gases and drugs used for general and local anesthesia. These factors are expected to contribute to the trend of moderate and stable growth in this business.

**Renal**

Worldwide sales of renal products and services continued to grow in 1997 and 1996. Strong pricing pressures in the United States and Europe along with continued market consolidation in the United States affected sales growth in these two regions. These factors were more than offset by increased penetration into developing markets, especially in Latin America. Another strong contributor to 1997 sales growth was revenue from the Renal Therapy Services (RTS) unit, which operates dialysis clinics outside the United States, frequently partnering with physicians and hospitals. Also contributing to sales growth in 1997 was the new Renal Management Strategies (RMS) unit, which is a renal disease-management organization dedicated to creating partnerships with nephrologists to lead renal-care networks throughout the United States. Continued growth in the RTS and RMS units and the early 1998 acquisition of Bieffe discussed above, are expected to enhance the sales growth trend of the Renal business. More than 70% of the sales of the Renal business are generated outside the United States. Therefore, the strengthening of the U.S. dollar over the last two years has significantly affected the U.S. dollar sales growth in this business.

**CardioVascular**

Sales growth in 1997 and 1996 was led by strong growth in the tissue heart valve and valve-repair product lines. The 1997 acquisition of Research Medical, Inc. (RMI), a manufacturer of specialized cannulae and cardioplegia products, also contributed to the sales growth. The acquisition of several perfusion-services businesses and strong sales of monitoring catheters were contributors to 1996 sales growth. The acquisitions of RMI and perfusion-services businesses are part of the company's strategy to offer a comprehensive approach for surgeons treating patients with late-stage cardiovascular disease, including products used in minimally invasive cardiac surgery. While pricing pressures continue to impact several product lines, sales are expected to continue to grow in 1998, with strong performances expected in the heart valve, valve repair and minimally invasive product lines.

## GROSS MARGIN AND EXPENSE RATIOS



| *years ended December 31 (as a percent of sales)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Gross margin | **45.6%** | 44.7% | 45.0% |
| Marketing and administrative expenses | **22.1%** | 21.0% | 21.5% |

The gross margin increased in 1997 primarily as a result of acquisitions and a more favorable product mix, particularly with respect to the Renal and I.V. Systems/Medical Products businesses. The decrease in the gross margin rate in 1996 reflects increased sales in the lower-margin cardiovascular-services business as a result of the 1996 perfusion-services business acquisitions, coupled with a slight change in the mix of product sales. The company expects its gross margin rate to be approximately 45% in 1998.

Marketing and administrative expenses increased as a percent of sales in 1997 primarily due to the acquisition of Immuno, and expansion into developing markets and new business initiatives, partially offset by a continued focus on cost control in all business units. The ratio decreased in 1996 primarily as a result of increased sales in the cardiovascular-services business, which has a lower cost structure, coupled with a continued focus on cost control in all business units. The company expects that its expense ratio will decrease in 1998 as the company continues to focus on cost control and realizes the benefits of integrating Immuno and other recent acquisitions.

The gross margin and expense ratios were affected in 1997 by favorable experience and related assumptions with respect to certain employee retirement plans.

## RESEARCH AND DEVELOPMENT

| | | | | Percent increase | |
|---|---|---|---|---|---|
| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 | **1997** | 1996 |
| Research and development expenses | **$392** | $340 | $327 | **15%** | 4% |
| as a percent of sales | **6%** | 6% | 6% | | |

Research and development (R&D) expenses above exclude in-process R&D charges of $220 million and $132 million relating to the 1997 acquisitions of Immuno and RMI, respectively, which are discussed in Note 3 to the Consolidated Financial Statements. The 1995 expense excludes the $18 million in-process R&D charge related to the acquisition of the remaining 30% of Nextran. R&D expenses are focused on initiatives such as hemoglobin therapeutics, xenotransplantation, medication-delivery systems and the Novacor® left-ventricular assist system. The company is conducting several clinical trials of its hemoglobin therapeutic, HemAssist™ (Hemoglobin Crosfumaril), or "blood substitute," in the United States and Europe. The company currently anticipates launching the product by late 1999 or early 2000.

**RESTRUCTURING PROGRAMS**

Baxter has two restructuring programs in process. See Note 5 to the Consolidated Financial Statements for a discussion of the charges, utilization of the reserves and position reductions to date. Management believes remaining restructuring reserves are adequate to complete the actions contemplated by the programs.

With respect to the 1993 program, the company realized approximately $129 million, $116 million and $90 million in pretax savings in 1997, 1996 and 1995, respectively, which were consistent with originally forecasted savings. Anticipated future savings of approximately $130 million annually are also in line with original targets. Management anticipates restructuring savings will continue to be partially invested in R&D and expansion into growing international markets.

The company is in the process of implementing the 1995 program. Management expects that the plant closures and consolidations in Puerto Rico will be substantially completed in 1999, and will lower manufacturing costs and help mitigate future exposure to gross margin erosion arising from pricing pressures, primarily in the United States.

Future cash expenditures related to both the 1993 and 1995 programs will be funded with cash generated from operations.



**LITIGATION AND OTHER INCOME AND EXPENSE**

Included in the 1995 results are net litigation charges in the amount of $96 million relating to the company's plasma-based therapies and mammary-implant product liabilities.

Net interest expense increased in 1997 primarily due to increased debt related to the acquisition of Immuno. Net interest expense is not expected to change significantly in 1998.

Goodwill amortization increased in 1997 primarily due to the acquisitions of Immuno and Clintec, and increased in 1996 primarily due to the acquisition of Clintec. Goodwill amortization is anticipated to increase in 1998 primarily due to the acquisition of Bieffe. The early 1998 acquisition of Bieffe and the pending acquisition of Ohmeda are expected to be nondilutive to earnings in 1998 and accretive in 1999.

Included in the 1997 results is a pretax gain of $32 million relating to the company's divestiture of certain assets of its Immunotherapy division. Refer to Note 3 to the Consolidated Financial Statements for further information. Also included in other income in 1997 and 1995 are pretax gains relating to the disposal of certain non-strategic investments totaling $17 million and $62 million, respectively.

**PRETAX INCOME FROM CONTINUING OPERATIONS**

| | | | | Percent increase (decrease) | |
|---|---|---|---|---|---|
| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 | **1997** | 1996 |
| Pretax income from continuing operations | **$523** | $793 | $524 | **(34%)** | 51% |

Excluding the in-process R&D charges and divestiture gains, the 1997 growth in pretax income from continuing operations would have been 4%. Excluding the restructuring, litigation and Nextran in-process R&D charges and the divestiture gain, all recorded in 1995, the 1996 growth in pretax income from continuing operations would have been 17%.

The effective income tax rate for continuing operations, excluding the in-process R&D charges, was approximately 25%, 27% and 30% in 1997, 1996 and 1995, respectively. The rate has declined primarily due to a larger portion of the company's earnings generated in lower tax jurisdictions. Management does not expect a significant change in the effective tax rate in 1998.

Income from discontinued operations in 1996 and 1995 related to the company's former health-care cost management and distribution businesses. In September 1996, Baxter stockholders received all of the outstanding stock of Allegiance Corporation (Allegiance), its health-care cost management and distribution businesses, in a tax-free spin-off. Income from discontinued operations decreased significantly from 1995 to 1996 due primarily to the net gain in 1995 resulting from the company's divestiture of its Industrial and Life Sciences business and to lower income in 1996 resulting from the spin-off of Allegiance at the end of the third fiscal quarter.

Excluding the in-process R&D charges and divestiture gains recorded in 1997, diluted earnings per share from continuing operations (EPS) in 1997 would have been $2.21, and the 1997 growth in diluted EPS would have been 7%. Excluding the 1995 restructuring, litigation and Nextran in-process R&D charges, and the divestiture gain, diluted EPS would have been $1.61 for the year ended December 31, 1995, and the 1996 growth in diluted EPS would have been 29%.

## FINANCIAL INSTRUMENT MARKET RISK

The company's business and financial results are affected by fluctuations in world financial markets, including currency exchange rates and interest rates. The company's hedging policy attempts to manage these risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity and costs. In hedging its currency and interest rate risks, the company utilizes primarily forward contracts, purchased options and swaps. Refer to Note 7 to the Consolidated Financial Statements for further information regarding these instruments. The company does not hold financial instruments for trading or speculative purposes.



### CURRENCY RISK

The company is primarily exposed to currency exchange-rate risk with respect to its transactions and net assets denominated in Japanese Yen, Belgian Francs, U.K. Pound Sterling, French Francs, German Marks, Austrian Schillings and Italian Lira. Business activities in various currencies expose the company to the risk that the eventual net dollar cash inflows resulting from transactions with foreign customers and suppliers denominated in foreign currencies may be adversely affected by changes in currency exchange rates. The company manages these risks utilizing various types of foreign exchange contracts. The company also enters into foreign exchange contracts to hedge anticipated, but not yet committed sales expected to be denominated in foreign currencies. In addition, the company hedges certain of its net investments in international affiliates.

As part of its risk-management process, the company uses a value-at-risk model to measure the potential loss related to its foreign currency financial instruments. The value-at-risk calculation approximates a potential loss amount from adverse movements in currency exchange rates. The company utilizes a Monte Carlo simulation, with a 95% confidence level, using implied volatilities and correlations (as of the measurement date) to estimate this potential loss. The company's calculated value-at-risk as of fiscal year-end 1997, assuming a one-year holding period, is $15 million; this amount excludes the potential effect of any changes in the value of the underlying transactions or balances. Actual future gains or losses may differ from this estimate based upon actual fluctuations in market rates, operating exposures and the timing thereof, and changes in the company's portfolio of derivatives during the measured period. In addition, the assumption within the value-at-risk model is that changes in currency exchange rates are adverse, which may not be the case. Any loss incurred on the financial instruments is expected to be offset by the effects of currency movements on the respective underlying hedged transactions and balances. However, since the company's risk-management program does not require the hedging of all exposures, there may be currency exchange-rate gains or losses in the future.

### INTEREST RATE RISK

As part of its risk-management program, the company performs sensitivity analyses to assess potential gains and losses in earnings and changes in fair value relating to hypothetical movements in interest rates. A 75 basis-point increase in interest rates (approximately 10% of the company's weighted average interest rate) affecting the company's financial instruments, including debt obligations and related derivatives, and investments, would have an immaterial effect on the company's 1998 pretax earnings and on the fair value of the company's fixed-rate financial instruments.

As discussed in Note 7 to the Consolidated Financial Statements, the fair values of the company's long-term litigation liabilities and related insurance receivables were computed by discounting the expected cash flows based on currently available information. A 10% movement in the assumed discount rate would have an immaterial effect on the fair values of those assets and liabilities.

### OTHER RISKS

With respect to the company's investments in affiliates accounted for on the cost basis, management believes any reasonably possible near-term losses in earnings, cash flows and fair values would not be material.

## LIQUIDITY AND CAPITAL RESOURCES

Management assesses the company's liquidity in terms of its overall ability to mobilize cash to support ongoing business levels and to fund its growth. Management uses an internal performance measure called operational cash flow that evaluates each operating business and geographic region on all aspects of cash flow under its direct control. The company exceeded its annual operational cash flow goals for the last three years.



Operational cash flow, as defined, reflects all litigation payments and related insurance recoveries except for those payments and recoveries relating to mammary implants, which the company never manufactured nor sold. If all the company's litigation payments, net of insurance recoveries, were excluded from operational cash flow (including those relating to plasma-based therapies), the amount generated from continuing operations would be $432 million, $587 million and $337 million in 1997, 1996 and 1995, respectively. The company expects to generate more than $500 million in operational cash flow in 1998.

Certain amounts on the Consolidated Balance Sheet have increased due to the acquisitions discussed above. In addition, the increases in accounts receivable reflect increased sales outside the United States, which have longer collection periods.

The following table reconciles cash flow provided by continuing operations, as determined by generally accepted accounting principles, to operational cash flow:

| *Brackets denote cash outflows*<br>*years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Cash flow provided by continuing operations | **$616** | $700 | $573 |
| Capital expenditures | **(496)** | (398) | (399) |
| Net interest after tax | **97** | 62 | 56 |
| Other | **57** | 126 | 86 |
| Operational cash flow — continuing operations | **274** | 490 | 316 |
| Operational cash flow — discontinued operations | **–** | 192 | 271 |
| **Total operational cash flow** | **$274** | $682 | $587 |

Cash flow provided by discontinued operations decreased from 1995 to 1996 primarily due to the spin-off of Allegiance, which occurred in September 1996, and the proceeds received in 1995 relating to the divestiture of the Industrial and Life Sciences business.

