

BAXTER INTERNATIONAL

ANNUAL REPORT 1998

All of Baxter's businesses hold leading positions in growing global markets. Driving this leadership are talented, dedicated people, all pursuing a common vision—to be recognized worldwide as the leader in providing critical therapies for life-threatening conditions.

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PROFILE: Baxter participates in four major businesses: Blood Therapies, CardioVascular, I.V. Systems/Medical Products and Renal. This profile provides an overview of each of these businesses.

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TO OUR SHAREHOLDERS: Baxter Chairman Vernon R. Loucks and President and CEO Harry M. Jansen Kraemer discuss highlights of 1998, goals for 1999 and Baxter's exciting future.

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FOCUSED ON GROWTH: Since 1931, Baxter has pioneered medical technologies to treat kidney failure, heart disease, hemophilia and many other conditions. Today, Baxter continues to drive growth by advancing these therapies.

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NEW PRODUCTS: Technological innovation continues to be one of Baxter's key growth strategies. One example is the Colleague® volumetric infusion pump, one of Baxter's most successful new products.

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ACQUISITIONS: In the last two years, Baxter has added to its capabilities in anesthesia products, renal and intravenous solutions, therapeutic proteins, recombinant technology and other areas through selective acquisitions.

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TREATING HEMOPHILIA: Baxter has a long history of leadership in the treatment of hemophilia. The company is expanding its production capacity to meet the growing needs of the hemophilia community.

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PERITONEAL DIALYSIS: Baxter's leadership in peritoneal dialysis (PD) is unquestioned. The company pioneered PD in the late 1970s. Today, PD continues to grow primarily due to the cost and lifestyle advantages it provides.

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STATE OF THE HEART: Baxter is the world's leading provider of tissue heart valves. The company continues to broaden its product offering to meet a full range of patient needs in heart-valve surgery.

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GLOBAL EXPANSION: The need for quality health care worldwide continues to drive growth, particularly in developing countries. Continuing to expand its presence outside the United States is one of Baxter's key growth strategies.

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BUSINESS EXCELLENCE: Baxter and its employees continue to earn high marks for environmental leadership, quality manufacturing, community involvement and employee work-and-life programs.

PROFILE: THE BUSINESSES OF **BAXTER**

**I.V. SYSTEMS /
MEDICAL PRODUCTS**

1998 Sales: \$2.3 billion



Colleague® triple-channel pump

CORE BUSINESS: Baxter provides a range of products that deliver fluids and drugs to patients. The company introduced the first commercially manufactured intravenous (IV) solutions in 1931, and remains the world's leading manufacturer and marketer of IV products for use in hospitals and other health-care settings. These products include IV solutions in flexible, plastic containers; IV tubing sets; electronic infusion pumps; IV nutrition products; anesthesia products and pharmaceutical agents; and ambulatory IV delivery systems.

BLOOD THERAPIES

1998 Sales: \$1.9 billion



Recombinant™ Antihemophilic Factor

CORE BUSINESS: Baxter develops and processes therapeutic proteins from plasma and through recombinant methods. These proteins are used to treat hemophilia, immune deficiencies and other blood-related disorders. The company manufactures blood-collection containers and automated blood-cell separation and collection systems used by hospitals and blood banks to collect blood components. These components are used to treat patients undergoing surgery, cancer therapy and other treatments. Baxter also manufactures products used by plasma centers to collect plasma for fractionation.

RENAL

1998 Sales: \$1.5 billion



HomeChoice® automated peritoneal dialysis machine

CORE BUSINESS: Baxter provides products and services for kidney dialysis. The company is the world's leading manufacturer of products for peritoneal dialysis (PD), a home-based therapy pioneered by Baxter in the late 1970s. Baxter also manufactures products for hemodialysis (HD), a therapy which takes place in a hospital or clinic. Baxter's Renal Therapy Services (RTS) unit operates dialysis clinics in select countries outside the United States. Renal Management Strategies Inc. (RMS) is a kidney-disease management company that partners with U.S. nephrologists.

CARDIOVASCULAR

1998 Sales: \$0.9 billion



Carpentier-Edwards® pericardial heart valve

CORE BUSINESS: Baxter develops and manufactures products to treat late-stage heart disease and vascular disorders. These products include replacement heart valves and valve-repair products; perfusion products, used to provide oxygen to the blood while the heart and lungs are stopped during open-heart surgery; vascular products, which remove clots from peripheral blood vessels; cardiac-monitoring systems; heart-assist systems; and contract perfusion services.

