# Addressing Critical Healthcare Challenges Worldwide

Baxter International Inc.
2009 Annual Report

Baxter

**About our cover**

Mikai Hall was one of more than 50 infants and children with mild to moderate dehydration that participated in a clinical trial using HYLENEX recombinant (hyaluronidase human injection) to facilitate subcutaneous rehydration as an alternative to intravenous administration of fluids. Baxter introduced HYLENEX for treatment of pediatric hydration in October 2009 and continues to support studies on its use in various clinical applications.

Healthcare needs around the world continue to expand. The challenges faced by healthcare providers, payers and patients are great. In this year's annual report, key opinion leaders from outside Baxter discuss some of the challenges they face in areas of medicine in which Baxter plays a part. These interviews confirm how vital healthcare is as an industry, and the role a company like Baxter can play in helping its customers address some of these critical healthcare challenges.

Baxter's mission is to apply innovative science to develop products that save and sustain patients' lives. This mission drives and motivates Baxter employees around the world, and provides a common purpose to which the company dedicates itself every day.

# A Conversation with Robert L. Parkinson, Jr.

## Chairman and Chief Executive Officer

*When Robert L. Parkinson, Jr., joined Baxter as chairman and chief executive officer in 2004, he defined a series of objectives that laid the groundwork for the company's future success. These included rebuilding Baxter's financial strength, re-establishing credibility with investors, establishing a new leadership team, re-engineering key business processes and, most important, defining a vision for Baxter's future. This vision included a renewed emphasis on innovation to meet healthcare needs worldwide. Over the last five years, Baxter's sales, earnings, cash flow and research investment have reached record levels, creating significant value for shareholders while positioning the company for sustained growth.*

**How would you assess Baxter's performance in 2009?**

Last year was another strong year for our company. Despite tough economic times and significant market challenges, we again met all of our major financial objectives and are well-positioned for continued growth in 2010. Particularly gratifying is how our new product pipeline continues to evolve. Research and development (R&D) is our most important strategic priority, and Baxter has never had a stronger pipeline than we have today. We had 14 pipeline projects in Phase III clinical trials at the end of 2009 compared to just two in 2006.

**Baxter has been able to deliver strong results despite a challenging economic environment. To what do you attribute this?**

While no company is immune to the effects of the global economic environment, we benefit from our diversified healthcare model, strong market positions and the medically necessary nature of our products. Virtually everything we develop, produce and market can mean the difference between life and death for a patient. Our products treat chronic, life-threatening diseases such as hemophilia, end-stage renal disease and primary immune deficiency, or are used in critical care, intensive care and other acute-care settings. As a result, we have not experienced a meaningful impact on demand for our products. In addition, our geographic presence has enabled us to meet the needs of markets outside the United States, where healthcare spending is growing fastest, particularly in developing and emerging countries. As economies in these markets continue to grow, a high priority is placed on healthcare, particularly on treating life-threatening diseases. Our diversification has two components: a business component and a geographic component. Both contributed to our strong results in 2009.

**How does the company balance short- and long-term growth in its strategic planning?**

We do this by being cognizant of both aspects. We're not going to stray from good execution today in our haste to invest for tomorrow, nor will we sacrifice investing in our future just to realize short-term gains. There's no magic formula for how to balance those two dimensions. It's about delivering value to your shareholders today, which can involve things like share repurchases, increasing dividends, growing earnings and supporting a strong stock price, while making prudent investments that ensure sustained growth in the future.

**Baxter continues to invest in R&D at record levels. What are the most significant aspects of Baxter's R&D activity?**

There are a number of projects that represent tremendous opportunities for Baxter, some of which are featured in this report. At year-end, we had approximately 30 projects in our pipeline that have peak-year sales potential of more than a quarter of a billion dollars a year. In total, as I mentioned earlier, this represents the strongest pipeline in the history of our company. We also continue to improve the productivity of new product development so we are able to optimize our R&D investment.

