Baxter International 1999 Annual Report

Saving Lives Worldwide

Baxter

Baxter's vision is to be the global leader in providing critical therapies for people with life-threatening conditions. We will achieve this vision by reaching our goals of:

- Best Team = Building the best global team in health care;
- Best Partner = Creating sustainable win-win customer relationships;
- Best Investment = Consistently delivering significant shareholder return.

The overall result is that Baxter will be recognized as one of the most admired companies in the world.

COVER PHOTO These are just a few of the patients around the world whose lives have been touched by Baxter. Every day, the company's products and technologies help thousands of people with kidney failure, hemophilia, infectious diseases, immune deficiencies and other life-threatening conditions lead active and productive lives.

Contents

The Businesses of

I.V. Systems / Medical Products

1999 Sales: $2.5 billion

BUSINESS DESCRIPTION Baxter manufactures a range of products used to deliver fluids and drugs to patients. These products provide fluid replenishment, nutrition therapy, pain management, antibiotic therapy, chemotherapy and other therapies. The company provides intravenous (IV) and irrigating solutions in flexible, plastic containers; premixed liquid and frozen drugs for IV delivery; IV access systems and tubing sets; electronic IV infusion pumps; solutions, containers and automated compounding systems for IV nutrition; IV anesthesia devices and inhalation agents; and ambulatory infusion systems. The company also provides custom IV solution compounding services in a number of markets around the world.

GLOBAL STRATEGY In established markets, such as North America, Australia and parts of Europe, Latin America and Asia, Baxter uses its recognized leadership in IV therapy to introduce value-added products that increase productivity and quality while reducing costs for hospitals and other health-care providers. In new and developing markets, Baxter's strategy is to establish a presence with selected products based on local market requirements and then broaden its offering as the market develops and market acceptance of Baxter's technologies grows. Although the company has a strong manufacturing presence all over the world, it also continues to form joint ventures to market or manufacture its IV products in developing regions of Asia, Latin America and Eastern Europe. Because IV products are used in such a broad range of medical therapies, Baxter expects much of its future growth to come from the continuing economic expansion of developing regions as health-care standards improve.

Blood Therapies

1999 Sales: $2.2 billion

BUSINESS DESCRIPTION Baxter produces therapeutic proteins from plasma and through recombinant methods to treat hemophilia, immune deficiencies and other blood-related disorders. These include coagulation factors, immune globulins, albumin, wound-management products and vaccines. Baxter also manufactures blood-collection containers and automated blood-cell separation and collection systems. These products are used by hospitals, blood banks and plasma-collection centers to collect and process blood components for therapeutic use, or for processing into therapeutic products, such as albumin. Therapeutic blood components are used to treat patients undergoing surgery, cancer therapy and other critical therapies.

GLOBAL STRATEGY The company expects continued growth from its Recombinate™ Antihemophilic Factor (recombinant), used to treat hemophilia A (the most common form of hemophilia, characterized by lack of a clotting factor, Factor VIII), as more production capacity comes on line in Baxter's recombinant facility in Thousand Oaks, California, in 2000. For Baxter's blood-collection products, increased automation and the incorporation of leukoreduction technologies (to eliminate unwanted white cells from collected blood components) is expected to continue to drive growth. Technologies to automate the collection of red cells and inactivate viral pathogens in collected blood components will provide opportunities for longer-term growth.

Renal

1999 Sales: $1.7 billion

BUSINESS DESCRIPTION Baxter provides a range of renal dialysis products and services to support people with kidney failure. The company is the world's leading manufacturer of products for peritoneal dialysis (PD), a home dialysis therapy. These products include PD solutions, container systems, and automated machines that cleanse patients' blood overnight while they sleep. Baxter also manufactures dialyzers and instrumentation for hemodialysis (HD). Baxter's Renal Therapy Services (RTS) operates dialysis clinics in 12 countries outside the United States, while Renal Management Strategies Inc. (RMS) partners with U.S. nephrologists to provide a kidney-disease management program to health-care payers.

GLOBAL STRATEGY There are approximately one million known dialysis patients in the world. Many more people with kidney disease currently go undiagnosed or untreated, particularly in developing countries. Because PD can offer a lower-cost alternative to HD, which requires an infrastructure of clinics, one of Baxter's strategies is to increase the use of PD in developing countries where people desperately need some form of dialysis treatment. Baxter also seeks to expand PD penetration in developed countries, where the lifestyle advantages offered by the therapy make it an attractive alternative to in-center care for certain patients. Baxter will continue to invest in both PD and HD and in its RTS business in order to improve patient outcomes and provide a full spectrum of quality, cost-effective dialysis products and services that best meet the needs of patients, physicians and payers.

Baxter International

PRODUCT DEVELOPMENT Two years ago, Baxter introduced the Colleague® single-channel volumetric infusion pump, and in 1999 launched a triple-channel version, allowing clinicians to administer up to three IV solutions at a time to a patient from a single pump. Also in 1999, Baxter launched a German-language version of the Colleague, and in 2000, will introduce Colleague in additional languages. In addition, last year Baxter launched a new electronic ambulatory infusion pump for pain management and a new multichamber bag for IV nutrition. In 2000, the company plans to release a new automated compounding system for use by hospital pharmacies to custom-mix patient-specific IV nutrition solutions. Baxter also continues to look at advancing technologies in the "needleless" IV access area, and at expanding its industry-leading line of premixed drugs.

ACQUISITIONS AND ALLIANCES Baxter's 1998 acquisition of Bieffe Medital S.p.A. brought low-volume, low-cost manufacturing technology to Baxter for IV and dialysis solutions. Also in 1998, Baxter acquired Ohmeda Pharmaceutical Products, establishing Baxter as a provider of anesthesia and anesthesia-related therapies and delivery devices in the United States. In 1999, Baxter reclaimed the distribution rights for its inhalation agents in Canada and Western Europe from Pharmacia & Upjohn, Inc., and also acquired its IV business in Germany. Baxter also began distributing Gensia Sicor's generic propofol anesthetic. Late in 1999, Baxter announced the acquisition of several outpatient infusion pumps and related medical systems from Sabratek Corporation. Baxter also continues to expand its alliances with pharmaceutical companies to premix and package their drugs in Baxter IV solution containers.

PRODUCT DEVELOPMENT In the first quarter of 1999, Baxter launched a recombinant Factor IX product in Europe. It is the only recombinant product available to treat patients with a less common form of hemophilia, hemophilia B. Baxter also continues to pursue a protein-free manufacturing process for recombinant blood-clotting factors. Other products in development include a next-generation fibrin sealant and vaccines for Lyme disease and influenza. In blood processing, Baxter and its development partner, Cerus Corporation, are in clinical trials with pathogen-inactivation technologies for platelets, plasma and red cells. Baxter also is developing technology for the automated collection of red cells. In addition, the company 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.

ACQUISITIONS AND ALLIANCES Baxter's 1997 acquisition of Immuno AG greatly expanded the company's portfolio of plasma-derived therapeutic proteins. It also added significant new wound-management products, like Tisseel® fibrin sealant, and vaccines to Baxter's product offering, while strengthening Baxter's market presence and research-and-development capabilities in Europe. In 1998, Baxter acquired Somatogen, Inc., a biopharmaceutical company engaged in recombinant hemoglobin technology. Recombinant hemoglobin solutions are designed to replicate the function of the hemoglobin molecule in carrying oxygen to vital organs in cases of severe blood loss. In November 1999, Baxter announced plans to acquire North American Vaccine, Inc., further broadening its position in the vaccines market. Also, Baxter's alliance with Cerus Corporation in the development of technologies to inactivate viral pathogens in collected blood components represents a significant area of potential future growth.

PRODUCT DEVELOPMENT In 1999, Baxter introduced a new generation of HomeChoice® technology: the HomeChoice® PRO with PD-Link.™ In addition to providing overnight dialysis, the device improves patient monitoring by allowing physicians to electronically access therapy data directly from the machine. Baxter also continues to develop new PD solutions to manage specific patient conditions. These include Nutrineal™ solution, which provides extra nutrition to patients, and Extraneal™ solution, which draws excess fluid from the bloodstream. For HD patients, Baxter has received approval from the U.S. Food and Drug Administration for its new Meridian™ hemodialysis instrument. The company also is investing in xenotransplantation—animal-to-human transplants. Baxter's Nextran unit is working to develop genetically modified pig organs that someday could be transplanted safely into humans. This research extends beyond kidneys to livers, hearts and other organs.

ACQUISITIONS AND ALLIANCES In late 1999, Baxter announced that it was acquiring Althin Medical AB, a Swedish manufacturer of hemodialysis instruments and dialyzers. Also in 1999, Baxter entered into a joint venture with Gambro AB of Sweden to create Tandem Healthcare LLC. Tandem manufactures dialyzers—the filters through which blood is circulated to cleanse it during hemodialysis—for both Baxter and Gambro in Baxter's Mountain Home, Arkansas, plant. The company's RTS business continues to acquire dialysis clinics in Asia, Europe and Latin America, where it operates the clinics in partnership with local physicians. RTS entered the year 2000 with more than 160 clinics in Argentina, Brazil, China, Colombia, France, Indonesia, Korea, Malaysia, Singapore, Spain, Taiwan and the United Kingdom.

To Our Shareholders

Welcome! It is my pleasure to give you, our shareholders, an update on your company. I say *your* company because, as one of Baxter's shareholders (like many Baxter team members around the world who own Baxter common shares), you *own* the company. It is incumbent on our management team to make sure that each of you understands what we're trying to accomplish as a company, and why we believe it will lead to higher returns for you.

Harry M. Jansen Kraemer, Jr.
Chairman and Chief Executive Officer

Having just completed my first year as Baxter's chief executive officer, and now in my first year as chairman of the company's board of directors, I'm excited to share with you Baxter's mission, our 1999 financial performance, and where we are headed as a company. In addition, I will set specific commitments for the year 2000 against which you can track our progress. I also will comment on how we intend to build for Baxter's future.

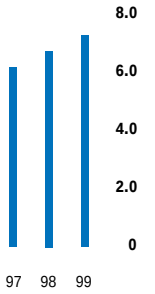
BAXTER'S MISSION

I believe we are truly privileged to be part of the global health-care industry. Virtually everything we do plays an important role in helping to save lives around the world. I receive many touching letters from patients and physicians during the year. These individuals articulate far better than I the significant difference that Baxter's 45,000 team members make each and every day. An example is a letter we received from Alvin Ornstein of Honeoye Falls, New York:

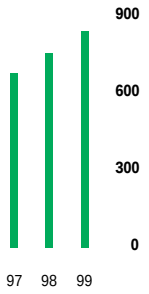
"I want to thank and commend you and all of the wonderful people at Baxter for their wonderful work in helping extend the life of my wife. Five years ago, we learned my wife had to have dialysis and it seemed like the end. We selected peritoneal dialysis with your HomeChoice® cycler. It became our lifeline. We lived at home normally and traveled across the country in our travel trailer with the cycler and supplies for four years. They were good times. She died a few weeks ago and I want you to know how great your people are whom I've had dealings with…"

He went on to single out the Baxter team members who delivered their supplies, helped with arrangements for their trips, and lent other support throughout the course of the therapy. What makes me feel very proud is that Baxter makes similar contributions to the lives of thousands of people around the world every day.

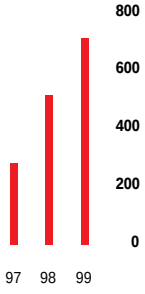
As will be discussed in the section of this report beginning on page 10, our



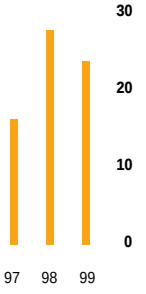
Net Sales[1]
(in billions of dollars)



Net Income[2]
(in millions of dollars)



Operational Cash Flow[3]
(in millions of dollars)



Compound Five-Year Annual Shareholder Return
(percentage including reinvested dividends)

global team is living a common mission: *providing critical therapies for people with life-threatening conditions.* As William Graham, chairman emeritus of Baxter's board of directors, has stated often during the past 50 years: "It's great to do well by doing good."

BAXTER'S 1999 FINANCIAL PERFORMANCE

I firmly believe that Baxter's credibility with shareholders is dependent on setting clear, specific financial commitments and consistently achieving each and every one of them. Your Baxter team did that once again in 1999. Our 1999 commitments and results, including the CardioVascular business, are summarized below.

Increase net sales approximately 10 percent. In 1999 we achieved growth in net sales of 10 percent. Of particular note was the 17 percent growth in our Blood Therapies business. On a geographical basis, Japan grew almost 20 percent.

Grow net earnings in the low double digits. In 1999, excluding special charges, we achieved growth in net earnings of 15 percent and diluted earnings per share were $2.86, an increase of 13 percent.

Generate $500 million in operational cash flow, after investing approximately $1 billion in capital expenditures and research and development. Clearly, a key driver of Baxter's financial strength and future stock price is the consistent generation of operational cash flow. In 1999, I'm proud to report that after investing a total of $1.1 billion in capital expenditures and research and development, we generated $719 million in operational cash flow. As you will see, we have even more aggressive goals in place for the year 2000.

In addition to achieving these three financial goals, we announced in July 1999 our plans to spin off Baxter's CardioVascular business as a separate publicly traded company. The new company, which will be named Edwards Lifesciences Corporation, is now expected to begin trading as an independent company by the end of the first quarter, 2000. I am very confident that Edwards Lifesciences will be a leader in the cardiovascular market going forward.

Baxter's compound five-year annual return for the period 1994–1999 is 23 percent, versus 26 percent for the S&P Medical Index. However, despite achieving all of our commitments for 1999, Baxter's total return to shareholders for the year was approximately zero percent. This return exceeded our peer group, the S&P Medical Index, by seven percentage points (zero percent versus a negative seven percent for the S&P Medical Index).

WHERE WE'RE HEADED

The key to Baxter achieving its vision is for all Baxter team members to live our

"We must build a culture of speed and clarity in everything we do."

"Using E-business to

Shared Values of *respect*, *responsiveness* and *results*. I believe that by truly respecting everyone on the team, bringing out the best in one another, and constantly improving our responsiveness to customers and patients, we will consistently generate significant results. Our Shared Values are the foundation of everything we do. As a result, we are well positioned to focus on our three key goals: building the *Best Team*, being the *Best Partner* and generating the *Best Investment* for our shareholders.

Best Team = *Building the best global team in health care.* This may seem easy or obvious, but it's not. Our objectives are to share ideas and resources across Baxter worldwide and ensure clear, frequent, two-way communication. The goal is not for individuals on the team to be right, but rather, to make sure we do the right thing consistently for patients, customers, shareholders and all members of the Baxter team. We must attract, develop and retain the best people and create an environment that inspires, motivates and rewards teams and individuals. We must build a culture of speed and clarity in everything we do.

I believe a key ingredient to becoming the Best Team is for each of us to bring our "whole person" to work every day. That whole person includes our job, our family, our health, our religious convictions and our social interactions. That's what makes each of us unique and adds life and vitality to the Baxter family. By creating a balance in our work and family life and creating a flexible work environment for all Baxter team members, I believe we're doing what is socially responsible *and* creating a significant competitive advantage for Baxter as a preferred place to work.

Best Partner = *Creating sustainable win-win customer relationships.* In a large company, it is important to keep in mind that the reason we've built a strong team is to serve patients and customers. We must remain extremely focused and align our priorities with the requirements of patients and customers. We need to consistently evaluate and meet agreed-upon patient and customer requirements and continue to develop innovative products and services to meet their needs. We are making progress and are always striving to make improvements.

