Baxter International

2000 Annual Report

Is the world prepared for the explosive growth in life-threatening conditions?

Around the world, the number of people with hemophilia, kidney disease, immune deficiencies and other life-threatening conditions is escalating at an unprecedented rate. The aging population also is creating an increasing need for health care. The greatest need is in developing countries, where today, many people currently go untreated. As economic expansion continues in these countries, treatment rates will increase. Baxter is poised to meet this growing demand for health care worldwide—today and into the future.

Baxter overview

[Our Mission] Baxter team members around the world are dedicated to a common mission: to provide critical therapies for people with life-threatening conditions. The company manufactures and markets products and services used to treat patients with hemophilia, immune deficiencies, infectious diseases, cancer, kidney disease, trauma and other disorders. 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 nearly 80 percent of sales coming from products with leading market positions.

[Core Capabilities] Baxter's businesses share several core strengths that uniquely position the company to serve the health-care needs of people around the world. These "core capabilities" include technological expertise, manufacturing and quality excellence, and global presence. The company has unmatched expertise in plastic-container technologies, sterile-fluid technologies, and plasma-based and recombinant processing technologies. Baxter's global manufacturing network allows the company to provide cost-effective, high-quality health-care products to patients worldwide. Baxter also allies with leading scientific and technical experts outside the company to complement its internal capabilities.

[Building 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 developing new recombinant proteins for use in a number of clinical therapies, and new vaccines for the prevention of infectious diseases. The company is working to enhance the safety of the blood supply with technologies to inactivate pathogens in collected blood components. Company researchers also are developing new technologies for renal therapy and medication delivery, with the intent of bringing quality health care to more and more people around the globe.

< *Baxter Chairman and Chief Executive Officer Harry M. Jansen Kraemer, Jr., in Tokyo with (left to right) Dr. Kiyoshi Kurokawa, dean of Tokai University School of Medicine; Noriyuki Kubo, medical representative, Baxter Limited in Japan; and Noriko Wakasone, deputy director, regulatory affairs, Baxter Limited.*

Dear Shareholders:

A year ago, I wrote to you after completing my first 12 months as Baxter's chief executive officer, and shared with you my vision for Baxter. This year, having completed my first year as chairman of Baxter's board of directors, I am even more excited, based on the results of a successful year 2000, and more importantly, what I believe are even better prospects for a dynamic decade of accelerating growth for your company.

First, let me remind you that Baxter serves an extremely important role. The products and services that we provide help people with hemophilia, kidney disease, cancer, immune deficiencies and other disorders. Our mission is to provide critical therapies for people with life-threatening conditions. We continue to enhance these therapies and make quality health care available to more and more people around the world. All of us on the Baxter team are very proud of our mission.

[A Successful Year: 2000] In Baxter's 1999 annual report, I discussed our focus on three key goals: building the Best Team in health care; being the Best Partner to customers and patients; and being the Best Investment for you, our shareholders. I am very pleased with our progress on these three goals. I also discussed our Shared Values of respect, responsiveness, and results as the foundation of everything we do. Our passion to achieve these goals and live our values makes it possible for us to achieve our business objectives.

As a shareholder, your interests, of course, are focused on the success of your investment. We are very proud of our investment results. The best barometer of our performance is Baxter's total return (the sum of stock appreciation plus dividends) compared to other indices. In the year 2000, the combination of the increase in Baxter's stock price and the dividend from the spin-off of Edwards Lifesciences gave you a return of more than 49 percent. Baxter's performance surpassed that of our peer group, the S&P Healthcare Composite Index, and was far higher than the S&P 500 and Dow Jones Industrial Average, both of which yielded negative returns in 2000. Our compound annual return since 1993 is 29 percent.

Also last year, I outlined for you specific financial commitments for the year 2000. They included increasing sales approximately 10 percent, growing earnings in the mid-teens, and generating at least $500 million in operational cash flow after investing more than $1 billion in capital expenditures and research and development. I am happy to report that we met all of our commitments, and I am confident that the momentum we have generated will continue into 2001 and beyond.

[Growth and Innovation] We have made tremendous progress in recent years in sharpening our operational focus, improving our financial position, and positioning Baxter for the future. We are now entering a phase in which our focus is to significantly increase the sales and earnings growth of the company while continuing to introduce medical breakthroughs that will make significant inroads in the treatment and prevention of disease.

Nearly 80 percent of our sales are in markets in which we hold leading positions. Yet, even in these markets, there are tremendous growth opportunities. As noted on the opening page of this report, many people in the

world with life-threatening diseases currently go untreated or are undertreated because their countries have not yet reached a stage of economic development to provide broad access to quality health care. The aging population is creating additional needs, as people require a disproportionate amount of health care in their later years. This creates a tremendous opportunity for Baxter.

Given our global presence, Baxter is uniquely positioned to meet these health-care needs around the world. Currently, more than 50 percent of our sales are generated outside the United States. Another advantage is our manufacturing strength. Today, we manufacture more than 85 percent of what we sell, and we are the highest-quality, best-cost manufacturer in virtually everything we produce.

Baxter also is uniquely positioned because of our focus on critical therapies for life-threatening conditions. We are increasing our investments in research and development to provide the best and most cost-effective therapies for these conditions in the years ahead.

[The Future] So, when we look to Baxter's future, there are several things you can expect. First, we will continue to develop our leadership positions in the critical therapies we're involved in today. For example, in hemophilia, we will continue to advance technologies used to produce clotting factor, while increasing our production capacity to meet a tremendous global need. In renal therapy, we will continue to develop new solutions and technologies for peritoneal dialysis while expanding our capabilities in hemodialysis and opening renal treatment centers.

You also will see us move into new areas that build off of or expand our core capabilities. One recent example of this is our growing vaccines business, where we continue to expand our expertise in recombinant technology. Another is anesthesia, the fastest-growing area of our Medication Delivery business, which builds on relationships we have with hospital pharmacists and others involved in drug delivery. We expect sales in each of these areas to exceed $1 billion by the end of the decade.

We also will continue to increase shareholder value by focusing on talent management, allowing us to attract, retain and develop the best talent in all functional areas; innovation, enabling us to develop new and better products and services that will contribute to the accelerated growth of the company; E-business, giving us the ability to significantly increase productivity and get closer to our customers, business partners and patients; and speed in decision-making, reducing bureaucracy and making us more agile in understanding and meeting customer and patient needs.

I believe we are strongly positioned for a great 2001, and equally important, for a great decade ahead. Thank you for your support. I can promise you that the dedicated Baxter team of 45,000 members around the world will continue to focus their energy and attention on making Baxter even better in the future than it has been in the past. Given our great heritage, this is no small task. But we are up to it. As you read the pages that follow, I'm sure you will agree that this is a special company, and the best is yet to come.

As shareholders, this is your company. I am very interested in hearing your views, comments and questions. Please do not hesitate to leave me an e-mail at *onebaxter@baxter.com*.

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

2001 commitments

In 2001, Baxter expects its operational performance to once again be very strong. Given the expansion of capacity in Thousand Oaks, California, where the company produces recombinant Factor VIII for people with hemophilia; new product introductions, which are covered in the following pages of this report; and the successful integration of recent acquisitions, Baxter expects its 2001 sales to grow at an accelerated rate, in the low double digits. Excluding the impact of foreign exchange, the company's sales growth rate will be even higher. Specifically:

– Sales growth in the company's BioScience business will be in the high teens, driven by the recombinant business growing more than 20 percent and the continuing trend toward leuko-reduction.

– Continuing efforts to grow peritoneal dialysis and expand the hemodialysis business, along with continued growth in the Renal Therapy Services (RTS) and RMS Disease Management businesses, will drive sales growth in the Renal business to the low to mid-teens in 2001.

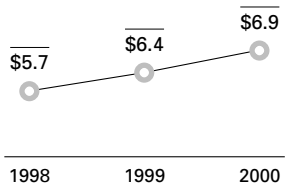
– Sales growth in the Medication Delivery business will be in the high single digits, driven by continued growth of the anesthesia business, which will reach $500 million in sales in 2001.

As a result of Baxter's accelerated sales growth and continued focus on increasing its operating profit margin, the company expects its earnings growth rate for 2001 to be in the mid-teens.

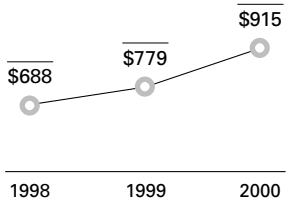
The company also expects to once again generate more than $500 million in operational cash flow, after investing more than $1 billion in research and development and capital expenditures.

2000 highlights

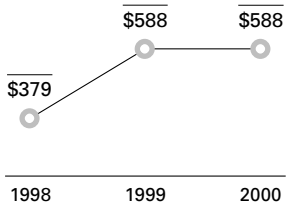
net sales[1]
[in billions of dollars]



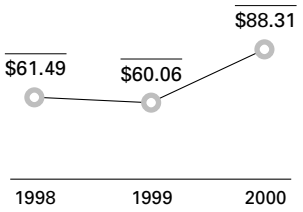
net income[1,2]
[in millions of dollars]



operational cash flow[1,3]
[in millions of dollars]



stock price
[as of December 31]



compound annual return
[through December 31, 2000]

1 year	3 year	5 year	7 year
49%	24%	22%	29%

1. Excludes Edwards Lifesciences Corporation.

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

3. See definition on page 24.

Hemophilia is a genetic disorder that affects approximately one in every 10,000 males born around the world. It is characterized by the absence of one or more proteins, specifically those responsible for clotting, in blood plasma. People with hemophilia risk spontaneous internal bleeding episodes, which may result in joint damage or even death if not treated. The most common form of hemophilia is hemophilia A, characterized by the absence of the clotting factor known as Factor VIII protein. Baxter is a leading provider of Factor VIII derived from both human plasma and recombinant methods.

While hemophilia A affects as many as 300,000 people worldwide, approximately three-quarters of this population receive little or no treatment. The situation is most acute in developing countries, but even in the industrialized nations of France, Germany and the United States, many patients continue to receive sub-optimal levels of treatment.

Demand for Factor VIII continues to grow for a number of reasons. These include improving access to quality care in developing nations; the aging of adolescent patients who, as they grow, require larger quantities of Factor VIII; and the increasing use of Factor VIII to prevent bleeding episodes versus only infusing it when bleeding episodes occur.

Baxter is well positioned to address the growing demand for Factor VIII and to enhance its leadership position in this marketplace. One reason is the company's history of innovation in hemophilia therapy. Baxter was the first company to introduce both a monoclonal-purified plasma and recombinant Factor VIII, and expects to be first with a next-generation recombinant Factor VIII using a totally protein-free manufacturing process. Secondly, the company's broad portfolio of products and services for hemophilia provides patients with the widest range of therapy and technology choices. A third reason is Baxter's strong presence in developing markets, where the need for hemophilia therapy is greatest. And finally, the company's extensive capabilities in both plasma fractionation and recombinant processing make Baxter a reliable source for meeting the therapeutic needs of the world's hemophilia population in a market where demand continues to outstrip supply.

*bio*science

Plasma is a straw-colored liquid derived from blood that contains a number of components that play important roles in the body. These components include various proteins that regulate the blood's ability to clot, and others, such as albumin, a blood-volume expander, and gammaglobulins, which bolster weakened immune systems. For years, Baxter has been a leader in the processing of therapeutic proteins from human plasma. Increasingly, the company has expanded its expertise in recombinant technology to produce a widening range of therapeutic proteins.

Baxter plans to grow its BioScience business aggressively in the years ahead. The company's current therapeutic proteins, leaders in their markets, have considerable growth potential. The company also has a robust future pipeline that will include recombinant replacements for current plasma-derived therapies, new biopharmaceuticals and eventually gene therapies.

Recombinate Antihemophilic Factor (rAHF)

Baxter's Recombinate Antihemophilic Factor (rAHF), produced in Thousand Oaks, California, is the leading genetically engineered Factor VIII on the market.

Historically, therapeutic proteins like Factor VIII were manufactured by plasma fractionation. Recombinant Factor VIII, produced in cell culture, does not depend on the availability or use of human plasma in the production process. Therefore, the amount of recombinant Factor VIII that can be produced is not limited by the availability of source plasma—which is very important given the tremendous need for Factor VIII by the world's hemophilia community.

Baxter is committed to increasing the supply of recombinant Factor VIII in the marketplace. In 2000, the company tripled its production capacity for its own recombinant Factor VIII, Recombinate Antihemophilic Factor (rAHF). This will lead to significant growth in sales of Recombinate Factor VIII, which already is the leading genetically engineered Factor VIII on the market. In Neuchâtel, Switzerland, Baxter is building a multi-purpose facility that will produce Baxter's next-generation recombinant Factor VIII using a totally protein-free manufacturing process, as well as additional recombinant proteins.

With recombinant products representing a greater portion of Baxter's BioScience business in the years ahead, the company will continue to invest in recombinant production capacity and technology. These investments will lead to future sales growth of products and services for the treatment of hemophilia, as well as from the introduction of new biopharmaceuticals and vaccines.

[Business Description] Baxter is a leading producer of biopharmaceuticals for the treatment of hemophilia, immune deficiencies and other life-threatening disorders. These products include coagulation factors, immune globulins, biosurgery products and vaccines. The company also is a leading manufacturer of manual and automated blood-collection, processing and storage systems. These products are used by hospitals, blood banks and plasma-collection centers to collect and process blood components for therapeutic use. Therapeutic blood components are used to treat patients undergoing surgery, cancer therapy and other critical therapies.