**There seemed to be more balanced growth among Baxter's businesses in the fourth quarter of 2009. Is this a trend you see continuing?**

Yes. In the last few years, strong growth in BioScience has enabled us to make the necessary investments in Medication Delivery and Renal that will allow those businesses to grow faster in the years ahead. We're already starting to see this happen. Medication Delivery just had its strongest year in the five years I've been here, and there are encouraging signs that growth in the Renal business is also accelerating.

**What effect will U.S. healthcare reform have on the company?**

There are two fundamental aspirations to healthcare reform. One is to expand access to healthcare for people who currently lack insurance, and the other is to control healthcare costs. Expanding access to care is positive for our business because it will increase demand for our products. As for cost control, our product development efforts aim not only to improve healthcare quality, but to do so in a way that is also more cost effective. All that said, with the specifics of reform still being debated, it is difficult to predict at this time the exact impact it may have on Baxter.

**With healthcare demand growing fastest in developing and emerging markets outside the United States, is Baxter equipped to meet these needs and take advantage of the growth opportunities they present?**

To the degree demand continues to grow for our products, we'll invest accordingly to meet that demand as long as we can do so profitably. Nearly 60 percent of our sales already come from outside the United States. We do business in more than 100 countries and have local manufacturing in more than two dozen. Given the medically necessary nature of our products, there is great demand for our products in developing markets, where many people with chronic, life-threatening conditions are currently under-treated. The challenge, of course, is how to finance access given the demand. That's the conundrum that all countries of the world are facing. We're prepared to use our global presence to help meet the need for life-saving and life-sustaining therapies anywhere in the world to the best of our ability.

**What are the most significant competitive threats to Baxter on the horizon?**

Conceptually, any technological advancement by a competitor that translates into loss of revenue for one of our products constitutes a competitive threat. Our goal, of course, is to be the company that advances the technology in all of the therapeutic areas in which we currently hold leadership. I think a bigger threat to our business is government regulation that inhibits our ability to innovate, or controls prices in a way that limits our ability to invest. Those aren't competitive threats as much as environmental threats that could affect not just us but the entire industry. Overall, however, I think innovation that makes a meaningful difference in patients' lives will continue to be rewarded.

**What do you find most promising about Baxter's future, both short and long term?**

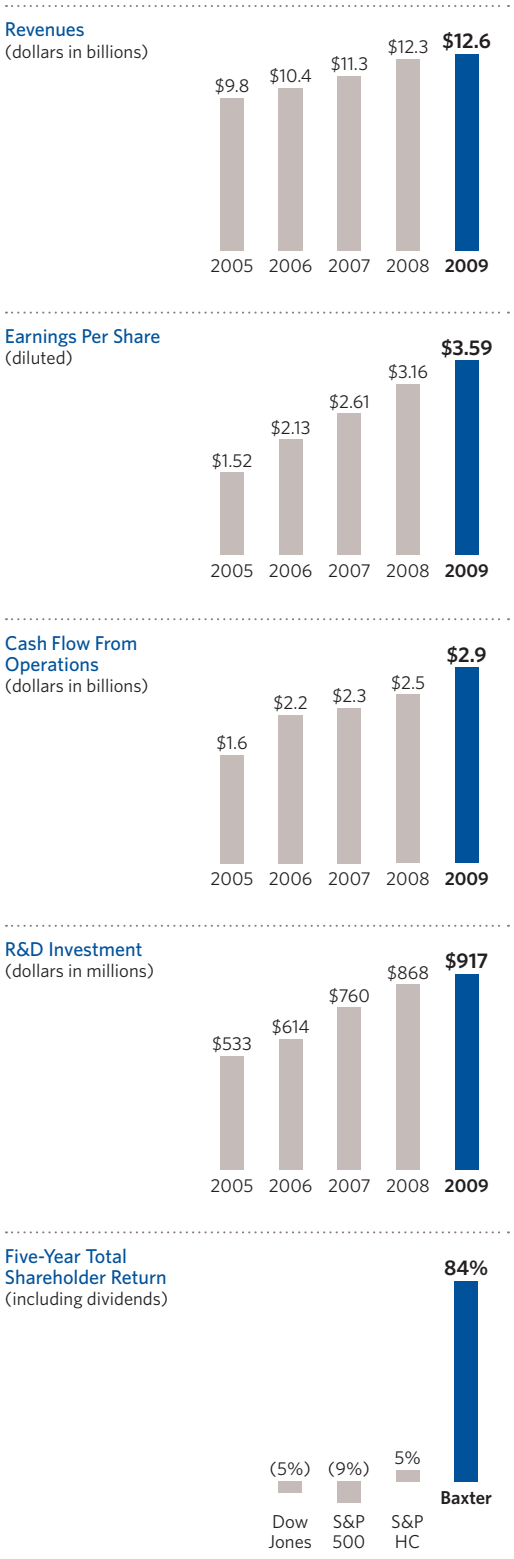
In the short term, it's our ability to continue the success we've enjoyed over the last five years by displaying the same financial discipline and continuous improvement we've seen during this period. Long term, I'm looking forward to two things. One is seeing the market launches of the various products in our R&D pipeline that can advance patient care. The other is identifying ways to accelerate the growth of the company through business development and acquisitions.