Capital expenditures are made at a sufficient level to support the strategic and operating needs of the businesses. Significant expenditures have included continuing construction of a manufacturing facility in Switzerland for HemAssist™ (Hemoglobin Crosfumaril), the company's hemoglobin therapeutic, construction of a new European distribution center in Belgium, and construction and continuing expansion of facilities in California for the production of genetically engineered proteins. Management expects to invest between $500 million and $600 million in capital expenditures in 1998.

Approximately $498 million and $48 million of the net cash flows used for acquisitions and investments in affiliates in 1997 related to the acquisition of Immuno and the early 1998 acquisition of Bieffe, respectively. The increase in net cash flows used for acquisitions and investments in affiliates in 1996 related primarily to purchases of cardiovascular-services businesses, the largest of which was PSICOR, Inc. Also included was the previously discussed acquisition of Clintec. See Notes 3 and 4 to the Consolidated Financial Statements for additional information.

The company's net-debt-to-capital ratio was 46.9% and 33.8% at December 31, 1997 and 1996, respectively. The increase in the ratio primarily was due to increased net debt relating to the acquisition of Immuno and the impact on total capital of the in-process R&D charges discussed above. Management expects the ratio to decline to the low-40% range over time as a result of ongoing operations. Refer to Note 6 to the Consolidated Financial Statements for a discussion of the company's credit facilities and long-term debt and lease obligations. Refer to Note 2 to the Consolidated Financial Statements regarding Allegiance's indirect assumption of company debt in 1996.

As authorized by the board of directors, the company repurchases its stock to optimize its capital structure depending upon its operational cash flows, net debt level and current market conditions. In November 1995, the board of directors authorized the repurchase of up to $500 million over a period of several years, of which $267 million was repurchased as of December 31, 1996. The company repurchased $500 million of its stock in 1995 under a prior board of directors' authorization. As discussed above, the company's net-debt-to-capital ratio is currently 46.9% and, therefore, management does not presently intend to repurchase shares.



Effective as of December 31, 1997, the company could issue up to $550 million in aggregate principal amount of additional senior unsecured debt securities under effective registration statements filed with the Securities and Exchange Commission. The company's debt ratings on senior debt are A3 by Moody's, A by Standard & Poor's and A- by Duff & Phelps.

The company intends to fund its short-term and long-term obligations as they mature by issuing additional debt or through cash flow from operations. The company believes it has lines of credit adequate to support ongoing operational requirements. Beyond that, the company believes it has sufficient financial flexibility to attract long-term capital on acceptable terms as may be needed to support its growth objectives.

In February 1998, the board of directors declared a quarterly dividend on the company's common stock of 29.10 cents per share (annualized rate of $1.164 per share). The company intends to continue lowering its dividend payout ratio in order to optimize its capital structure.

See Note 13 to the Consolidated Financial Statements for a discussion of the company's legal contingencies and related insurance coverage with respect to cases and claims relating to the company's plasma-based therapies and mammary implants, as well as other matters. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established reserves. While such a future charge could have a material adverse effect on the company's net income or cash flows in the period in which it is recorded or paid, based on the advice of counsel, management believes that any outcome of these actions, individually or in the aggregate, will not have a material adverse effect on the company's consolidated financial position.

Based on the company's assessment of the costs associated with its environmental responsibilities, including recurring administrative costs, capital expenditures and other compliance costs, such costs have not had, and in management's opinion, will not have in the foreseeable future, a material effect on the company's financial position, results of operations, cash flows or competitive position.

The company is in the process of implementing appropriate courses of action to ensure its computer systems, selected products and other processes will be "year 2000" compliant. The costs of new software will be capitalized and amortized over the software's estimated useful life and software modification costs will be expensed as incurred. The amounts expensed to date have been immaterial and the company does not expect the amounts required to be expensed in the future to have a material effect on its financial position or results of operations. A significant portion of the anticipated modification effort will be accomplished by a redeployment of existing internal information technology resources. Management presently believes that, with planned modifications to existing software and conversions to new software, year 2000 compliance will not pose significant operational problems. However, if such modifications and conversions are not completed on a timely basis, or if the company's trading partners have significant unresolved systems problems, there is a risk that year 2000 compliance could have a material impact on the operations of the company.

The matters discussed in this section include forward-looking statements that involve risks and uncertainties, including, but not limited to, currency exchange rates, technological advances in the medical field, economic conditions, product demand and industry acceptance of the company's new products, competitive products and pricing, manufacturing efficiencies, new product development, ability to enforce patents, availability of raw materials and manufacturing capacity, new plant start-ups, the U.S. and global regulatory, trade and tax environment, year 2000 compliance, and other risks more completely reflected in the company's filings with the Securities and Exchange Commission.



## ADOPTION OF NEW ACCOUNTING STANDARDS

In June 1997, the FASB issued Statement No. 130, "Reporting Comprehensive Income," which is effective for fiscal years beginning after December 15, 1997, and requires reclassification of prior-period financial statements. Statement No. 130 requires the presentation of comprehensive income, which consists of net income and other comprehensive income, and its components in a full set of financial statements. The company's other comprehensive income will consist of foreign currency translation adjustments, which totaled $(202) million, $(44) million and $29 million in 1997, 1996 and 1995, respectively, and which currently are reported as a component of stockholders' equity. Additional items may be included in other comprehensive income in the future. The company plans to display comprehensive income and its components in the Consolidated Statement of Stockholders' Equity beginning in 1998.

In June 1997, the FASB issued Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information," which is effective for fiscal years beginning after December 15, 1997, and requires reclassification of prior-period financial statements. Statement No. 131 establishes standards for reporting information about operating segments and related disclosures about products and services, geographic areas and major customers in annual financial statements and interim financial reports. Management currently is evaluating its reportable segments under the new Statement and anticipates disclosures for more than one segment under the new rules.

The accompanying financial statements and other financial data have been prepared by management, which is responsible for their integrity and objectivity. The statements have been prepared in conformity with generally accepted accounting principles and include some amounts that are based upon management's best estimates and judgments.

Management is responsible for establishing and maintaining a system of internal control over financial reporting and safeguarding of assets against unauthorized acquisition, use or disposition that is designed to provide reasonable assurance as to the integrity and reliability of financial reporting and asset safeguarding. The concept of reasonable assurance is based on the recognition that there are inherent limitations in all systems of internal control, and that the cost of such systems should not exceed the benefits to be derived from them.

Management believes that the foundation of an appropriate system of internal control is a strong ethical company culture and climate. The Corporate Responsibility Office, which reports to the Public Policy Committee of the board of directors, is responsible for developing and communicating appropriate business practice, policies and initiatives; maintaining independent channels of communication for providing guidance and reporting potential business practice violations; and monitoring compliance with the company's business practices, including annual compliance certifications by senior managers worldwide. Additionally, a professional staff of corporate auditors reviews the design of the related internal control system and the accounting policies and procedures supporting this system and compliance with them. The results of these reviews are reported at least annually to the Public Policy and/or Audit Committees.



Price Waterhouse LLP performs audits, in accordance with generally accepted auditing standards, which include a review of the system of internal controls and result in assurance that the financial statements are, in all material respects, fairly presented.

The board of directors, through its Audit Committee comprised solely of non-employee directors, is responsible for overseeing the integrity and reliability of the company's accounting and financial reporting practices and the effectiveness of its system of internal controls. The independent certified public accountants and corporate auditors meet regularly with, and have access to, this committee, with and without management present, to discuss the results of the audit work.

*Vernon R. Loucks Jr.*
Chairman of the Board and
Chief Executive Officer

*Harry M. Jansen Kraemer Jr.*
President

*Brian P. Anderson*
Senior Vice President and
Chief Financial Officer

**BOARD OF DIRECTORS AND STOCKHOLDERS**
**BAXTER INTERNATIONAL INC.**

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and stockholders' equity present fairly, in all material respects, the financial position of Baxter International Inc. (the company) and its subsidiaries at December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.



Price Waterhouse LLP

Price Waterhouse LLP
Chicago, Illinois
February 5, 1998

| *as of December 31 (in millions, except shares)* | | **1997** | 1996 |
|---|---|---|---|
| **CURRENT ASSETS** | Cash and equivalents | **$ 465** | $ 761 |
| | Accounts receivable | **1,372** | 1,219 |
| | Notes and other current receivables | **367** | 266 |
| | Inventories | **1,208** | 883 |
| | Short-term deferred income taxes | **253** | 212 |
| | Prepaid expenses | **205** | 139 |
| | **Total current assets** | **3,870** | 3,480 |
| **PROPERTY, PLANT AND EQUIPMENT, NET** | | **2,360** | 1,843 |
| **OTHER ASSETS** | Goodwill and other intangibles | **1,622** | 1,386 |
| | Insurance receivables | **409** | 641 |
| | Other | **446** | 246 |
| | **Total other assets** | **2,477** | 2,273 |
| | **Total assets** | **$8,707** | $7,596 |
| **CURRENT LIABILITIES** | Notes payable to banks | **$ 102** | $ 121 |
| | Current maturities of long-term debt and lease obligations | **42** | 225 |
| | Accounts payable and accrued liabilities | **1,963** | 1,704 |
| | Income taxes payable | **450** | 395 |
| | **Total current liabilities** | **2,557** | 2,445 |
| **LONG-TERM DEBT AND LEASE OBLIGATIONS** | | **2,635** | 1,695 |
| **LONG-TERM DEFERRED INCOME TAXES** | | **316** | 255 |
| **LONG-TERM LITIGATION LIABILITIES** | | **210** | 365 |
| **OTHER LONG-TERM LIABILITIES** | | **370** | 332 |
| **STOCKHOLDERS' EQUITY** | Common stock, $1 par value, authorized 350,000,000 shares, issued 287,701,247 shares in 1997 and 1996 | **288** | 288 |
| | Additional contributed capital | **1,876** | 1,825 |
| | Retained earnings | **1,006** | 1,022 |
| | Common stock in treasury, at cost, 7,662,187 shares in 1997 and 15,261,100 shares in 1996 | **(329)** | (611) |
| | Cumulative foreign currency adjustment | **(222)** | (20) |
| | **Total stockholders' equity** | **2,619** | 2,504 |
| | **Total liabilities and stockholders' equity** | **$8,707** | $7,596 |

*The accompanying notes are an integral part of these consolidated financial statements.*

| *years ended December 31 (in millions, except per share data)* | | **1997** | 1996 | 1995 |
|---|---|---|---|---|
| **OPERATIONS** | **Net sales** | **$6,138** | $5,438 | $5,048 |
| | Costs and expenses | | | |
| | Cost of goods sold | **3,340** | 3,009 | 2,777 |
| | Marketing and administrative expenses | **1,356** | 1,142 | 1,084 |
| | Research and development expenses | **392** | 340 | 327 |
| | Acquired research and development | **352** | – | 18 |
| | Special charges for litigation and restructuring | **–** | – | 199 |
| | Interest, net | **163** | 103 | 96 |
| | Goodwill amortization | **45** | 36 | 28 |
| | Other (income) expense | **(33)** | 15 | (5) |
| | **Total costs and expenses** | **5,615** | 4,645 | 4,524 |
| | Income from continuing operations before income taxes | **523** | 793 | 524 |
| | Income tax expense | **223** | 218 | 153 |
| | **Income from continuing operations** | **300** | 575 | 371 |
| | Discontinued operations | **–** | 94 | 278 |
| | **Net income** | **$ 300** | $ 669 | $ 649 |
| **PER SHARE DATA** | **Basic earnings per common share** | | | |
| | Continuing operations | **$ 1.08** | $ 2.11 | $ 1.34 |
| | Net income | **$ 1.08** | $ 2.46 | $ 2.35 |
| | **Diluted earnings per common share** | | | |
| | Continuing operations | **$ 1.06** | $ 2.07 | $ 1.32 |
| | Net income | **$ 1.06** | $ 2.41 | $ 2.31 |