[Growth Strategy] Baxter will continue to grow its global leadership in biopharmaceuticals for the treatment of hemophilia and immune deficiencies by broadening its portfolio, advancing technology and increasing production capacity. Growth opportunities are presented by the tremendous need for and increasing use of these products around the world, and the continued growth of both plasma-derived and recombinant-derived therapies. Baxter will continue to expand its pipeline of innovative biopharmaceuticals and vaccines through both internal development and acquisitions and alliances. Baxter also continues to focus on increased production and safety of transfusion products through advanced automation, leukoreduction and pathogen inactivation.

[Product Development] In 2000, Baxter received approval in the United Kingdom for NeisVac-C, a new meningococcemia vaccine. The company also received approval from the U.S. Food and Drug Administration (FDA) for a new application device for its Tisseel fibrin sealant. In the next 12 months, Baxter expects FDA approval for a liquid form of IGIV, and European approval for a new therapeutic protein for protein C deficiency and pathogen-inactivation technology for platelets. Other products in development include a next-generation recombinant Factor VIII using a totally protein-free manufacturing process; a cell culture-derived vaccine for influenza; a new tetanus, diphtheria and acellular pertussis vaccine; a European vaccine for Lyme disease; pathogen-inactivation technology for plasma and red cells; and a recombinant form of hemoglobin that may be used instead of blood to carry oxygen to vital organs.

[Acquisitions and Alliances] In 2000, Baxter completed its acquisition of North American Vaccine Inc., based in Columbia, Maryland, broadening its position in the global vaccines market. The company also established an equity position in British vaccine developer Acambis (formerly known as Peptide Therapeutics Group), which will better position each company to develop and commercialize their respective vaccine pipelines. In addition, Baxter formed alliances with XOMA Ltd. for the rights to a recombinant protein for treatment of a range of diseases caused by bacteria; Arriva Pharmaceuticals (formerly known as AlphaOne Pharmaceuticals, Inc.) to co-develop a recombinant alpha-1-antitrypsin protein to treat hereditary emphysema and other respiratory diseases; and Pharming Group N.V. to collaborate on the development of a recombinant, transgenic C1 inhibitor to treat hereditary angioedema.

Baxter's acquisition of North American Vaccine Inc. in 2000 enhanced Baxter's presence in the $7-billion global vaccines market—a market that is expected to grow 13 percent annually over the next five years, resulting in a $13-billion market by 2005. More than 80 percent of future vaccines will be produced using recombinant technology.

Baxter will continue to build its expertise in recombinant technology through both internal development and alliances with outside partners. Other examples of recombinant proteins currently under development include alpha-1-antitrypsin for treatment of hereditary emphysema and other respiratory diseases; C1 Esterase Inhibitor for treatment of hereditary angioedema; a bactericidal permeability increasing (BPI) protein to treat a range of diseases caused by bacteria; and recombinant hemoglobin, to deliver oxygen to vital organs.

*kidney**therapy***

Fifty years ago, people with end-stage renal disease (ESRD), or kidney failure, faced certain death. There was no treatment that could replicate the function of the kidneys—to remove toxins, waste and excess water from the bloodstream—and transplants were not yet a viable option. In 1956, Baxter introduced the first commercial hemodialysis (HD) machine, making life-saving dialysis therapy possible for thousands of people worldwide.

Today, there are approximately one million dialysis patients worldwide. Approximately 86 percent of them use HD as their primary therapy. The other 14 percent use peritoneal dialysis (PD), a newer, home-based therapy pioneered by Baxter in the late 1970s. Today, Baxter is a world leader in providing products and services to people with ESRD, serving patients in more than 100 countries.

In developing countries, many people with ESRD currently go untreated. For example, dialysis-treatment rates in Latin America, parts of Asia, Eastern Europe and other developing regions lag far behind those of more developed countries. In Latin America, dialysis-treatment rates average approximately 250 patients per million. By contrast, the United States has nearly 1,000 dialysis patients per million, and Japan, which has a very high incidence of kidney disease, has more than 1,600 per million.

Fortunately, dialysis-treatment rates are expected to grow significantly in developing countries in the years ahead as economic growth occurs. In Latin America, for example, dialysis-treatment rates are expected to double over the next several years due to the aging population, increasing health-care coverage and greater diagnosis of kidney disease. Baxter already has a presence in many developing regions and is poised to bring life-saving dialysis therapy to the millions who need it.

There is no cure for ESRD. Without either dialysis or a kidney transplant, a person with ESRD will die. Baxter is committed to providing a full range of products and services for patients with kidney disease in the years to come.

kidney therapy

Baxter introduced peritoneal dialysis (PD) in the late 1970s and continues to focus on increasing the number of patients using PD as a complementary option to the more traditional treatment of hemodialysis (HD). As a home therapy, PD presents lifestyle advantages, allowing patients to work or be at home while administering their therapy. It also does not require a capital-intensive infrastructure (clinics and personnel), making it ideal for use in developing countries, where many people with kidney disease currently go untreated.

PD growth continues to be a significant priority for Baxter. One challenge is to continue to educate patients, the medical community and reimbursement authorities about the cost, lifestyle, clinical outcomes and other advantages of the therapy. For example, not only is the average annual total cost of PD to the health-care system less than HD, current research reveals clinical advantages, as well. Recent studies show lower mortality rates among PD patients compared to patients on HD during the first two years of therapy, with equivalent outcomes after two years.

Extraneal peritoneal dialysis solution improves the removal of excess fluids and toxins from patients with end-stage renal disease. The product is approved in 28 countries and under regulatory review in the United States.

A tremendous opportunity also exists for Baxter in HD. Recently, the company has made significant investments to increase its presence in the HD market while continuing its commitment to growing PD. A major step was the recent acquisition of Althin Medical AB, a Swedish manufacturer of dialyzers and instrumentation for HD. Baxter also plans to introduce a first-generation instrument for home hemodialysis in 2001. By strengthening its portfolio in both PD and HD, Baxter provides products and services along the entire continuum of care for patients, many of whom may benefit from both therapies during the course of their treatment.

Baxter has several initiatives to ensure that patients are aware of therapeutic advances and treatment options. For example, last year Baxter launched an educational Web site (kidneydirections.com) worldwide, which has been visited by tens of thousands of people. This program provides relevant information to patients as they progress through the phases of kidney disease. Another example is the company's Kidney Patient Educator program. Baxter employs nurses as kidney patient educators in the United States to whom nephrologists refer their patients in the early phase of end-stage kidney disease. The kidney patient educators provide information on a patient's treatment options, enabling them to make informed choices about which treatment modality they might prefer.

[Business Description] Baxter provides a range of products and services for the treatment of kidney disease. These include products for both peritoneal dialysis (PD) and hemodialysis (HD) as well as research initiatives in xenotransplantation. Baxter is the world's leading manufacturer of PD products, which include dialysis solutions, container systems and automated cyclers. For HD, Baxter manufactures dialyzers and HD machines. The company's Renal Therapy Services (RTS) business operates dialysis clinics in partnership with local physicians in 13 countries outside the United States, while RMS Disease Management Inc. partners with U.S. nephrologists to provide a kidney disease management program to health-care payers. Baxter's RMS Lifeline Inc. helps to improve the delivery and outcomes of interventional renal care in the United States through dedicated outpatient centers.

[Growth Strategy] The company's strategy is to continue to drive PD growth while also investing in significant expansion of HD products and services. New products will come from internal development, acquisitions, alliances and e-health initiatives. The company also continues to grow its RTS business and expand its product lines globally, particularly in developing markets where many people with end-stage renal disease are currently under-treated. In addition, Baxter intends to continue developing technology-based products and services that improve therapeutic outcomes.

[Product Development] Baxter continues to develop new PD solutions to better manage specific patient needs. One example is Extraneal, which improves the removal of excess fluids and toxins from patients with end-stage renal disease. Introduced in Europe in 1997 and approved in 28 countries, Extraneal today is being used by more than 6,000 European patients—more than a third of Baxter's European PD population—and is currently under regulatory review in the United States. Another solution, Physioneal, was introduced in Europe and began clinical trials in Japan in 2000. Also in 2000, as a result of Baxter's acquisition of Althin Medical, the company began selling an HD machine globally called the Tina. Baxter also introduced a new HD machine called Meridian in the United States. Future products include several new HD dialyzers and the Aurora home HD machine. The company also is continuing research in the area of xenotransplantation.

[Acquisitions and Alliances] In March 2000, Baxter completed its acquisition of Althin Medical AB, a leading manufacturer of HD products, based in Ronneby, Sweden. The acquisition greatly expands Baxter's product offering for HD and strengthens its position in the global HD marketplace. The company's joint venture with Gambro AB of Sweden for the manufacture of dialyzers for both Baxter and Gambro at Baxter's renal-products plant in Mountain Home, Arkansas, continues to perform well, with more than 3 million dialyzers manufactured in 2000.

According to a recent study, when informed of their choices, nearly half of the patients say they would prefer PD over HD. Over the past three years, Baxter's kidney patient educators have met with more than 20,000 U.S. patients, of which approximately 6,000 have initiated dialysis, with about one-third of them starting on PD therapy. The current national average for patients initiating PD across the United States is approximately 10 percent.

Baxter is fully committed to helping people with kidney disease live better lives through innovative products and services, and through timely and comprehensive education programs. By meeting the needs of the kidney patient, Baxter is continually improving the quality and availability of renal care for people around the world.

medication*delivery*

Before 1931, hospitals considered intravenous (IV) therapy a last resort due to inadequate quality control in the preparation of IV solutions. In 1931, Baxter revolutionized health care by inventing an innovative process to manufacture large, carefully controlled batches of IV solutions premixed in glass, and later, flexible containers. Since then, the company has expanded its capabilities to include a broad range of technologies to help physicians, pharmacists, nurses and anesthesiologists effectively and efficiently treat countless patients worldwide. These and other medication-delivery products replenish fluids, provide nutrition, prevent pain, and deliver antibiotics and other drugs to patients through a wide range of containers, access systems and electronic infusion pumps.

More than 15,000 employees in approximately 30 Baxter manufacturing plants around the world—from Toongabbie, Australia, to Alliston, Canada—produce more than a billion finished goods for this business a year. They fill nearly two and a half million units of IV solutions a day. Baxter also manufactures the majority of its access systems and electronic infusion pumps through its worldwide network of manufacturing plants. These plants have consistently reduced manufacturing costs while improving product quality through high-speed automation, more efficient supply-chain practices and other measures.

With a growing array of new products, continuous inroads in global expansion and ongoing manufacturing excellence, Baxter's Medication Delivery business has a bright future. Consistent with its rich past, it is ready to continue making medical history.

***medication**delivery*

Baxter is known worldwide as a leading manufacturer of intravenous (IV) solutions. But standard IVs—used primarily for fluid replenishment, electrolyte therapy and vein access—make up only about a quarter of Baxter's sales in the area of medication delivery. Higher-margin "specialty products," such as anesthetic agents, premixed drugs and reconstitution devices, nutrition products, and delivery devices, such as the Colleague pump and others, make up the rest and represent the greatest areas of growth for Baxter.

Anesthesia, the fastest-growing area of Baxter's Medication Delivery business, has played a major role in making surgical intervention a viable therapeutic option in health care. Certainly, no surgical procedure could take place if not for a way to keep the patient from feeling pain.

Colleague volumetric infusion pump

The Colleague triple-channel volumetric infusion pump allows clinicians to administer up to three intravenous solutions at a time to a patient from a single pump.

In just over two years, Baxter's anesthesia business has grown from $80 million in sales to more than $450 million today, and is expected to be a $1-billion business for Baxter by 2005. This growth is built on the acquisition in 1998 of Ohmeda Pharmaceutical Products, a U.S.-based manufacturer of inhalation agents and acute-care injectible drugs, whose product line was a perfect complement to Baxter's existing line of anesthesia-delivery devices; geographic expansion; and the broadening of the product offering and call points within the critical-care setting.

Greatly contributing to the financial success of the anesthesia business in 2000 was Baxter's launch in 1999 of the first generic propofol, supplied through an alliance with Sicor Inc. (formerly GensiaSicor Pharmaceuticals). This injectible, generic form of the drug, which previously had been under patent, offered customers, for the first time, a comparable product at a lower price. Sales of propofol exceeded $100 million in 2000.

In the area of anesthesia devices, the company acquired the U.S. rights to the PSA 4000 Patient State Analyzer, manufactured by Physiometrix Inc. of North Billerica, Massachusetts. The device monitors a patient's response to anesthesia, providing the anesthesiologist with a real-time picture of brain-wave activity to optimize the delivery of anesthetic agents. Baxter also launched a new anesthesia pump, called the Ipump Pain Management System, which delivers pain medication epidurally.

[Business Description] Baxter manufactures a range of products that deliver fluids and drugs to patients. These include large- and small-volume intravenous (IV) solutions, IV administration sets, premixed drugs for IV administration, reconstitution devices, IV nutrition solutions and devices, IV infusion pumps, anesthesia-delivery devices, anesthetic agents, acute-care injectible pharmaceuticals, ambulatory infusion systems and pharmacy services.