Best Investment = *Consistently delivering significant shareholder return.* I believe there are several key drivers of shareholder return. It is crucial to have a strong team and be patient- and customer-focused, but we must also be innovative. We will do this by delivering new products and services through internal development, acquisitions and alliances, which will generate profitable growth in sales and earnings, leading to long-term growth in operational cash flow.

As a result of achieving our goals of Best Team, Best Partner and Best Investment, Baxter will be recognized as one of the most admired companies in the world.

Given the high projected growth and increased need for health care around the world, the key disease states on which we focus, and our core

enhance our competitive position is one of my top priorities."

capabilities, I believe we have a host of future opportunities. Each of these topics is discussed in more detail in the body of this report.

COMMITMENTS FOR THE YEAR 2000

Our specific commitments for the year 2000, excluding Edwards Lifesciences, are as follows:

- *Increase net sales approximately 10 percent.*
- *Grow net earnings in the mid-teens.*
- *Generate a minimum of $500 million in operational cash flow after investing more than $1 billion in capital expenditures and research and development.*

We are working aggressively to incorporate E-business applications into all aspects of our business. We are expanding our web sites to link us more closely with patients, physicians and points of care. We are using the Internet to facilitate collaboration with research partners in product development. We are using E-business tools to increase the speed and efficiency with which we deal with customers, suppliers and other Baxter team members in our day-to-day operations. Using E-business to enhance our competitive position is one of my top priorities. I will keep you apprised of our progress in this area.

LOOKING TO THE FUTURE

As you know, in December 1999, Vern Loucks retired as Baxter's chairman of the board, having served in that capacity for 15 years, and having served Baxter for a total of 34 years. I have always considered him an excellent mentor, advisor and friend, and I wish him well in his future endeavors. In addition, I want to thank Mike Mussallem for his many contributions to Baxter and wish him success as Edwards Lifesciences' chairman and chief executive officer.

SUMMARY

I believe Baxter is uniquely positioned for the future. As you read this report, I hope you will gain an understanding of: 1) Baxter's growth opportunities; 2) the company's mission; 3) our core capabilities and how we leverage them across the company, and 4) new product development and our plans for the future.

It's important to me that you, our shareholders, understand where we're headed. I would appreciate hearing from you with any questions or comments. Feel free to reach me via e-mail at onebaxter@baxter.com and I'll make sure that we get back to you very quickly.

Thanks for your attention. Here's wishing you, your families and friends a fantastic year 2000!

On behalf of the entire Baxter team,

Sincerely,

Harry M. Jansen Kraemer, Jr.
Chairman and Chief Executive Officer

1. Includes the CardioVascular business.

2. Net income excludes special charges for spin-off costs, the cumulative effect of an accounting change, in-process research and development, net litigation, and exit and other reorganization costs, as applicable in each year.

3. See definition on page 27.

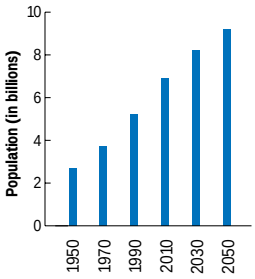
A World Of

LIVING LONGER LIVES People are living longer all over the world. The year 2000 marks the first time in history that people over age 60 will outnumber those age 14 and younger in industrialized countries. The population of Third World countries is aging at an even greater rate. As people age, the severity of illness becomes more acute, creating a greater need for health-care resources.

Opportunity

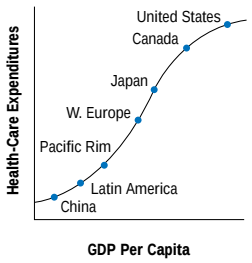
Health care is one of the fastest-growing industries in the world. This growth is being fueled by a combination of factors, including a growing and aging population. On October 12, 1999, the world population exceeded six billion and it is projected to double to 12 billion before the end of the 21st century. The greatest population growth is in developing countries—places like China, India and Latin America. As the economic expansion continues in these countries, their spending on health care will increase. In addition, the world population is aging. Globally, the average life span has jumped from 49.5 years in 1972 to more than 63 years today. As people get older, they usually require more health care. As these trends continue, the demand for the products, services and therapies that Baxter provides will increase. With Baxter's significant global presence, the company is well positioned to meet the needs of patients in high-growth markets worldwide. ■

WORLD POPULATION 1950—2050



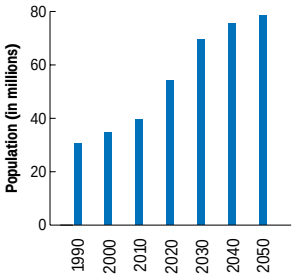
The world's population continues to grow steadily. It exceeded 6 billion during 1999 and is expected to reach 9 billion by the year 2050. (Source: United Nations world population estimates)

HEALTH-CARE EXPENDITURES PER CAPITA



As the economy of a country grows, its heath-care spending increases, making developing countries Baxter's fastest-growing markets. (Source: Baxter estimates)

THE AGING POPULATION



In the United States, the number of people age 65 and older will more than double, reaching nearly 80 million, by the year 2050. Similar trends exist worldwide. (Source: U.S. Bureau of the Census)

We're Living

SURGICAL INTERVENTION During a surgical procedure, most patients will likely receive a product that is made by Baxter. Whether it be an intravenous (IV) solution delivered by a Baxter IV pump, a blood transfusion from a Baxter blood bag, an anesthetic agent for general anesthesia, fibrin sealant to promote blood clotting and help seal wounds in surgery, or even pain management following surgery, Baxter provides a range of products to meet the needs of surgical patients.

Our Mission

As we enter the 21st century, the growing, aging population is creating unprecedented, explosive growth in medical conditions that occur more frequently and grow more acute with age. Baxter manufactures and markets products and services that are used to treat patients with many of these conditions, including cancer, trauma, hemophilia, immune deficiencies, infectious diseases, kidney disease and other disorders. The company also manufactures products that are used in the treatment of patients undergoing most surgical procedures. All of these conditions can cause severe physical, emotional and financial burdens to patients and their families. Baxter's role is to help alleviate these burdens by developing innovative technologies that improve the patient's quality of life and medical outcome, and lower the overall cost of patient care. The majority of Baxter's businesses are pioneers in their fields, with more than 70 percent of sales coming from products with leading market positions. Driving this leadership are talented, dedicated Baxter team members around the world, all living a common mission—to provide critical therapies for people with life-threatening conditions. ■

Cancer Cancer kills millions of people a year of all ages. More than half of all malignant cancers disable patients during their most productive years. For patients undergoing high-dose chemotherapy, Baxter manufactures automated blood-component collection systems that harvest "stem cells" from patients' blood for reinfusion to rebuild their immune systems. These systems also collect other blood components, such as platelets, that are used in cancer therapy. Baxter also provides intravenous (IV) immune globulins to bolster weakened immune systems, and a range of medication-delivery products, including nutrition products and portable infusion pumps that deliver pain medication or chemotherapy drugs to patients.

Trauma Injury or trauma is the leading cause of death for people under age 44. Many trauma victims receive Baxter products—IV solutions, plasma-volume expanders, blood-transfusion products, and other products for fluid replenishment and blood-volume stabilization. In addition, the company is developing a genetically engineered hemoglobin solution to replicate the function of the hemoglobin molecule in carrying oxygen to vital organs in emergency situations and other settings. While still in development, the product has the potential to change the way emergency medicine is practiced. Unlike blood, it would not have to be typed and cross-matched before it is administered, and its availability would not be dependent on the blood supply.

Blood Disorders Hemophilia is one of a number of inherited bleeding disorders characterized by an abnormality in the blood's ability to clot. There is no cure, but many people with hemophilia can lead productive lives with regular infusions of clotting factor. Baxter is a leading manufacturer of both genetically engineered and plasma-based clotting factor for people with hemophilia worldwide. Since 1995, global demand for recombinant Factor VIII—the clotting factor absent from the blood of most hemophilia patients—has nearly doubled. The company also manufactures other therapeutic blood proteins for people with immune deficiencies and other blood-related disorders.

Infectious Diseases Infectious diseases continue to cause illness and death around the world. While some infectious diseases have been conquered in some geographies through modern advances in antibiotics and vaccines, new diseases are constantly emerging. Lyme disease, AIDS and new strains of influenza are all diseases that have emerged within the last 20 years. Baxter manufactures the leading vaccine for tick-borne encephalitis (TBE), a potentially fatal disease common in portions of Europe and Asia. The company recently introduced its next-generation TBE vaccine, called Ticovac.™ Baxter also is developing vaccines for influenza and Lyme disease.

Surgical Intervention Baxter products are used in a variety of surgical applications. Most people undergoing surgery require IV access for solutions and medications. Precise infusion requires sophisticated electronic infusion pumps to regulate flow. Baxter provides a broad range of anesthetic agents and delivery devices for general anesthesia. The company manufactures fibrin sealant to facilitate blood clotting and wound healing in surgery. Baxter blood-collection and storage containers are used by blood banks to provide blood to hospitals and surgery centers for transfusions. The company also manufactures ambulatory IV infusion pumps used for patient-controlled pain management following surgery.

Kidney Disease Kidney disease continues to be a growing cause of illness and death around the world. Patients with end-stage renal disease (ESRD), or kidney failure, require dialysis or a kidney transplant to cleanse their blood of toxins, waste and excess water normally removed by healthy kidneys. Baxter was a pioneer in dialysis and remains the world's leading provider of products for dialysis. Therapy options include peritoneal dialysis, a home-based therapy that can offer significant lifestyle benefits to patients, and hemodialysis, normally provided at specialized dialysis centers. In some geographies outside the United States, Baxter operates dialysis clinics in partnership with local physicians to provide cost-effective renal therapy. In the United States, Baxter offers renal disease-management programs to health-care payers.

Leveraging Our

MANUFACTURING EXCELLENCE Baxter has extended its expertise in plastics extrusion and automated sterile-filling of intravenous and peritoneal-dialysis solutions to production facilities worldwide. In recent years, Baxter has opened or expanded manufacturing plants in China, Latin America and other developing regions of the world to cost-effectively serve the health-care needs of a growing global marketplace.

Core Capabilities

Baxter is well positioned to serve the health-care needs of people around the world because of its unique blend of capabilities and technological leadership. The company's leadership positions are unmatched in the health-care industry, and are built on several core strengths shared by Baxter's three major businesses: technological expertise, manufacturing and quality excellence, and global presence. The company is a leading developer of products and technologies that collect, separate and store blood, as well as therapeutic proteins derived from blood. Baxter continues to build on its expertise in plastic-container technologies, sterile-fluid technologies, and plasma-based and recombinant manufacturing technologies. The company's global manufacturing network is a key competitive advantage, allowing Baxter to provide cost-effective, high-quality health-care products to patients worldwide. Baxter plants share expertise in plastics extrusion, heat-sealing and filling, sterilization and many other processes. The company also allies with leading scientific and technical experts outside the company to complement its internal capabilities. Baxter will continue to leverage these core strengths to bring quality products and services to more and more patients around the world. ■

We're Building

RECOMBINANT TECHNOLOGY Baxter is expanding its expertise in recombinant technology, which holds the key to the future for many medical therapies. Baxter's production facility in Thousand Oaks, California, continues to bring new manufacturing capacity on line, greatly increasing the company's ability to manufacture new recombinant proteins.

For The Future

The new millennium will bring medical breakthroughs that will extend the average life span and make significant inroads in the treatment and prevention of disease. Baxter is involved in a number of these activities. For example:

- Baxter researchers are working to enhance the safety of the blood supply with technologies to inactivate pathogens in collected blood components.
- The company has development efforts underway in xenotransplantation—genetically engineering animal organs for transplant into humans.
- Baxter researchers are developing new recombinant proteins for use in a number of clinical therapies.
- The company is developing new and improved vaccines for the prevention of a variety of infectious diseases.
- The company is advancing its efforts to develop a genetically engineered hemoglobin therapeutic that can replicate the function of the hemoglobin molecule in carrying oxygen to vital organs in cases of severe blood loss.

The combination of these technologies with the global trends of a growing and aging population should generate growth for Baxter in the years ahead. By remaining true to our mission of providing critical therapies for people with life-threatening conditions, Baxter will continue to positively impact human lives around the world. ■

A Leading

HELPING THOSE IN NEED In 1999, The Baxter Allegiance Foundation donated money to the American Refugee Committee to provide medical care to Kosovo refugees. The grant was one of the largest received and was used to support six mobile medical units in Macedonia, where more than 120,000 refugees were living after being driven from their homes in Kosovo. The grant provided basic necessities, including vaccinations against measles and polio, for the refugees, the majority of whom were women and children.

Corporate Citizen

Baxter is committed to being a leading corporate citizen through its work/life initiatives, charitable giving and environmental achievements. Baxter takes pride in promoting work and life balance for all employees, and its commitment to work/life initiatives is a key competitive advantage. In 1999, Baxter won the Catalyst Award for its record in advancing women into leadership positions and its work/life programs. Since 1996, the number of women at the vice-president level at Baxter has increased nearly 30 percent, and the percentage of employees in the United States using alternate work arrangements has doubled to approximately 14 percent. The Baxter Allegiance Foundation helped increase access to health care in the United States and 13 other countries in 1999. Foundation grants totaling $5.5 million improved access to care for children, the uninsured and the elderly; helped prevent child abuse and neglect; promoted health education; and expanded education opportunities for health-care providers. The foundation also provided grants to aid victims of global disasters, while Baxter provided product donations and other relief aid. Many Baxter employees donated their time to charitable organizations and participated in fund-raising activities in their communities. In addition, Baxter facilities made progress in meeting aggressive environmental goals in waste reduction, recycling and emissions, while also developing a range of employee health and safety programs. ■

Financial Information

Management's Discussion and Analysis

This discussion and analysis presents the factors that had a material effect on Baxter International Inc.'s (Baxter or the company) cash flows and results of operations during the three years ended December 31, 1999, 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

In last year's Annual Report, management outlined its key financial objectives for 1999. The objectives, which are summarized below, were established based on total company results prior to the July 1999 announcement of the plan to spin off the CardioVascular business in a distribution to stockholders. Baxter's consolidated financial statements have been restated to reflect the financial position, results of operations and cash flows of the CardioVascular business as a discontinued operation. However, the objectives and results presented below reflect the combined results for both continuing and discontinued operations.

1999 OBJECTIVES	RESULTS
• Increase net sales approximately 10 percent.	• Net sales increased 10 percent in 1999.
• Grow net earnings in the low double digits.	• Excluding the cumulative effect of a change in accounting principle, and special charges, net income increased 15 percent in 1999.
• Generate at least $500 million in operational cash flow, after investing approximately $1 billion in capital improvements and research and development.	• The company generated operational cash flow of $719 million during 1999. The total of capital expenditures and research and development expenses was approximately $1.1 billion.

COMPANY AND INDUSTRY OVERVIEW

Baxter is a global leader in critical therapies for patients with life-threatening conditions. The company operates in three segments, which are described in Note 13 to the Consolidated Financial Statements.

The company generates more than 50 percent 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. The company's strategies emphasize global expansion and technological innovation to advance medical care worldwide.