*The accompanying notes are an integral part of these consolidated financial statements.*

| *years ended December 31 (in millions) (brackets denote cash outflows)* | | **1997** | 1996 | 1995 |
|---|---|---|---|---|
| **CASH FLOWS FROM CONTINUING OPERATIONS** | Income from continuing operations | **$300** | $575 | $371 |
| | Adjustments | | | |
| | Depreciation and amortization | **398** | 348 | 336 |
| | Deferred income taxes | **(1)** | 74 | (17) |
| | Gain on asset dispositions | **(48)** | (9) | (65) |
| | Acquired research and development | **352** | – | 18 |
| | Restructuring and litigation charges | **–** | – | 199 |
| | Other | **9** | 17 | 20 |
| | Changes in balance sheet items | | | |
| | Accounts receivable | **(56)** | (258) | (121) |
| | Inventories | **(102)** | 59 | (90) |
| | Accounts payable and accrued liabilities | **103** | 79 | 104 |
| | Income taxes payable | **3** | 6 | (19) |
| | Net litigation payments | **(215)** | (219) | (87) |
| | Restructuring program payments | **(19)** | (37) | (40) |
| | Other | **(108)** | 65 | (36) |
| | **Cash flows from continuing operations** | **616** | 700 | 573 |
| **CASH FLOWS FROM DISCONTINUED OPERATIONS** | | **–** | 93 | 763 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | Capital expenditures | **(403)** | (318) | (309) |
| | Additions to the pool of equipment leased or rented to customers | **(93)** | (80) | (90) |
| | Acquisitions (net of cash received) and investments in affiliates | **(622)** | (294) | (44) |
| | Proceeds from assets dispositions | **(23)** | (15) | 91 |
| | **Cash flows from investing activities** | **(1,141)** | (707) | (352) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | Issuances of debt and lease obligations | **855** | 1,855 | 1,296 |
| | Redemption of debt and lease obligations | **(465)** | (1,674) | (891) |
| | Increase (decrease) in debt with maturities of three months or less, net | **81** | 429 | (698) |
| | Common stock cash dividends | **(316)** | (320) | (306) |
| | Stock issued under employee benefit plans | **110** | 193 | 103 |
| | Purchase of treasury stock | **–** | (267) | (500) |
| | **Cash flows from financing activities** | **265** | 216 | (996) |
| **EFFECT OF FOREIGN EXCHANGE RATE CHANGES ON CASH AND EQUIVALENTS** | | **(36)** | (17) | 20 |
| **(DECREASE) INCREASE IN CASH AND EQUIVALENTS** | | **(296)** | 285 | 8 |
| **CASH AND EQUIVALENTS AT BEGINNING OF YEAR** | | **761** | 476 | 468 |
| **CASH AND EQUIVALENTS AT END OF YEAR** | | **$465** | $761 | $476 |
| **Supplemental information:** | | | | |
| Interest paid, net of portion capitalized | | **$155** | $215 | $176 |
| Income taxes paid | | **$174** | $114 | $182 |

*The accompanying notes are an integral part of these consolidated financial statements.*

| *years ended December 31 (in millions)* | | **1997** | 1996 | 1995 |
|---|---|---|---|---|
| **COMMON STOCK** | Balance, beginning and end of year | **$ 288** | $ 288 | $ 288 |
| **ADDITIONAL CONTRIBUTED CAPITAL** | Balance, beginning of year | **1,825** | 1,837 | 1,810 |
| | Stock issued under employee-benefit plans | **6** | (12) | 27 |
| | Stock issued for acquisitions | **45** | – | – |
| | Balance, end of year | **1,876** | 1,825 | 1,837 |
| **RETAINED EARNINGS** | Balance, beginning of year | **1,022** | 2,105 | 1,762 |
| | Net income | **300** | 669 | 649 |
| | Common stock cash dividends | **(316)** | (320) | (306) |
| | Distribution of Allegiance Corporation common stock to stockholders | **–** | (1,432) | – |
| | Balance, end of year | **1,006** | 1,022 | 2,105 |
| **COMMON STOCK IN TREASURY** | Balance, beginning of year | **(611)** | (550) | (135) |
| | Purchases | **–** | (267) | (500) |
| | Stock issued under employee-benefit plans | **104** | 205 | 76 |
| | Stock issued for acquisitions | **178** | 1 | 9 |
| | Balance, end of year | **(329)** | (611) | (550) |
| **CUMULATIVE FOREIGN CURRENCY ADJUSTMENT** | Balance, beginning of year | **(20)** | 24 | (5) |
| | Currency fluctuations | **(202)** | (44) | 29 |
| | Balance, end of year | **(222)** | (20) | 24 |
| | **Total stockholders' equity** | **$2,619** | $2,504 | $3,704 |

*The accompanying notes are an integral part of these consolidated financial statements.*

## 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Financial statement presentation**

The preparation of the financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

**Basis of consolidation**

The consolidated financial statements include the accounts of Baxter International Inc. and its majority-owned, controlled subsidiaries (Baxter or the company). Operations outside the United States and its territories are included in the consolidated financial statements on the basis of fiscal years ending November 30 in order to facilitate timely consolidation.

**INVENTORIES**

| *as of December 31 (in millions)* | **1997** | 1996 |
|---|---|---|
| Raw materials | **$ 279** | $190 |
| Work in process | **243** | 152 |
| Finished products | **686** | 541 |
| **Total inventories** | **$1,208** | $883 |

Inventories are stated at the lower of cost (first-in, first-out method) or market. Market for raw materials is based on replacement costs and for other inventory classifications on net realizable value.

**PROPERTY, PLANT AND EQUIPMENT**

| *as of December 31 (in millions)* | **1997** | 1996 |
|---|---|---|
| Land | **$ 106** | $ 85 |
| Buildings and leasehold improvements | **994** | 719 |
| Machinery and equipment | **2,515** | 2,290 |
| Equipment leased or rented to customers | **449** | 400 |
| Construction in progress | **343** | 301 |
| **Total property, plant and equipment, at cost** | **4,407** | 3,795 |
| Accumulated depreciation and amortization | **(2,047)** | (1,952) |
| **Net property, plant and equipment** | **$2,360** | $1,843 |

Depreciation and amortization are principally calculated on the straight-line method over the estimated useful lives of the related assets. Leasehold improvements are amortized over the life of the related facility leases or the asset, whichever is shorter. Straight-line and accelerated methods of depreciation are used for income tax purposes.

Depreciation expense was $299 million, $258 million and $254 million in 1997, 1996 and 1995, respectively. Repairs and maintenance expense was $103 million, $93 million and $79 million in 1997, 1996 and 1995, respectively.

**GOODWILL AND OTHER INTANGIBLE ASSETS**

| *as of December 31 (in millions)* | **1997** | 1996 |
|---|---|---|
| Goodwill | **$1,571** | $1,388 |
| Accumulated amortization | **(379)** | (334) |
| **Net goodwill** | **$1,192** | $1,054 |
| Other intangibles | **$ 804** | $ 663 |
| Accumulated amortization | **(374)** | (331) |
| **Net other intangibles** | **$ 430** | $ 332 |

Intangible assets are amortized on a straight-line basis. Goodwill is amortized over estimated useful lives ranging from 15 to 40 years; other intangible assets, consisting of purchased patents, trademarks, deferred charges and other identified rights, are amortized over their legal or estimated useful lives, whichever is shorter (generally not exceeding 17 years). Based upon management's assessment of the future undiscounted operating cash flows of acquired businesses, the carrying value of goodwill at December 31, 1997, has not been impaired.

**Earnings per share**

The numerator for both basic and diluted EPS is income from continuing operations or net income, as applicable. The denominator for basic EPS is the weighted-average number of common shares outstanding during the period. The following is a reconciliation of the shares (denominator) of the basic and diluted per-share computations:

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Basic EPS | **278** | 272 | 277 |
| Effect of dilutive securities: | | | |
| Employee stock options | **4** | 4 | 4 |
| Employee stock subscriptions | **0** | 1 | 1 |
| Diluted EPS | **282** | 277 | 282 |

Basic and diluted EPS from discontinued operations (net of costs associated with effecting the business distribution) were $0.35 and $0.34, respectively, in 1996 and $1.01 and $0.99, respectively, in 1995.

**Derivatives**

Realized gains and losses on hedges of existing assets or liabilities are included in the carrying amounts of those assets or liabilities and ultimately are recognized in income. Gains and option premiums relating to qualifying hedges of firm commitments or anticipated transactions are deferred and recognized in income as offsets of gains and losses resulting from the underlying hedged transactions. Gains and losses relating to terminations of qualifying hedges are included in the carrying amounts and amortized over the remaining expected lives of the underlying assets or liabilities. In circumstances where the underlying assets or liabilities are sold or no longer exist, any remaining carrying value adjustments are recognized in other income or expense. Gains and losses on hedges of net investments are reported as foreign currency adjustments in stockholders' equity. The interest rate differential relating to interest rate swaps used to hedge debt obligations and net investments in foreign affiliates is reflected as an adjustment to interest expense over the lives of the swaps. Cash flows from derivatives are classified in the same category as the cash flows from the related investment, borrowing or foreign exchange activity.

**Cash and equivalents**



Cash and equivalents include cash, certificates of deposit and marketable securities with a maturity of three months or less.

**Reclassifications**

Certain reclassifications have been made to conform the 1996 and 1995 financial statements and footnotes to the 1997 presentation.

## 2 DISCONTINUED OPERATIONS

On September 30, 1996, Baxter stockholders of record on September 26, 1996, received all of the outstanding stock of Allegiance Corporation (Allegiance), which was the company's health-care cost management and distribution business, in a tax-free spin-off. As of that date, Allegiance began operating as an independent publicly owned company.

In 1996 and 1995, the company recorded income from discontinued operations of $81 million and $304 million, respectively, which was net of income tax expense of $14 million and $88 million, respectively. In addition, the company recorded an additional $13 million in 1996, which consisted of $36 million in benefit plan curtailment gains, net of costs of the distribution and income tax expense of $11 million. Costs of the distribution totaled $26 million in 1995, which were net of an income tax benefit of $8 million.

Through an issuance of new third-party debt, $1.15 billion of Baxter's existing debt was indirectly assumed by Allegiance upon spin-off. Approximately $1.4 billion of net assets were transferred to Allegiance upon spin-off.

## 3 ACQUISITIONS AND DIVESTITURES

All acquisitions during the three years ended December 31, 1997, were accounted for under the purchase method. The purchase price of each acquisition was allocated to the net assets acquired based on estimates of their fair values at the date of the acquisition. The excess of the purchase price over the fair values of the net tangible assets and liabilities acquired is allocated to intangible assets. On the basis of independent appraisals in 1997, a portion of the purchase price for certain of the acquisitions during 1997 and 1995 was allocated to in-process research and development (R&D) which, under generally accepted accounting principles, was immediately expensed.

Results of operations of acquired companies are included in the company's results of operations as of the respective acquisition dates. The pro forma information presented below is not necessarily indicative of what operating results would have been had the acquisitions occurred on the indicated dates, nor is it necessarily indicative of future operating results.

**Immuno International AG**

In the first fiscal quarter of 1997, the company acquired Immuno International AG (Immuno), a global manufacturer of biopharmaceutical products and services for transfusion medicine. The acquisition cost was approximately $600 million plus assumption of $280 million of net debt. Approximately $58 million of the purchase price is being withheld to cover certain legal contingencies, as further discussed in Note 13. Approximately $220 million of the purchase price was allocated to in-process R&D, and expensed, as discussed above. Approximately $95 million of the purchase price was allocated to existing product technology and is being amortized on a straight-line basis over 20 years. Approximately $82 million of the purchase price was allocated to goodwill and is being amortized on a straight-line basis over 40 years.

**Research Medical, Inc.**

In March 1997, Baxter acquired Research Medical, Inc. (RMI), a provider of specialized products used in open-heart surgery. The purchase price was $239 million and was principally settled with 4,801,711 shares of Baxter International Inc. common stock, issued from treasury. Approximately $132 million of the purchase price was allocated to in-process R&D, and expensed, as discussed above. Approximately $40 million of the purchase price was allocated to existing product technology and is being amortized on a straight-line basis over 14 years. Approximately $29 million of the purchase price was allocated to goodwill and is being amortized on a straight-line basis over 20 years.