[Growth Strategy] Baxter continues to participate in the consolidation of the global marketplace for medication-delivery products, particularly in developing markets where there are still a large number of local and regional players. The company will accelerate expansion of its higher-margin specialty products outside the United States, where currently the business has a strong base in IV sets and solutions, and will continue to develop new technologies for medication delivery through internal product development and acquisitions and alliances. Baxter also will leverage its strength in the anesthesia marketplace to expand its position in medication delivery across the peri-operative arena—pre-surgery, surgery and post-surgery.

[Product Development] In 2000, Baxter upgraded its Colleague electronic infusion pump for global use, and added multiple languages for certain key markets. Worldwide placements of the Colleague pump continue to rise, with 50,000 new channels placed in 2000. Also in 2000, the company introduced a new pump for post-operative pain management, called the Ipump Pain Management System, in the United States. Also programmed in multiple languages and designed for global use, Baxter will launch the Ipump in Europe and Canada in 2001. In addition, the company launched several new premixed IV drugs in 2000, including its first global premixed drug, called AGGRASTAT, a cardiac compound developed by Merck.

[Acquisitions and Alliances] Over the last two years, Baxter has made several acquisitions intended to broaden its portfolio of medication-delivery products. These include Ohmeda Pharmaceutical Products, enhancing Baxter's offering in anesthesia; Pharmacia & Upjohn's German-based IV and nutrition business; and the ambulatory infusion pump business of Sabratek Corporation. Baxter also reacquired the distribution rights for the Ohmeda pharmaceutical products in Europe and Canada to serve as a base to build its specialty-product offerings in these key markets. Baxter acquired a French company called Biodome, which has a technology for efficient, low-cost reconstitution of drugs for both injection and infusion. The company also received exclusive U.S. distribution rights from Physiometrix Inc. for the PSA 4000 anesthesia monitoring system, which helps anesthesiologists monitor a patient's level of consciousness during surgery.

To date, Baxter's anesthesia products have been sold primarily in the United States, but the company expects tremendous growth for these products in other markets. In 2000, the company made major inroads in establishing Canadian and European anesthesia organizations. The company created direct sales and marketing forces in Belgium, France, Germany, Ireland, Italy, The Netherlands, the Nordic region, Switzerland and the United Kingdom to sell both current and future anesthesia products in Europe.

The area of anesthesia encompasses all three aspects of Baxter's growth strategy for its Medication Delivery business: technological innovation, geographic expansion of specialty products and entry into new market segments. By the year 2005, more than half of Baxter's Medication Delivery business will be outside the United States, with the greatest growth derived from higher-margin specialty products.

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) results of operations and cash flows during the three years ended December 31, 2000, 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.

The matters discussed in this Annual Report include forward-looking statements that involve risks and uncertainties, including, but not limited to, currency exchange rates, interest rates, technological advances in the medical field, 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. 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.

Management's financial objectives for 2000, which were outlined in last year's Annual Report and are summarized below, were established based on Baxter's results excluding the cardiovascular business, the stock of which was distributed to shareholders on March 31, 2000. Refer to Note 2 to the consolidated financial statements for further information regarding the spin-off of the cardiovascular business. The company's consolidated financial statements and related notes have been restated to reflect the financial position, results of operations and cash flows of the cardiovascular business as a discontinued operation. The results presented below reflect the results of continuing operations only.

Key Financial Objectives and Results

2000 OBJECTIVES	RESULTS
Increase net sales approximately 10 percent.	*Net sales increased eight percent in 2000. Excluding fluctuations in currency exchange rates, net sales increased 12 percent.*
Grow net earnings in the mid-teens.	*Net earnings from continuing operations increased 17 percent in 2000, excluding the cumulative effect of a change in accounting principle in 1999 and the charge for in-process research and development (IPR&D) and acquisition-related costs in 2000.*
Generate a minimum of $500 million in operational cash flow after investing more than $1 billion in capital improvements and research and development.	*The company generated operational cash flow of $588 million during 2000. The total of capital expenditures and research and development expenses was more than $1 billion.*

Company and Industry Overview

Baxter is a global leader in providing critical therapies for life-threatening conditions and operates in three segments, which are described in Note 13. The company manufactures and markets products and services used to treat patients with hemophilia, immune deficiencies, infectious diseases, cancer, kidney disease, trauma and other disorders. 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 innovative products and services, investing in human resources, upgrading and expanding 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)	**2000**	1999	1998	Percent increase **2000**	Percent increase 1999
Medication Delivery	$2,719	$2,524	$2,314	8%	9%
BioScience	2,353	2,176	1,862	8%	17%
Renal	1,824	1,680	1,530	9%	10%
Total net sales	$6,896	$6,380	$5,706	8%	12%

years ended December 31 (in millions)	**2000**	1999	1998	Percent increase **2000**	Percent increase 1999
United States	$3,194	$2,921	$2,609	9%	12%
International	3,702	3,459	3,097	7%	12%
Total net sales	$6,896	$6,380	$5,706	8%	12%

Excluding fluctuations in currency exchange rates, which impacted sales growth unfavorably for all three segments, total net sales growth was 12 percent in 2000. The company's sales growth was unfavorably impacted by fluctuations in currency exchange rates in 2000 principally due to the weakening of the Euro relative to the United States Dollar, partially offset by the strengthening of the Japanese Yen.

Medication Delivery The Medication Delivery segment generated eight percent and nine percent sales growth in 2000 and 1999, respectively. Excluding the impact of fluctuations in currency exchange rates, sales growth was 11 percent in 2000. Of the constant-currency sales growth, approximately two points and four points of growth in 2000 and 1999, respectively, was generated by recent acquisitions, principally the January 2000 acquisition of a domestic ambulatory and infusion pump business, the September 1999 acquisition of a nutrition and fluid therapy business in Europe and the April 1998 acquisition of a domestic manufacturer of inhalants and drugs used for general and local anesthesia. Approximately three points of growth in both 2000 and 1999 was generated from the segment's late-1999 exclusive agreement to sell the first generic formulation of Propofol approved by the United States Food and Drug Administration. Propofol is an intravenous drug used for the induction or maintenance of anesthesia in surgery, and as a sedative in monitored anesthesia care. The remaining sales growth in both periods was principally due to increased sales of Colleague® electronic infusion pumps and intravenous fluids and administration sets used with electronic infusion pumps, as well as growth in products for nutrition-based therapies. Such sales growth in 2000 was partially offset by the effect of terminations of certain distribution agreements that were not part of the segment's core businesses. Sales in the United States and Western Europe have been impacted by competitive pricing pressures and cost pressures from health-care providers. These factors were more than offset by increased penetration and new product introductions in emerging markets, as well as increased sales due to new distribution and alliance agreements, new products and acquisitions. Management expects these trends to continue.

BioScience Sales in the BioScience segment increased eight percent and 17 percent in 2000 and 1999, respectively. Excluding the impact of fluctuations in currency exchange rates, sales growth was 14 percent in 2000, with growth particularly strong outside the United States. The June 2000 acquisition of North American Vaccine, Inc. (NAV), which is further discussed in Note 3, contributed approximately three points to the segment's constant-currency sales growth rate in 2000. As a result of the company's increase in manufacturing capacity for Recombinate Antihemophilic Factor (rAHF) in late 1998 and late 2000, and the strong demand for this product, sales of Recombinate contributed approximately three points and nine points to the segment's constant-currency percentage sales growth in 2000 and 1999, respectively. Strong sales growth is expected to continue as a result of the recent capacity expansions and anticipated demand for this product. Approximately six points of the growth in both 2000 and 1999 was due to increased sales of plasma-derived products, primarily as a result of improved product supply and strong growth of Gammagard® S/D IGIV. Sales in the blood-collection and processing businesses also grew in both 2000 and 1999, principally due to an increase in sales of products that

provide for leukoreduction, which is the removal of white blood cells from blood products used for transfusion. Sales growth in these businesses has been negatively affected by regulatory and production issues facing certain of the company's customers in the plasma-fractionation industry. The effects of regulatory, supply, competitive and other pressures on the BioScience 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.

Renal The Renal segment generated sales growth of nine percent and 10 percent in 2000 and 1999, respectively. Excluding the impact of fluctuations in currency exchange rates, sales growth was 11 percent in 2000 and six percent in 1999. Sales related to the March 2000 acquisition of Althin Medical A.B. (Althin), a manufacturer of hemodialysis products, contributed approximately four points to the segment's growth rate in 2000. Significant growth was generated by the segment's Renal Therapy Services business, which operates dialysis clinics in partnership with local physicians in international markets, and the Renal Management Strategies business, which is a renal-disease management organization, with revenues from these businesses increasing over $60 million in 2000 and over $80 million in 1999. The remaining sales growth in the Renal segment was driven principally by continued penetration of products for peritoneal dialysis. Penetration of products used for peritoneal dialysis continues to be strongest in emerging markets such as Latin America and Asia, where many people with end-stage renal disease are currently under-treated. 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 sales of hemodialysis products, continued expansion into developing markets, and alliances and acquisitions.

Gross Margin and Expense Ratios

years ended December 31 (as a percent of sales)	**2000**	1999	1998
Gross margin	44.4%	44.1%	44.9%
Marketing and administrative expenses	20.1%	20.5%	21.2%

The change in the gross margin in both 2000 and 1999 was partly due to changes in the products and services mix and fluctuations in currency exchange rates. The improved sales mix in 2000 was principally due to significantly higher sales of Recombinate and vaccines within the BioScience segment. The reduction in 1999 was impacted by higher costs related to increased investments and reduced production in the BioScience segment in response to heightened FDA regulatory activity with respect to safety and quality systems.

The reduction in the expense ratio in both 2000 and 1999 was due to a number of factors. The company has been making significant investments in order to attract and retain a highly talented workforce. Such investments include increased cash compensation as well as increased long-term Baxter stock incentives. The effect of these strategic investments was more than offset by the company's aggressive management of expenses, leveraging of recent acquisitions, improved pension plan asset returns and hedging activities.

In addition, various recently implemented e-business and strategic sourcing initiatives have resulted in significant efficiencies and cost savings to the company, which has contributed to an improved gross margin and expense ratio, particularly in 2000, and have allowed management to redeploy valuable resources within the company. Management expects to continue to make strategic investments while leveraging and closely managing costs in 2001.

Research and Development

				Percent increase	
years ended December 31 (in millions)	**2000**	1999	1998	**2000**	1999
Research and development expenses	$379	$332	$323	14%	3%
as a percent of sales	5%	5%	6%		

Research and development (R&D) expenses above exclude in-process R&D (IPR&D) charges, which principally consisted of a $250 million IPR&D charge relating to the acquisition of NAV in 2000 and a $116 million IPR&D charge relating to the acquisition of Somatogen, Inc. in 1998. Refer to Note 3 for a discussion of significant acquisitions, along with related IPR&D charges. R&D expenses increased in all three segments in both 2000 and 1999. The overall increase was primarily due to spending in the BioScience segment, principally relating to the next-generation recombinant product, the next-generation oxygen-therapeutics program, initiatives in the wound management and plasma-based products areas, and, in 2000, to the acquisition of NAV. Management plans to continue to make significant investments in the R&D initiatives mentioned above as well as other projects across the three segments in 2001.

Exit and Other Reorganization Costs

Refer to Note 4 for a discussion of a charge recorded in 1998 for exit and other reorganization costs. The company recorded a $122 million charge in 1998 principally related to the decisions to end the clinical development of the company's first-generation oxygen-carrying therapeutic program, exit certain non-strategic investments, primarily in Asia, and reorganize certain other activities. The program is substantially complete as originally planned. Management believes remaining reserves for exit and other reorganization programs are adequate to complete the actions contemplated by the programs. Future cash expenditures will be funded with cash generated from operations. Management anticipates employee compensation and other cost savings from the programs will be invested in R&D, new business initiatives, and expansion into growing international markets.

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, which are further discussed in Note 3, 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. Management believes remaining reserves are adequate to complete the actions contemplated by the plans.

Net Litigation Charge

As further discussed in Note 12, the company recorded $29 million of income in 2000, which was principally a result of favorable adjustments to the mammary implant insurance receivables due to settlements negotiated with certain insurance companies during 2000. The company recorded a $178 million net litigation charge in 1998 relating to mammary implants, plasma-based therapies (relating to the BioScience segment) and other litigation.

Goodwill Amortization

Goodwill amortization increased in 2000 principally due to the acquisition of NAV.

Other Income and Expense

Net interest expense declined in 2000 and 1999 due principally to the impact of a greater mix of foreign currency denominated debt, which bears a lower average interest rate, and to lower average debt levels. In 2000, these factors were partially offset by the impact of increased interest rates, principally in the United States and Europe. Management does not expect net interest expense to change significantly in 2001.

As further discussed in Note 10, other income in 2000 consisted principally of net gains relating to foreign currency hedging instruments, partially offset by losses relating to the early termination of debt. 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 Medication Delivery segment.

Pretax Income

Refer to Note 13 for a summary of financial results by segment. Certain items are maintained at the company's corporate headquarters and are not allocated to the segments. They primarily include hedging activities, certain foreign currency fluctuations, net interest expense, corporate headquarters costs, and certain nonrecurring gains and losses.

Medication Delivery Growth in pretax income of one percent and eight percent in 2000 and 1999, respectively, was primarily a result of strong sales, and the leveraging of expenses in conjunction with recent acquisitions, partially offset by the unfavorable impact of fluctuations in currency exchange rates in both periods, increased pump service costs in 2000 and the termination of certain non-core distribution agreements in 2000.