INTERNATIONAL

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™ containers carry the industry's broadest line of premixed drugs for IV delivery. The Colleague® volumetric infusion pump provides accurate, cost-effective electronic infusion at a wide range of flow rates. The company also provides solutions and automated compounding equipment for IV nutrition; ambulatory-infusion devices; and a full range of anesthesia-delivery devices and anesthetic agents.

PRODUCT DEVELOPMENT: In the area of automated electronic IV infusion systems, Baxter has made advancements to its Colleague pump technology, introducing the new triple-channel Colleague pump in 1998. The triple-channel pump allows for the infusion of up to three IV solutions to a patient from a single pump. The company also continues to expand its industry-leading line of premixed drugs in Mini-Bag containers, and the acquisition of Bieffe Medital S.p.A. adds new cost-effective technology for manufacturing IV solutions in non-PVC containers.

GLOBAL STRATEGY: In established markets, such as North America and parts of Europe, Baxter uses its recognized leadership in IV solutions to introduce specialty products that increase productivity and reduce costs for customers. In new markets, Baxter's strategy is to establish a presence with its basic products and then broaden its offering as the focus on health care increases. The company has a strong IV manufacturing presence in many parts of the world, and also continues to form joint ventures to market or manufacture IV products in the Latin American, Asian and Eastern European regions.

KEY PRODUCTS: Therapeutic proteins include Recombinate™ Antihemophilic Factor (recombinant); Gammagard® S/D IGIV, which boosts weakened immune systems; and Tisseel® fibrin sealant, used to control bleeding in surgery. Baxter also manufactures vaccines, including the leading vaccine for tick-borne encephalitis; the Fenwal Blood-Pack® unit for blood collection; the Autopheresis-C® system for collecting plasma for fractionation; the Amicus® separator for collection of platelets and plasma for transfusion; and leukoreduction systems.

PRODUCT DEVELOPMENT: Baxter is pursuing a 100-percent protein-free manufacturing process for a recombinant blood-clotting factor and other recombinant proteins, as well as new plasma fractions, wound-management products and vaccines. In blood collection, Baxter is developing technology to automate the collection of red cells, and has partnered with Cerus Corporation on pathogen-inactivation technologies. Baxter also is developing a recombinant solution to replicate the function of the hemoglobin molecule in carrying oxygen to vital organs in cases of severe blood loss.

GLOBAL STRATEGY: Baxter continues to develop technologies that result in enhanced safety and purity of blood therapies, and expand the use of these technologies around the globe. In 1998, more than a third of the sales of Baxter's blood-therapy products were in Europe. These products also have strong positions in North America and Japan. Established products like blood-collection containers and plasma-derived clotting-factor concentrates continue to drive growth in developing markets in Asia and Latin America.

KEY PRODUCTS: Baxter's Dianeal® solution is the world's leading PD solution. Baxter also provides solutions developed for specific patient needs, such as Nutrineal™ solution, which provides extra nutrition to patients, and Extraneal™ solution, which draws more waste from the bloodstream. Baxter's UltraBag™ twin-container system simplifies solution-exchanges and lowers infection rates for patients on continuous ambulatory peritoneal dialysis (CAPD). The HomeChoice® automated PD machine is a lightweight, compact PD system that cleanses the blood overnight while the patient sleeps.

PRODUCT DEVELOPMENT: Baxter continues to develop new PD solutions to manage specific patient conditions and advanced hardware systems for both PD and HD. The company also is investing in transplantation, the only alternative to dialysis in the treatment of end-stage renal disease. Baxter's Nextran unit leads research-and-development efforts in xenotransplantation—animal-to-human transplants. Researchers are working to develop genetically modified pig organs that will be transplanted safely into humans someday. This research extends beyond kidneys to livers, hearts and other organs.

GLOBAL STRATEGY: There are more than 800,000 known dialysis patients worldwide. Many more people with end-stage renal disease, particularly in developing countries, are not treated. Baxter's strategy is to increase PD penetration in developed countries, and expand rapidly in developing countries, where PD is the preferred treatment due to its low start-up costs. Baxter also will continue to invest in hemodialysis products, its RTS business and its RMS business.