**Clintec Nutrition Company**

In October 1996, the company and Nestlé S.A. (Nestlé) dissolved Clintec Nutrition Company (Clintec), a joint venture between Baxter and Nestlé. Under the dissolution agreement, the company funded its share of previously guaranteed joint venture debt totaling $66 million and received the assets and liabilities associated with Clintec's parenteral-nutrition business for a total consideration of the company's 50% share of Clintec's enteral business and a net cash payment to Nestlé of $50 million. Approximately $198 million of the purchase price was allocated to goodwill and is being amortized on a straight-line basis over 40 years.

**PSICOR, Inc.**

In January 1996, the company acquired PSICOR, Inc. (PSICOR), a perfusion-services business, for $84 million. Approximately $70 million of the purchase price was allocated to goodwill and is being amortized on a straight-line basis over 15 years.

**Pro Forma Information (Unaudited)**

Had the acquisitions of Immuno and RMI taken place at the beginning of the first fiscal quarter of 1997, net sales, net income and basic earnings per share would not have been materially different from the reported amounts and, therefore, pro forma information is not presented. Had the acquisitions of Immuno, RMI, Clintec and PSICOR taken place at the beginning of the first fiscal quarter of 1996, the company's pro forma net sales in 1996 would have been approximately $6.2 billion. Excluding the in-process R&D charge relating to the acquisitions of Immuno and RMI, pro forma net income and basic earnings per share for the year ended December 31, 1996, would have been $701 million and $2.54 per share, respectively.

**VIMRX Pharmaceuticals Inc.**

In December 1997, the company and VIMRX Pharmaceuticals Inc. (VIMRX) formed a new cell-therapy company to develop innovative treatments for cancer and other life-threatening diseases. The company transferred certain assets of its Immunotherapy division into the new company and holds a minority ownership position along with warrants to acquire an additional ownership interest in the future. VIMRX obtained a majority interest in the new company in exchange for 11 million shares of VIMRX common stock and convertible preferred shares with a nominal value of approximately $66 million. The securities received by Baxter are reflected on the company's balance sheet in other noncurrent assets. Baxter is restricted from selling the common stock or converting the convertible preferred stock for a period of time pursuant to government regulations and contractual agreement, respectively. The company recognized a pretax gain from the transaction of $32 million. The company and VIMRX loaned $30 million and $10 million, respectively, to the new company to provide initial operating funds.

## 4 SUBSEQUENT EVENTS

**Bieffe Medital S.p.A.**

In July 1997, the company signed a definitive agreement to acquire Bieffe Medital S.p.A., a European manufacturer of dialysis and intravenous solutions and containers, for approximately $235 million, which includes assumption of debt. Approximately $48 million in purchase price installments were made during 1997. The acquisition will be recorded in early 1998, when the company became a majority shareholder. The purchase of the remaining shares is expected to be completed in mid-1998.

**Pharmaceutical Products Division of the BOC Group**

In January 1998, the company signed a definitive agreement to acquire the Pharmaceutical Products Division of the BOC Group's Ohmeda health-care business (Ohmeda), a manufacturer of gases and drugs used for general and local anesthesia, for approximately $104 million. The transaction is subject to customary antitrust review and is expected to close in 1998.

## 5 RESTRUCTURING PROGRAMS

The company has two restructuring programs in place. In November 1993, the company recorded a $216 million restructuring charge for costs associated with strategic actions designed to accelerate growth and reduce costs in the company's businesses worldwide, including reorganizations and consolidations in the United States, Europe, Japan and Canada. The restructuring program is expected to be substantially completed in 1998. Employee-related costs include provisions for severance, outplacement assistance, relocation and retention payments. Since the inception of the program, the company has eliminated approximately 1,950 positions, which exceeds the 1,640 positions originally targeted.

In September 1995, the company recorded a restructuring charge of $103 million primarily to eliminate excess plant capacity and reduce manufacturing costs, as well as to initiate certain organizational structure changes. The charge predominantly relates to the closure of the intravenous-solutions plant and warehouse in Carolina, Puerto Rico. Production and warehousing will be transferred and consolidated into other facilities. Employee-related costs consist primarily of severance. The company currently estimates that approximately 1,200 positions will be eliminated in total. Approximately 350 positions have been eliminated to date and completion of the plan is anticipated in 1999. The original timetable for the 1995 program has been affected by delays in required governmental regulatory reviews relating to the transfer of equipment and production processes to other facilities in Puerto Rico and the United States.

### RESTRUCTURING PROGRAMS

| *(in millions)* | Employee-related costs | Divestitures and asset write-downs | Other costs | **Total** |
|---|---|---|---|---|
| Reserves at December 31, 1994 | $94 | $113 | $49 | **$256** |
| 1995 utilization: | | | | |
| Cash | 20 | – | 17 | **37** |
| Noncash | – | 72 | – | **72** |
| 1996 utilization: | | | | |
| Cash | 26 | – | 27 | **53** |
| Noncash | – | 20 | – | **20** |
| Reallocation of reserves | 18 | (6) | (12) | **–** |
| 1997 utilization: | | | | |
| Cash | 10 | – | 5 | **15** |
| Noncash and adjustments | 3 | 10 | 2 | **15** |
| Reserves at December 31, 1997 | $17 | $ 17 | $10 | **$ 44** |

## 6 LONG-TERM DEBT, CREDIT FACILITIES AND LEASE OBLIGATIONS

| *as of December 31 (in millions)* | Effective interest rate | **1997** | 1996 |
|---|---|---|---|
| Commercial paper | 5.7% | **$1,053** | $ 694 |
| Short-term notes | 5.7% | **119** | 49 |
| 7.5% notes due 1997 | | **–** | 200 |
| 8.875% notes redeemable by company in 1998 | 8.9% | **87** | 86 |
| 9.25% notes due 1999 | 10.0% | **99** | 98 |
| Zero coupon notes due 2000 | 9.7% | **112** | 98 |
| 8.125% notes due 2001 | 6.0% | **160** | 151 |
| 7.625% notes due 2002 | 7.4% | **151** | 150 |
| 7.125% notes due 2007 | 6.4% | **252** | – |
| 7.25% notes due 2008 | 7.5% | **198** | 198 |
| 9.5% notes due 2008 | 10.2% | **100** | 100 |
| 7.65% debentures due 2027 | 6.9% | **202** | – |
| Other | | **144** | 96 |
| Total long-term debt and lease obligations | | **2,677** | 1,920 |
| Current portion | | **(42)** | (225) |
| Long-term portion | | **$2,635** | $1,695 |

At December 31, 1997 and 1996, commercial paper and short-term notes together totaling $1,172 million and $743 million, respectively, have been classified with long-term debt as they are supported by a long-term credit facility, as discussed below, which management intends to continue to refinance. The company had unamortized original issue discounts of $36 million and $47 million for the Zero coupon notes due 2000 at December 31, 1997 and 1996, respectively.

The company leases certain facilities and equipment under capital and operating leases expiring at various dates. Most of the operating leases contain renewal options. Rent expense under operating leases was $86 million, $81 million and $88 million in 1997, 1996 and 1995, respectively.

### FUTURE MINIMUM LEASE PAYMENTS AND DEBT MATURITIES

| *as of and for the years ended December 31 (in millions)* | Operating leases | Aggregate debt maturities and capital leases |
|---|---|---|
| 1998 | **$ 69** | **$ 47** |
| 1999 | **48** | **114** |
| 2000 | **31** | **145** |
| 2001 | **22** | **1,324**[1] |
| 2002 | **19** | **350** |
| Thereafter | **34** | **718** |
| Total obligations and commitments | **$223** | **2,698** |
| Amounts representing interest, discounts, premiums and deferred financing costs | | **(21)** |
| Present value of long-term debt and lease obligations | | **$2,677** |

*1. Includes $1,172 million of commercial paper and short-term notes supported by long-term credit facilities expiring in 2001.*

Baxter maintains a $1.5 billion revolving credit facility, which expires in 2001 and enables the company to borrow funds on an unsecured basis at variable interest rates. The agreement contains covenants, which include a maximum debt-to-capital ratio and a minimum interest coverage ratio. At December 31, 1997, there were no borrowings outstanding under this facility.

Baxter also maintains short-term credit arrangements totaling approximately $829 million in support of international and domestic operations. At December 31, 1997, approximately $221 million of borrowings were outstanding under these facilities, of which $119 million is classified as long-term debt as discussed above.

## 7 FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

**Concentrations of credit risk**

In the normal course of business, the company provides credit to customers in the health-care industry, performs credit evaluations of these customers and maintains reserves for potential credit losses which, when realized, have been within the range of management's allowance for doubtful accounts. The allowance for doubtful accounts was $29 million and $24 million at December 31, 1997 and 1996, respectively.

The company invests the majority of its excess cash in certificates of deposit or money market accounts and, where appropriate, diversifies the concentration of cash among different financial institutions. With respect to financial instruments, where appropriate, the company has diversified its selection of counterparties, and has arranged collateralization and master-netting agreements to minimize the risk of loss.

**Interest rate risk management**

Baxter uses forward contracts, options and interest rate swaps generally from one to three years in duration to manage the company's exposure to adverse movements in interest rates. The book values of debt at December 31, 1997 and 1996, reflect deferred hedge gains of $19 million and $2 million, respectively, offset by $3 million and $4 million of deferred hedge losses, respectively.

**Foreign exchange risk management**

The company enters into various types of foreign exchange contracts to protect the company from the risk that the eventual net dollar cash inflows resulting from transactions with foreign customers and suppliers may be adversely affected by changes in currency exchange rates. The company also enters into foreign exchange contracts, with terms generally less than one year, to hedge anticipated but not yet committed sales expected to be denominated in foreign currencies. Deferred hedging gains on hedges of anticipated but not yet committed sales totaled $15 million and $3 million at December 31, 1997 and 1996, respectively.

The company has entered into foreign exchange contracts, for up to 10 years, to hedge certain of its net investments in foreign affiliates. These contracts hedge the U.S. dollar value of foreign currency denominated net assets from the effects of volatility in currency exchange rates by changing the currency denomination of certain of Baxter's debt repayments and interest payments from the U.S. dollar to the respective currencies of the underlying net assets.

The company principally hedges the following currencies: Japanese Yen, Belgian Francs, French Francs, Italian Lira, U.K. Pound Sterling, German Marks and Austrian Schillings.



**INTEREST RATE AND FOREIGN EXCHANGE CONTRACTS**

| *as of December 31 (in millions)* | **1997** | | | 1996 | | |
|---|---|---|---|---|---|---|
| | **Notional amounts** | **Market value gain (loss)** | **Weighted-average interest rate** | Notional amounts | Market value gain (loss) | Weighted-average interest rate |
| **Interest Rate Contracts** | | | | | | |
| Floating to fixed rate hedges | **$400** | **$(1)** | | $850 | $2 | |
| Average pay rate | | | **5.4%** | | | 5.8% |
| Average receive rate | | | **5.8%** | | | 5.5% |
| Fixed to floating rate (swapped notes) | **–** | **–** | | 325 | 7 | |
| Average pay rate | | | | | | 4.3% |
| Average receive rate | | | | | | 5.8% |
| Call Option | **25** | **6** | | 25 | 4 | |
| Floor | **–** | **–** | | 150 | 11 | |
| **Foreign Exchange Contracts** | | | | | | |
| Forwards and options used to hedge anticipated sales | **397** | **(4)** | **N/A** | 68 | 0 | N/A |
| Forwards and swaps used to hedge certain receivables and payables | **290** | **7** | **N/A** | 102 | 6 | N/A |
| Forwards and swaps used to hedge net investments in foreign affiliates | **1,546** | **10** | **N/A** | 144 | (11) | N/A |

### FAIR VALUES OF FINANCIAL INSTRUMENTS

| | Carrying amounts | | Approximate fair values | |
|---|---|---|---|---|
| *as of December 31 (in millions)* | **1997** | 1996 | **1997** | 1996 |
| Assets | | | | |
| Long-term insurance receivables | **$409** | $641 | **$339** | $548 |
| Investment in affiliates | **180** | 64 | **192** | 74 |
| Liabilities | | | | |
| Notes payable to banks | **102** | 121 | **102** | 121 |
| Short-term borrowings classified as long-term[2] | **1,172** | 743 | **1,173** | 741 |
| Other long-term debt and lease obligations [1, 2] | **1,505** | 1,177 | **1,625** | 1,224 |
| Foreign exchange hedges | **26** | (18) | **13** | (5) |
| Long-term litigation liabilities | **210** | 365 | **191** | 290 |

*1. Based on quoted market prices.*

*2. Interest rate hedge carrying amounts are included in corresponding debt balances.*

Although the company's litigation remains unresolved by final orders or settlement agreements in some cases, the estimated fair values of insurance receivables and long-term litigation liabilities were computed by discounting the expected cash flows based on currently available information.