The company's primary markets are highly competitive and subject to substantial regulation. There has been consolidation in the company's customer base and by its competitors, which has resulted in pricing and market share pressures. The company has experienced increases in its labor and material costs, which are partly influenced by general inflationary trends. Competitive market conditions have minimized inflation's impact on the selling prices of the company's products and services. Management expects these trends to continue. The company will continue to manage these issues by capitalizing on its market-leading positions, developing new products and services, investing in capital and human resources to upgrade and expand facilities, leveraging its cost structure, making acquisitions, and entering into alliances and joint venture arrangements.

RESULTS OF CONTINUING OPERATIONS

NET SALES TRENDS

years ended December 31 (in millions)	1999	1998	1997	Percent increase 1999	Percent increase 1998
I.V. Systems/Medical Products	$2,524	$2,314	$2,110	9%	10%
Blood Therapies	2,176	1,862	1,765	17%	5%
Renal	1,680	1,530	1,384	10%	11%
Total net sales	$6,380	$5,706	$5,259	12%	8%

years ended December 31 (in millions)	1999	1998	1997	Percent increase 1999	Percent increase 1998
United States	$2,921	$2,609	$2,371	12%	10%
International	3,459	3,097	2,888	12%	7%
Total net sales	$6,380	$5,706	$5,259	12%	8%

Excluding the effect of changes in currency exchange rates, international sales growth would have been 12 percent in 1998.

I.V. Systems/Medical Products

Sales growth of nine percent in 1999 and 10 percent in 1998 in the I.V. Systems/Medical Products segment was significantly driven by increased sales from a multiyear agreement with Premier, Inc., a major U.S. customer, as well as strong sales of the Colleague® single-channel and triple-channel volumetric pumps, and related products, particularly in the domestic market. Sales of products and services used in anesthesiology also contributed significantly to 1999 growth and enhanced 1998 growth as well. In April 1998, the company acquired the Pharmaceutical Products Division of The BOC Group's Ohmeda health-care business (Ohmeda), a domestic manufacturer of inhalants and drugs used for general and local anesthesia, which contributed over three points and five points to the segment's 1999 and 1998 sales growth, respectively. During 1999, the segment entered into an exclusive agreement to sell the first generic formulation of Propofol approved by the United States Food and Drug Administration (FDA). Sales from this new agreement contributed over two points to the segment's 1999 sales growth. Also contributing approximately three points to 1998 sales growth was the acquisition of Bieffe Medital S.p.A. (Bieffe), a European manufacturer of dialysis and intravenous solutions and containers. Refer to Note 3 to the Consolidated Financial Statements for further information regarding the company's significant acquisitions. Partially offsetting these increases in 1998 were decreased sales of over $75 million due to the termination of a European distribution agreement with Allegiance Corporation, which was spun off from the company in 1996, the termination of a joint venture in Asia and other divestitures. In addition, currency exchange rate fluctuations reduced the segment's sales growth by approximately two points in 1998. Sales in the United States and Western Europe have been impacted by competitive pricing pressures and cost pressures from health-care providers in all periods. These factors were more than offset by increased penetration and new product introductions in Latin America and other emerging markets, as well as increased sales due to new agreements, new products and acquisitions. Management expects these trends to continue.

Blood Therapies

Sales in the Blood Therapies segment increased 17 percent and five percent in 1999 and 1998, respectively. Fluctuations in currency exchange rates unfavorably impacted the segment's sales growth in 1998, reducing the percentage growth by approximately two points. As a result of the company's increase in manufacturing capacity for Recombinate™ Antihemophilic Factor (recombinant) in 1998 and the strong demand for this product, sales of Recombinate generated significant worldwide growth in both 1999 and 1998, particularly in the United States. Recombinate contributed approximately eight points and four points, respectively, of the segment's total percentage sales growth. While strong sales growth for this product is expected to continue as the company is providing for increased manufacturing capacity by the end of 2000, the growth rate is expected to be less than in 1999. U.S. sales growth in 1998 of plasma-based products was unfavorably affected by regulatory and production issues impacting the supply of factor concentrates in the entire industry. These supply constraints eased in late 1998, and sales of plasma-based products were strong in 1999, especially in the United States, contributing approximately six points of growth. Sales grew approximately three

percent in the automated and manual blood-collection businesses in 1999 and declined approximately five percent in 1998. The increase in 1999 was principally due to an increase in sales of products which provide for leukoreduction, which is the removal of white blood cells from blood products used for transfusion. Sales growth in these businesses has also been negatively affected by regulatory and production issues in the plasma-fractionation industry. The effect of these supply issues, as well as competitive pricing pressures, was partially offset by continued penetration of basic blood-collection products into developing markets. The effects of regulatory, supply, competitive and other pressures on the Blood Therapies segment are expected to continue to be more than offset by the effects of global expansion, technological advancement and innovation, increases in manufacturing capacity, and strategic alliances, joint ventures and acquisitions. In November 1999, the company entered into a definitive agreement to acquire North American Vaccine, Inc., a developer of vaccines for the prevention of infectious diseases, as further discussed in Note 3 to the Consolidated Financial Statements.

Renal

The Renal segment generated sales growth of 10 percent and 11 percent in 1999 and 1998, respectively. Significant growth was generated from the Renal Therapy Services business, which operates dialysis clinics in partnership with local physicians and hospitals in international markets. Significant growth was also generated from the Renal Management Services business, a renal-disease management organization which creates partnerships with nephrologists to lead renal-care networks throughout the United States. Revenues generated from these services businesses increased over $80 million in both 1999 and 1998. Sales growth was also strong in the base peritoneal and hemodialysis businesses, driven in part by continued penetration of products used for peritoneal dialysis. Emerging markets in the Latin American and Asian regions continue to generate the strongest growth. Fluctuations in currency exchange rates favorably impacted sales growth in 1999 by approximately two points and unfavorably impacted sales growth in 1998 by approximately three points. The acquisition of Bieffe in the beginning of 1998 contributed to the 1998 sales growth rate, adding approximately three points to the total segment sales growth rate for the year. Sales in certain geographic markets continue to be affected by strong pricing pressures and the effects of market consolidation. These issues are expected to continue to be more than offset by increased penetration of peritoneal dialysis, growth in the sales of hemodialysis products, the development of new businesses and technologies, and alliances and acquisitions. In December 1999, the company entered into a definitive agreement to acquire Althin Medical AB, a manufacturer of hemodialysis products, as further discussed in Note 3 to the Consolidated Financial Statements.

GROSS MARGIN AND EXPENSE RATIOS

years ended December 31 (as a percent of sales)	**1999**	1998	1997
Gross margin	**44.1%**	44.9%	45.3%
Marketing and administrative expenses	**20.5%**	21.2%	21.8%

The gross margin decreased in 1999 and 1998 due principally to a less favorable products and services mix. In 1998 and early 1999, the gross margin was also impacted by the recognition of unfavorable manufacturing variances. These variances related to increased investments and reduced production in 1998 in the Blood Therapies segment in response to heightened FDA regulatory activity with respect to safety and quality systems. Changes in currency exchange rates also unfavorably impacted the gross margin in 1998.

Marketing and administrative expenses decreased as a percent of sales in both 1999 and 1998 as the company has more than offset the incremental costs of expanding into developing markets and new business initiatives with a continued focus on cost control across all businesses. In addition, the company has realized benefits from the integration of the acquisitions of Bieffe, Ohmeda, Immuno International AG (Immuno) and other recent acquisitions. Management expects to further leverage costs in 2000.

RESEARCH AND DEVELOPMENT

				Percent increase (decrease)	
years ended December 31 (in millions)	**1999**	1998	1997	**1999**	1998
Research and development expenses	**$332**	$323	$339	**3%**	(5%)
as a percent of sales	**5%**	6%	6%		

Research and development (R&D) expenses above exclude the in-process R&D (IPR&D) charges relating to the acquisitions of Somatogen, Inc. in 1998 and Immuno in 1997, both of which are included in the Blood Therapies segment and are further discussed in Note 3 to the Consolidated Financial Statements. R&D expenses increased in 1999 primarily due to increased spending in the Blood Therapies segment, principally relating to the next-generation recombinant product. The decrease in 1998 was principally due to the September 1998 decision to end the clinical development of the company's first-generation oxygen-carrying therapeutic program called HemAssist® (DCLHb). Excluding R&D expenses relating to the terminated HemAssist (DCLHb) program, R&D expenses decreased four percent in 1998. The decrease in 1998 is also partially due to a rationalization of R&D spending in the Blood Therapies segment as a result of the acquisition of Immuno in the beginning of 1997. Management expects the growth rate in R&D expenses will increase in the future as the company focuses on the next-generation oxygen-therapeutics program and the next-generation recombinant product within its Blood Therapies segment, as well as on other R&D initiatives across the three segments. With respect to the pending acquisition of North American Vaccine, Inc., it is expected that a substantial portion of the purchase price will be allocated to IPR&D and immediately expensed.

EXIT AND OTHER REORGANIZATION COSTS

Refer to Note 4 to the Consolidated Financial Statements for a discussion of charges recorded in 1998 and 1995 for exit and other reorganization costs. The company recorded a $122 million charge in 1998 that related principally to the decision to end the clinical development of HemAssist (DCLHb), as discussed above, exit certain non-strategic investments, primarily in Asia, and reorganize certain other activities.

The 1998 program is substantially complete as originally planned. The expected benefits of the program have been achieved. Management believes remaining reserves for exit and other reorganization programs are adequate to complete the actions contemplated by the program. Future cash expenditures will be funded with cash generated from operations. Management anticipates savings from the programs will be partially invested in R&D, new business initiatives, and expansion into growing international markets. The 1995 program is complete. Management's objectives for the plan were met for the originally estimated cost. This program, which eliminated excess capacity and reduced manufacturing costs, will help mitigate future exposure to gross margin erosion from pricing pressures, primarily in the United States.

Acquisition Reserves

Based on plans formulated at acquisition date, reserves have been established for certain acquisitions as part of the allocation of purchase price. The reserves principally consisted of employee severance costs associated with headcount reductions at the acquired companies, and the costs of exiting activities and terminating distribution, lease and other contracts of the acquired companies that existed prior to the respective dates of acquisition and either continued with no economic benefit or required payment of a cancellation penalty. Refer to Note 3 for further information. Actions executed to date and anticipated in the future are substantially consistent with the original plans. Management believes remaining reserves are adequate to complete the actions contemplated by the plans.

NET LITIGATION CHARGE

As further discussed in Note 12 to the Consolidated Financial Statements, the company recorded a $178 million net litigation charge in 1998 relating to mammary implants, plasma-based therapies (relating to the Blood Therapies segment) and other litigation.

OTHER INCOME AND EXPENSE

Net interest expense declined in 1999 and 1998 due principally to the impact of a greater mix of foreign currency denominated debt, which bears a lower average interest rate and, in 1999, to slightly lower average debt levels. In 1998, the impact of a favorable currency denomination mix of debt was partially offset by higher average debt levels due primarily to acquisitions.

Goodwill amortization did not change significantly from 1998 to 1999 and increased from 1997 to 1998 primarily as a result of the acquisition of Bieffe.

Other expense in 1999 principally related to losses on disposals of nonstrategic investments and fluctuations in currency exchange rates. Included in other income in 1998 was a pretax gain of $20 million relating to the disposal of a nonstrategic investment in the I.V. Systems/Medical Products segment. Included in other income in 1997 was a pretax gain of $17 million relating to the disposal of a nonstrategic investment in the Blood Therapies segment. Other income in 1997 also included a pretax gain of $32 million relating to the divestiture by the Blood Therapies segment of certain assets of its Immunotherapy division, as further discussed in Note 3 to the Consolidated Financial Statements.

PRETAX INCOME

Refer to Note 13 to the Consolidated Financial Statements for a summary of financial results by segment.

I.V. Systems/Medical Products

Pretax income increased eight percent in 1999 due principally to strong sales, particularly of the Colleague single-channel and triple-channel volumetric pumps and anesthesia products. In addition, the gross margin improved, particularly in the United States, due to a more favorable sales mix and manufacturing efficiencies. Pretax income increased 18 percent in 1998 due principally to acquisitions, introduction of the Colleague single-channel pump in late 1997 and the triple-channel pump in 1998 and an improved gross margin due to a more favorable sales mix and leveraging of costs, partially offset by the effects of unfavorable currency fluctuations.

Blood Therapies

Pretax income increased eight percent in both 1999 and 1998. As discussed above, increased regulatory activity in the factor concentrates industry in 1998 unfavorably impacted the sales growth and gross profit margin in this segment. Partially offsetting the impact of this activity were decreased R&D spending and other synergies as management integrated recent acquisitions. Pretax profits increased in late 1998 and 1999 as supply constraints in the plasma-based products industry eased, as production of Recombinate increased as a result of the company's manufacturing capacity expansion, and as profits increased in the blood-collection businesses. Partially offsetting growth in 1998 was reduced profitability in the blood-collection businesses due primarily to a less favorable mix of sales, pricing pressures due to competition, and the above-mentioned regulatory activity, which has affected certain of the segment's customers.

Renal

Pretax income grew 43 percent in 1999 and declined 26 percent in 1998. The decline in 1998 was principally due to significant unfavorable currency exchange rate fluctuations, primarily with respect to the Japanese Yen. The increase in 1999 was principally due to the strengthening of the Japanese Yen. Segment results do not include income or expense relating to the company's hedging activities. Excluding the effects of currency, growth was driven by the base peritoneal dialysis and hemodialysis businesses and manufacturing efficiencies, partially offset by the effect of a less favorable sales mix and investments in the business.

INCOME TAXES

Excluding the divestiture gains and the charges for IPR&D, net litigation and exit and other reorganization costs, and a related provision for U.S. taxes on previously unremitted foreign earnings, the effective income tax rate for continuing operations before cumulative effect of accounting change was approximately 26 percent, 24 percent and 24 percent in 1999, 1998 and 1997, respectively. The rate increase in 1999 was primarily due to a larger portion of the company's earnings generated in higher tax jurisdictions. Management does not expect a significant change in the effective tax rate in 2000.

INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE

				Percent increase (decrease)	
years ended December 31 (in millions)	**1999**	1998	1997	**1999**	1998
Income from continuing operations before cumulative effect of accounting change	**$779**	$275	$371	**183%**	(26%)

Excluding the divestiture gains and the charges for IPR&D, net litigation, and exit and other reorganization costs, as applicable in 1998 and 1997, the 1999 and 1998 growth in income from continuing operations before cumulative effect of accounting change would have been 15 percent and 20 percent, respectively.

EARNINGS PER SHARE

Excluding the divestiture gains and the charges for IPR&D, net litigation, and exit and other reorganization costs, as applicable in 1998 and 1997, earnings per diluted share in 1998 and 1997 would have been $2.34 and $1.99, respectively, and the 1999 and 1998 growth would have been 13 percent and 17 percent, respectively.

DISCONTINUED OPERATION

Income from discontinued operation grew 60 percent, or approximately $24 million, in 1999 and, excluding a $132 million IPR&D charge relating to the acquisition of Research Medical, Inc. in 1997, declined 34 percent in 1998. These results primarily reflect growth in the higher-margin tissue heart valves and valve-repair product lines, partially offset by reduced profits in certain other product and service lines due to pricing, declines in surgical procedures, and competitive pressures. Favorable currency exchange rate fluctuations and an improved mix of sales contributed to the growth in pretax income in 1999. Unfavorable currency exchange rate fluctuations, costs relating to headcount reductions and a loss associated with the impairment of a minority equity investment contributed to the decline in 1998. Partially offsetting these increased costs in 1998 were insurance proceeds associated with hurricane damage at a manufacturing facility.