KEY PRODUCTS: The Carpentier-Edwards® pericardial heart valve is the world's leading tissue heart valve. The company's Swan-Ganz® catheters, used to measure pressures in the heart as well as cardiac output, and Fogarty® catheters, used in vascular surgery, are industry standards. The Novacor® left-ventricular assist system, an implantable heart-assist device for patients in need of a transplant, was approved as a bridge to heart transplant in the United States in 1998. It has been approved in Europe as both a bridge and an alternative to heart transplant since 1994.

PRODUCT DEVELOPMENT: Baxter works with leading clinicians around the world to develop new products and services to treat late-stage cardiovascular disease. These include new heart valves, both tissue and mechanical, and valve-repair products; vascular products to treat diseased blood vessels; enhanced perfusion products, and other technologies. A major emphasis in these development efforts is the trend toward products that lend themselves to less invasive and less traumatic surgical techniques.

GLOBAL STRATEGY: Heart disease claims more lives and requires greater financial resources than any other medical ailment. Baxter focuses on products and services for late-stage cardiovascular disease, when conditions are most likely to have a devastating impact on a patient's quality of life. This business is most successful in countries such as North America, Europe and Japan, where technological advancements are more widely accepted. An aging population and the progressive nature of cardiovascular disease will continue to drive growth in these markets. Developing countries represent longer-term growth opportunities.

TO OUR SHAREHOLDERS

A LETTER FROM BAXTER MANAGEMENT:

At Baxter International, we meet 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. Important to our employees, who know they are in the business of saving and improving lives. And important to our shareholders, who invest in the opportunity to advance the frontiers of medicine around the world.

All of us on the Baxter team are inspired by a very meaningful mission: providing critical medical therapies for life-threatening conditions. Millions of people around the world suffering from heart disease, kidney failure, hemophilia, cancer and other illnesses count on us, our products, and our services to dramatically improve the quality of their lives. Often, we make the difference between life and death.

A YEAR OF SUCCESS Baxter had another strong year in 1998. We received approval from the U.S. Food and Drug Administration (FDA) to manufacture Recombinate™ Antihemophilic Factor (recombinant) at our facility in Thousand Oaks, California. We introduced a number of new products in the U.S., such as Tisseel® fibrin sealant, a triple-channel version of our highly successful Colleague® volumetric infusion pump and our Novacor® left-ventricular assist system. We added clinics to our Renal Therapy Services business in Europe, Asia and Latin America. We also made several acquisitions, such as Ohmeda Pharmaceutical Products Division of The BOC Group, which gives us a full range of products for use in anesthesia; and Somatogen, Inc., which is developing a recombinant solution to deliver oxygen to vital organs in cases of severe blood loss. These and other successes allowed us to once again deliver strong returns to you, our shareholders.

1998 FINANCIAL COMMITMENTS In 1998, Baxter generated a total return to shareholders (including reinvested dividends) of 30 percent, which represents our fifth consecutive year of strong financial returns. Over the last five years, the annual return to shareholders (including reinvested dividends) was 28 percent. This compares to the Dow Jones

Industrial Average return of 20 percent and the S&P Medical Products and Supplies Index return of 33 percent. The following represents our 1998 financial commitments and our results:

- **Increase net sales approximately 10 percent, before acquisitions and the impact of foreign exchange.** Sales rose 11 percent, including acquisitions and before the impact of foreign exchange. Excluding acquisitions and foreign exchange, sales grew 8 percent.
- **Grow net earnings in the mid-teens, before the impact of foreign exchange, and in the low double digits after absorbing the impact of foreign exchange.** Excluding special charges, income from continuing operations increased 12 percent. Excluding special charges and the impact of foreign exchange, income from continuing operations exceeded our goal of mid-teens growth.
- **Generate at least \$500 million in operational cash flow, after investing approximately \$1 billion in capital expenditures and research and development.** Baxter generated \$515 million in operational cash flow, and excluding special charges, invested \$975 million in research and development and capital expenditures.

This year also presented some challenges. Foreign-currency fluctuations had a negative impact on our financial results. We experienced manufacturing capacity constraints for some of our Blood Therapies products. We also decided to focus on the development of our recombinant oxygen-carrying hemoglobin therapeutic while discontinuing testing of our plasma-based product, HemAssist® (DCLHb).