The carrying values of all other financial instruments approximate their fair values due to the short-term maturities of these assets and liabilities.

## 8 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

| *as of December 31 (in millions)* | **1997** | 1996 |
|---|---|---|
| Accounts payable, principally trade | **$ 572** | $ 442 |
| Employee compensation and withholdings | **225** | 222 |
| Restructuring | **34** | 30 |
| Litigation | **400** | 465 |
| Pension and other deferred benefits | **38** | 25 |
| Property, payroll and other taxes | **74** | 63 |
| Other | **620** | 457 |
| Accounts payable and accrued liabilities | **$1,963** | $1,704 |

## 9 COMMON STOCK

Baxter has several stock-based compensation plans, which are described below. The company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and its stock purchase plans. The compensation expense recognized for continuing operations for performance-based and restricted plans was $13 million, $20 million and $17 million in 1997, 1996 and 1995, respectively. Had compensation cost for all of the company's stock-based compensation plans been determined based on the fair value at the grant dates consistent with the method of FASB Statement No. 123, "Accounting for Stock-Based Compensation," the company's income and earnings per share (EPS) would have been reduced to the pro forma amounts indicated below:

### PRO FORMA INCOME AND EPS FROM CONTINUING OPERATIONS

| *years ended December 31 (in millions, except per share data)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Income from continuing operations: | | | |
| As reported | **$ 300** | $ 575 | $ 371 |
| Pro forma | **$ 266** | $ 557 | $ 358 |
| EPS from continuing operations: | | | |
| Basic, as reported | **$1.08** | $2.11 | $1.34 |
| Pro forma | **$0.96** | $2.05 | $1.29 |

Excluding the $352 million in-process R&D expense recorded in 1997, and further discussed in Note 3, pro forma income from continuing operations and EPS from continuing operations in 1997 was $618 million and $2.22, respectively, compared to income from continuing operations and EPS from continuing operations of $652 million and $2.35, respectively.

The pro forma amounts reflected above are not likely to be representative of the pro forma amounts in future years due to the FASB Statement No. 123 transition rules that require pro forma disclosures only for awards granted after 1994. In addition, the pro forma expense in 1997 is higher than the amounts in 1996 and 1995 due principally to accelerated vesting as a result of achievement in 1997 of the specified stock price level relating to the stock options granted in 1995.

Pro forma income and EPS from discontinued operations were $66 million and $0.24, respectively, for 1996 and $299 million and $1.08, respectively, for 1995. All outstanding options were modified as a result of the spin-off of Allegiance. Equitable adjustments were made to the number of shares and exercise price for each option and employee stock subscription outstanding.

Pro forma compensation expense for stock options and employee-stock subscriptions was calculated using the Black-Scholes model.

**Fixed stock option plans**

Stock options have been granted at various dates. All grants have a 10-year initial term and most have an exercise price equal to 100% of market value on the date of grant. Vesting terms vary, with some options vesting ratably over three years and others vesting 100% in five years or three years. Some grants vest on an accelerated basis upon the achievement of specified stock price levels.

Employees transferring to Allegiance generally were required to exercise any vested options within 90 days from the date of spin-off, and all unexercised options were canceled after that date. All unvested options held by Allegiance employees were canceled 90 days after the date of spin-off. Under the rules of FASB Statement No. 123, the modified options held by employees remaining with the company were treated as an exchange of the original award for a new award.

**FIXED STOCK OPTIONS OUTSTANDING**

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Outstanding December 31, 1997 | Weighted-average remaining contractual life (years) | Weighted-average exercise price per share | Exercisable December 31, 1997 | Weighted-average exercise price per share |
| $14 – 18 | 110,516 | .69 | 16.93 | 110,516 | 16.93 |
| 19 – 26 | 2,502,332 | 5.34 | 24.03 | 2,502,332 | 24.03 |
| 27 – 40 | 3,701,575 | 6.58 | 34.15 | 3,701,575 | 34.15 |
| 41 – 51 | 7,470,124 | 8.22 | 47.70 | – | – |
| 52 – 58 | 97,800 | 9.67 | 57.19 | – | – |
| $14 – 58 | 13,882,347 | 6.10 | 39.64 | 6,314,423 | 29.84 |



**STOCK OPTION PLAN STATUS**
**(Exercise Price Equals Market Price)**

| *as of and for the years ended December 31* | **1997** | | 1996 | | 1995 | |
|---|---|---|---|---|---|---|
| | **Shares** | **Weighted-average exercise price** | Shares | Weighted-average exercise price | Shares | Weighted-average exercise price |
| Outstanding at beginning of year | **12,501,329** | **$34.89** | 14,651,835 | $31.35 | 12,368,320 | $27.83 |
| Granted | **4,208,302** | **47.59** | 3,538,300 | 48.12 | 5,193,650 | 37.23 |
| Exercised | **(2,406,409)** | **29.04** | (4,080,414) | 27.88 | (2,107,441) | 25.29 |
| Forfeited | **(420,875)** | **38.76** | (2,404,225) | 33.09 | (802,694) | 30.91 |
| Equitable adjustment | **–** | **–** | 795,833 | 29.98 | – | – |
| Outstanding at end of year | **13,882,347** | **$39.64** | 12,501,329 | $34.89 | 14,651,835 | $31.35 |
| Options exercisable at end of year | **6,314,423** | **$29.84** | 4,542,496 | $26.65 | 6,258,117 | $29.02 |
| Weighted-average fair value of options granted during the year | | **$15.95** | | $12.05 | | $11.35 |

During 1996, approximately 2.4 million stock options were granted with an exercise price of $51 (120% of the market price of the stock on grant date) and a weighted-average fair value of $11.00. All of the options were outstanding at year-end 1997.

Pro forma compensation expense was calculated with the following weighted-average assumptions for grants in 1997, 1996, and 1995, respectively: dividend yield of 2.1%, 2.7% and 2.7%; expected life of seven, eight and seven years; expected volatility of 28%, 25% and 26%; and risk-free interest rates of 6.2%, 6.6% and 6.5%.

Stock options have also been granted to The Baxter Allegiance Foundation (a philanthropic organization), as follows: an option to purchase 1,124,478 shares of common stock at $31.45 per share was granted on April 22, 1991, and expires in 2001; and an option to purchase 1,074,000 shares of common stock at $31.42 per share was granted on December 2, 1992, and expires in 2002.

**Employee stock purchase plans**

The company has employee stock purchase plans whereby it is authorized, as of December 31, 1996, to issue up to 12 million shares of common stock to its employees, nearly all of whom are eligible to participate. The purchase price is the lower of 85% of the closing market price on the date of subscription or 85% of the closing market price as defined by the plans. The total subscription amount for each participant cannot exceed 25% of current annual pay. Under the plans, the company sold 760,490, 1,121,907 and 1,579,425 shares to employees in 1997, 1996 and 1995, respectively. Pro forma compensation expense was estimated with the following weighted-average assumptions for 1997, 1996 and 1995, respectively: dividend yield of 2.1%, 2.7% and 2.7%; expected life of one year for all periods; expected volatility of 33%, 26% and 23%, and risk-free interest rates of 5.7%, 5.7% and 5.8%. The weighted-average fair value of those purchase rights granted in 1997, 1996 and 1995 was $13.27, $10.93 and $8.51, respectively.

**Restricted stock and performance-share plans**

Under various plans, the company has made grants of restricted stock and performance shares in the form of the company's common stock to provide incentive compensation to key employees and non-employee directors. Under the long-term incentive plan, grants are generally made annually and are earned based on the achievement of financial performance targets, adjusted up or down by the company's stock performance against the change in the Standard & Poor's Medical Products and Supplies Index. The restricted shares vest one year after they are earned.

At December 31, 1997, 61,220 shares were subject to restrictions, which lapse between 1998 and 2002, and 1,144,963 shares were subject to restrictions that lapse upon achievement of future performance objectives and related vesting periods. During 1997, 1996 and 1995, 24,930, 720,043 and 574,174 shares, respectively, of restricted stock and performance shares were granted at weighted-average grant-date fair values of $51.29, $41.89 and $30.52 per share, respectively.

**Other**

In connection with a voluntary Shared Investment Plan implemented during 1994, members of Baxter's senior-management team purchased shares of the company's common stock. Baxter managers used personal full-recourse loans to purchase the stock at the June 15, 1994, closing price. Baxter has agreed to guarantee repayment to the banks in the event of default by a participant. The participant loan amount outstanding at December 31, 1997, is $77 million.

Approximately 100 million shares of no par value preferred stock are authorized for issuance in series with varying terms as determined by the board of directors.

During 1989, common stockholders received a dividend of one preferred stock purchase right (collectively, the "Rights") for each share of common stock. Each Right, under specified circumstances, entitles the owner to purchase one one-hundredth of a share of Series A Junior Participating Preferred Stock at a purchase price of $70. The Rights become exercisable at a price of $140 and at a specified time after (1) a person or group acquires 20% or more of the company's common stock or (2) a tender or exchange offer for 20% or more of the company's common stock. The Rights expire on March 20, 1999, unless earlier redeemed by the company under certain circumstances at a price of $0.01 per Right.

## 10 RETIREMENT AND OTHER BENEFIT PROGRAMS

The company has defined benefit pension plans that cover substantially all employees in the United States and Puerto Rico, and its funding policy is to meet or exceed the minimum requirements of the Employee Retirement Income Security Act of 1974. The benefits are generally based on individual participants' years of service and compensation near retirement. Assets held by the trusts of the plans consist primarily of equity and fixed income securities. The company also has various retirement plans in locations outside the United States and Puerto Rico.

### PENSION EXPENSE

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Service cost | **$36** | $42 | $27 |
| Interest cost on projected benefit obligation | **90** | 76 | 62 |
| Actual return on assets | **(183)** | (155) | (159) |
| Net amortization and deferral | **82** | 84 | 105 |
| Total pension expense | **$25** | $47 | $35 |

### FUNDED STATUS AND CONSOLIDATED BALANCE SHEET AMOUNTS

| *as of December 31 (in millions)* | Plans with accumulated benefits exceeding assets **1997** | Plans with accumulated benefits exceeding assets 1996 | Plans with assets exceeding accumulated benefits **1997** | Plans with assets exceeding accumulated benefits 1996 |
|---|---|---|---|---|
| Actuarial present value of benefit obligations: | | | | |
| Vested benefits | **$100** | $ 74 | **$1,046** | $ 955 |
| Accumulated benefits | **$110** | $ 81 | **$1,074** | $ 978 |
| Projected benefits | **$132** | $100 | **$1,169** | $1,040 |
| Less plan assets at fair value | **15** | 15 | **1,290** | 1,175 |
| Projected benefit obligation less plan assets | **117** | 85 | **(121)** | (135) |
| Unrecognized net gains and unrecognized prior service cost | **(4)** | (5) | **59** | 70 |
| Unrecognized obligation at January 1, net of amortization | **(7)** | (6) | **(17)** | (22) |
| Net pension liability (asset) | **$106** | $ 74 | **$ (79)** | $ (87) |

### ASSUMPTIONS USED IN DETERMINING FUNDED STATUS

| *as of December 31* | **1997** | 1996 |
|---|---|---|
| Annual rate of increase in compensation levels: | | |
| U.S. and Puerto Rico plans | **4.5%** | 4.5% |
| International plans (average) | **4.5%** | 4.6% |
| Discount rate applied to benefit obligations: | | |
| U.S. and Puerto Rico plans | **7.5%** | 8.0% |
| International plans (average) | **6.0%** | 6.0% |
| Return on assets: | | |
| U.S. and Puerto Rico plans | **10.5%** | 9.5% |
| International plans (average) | **7.5%** | 7.0% |

In addition to pension benefits, the company sponsors certain unfunded contributory health-care and life insurance benefits for substantially all domestic retired employees.