**What kind of acquisitions and business development activities might we expect to see going forward?**

While I expect that we'll be more active in this area, this doesn't mean we'll be less disciplined. We're going to continue to be very focused and objective in assessing potential acquisitions and partnerships. We will not do deals for the sake of doing deals. Our primary focus will remain on business development activities that complement or extend businesses we're in today.

**Why is sustainability important to Baxter?**

It's important for many reasons. Sustained financial strength allows us to create jobs, invest in innovation, and bring to market new and improved products that save and sustain lives while rewarding shareholders. Of course, it's also important to do this in a way that is complementary with the needs of society, from increasing access to healthcare to making the planet more environmentally friendly.




### How is sustainability embedded in Baxter's culture?

It starts with our mission, vision and values, and our aspiration to build a truly great company. It also is aligned with our commitment to innovation and bringing to the marketplace products that save and sustain lives. More formally, our creation in 2006 of an executive-level Sustainability Steering Committee to guide our global sustainability efforts further institutionalized sustainability at Baxter and elevated accountability for sustainability across the company and to the highest levels of management. The development of nine sustainability priorities in 2007 was the next step in this process. These priorities define what we consider to be the most important sustainability areas in the company and help us channel our resources where we can maximize our impact. Since then, we've added specific long-term goals for each priority to further clarify our expected progress.

### What are some key areas of focus in Baxter's sustainability efforts?

Sustainability at Baxter is a fundamental part of what we do and what we stand for as a company. We're committed to protecting the environment, operating in a sound and ethical manner, providing a safe and healthy workplace for employees, using our financial resources wisely, and supporting the communities in which we operate, locally and globally. An additional area of focus is expanding access to healthcare. As a healthcare company, we clearly have a role to play in helping bring much-needed healthcare to more patients across the world, both through our business and our community efforts. Much of our community involvement focuses on programs that increase access to healthcare for the poor and underserved. We also do our part in times of crisis, such as in January 2010, when Baxter, The Baxter International Foundation and Baxter employees provided products, funding and other support to victims of the earthquake in Haiti.