CHANGE IN ACCOUNTING PRINCIPLE

In the first quarter of 1999, the company recorded a $27 million after-tax charge for the cumulative effect of a change in accounting principle related to the adoption of AICPA Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-up Activities." Excluding the initial effect of adopting this standard, the impact of the new SOP is not material.

LIQUIDITY AND CAPITAL RESOURCES

Cash flows from continuing operations as reported in the Consolidated Statements of Cash Flows increased during 1999 due principally to higher earnings and a decrease in inventories, as the company focuses on growing the business while effectively managing inventory levels. These increases were partially offset by higher net cash outflows relating to litigation (litigation payments net of insurance recoveries), and higher other asset balances. In 1998, net cash inflows from continuing operations increased principally due to higher earnings before noncash charges, lower net cash outflows relating to litigation (primarily due to higher insurance recoveries in 1998 relating to the company's mammary implant and plasma-based therapies litigation), a higher accounts payable and accrued liabilities balance, and a lower increase in inventories. Partially offsetting these factors in 1999 and 1998 were increases in accounts receivable due to sales growth from acquisitions and sales in certain regions outside the United States, which have longer collection periods. In addition, approximately $65 million and $150 million in proceeds were generated from the sales of certain receivables in 1999 and 1998, respectively. Such receivables were sold to reduce the overall costs of financing the receivables.

Cash flows from discontinued operation relate to the company's CardioVascular business. Cash flows were relatively unchanged from 1998 to 1999, with increased earnings and a lower accounts receivable balance partially offset by an increase in inventories and a decrease in liabilities. Included in cash flows in 1998 were approximately $22 million in proceeds from the sales of certain receivables. Refer to Note 2 to the Consolidated Financial Statements for further information regarding the discontinued operation.

Cash outflows relating to investing activities decreased in both 1999 and 1998. Capital expenditures (including additions to the pool of equipment leased or rented to customers) increased 13 percent and 22 percent in 1999 and 1998, respectively, as the company increased its investments in various capital projects across the three segments. Capital expenditures are made at a sufficient level to support the strategic and operating needs of the businesses. Recent significant expenditures have included implementation of a new integrated operational system and continuing expansion of facilities for the production of genetically engineered proteins. Management expects to invest approximately $700 million in capital expenditures in 2000. Net cash outflows relating to acquisitions decreased in 1999 and 1998. In 1999, net cash outflows relating to acquisitions included approximately $36 million for a contingent purchase price payment pertaining to the 1997 acquisition of Immuno. Approximately $22 million of the 1999 total related to acquisitions of dialysis centers in international markets and approximately $88 million related to the acquisition of a business in the I.V. Systems/Medical Products segment. In 1999, the company also generated approximately $42 million of cash relating to the sale and leaseback of certain assets and approximately $30 million relating to a prior year divestiture in the Blood Therapies segment. In 1998, net cash outflows relating to acquisitions included approximately $142 million pertaining to the acquisition of Bieffe, approximately $94 million related to the acquisition of Ohmeda, and the remainder primarily related to acquisitions of dialysis centers in international markets. Approximately $498 million and $48 million of the net cash flows used for acquisitions in 1997 related to the acquisitions of Immuno and Bieffe, respectively.

Cash flows from financing activities decreased during 1999 and 1998. Included in the total for 1999 was $198 million in cash inflows relating to the Shared Investment Plan, which is discussed in Note 8 to the Consolidated Financial Statements. Cash received for stock issued under employee benefit plans increased in 1999 and 1998. Offsetting these increased inflows were increased common stock cash dividends due to a higher number of shares outstanding, $184 million in cash outflows in 1999 related to repurchases of Baxter common stock, as further discussed below, and other factors.

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 their direct control. 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 or sold. The company expects to generate more than $500 million in operational cash flow from continuing operations in 2000.

The following table reconciles cash flows from continuing operations, as determined by generally accepted accounting principles (GAAP), to operational cash flow, which is not a measure defined by GAAP:

Brackets denote cash outflows *years ended December 31 (in millions)*	**1999**	1998	1997
Cash flows from continuing operations per the company's Consolidated Statements of Cash Flows	**$977**	$837	$472
Capital expenditures	**(631)**	(556)	(454)
Net interest after tax	**52**	74	78
Other	**190**	24	57
Operational cash flow – continuing operations	**588**	379	153
Operational cash flow – discontinued operation	**131**	136	121
Total operational cash flow	**$719**	$515	$274

The company's net-debt-to-capital ratio was 40.2 percent and 48.4 percent at December 31, 1999 and 1998, respectively. During 1998, a wholly-owned subsidiary of the company entered into an $800 million revolving credit facility. Due to the subsidiary's covenants under the facility, certain assets are restricted to the parent company. Refer to Note 5 to the Consolidated Financial Statements for further information regarding the company's credit facilities, long-term debt and lease obligations, and related restrictions and covenants.

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. This program is substantially complete as of December 31, 1999. In November 1999, the board of directors authorized the repurchase of an additional $500 million over a period of several years. As the company's net-debt-to-capital ratio is now in the targeted low 40 percent range, management has resumed its stock repurchase program, and expects to continue to repurchase common stock in 2000.

As of December 31, 1999, the company can 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 December 1999, the Baxter 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), which was paid in January 2000. This is expected to be the last cash dividend payable prior to the spin-off of the CardioVascular business. Subsequent to the spin-off, Baxter expects to continue to pay a dividend at the current rate and will do so on an annual basis, with the first annual dividend expected to be declared in December 2000 and paid in January 2001. The company presently anticipates that the dividend payout ratio will decrease over time in order to optimize the company's capital structure and become more consistent with the payout ratios of peer companies.

EURO CONVERSION

On January 1, 1999, 11 of the 15 countries that are members of the European Union introduced a new currency called the "Euro." The conversion rates between the Euro and the participating nations' currencies were fixed irrevocably as of January 1, 1999. Prior to full implementation of the new currency on January 1, 2002, there is a transition period during which parties may use either the existing currencies or the Euro for financial transactions.

Action plans are currently being implemented which are expected to result in compliance with all laws and regulations relating to the Euro conversion. Management expects that the adaptation of its information technology and other systems to accommodate Euro-denominated transactions as well as the requirements of the transition period will not have a material impact on the company's results of operations. The company is also addressing the impact of the Euro on currency exchange-rate risk, taxation, contracts, competition and pricing. While it is not possible to accurately predict the impact the Euro will have on the company's business or on the economy in general, management currently does not anticipate that the Euro conversion will have a material adverse impact on the company's results of operations or financial condition.

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, options and swaps. 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, the Euro and Swiss Franc. 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. Such contracts hedge the U.S. dollar value of foreign currency denominated net assets from the effects of volatility in currency exchange rates by creating debt denominated in the respective currencies of the underlying net assets. Any changes in the carrying value of these net investments that are a result of fluctuations in currency exchange rates are offset by changes in the carrying value of the foreign currency denominated debt that are a result of the same fluctuations in currency exchange rates.

As part of its risk-management process, the company uses a value-at-risk (VAR) model related to its foreign currency financial instruments to measure a potential loss in earnings as a result of adverse movements in currency exchange rates. The company utilizes a Monte Carlo simulation, with a 95 percent confidence level, using implied volatilities and correlations (as of the measurement date) to estimate this potential loss. The company's calculated VAR as of fiscal year-end 1999 and 1998, assuming a one-year holding period, is $72 million and $42 million, respectively. These amounts exclude the potential effects of any changes in the value of the underlying transactions or balances. The VAR increased in 1999 primarily due to a larger portfolio of instruments as a result of an increase in the amount of underlying transactions denominated in foreign currencies and a lengthening of the future period hedged, higher implied volatilities with respect to the Japanese Yen and the Euro, and a higher volume of sold call options. As part of the strategy to manage risk while minimizing hedging costs, the company utilizes sold call options in conjunction with purchased put options to create collars. Actual future gains or losses may differ from these estimates 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 periods. 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. The company's actual experience in 1999 and 1998 was favorable as compared to the VAR calculated as of fiscal year-end 1998 and 1997, respectively.

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 45 basis-point increase in interest rates (approximately 10 percent 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 1999 and 1998 pretax earnings and on the fair value of the company's fixed-rate financial instruments as of the end of such fiscal years.

As discussed in Note 6 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 percent 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 unconsolidated investments, management believes any reasonably possible near-term losses in earnings, cash flows and fair values would not be material.

YEAR 2000

The company implemented a comprehensive program to address Year 2000 issues and all necessary implementation efforts were completed as of December 31, 1999. There have been no material Year 2000 issues associated with the company's internal systems, customers, products and services, or suppliers and other critical business partners. Management does not expect any material Year 2000 issues in the future. None of the company's systems were upgraded or replaced solely to address Year 2000 issues, although in some cases the timing of the system upgrades and replacements was accelerated. The total cost of these system upgrades was approximately $150 million. No critical projects were deferred due to the Year 2000 program. Incremental out-of-pocket costs of the Year 2000 program, which were required to be expensed as incurred, were immaterial to the company's financial results.

LEGAL PROCEEDINGS

See Note 12 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.

FORWARD-LOOKING INFORMATION

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, unforeseen information technology issues related to the company or third parties, economic conditions, demand and market acceptance risks for new and existing products, technologies and health-care services, the impact of competitive products and pricing, manufacturing capacity, new plant start-ups, global regulatory, trade and tax policies, continued price competition, product development risks, including technological difficulties, ability to enforce patents, unforeseen commercialization and regulatory factors, and other risks more completely reflected in the company's filings with the Securities and Exchange Commission. In particular, the company, as well as other companies in its industry, has experienced increased regulatory activity by the U.S. Food and Drug Administration with respect to its plasma-based biologicals and its complaint-handling systems. It is not possible to predict the extent to which the company or the health-care industry might be adversely affected by these factors in the future.

NEW ACCOUNTING AND DISCLOSURE STANDARD

In June 1998, the FASB issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (Statement No. 133), which was later amended by Statement No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133". Statement No. 133, as amended, requires companies to record derivatives on the balance sheet date as assets or liabilities measured at fair value. The accounting treatment of gains and losses resulting from changes in the value of derivatives depends on the use of the derivative and whether it qualifies for hedge accounting. The company will adopt SFAS No. 133, as amended, as required no later than January 1, 2001, and is currently assessing the impact of adoption on its consolidated financial statements.

Management's Responsibilities for Financial Reporting

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 accounting principles generally accepted in the United States and include 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 assets against unauthorized acquisition, use or disposition. This system 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 practices, 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 of the board of directors.

PricewaterhouseCoopers 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. PricewaterhouseCoopers LLP and the corporate auditors meet regularly with, and have access to, this committee, with and without management present, to discuss the results of the audit work.

Harry M. Jansen Kraemer, Jr.
Chairman and Chief Executive Officer

Brian P. Anderson
Senior Vice President and Chief Financial Officer

Report of Independent Accountants

Board of Directors and Stockholders of Baxter International Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and stockholders' equity and comprehensive income present fairly, in all material respects, the financial position of Baxter International Inc. (the company) and its subsidiaries at December 31, 1999 and 1998, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States. 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 auditing standards generally accepted in the United States 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.

PricewaterhouseCoopers LLP
Chicago, Illinois
February 16, 2000

Consolidated Balance Sheets

as of December 31 (in millions, except share information)		1999	1998
CURRENT ASSETS	Cash and equivalents	**$ 606**	$ 709
	Accounts receivable	**1,504**	1,429
	Notes and other current receivables	**148**	317
	Inventories	**1,116**	1,167
	Short-term deferred income taxes	**216**	453
	Prepaid expenses	**229**	220
	Total current assets	**3,819**	4,295
PROPERTY, PLANT AND EQUIPMENT, NET		**2,650**	2,445
OTHER ASSETS	Net assets of discontinued operation	**1,231**	1,275
	Goodwill and other intangible assets	**921**	930
	Insurance receivables	**301**	378
	Other	**722**	550
	Total other assets	**3,175**	3,133
	Total assets	**$9,644**	$9,873
CURRENT LIABILITIES	Short-term debt	**$ 125**	$ 156
	Current maturities of long-term debt and lease obligations	**130**	115
	Accounts payable and accrued liabilities	**1,805**	2,024
	Income taxes payable	**640**	536
	Total current liabilities	**2,700**	2,831
LONG-TERM DEBT AND LEASE OBLIGATIONS		**2,601**	3,096
LONG-TERM DEFERRED INCOME TAXES		**311**	461
LONG-TERM LITIGATION LIABILITIES		**273**	246
OTHER LONG-TERM LIABILITIES		**411**	400
COMMITMENTS AND CONTINGENCIES			
STOCKHOLDERS' EQUITY	Common stock, $1 par value, authorized 350,000,000 shares, issued 294,363,251 shares in 1999 and 291,248,251 shares in 1998	**294**	291
	Common stock in treasury, at cost, 4,163,737 shares in 1999 and 4,919,141 shares in 1998	**(269)**	(210)
	Additional contributed capital	**2,282**	2,064
	Retained earnings	**1,415**	990
	Accumulated other comprehensive loss	**(374)**	(296)
	Total stockholders' equity	**3,348**	2,839
	Total liabilities and stockholders' equity	**$9,644**	$9,873

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

Consolidated Statements of Income

years ended December 31 (in millions, except per share data)		1999	1998	1997
OPERATIONS	**Net sales**	**$6,380**	$5,706	$5,259
	Costs and expenses			
	Cost of goods sold	**3,568**	3,142	2,877
	Marketing and administrative expenses	**1,311**	1,208	1,145
	Research and development expenses	**332**	323	339
	In-process research and development	**–**	116	220
	Exit and other reorganization costs	**–**	122	–
	Net litigation charge	**–**	178	–
	Interest, net	**87**	124	131
	Goodwill amortization	**19**	18	11
	Other expense (income)	**11**	(18)	(34)
	Total costs and expenses	**5,328**	5,213	4,689
	Income from continuing operations before income taxes and cumulative effect of accounting change	**1,052**	493	570
	Income tax expense	**273**	218	199
	Income from continuing operations before cumulative effect of accounting change	**779**	275	371
	Discontinued operation			
	Income (loss) from discontinued operation, net of applicable income tax expense of $19 in 1999, $16 in 1998 and $24 in 1997	**64**	40	(71)
	Net costs associated with effecting the business distribution	**(19)**	–	–
	Total discontinued operation	**45**	40	(71)
	Income before cumulative effect of accounting change	**824**	315	300
	Cumulative effect of accounting change, net of income tax benefit of $7	**(27)**	–	–
	Net income	**$ 797**	$ 315	$ 300
PER SHARE DATA	**Earnings per basic common share**			
	Continuing operations, before cumulative effect of accounting change	**$ 2.69**	$ .97	$ 1.34
	Discontinued operation	**.15**	.14	(.26)
	Cumulative effect of accounting change	**(.09)**	–	–
	Net income	**$ 2.75**	$ 1.11	$ 1.08
	Earnings per diluted common share			
	Continuing operations, before cumulative effect of accounting change	**$ 2.64**	$ .95	$ 1.31
	Discontinued operation	**.15**	.14	(.25)
	Cumulative effect of accounting change	**(.09)**	–	–
	Net income	**$ 2.70**	$ 1.09	$ 1.06
	Weighted average number of common shares outstanding			
	Basic	**290**	284	278
	Diluted	**295**	289	282