### NET POSTRETIREMENT HEALTH-CARE AND LIFE INSURANCE EXPENSE

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Service cost | **$ 3** | $ 5 | $ 3 |
| Interest cost on projected benefit obligation | **14** | 15 | 15 |
| Net amortization and deferral | **(6)** | (2) | (2) |
| Net postretirement benefits cost | **$11** | $18 | $16 |

### PRESENT VALUE OF APBO OBLIGATION INCLUDED IN CONSOLIDATED BALANCE SHEETS

| *as of December 31 (in millions)* | **1997** | 1996 |
|---|---|---|
| Accumulated postretirement benefit obligation ("APBO") | | |
| Retirees | **$118** | $138 |
| Fully eligible active participants | **25** | 10 |
| Other active participants | **59** | 65 |
| Unrecognized net gains | **70** | 55 |
| Accrued postretirement benefit liability | **$272** | $268 |

### ASSUMPTIONS USED IN DETERMINING THE APBO

| *as of December 31* | **1997** | 1996 |
|---|---|---|
| Discount rate applied to APBO | **7.5%** | 8.0% |
| Annual rate of increase in the per-capita cost | **9.0%** | 10.0% |
| Rate decreased to | **5.0%** | 5.0% |
| By the year ended | **2002** | 2002 |
| Increase if health-care trend rates increase by 1% in each year (in millions) | | |
| APBO | **$27** | $28 |
| Expense | **$ 3** | $ 3 |

Most U.S. employees are eligible to participate in a qualified defined contribution plan. Participants may contribute up to 12% of their annual compensation to the plan and the company matches participants' contributions up to 3% of compensation (subject to legal limits). Company matching contributions were $14 million, $14 million and $13 million in 1997, 1996 and 1995, respectively.

## 11 INTEREST AND OTHER (INCOME) EXPENSE

### INTEREST EXPENSE

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Interest, net | | | |
| Interest costs | **$206** | $219 | $219 |
| Interest costs capitalized | **(8)** | (5) | (5) |
| Interest expense | **198** | 214 | 214 |
| Interest income | **(35)** | (44) | (34) |
| Total interest, net | **$163** | $170 | $180 |
| Less interest allocated to discontinued operations[1] | **–** | (67) | (84) |
| Interest allocated to continuing operations[1] | **$163** | $103 | $ 96 |

*1. Allocation of interest to continuing and discontinued operations was based on relative net assets of these operations.*

### OTHER (INCOME) EXPENSE

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Equity in (income) losses of affiliates | **$ (2)** | $13 | $17 |
| Asset dispositions, net | **(48)** | (9) | (65) |
| Foreign exchange | **(22)** | 1 | 22 |
| Other | **39** | 10 | 21 |
| Total (income) expense | **$(33)** | $15 | $ (5) |

## 12 INCOME TAXES

U.S. federal income tax returns filed by Baxter International Inc. through December 31, 1990, have been examined and closed by the Internal Revenue Service. The company has ongoing audits in U.S. and international jurisdictions. In the opinion of management, the company has made adequate provisions for tax expenses for all open years.

### INCOME BEFORE TAX EXPENSE BY CATEGORY

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| U.S. | **$ 92** | $188 | $ 4 |
| International | **431** | 605 | 520 |
| Income from continuing operations before income tax expense | **$523** | $793 | $524 |

Income tax expense (benefit) related to continuing operations by category and by income statement classification is as follows:

### INCOME TAX EXPENSE

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Current | | | |
| U.S. | | | |
| Federal | **$ 98** | $ (16) | $ 21 |
| State and local | **(6)** | 12 | 26 |
| International | **132** | 148 | 123 |
| Current income tax expense | **224** | 144 | 170 |
| Deferred | | | |
| U.S. | | | |
| Federal | **(50)** | 40 | 13 |
| State and local | **23** | 22 | (27) |
| International | **26** | 12 | (3) |
| Deferred income tax expense (benefit) | **(1)** | 74 | (17) |
| Income tax expense | **$223** | $218 | $153 |

The income tax for continuing operations was calculated as if Baxter were a stand-alone entity (without income from discontinued operations).

### DEFERRED TAX ASSETS AND LIABILITIES

| *as of December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Deferred tax assets | | | |
| Accrued expenses | **$ 10** | $ 88 | $192 |
| Accrued postretirement benefits | **103** | 97 | 80 |
| Merger and restructuring costs | **19** | 29 | 97 |
| Alternative minimum tax credit | **114** | 90 | 62 |
| Tax credits and net operating losses | **136** | 27 | 20 |
| Valuation allowances | **(46)** | (36) | (30) |
| Total deferred tax assets | **336** | 295 | 421 |
| Deferred tax liabilities | | | |
| Asset basis differences | **294** | 227 | 241 |
| Subsidiaries' unremitted earnings | **91** | 80 | 121 |
| Other | **4** | 25 | 26 |
| Total deferred tax liabilities | **389** | 332 | 388 |
| Net deferred tax asset (liability) | **$(53)** | $(37) | $ 33 |

There are $63 million of loss carryforwards which expire in 2012 and $23 million of foreign tax credit carryforwards which expire in 2001, and $10 million of foreign tax credit carryforwards which expire in 2002.

**INCOME TAX EXPENSE**

Income tax expense applicable to income from continuing operations differs from income tax expense calculated by using the U.S. federal income tax rate for the following reasons:

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Income tax expense at statutory rate | **$183** | $278 | $183 |
| Tax-exempt operations | **(130)** | (130) | (125) |
| Nondeductible goodwill | **12** | 10 | 8 |
| State and local taxes | **(5)** | 3 | 7 |
| Repatriation of foreign earnings | **–** | 17 | 57 |
| Foreign tax expense | **40** | 33 | 14 |
| Acquired R&D expense | **123** | – | – |
| Other factors | **–** | 7 | 9 |
| Income tax expense | **$223** | $218 | $153 |

The company has received a tax-exemption grant from Puerto Rico, which provides that its manufacturing operations will be partially exempt from local taxes until the year 2002. Appropriate taxes have been provided for these operations assuming repatriation of all available earnings. In addition, the company has other manufacturing operations outside the United States, which benefit from reductions in local tax rates under tax incentives that will continue at least through 1999.

U.S. federal income taxes, net of available foreign tax credits, on unremitted earnings deemed permanently reinvested would be approximately $270 million as of December 31, 1997.

## 13 LEGAL PROCEEDINGS

Baxter International Inc. and certain of its subsidiaries are named as defendants in a number of lawsuits, claims and proceedings, including product liability claims involving products now or formerly manufactured or sold by the company or by companies that were acquired by Baxter. These cases and claims raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. Accordingly, in many cases, the company is not able to estimate the amount of its liabilities with respect to such matters.

Upon resolution of any of the legal matters discussed below, Baxter may incur charges in excess of presently established reserves. While such a future charge could have a material adverse impact on the company's net income and net cash flows in the period in which it is recorded or paid, management believes that no such charge would have a material adverse effect on Baxter's consolidated financial position.

**Mammary implant litigation**

The company, together with certain of its subsidiaries, is currently a defendant in various courts in a number of lawsuits brought by individuals, all seeking damages for injuries of various types allegedly caused by silicone mammary implants formerly manufactured by the Heyer-Schulte division (Heyer-Schulte) of American Hospital Supply Corporation (AHSC). AHSC, which was acquired by the company in 1985, divested its Heyer-Schulte division in 1984. It is not known how many of these claims and lawsuits involve products manufactured and sold by Heyer-Schulte, as opposed to other manufacturers.

As of December 31, 1997, Baxter, together with certain of its subsidiaries, had been named as a defendant or co-defendant in 7,762 lawsuits and 1,734 claims relating to mammary implants, brought by approximately 16,480 plaintiffs. Of those plaintiffs, 8,963 currently are included in the *Lindsey* class action Revised Settlement described below, which accounts for 3,902 of the pending lawsuits against the company. Additionally, 7,151 plaintiffs have opted out of the Revised Settlement (representing 3,572 pending lawsuits), and the status of the remaining plaintiffs with pending lawsuits is unknown. Some of the opt-out plaintiffs filed their cases naming multiple defendants and without product identification; thus, not all of the opt-out plaintiffs will have viable claims against the company. As of December 31, 1997, 2,527 of the opt-out plaintiffs had confirmed Heyer-Schulte mammary implant product identification. Furthermore, during 1997, Baxter obtained dismissals, or agreements for dismissals, with respect to 7,383 plaintiffs.

In addition to the individual suits against the company, a class action on behalf of all women with silicone mammary implants was filed on March 23, 1994, in the United States District Court (U.S.D.C.) for the Northern District of Alabama involving most manufacturers of such implants, including Baxter (*Lindsey, et al., v. Dow Corning, et al.*, U.S.D.C., N. Dist. Ala., CV 94-P-11558-S). The class action was certified for settlement purposes only by the court on September 1, 1994, and the settlement terms subsequently were revised and approved on December 22, 1995 (the Revised Settlement). The monetary provisions of the Revised Settlement provide compensation for all present and future plaintiffs and claimants through a series of specific funds and a disease-compensation program involving certain specified medical conditions. Appeals have been filed challenging the Revised Settlement.

On May 15, 1995, Dow Corning Corporation, one of the defendants in the mammary implant cases, declared bankruptcy and filed for protection under Chapter 11 (*In re: Dow Corning Corporation*, U.S.D.C., E.D. Mich. 95-20512, 95CV72397-DT). The full impact of these proceedings on the Revised Settlement is unclear.

On January 16, 1996, Baxter, Bristol-Myers Squibb Company and Minnesota Mining and Manufacturing Company each paid $125 million into the court-established fund as an initial fund to pay claims under the Revised Settlement. Union Carbide Corporation and McGhan Medical Corporation also are parties to the Revised Settlement. Under the Revised Settlement, plaintiffs and claimants have a second opportunity to opt out of the Revised Settlement, once they receive a "Notification of Status" letter from the claims-administration office. "Notification of Status" letters were delivered to virtually all domestic claimants by July 1997, and the opt-out period for most claimants expired on September 1, 1997.

In addition to the *Lindsey* class action, the company also has been named in 11 other purported class actions in various state and provincial courts, only one of which is certified: *Harrington v. Dow Corning Corp., et al.,* Supreme Court, British Columbia, C954330. The class action in British Columbia has been certified solely with respect to the issue of whether silicone gel breast implants are reasonably fit for their intended purpose.



In the fourth quarter of 1993, Baxter accrued $556 million for its estimated liability resulting from the settlement of the *Lindsey* class action and recorded a receivable for estimated insurance recoveries totaling $426 million, resulting in a net charge of $130 million. Based on its continuing evaluation of the remaining opt-outs, the company accrued an additional $298 million for its estimated liability to litigate or settle cases and claims involving opt-outs and recorded an additional receivable for estimated insurance recoveries totaling $258 million, resulting in an additional net charge of $40 million in the first quarter of 1995.

The mammary implant litigation includes issues related to which of the Baxter's insurers are responsible for covering each matter and the extent of the company's claims for contribution against third parties. Baxter believes that a substantial portion of its liability and defense costs for mammary implant litigation will be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer solvency. The company has entered into "coverage-in-place" agreements with a number of its insurers, each of which issued or subscribed to policies of insurance between 1974 and 1985. These agreements resolve the signatory insurers' coverage defenses and specify rules and procedures for allocation and payment of defense and indemnity costs pursuant to which signatory insurers will reimburse Baxter for mammary implant losses. Five of the company's claims-made insurers, which issued policies subsequent to 1985, have agreed to pay under their policies with respect to mammary implant claims. The combined total of the amount thus far paid by insurers, committed for payment, and projected by Baxter to be paid by insurers under these agreements is in excess of $550 million, based on the company's current estimate of mammary implant expenditures. The insurers with which Baxter has not reached coverage agreements generally have reserved (i.e., neither admitted nor denied), and may attempt to reserve in the future, the right to deny coverage, in whole or in part, due to differing theories regarding, among other things, the applicability of coverage and when coverage may attach. Baxter is engaged in active litigation with each of these insurers and is negotiating with certain of them to resolve outstanding insurance coverage issues.

**Factor concentrates litigation**

Baxter currently is a defendant in a number of claims and lawsuits brought by individuals who have hemophilia, all seeking damages for injuries allegedly caused by anti-hemophilic factor concentrates VIII or IX derived from human blood plasma (factor concentrates) processed by the company in the early and mid-1980s. The typical case or claim alleges that the individual was infected with the HIV virus by factor concentrates, which contained the HIV virus. None of these cases involves factor concentrates currently processed by the company.