### Are there other areas of focus unique to Baxter?

In my view, a healthy and educated public make up the underpinnings of a sustainable society. As a result, supporting education, particularly in math and science, is another of our sustainability priorities. In 2009, Baxter was named "Outstanding Partner" by the Chicago Public Schools (CPS) in recognition of our Science@Work program. Through Science@Work, more than 24,000 CPS students received education in biotechnology and other life sciences in 2009. These efforts, combined with our

other sustainability activities, have earned Baxter much recognition in recent years. In 2009, we were named to the Dow Jones Sustainability Index for the 11th consecutive year and the Medical Products Industry Leader for the eighth time. We also were named to the 100 Best Corporate Citizens list by *Corporate Responsibility Officer* magazine, the eighth time Baxter has been included on this list, and one of the World's Most Ethical Companies by the Ethisphere Institute. In early 2010, Innovest Strategic Value Advisors named Baxter one of the Global 100 Most Sustainable Corporations in the World for the sixth straight year. Baxter is one of only two healthcare companies globally, and the only U.S. healthcare company, to have been recognized in the Global 100 each year since the list was first published in 2005.

**How do you see healthcare changing over the next five years? What do you see as the biggest impacts?**

I think the notion of comparative effectiveness – the relative value of different products and therapies, and how that gets assessed – will have an increasingly greater impact on healthcare in the years ahead. Best-practice standards and evidence-based medicine will play a key role in therapy choice, particularly as patients take more ownership of their healthcare. I think that's the biggest change we're going to see in the next five to 10 years. I also think the setting where care is provided will continue to move from the acute-care environment to lower-cost venues, including the home. Many Baxter products are already used in the home, and this should increase in the years ahead. Finally, I think we're going to see non-physician healthcare providers playing a greater role in providing care to patients, with information technology enabling doctors to continue directing the care.

**Finally, when you say you aspire to make Baxter a "great company," what do you mean?**

It's about continuing to evolve in a way that positions Baxter as an absolute top-tier company. First and foremost, it requires sustained financial strength. In our industry, it also requires that you be an innovator, devoted to continuous improvement, and committed to quality and excellence in everything you do. Other elements of being a great company touch on some of the aspects of sustainability I just mentioned. Being a great company means being a great place to work and develop one's career, creating a work environment where all of our employees derive fulfillment and a sense of purpose from what they do. It means being a good corporate citizen and engaged in the community, both locally and globally. It means being committed to the environment, to increased access to healthcare, and to a diverse and inclusive culture that embraces differences and respects the contributions of all. This is our aspiration, a guiding light that drives everything we do. Based on the talent, devotion and commitment of the nearly 50,000 men and women of Baxter worldwide, it's an aspiration I believe we will attain.

**Dear Shareholders**

In the following pages, you will hear patients, customers and thought leaders from around the world talking about some of the challenges they face in areas of healthcare in which Baxter participates, and how Baxter is helping to address a number of these challenges. This includes updates on some of our most important research and development initiatives.

We continue to accelerate our investment in R&D to bring new and improved products to market that save and sustain lives. We also continue to expand geographically to meet the ever-increasing need for our therapies in developing and emerging markets. As I've said on numerous occasions, we at Baxter are privileged to work in an industry where what we do benefits so many people in such a profound way.

I hope you find this year's annual report to be informative and useful to you as a Baxter shareholder. Perhaps you will gain new insight into the role we play in advancing patient care around the world, and the role we will continue to play as the products in our R&D pipeline are brought to market. We've made great progress on a number of fronts over the last five years. I remain confident that we will continue to grow and create additional shareholder value in the years ahead.

Robert L. Parkinson, Jr.
Chairman and Chief Executive Officer

February 22, 2010

## Q1 2009

- Baxter announces 2008 financial results, achieving record sales, earnings and cash flow for the year.
- *Corporate Responsibility Officer* magazine ranks Baxter 19th in its "100 Best Corporate Citizens" list. It is the eighth year Baxter has been included on the list since it was developed in 2000.
- Baxter is named to the "Global 100 Most Sustainable Corporations in the World" list by Innovest Strategic Value Advisors. Baxter is one of two healthcare companies globally, and the only U.S. healthcare company, to be recognized each year since the list was first published in 2005.
- Baxter's U.S. Renal Homecare Services receives "International Service Excellence Award" from International Council of Customer Service Organizations.
- *Fortune* recognizes Baxter as one of the "World's Most Admired Companies" based on a survey of top executives, directors and members of the financial community.
- Baxter receives Catalyst Award for its "Building Talent Edge" program, which created a 50/50 gender balance in executive and management positions across 14 countries in Baxter's Asia-Pacific region.
- *Institutional Investor* names Baxter "Most Shareholder Friendly Company" in Medical Supplies and Devices sector.