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

Consolidated Statements of Cash Flows

years ended December 31 (in millions) (brackets denote cash outflows)		**1999**	1998	1997
CASH FLOWS FROM CONTINUING OPERATIONS	Income from continuing operations before cumulative effect of accounting change	**$779**	$275	$371
	Adjustments			
	Depreciation and amortization	**372**	344	318
	Deferred income taxes	**92**	(56)	3
	Gain (loss) on asset dispositions	**13**	(23)	(48)
	In-process research and development	**–**	116	220
	Exit and other reorganization costs	**–**	122	–
	Net litigation charge	**–**	178	–
	Other	**20**	2	8
	Changes in balance sheet items			
	Accounts receivable	**(103)**	(153)	(59)
	Inventories	**17**	(79)	(112)
	Accounts payable and accrued liabilities	**30**	165	83
	Net litigation payments and other	**(243)**	(54)	(312)
	Cash flows from continuing operations	**977**	837	472
CASH FLOWS FROM DISCONTINUED OPERATION		**106**	102	86
CASH FLOWS FROM OPERATIONS		**1,083**	939	558
CASH FLOWS FROM INVESTING ACTIVITIES	Capital expenditures	**(529)**	(461)	(367)
	Additions to the pool of equipment leased or rented to customers	**(102)**	(95)	(87)
	Acquisitions (net of cash received) and investments in affiliates	**(179)**	(319)	(606)
	Divestitures and other asset dispositions	**75**	3	(23)
	Cash flows from investing activities	**(735)**	(872)	(1,083)
CASH FLOWS FROM FINANCING ACTIVITIES	Issuances of debt and lease obligations	**764**	1,143	855
	Redemption of debt and lease obligations	**(481)**	(598)	(465)
	Increase (decrease) in debt with maturities of three months or less, net	**(552)**	(159)	81
	Common stock cash dividends	**(338)**	(331)	(316)
	Stock issued under Shared Investment Plan	**198**	–	–
	Stock issued under employee benefit plans	**148**	118	110
	Purchases of treasury stock	**(184)**	–	–
	Cash flows from financing activities	**(445)**	173	265
EFFECT OF CURRENCY EXCHANGE RATE CHANGES ON CASH AND EQUIVALENTS		**(6)**	4	(36)
INCREASE (DECREASE) IN CASH AND EQUIVALENTS		**(103)**	244	(296)
CASH AND EQUIVALENTS AT BEGINNING OF YEAR		**709**	465	761
CASH AND EQUIVALENTS AT END OF YEAR		**$606**	$709	$465
Supplemental information				
Interest paid, net of portion capitalized		**$150**	$191	$174
Income taxes paid		**$197**	$143	$170

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

Consolidated Statements of Stockholders' Equity and Comprehensive Income

years ended December 31 (in millions)	**1999**	1998	1997
COMMON STOCK			
Beginning of year	**$ 291**	$ 288	$ 288
Common stock issued for acquisitions	**–**	3	–
Stock issued under Shared Investment Plan	**3**	–	–
End of year	**$ 294**	$ 291	$ 288
COMMON STOCK IN TREASURY			
Beginning of year	**$ (210)**	$ (329)	$ (611)
Common stock issued for acquisitions	**–**	–	178
Purchases of common stock	**(184)**	–	–
Common stock issued under employee benefit plans	**125**	119	104
End of year	**$ (269)**	$ (210)	$ (329)
ADDITIONAL CONTRIBUTED CAPITAL			
Beginning of year	**$2,064**	$1,876	$1,825
Common stock issued for acquisitions	**–**	189	45
Stock issued under Shared Investment Plan	**195**	–	–
Common stock issued under employee benefit plans	**23**	(1)	6
End of year	**$2,282**	$2,064	$1,876
RETAINED EARNINGS			
Beginning of year	**$ 990**	$1,006	$1,022
Net income	**797**	315	300
Elimination of reporting lag for certain international operations	**(34)**	–	–
Common stock cash dividends	**(338)**	(331)	(316)
End of year	**$1,415**	$ 990	$1,006
ACCUMULATED OTHER COMPREHENSIVE LOSS			
Beginning of year	**$ (296)**	$ (222)	$ (20)
Other comprehensive loss	**(78)**	(74)	(202)
End of year	**$ (374)**	$ (296)	$ (222)
Total stockholders' equity	**$3,348**	**$2,839**	**$2,619**
COMPREHENSIVE INCOME			
Currency translation adjustments, net of tax (benefit) of $87 in 1999 and ($56) in 1998	**$ (80)**	$ (75)	$ (202)
Unrealized net gain on marketable equity securities, net of tax of $1 in 1999 and $1 in 1998	**2**	1	–
Other comprehensive loss	**(78)**	(74)	(202)
Net income	**797**	315	300
Elimination of reporting lag for certain international operations, net of tax benefit of $22	**(34)**	–	–
Total comprehensive income	**$ 685**	**$ 241**	**$ 98**

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). Prior to fiscal 1999, all operations outside the United States and its territories had been included in the consolidated financial statements on the basis of fiscal years ending November 30 in order to facilitate timely consolidation. In conjunction with the implementation of new financial systems, this one-month lag was eliminated as of the beginning of fiscal 1999 for certain of these international operations, and the December 1998 net loss from operations of $34 million for these entities was recorded directly to retained earnings. The one-month reporting lag for the remainder of the international operations will be eliminated in 2001.

Foreign currency translation

The results of operations for non-U.S. subsidiaries, other than those located in highly inflationary countries, are translated into U.S. dollars using the average exchange rates during the year, while assets and liabilities are translated using period-end rates. Resulting translation adjustments are recorded as currency translation adjustments within other comprehensive income. Where foreign affiliates operate in highly inflationary economies, non-monetary amounts are remeasured at historical exchange rates while monetary assets and liabilities are remeasured at the current rate with the related adjustments reflected in the consolidated statements of income.

Revenue recognition

The company's practice is to recognize revenues from product sales when title transfers.

Inventories

as of December 31 (in millions)	**1999**	1998
Raw materials	**$ 251**	$ 282
Work in process	**193**	226
Finished products	**672**	659
Total inventories	**$1,116**	$1,167

Inventories are stated at the lower of cost (first-in, first-out method) or market value. Market value for raw materials is based on replacement costs and, for other inventory classifications, on net realizable value. Reserves for excess and obsolete inventory were $78 million and $97 million at December 31, 1999 and 1998 respectively.

Property, plant and equipment

as of December 31 (in millions)	**1999**	1998
Land	**$ 93**	$ 92
Buildings and leasehold improvements	**987**	1,009
Machinery and equipment	**2,615**	2,526
Equipment with customers	**489**	444
Construction in progress	**525**	437
Total property, plant and equipment, at cost	**4,709**	4,508
Accumulated depreciation and amortization	**(2,059)**	(2,063)
Property, plant and equipment, net	**$2,650**	$2,445

Depreciation and amortization are principally calculated on the straight-line method over the estimated useful lives of the related assets, which range from 20 to 50 years for buildings and improvements and from three to 15 years for machinery and equipment. Leasehold improvements are amortized over the life of the related facility lease or the asset, whichever is shorter. Straight-line and accelerated methods of depreciation are used for income tax purposes. Accumulated amortization for assets under capital lease was $10 million and $5 million at December 31, 1999 and 1998, respectively. Depreciation expense was $290 million, $269 million and $266 million in 1999, 1998 and 1997, respectively. Repairs and maintenance expense was $97 million, $93 million and $96 million in 1999, 1998 and 1997, respectively.

Goodwill and other intangible assets

as of December 31 (in millions)	**1999**	1998
Goodwill	**$737**	$684
Accumulated amortization	**(113)**	(94)
Net goodwill	**624**	590
Other intangible assets	**677**	688
Accumulated amortization	**(380)**	(348)
Net other intangible assets	**297**	340
Goodwill and other intangible assets	**$921**	$930

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 and other identified rights, are amortized over their legal or estimated useful lives, whichever is shorter (generally not exceeding 17 years). The company's policy is to review the carrying amounts of goodwill and other intangible assets whenever events or changes in

circumstances indicate that the carrying amount of an asset may not be recoverable. Such events or circumstances might include a significant decline in market share, a significant decline in profits, rapid changes in technology, significant litigation or other items. In evaluating the recoverability of goodwill and other intangible assets, management's policy is to compare the carrying amounts of such assets with the estimated undiscounted future operating cash flows. In the event an impairment exists, an impairment charge would be determined by comparing the carrying amounts of the asset to the applicable estimated future cash flows, discounted at a risk-adjusted interest rate. In addition, the remaining amortization period for the impaired asset would be reassessed and revised if necessary. Management does not believe the carrying amounts of goodwill and other intangible assets are impaired at December 31, 1999.

Earnings per share (EPS)

The numerator for both basic and diluted EPS is net earnings available to common shareholders. 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 million of shares)	**1999**	1998	1997
Basic EPS	**290**	284	278
Effect of dilutive securities			
Employee stock options	**4**	5	4
Employee stock purchase plans and equity forward agreements	**1**	–	–
Diluted EPS	**295**	289	282

Comprehensive income

Comprehensive income encompasses all changes in stockholders' equity other than those arising from stockholders, and generally consists of net income, currency translation adjustments and unrealized net gains and losses on marketable equity securities. Accumulated currency translation adjustments were ($377) million, ($297) million, and ($222) million at December 31, 1999, 1998 and 1997, respectively. Accumulated unrealized net gains on marketable equity securities were immaterial in each year.

Start-up costs

Effective at the beginning of 1999, the company adopted AICPA Statement of Position (SOP) 98-5, "Reporting on the Costs of Start-up Activities." This SOP required that the costs of start-up and organization activities previously capitalized be expensed and reported as a cumulative effect of a change in accounting principle, and requires that such costs subsequent to adoption be expensed as incurred. The after-tax cumulative effect of this accounting change was $27 million.

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 other income or expense. Gains and losses 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 currency translation 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. Equity forward agreements are accounted for in accordance with their settlement terms and are recorded directly to equity. 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 an original maturity of three months or less.

Reclassifications

Certain reclassifications have been made to conform the 1998 and 1997 financial statements and notes to the 1999 presentation.

New accounting pronouncement

In June 1998, the FASB issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (Statement No. 133), which was later amended by Statement No. 137, "Accounting for Derivative Instruments and Hedging Activities — Deferral of the Effective Date of FASB Statement No. 133". Statement No. 133, as amended, requires companies to record derivatives on the balance sheet as assets or liabilities measured at fair value. The accounting treatment of gains and losses resulting from changes in the value of derivatives will depend on the use of the derivative and whether it qualifies for hedge accounting. The company will adopt SFAS No. 133, as amended, no later than January 1, 2001, as required, and is currently assessing the impact of adoption on its consolidated financial statements.

2 DISCONTINUED OPERATION

On July 11, 1999, the board of directors of Baxter approved a plan to spin off to Baxter stockholders its CardioVascular business, to be named Edwards Lifesciences Corporation (Edwards), which provides a comprehensive line of products and services to treat late-stage cardiovascular disease. Management expects that shares of Edwards will be distributed in a tax-free distribution to Baxter stockholders on March 31, 2000. The distribution will result in Edwards operating as an independent entity with publicly traded common stock. The company's consolidated financial statements and related notes have been adjusted and restated to reflect the financial position, results of operations and cash flows of Edwards as a discontinued operation.

The following selected financial data for Edwards is presented for informational purposes only and does not necessarily reflect what the results of operations and financial position would have been had the business operated as a stand-alone entity.

years ended December 31 (in millions)	**1999**	1998	1997
Net sales	**$906**	$893	$879

Income from discontinued operation in 1999 included $19 million in net costs directly associated with effecting the business distribution. Basic and diluted EPS in 1999 relating to the net-of-tax net cost was $.07 and $.06.

as of December 31 (in millions)	**1999**	1998
Net current assets	**$ 207**	$ 200
Net noncurrent assets	**1,024**	1,075
Total net assets	**$1,231**	$1,275

Through the issuance of new third-party debt, approximately $550 million of Baxter's existing debt will be indirectly assumed by Edwards.

3 ACQUISITIONS AND DIVESTITURES

Accounting for acquisitions

All acquisitions during the three years ended December 31, 1999, were accounted for under the purchase method. Results of operations of acquired companies are included in the company's results of operations as of the respective acquisition dates. Pro forma information is not presented with respect to the acquisitions as it is not material. 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, identifiable intangible assets and liabilities acquired was allocated to goodwill, and is being amortized on a straight-line basis over periods ranging from 15 to 40 years. As further discussed below, a portion of the purchase price for certain of the acquisitions was allocated to in-process research and development (IPR&D) which, under GAAP, was immediately expensed.

Significant acquisitions

The following is a summary of the company's significant recent acquisitions along with the purchase price and the allocation of the purchase price to IPR&D and intangible assets.

(in millions)	Acquisition date	Purchase price	IPR&D	Intangible assets: Goodwill	Intangible assets: Other
Somatogen, Inc.	May 1998	$206	$116	$2	$3
Bieffe Medital S.p.A.	December 1997	188	–	124	15
Immuno International AG	December 1996	569	220	96	125

Somatogen, Inc. (Somatogen) was a developer of recombinant hemoglobin-based technology, which was acquired for approximately 3.5 million shares of Baxter International Inc. common stock. Somatogen shareholders are entitled to a contingent deferred cash payment of up to $2.00 per Somatogen share, or approximately $42 million, based on a percentage of sales of future products through the year 2007. Bieffe Medital S.p.A. (Bieffe) was a manufacturer of dialysis and intravenous solutions and containers. Immuno International AG (Immuno) was a manufacturer of biopharmaceutical products and services for transfusion medicine. In addition, Research Medical, Inc., which is part of the discontinued operation, was acquired in March 1997 for approximately 4.8 million shares of Baxter International Inc. common stock.

In November 1999, the company entered into a definitive agreement to acquire North American Vaccine, Inc. (NAV), a developer of vaccines for the prevention of infectious diseases, for approximately $390 million. Prior to the closing of the acquisition, Baxter has guaranteed a $30 million NAV credit facility, of which $10 million of NAV borrowings were outstanding at December 31, 1999. It is expected that a substantial portion of the purchase price of NAV will be allocated to IPR&D and immediately expensed. In December 1999, the company entered into a definitive agreement to acquire Althin Medical, a manufacturer of hemodialysis products, for approximately $130 million, including assumed debt. Management is in the process of estimating the portion of the purchase price which will be allocated to IPR&D. The closings of the acquisitions are subject to certain terms and conditions. Both transactions are expected to close in the first six months of 2000.

IPR&D

Amounts allocated to IPR&D were determined on the basis of independent appraisals using the income approach, which measures the value of an asset by the present value of its future economic benefits. Estimated cash flows were discounted to their present values at rates of return that incorporate the risk-free rate, the expected rate of inflation, and risks associated with the particular projects, including their stages of completion. Projected revenue and cost assumptions were determined considering the company's historical experience and industry trends and averages. No value was assigned to any IPR&D project unless it was probable of being further developed.