As of December 31, 1997, Baxter had been named in 486 lawsuits and 410 claims in the United States, Canada, Ireland, Italy, Taiwan, Japan and the Netherlands. All U.S. federal court factor concentrate cases have been transferred to the U.S.D.C. for the Northern District of Illinois for case management under Multi District Litigation (MDL) rules (MDL Docket No. MDL-986). The company also has been named in eight purported class actions. None of these class actions has been certified, and five have been transferred to the MDL for discovery.

In most states, Baxter's potential liability is limited by laws that provide that the sale of blood or blood derivatives, including factor concentrates, is not covered by the doctrine of strict liability. As a result, each claimant must prove that his or her injuries were caused by the company's negligence.

On May 6, 1997, the court approved a settlement submitted by the plaintiffs' steering committee for the MDL, Baxter, Alpha Therapeutic Corporation, Armour Pharmaceutical and Bayer Corporation. The essential terms of the settlement provide payments of $100,000 per person to each HIV-positive person with hemophilia in the United States who can demonstrate use of factor concentrates produced by one of the settling defendants between 1978 and 1985. Additionally, the defendants have established a $40 million fund for payment of attorneys' fees, costs and court-administration expenses. Baxter's agreed contribution to the proposed settlement is 20% of the total settlement proceeds.

The settlement requires insurance-carrier approval and the signing of releases. Baxter and the other defendants have reached agreements to settle potential

subrogation and reimbursement claims with most private insurers, the federal government and all 50 states, the District of Columbia and Puerto Rico. Although the period for claimants to decide whether or not to participate in the settlement is anticipated not to expire until March 31, 1998, the approximate number of eligible claimants as of December 31, 1997, was 5,581, and the number of eligible opt-outs was approximately 533. On July 29, 1997, the court dismissed two appeals that had been filed challenging the settlement. The defendants had paid 1,737 claimants as of December 31, 1997. Payments are expected to continue through the middle of 1998 as documents are sent to all eligible claimants.

In Japan, Baxter is a defendant, along with the Japanese government and four other co-defendants, in factor concentrate cases in Osaka, Tokyo, Nagoya, Tohoku, Fukuoka, Sapporo and Kumamoto. As of December 31, 1997, the cases involved 1,257 plaintiffs, of whom 1,206 allegedly used factor concentrates manufactured by the company. Based upon the Osaka and Tokyo courts' recommendations, the parties have agreed to a settlement of all pending and future factor concentrate cases. In general, the settlement provides for payment of an up-front, lump-sum amount of approximately $360,000 per plaintiff to be funded 40% by the Japanese government and 60% by the corporate defendants. The share of the settlement to be paid by each corporate defendant was determined based upon its market share, resulting in a contribution by the Baxter of approximately 15.36%. The portion of the settlement to be funded by the corporate defendants will include prior payments made by the corporate defendants under a Japanese government-administered program, which pays monthly amounts to HIV-positive and AIDS-manifested people with hemophilia and their survivors. Additionally, monthly payments will be made to each plaintiff according to a set schedule.

In Spain, Baxter was notified in 1995 that approximately 1,370 HIV-positive people with hemophilia wished to explore settlement possibilities with the company in lieu of filing suit in both Spain and the United States. The parties have reached agreement on the terms of a settlement whereby each claimant will receive $25,000 (including attorneys' fees and costs) in return for a general release and protection against contribution claims by other defendants. As of December 31, 1997, 1,370 claimants had agreed to the settlement. Baxter does not expect any additional claimants to come forward.

The company believes that a substantial portion of the liability and defense costs related to factor concentrate litigation will be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer solvency. Baxter has entered into coverage in place agreements with certain of its insurers that issued or subscribed to policies of insurance between 1978 and 1985. These agreements resolve the signatory insurers' coverage defenses and specify rules and procedures for allocation and payment of defense and indemnity costs pursuant to which the signatory insurers will reimburse the company for factor concentrate losses. The insurers with which Baxter has not reached coverage agreements generally have reserved (i.e., neither admitted nor denied), and may attempt to reserve in the future, the right to deny coverage, in whole or in part, due to differing theories regarding, among other things, the applicability of coverage and when coverage may attach. Baxter is engaged in active litigation and negotiations with certain of these insurers to resolve outstanding insurance coverage issues.

In the fourth quarter of 1993, the company accrued $131 million for its estimated worldwide liability for litigation and settlement expenses involving factor concentrate cases and recorded a receivable for insurance coverage of $83 million, resulting in a net charge of $48 million. In the third quarter of 1995, significant developments occurred, primarily in the United States, Europe and Japan relative to claims and litigation pertaining to the Baxter's plasma-based therapies. After analyzing circumstances in light of recent developments and considering various factors and issues unique to each geography, the company revised its estimated exposure from the $131 million previously recorded for factor concentrate litigation to $378 million for all litigation relating to plasma-based therapies, including the factor concentrate litigation and the Gammagard ® IVIG litigation (see Other Litigation below). Related estimated insurance recoveries were revised from $83 million for factor concentrates to $274 million for all plasma-based therapies. This resulted in a net charge of $56 million in the third quarter of 1995.



In addition, as described in Note 3, Baxter acquired Immuno International AG (Immuno) in fiscal year 1997. Immuno has unsettled claims for damages for injuries allegedly caused by its plasma-based therapies. The typical claim alleges that the individual with hemophilia was infected with HIV by factor concentrates containing the HIV virus. Additionally, Immuno faces multiple claims stemming from its vaccines and other biologically derived therapies. A portion of the liability and defense costs related to these claims will be covered by insurance, subject to exclusions, conditions, policy limits and other factors. In addition, the stock purchase agreement between the company and Immuno provides that approximately 84 million Swiss francs (or approximately $58 million at year end) of the purchase price will be withheld to cover these contingent liabilities. Based on management's estimates, the amount of these contingencies, net of insurance recoveries and reserves, is not expected to exceed the negotiated contingent payment held back from the total purchase price.

**Other litigation**

Baxter is currently a defendant in a number of claims and lawsuits brought by individuals who infused the company's Gammagard® IVIG (intravenous immuno-globulin), all of whom are seeking damages for Hepatitis C infections allegedly

caused by infusing Gammagard® IVIG. As of December 31, 1997, Baxter was a defendant in 134 lawsuits and 70 claims in the United States, Denmark, France, Germany, Italy, Spain, Sweden and the United Kingdom. Eleven suits currently pending in the United States have been filed as purported class actions but only one has been certified. All U.S. federal court Gammagard® IVIG cases have been transferred to the U.S.D.C. for the Central District of California for case management under MDL rules. On February 21, 1996, the court certified a nationwide class of persons who had infused Gammagard® IVIG (*Fayne, et al., v. Baxter Healthcare Corporation,* U.S.D.C., C.D., CA, ML-95-160-R). The company sought an immediate stay of the class notice from the 9th Circuit Court of Appeals and subsequently filed a Writ of Mandamus seeking class decertification. The 9th Circuit Court of Appeals granted the stay of the class notice on March 19, 1996, and on April 12, 1996, granted a stay of the class certification pending final determination on the writ. On August 5, 1997, the 9th Circuit Court of Appeals denied the Writ of Mandamus. Baxter is vigorously defending these cases.

As of September 30, 1996, Allegiance assumed the defense of litigation involving claims related to Allegiance's businesses, including certain claims of alleged personal injuries as a result of exposure to natural rubber latex gloves. Allegiance has not been named in most of this litigation but will be defending and indemnifying Baxter pursuant to certain contractual obligations for all expenses and potential liabilities associated with claims pertaining to latex gloves. As of December 31, 1997, the company had been named as a defendant in 171 lawsuits, including the following purported class actions: *Wolf v. Baxter Healthcare Corp., et al.,* Circuit Court, Wayne County, MI, 96-617844NP; *Murray, et al., v. Baxter Healthcare Corp., et al.,* U.S.D.C., S. Dist. Ind., IP96-1889C, and *Cowart, Alma M. v. Baxter International, Inc.,* U.S.D.C. E. Dist., LA 97-1681. On February 26, 1997, all federal cases involving latex gloves were ordered to be transferred to the U.S.D.C. for the Eastern District of Pennsylvania for case management under the MDL rules (MDL Docket No. 1148).

A purported class action has been filed against Baxter, Caremark International Inc. (Caremark), C.A. (Lance) Piccolo, James G. Connelly and Thomas W. Hodson (all former officers of Caremark) alleging securities law disclosure violations in connection with the November 30, 1992, spin-off of Caremark in the Registration and Information Statement (Registration Statement) and subsequent SEC filings submitted by Caremark (*Isquith v. Caremark International Inc., et al.,* U.S.D.C., N. Dist. Ill., 94C 5534). On March 26, 1997, the Court dismissed the action against the company essentially on the ground that plaintiffs lacked standing to bring this action. On April 24, 1997, plaintiffs filed a notice of appeal which is still pending. Additionally, in February 1997, the plaintiffs served a separate state court action, styled as a class action, against Mr. Piccolo, Vernon R. Loucks Jr., William H. Gantz, William B. Graham and James R. Tobin, alleging violations of various state laws pertaining to the Caremark spin-off (*Isquith, et al., v. C. A. (Lance) Piccolo, et al.*, Circuit Court, Cook County, IL, Chancery Division, 96CH0013652). Baxter and the other defendants are vigorously defending this action.

Baxter has been named a potentially responsible party (PRP) for environmental cleanup costs at 16 hazardous-waste sites. Under the United States Superfund statute and many state laws, generators of hazardous waste that is sent to a disposal or recycling site are liable for cleanup of the site if contaminants from that property later leak into the environment. The laws generally provide that a PRP may be held jointly and severally liable for the costs of investigating and remediating the site. Allegiance has assumed responsibility for 10 of these sites, the largest of which is the Thermo-Chem site in Muskegan, Michigan. The estimated exposure for Baxter's remaining six sites is approximately $2 million, which has been accrued (and not discounted) in the company's financial statements.

In addition to the cases discussed above, Baxter is a defendant in a number of other claims, investigations and lawsuits. Based on the advice of counsel, management does not believe that, individually or in the aggregate, these other claims, investigations and lawsuits will have a material adverse effect on the company's results of operations, cash flows or consolidated financial position.



## 14 INDUSTRY AND GEOGRAPHIC INFORMATION

Baxter operates in a single industry segment as a global medical products and services company that is a leader in technologies related to the blood and circulatory system. It has market-leading positions in four businesses: *Blood Therapies*, which develops biopharmaceutical and blood-collection and separation products and technologies; *I.V. Systems/Medical Products*, which develops technologies and systems to improve intravenous medication delivery, and distributes medical products; *Renal*, which develops products and services to treat kidney disease; and *CardioVascular*, which develops products and provides services to treat late-stage heart disease and vascular disorders. The company's products include blood-clotting therapies and machines and supplies for collecting, separating and storing blood; prosthetic heart valves and cardiac catheters; dialysis equipment and supplies; and intravenous solutions and pumps.

## FINANCIAL INFORMATION BY GEOGRAPHIC AREA

*years ended December 31 (in millions)*

| | United States | Europe | Pacific Rim[1] | Latin America | Canada and other international | Other[2] | Inter-area eliminations | Total |
|---|---|---|---|---|---|---|---|---|
| **1997** | | | | | | | | |
| Trade sales | **$3,054** | **1,707** | **888** | **342** | **147** | **–** | **–** | **$6,138** |
| Inter-area sales | **$ 709** | **249** | **189** | **112** | **1** | | **(1,260)** | **–** |
| Total sales | **$3,763** | **1,956** | **1,077** | **454** | **148** | **–** | **(1,260)** | **$6,138** |
| Pretax income (loss) | **$ 324** | **370** | **248** | **61** | **35** | **(515)** | **–** | **$ 523** |
| Identifiable assets | **$5,480** | **2,202** | **551** | **427** | **80** | **–** | **(33)** | **$8,707** |
| 1996 | | | | | | | | |
| Trade sales | $ 2,824 | 1,322 | 890 | 260 | 142 | – | – | $ 5,438 |
| Inter-area sales | $ 761 | 182 | 179 | 129 | 3 | – | (1,254) | – |
| Total sales | $ 3,585 | 1,504 | 1,069 | 389 | 145 | – | (1,254) | $ 5,438 |
| Pretax income (loss) | $ 215 | 337 | 268 | 45 | 31 | (103) | – | $ 793 |
| Identifiable assets | $ 5,385 | 1,246 | 641 | 312 | 85 | – | (73) | $ 7,596 |
| 1995 | | | | | | | | |
| Trade sales | $ 2,634 | 1,215 | 860 | 204 | 135 | – | – | $ 5,048 |
| Inter-area sales | $ 675 | 158 | 191 | 113 | 2 | – | (1,139) | – |
| Total sales | $ 3,309 | 1,373 | 1,051 | 317 | 137 | – | (1,139) | $ 5,048 |
| Pretax income (loss) | $ 121 | 244 | 284 | 30 | 37 | (192) | – | $ 524 |
| Identifiable assets | $ 4,933 | 1,156 | 575 | 209 | 82 | – | (137) | $ 6,818 |

*1. Includes Japan, Australia, New Zealand and South Asia.*

*2. Consists of interest, net and in-process research and development charges (in 1997 and 1995) and litigation charges (in 1995).*

Inter-area transactions are accounted for using arm's-length principles. Identifiable assets are those assets associated with a specific geographic area. Goodwill and amortization have been allocated to geographic areas, as applicable.