## Q2 2009

- Baxter enters into exclusive agreement with Sigma International General Medical Apparatus, LLC (SIGMA), enabling Baxter to provide SIGMA SPECTRUM large-volume intravenous infusion pumps to customers and granting Baxter access to SIGMA's product-development pipeline.
- Baxter holds its Annual Meeting of Shareholders in Chicago.
- Company issues its 10th annual sustainability report on its social, economic and environmental performance. The report features Baxter's commitment to addressing sustainability challenges through a range of initiatives, with an emphasis on the progress the company has made toward its sustainability priorities and goals.
- Baxter begins full-scale production of a commercial H1N1 vaccine using its Vero cell-culture technology.
- Ethisphere Institute includes Baxter on its list of the "World's Most Ethical Companies." It is the second time Baxter is named to the list, which was established in 2007.
- Baxter initiates a Phase III study evaluating TISSEEL fibrin sealant as a hemostatic agent in vascular surgery.
- Baxter agrees to acquire certain assets related to the Continuous Renal Replacement Therapy (CRRT) business of Edwards Lifesciences Corporation.



## Q3 2009

- Baxter and Flamel Technologies announce collaboration to formulate longer-acting forms of blood-clotting factors.
- Baxter and Halozyme Therapeutics, Inc., announce completion of patient enrollment in pivotal Phase III trial for subcutaneous administration of GAMMAGARD LIQUID Immune Globulin Intravenous.
- Baxter named to Dow Jones Sustainability Index for the 11th consecutive year and the Medical Products Industry Leader for the eighth time.
- Company completes Phase III confirmatory study of seasonal influenza vaccine in the United States.
- Baxter begins Phase III study on use of ARTISS fibrin sealant in facial surgery in the United States.
- Baxter technology partner DEKA files an Investigational Device Exemption with the U.S. Food and Drug Administration for a new Baxter home hemodialysis system.
- Baxter opens new headquarters in Zurich, Switzerland, for its Europe, Middle East and Africa (EMEA) region. The headquarters was designed and built using the latest energy-efficient and sustainable building concepts.
- *Newsweek* ranks Baxter 35th in its inaugural Green Rankings of the 500 largest U.S. companies.
- Baxter's plasma fractionation facility in Los Angeles becomes the first biologics facility to win the Shingo Bronze Medallion for Operational Excellence.

## Q4 2009

- Baxter announces the commercial launch of HYLENEX recombinant (hyaluronidase human injection) in the United States for use in pediatric hydration, providing a subcutaneous alternative to intravenous administration of fluids.
- The European Commission grants marketing authorization for CELVAPAN H1H1 pandemic vaccine. It is the first cell culture-based and non-adjuvanted vaccine to receive marketing authorization in the European Union.
- Baxter's Asia-Pacific region surpasses 50,000 peritoneal dialysis (PD) patients. China, Taiwan and Southeast Asia contribute the most growth in the region, where Baxter expects the number of PD patients to reach 100,000 within five years.
- Baxter's Aibonito, Puerto Rico, manufacturing plant is named one of the "20 Best Employers in Puerto Rico" based on a study sponsored by Hewitt Associates and PricewaterhouseCoopers, LLP.
- Baxter's FLEXBUMIN product – the first and only albumin in a flexible, plastic container – receives carbon footprint certification from the Carbon Trust.
- The Chicago Public Schools (CPS) names Baxter an "Outstanding Partner" for the company's Science@ Work program. The program is aimed at providing enhanced science education opportunities for CPS students and teachers focused on biotechnology.