The following is a summary of the amounts allocated to IPR&D by significant project category:

(in millions)	Somatogen	Immuno
Oxygen-carrying therapeutics	$116	
Plasma-based therapies		$142
Vaccines		78
Total	$116	$220

Somatogen was a development-stage company and no revenue had ever been generated from commercial product sales. The development of oxygen-carrying therapeutics is a strategic priority to Baxter. At the time of the acquisition, Baxter was in final-stage (Phase III) clinical trials with its HemAssist® (DCLHb) product. Baxter acquired Somatogen to advance the development of new generations of recombinant oxygen-carrying technology-based products with enhanced attributes. Subsequent to the date of the acquisition, Baxter decided to end its HemAssist (DCLHb) program and focus on Somatogen's next-generation program. Material net cash inflows relating to Somatogen's IPR&D were forecasted in the valuation to begin in 2004. Estimated research and development (R&D) costs to be incurred prior to 2004 were forecasted in the valuation to total approximately $100 million. A discount rate of 22 percent was used in the valuation. As the R&D efforts progress, it is currently forecasted that material net cash inflows relating to Somatogen's IPR&D as of acquisition date will not begin until after 2005. Also, it is currently estimated that over $250 million of R&D costs will be incurred between the date of acquisition and 2006, with increasing levels of spending to be incurred each year. Approximately $18 million and $10 million of R&D costs were expensed in 1999 and 1998, respectively.

With respect to Immuno, the two project categories were comprised of 18 projects, many of which were comprised of multiple sub-projects. The status of development, stage of completion, assumptions, nature and timing of remaining efforts for completion, risks and uncertainties, and other key factors varied by individual project. Discount rates of 18 percent and 35 percent were used for plasma-based therapies and vaccines, respectively. Material net cash inflows for the most significant projects were forecasted to commence between 1998 and 2000. Assumed additional research and development expenditures prior to the various dates of project introductions totaled approximately $77 million. The projects are currently at various stages of development and virtually all of the significant projects that were in-process at the acquisition date are ongoing at December 31, 1999. As part of the post-acquisition integration and R&D rationalization process, management reassessed all of Immuno's ongoing R&D projects in conjunction with a re-evaluation of Baxter's existing R&D projects, and re-prioritized certain projects, resulting in modifications to originally planned timetables for certain of the projects. Such changes in timetables were also significantly influenced by marketplace trends and competitive factors occurring since the acquisition date. Most significantly, the timetables for certain of the plasma-based therapies projects have been delayed in order to accelerate the development of the next-generation recombinant Factor VIII concentrate for hemophilia treatment, given the strong and accelerating demand for recombinant products in the marketplace. In general, projects are not currently projected to be delayed by more than two to four years from the acquisition date timetables. Total additional R&D expenditures prior to the various dates of product introductions are not currently forecasted to be substantially different from that assumed in the model. Approximately $24 million, $25 million and $36 million of R&D costs have been expensed in 1999, 1998 and 1997, respectively.

With respect to Somatogen and Immuno IPR&D, the products currently under development are at various stages of development, and substantial further research and development, pre-clinical testing and clinical trials will be required to determine their technical feasibility and commercial viability. There can be no assurance such efforts will be successful. Delays in the development, introduction or marketing of the products under development could result either in such products being marketed at a time when their cost and performance characteristics would not be competitive in the marketplace or in a shortening of their commercial lives. If the products are not completed on time, the expected return on the company's investments could be significantly and unfavorably impacted.

Acquisition reserves

Based on plans formulated at acquisition date, as part of the allocation of purchase price, reserves have been established for certain acquisitions. The following is a summary of significant reserves and related activity for recent acquisitions. Actions executed to date and anticipated in the future with respect to these acquisitions are substantially consistent with the original plans. Management expects the plans to be substantially complete in accordance with the originally established timetable. Management believes remaining reserves are adequate to complete the actions contemplated by the plans.

as of or for the years ended December 31(in millions)	Bieffe	Immuno	Clintec
Original reserve			
Employee-related costs	$ 6	$38	$18
Contract termination and other costs	13	41	5
Total original reserve	$19	$79	$23
1997 reserve utilization	n/a	(4)	(1)
1998 reserve utilization	(3)	(22)	(3)
1999 reserve utilization	(2)	(11)	(1)
Balance at December 31, 1999	$14	$42	$18

Employee-related costs consisted principally of employee severance associated with headcount reductions in Europe impacting various functions at the acquired companies. The headcount reductions for Immuno primarily impacted the sales and marketing functions, and for Clintec Nutrition Company (Clintec), primarily impacted the manufacturing function. Utilization of reserves for employee-related costs totaled $2 million in 1998 for Bieffe, $6 million, $16 million and $2 million in 1999, 1998 and 1997, respectively, for Immuno, and $3 million and $1 million in 1998 and 1997, respectively, for Clintec.

Contract termination and other costs related principally to the exiting of activities and termination of distribution, lease and other contracts of the acquired companies that existed prior to the acquisition date that either continued with no economic benefit or required payment of a cancellation penalty.

Divestiture

In December 1997, the company sold certain assets of its Immunotherapy division to Nexell Therapeutics Inc. (Nexell) and recognized a pretax gain of $32 million. Proceeds received included publicly traded common stock, convertible preferred stock and warrants to acquire additional common stock in the future. Sale of the common stock is subject to certain restrictions.

4 EXIT AND OTHER REORGANIZATION COSTS

In September 1998, the company decided to end the clinical development of the Blood Therapies' segment's first-generation oxygen-carrying therapeutic, HemAssist (DCLHb), which was based on human hemoglobin, and focus on the next-generation program, which is based on genetically engineered hemoglobin molecules. The company also decided to exit certain non-strategic investments, primarily in Asia, and reorganize certain other activities. As a result of these decisions, the company recorded a $122 million pretax charge in the third quarter of 1998.

Included in the total charge was a $74 million charge to write down certain assets to estimated sales or salvage value due to impairment. The majority of the asset writedowns related to assets located in a manufacturing facility in Neuchâtel, Switzerland, that were used solely in the development and manufacture of HemAssist (DCLHb), and had no alternative future use. Activities ceased upon the decision to end the clinical development of HemAssist (DCLHb). In 1999, the company began modifications to this manufacturing facility, which was designed to manufacture a human hemoglobin product, to produce recombinant biopharmaceutical products. Such alternate production is expected to commence at the Neuchâtel facility in the next two to three years.

The following is a summary of the components of the remainder of the charge and utilization of such reserves to date:

as of or for the years ended December 31 (in millions)	Employee-related costs	Other costs	Total
Original charge	$34	$14	$48
1998 utilization	(12)	(6)	(18)
1999 utilization	(16)	(7)	(23)
Reserves at December 31, 1999	$ 6	$ 1	$ 7

Employee-related costs consisted principally of employee severance resulting from the elimination of approximately 375 positions worldwide. The headcount reductions affected various functions and pertained principally to the Blood Therapies and I.V. Systems/Medical Products segments. Approximately 340 positions have been eliminated through December 31, 1999. The other costs related principally to contractual obligations that existed prior to the date of the charge that either continued with no economic benefit or required payment of a cancellation penalty. The majority of such costs related to the terminated HemAssist (DCLHb) program and included cancellation costs associated with a minimum purchase agreement.

In September 1995, the company recorded a pretax charge of $103 million primarily to eliminate excess plant capacity and reduce manufacturing costs. The charge predominantly related to the closure and disposal of the intravenous-solutions plant and warehouse in Carolina, Puerto Rico, which was part of the I.V. Systems/Medical Products segment. Management's plan entailed transferring production to other facilities in Puerto Rico and the United States upon receipt of the necessary approvals from the United States Food and Drug Administration, and then selling or otherwise disposing of the facility. All production and warehousing was consolidated into other facilities as of year-end 1998 in accordance with the original plan. The total charge included a $67 million charge to write down the facility to estimated sales value due to impairment. Suspended depreciation on the facility totaled approximately $6 million per year since the date of the charge.

The following is a summary of the components of the remainder of the charge and utilization of such reserves by year and category:

as of or for the years ended December 31 (in millions)	Employee-related costs	Other costs	Total
Original charge	$ 27	$9	$ 36
1995 utilization	(1)	–	(1)
1996 utilization	(10)	(1)	(11)
1997 utilization	(1)	(2)	(3)
1998 utilization	(5)	(6)	(11)
1999 utilization	(10)	–	(10)
Reserves at December 31, 1999	$ –	$–	$ –

Employee-related costs consisted principally of employee severance resulting from the elimination of approximately 1,200 positions, principally in Puerto Rico. Certain positions, primarily direct labor, were added to other facilities to support the increased production levels at those sites. Other costs principally related to contractual obligations that existed prior to the date of the charge and either continued with no economic benefit or required payment of a cancellation penalty. The reserves were fully utilized during 1999 as employee severance was paid and other wind-down activities were completed. Management's objectives for the plan were met substantially in accordance with the originally estimated cost and timetable.

5 LONG-TERM DEBT, CREDIT FACILITIES & LEASE OBLIGATIONS

as of December 31 (in millions)	Effective interest rate	1999	1998
Commercial paper	5.3%	**$ 668**	$ 800
Short-term notes	3.0%	**646**	659
9.25% notes due 1999	9.6%	**–**	99
Zero coupon notes due 2000 (unamortized original issue discounts of $9 and $24, respectively)	10.9%	**120**	123
8.125% notes due 2001	6.2%	**155**	158
7.625% notes due 2002	7.5%	**151**	151
7.125% notes due 2007	7.1%	**251**	251
7.25% notes due 2008	7.5%	**198**	198
9.5% notes due 2008	9.5%	**75**	75
7.65% debentures due 2027	7.6%	**202**	202
6.625% debentures due 2028	6.7%	**249**	249
Other		**16**	246
Total long-term debt and lease obligations		**2,731**	3,211
Current portion		**(130)**	(115)
Long-term portion		**$2,601**	$3,096

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 $91 million, $79 million and $77 million in 1999, 1998 and 1997, respectively.

Future minimum lease payments and debt maturities

as of or for the years ended December 31 (in millions)	Operating leases	Aggregate debt maturities and capital leases
2000	**$ 73**	**$ 138**
2001	**56**	**61**
2002	**42**	**154**
2003	**28**	**1,388**[1]
2004	**25**	**3**
Thereafter	**58**	**1,013**
Total obligations and commitments	**$282**	**2,757**
Amounts representing interest, discounts, premiums and deferred financing costs		**(26)**
Total long-term debt and present value of lease obligations		**$2,731**

1. Includes $1,314 million of commercial paper and short-term notes supported by long-term credit facilities expiring in 2003.

The company maintains two revolving credit facilities which total $1.2 billion. Of this total, $400 million will expire in 2000 and another $800 million facility will expire in 2003. The facilities enable the company to borrow funds on an unsecured basis at variable interest rates and contain various covenants, including a maximum debt-to-capital ratio and a minimum interest coverage ratio. There were no borrowings outstanding under these facilities at December 31, 1999 or 1998. Baxter also maintains or guarantees other short-term credit arrangements which totaled approximately $447 million at December 31, 1999. Approximately $93 million and $94 million of borrowings were outstanding under these facilities at December 31, 1999 and 1998, respectively. At December 31, 1999 and 1998, commercial paper and short-term notes together totaling $718 million and $800 million, respectively, have been classified with long-term debt as they are supported by the long-term credit facilities, which management intends to continue to refinance.

During 1998, a wholly-owned subsidiary of the company entered into an $800 million revolving credit facility, which expires in 2003 and enables the subsidiary to borrow funds at variable interest rates. The agreement contains various covenants, including a minimum interest coverage ratio, a maximum debt-to-adjusted earnings ratio and a minimum adjusted net worth amount. There were $596 million and $659 million in borrowings outstanding under this facility at

December 31, 1999 and 1998, respectively, and they were denominated in Swiss Francs. These borrowings are secured and guaranteed by a pledge of the shares of the borrower and certain of its subsidiaries.

6 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 $34 million and $37 million at December 31, 1999 and 1998, 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, 1999 and 1998 reflect deferred hedge gains of $11 million and $16 million, respectively, offset by $2 million and $2 million of deferred hedge losses, respectively.

Foreign exchange risk management

The company principally hedges the following currencies: Japanese Yen, the Euro and Swiss Franc. The company enters into various types of foreign exchange contracts to protect the company from the risk that the eventual net dollar cash flows 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 two years, 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 $7 million and $2 million at December 31, 1999 and 1998, 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 creating debt denominated in the respective currencies of the underlying net assets. The increase or decrease in the debt balance is directly offset by a corresponding fluctuation in the underlying net assets.

Interest rate and foreign exchange contracts

as of December 31 (in millions)	**1999**		1998	
	Notional amounts	**Market values**	Notional amounts	Market values
Interest rate contracts				
Floating to fixed rate hedges	**$ 300**	**$ 3**	$ 600	$ (3)
Average pay rate 7.4% in 1999 and 5.4% in 1998				
Average receive rate 5.8% in 1999 and 5.6% in 1998				
Foreign exchange contracts				
Forwards and options primarily used to hedge anticipated sales				
Japanese Yen	**$ 714**	**$ (2)**	$ 489	$ (1)
Euro	**672**	**17**	220	2
Other currencies	**40**	**–**	88	2
Total	**$1,426**	**$ 15**	$ 797	$ 3
Forwards and swaps used to hedge net investments in foreign affiliates				
Japanese Yen	**$ 315**	**$(113)**	$ 315	$ (58)
Euro	**2,650**	**175**	2,250	(144)
Other currencies	**15**	**–**	82	–
Total	**$2,980**	**$ 62**	$2,647	$(202)
Forwards used to hedge certain receivables and payables (primarily Japanese Yen, Euro and Swiss Franc)	**$ 58**	**$ –**	$ 274	$ –

In conjunction with the spin-off of Edwards, it is expected that certain of the foreign exchange contracts summarized above, principally those used to hedge anticipated sales, will be transferred to Edwards. The estimated total notional amount and market value of such contracts totaled $350 million and $1 million, respectively, at December 31, 1999.

Fair values of financial instruments

	Carrying amounts		Approximate fair values	
as of December 31 (in millions)	**1999**	1998	**1999**	1998
Assets				
Long-term insurance receivables	**$301**	$408	**$248**	$351
Investments in affiliates	**145**	118	**158**	115
Foreign exchange hedges	**25**	8	**15**	4
Liabilities				
Short-term debt	**125**	156	**125**	156
Short-term borrowings classified as long term	**1,314**	1,459	**1,312**	1,462
Other long-term debt and lease obligations	**1,417**	1,752	**1,326**	1,854
Long-term litigation liabilities	**273**	246	**237**	217

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 approximate fair values of other assets and liabilities are based on quoted market prices, where available.

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

7 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

as of December 31 (in millions)	**1999**	1998
Accounts payable, principally trade	**$ 612**	$ 507
Employee compensation and withholdings	**260**	222
Litigation	**183**	475
Pension and other deferred benefits	**40**	18
Property, payroll and other taxes	**105**	85
Other	**605**	717
Accounts payable and accrued liabilities	**$1,805**	$2,024

8 COMMON AND PREFERRED 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, restricted and other stock plans was $26 million, $15 million and $11 million in 1999, 1998 and 1997, 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 from continuing operations before cumulative effect of accounting change and related earnings per share (EPS) would have been reduced to the pro forma amounts indicated below:

Pro forma income and EPS

years ended December 31 (in millions, except per share data)	**1999**	1998	1997
Pro forma income	**$ 728**	$222	$ 340
Pro forma basic EPS	**$2.51**	$ .78	$1.22
Pro forma diluted EPS	**$2.48**	$ .77	$1.21

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 have an exercise price at least equal to 100% of market value on the date of grant. Vesting terms vary, with most outstanding options vesting 100% in three years, 100% in five years, or ratably over three years.

Employees of Edwards will be required to exercise any vested options within 90 days from the date of spin-off, which is currently anticipated to occur on March 31, 2000. All unvested options will be canceled 90 days after the date of spin-off.