BioScience The 23 percent and eight percent growth in pretax income in 2000 and 1999, respectively, was principally driven by strong sales, improved manufacturing efficiencies, and the leveraging and close management of marketing and administrative expenses, partially offset by the unfavorable impact of fluctuations in currency exchange rates and significantly increased R&D expenditures. The impact of eased supply constraints and manufacturing capacity expansions for Recombinate also contributed to the growth in pretax income.

Renal Pretax income declined three percent and increased 43 percent in 2000 and 1999, respectively. A significant contributor to the increase in 1999 was the impact of the strengthening Japanese Yen. In 2000, the effect of the strengthening Japanese Yen was more than offset by the effect of the significantly weakening Euro. Excluding the effects of currency exchange rate fluctuations, pretax income increased due to strong sales, partially offset by a less favorable mix of sales and services, and higher R&D and sales and marketing investments in the business.

Income Taxes

Excluding the 2000 charge for IPR&D and acquisition-related costs and the 1998 charges for IPR&D, exit and other reorganization costs and net litigation, along with a related provision in 1998 for U.S. taxes on previously unremitted foreign earnings (collectively, "special charges"), the effective income tax rate from continuing operations was approximately 26 percent, 26 percent and 24 percent in 2000, 1999 and 1998, respectively. Management does not expect a significant change in the effective tax rate in 2001.

Income from Continuing Operations Before Cumulative Effect of Accounting Change and Special Charges

				Percent increase	
years ended December 31 (in millions)	**2000**	1999	1998	**2000**	1999
Income from continuing operations before cumulative effect of accounting change in 1999 and special charges in 2000 and 1998	$915	$779	$688	17%	13%

Income from continuing operations before cumulative effect of accounting change per the consolidated statements of income was $738 million, $779 million and $275 million in 2000, 1999 and 1998, respectively.

Earnings Per Share from Continuing Operations

Excluding the cumulative effect of an accounting change in 1999 and the special charges in 2000 and 1998, earnings per diluted share in 2000, 1999 and 1998 were $3.06, $2.64 and $2.38, respectively, and the growth in earnings per diluted share was 16 percent and 11 percent in 2000 and 1999, respectively.

Discontinued Operation

As further discussed in Note 2, on March 31, 2000, Baxter stockholders of record on March 29, 2000 received all of the outstanding stock of Edwards Lifesciences Corporation (Edwards), the company's cardiovascular business, in a tax-free spin-off. Income from the discontinued operation grew 60 percent in 1999, or approximately $24 million, largely due to favorable currency exchange rate fluctuations, principally due to the strengthening of the Japanese Yen, and an improved mix of sales.

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 SOP does not have a material impact on the company's results of operations.

Liquidity and Capital Resources

Cash flows from continuing operations per the consolidated statements of cash flows increased during 2000 principally as a result of higher earnings (before non-cash items), decreased cash payments pertaining to the company's litigation, a decrease in receivables and a higher liabilities balance. These increases in cash flows were partially offset by the effect of higher inventories. Cash flows from continuing operations increased in 1999 due principally to higher earnings, lower inventories and lower other asset balances. These increases were partially offset principally by higher net cash outflows relating to litigation and lower liabilities balances. Accounts receivable balances generally increase as the company generates sales growth in certain regions outside the United States, which have longer collection periods. As further discussed in Note 6, cash flows benefited from the sales of certain trade accounts receivable whereby the company realized net cash inflows of $195 million, $65 million and $150 million in 2000, 1999 and 1998, respectively. Such receivables were sold to reduce the overall costs of financing the receivables.

Cash flows related to the discontinued operation decreased in 2000 due to the effect of the spin-off of Edwards on March 31, 2000.

Cash outflows from investing activities increased in 2000 and decreased in 1999. Capital expenditures (including additions to the pool of equipment leased or rented to customers) increased three and 13 percent in 2000 and 1999, respectively, as the company increased its investments in various capital projects across all three segments. The growth in capital expenditures principally reflected increases in manufacturing capacity in the BioScience segment, and, in 1999, to the implementation of a new integrated operational system. Capital expenditures are made at a sufficient level to support the strategic and operating needs of the businesses. Management expects to invest between $600 million and $700 million in capital expenditures in 2001.

Net cash outflows relating to acquisitions increased in 2000 and decreased in 1999. In 2000, net cash outflows relating to acquisitions included approximately $55 million related to the acquisition of Althin and approximately $63 million related to the acquisition of NAV. As further discussed in Note 3, a portion of the purchase price for both of these acquisitions was paid in Baxter International Inc. common stock. Approximately $131 million of the total outflows in 2000 related to several acquisitions and investments in the Medication Delivery segment, principally the acquisition of a domestic ambulatory and infusion pump business and a contingent purchase price payment associated with the 1998 acquisition of a domestic manufacturer of inhalants and drugs used for general and local anesthesia. Approximately $15 million of the company's net cash outflows relating to acquisitions in 2000 related to the acquisition of dialysis centers in international markets. 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 International AG. 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 nutrition and fluid therapy business in Europe. In 1998, net cash outflows relating to acquisitions included approximately $142 million pertaining to the acquisition of Bieffe Medital S.p.A., a manufacturer of dialysis and intravenous solutions and containers, approximately $94 million related to an acquisition of a domestic manufacturer of inhalants and drugs used for general and local anesthesia, and the remainder primarily related to acquisitions of dialysis centers in international markets. Refer to Note 3 for further information regarding significant acquisitions.

The cash flows relating to divestitures and other asset dispositions in 2000 principally related to the spin-off of Edwards on March 31, 2000. In 1999, the company generated approximately $30 million of cash relating to a prior year divestiture in the BioScience segment and approximately $42 million of cash relating to the sale and leaseback of certain assets.

Cash flows from financing activities increased in 2000 and decreased in 1999. Common stock dividends decreased in 2000 due to the company's change from a quarterly to an annual dividend payout schedule effective at the beginning of the year, and increased in 1999 due to a higher number of shares outstanding. As further discussed in Note 8, included in total outflows in 1999 was $198 million in cash inflows relating to the Shared Investment Plan. Cash received for stock issued under employee benefit plans increased in 2000 and 1999 primarily due to a higher level of employee stock option exercises, coupled with a higher average stock option exercise price. A portion of the increase in 2000 was due to required exercises of stock options by employees transferring to Edwards as a result of the March 31, 2000 spin-off of that business, as well as to increased stock purchases by employees. Purchases of treasury stock increased in both 2000 and 1999, as more shares were purchased at higher market prices.

Management assesses the company's liquidity in terms of its overall ability to mobilize cash to support ongoing business levels and to fund its growth. Management uses an internal performance measure called operational cash flow that evaluates each operating business and geographic region on all aspects of cash flow under its direct control. 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 in 2001.

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)*	**2000**	1999	1998
Cash flows from continuing operations per the company's consolidated statements of cash flows	$1,233	$977	$837
Capital expenditures	(648)	(631)	(556)
Net interest after tax	51	52	74
Other	(48)	190	24
Operational cash flow–continuing operations	$ 588	$588	$379

The company's net-debt-to-capital ratio was 40.1 percent and 40.2 percent at December 31, 2000 and 1999, respectively. In order to better match the currency denomination of its assets and liabilities, the company rebalanced certain of its debt during 2000. The company acquired approximately $878 million of its U.S. Dollar denominated debt securities during 2000 and increased its non-U.S. Dollar denominated debt. 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 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 company's board of directors authorized the repurchase of up to $500 million of common stock over a period of several years, all of which was repurchased by early 2000. In November 1999, the board of directors authorized the repurchase of an additional $500 million over a period of several years, of which approximately two-thirds has been repurchased as of December 31, 2000.

As of December 31, 2000, 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 November 2000, the board of directors declared an annual dividend on the company's common stock of $1.164 per share. The dividend, which was payable on January 8, 2001 to stockholders of record as of December 15, 2000, is a continuation of the current annual rate.

Euro Conversion

On January 1, 1999, certain member countries 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 or financial condition. 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, management 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. Refer to Note 6 for further information regarding the company's financial instruments.

Currency Risk The company operates on a global basis and is exposed to the risk that its earnings, cash flows and equity could be adversely impacted by fluctuations in currency exchange rates. The company is primarily exposed to currency exchange-rate risk with respect to its transactions and net assets denominated in Japanese Yen, Euro, British Pound and Swiss Franc. The company manages its foreign currency exposures and capital structure on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. The company also utilizes derivative financial instruments to further reduce the net exposure to currency fluctuations. The company principally enters into foreign currency option and forward agreements to hedge firm commitments and anticipated but not yet committed sales expected to be denominated in foreign currencies. The company enters into foreign currency forward agreements to hedge certain receivables and payables denominated in foreign currencies. The company also hedges certain of its net investments in international affiliates principally using cross-currency swap agreements.

As part of its risk-management program, the company performs sensitivity analyses to assess potential changes in fair value relating to hypothetical movements in currency exchange rates. A sensitivity analysis of changes in the fair value of foreign exchange option and forward contracts outstanding at December 31, 2000 indicated that, if the U.S. Dollar uniformly fluctuated unfavorably by 10 percent against all currencies, the fair value of those contracts would decrease by $20 million. A similar analysis performed with respect to option and forward contracts outstanding at December 31, 1999 indicated that the fair value of such contracts would decrease by $16 million. With respect to the company's cross-currency swap agreements, if the U.S. Dollar uniformly weakened by 10 percent, the fair value of the contracts would decrease by $83 million and $295 million as of December 31, 2000 and 1999, respectively. Any increase or decrease in the fair value of cross-currency swap agreements as a result of fluctuations in currency exchange rates is offset almost completely by the change in the value of the hedged net investments in foreign affiliates. The amount above for 2000 is less than that for 1999 due to the significantly lower notional amount of cross-currency swap agreements outstanding at December 31, 2000 as compared to the prior year-end. These sensitivity analyses disregard the possibility that currency exchange rates can move in opposite directions and that gains from one currency may or may not be offset by losses from another currency.

Interest Rate Risk As part of its risk-management program, the company performs sensitivity analyses to assess potential gains and losses in earnings relating to hypothetical movements in interest rates. A 44 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 2000 and 1999 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, 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 to the company's consolidated financial position.

Legal Proceedings

See Note 12 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.

New Accounting and Disclosure Standards

Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133" and SFAS No. 138, "Accounting for Certain Hedging Activities" (collectively, SFAS No. 133), is effective for the company as of January 1, 2001. SFAS No. 133 requires that a company recognize all derivatives as assets or liabilities measured at fair value. The accounting for changes in the fair value of a derivative depends on the use of the derivative. Adoption of SFAS No. 133 will result in a cumulative after-tax reduction in net income of approximately $52 million and a cumulative after-tax increase in other comprehensive income of approximately $8 million, both of which will be recorded at the beginning of fiscal year 2001. The ongoing impact of SFAS No. 133 is not expected to be material.

SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140) was issued in September 2000 and is effective for transfers, servicings and extinguishments occurring after March 31, 2001. SFAS No. 140 replaces SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 125). Although SFAS No. 140 clarifies or amends various aspects of SFAS No. 125, most of the fundamental concepts from SFAS No. 125 have been brought forward without modification. SFAS No. 140 is not expected to have a material impact on the company's 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.

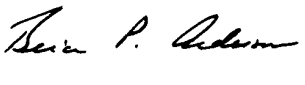
Management is responsible for establishing and maintaining a system of internal control over financial reporting and safeguarding assets against unauthorized acquisition, use or disposition. This system is designed to provide reasonable assurance as to the integrity and reliability of financial reporting and safeguarding of assets. 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

To the 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, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. 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 of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. 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 our opinion.