## NET SALES AND NET ASSETS OF CONSOLIDATED FOREIGN SUBSIDIARIES AND BRANCHES

| *years ended December 31 (in millions)* | **1997** | 1996 | 1995 |
|---|---|---|---|
| Foreign net sales[1] | **$3,251** | $2,773 | $2,556 |
| Foreign assets[2] net of liabilities at end of year | **$2,601** | $1,876 | $1,424 |

*1. Includes U.S. export sales.*

*2. Includes advances from the company and its subsidiaries.*

## 15 QUARTERLY FINANCIAL RESULTS AND MARKET FOR THE COMPANY'S STOCK (UNAUDITED)

| *years ended December 31 (in millions, except per share data)* | First quarter | Second quarter | Third quarter | Fourth quarter | Total year |
|---|---|---|---|---|---|
| **1997** | | | | | |
| Net sales | **$1,443** | **$1,569** | **$1,494** | **$1,632** | **$6,138** |
| Gross profit | **661** | **714** | **669** | **754** | **2,798** |
| Income from continuing operations[1, 2] | **(203)** | **162** | **159** | **182** | **300** |
| Net income[1, 2] | **(203)** | **162** | **159** | **182** | **300** |
| Per common share: | | | | | |
| Income from continuing operations[1]: | | | | | |
| Basic | **(.74)** | **.58** | **.57** | **.65** | **1.08** |
| Diluted | **(.74)** | **.57** | **.56** | **.64** | **1.06** |
| Net income[1]: | | | | | |
| Basic | **(.74)** | **.58** | **.57** | **.65** | **1.08** |
| Diluted | **(.74)** | **.57** | **.56** | **.64** | **1.06** |
| Dividends | **.2825** | **.2825** | **.2825** | **.2910** | **1.139** |
| Market price | | | | | |
| High | **49.75** | **56.125** | **60.25** | **57.125** | **60.25** |
| Low | **39.875** | **41.563** | **51.375** | **43.625** | **39.875** |
| 1996 | | | | | |
| Net sales | $1,299 | $1,335 | $1,310 | $1,494 | $5,438 |
| Gross profit | 578 | 594 | 590 | 667 | 2,429 |
| Income from continuing operations | 138 | 142 | 137 | 158 | 575 |
| Net income[3] | 158 | 176 | 177 | 158 | 669 |
| Per common share: | | | | | |
| Income from continuing operations: | | | | | |
| Basic | .51 | .52 | .50 | .58 | 2.11 |
| Diluted | .50 | .51 | .49 | .57 | 2.07 |
| Net income: | | | | | |
| Basic | .58 | .65 | .65 | .58 | 2.46 |
| Diluted | .57 | .64 | .64 | .57 | 2.41 |
| Dividends | .2825 | .3025 | .3025 | .2825 | 1.17 |
| Market price | | | | | |
| High | 47.125 | 47.875 | 47.75 | 46.25 | 47.875 |
| Low | 40.00 | 41.25 | 41.375 | 40.125 | 40.00 |

*1. The first quarter includes $352 million of in-process research and development charges relating to the acquisitions of Immuno and RMI. The charges decreased earnings per share by $1.28.*

*2. The fourth quarter includes a pretax gain of $32 million relating to the divestiture of certain assets of the company's Immunotherapy division.*

*3. The third quarter includes a pretax gain of $36 million relating to the curtailment of the majority of Allegiance employees' participation in the company's pension and other postemployment benefit plans and a pretax charge of $12 million for costs associated with effecting the distribution of Allegiance.*

Baxter common stock is listed on the New York, Chicago and Pacific Stock Exchanges, on The London Stock Exchange and on the Swiss stock exchanges of Zurich, Basel and Geneva. The New York Stock Exchange is the principal market on which the company's common stock is traded.

## BOARD OF DIRECTORS

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President and Chief Executive Officer
Rogers Corporation

*Pei-yuan Chia*
Retired Vice Chairman
Citicorp and Citibank, N. A.

*John W. Colloton*
Vice President for Statewide
Health Services
The University of Iowa

*Susan Crown*
Vice President
Henry Crown and Company

*Mary Johnston Evans*
Former Director and Vice Chairman
Amtrak

*Frank R. Frame*
Adviser to the Board
HSBC Holdings plc
Retired Deputy Chairman
The Hongkong and Shanghai
Banking Corporation Limited

*Martha R. Ingram*
Chairman of the Board and
Chief Executive Officer
Ingram Industries Inc.

*Harry M. Jansen Kraemer Jr.*
President
Baxter International Inc.

*Arnold J. Levine, Ph.D.*
Professor of Biology and
Chairman of the Molecular
Biology Department
Princeton University

*Vernon R. Loucks Jr.*
Chairman of the Board and
Chief Executive Officer
Baxter International Inc.

*Georges C. St. Laurent Jr.*
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Western Bank

*Monroe E. Trout, M.D.*
Chairman Emeritus of the Board
American Healthcare Systems

*Reed V. Tuckson, M.D.*
Group Vice President for
Professional Standards
American Medical Association

*Fred L. Turner*
Senior Chairman of the Board and
Chairman of the Executive Committee
McDonald's Corporation

## HONORARY DIRECTORS

*William B. Graham*
Chairman Emeritus of the Board
Baxter International Inc.

*Ralph Falk II*
Private Investments



## EXECUTIVE OFFICERS

### Baxter International Inc.

*Vernon R. Loucks Jr.*
Chairman of the Board and
Chief Executive Officer

*Harry M. Jansen Kraemer Jr.* [1,2]
President

*Brian P. Anderson* [1,2]
Senior Vice President and
Chief Financial Officer

*Arthur F. Staubitz* [1,2]
Senior Vice President
Portfolio Strategy

*Michael J. Tucker*
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*John F. Gaither Jr.* [1,2]
Corporate Vice President
Corporate Development and Strategy

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Corporate Vice President and
Deputy General Counsel

*Kshitij Mohan*
Corporate Vice President
Research and Technical Services

*John L. Quick*
Corporate Vice President
Quality Management

*Thomas J. Sabatino Jr.* [1,2]
Corporate Vice President and
General Counsel

*Jan Stern Reed* [1,2]
Corporate Secretary

*Steven J. Meyer* [1,2]
Treasurer

### Baxter World Trade Corporation

*Timothy B. Anderson* [1]
Group Vice President
Biopharmaceuticals

*Donald W. Joseph* [1]
Group Vice President
Renal

*Carlos del Salto*
Senior Vice President
Latin America/Intercontinental

*J. Robert Hurley*
Corporate Vice President
Japan

*Roberto E. Perez* [1]
Corporate Vice President
and President
Fenwal

### Baxter Healthcare Corporation

*Jack L. McGinley*
Group Vice President
I.V. Systems/Medical Products

*Michael A. Mussallem*
Group Vice President
CardioVascular

*David F. Drohan*
Corporate Vice President
and President
I.V. Systems

*J. Michael Gatling*
Corporate Vice President
Global Manufacturing Operations

*1. Also an executive officer of Baxter Healthcare Corporation*

*2. Also an executive officer of Baxter World Trade Corporation*

*As of February 28, 1998*

**Corporate Headquarters**
Baxter International Inc.
One Baxter Parkway
Deerfield, Illinois 60015-4633
Telephone: (847) 948-2000
Internet: www.baxter.com

**Stock Exchange Listings**
Baxter common stock is listed on the New York, Chicago and Pacific Stock Exchanges, on The London Stock Exchange and on the Swiss stock exchanges of Zurich, Basel and Geneva. The New York Stock Exchange is the principal market on which the company's common stock is traded.

**Annual Meeting**
The 1998 Annual Meeting of Stockholders will be held on Tuesday, May 5 at 10:30 a.m. at Baxter's North Cove manufacturing facility, located in Marion, North Carolina.

**Transfer Agent**
First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303-2500
Telephone: (201) 324-0498
Internet: www.fctc.com

Correspondence concerning Baxter International stock holdings, lost or missing dividend checks, duplicate mailings, or changes of address should be directed to the above address.

**Dividend Reinvestment**
The company offers an automatic dividend-reinvestment program to all holders of Baxter International Inc. common stock. A detailed brochure is available on request from:
First Chicago Trust Company of New York
P.O. Box 2598
Jersey City, New Jersey 07303-2598
Telephone: (201) 324-0498

**Corporate News and Other Publications**
Corporate news releases, *Forms 10-K* and *10-Q*, and the company's annual report filed with the Securities and Exchange Commission, are available through Baxter's home page on the Internet at: www.baxter.com.

Baxter's *Form 10-K* also is available on request from:
Baxter International Inc.
Investor Relations
One Baxter Parkway
Deerfield, Illinois 60015-4633
Telephone: (847) 948-4550

Audio cassette copies of Baxter's *1997 Annual Report* also are available on request at the above address.

Stockholders who would like to receive a telefax copy of Baxter's most recent corporate news or earnings releases may call toll free in the United States at (800) 758-5804, and enter 100340 when an identification number is requested.

**Customer Inquiries**
Customers who would like general information about Baxter's products and services may call the Center for One Baxter toll free in the United States at (800) 422-9837, or by dialing (847) 948-4770. For specific information, please contact your sales or customer-service representative.

| *as of and for the years ended December 31* | | 1997[1] | 1996[2] | 1995[3] | 1994 | 1993[4] |
|---|---|---|---|---|---|---|
| OPERATIONS *(in millions)* | Net sales | $6,138 | 5,438 | 5,048 | 4,479 | 4,116 |
| | Income (loss) from continuing operations | $ 300 | 575 | 371 | 406 | (193) |
| | Depreciation and amortization | $ 398 | 348 | 336 | 302 | 273 |
| | Research-and-development expenses[5] | $ 392 | 340 | 327 | 303 | 280 |
| CAPITAL EMPLOYED *(in millions)* | Capital expenditures | $ 496 | 398 | 399 | 380 | 332 |
| | Total assets | $8,707 | 7,596 | 9,437 | 9,039 | 9,211 |
| | Long-term debt and lease obligations | $2,635 | 1,695 | 2,372 | 2,341 | 2,800 |
| | Operational cash flow from continuing operations[6] | $ 274 | 490 | 316 | 618 | 160 |
| PER COMMON SHARE | Average number of common shares outstanding (in millions)[7] | 278 | 272 | 277 | 280 | 277 |
| | Income (loss) from continuing operations per common share: | | | | | |
| | Basic | $ 1.08 | 2.11 | 1.34 | 1.45 | (0.70) |
| | Diluted | $ 1.06 | 2.07 | 1.32 | 1.44 | (0.70) |
| | Cash dividends per common share | $1.139 | 1.17 | 1.11 | 1.025 | 1.00 |
| | Year-end market price per common share | $50.44 | 41.00 | 41.88 | 28.25 | 24.38 |

*1. Income from continuing operations includes an in-process research-and-development charge of $352 million.*

*2. Certain balance sheet and other data are significantly affected by the spin-off of Allegiance Corporation, which occurred on September 30, 1996.*

*3. Income from continuing operations includes a pretax restructuring charge of $103 million, a pretax litigation charge of $96 million and an in-process research-and-development charge of $18 million.*

*4. Loss from continuing operations includes a pretax restructuring charge of $216 million and a pretax litigation charge of $330 million.*

*5. Excludes in-process research-and-development charges of $352 million and $18 million in 1997 and 1995, respectively.*

*6. The company's operational cash flow measurement is defined on page 22.*

*7. Excludes common stock equivalents.*

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