Stock options outstanding at December 31, 1999

(option shares in thousands)	Options outstanding			Options exercisable	
Range of exercise prices	Outstanding	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Exercisable	Weighted-average exercise price
$19 – 26	1,346	3.7	$24.32	1,346	$24.32
27 – 40	2,222	4.6	34.17	2,222	34.17
41 – 51	5,947	7.2	47.48	4,717	47.57
52 – 84	9,294	8.7	63.58	470	56.34
$19 – 84	18,809	6.1	$52.20	8,755	$41.06

As of December 31, 1998 and 1997, there were 4,565,000 and 6,314,000 options exercisable, respectively, at weighted-average exercise prices of $30.27 and $29.84, respectively.

Stock option activity

(option shares in thousands)	Shares	Weighted-average exercise price
Options outstanding at January 1, 1997	12,501	$34.89
Granted	4,208	47.59
Exercised	(2,406)	29.04
Forfeited	(421)	38.76
Options outstanding at December 31, 1997	13,882	39.64
Granted	4,806	59.83
Exercised	(1,728)	28.69
Forfeited	(587)	49.51
Options outstanding at December 31, 1998	16,373	46.37
Granted	5,013	66.73
Exercised	(1,958)	39.18
Forfeited	(619)	56.73
Options outstanding at December 31, 1999	18,809	$52.20

Included in the tables above are grants of certain premium-priced options. During 1998, approximately 450,000 premium-priced stock options were granted with a weighted-average exercise price of $76.78 and a weighted-average fair value of $12.70. During 1996, approximately 2.4 million premium-priced stock options were granted with an exercise price of $51 and a weighted-average fair value of $11.01. All of such options granted in 1998 and 1.7 million of such options granted in 1996 are outstanding at December 31, 1999.

Pro forma compensation expense was calculated with the following weighted-average assumptions for grants in 1999, 1998, and 1997, respectively: dividend yield of 1.5%, 1.5% and 2.1%; expected life of six, six and seven years; expected volatility of 29%, 29% and 28%; and risk-free interest rates of 5.4%, 5.3% and 6.2%. The weighted-average fair value of options granted during the year were $22.59, $18.58 and $15.95 in 1999, 1998 and 1997, respectively.

Stock options had also been granted to The Baxter Allegiance Foundation (a philanthropic organization). A total of 2,198,478 options had been granted in 1991 and 1992 at a weighted-average exercise price of $31.44. All of the 1,952,253 options outstanding at December 31, 1998 were either exercised or forfeited during 1999.

Employee stock purchase plans

The company has employee stock purchase plans whereby it is authorized, as of December 31, 1999, to issue up to 10 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 777,618, 810,855 and 760,490 shares to employees in 1999, 1998 and 1997, respectively. Pro forma compensation expense was estimated with the following weighted-average assumptions for 1999, 1998 and 1997, respectively: dividend yield of 1.5%, 1.5% and 2.1%; expected life of one year for all periods; expected volatility of 33% for all periods, and risk-free interest rates of 5.4%, 4.4% and 5.7%. The weighted-average fair value of those purchase rights granted in 1999, 1998 and 1997 was $20.09, $15.16 and $13.27, 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, 1999, 589,950 shares were subject to restrictions, which lapse between 2000 and 2002, and 348,553 shares were subject to restrictions that lapse upon achievement of future performance objectives and related vesting periods. During 1999, 1998 and 1997, 542,500, 242,740 and 24,930 shares, respectively, of restricted stock and performance shares were granted at weighted-average grant-date fair values of $63.99, $58.74 and $51.29 per share, respectively.

Shared investment plan

In 1999, the company sold approximately 3.1 million shares of the company's common stock to 142 of Baxter's senior managers for approximately $198 million in cash. This plan, which is similar to one implemented in 1994, directly aligns management and shareholder interests. The Baxter managers used full-recourse personal bank loans to purchase the stock at the May 3, 1999 closing price of $63.625. Baxter has agreed to guarantee repayment to the banks in the event of default by a participant in the plan. The total outstanding participant loan amount relating to the 1999 Shared Investment Plan at December 31, 1999 was $195 million.

Stock repurchase programs

In November 1995, the company's board of directors authorized the repurchase of up to $500 million of common stock over a period of several years, of which $451 million has been repurchased as of December 31, 1999. The remainder of the authorized amount is expected to be repurchased in 2000. In November 1999, the board of directors authorized the repurchase of an additional $500 million over a period of several years.

Equity forward agreements

In order to partially offset the dilutive effect of stock issuances under the company's employee stock option plans, the company entered into forward agreements during 1999 with independent third parties related to approximately 7.5 million shares of Baxter common stock. The forward agreements require the company to purchase its common stock from the counterparties on specified future dates and at specified prices. The company can, at its option, require settlement of the agreements with shares of its common stock or, in some cases, cash, in lieu of physical settlement. The company may, at its option, terminate and settle these agreements early at any time before maturity. In conjunction with its stock repurchase program, the company terminated one of the agreements during 1999 prior to original maturity date, delivering approximately $33 million in cash to the counterparty for 500,000 shares of its common stock. As of December 31, 1999, agreements related to approximately 3.3 million shares mature in 2000 at exercise prices ranging from $68 to $71 per share and agreements related to approximately 3.7 million shares mature in 2002 at exercise prices ranging from $73 to $81 per share.

Other

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.

In March 1999, common stockholders received a dividend of one preferred stock purchase right (collectively, the "Rights") for each share of common stock. These Rights replaced similar rights that expired in March 1999. The Rights may become exercisable at a specified time after (1) a person or group acquires 15% or more of the company's common stock or (2) a tender or exchange offer for 15% or more of the company's common stock. Once exercisable, the holder of each Right is entitled to purchase, upon payment of the exercise price, shares of the company's common stock having a market value equal to two times the exercise price of the Rights. The Rights have a current exercise price of $275. The Rights expire on March 23, 2009, unless earlier redeemed by the company under certain circumstances at a price of $0.01 per Right.

9 RETIREMENT AND OTHER BENEFIT PROGRAMS

The company sponsors several qualified and nonqualified pension plans and other postretirement benefit plans for its employees.

Reconciliation of plans' benefit obligations, assets and funded status

	Pension benefits		Other benefits	
as of or for the years ended December 31 (in millions)	**1999**	1998	**1999**	1998
Benefit obligation				
Beginning of year	**$1,427**	$1,305	**$ 200**	$ 202
Service cost	**48**	41	**3**	3
Interest cost	**103**	96	**13**	14
Participant contributions	**2**	2	**3**	3
Actuarial (gain) loss	**(148)**	60	**(30)**	(12)
Acquisitions	**1**	–	**–**	–
Curtailment gain	**(7)**	(3)	**(3)**	–
Benefit payments	**(76)**	(74)	**(11)**	(10)
Currency exchange-rate changes and other	**(6)**	–	**–**	–
End of year	**1,344**	1,427	**175**	200
Fair value of plan assets				
Beginning of year	**1,472**	1,309	**–**	–
Actual return on plan assets	**302**	179	**–**	–
Employer contributions	**13**	53	**8**	7
Participant contributions	**2**	2	**3**	3
Acquisitions	**11**	–		–
Benefit payments	**(76)**	(74)	**(11)**	(10)
Currency exchange-rate changes and other	**–**	3	**–**	–
End of year	**1,724**	1,472	**–**	–
Funded status				
Funded status at December 31	**380**	45	**(175)**	(200)
Unrecognized transition obligation	**9**	18	**–**	–
Unrecognized net gains	**(390)**	(66)	**(98)**	(75)
Unrecognized prior-service cost	**(3)**	2	**–**	–
Net amount recognized	**$ (4)**	$ (1)	**$(273)**	$(275)
Prepaid benefit cost	**$ 121**	$ 119	**$ –**	$ –
Accrued benefit liability	**(125)**	(120)	**(273)**	(275)
Net amount recognized	**$ (4)**	$ (1)	**$(273)**	$(275)

The accumulated benefit obligation is in excess of plan assets for certain of the company's pension plans. The projected benefit obligation, accumulated benefit obligation, and fair value of plan assets for these plans was $140 million, $128 million and $23 million, respectively, at December 31, 1999, and $146 million, $123 million and $18 million, respectively, at December 31, 1998.

Net periodic benefit cost

years ended December 31 (in millions)	**1999**	1998	1997
Pension benefits			
Service cost	**$48**	$41	$36
Interest cost	**102**	96	90
Expected return on plan assets	**(133)**	(117)	(109)
Amortization of prior service cost	**1**	1	2
Amortization of transition obligation	**6**	6	6
Net periodic pension benefits cost	**$24**	$27	$25
Other benefits			
Service cost	**$ 3**	$ 3	$ 3
Interest cost	**12**	14	14
Recognized actuarial gain	**(7)**	(6)	(6)
Net periodic other benefits cost	**$ 8**	$11	$11

The net periodic benefit cost amounts pertain to both continuing and discontinued operations.

Assumptions used in determining benefit obligations

	Pension benefits		Other benefits	
	1999	1998	**1999**	1998
Discount rate				
U.S. and Puerto Rico plans	**8.25%**	7.25%	**8.25%**	7.25%
International plans (average)	**5.7%**	5.4%	**n/a**	n/a
Expected return on plan assets				
U.S. and Puerto Rico plans	**10.5%**	10.5%	**n/a**	n/a
International plans (average)	**6.9%**	7.0%	**n/a**	n/a
Rate of compensation increase				
U.S. and Puerto Rico plans	**4.5%**	4.5%	**n/a**	n/a
International plans (average)	**4.1%**	4.2%	**n/a**	n/a
Annual rate of increase in the per-capita cost	**n/a**	n/a	**7.5%**	8.0%
Rate decreased to	**n/a**	n/a	**5.5%**	5.0%
By the year ended	**n/a**	n/a	**2002**	2002

Effect of a one percent change in assumed health-care cost trend rate

	One percent increase		One percent decrease	
(in millions)	**1999**	1998	**1999**	1998
Effect on total of service and interest cost components	**$2**	$3	**$2**	$2
Effect on postretirement benefit obligation	**21**	28	**18**	22

Most U.S. employees are eligible to participate in a qualified defined contribution plan. Company matching contributions relating to continuing operations were $14 million, $14 million and $11 million in 1999, 1998 and 1997, respectively.

With respect to employees of the CardioVascular business, the company has announced its intent to freeze benefits at the date of spin-off under the U.S. defined benefit pension plan and under other plans that provide retirees with health-care and life insurance benefits. The pension liability related to such employees' service prior to the spin-off date will remain with Baxter. Included in net costs associated with effecting the business distribution in 1999 was a $5 million gain (net of tax of $4) relating to these benefit plan curtailments.

10 INTEREST AND OTHER (INCOME) EXPENSE

Interest expense, net

years ended December 31 (in millions)	**1999**	1998	1997
Interest, net			
Interest costs	**$165**	$198	$206
Interest costs capitalized	**(13)**	(5)	(8)
Interest expense	**152**	193	198
Interest income	**(35)**	(32)	(35)
Total interest, net	**$117**	$161	$163
Allocated to discontinued operation	**$ 30**	$ 37	$ 32
Allocated to continuing operations	**$ 87**	$124	$131

The allocation of interest to continuing and discontinued operations was based on relative net assets of these operations.

Other expense (income)

years ended December 31 (in millions)	**1999**	1998	1997
Equity in (income) losses of affiliates	**$ 5**	$ 3	$ (2)
Asset dispositions, net	**13**	(23)	(48)
Foreign exchange	**(8)**	–	(22)
Other	**1**	2	38
Total other expense (income)	**$11**	$(18)	$(34)

11 INCOME TAXES

U.S. federal income tax returns filed by Baxter International Inc. through December 31, 1994, 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 years subject to examination.

Income before income tax expense by category

years ended December 31 (in millions)	1999	1998	1997
U.S.	$ 330	$ 78	$167
International	722	415	403
Income from continuing operations before income taxes and cumulative effect of accounting change	$1,052	$493	$570

Income tax expense

years ended December 31 (in millions)	1999	1998	1997
Current			
U.S.			
Federal	$ (12)	$119	$ 91
State and local	35	3	(19)
International	151	151	125
Current income tax expense	174	273	197
Deferred			
U.S.			
Federal	68	(3)	(49)
State and local	17	5	25
International	14	(57)	26
Deferred income tax expense (benefit)	99	(55)	2
Income tax expense	$273	$218	$199

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

Deferred tax assets and liabilities

years ended December 31 (in millions)	1999	1998	1997
Deferred tax assets			
Accrued expenses	$389	$349	$280
Accrued postretirement benefits	102	103	103
Alternative minimum tax credit	162	164	114
Tax credits and net operating losses	100	179	136
Valuation allowances	(43)	(34)	(45)
Total deferred tax assets	710	761	588
Deferred tax liabilities			
Asset basis differences	471	473	510
Subsidiaries' unremitted earnings	160	188	91
Other	35	13	4
Total deferred tax liabilities	666	674	605
Net deferred tax asset (liability)	$ 44	$ 87	$ (17)

There are $4 million and $15 million of foreign tax credit carryforwards which expire in 2002 and 2003, respectively.

Income tax expense rate reconciliation

years ended December 31 (in millions)	1999	1998	1997
Income tax expense at statutory rate	$368	$172	$200
Tax-exempt operations	(134)	(120)	(114)
State and local taxes	23	(3)	(7)
Repatriation of foreign earnings	–	87	–
Foreign tax expense	18	46	43
IPR&D expense	–	41	77
Other factors	(2)	(5)	–
Income tax expense	$273	$218	$199

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 until 2002.

U.S. federal income taxes, net of available foreign tax credits, on unremitted earnings deemed permanently reinvested would be approximately $371 million as of December 31, 1999.

12 LEGAL PROCEEDINGS, COMMITMENTS & CONTINGENCIES

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 pending legal matters, 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.

Following is a summary of certain legal matters pending against the company. For a more extensive description of such matters and other lawsuits, claims and proceedings against the company, see Baxter's Annual Report on Form 10-K for the year ended December 31, 1999.

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.

A class action on behalf of all women with silicone mammary implants was filed in March 1994. The class action was certified for settlement purposes only by the federal court in which it was filed in September 1994, and the settlement terms were subsequently revised and approved in December 1995. The monetary provisions of the 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. All appeals directly challenging the settlement have been dismissed. In January 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 settlement. In addition to the class action, there are a large number of individual suits currently pending against the company, primarily consisting of plaintiffs who have opted-out of the class action.

In 1993, Baxter accrued $556 million for its estimated liability resulting from the settlement of the mammary related class action and recorded a receivable for estimated insurance recoveries totaling $426 million, resulting in a net charge of $130 million. In 1995, based on a continuing evaluation of this litigation, 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 1998, the company accrued an additional $250 million for its estimated liability resulting from the class action settlement and remaining opt-out cases and claims, and recorded a receivable for related estimated insurance recoveries of $121 million, resulting in an additional net charge of $129 million.

In December 1998, a panel of independent medical experts appointed by a federal judge announced their findings that reported medical studies contained no clear evidence of a connection between silicone mammary implants and traditional or atypical systemic diseases. In June 1999, a similar conclusion was announced by a committee of independent medical experts from the Institute of Medicine, an arm of the National Academy of Sciences.

The mammary implant litigation includes issues related to which of 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.

Plasma-based therapies 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 antihemophilic factor concentrates VIII or IX derived from human blood plasma (factor concentrates) processed by the company from the late 1970s to the 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.