PricewaterhouseCoopers LLP
Chicago, Illinois
February 16, 2001, except for Note 14,
which is as of February 28, 2001

Consolidated Balance Sheets

as of December 31 (in millions, except share information)		**2000**	1999
Current Assets	Cash and equivalents	$ 579	$ 606
	Accounts receivable	1,387	1,504
	Notes and other current receivables	155	148
	Inventories	1,159	1,116
	Short-term deferred income taxes	159	216
	Prepaid expenses	212	229
	Total current assets	3,651	3,819
Property, Plant and Equipment, Net		2,807	2,650
Other Assets	Net assets of discontinued operation	–	1,231
	Goodwill and other intangible assets	1,239	921
	Insurance receivables	160	301
	Other	876	722
	Total other assets	2,275	3,175
	Total assets	$8,733	$9,644
Current Liabilities	Short-term debt	$ 576	$ 125
	Current maturities of long-term debt and lease obligations	58	130
	Accounts payable and accrued liabilities	1,990	1,805
	Income taxes payable	748	640
	Total current liabilities	3,372	2,700
Long-Term Debt and Lease Obligations		1,726	2,601
Long-Term Deferred Income Taxes		160	311
Long-Term Litigation Liabilities		184	273
Other Long-Term Liabilities		632	411
Commitments and Contingencies			
Stockholders' Equity	Common stock, $1 par value, authorized 350,000,000 shares, issued 298,133,251 shares in 2000 and 294,363,251 shares in 1999	298	294
	Common stock in treasury, at cost, 4,953,062 shares in 2000 and 4,163,737 shares in 1999	(349)	(269)
	Additional contributed capital	2,506	2,282
	Retained earnings	853	1,415
	Accumulated other comprehensive loss	(649)	(374)
	Total stockholders' equity	2,659	3,348
	Total liabilities and stockholders' equity	$8,733	$9,644

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)		**2000**	1999	1998
Operations	**Net sales**	$6,896	$6,380	$5,706
	Costs and expenses			
	Cost of goods sold	3,833	3,568	3,142
	Marketing and administrative expenses	1,385	1,311	1,208
	Research and development expenses	379	332	323
	In-process research and development and acquisition-related costs	286	–	116
	Exit and other reorganization costs	–	–	122
	Net litigation (income) costs	(29)	–	178
	Goodwill amortization	31	19	18
	Operating income	1,011	1,150	599
	Interest expense, net	85	87	124
	Other (income) expense	(20)	11	(18)
	Income from continuing operations before income taxes and cumulative effect of accounting change	946	1,052	493
	Income tax expense	208	273	218
	Income from continuing operations before cumulative effect of accounting change	738	779	275
	Discontinued operation	2	45	40
	Income before cumulative effect of accounting change	740	824	315
	Cumulative effect of accounting change, net of income tax benefit of $7	–	(27)	–
	Net income	$ 740	$ 797	$ 315
Per Share Data	**Earnings per basic common share**			
	Continuing operations	$ 2.52	$ 2.69	$ 0.97
	Discontinued operation	0.01	0.15	0.14
	Cumulative effect of accounting change	–	(0.09)	–
	Net income	$ 2.53	$ 2.75	$ 1.11
	Earnings per diluted common share			
	Continuing operations	$ 2.47	$ 2.64	$ 0.95
	Discontinued operation	0.01	0.15	0.14
	Cumulative effect of accounting change	–	(0.09)	–
	Net income	$ 2.48	$ 2.70	$ 1.09
	Weighted average number of common shares outstanding			
	Basic	292	290	284
	Diluted	299	295	289

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

Consolidated Statements of Cash Flows

as of or for the years ended December 31 (in millions) (brackets denote cash outflows)		**2000**	1999	1998
Cash Flows from Operations	Income from continuing operations before cumulative effect of accounting change	$738	$779	$275
	Adjustments			
	Depreciation and amortization	405	372	344
	Deferred income taxes	(170)	92	(56)
	Loss (gain) on asset dispositions	6	13	(23)
	In-process research and development and acquisition-related costs	286	–	116
	Exit and other reorganization costs	–	–	122
	Net litigation (income) charge	(29)	–	178
	Other	55	20	2
	Changes in balance sheet items			
	Accounts receivable	54	(103)	(153)
	Inventories	(114)	17	(79)
	Accounts payable and accrued liabilities	60	30	165
	Net litigation payments and other	(58)	(243)	(54)
	Cash flows from continuing operations	1,233	977	837
	Cash flows from discontinued operation	(19)	106	102
	Cash flows from operations	1,214	1,083	939
Cash Flows from Investing Activities	Capital expenditures	(547)	(529)	(461)
	Additions to the pool of equipment leased or rented to customers	(101)	(102)	(95)
	Acquisitions (net of cash received) and investments in affiliates	(345)	(179)	(319)
	Divestitures and other asset dispositions	(60)	75	3
	Cash flows from investing activities	(1,053)	(735)	(872)
Cash Flows from Financing Activities	Issuances of debt obligations	1,180	764	1,143
	Redemption of debt obligations	(1,953)	(481)	(598)
	Increase (decrease) in debt with maturities of three months or less, net	879	(552)	(159)
	Common stock cash dividends	(84)	(338)	(331)
	Stock issued under Shared Investment Plan	–	198	–
	Stock issued under employee benefit plans	233	148	118
	Purchases of treasury stock	(375)	(184)	–
	Cash flows from financing activities	(120)	(445)	173
Effect of Foreign Exchange Rate Changes on Cash and Equivalents		(68)	(6)	4
Increase (Decrease) in Cash and Equivalents		(27)	(103)	244
Cash and Equivalents at Beginning of Year		606	709	465
Cash and Equivalents at End of year		$579	$606	$709
Supplemental information:				
Interest paid, net of portion capitalized		$110	$150	$191
Income taxes paid		$279	$197	$143

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)	**2000**	1999	1998
Common Stock			
Beginning of year	$ 294	$ 291	$ 288
Common stock issued for acquisitions	4	–	3
Stock issued under Shared Investment Plan	–	3	–
End of year	298	294	291
Common Stock in Treasury			
Beginning of year	(269)	(210)	(329)
Common stock issued for acquisitions	47	–	–
Purchase of common stock	(375)	(184)	–
Common stock issued under employee benefit plans	248	125	119
End of year	(349)	(269)	(210)
Additional Contributed Capital			
Beginning of year	2,282	2,064	1,876
Common stock issued for acquisitions	239	–	189
Stock issued under Shared Investment Plan	–	195	–
Common stock issued under employee benefit plans	(15)	23	(1)
End of year	2,506	2,282	2,064
Retained Earnings			
Beginning of year	1,415	990	1,006
Net income	740	797	315
Elimination of reporting lag for certain international operations	–	(34)	–
Common stock cash dividends	(341)	(338)	(331)
Distribution of Edwards Lifesciences Corporation common stock to stockholders	(961)	–	–
End of year	853	1,415	990
Accumulated Other Comprehensive Loss			
Beginning of year	(374)	(296)	(222)
Other comprehensive loss	(275)	(78)	(74)
End of year	(649)	(374)	(296)
Total stockholders' equity	$2,659	$3,348	$2,839
Comprehensive Income			
Net income	$ 740	$ 797	$ 315
Currency translation adjustments, net of tax expense (benefit) of $82 in 2000, $87 in 1999 and $(56) in 1998	(297)	(80)	(75)
Unrealized net gain on marketable equity securities, net of tax of $15 in 2000, $1 in 1999 and $1 in 1998	22	2	1
Other comprehensive loss	(275)	(78)	(74)
Elimination of reporting lag for certain international operations, net of tax benefit of $22	–	(34)	–
Total comprehensive income	$ 465	$ 685	$ 241

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

Notes to 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). Effective in the first quarter of 1999 and in conjunction with the implementation of new financial systems, the company eliminated the one-month lag in reporting certain international operations to facilitate more timely consolidation. The December 1998 net loss of $34 million for these operations was recorded directly to retained earnings in the first fiscal quarter of 1999. Effective in the first quarter of 2001, the one-month lag was eliminated for the remaining international operations.

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 policy is to recognize revenues from product sales and services when earned, as defined by GAAP, and in accordance with SEC Staff Accounting Bulletin No. 101. Revenue is recognized when persuasive evidence of the arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. For product sales, revenue is not recognized until title and risk of loss have transferred. Prior to revenue recognition, the company substantially completes the terms specified in the arrangement, and any remaining obligations are inconsequential or perfunctory. Provisions for discounts, rebates to customers, and returns are provided for at the time the related sales are recorded, and are classified as adjustments to sales.

Warranty expense

The company provides for the estimated costs that may be incurred under its warranty programs at the time revenue is recognized.

Inventories

as of December 31 (in millions)	**2000**	1999
Raw materials	$ 261	$ 251
Work in process	174	193
Finished products	724	672
Total inventories	$1,159	$1,116

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 $110 million and $78 million at December 31, 2000 and 1999, respectively.

Property, plant and equipment

as of December 31 (in millions)	**2000**	1999
Land	$ 113	$ 93
Buildings and leasehold improvements	967	987
Machinery and equipment	2,822	2,615
Equipment with customers	484	489
Construction in progress	592	525
Total property, plant and equipment, at cost	4,978	4,709
Accumulated depreciation and amortization	(2,171)	(2,059)
Property, plant and equipment, net	$2,807	$2,650

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 $11 million and $10 million at December 31, 2000 and 1999, respectively. Depreciation expense was $308 million, $290 million and $269 million in 2000, 1999 and 1998, respectively. Repairs and maintenance expense was $105 million, $97 million and $93 million in 2000, 1999 and 1998, respectively.

Goodwill and other intangible assets

as of December 31 (in millions)	**2000**	1999
Goodwill	$1,094	$737
Accumulated amortization	(138)	(113)
Net goodwill	956	624
Other intangible assets	701	677
Accumulated amortization	(418)	(380)
Net other intangible assets	283	297
Goodwill and other intangible assets	$1,239	$921

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 intangibles 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 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, 2000.

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)	**2000**	1999	1998
Basic	292	290	284
Effect of dilutive securities			
Employee stock options	6	4	5
Employee stock purchase plans and equity forward agreements	1	1	–
Diluted	299	295	289

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 ($674) million and ($377) million at December 31, 2000 and 1999, respectively. Accumulated unrealized net gains on unrestricted marketable equity securities were $25 million and $3 million at December 31, 2000 and 1999, respectively.

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 that such costs subsequent to adoption be expensed as incurred. The after-tax cumulative effect of this accounting change was $27 million.

Derivatives

Gains and losses relating to foreign currency purchased options and forward agreements that are designated and effective as hedges of firm commitments and anticipated transactions are deferred and recognized in income as offsets of gains and losses resulting from the underlying hedged items. Purchased option premiums are deferred and recognized in income to the extent considered effective. Premiums and discounts related to forward agreements are capitalized and amortized over the period of the underlying agreement. Deferred amounts are classified in inventories. Gains, losses and option premiums relating to foreign currency derivative instruments not qualifying as hedges for accounting purposes are recognized in income immediately. Such instruments are classified in accounts payable and accrued liabilities. Gains, losses relating to terminations of qualifying hedges are generally deferred and recognized consistent with the income or loss recognition of the underlying hedged items. In circumstances where the underlying hedged items are sold or no longer exist, any remaining gains or losses are recognized immediately in income. The effective portions of gains and losses on hedges of net investments in foreign affiliates are reported as currency translation adjustments in stockholders' equity. The interest rate differentials relating to interest rate swaps used to hedge debt obligations and cross-currency swap contracts used to hedge net investments in foreign affiliates are reflected as an adjustment to interest expense over the lives of the financial instruments. Gains or losses relating to terminations of cross-currency swap contracts used to hedge net investments in foreign affiliates are recognized immediately and recorded in other income or expense. Instruments that are indexed to and potentially settled in the company's stock are accounted for in accordance with Emerging Issues Task Force Issue Nos. 00-7 and 00-19. Cash flows from derivatives are classified in the same category as the cash flows from the related hedged activity.

Cash and equivalents

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

Shipping and handling costs

Shipping and handling costs are classified in either cost of goods sold or marketing and administrative expenses based on their nature. Approximately $200 million of shipping and handling costs were classified in marketing and administrative expenses in each of 2000, 1999 and 1998.

Reclassifications

Certain reclassifications have been made to conform the 1999 and 1998 financial statements and notes to the 2000 presentation.

New accounting pronouncements

Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133" and SFAS No. 138, "Accounting for Certain Hedging Activities" (collectively, SFAS No. 133), is effective for the company as of January 1, 2001. SFAS No. 133 requires that a company recognize all derivatives as assets or liabilities measured at fair value. The accounting for changes in the fair value of a derivative depends on the use of the derivative. Adoption of SFAS No. 133 will result in a cumulative after-tax reduction in net income of approximately $52 million and a cumulative after-tax increase in other comprehensive income of approximately $8 million, both of which will be recorded at the beginning of fiscal year 2001. The ongoing impact of SFAS No. 133 is not expected to be material.

SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 140) was issued in September 2000 and is effective for transfers, servicings and extinguishments occurring after March 31, 2001. SFAS No. 140 replaces SFAS No. 125, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" (SFAS No. 125). Although SFAS No. 140 clarifies or amends various aspects of SFAS No. 125, most of the fundamental concepts from SFAS No. 125 have been brought forward without modification. SFAS No. 140 is not expected to have a material impact on the company's consolidated financial statements.

2 *Discontinued Operation*

On March 31, 2000, Baxter stockholders of record on March 29, 2000, received all of the outstanding stock of Edwards Lifesciences Corporation (Edwards), the company's cardiovascular business, in a tax-free spin-off. 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.

In 2000, 1999 and 1998, the company recorded income from the discontinued operation of $14 million, $64 million and $40 million, respectively, which was net of income tax expense of $5 million, $19 million and $16 million, respectively. In addition, in 2000 and 1999 the company recorded $12 million (including tax of $6 million) and $19 million, respectively, of net costs directly associated with effecting the business distribution. The impact of these costs on basic earnings per share was $.04 and $.07 in 2000 and 1999, respectively, and the impact on diluted earnings per share was $.04 and $.06 in 2000 and 1999, respectively. Net sales of the discontinued operation were $906 million in 1999, $893 million in 1998, and $252 million for the three-month period ended March 31, 2000.

Through the issuance of new third-party debt, approximately $502 million of Baxter's debt was indirectly assumed by Edwards upon spin-off. The distribution of Edwards stock totaled $961 million.

The cardiovascular business in Japan was not transferred to Edwards at the time of distribution due to Japanese regulatory requirements and business culture considerations. The business is operated pursuant to a contractual joint venture under which a Japanese subsidiary of Baxter retains ownership of the business assets, but a subsidiary of Edwards holds a 90 percent profit interest. Edwards has an option to purchase the Japanese assets, which option may be exercised no earlier than 28 months following the spin-off date and no later than 60 months following the spin-off date. The exercise price of the option is approximately 26.4 billion Japanese Yen, of which Edwards would obtain approximately 23.2 billion Japanese Yen upon termination of the joint venture for the return of its fair value in the joint venture at inception. Included in Baxter's consolidated balance sheet at December 31, 2000 was a $203 million liability relating to this contractual joint venture, which was established in connection with the accounting for the spin-off of Edwards.