In addition, Immuno has unsettled claims for damages for injuries allegedly caused by its plasma-based 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, pursuant to the stock purchase agreement between the company and Immuno, approximately 84 million Swiss Francs of the purchase price was withheld to cover these contingent liabilities. In April 1999, the stock purchase agreement between the company and Immuno was amended to revise the holdback amount from 84 million Swiss Francs to 26 million Swiss Francs (or approximately $16 million at December 31, 1999) in consideration for an April 1999 payment by the company of 29 million Swiss Francs to Immuno as additional purchase price. Based on management's estimates, the company has recorded an appropriate liability and related insurance receivable with regard to the matters above.

Baxter is also currently a defendant in a number of claims and lawsuits, including one certified class action in the U.S.D.C. for the Central District of California, brought by individuals who infused the company's Gammagard® IVIG (intravenous immunoglobulin), all of whom are seeking damages for Hepatitis C infections allegedly caused by infusing Gammagard® IVIG. In December 1999, the U.S.D.C. for the Central District of California granted preliminary approval to a proposed settlement of the class action agreed upon by plaintiffs' class counsel and Baxter that would provide financial compensation for U.S. individuals who used Gammagard® IVIG between January 1993 and February 1994.

Baxter believes that a substantial portion of the liability and defense costs related to its plasma-based therapies litigation will be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer solvency.

In 1993, the company accrued $131 million for its estimated worldwide liability for litigation and settlement expenses involving factor concentrates cases and recorded a receivable for insurance coverage of $83 million, resulting in a net charge of $48 million. In 1995, significant developments occurred, primarily in the United States, Europe and Japan relative to claims and litigation pertaining to Baxter's plasma-based therapies. The company revised its estimated exposure from the $131 million previously recorded for factor concentrates litigation to $378 million for all litigation relating to plasma-based therapies, including the factor concentrates litigation and the Gammagard ® IVIG litigation. 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 1995. The company further revised its estimate of liabilities and insurance recoveries in 1998, and accrued an additional $180 million for its estimated liability for plasma-based therapies litigation and other litigation and recorded a receivable for related estimated insurance recoveries of $131 million, for a net charge of $49 million.

Other litigation

As of September 30, 1996, Allegiance Corporation (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.

In addition to the cases discussed above, Baxter is a defendant in a number of other claims, investigations and lawsuits, including certain environmental proceedings. 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.

Commitment

In November 1999, the company and Nexell entered into an agreement whereby Baxter agreed to guarantee certain amounts, up to a maximum of $63 million, associated with a private placement by Nexell of preferred stock and other securities.

13 SEGMENT INFORMATION

Baxter's continuing operations are comprised of three segments, each of which are strategic businesses that are managed separately because each business develops, manufactures and sells distinct products and services. The segments are as follows: **I.V. Systems/Medical Products**, technologies and systems to provide intravenous fluid and drug delivery; **Blood Therapies**, biopharmaceutical and blood-collection and separation products and technologies; and **Renal**, products and services to treat end-stage kidney disease. As discussed in Note 2, the company plans to spin off Edwards to Baxter shareholders. Financial information for Edwards, which is substantially the same as the former CardioVascular segment, is now being reported as a discontinued operation. The three segments' principal products include intravenous solutions and infusion pumps; blood-clotting therapies, vaccines, and machines for collecting, separating and storing blood; and dialysis equipment, solutions and supplies. The company's products and services are used in more than 100 countries, with the principal markets being the United States, Europe, Japan and Latin America.

Management utilizes more than one measurement and multiple views of data to measure segment performance and to allocate resources to the segments. However, the dominant measurements are consistent with the company's consolidated financial statements and, accordingly, are reported on the same basis herein. Management evaluates the performance of its segments and allocates resources to them primarily based on pretax income along with cash flows and overall economic returns. Intersegment sales are generally accounted for at amounts comparable to sales to unaffiliated customers, and are eliminated in consolidation. The accounting policies of the segments are substantially the same as those described in the summary of significant accounting policies, as discussed in Note 1.

Certain items are maintained at the company's corporate headquarters (Corporate) and are not allocated to the segments. They primarily include most of the company's debt and cash and equivalents and related net interest expense, corporate headquarters costs, certain non-strategic investments and nonrecurring gains and losses, deferred income taxes, certain foreign currency fluctuations, hedging activities, and certain litigation liabilities and related insurance receivables.

as of or for the years ended December 31 (in millions)	I.V. Systems/ Medical Products	Blood Therapies	Renal	Other	Total
1999					
Net sales	**$2,524**	**$2,176**	**$1,680**	**–**	**$6,380**
Depreciation and amortization	**145**	**114**	**81**	**$ 32**	**372**
Pretax income	**424**	**435**	**318**	**(125)**	**1,052**
Assets	**2,447**	**2,632**	**1,342**	**3,223**	**9,644**
Expenditures for long-lived assets	**175**	**235**	**125**	**96**	**631**
1998					
Net sales	$2,314	$1,862	$1,530	–	$5,706
Depreciation and amortization	137	101	81	$ 25	344
Pretax income	392	404	223	(526)	493
Assets	2,257	2,655	1,353	3,608	9,873
Expenditures for long-lived assets	146	212	129	69	556
1997					
Net sales	$2,110	$1,765	$1,384	–	$5,259
Depreciation and amortization	128	98	67	$ 25	318
Pretax income	331	375	301	(437)	570
Assets	1,937	2,305	1,055	3,215	8,512
Expenditures for long-lived assets	135	191	100	28	454

Included in 1997 pretax income for the Blood Therapies segment is a $17 million gain relating to the disposal of a non-strategic investment, and a $32 million gain relating to the divestiture of certain assets of the Immunotherapy division.

as of or for the years ended December 31 (in millions)	**1999**	1998	1997
Pretax income			
Total pretax income from segments	**$1,177**	$1,019	$1,007
Unallocated amounts			
In-process research and development expense	**–**	(116)	(220)
Charge for exit and other reorganization costs	**–**	(122)	–
Net litigation charge	**–**	(178)	–
Interest expense, net	**(87)**	(124)	(131)
Certain currency exchange rate fluctuations	**25**	27	41
Gain on disposal of investment	**–**	20	–
Other Corporate items	**(63)**	(33)	(127)
Consolidated income from continuing operations before income taxes and cumulative effect of accounting change	**$1,052**	$ 493	$ 570

	1999	1998	1997
Assets			
Total segment assets	**$6,421**	$6,265	$5,297
Unallocated assets			
Cash and equivalents	**606**	709	465
Deferred income taxes	**417**	583	280
Insurance receivables	**417**	639	735
Net assets of discontinued operation	**1,231**	1,275	1,337
Other Corporate assets	**552**	402	398
Consolidated total assets	**$9,644**	$9,873	$8,512

With respect to depreciation and amortization, and expenditures for long-lived assets, the difference between the segment totals and the consolidated totals related to assets maintained at Corporate.

Geographic information

The following geographic area data include net sales based on product shipment destination and long-lived assets based on physical location.

as of or for the years ended December 31 (in millions)	**1999**	1998	1997
Net sales			
United States	**$2,921**	$2,609	$2,371
Japan	**482**	405	416
Other countries	**2,977**	2,692	2,472
Consolidated totals	**$6,380**	$5,706	$5,259
Long-lived assets			
United States	**$1,361**	$1,250	$1,078
Austria	**344**	326	304
Other countries	**945**	869	761
Consolidated totals	**$2,650**	$2,445	$2,143

14 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
1999					
Net sales	**$1,462**	**$1,560**	**$1,589**	**$1,769**	**$6,380**
Gross profit	**625**	**690**	**713**	**784**	**2,812**
Income from continuing operations before cumulative effect of accounting change	**162**	**189**	**197**	**231**	**779**
Net income	**151**	**207**	**210**	**229**	**797**
Per common share					
Income from continuing operations before cumulative effect of accounting change					
Basic	**.56**	**.65**	**.67**	**.80**	**2.69**
Diluted	**.55**	**.64**	**.67**	**.78**	**2.64**
Net income[1,2]					
Basic	**.53**	**.71**	**.72**	**.79**	**2.75**
Diluted	**.52**	**.70**	**.71**	**.77**	**2.70**
Dividends	**.2910**	**.2910**	**.2910**	**.2910**	**1.164**
Market price					
High	**75.94**	**68.63**	**70.75**	**68.75**	**75.94**
Low	**62.56**	**60.38**	**58.69**	**59.31**	**58.69**
1998					
Net sales	$1,256	$1,419	$1,427	$1,604	$5,706
Gross profit	563	654	633	714	2,564
Income (loss) from continuing operations[3,4]	148	52	(127)	202	275
Net income (loss)[3,4]	164	63	(124)	212	315
Per common share					
Income (loss) from continuing operations[3,4]					
Basic	.53	.18	(.44)	.70	.97
Diluted	.52	.18	(.44)	.69	.95
Net income (loss)[3,4]					
Basic	.59	.22	(0.43)	.74	1.11
Diluted	.58	.22	(0.43)	.73	1.09
Dividends	.2910	.2910	.2910	.2910	1.164
Market price					
High	62.44	59.56	63.50	66.00	66.00
Low	48.50	51.50	52.38	56.38	48.50

1. The first quarter includes a $27 million charge for the cumulative effect of an accounting change.

2. The fourth quarter includes $19 million in net costs associated with effecting the distribution of the CardioVascular business.

3. The second quarter includes a $116 million charge for in-process research and development relating to the acquisition of Somatogen.

4. The third quarter includes a $178 million net litigation charge and a $122 million charge for exit and other reorganization costs.

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. At January 31, 2000, there were approximately 60,800 holders of record of the company's common stock.

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Baxter International Inc.

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Senior Vice President and
Chief Financial Officer

Timothy B. Anderson[1,2]
Group Vice President
Corporate Strategy and
Development

John F. Gaither, Jr.[1,2]
Corporate Vice President
Corporate Development

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Corporate Research and
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Senior Vice President
Human Resources

Baxter World Trade Corporation

Eric A. Beard
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and President
Global Hemodialysis and Europe

Carlos del Salto
Senior Vice President
Intercontinental/Asia and
President Latin America

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Corporate Vice President
and President
Hyland Immuno

J. Robert Hurley
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Group Vice President
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Baxter Healthcare Corporation

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Corporate Vice President
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I.V. Systems/Medical Products

J. Michael Gatling
Corporate Vice President
Global Manufacturing Operations

Jack L. McGinley[2]
Group Vice President
I.V. Systems/Medical Products,
Renal and Fenwal

David C. McKee[2]
Corporate Vice President
and Deputy General Counsel

Michael A. Mussallem[2]
Group Vice President
CardioVascular
and Biopharmaceuticals

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

As of February 23, 2000

Company Information

CORPORATE HEADQUARTERS
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One Baxter Parkway
Deerfield, IL 60015-4633
Telephone: (847) 948-2000
Internet: www.baxter.com

STOCK EXCHANGE LISTINGS
Ticker Symbol: BAX
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 2000 Annual Meeting of Stockholders will be held on Tuesday, May 2, at 10:00 a.m. at the Drury Lane Oak Brook in Oakbrook Terrace, Illinois.

STOCK TRANSFER AGENT
Correspondence concerning Baxter International stock holdings, lost or missing certificates or dividend checks, duplicate mailings or changes of address should be directed to:
First Chicago Trust Company,
a division of EquiServe
P.O. Box 2500
Jersey City, NJ 07303-2500
Telephone: (800) 446-2617 or
(201) 324-0498
Internet: www.equiserve.com

Correspondence concerning Baxter International Contingent Payment Rights related to the acquisition of Somatogen, Inc. should be directed to:
U.S. Bank Trust National Association
Telephone: (800) 934-6802 or
(312) 228-9455

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,
a division of EquiServe
P.O. Box 2598
Jersey City, NJ 07303-2598
Telephone: (800) 446-2617 or
(201) 324-0498
Internet: www.equiserve.com

INFORMATION RESOURCES

Internet

www.baxter.com
Please visit our Internet site for:
- General company information
- Corporate news or earnings releases
- Annual report
- Form 10-K
- Form 10-Q
- Proxy Statement
- Annual environmental report

Stockholders may elect to view future proxy materials and annual reports on line via the Internet instead of receiving them by mail. Simply provide your e-mail address to our stock transfer agent, First Chicago Trust Company, at (800) 446-2617. We then will discontinue mailing these materials to you and notify you via e-mail how to access them.

Stockholders also may access personal account information on line via the Internet by visiting www.equiserve.com and selecting the "Account Access" menu.

By Mail
Information also is available by mail on request from:
Baxter International Inc.
Investor Relations
One Baxter Parkway
Deerfield, Illinois 60015-4633
Telephone: (847) 948-4550

INVESTOR RELATIONS
Securities analysts, investment professionals and investors seeking additional investor information should contact:
Baxter Investor Relations
Telephone: (847) 948-4551

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.

References in this report to Baxter are intended to refer collectively to Baxter International Inc. and its U.S. and international subsidiaries and their operating divisions.

Five-Year Summary of Selected Financial Data

as of or for the years ended December 31			**1999**	1998[1]	1997[2]	1996[3]	1995[4]
OPERATING RESULTS *(in millions)*	Net sales	$	**6,380**	5,706	5,259	4,583	4,318
	Income from continuing operations	$	**779**	275	371	505	322
	Depreciation and amortization	$	**372**	344	318	269	270
	Research and development expenses[5]	$	**332**	323	339	291	296
BALANCE SHEET AND CASH FLOW INFORMATION *(in millions)*	Capital expenditures	$	**631**	556	454	362	357
	Total assets	$	**9,644**	9,873	8,511	7,407	9,282
	Long-term debt and lease obligations	$	**2,601**	3,096	2,635	1,695	2,372
	Cash flows from continuing operations	$	**977**	837	472	530	479
	Cash flows from discontinued operation	$	**106**	102	86	108	813
	Cash flows from investing activities	$	**(735)**	(872)	(1,083)	(552)	(308)
	Cash flows from financing activities	$	**(445)**	173	265	216	(996)
COMMON STOCK INFORMATION	Average number of common shares outstanding (in millions)[6]		**290**	284	278	272	277
	Income from continuing operations per common share						
	Basic	$	**2.69**	.97	1.34	1.85	1.16
	Diluted	$	**2.64**	.95	1.31	1.82	1.15
	Cash dividends declared per common share	$	**1.164**	1.164	1.139	1.17	1.11
	Year-end market price per common share		**$62.8125**	64.3125	50.44	41.00	41.88
OTHER INFORMATION	Net-debt-to-capital ratio		**40.2%**	48.4%	46.9%	33.8%	36.3%
	"Operational cash flow" from continuing operations (in millions)[7]	$	**588**	379	153	341	246
	Total shareholder return[8]		**(0.5%)**	30.1%	25.9%	14.1%	52.6%
	Common stockholders of record at year-end		**61,200**	61,000	62,900	65,400	74,400

1. Income from continuing operations includes charges for in-process research and development, net litigation, and exit and other reorganization costs of $116 million, $178 million and $122 million, respectively.

2. Income from continuing operations includes a charge for in-process research and development of $220 million.

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

4. Income from continuing operations includes charges for net litigation of $96 million and exit and other reorganization costs of $103 million.

5. Excludes charges for in-process research and development, as noted above.

6. Excludes common stock equivalents.

7. The company's internal "operational cash flow" measurement is defined on page 27 and is not a measure defined by generally accepted accounting principles.

8. Represents the total of appreciation in market price plus cash dividends paid on common shares for the year.

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