3 *Acquisitions and Divestitures*

Accounting for acquisitions

All acquisitions during the three years ended December 31, 2000 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. 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. 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 allocation of the purchase price to IPR&D and intangible assets.

(in millions)	Acquisition date	Purchase price	IPR&D	Intangible assets Goodwill	Other
North American Vaccine, Inc.	June 2000	$328	$250	$245	$10
Somatogen, Inc.	May 1998	206	116	2	3
Bieffe Medital S.p.A.	December 1997	188	–	124	15

North American Vaccine, Inc. (NAV) was engaged in the research, development, production and sales of vaccines for the prevention of human infectious diseases. Somatogen, Inc. (Somatogen) was a developer of recombinant hemoglobin-based technology, and no revenue had ever been generated from commercial product sales. 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. The acquisitions of NAV and Somatogen are included in the BioScience segment. Bieffe Medital S.p.A. (Bieffe), which was a manufacturer of dialysis and intravenous solutions and containers, is included in both the Renal and the Medication Delivery segments. The purchase prices of NAV and Somatogen were principally paid in approximately 3,770,000 and 3,547,000 shares, respectively, of Baxter International Inc. common stock. A portion of the purchase price of the Renal segment's acquisition of Althin Medical A.B. was paid in approximately 592,000 shares of Baxter common stock.

The $286 million charge for IPR&D and acquisition-related costs recorded in 2000 consisted principally of the above-mentioned $250 million charge relating to NAV, insignificant IPR&D charges pertaining to three other acquisitions, as well as certain charges associated with one of the Medication Delivery segment's acquisitions.

IPR&D

Amounts allocated to IPR&D were determined on the basis of independent valuations 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. The valuations incorporated the stages of completion of the IPR&D projects. 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 significant amounts allocated to IPR&D during the last several years, by significant project category.

(in millions)	NAV	Somatogen	Immuno
Oxygen-carrying therapeutics		$116	
Plasma-based therapies			$142
Vaccines	$250		78
Total	$250	$116	$220

Material net cash inflows for significant IPR&D projects for NAV were forecasted in the valuation to commence between 2002 and 2005. A discount rate of 20 percent was used for all projects, which include Streptococcal B, Pneumococcal, Meningococcal B/C/Y and other vaccines. Assumed additional research and development (R&D) expenditures prior to the dates of product introductions totaled approximately $85 million. 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 vaccine project. The percentage completion rate for significant projects ranged in the valuation from approximately 65 percent to over 90 percent, with the weighted-average completion rate approximately 70 percent. Subsequent to the June 2000 acquisition date, the projects have been proceeding in accordance with the original projections. Approximately $8 million of R&D costs were expensed in 2000 subsequent to the acquisition date relating to these projects.

Material net cash inflows relating to Somatogen's IPR&D were forecasted to begin in 2004. A discount rate of 22 percent was used in the valuation. Estimated R&D costs to be incurred prior to 2004 were forecasted to total approximately $100 million. 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 2006. Also, it is currently estimated that over $200 million of R&D costs will be incurred between the date of acquisition and 2006. During 2000, the results of preclinical studies were submitted to the U.S. Food and Drug Administration as part of an investigational new drug application. Pending the outcome of the FDA's review of the application, the company plans to begin human clinical trials in 2001. Approximately $18 million, $18 million and $10 million of R&D costs were expended in 2000, 1999 and 1998, respectively, relating to these projects.

Immuno International AG (Immuno), a manufacturer of bio-pharmaceutical products and services for transfusion medicine, was acquired by the company in December 1996, and is included in the BioScience segment. The two project categories were comprised of 18 projects, many of which were comprised of multiple sub-projects. 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 and terminations of other projects. Such revisions to original plans 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 altered 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. As a result of the timetable revisions and terminations, actual R&D expenditures since acquisition date have been over 40 percent lower than that assumed in the model. Total additional R&D expenditures are currently forecasted to be less than those assumed in the model. Approximately $15 million, $30 million and $25 million of R&D costs have been expensed in 2000, 1999 and 1998, respectively, relating to these projects.

With respect to NAV, 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 market-place 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.

Pro forma information

The following unaudited pro forma information presents a summary of the company's consolidated results of operations as if acquisitions had occurred as of the beginning of fiscal years 2000 and 1999, respectively, giving effect to purchase accounting adjustments but excluding the 2000 charge for IPR&D and acquisition-related costs.

years ended December 31 (in millions, except per share data)	**2000**	1999
Net sales	$7,005	$6,614
Income from continuing operations before cumulative effect of accounting change	$ 896	$ 781
Net income	$ 896	$ 754
Net income per diluted common share	$ 2.99	$ 2.52

These pro forma results of operations have been presented for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on the date indicated, or which may result in the future. The diluted pro forma earnings and per-share earnings included in the table above primarily reflect the historical pre-acquisition net losses reported by NAV.

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 the reserves and related activity pertaining to the acquisition of Immuno. Reserves established for certain of the company's acquisitions during the period are not included below as such reserves were not material. Actions executed to date and anticipated in the future with respect to the acquisition-related plans are substantially consistent with the original plans. 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)	Immuno
Original reserve	
Employee-related costs	$38
Contract termination and other costs	41
Total original reserve	79
1998 and prior reserve utilization	(26)
1999 reserve utilization	(11)
2000 reserve utilization	(16)
Balance at December 31, 2000	$26

Employee-related costs consisted principally of employee severance associated with headcount reductions in Europe and primarily impacted the sales and marketing functions. Utilization of reserves for employee-related costs totaled $3 million, $6 million and $16 million in 2000, 1999 and 1998, respectively. Contract termination and other costs related principally to the exiting of activities and termination of distribution, lease and other contracts of the acquired company that existed prior to the acquisition date that either continued with no economic benefit or required payment of a cancellation penalty.

4 *Exit and Other Reorganization Costs*

In 1998, the company decided to end the clinical development of the BioScience 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 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 machinery and equipment 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 years.

The following is a summary of the components of the remainder of the charge and the utilization of such reserves.

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)
2000 utilization	(4)	–	(4)
Reserves at December 31, 2000	$ 2	$ 1	$ 3

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 BioScience and Medication Delivery segments. Approximately 360 positions have been eliminated through December 31, 2000. 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.

5 *Long-Term Debt, Credit Facilities and Lease Obligations*

as of December 31 (in millions)	Effective interest rate	**2000**	1999
Commercial paper	6.4%	$ 800	$ 668
Short-term notes	3.5%	513	646
Zero coupon notes due 2000 (unamortized original issue discount of $9)	10.3%	–	120
8.125% notes due 2001	6.2%	40	155
7.625% notes due 2002	7.5%	46	151
7.125% notes due 2007	7.1%	54	251
7.25% notes due 2008	7.5%	29	198
9.5% notes due 2008	9.5%	75	75
7.65% debentures due 2027	7.6%	5	202
6.625% debentures due 2028	6.7%	147	249
Other		75	16
Total long-term debt and lease obligations		1,784	2,731
Current portion		(58)	(130)
Long-term portion		$1,726	$2,601

In order to better match the currency denomination of its assets and liabilities, the company rebalanced certain of its debt during 2000. The company acquired approximately $878 million of its U.S. Dollar denominated debt securities during 2000 and increased its Japanese Yen and Euro denominated debt. The net costs associated with the early termination of the U.S. Dollar denominated debt of $15 million were recorded in other expense as they were not material. The increase in debt denominated in Japanese Yen and Euro was classified in short-term debt as of December 31, 2000. Management intends to replace the majority of this short-term debt with long-term debt during 2001.

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 $99 million, $91 million and $79 million in 2000, 1999 and 1998, respectively.

Future minimum lease payments and debt maturities

as of and for the years ended December 31 (in millions)	Operating leases	Aggregate debt maturities and capital leases
2001	$ 82	$ 62
2002	66	50
2003	52	1,336[1]
2004	42	3
2005	36	2
Thereafter	70	341
Total obligations and commitments	$348	1,794
Amounts representing interest, discounts, premiums and deferred financing costs		(10)
Total long-term debt and present value of lease obligations		$1,784

1. Includes approximately $1.3 billion 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 $1.5 billion. Of this total, $700 million will expire in 2001 and $800 million will expire in 2003. The facilities enable the company to borrow funds in U.S. Dollars or Euros 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, 2000 or 1999. Baxter also maintains or guarantees other short-term credit arrangements which totaled approximately $418 million at December 31, 2000. Approximately $61 million and $93 million of borrowings were outstanding under these facilities at December 31, 2000 and 1999, respectively.

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 $513 million and $596 million in borrowings outstanding under this facility at December 31, 2000 and 1999, 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.

At December 31, 2000 and 1999, commercial paper and short-term notes together totaling approximately $1.3 billion have been classified with long-term debt as they are supported by the long-term credit facilities discussed above, which management intends to continue to refinance.

6 *Financial Instruments and Risk Management*

Accounts receivable

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 $43 million and $34 million at December 31, 2000 and 1999, respectively.

In order to reduce its overall financing costs, the company periodically sells its trade accounts receivable. In 2000, the company generated net operating cash inflows of approximately $195 million relating to such sales. Under the terms of the sales arrangements, the company has the ability to sell certain accounts receivable on an ongoing basis, continues to service the sold receivables, and is subject to recourse provisions. Management believes the company is adequately reserved with respect to the recourse provisions. In 2000, proceeds from new sales totaled approximately $1.5 billion and cash collections reinvested totaled approximately $1.3 billion. The portfolio of accounts receivable that the company services totaled approximately $590 million at December 31, 2000. The net gains and losses recognized upon sale of the receivables, amounts relating to the company's servicing of the receivables, and delinquencies were not material to the consolidated financial statements.

Other concentrations of risk

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 interest rate swaps generally from less than one year 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, 2000 and 1999 reflect deferred hedge gains of $2 million and $11 million, respectively, offset by $2 million of deferred hedge losses at December 31, 1999.

Foreign exchange risk management

The company enters into various types of foreign exchange contracts to protect the company from risks associated with the fluctuation in currency exchange rates. The company principally enters into foreign currency option and forward contracts, with terms generally less than three years, to hedge firm commitments and 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 $20 million and $7 million at December 31, 2000 and 1999, respectively. The company also enters into foreign currency forward agreements to hedge certain receivables and payables denominated in foreign currencies. The company principally hedges the following currencies: Japanese Yen, Euro, British Pound and Swiss Franc.

The company also enters into cross-currency swap agreements, with original maturities up to 10 years, to hedge certain of its net investments in foreign affiliates. In conjunction with the company's rebalancing of its debt portfolio and in anticipation of the adoption of SFAS No. 133, certain of such contracts were terminated in 2000, and a gain was recognized in other income. Refer to Note 10 for further information. In order to hedge certain of its net investments in foreign affiliates in the future, the company plans to designate a portion of its debt denominated in foreign currencies as hedges of these net investments, as well as use cross-currency swap agreements.

Interest rate and foreign exchange contracts

	2000		1999	
as of December 31 (in millions)	Notional amounts	Market values	Notional amounts	Market values
Interest rate contracts				
Floating to fixed rate swaps	$ 100	$ –	$ 300	$ 3
Average pay rate 5.1% in 2000 and 7.4% in 1999				
Average receive rate 6.3% in 2000 and 5.8% in 1999				
Foreign exchange contracts				
Forwards and options used to hedge firm commitments and anticipated sales				
Japanese Yen	$ 578	$ 26	$ 483	$ (1)
Euro	439	12	610	15
Other currencies	69	2	34	1
Total	$1,086	$ 40	$1,127	$ 15
Forwards and swaps used to hedge net investments in foreign affiliates				
Japanese Yen	$ 115	$ (6)	$ 315	$(113)
Euro	650	(64)	2,650	175
Other currencies	68	(3)	15	–
Total	$ 833	$(73)	$2,980	$ 62
Forwards used to hedge certain receivables and payables (primarily Japanese Yen, Euro and Swiss Franc)	$ 21	$ 14	$ 58	$ –

Equity risk management

In order to partially offset the potentially dilutive effect of employee stock options, the company has entered into forward agreements with independent third parties related to the company's 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. At December 31, 2000, agreements related to approximately 2.5 million shares mature in 2001 at an average exercise price of approximately $58 per share and agreements related to approximately 3.7 million shares mature in 2002 at exercise prices ranging from $70 to $78 per share. At December 31, 1999, agreements related to approximately 7.0 million shares were outstanding.

In connection with the company's stock repurchase program, during 2000 the company issued put options and purchased call options on shares of its common stock. The put options give the purchaser the right to sell Baxter common stock to the company at contractually specified prices. The call options give the company the right to purchase Baxter common stock at contractually specified prices. The agreements were executed with independent third parties, and the cost of the call options was offset by the premium from the put options. 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 at any time before maturity. In conjunction with its stock repurchase program, the company terminated certain of these contracts during the 2000. At December 31, 2000, put options for approximately 1.5 million shares of common stock and call options for approximately 1.0 million shares of common stock were outstanding. The exercise prices of the outstanding put options were $56 per share and the exercise prices of the outstanding call options were $62 per share. The contracts mature in 2001.

The following is a summary of the carrying amounts and approximate fair values of the company's financial instruments included in the consolidated balance sheets.

Fair values of financial instruments

as of December 31	Carrying amounts		Approximate fair values	
(in millions)	**2000**	1999	**2000**	1999
Assets				
Long-term insurance receivables	$160	$301	$145	$248
Investments in affiliates	195	145	312	158
Foreign exchange hedges	65	20	51	15
Liabilities				
Short-term debt	576	125	576	125
Short-term borrowings classified as long term[1]	1,313	1,314	1,313	1,311
Other long-term debt and lease obligations[2]	471	1,417	487	1,326
Long-term litigation liabilities	184	273	170	237

1. Includes interest rate hedging instruments.

2. Includes swaps used to hedge net investments in foreign affiliates.

The fair values of certain of the investments in affiliates are not readily determinable as the investments are not traded in a market. For these investments, fair value is assumed to approximate carrying value. With respect to the approximate fair values of the company's unrestricted marketable investments in affiliates, the total net unrealized gain at December 31, 2000 consists of gross unrealized gains of $50 million net of gross unrealized losses of $9 million, and the total at December 31, 1999 consists of gross unrealized gains of $7 million net of gross unrealized losses of $2 million. 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)	**2000**	1999
Accounts payable, principally trade	$ 659	$ 612
Employee compensation and withholdings	238	260
Litigation	177	183
Pension and other deferred benefits	17	40
Property, payroll and other taxes	77	105
Other	822	605
Accounts payable and accrued liabilities	$1,990	$1,805

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. No compensation cost has been recognized for fixed stock option plans and stock purchase plans. The compensation expense recognized for continuing operations for performance-based, restricted and other stock plans was $23 million, $26 million and $15 million in 2000, 1999 and 1998, 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 SFAS No. 123, "Accounting for Stock-Based Compensation," the company's net income and related earnings per share (EPS) would have been reduced to the pro forma amounts indicated below.

Pro forma net income and EPS

years ended December 31 *(in millions, except per share data)*	**2000**	1999	1998
Pro forma net income	$ 681	$ 746	$262
Pro forma basic EPS	$2.33	$2.57	$ .92
Pro forma diluted EPS	$2.29	$2.54	$ .91

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

All outstanding options were modified as a result of the spin-off of Edwards. Equitable adjustments were made to the number of shares and exercise price for each option and employee stock subscription outstanding.

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 one year or 100% in three years.

Stock options outstanding at December 31, 2000

(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
$20-39	2,495	3.5	$29.42	2,495	$29.42
40-49	4,583	6.2	45.45	4,583	45.45
50-59	5,934	8.1	54.72	247	53.87
60-79	4,556	8.2	64.53	–	–
80-83	6,933	9.8	82.53	–	–
$20-83	24,501	7.8	$60.21	7,325	$40.66

As of December 31, 1999 and 1998, there were 8,755,000 and 4,565,000 options exercisable, respectively, at weighted-average exercise prices of $41.06 and $30.27, respectively.

Stock option activity

(option shares in thousands)	Shares	Weighted-average exercise price
Options outstanding at January 1, 1998	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
Granted	9,520	75.32
Exercised	(2,853)	39.47
Forfeited	(1,921)	57.81
Equitable adjustment	946	–
Options outstanding at December 31, 2000	24,501	$60.21

Included in the tables above are certain premium-priced options. During 1998, approximately 470,000 premium-priced stock options were granted with a weighted-average exercise price of $73 and a weighted-average fair value of approximately $13 per option. During 1996, approximately 2.5 million premium-stock options were granted with an exercise price of $49 and a weighted-average fair value of approximately $11 per option. All of such options granted in 1998 and 1.4 million of such options granted in 1996 are outstanding at December 31, 2000.

Pro forma compensation expense was calculated with the following weighted-average assumptions for grants in 2000, 1999 and 1998, respectively: dividend yield of 1.25%, 1.5% and 1.5%; expected life of six years for all periods; expected volatility of 31%, 29% and 29%; and risk-free interest rates of 6.1%, 5.4% and 5.3%. The weighted-average fair value of options granted during the year were $27.49, $22.59 and $18.58 in 2000, 1999 and 1998, respectively.

Employees of Edwards were required to exercise any vested options within 90 days from the date of spin-off, which occurred on March 31, 2000. All unvested options were canceled 90 days after the date of spin-off.

Employee stock purchase plans

The company has employee stock purchase plans whereby it is authorized, as of December 31, 2000, 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 percent of the closing market price on the date of subscription or 85 percent of the closing market price as defined by the plans. The total subscription amount for each participant cannot exceed 25 percent of current annual pay. Under the plans, the company sold 1,387,022 and 777,618 and 810,855 shares to employees in 2000, 1999 and 1998, respectively. Pro forma compensation expense was estimated with the following weighted-average assumptions for 2000, 1999 and 1998, respectively: dividend yield of 1.4%, 1.5% and 1.5%: expected volatility of 33% for all periods, and risk-free interest rates of 6.2%, 5.4% and 4.4%. The weighted-average fair value of those purchase rights granted in 2000, 1999 and 1998 was $22.98, $20.09 and $15.16, respectively.

Restricted stock and performance-share plans

The long-term incentive plan includes both stock options and restricted stock. Under the plan, grants of restricted stock are generally made annually and are earned based on the achievement of financial performance targets. The restricted stock component of the long-term incentive plan is being eliminated effective in 2001 and, instead, a greater number of stock options will be granted to participants in the plan with terms and conditions similar to existing stock option plans. The year 2000 was a transition year whereby most participants in the plan elected to receive incremental stock options and were no longer eligible to earn restricted stock. The number of stock options granted pursuant to the revised plan is based on the achievement of financial performance objectives.

The company also has other incentive compensation plans whereby grants of restricted stock and performance shares are made to key employees and non-employee directors. At December 31, 2000, approximately 84,000 shares of stock were subject to restrictions, the majority of which lapse in 2001 and 2002. During 2000, 1999 and 1998, approximately 249,500, 542,500 and 242,700 shares, respectively, of restricted stock and performance shares were granted at weighted-average grant-date fair values of $65.75, $63.99 and $58.74 per share, respectively. The majority of the restricted stock granted in 2000 was forfeited pursuant to the long-term incentive plan transition discussed above.

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 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 $63.63. 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 at December 31, 2000 was $188 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, all of which was repurchased by early 2000. In November 1999, the board of directors authorized the repurchase of an additional $500 million over a period of several years, of which approximately two-thirds has been repurchased as of December 31, 2000.

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 percent or more of the company's common stock or (2) a tender or exchange offer for 15 percent 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 for its employees. The company also sponsors certain unfunded contributory health-care and life insurance benefits for substantially all domestic retired employees.

Reconciliation of plans' benefit obligations, assets and funded status

as of and for the years ended December 31 (in millions)	Pension benefits **2000**	Pension benefits 1999	Other benefits **2000**	Other benefits 1999
Benefit obligations				
Beginning of year	$1,344	$1,427	$ 175	$ 200
Service cost	41	48	3	3
Interest cost	113	102	14	12
Participant contributions	2	2	3	3
Actuarial loss (gain)	147	(148)	35	(30)
Acquisitions (divestitures), net	(10)	1	–	–
Curtailments and settlements	(10)	(7)	–	(3)
Benefit payments	(78)	(76)	(11)	(11)
Currency exchange-rate changes and other	6	(5)	–	1
End of year	1,555	1,344	219	175
Fair value of plan assets				
Beginning of year	1,724	1,472	–	–
Actual return on plan assets	173	302	–	–
Employer contributions	19	13	8	8
Participant contributions	2	2	3	3
Acquisitions (divestitures), net	(8)	11	–	–
Curtailments and settlements	(11)	–	–	–
Benefit payments	(78)	(76)	(11)	(11)
Currency exchange-rate changes and other	(14)	–	–	–
End of year	1,807	1,724	–	–
Funded status				
Funded status at December 31	252	380	(219)	(175)
Unrecognized transition obligation	4	9	–	–
Unrecognized net gains	(252)	(390)	(56)	(98)
Unrecognized prior-service cost	–	(3)	–	–
Net amount recognized	$ 4	$ (4)	$(275)	$(273)
Prepaid benefit cost	$ 143	$ 121	$ –	$ –
Accrued benefit liability	(139)	(125)	(275)	(273)
Net amount recognized	$ 4	$ (4)	$(275)	$(273)

Assets held by the trusts of the plans consist primarily of equity securities. 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 $159 million, $142 million and $17 million, respectively, at December 31, 2000, and $140 million, $128 million and $23 million, respectively, at December 31, 1999.

Net periodic benefit cost

years ended December 31 (in millions)	**2000**	1999	1998
Pension benefits			
Service cost	$41	$48	$41
Interest cost	113	102	96
Expected return on plan assets	(159)	(133)	(117)
Amortization of prior service cost	–	1	1
Amortization of transition obligation	5	6	6
Net periodic pension benefit cost	$ –	$24	$27
Other benefits			
Service cost	$ 3	$ 3	$ 3
Interest cost	14	12	14
Recognized actuarial gain	(7)	(7)	(6)
Net periodic other benefit cost	$10	$ 8	$11

The net periodic benefit cost amounts principally pertain to continuing operations.

Assumptions used in determining benefit obligations

	Pension benefits **2000**	Pension benefits 1999	Other benefits **2000**	Other benefits 1999
Discount rate				
U.S. and Puerto Rico plans	7.75%	8.25%	7.75%	8.25%
International plans (average)	5.8%	5.7%	n/a	n/a
Expected return on plan assets				
U.S. and Puerto Rico plans	11.0%	10.5%	n/a	n/a
International plans (average)	8.1%	6.9%	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)	4.0%	4.1%	n/a	n/a
Annual rate of increase in the per-capita cost	n/a	n/a	7.5%	7.5%
Rate decreased to	n/a	n/a	5.5%	5.5%
by the year ended	n/a	n/a	2003	2002

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

(in millions)	One percent increase **2000**	One percent increase 1999	One percent decrease **2000**	One percent decrease 1999
Effect on total of service and interest cost components	$ 3	$ 2	$ 2	$ 2
Effect on postretirement benefit obligation	$29	$21	$24	$18

With respect to the employees of Edwards, the company froze benefits at the date of spin-off under the U.S. defined benefit pension plan and under plans that provide retirees with health-care and life insurance benefits. The pension liabilities related to such employees' service prior to the spin-off date 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 million) relating to these benefit plan curtailments.

Most U.S. employees are eligible to participate in a qualified defined contribution plan. Company matching contributions relating to continuing operations were $15 million, $14 million and $14 million in 2000, 1999 and 1998, respectively.

10 *Interest and Other (Income) Expense*

Interest expense, net

years ended December 31 (in millions)	**2000**	1999	1998
Interest expense, net			
Interest costs	$146	$165	$198
Interest costs capitalized	(15)	(13)	(5)
Interest expense	131	152	193
Interest income	(39)	(35)	(32)
Total interest expense, net	$ 92	$117	$161
Allocated to discontinued operation	$ 7	$ 30	$ 37
Allocated to continuing operations	$ 85	$ 87	$124

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

Other (income) expense

years ended December 31 (in millions)	**2000**	1999	1998
Equity in losses of affiliates and minority interests	$ 9	$ 5	$ 3
Asset dispositions, net	6	13	(23)
Foreign currency	(57)	(8)	–
Loss on early extinguishments of debt	15	–	–
Other	7	1	2
Total other (income) expense	$(20)	$11	$(18)

Included in foreign currency income in 2000 was approximately $66 million of gains associated with the termination of cross-currency swap agreements, as further discussed in Note 6.

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)	**2000**	1999	1998
U.S.	$353	$ 330	$ 78
International	593	722	415
Income from continuing operations before income taxes and cumulative effect of accounting change	$946	$1,052	$493

Income tax expense

years ended December 31 (in millions)	**2000**	1999	1998
Current			
U.S.			
Federal	$142	$ (13)	$119
State and local	47	38	3
International	189	156	152
Current income tax expense	378	181	274
Deferred			
U.S.			
Federal	(98)	69	(3)
State and local	(21)	14	5
International	(51)	9	(58)
Deferred income tax expense (benefit)	(170)	92	(56)
Income tax expense	$208	$273	$218

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)	**2000**	1999	1998
Deferred tax assets			
Accrued expenses	$374	$389	$349
Accrued postretirement benefits	102	102	103
Alternative minimum tax credit	146	162	164
Tax credits and net operating losses	92	100	179
Valuation allowances	(50)	(43)	(34)
Total deferred tax assets	664	710	761
Deferred tax liabilities			
Asset basis differences	410	471	473
Subsidiaries' unremitted earnings	85	160	188
Other	38	35	13
Total deferred tax liabilities	533	666	674
Net deferred tax asset	$131	$ 44	$ 87

Income tax expense rate reconciliation

years ended December 31 (in millions)	**2000**	1999	1998
Income tax expense at statutory rate	$331	$368	$172
Tax-exempt operations	(147)	(134)	(120)
State and local taxes	9	23	(3)
Repatriation of foreign earnings	–	–	87
Foreign tax expense	31	18	46
IPR&D expense	–	–	41
Other factors	(16)	(2)	(5)
Income tax expense	$208	$273	$218

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 2013. 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 $424 million as of December 31, 2000.

12 *Legal Proceedings, Commitments and 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 the company. 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 and 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 Form 10-K for the year ended December 31, 2000.

Mammary implant litigation

The company, together with certain of its subsidiaries, is 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.

Settlement of a class action on behalf of all women with silicone mammary implants was approved by the U.S. District Court (U.S.D.C.) for the Northern District of Alabama 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. 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.

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 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. Pursuant to the stock purchase agreement between the company and Immuno, as revised in April 1999 for consideration by the company of a 29 million Swiss Franc payment to Immuno as additional purchase price, approximately 26 million Swiss Francs of the purchase price is being withheld to cover these contingent liabilities.

Baxter is also 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 September 2000, the U.S. D.C. for the Central District of California approved a settlement of the class action 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.

Net litigation charges

Baxter began accruing for its estimated liability resulting from the settlement of the mammary implant-related class action and to litigate or settle cases and claims involving opt-outs in 1993. 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.

Baxter began accruing for its estimated worldwide liability for litigation and settlement costs involving plasma-based therapies in 1993. The company 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.

In 2000, the company recorded $29 million of income relating to its mammary implant and plasma-based therapies litigation. The income was principally a result of favorable adjustments to the mammary implant insurance receivables due to settlements negotiated with certain insurance companies during 2000.

Other

Allegiance Corporation (Allegiance) was spun off from the company in a tax-free distribution to shareholders on September 30, 1996. As of September 30, 1996, Allegiance assumed the defense of litigation involving claims related to its businesses, including certain claims of alleged personal injuries as a result of exposure to natural rubber latex gloves. Although Allegiance has not been named in all of this litigation, it 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.

In November 1999, the company and Nexell Therapeutics Inc. (Nexell) entered into an agreement whereby Baxter agreed to issue put rights in connection with a $63 million private placement by Nexell of preferred stock. This preferred stock is convertible at the option of the holders into common stock of Nexell at $11 per share at any time until November 2006. The put rights provide the holders of the preferred stock with the ability to cause Baxter to purchase the preferred stock from November 2002 until November 2004. The purchase price to be paid by Baxter would reflect a per annum compounded return to the holders of the preferred stock of 5.91%.

In connection with the spin-off of its cardiovascular business, Baxter obtained a ruling from the Internal Revenue Service to the effect that the distribution should qualify as a tax-free spin-off in the United States. In many countries throughout the world, Baxter has not sought similar rulings from the local tax authorities and has taken the position that the spin-off was a tax-free event to Baxter. In the event that one or more countries' taxing authorities successfully challenge this position, Baxter would be liable for any resulting liability. Baxter believes that it has established adequate reserves to cover the expected tax liabilities. There can be no assurance, however, that Baxter will not incur losses in excess of such reserves.

13 *Segment Information*

Baxter operates in 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: **Medication Delivery**, medication delivery products and services, including intravenous infusion pumps and solutions, anesthesia-delivery devices and pharmaceutical agents; **BioScience**, biopharmaceutical and blood-collection, separation and storage products and technologies; and **Renal**, products and services to treat end-stage kidney disease. As discussed in Note 2, the company spun off Edwards on March 31, 2000. Financial information for Edwards, which is substantially the same as the former CardioVascular segment, is reflected in the consolidated financial statements as a discontinued operation.

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

Segment information

as of and for the years ended December 31 (in millions)

	Medication Delivery	BioScience	Renal	Other	Total
2000					
Net sales	$2,719	$2,353	$1,824	$ –	$6,896
Depreciation and amortization	147	125	96	37	405
Pretax income	426	533	310	(323)	946
Assets	2,453	2,935	1,591	1,754	8,733
Expenditures for long-lived assets	185	248	126	89	648
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

Pretax income reconciliation

for the years ended December 31 (in millions)	**2000**	1999	1998
Total pretax income from segments	$1,269	$1,177	$1,019
Unallocated amounts:			
In-process research and development expense and acquisition-related costs	(286)	–	(116)
Charge for exit and other reorganization costs	–	–	(122)
Net litigation income (costs)	29	–	(178)
Interest expense, net	(85)	(87)	(124)
Certain currency exchange rate fluctuations	15	25	27
Other Corporate items	4	(63)	(13)
Consolidated income from continuing operations before income taxes and cumulative effect of accounting change	$ 946	$1,052	$ 493

Assets reconciliation

as of December 31 (in millions)	**2000**	1999	1998
Total segment assets	$6,979	$6,421	$6,265
Unallocated assets			
Cash and equivalents	579	606	709
Deferred income taxes	308	417	583
Insurance receivables	277	417	639
Net assets of discontinued operation	–	1,231	1,275
Other Corporate assets	590	552	402
Consolidated total assets	$8,733	$9,644	$9,873

Geographic information

Net sales are based on product shipment destination and long-lived assets are based on physical location.

as of and for the years ended December 31 (in millions)	**2000**	1999	1998
Net sales			
United States	$3,194	$2,921	$2,609
Japan	485	482	405
Other countries	3,217	2,977	2,692
Consolidated net sales	$6,896	$6,380	$5,706
Long-lived assets			
United States	$1,543	$1,361	$1,250
Austria	294	344	326
Other countries	970	945	869
Consolidated long-lived assets	$2,807	$2,650	$2,445

14 *Subsequent Event*

On February 27, 2001, Baxter's board of directors approved a 2 for 1 stock split of the company's common shares. This approval is subject to shareholder approval of the authorization of additional shares at the company's annual meeting to be held on May 1, 2001.

Baxter's historical earnings per share for the years ended December 31, on a pro forma basis assuming the stock split had occurred as of January 1, 1998, would be as follows (unaudited).

	2000	1999	1998
Pro forma earnings per basic common share			
Continuing operations	$1.26	$1.35	$0.49
Discontinued operation	0.01	0.08	0.07
Cumulative effect of accounting change	–	(0.05)	–
Net income	$1.27	$1.38	$0.56
Pro forma earnings per diluted common share			
Continuing operations	$1.23	$1.32	$0.48
Discontinued operation	0.01	0.08	0.07
Cumulative effect of accounting change	–	(0.05)	–
Net income	$1.24	$1.35	$0.55

15 *Quarterly Financial Results and Market for the Company's Stock (Unaudited)*

years ended December 31 (in millions, except per share data)	First quarter	Second quarter	Third quarter	Fourth quarter	Total year
2000					
Net sales	$1,583	$1,694	$1,687	$1,932	$6,896
Gross profit	687	747	762	867	3,063
Income from continuing operations[1]	191	46	231	270	738
Net income[1]	191	48	231	270	740
Per common share					
Income from continuing operations[1]					
Basic	.66	.15	.78	.92	2.52
Diluted	.65	.15	.77	.90	2.47
Net income[1]					
Basic	.66	.16	.78	.92	2.53
Diluted	.65	.16	.77	.90	2.48
Dividends declared	–	–	–	1.164	1.164
Market price					
High	67.56	72.00	84.75	88.62	88.62
Low	51.81	56.44	69.50	75.75	51.81
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[2]	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[2]					
Basic	.53	.71	.72	.79	2.75
Diluted	.52	.70	.71	.77	2.70
Dividends declared	.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

1. *The second quarter of 2000 includes a $286 million charge for in-process research and development and acquisition-related costs. The fourth quarter of 2000 includes income of $29 million relating to litigation.*
2. *The first quarter of 1999 includes a $27 million charge for the cumulative effect of an accounting change. The fourth quarter of 1999 includes a $19 million in net costs associated with effecting the distribution of the cardiovascular business.*

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, 2001, there were approximately 58,800 holders of record of the company's common stock.

Directors and Executive Officers

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President and Chief Executive Officer Rogers Corporation

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

John W. Colloton
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Martha R. Ingram
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Vice Chairman and Chief Executive Officer MSX International

Monroe E. Trout, M.D.
Chairman of the Board Cytyc Corporation

Fred L. Turner
Senior Chairman McDonald's Corporation

Honorary Director

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

Executive Officers

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

Neville J. Jeharajah
Corporate Vice President Investor Relations and Financial Planning

Harry M. Jansen Kraemer, Jr.[1,2]
Chairman and Chief Executive Officer

Karen J. May
Corporate Vice President Human Resources

Steven J. Meyer[1,2]
Treasurer

J. Robert Hurley
Corporate Vice President Integration Management

John L. Quick
Corporate Vice President Quality/Regulatory

Jan Stern Reed[1,2]
Corporate Secretary and Associate General Counsel

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

Michael J. Tucker
Senior Vice President Human Resources and Communications

Baxter World Trade Corporation

Eric A. Beard
Corporate Vice President and President–Europe, Africa and Middle East

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

Thomas H. Glanzmann[1]
Corporate Vice President and President–Hyland Immuno

Baxter Healthcare Corporation

David F. Drohan
Corporate Vice President and President–Medication Delivery

J. Michael Gatling
Corporate Vice President Global Manufacturing Operations

Alan L. Heller[2]
Group Vice President and President–Global Renal

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

Gregory P. Young
Corporate Vice President and President–Fenwal

1. Also an executive officer of Baxter Healthcare Corporation

2. Also an executive officer of Baxter World Trade Corporation

As of February 28, 2001

Company Information

Corporate Headquarters

Baxter International Inc.
One Baxter Parkway
Deerfield, IL 60015-4633
Telephone: (847) 948-2000
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Stock Exchange Listings

Ticker Symbols: BAX, BXL, bax
Baxter common stock is listed on the New York, Chicago and Pacific Stock Exchanges, on the London Stock Exchange and on the SWX Swiss Exchange. The New York Stock Exchange is the principal market on which the company's common stock is traded.

Annual Meeting

The 2001 Annual Meeting of Shareholders will be held on Tuesday, May 1, at 10:30 a.m. at the Drury Lane Theatre 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:

Equiserve
P.O. Box 2500
Jersey City, NJ 07303-2500

Telephone: (800) 446.2617 / (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 / (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 upon request from:

Equiserve
P.O. Box 2598
Jersey City, NJ 07303-2598

Telephone: (800) 446-2617 / (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-Q*
- *Form 10-K*
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Shareholders may elect to receive future proxy materials and annual reports on-line via the Internet instead of receiving them by mail. To sign up for this service, please go to http://www.econsent.com/bax. When the next proxy materials and annual reports are distributed, you will be supplied with a proxy control number and a link to the Web site where you can cast your proxy vote on-line. Once you provide your consent to receive electronic delivery of proxy materials via the Internet, your consent will remain in effect until you revoke it.

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

Investor Relations

Securities analysts, investment professionals and investors seeking additional investor information should contact:

Baxter Investor Relations
Telephone: (847) 948-4551

Customer Inquiries / General Information

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.

Baxter would like to thank Cornerstone Medical in Wheaton, Illinois, for the use of its facility in taking the photo that appears on the cover of this report.

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Five-Year Summary of Selected Financial Data

as of or for the years ended December 31		**2000**[1,2]	1999	1998[3]	1997[4]	1996[2]
Operating Results *(in millions)*	Net sales	$ 6,896	6,380	5,706	5,259	4,583
	Income from continuing operations	$ 738	779	275	371	505
	Depreciation and amortization	$ 405	372	344	318	269
	Research and development expenses[5]	$ 379	332	323	339	291
Balance Sheet and Cash Flow Information *(in millions)*	Capital expenditures	$ 648	631	556	454	362
	Total assets	$ 8,733	9,644	9,873	8,511	7,407
	Long-term debt and lease obligations	$ 1,726	2,601	3,096	2,635	1,695
	Cash flows from continuing operations	$ 1,233	977	837	472	530
	Cash flows from discontinued operation	$ (19)	106	102	86	108
	Cash flows from investing activities	$ (1,053)	(735)	(872)	(1,083)	(552)
	Cash flows from financing activities	$ (120)	(445)	173	265	216
Common Stock Information	Average number of common shares outstanding (in millions)[6]	292	290	284	278	272
	Income from continuing operations per common share					
	Basic	$ 2.52	2.69	0.97	1.34	1.85
	Diluted	$ 2.47	2.64	0.95	1.31	1.82
	Cash dividends declared per common share	$ 1.164	1.164	1.164	1.139	1.17
	Year-end market price per common share	$ 88.31	62.81	64.31	50.44	41.00
Other Information	Net-debt-to-capital ratio	40.1%	40.2%	48.4%	46.9%	33.8%
	"Operational cash flow" from continuing operations (in millions)[7]	$ 588	588	379	153	341
	Total shareholder return[8]	48.1%	(0.5%)	30.1%	25.9%	13.9%
	Common stockholders of record at year-end	59,100	61,200	61,000	62,900	65,400

1. *Income from continuing operations includes a charge for in-process research and development and acquisition-related costs of $286 million and income from litigation of $29 million.*
2. *Certain balance sheet and other data are affected by the spin-off of Edwards Lifesciences Corporation in 2000 and the spin-off of Allegiance Corporation in 1996.*
3. *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.*
4. *Income from continuing operations includes a charge for in-process research and development of $220 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 24 and is not a measure defined by generally accepted accounting principles.*
8. *Represents the total of appreciation in market price plus cash dividends declared on common shares plus the effect of any stock dividends for the year.*

Baxter

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View this report online at www.baxter.com

Vaccines represent a major growth area for Baxter. The company's acquisition of North American Vaccine Inc. in 2000 enhanced Baxter's presence in the $7-billion global vaccines market—a market that is expected to grow 13 percent annually over the next five years.