## A Pioneer in Healthcare

Baxter's history of medical "firsts" is significant. It includes the first commercially manufactured intravenous solutions, the first commercial kidney dialysis machine, the first concentrated clotting factor to treat hemophilia and many other breakthroughs. More recent "firsts" include the first recombinant factor VIII for hemophilia produced without any blood additives, and the first cell culture-derived pandemic flu vaccine.

## Life-Saving Products

Baxter products are used to provide critical, life-saving and life-sustaining therapies. No matter where one lives in the world, patients with hemophilia, end-stage renal disease, primary immune deficiency and a range of other diseases depend on Baxter products. This creates a common purpose among Baxter's nearly 50,000 employees worldwide: to save and sustain lives.

## Scientific Capabilities

Innovation is the driving force behind Baxter's success. The company is a technology leader in the development of recombinant and plasma-derived therapeutic proteins, intravenous and dialysis solutions, drug packaging and delivery systems, and many other areas. Baxter's businesses share expertise in medical plastics, biologics, sterilization and other scientific disciplines to create life-saving products.

## Global Scope

Baxter products are sold in more than 100 countries, with approximately 60 percent of the company's revenues coming from outside the United States. Sales are growing rapidly in developing and emerging markets, where many people with life-threatening conditions currently are under-treated. As the economies of these countries continue to develop, so will Baxter's opportunity for growth in these regions.

## Manufacturing Strength

Baxter's manufacturing strength and commitment to quality are foundations of the company, built on more than 75 years of leadership in healthcare. With 55 production facilities in 27 countries, proprietary technologies, and complementary manufacturing platforms across all of its businesses, Baxter is able to manufacture high-quality products cost-effectively for local and regional markets.

## A Socially Responsible Citizen

Part of being a great company is being a responsible corporate citizen. Baxter gives back to the communities it serves through environmental stewardship, employee volunteerism, corporate giving and other initiatives. Baxter is a recognized leader in corporate sustainability, the company's long-term approach to balancing its business priorities with its social, economic and environmental responsibilities.

# A Conversation with Mark Skinner

## President of World Federation of Hemophilia Discusses Disparities of Care Worldwide

*As president of the World Federation of Hemophilia (WFH), Mark Skinner is a tireless advocate of treatment for all people living with bleeding disorders worldwide. Before becoming president of WFH in 2004, Skinner served as president of the U.S. National Hemophilia Foundation (NHF), where he was the inaugural recipient of the NHF Distinguished Leaders Award in 2003 and was named their Humanitarian of the Year. He also is a member of the NHF's Medical and Scientific Advisory Council.*

**What is the role of WFH in addressing the needs of people with hemophilia worldwide?**

The WFH is an international nonprofit organization founded in 1963. It is made up of 113 national member organizations, which gives us a broad network of medical and lay volunteers, all focused on our vision of treatment for all. We do this through a range of development programs, activities and educational resources. But our core mission is to improve quality of and access to care for people with inherited bleeding disorders throughout the world.

**What is the Global Alliance for Progress (GAP) program? What role does Baxter play in this program?**

GAP is a 10-year program established by WFH in 2003. The GAP program seeks to close the gap between developed and developing countries in diagnosing hemophilia, reducing childhood mortality and expanding access to treatment. Over this 10-year time frame, we hope to develop sustainable national care programs in up to 30 countries. Today, there are 16 countries enrolled in all regions of the world. We work with governments, providers and patient groups to build the care delivery system, improve medical expertise and diagnosis, and enhance the quality of therapy for people with hemophilia in these countries. Through GAP, we're putting hemophilia on the national health agenda where it did not exist before, and with the support of the health ministries, we think these care programs will be sustainable long after our development work concludes. Baxter is the founding sponsor of GAP and donates treatment product to help launch national hemophilia care programs in GAP countries.

**What are the greatest challenges facing people with hemophilia today?**

Today, 70 percent of the estimated 400,000 people living with hemophilia around the world are not yet diagnosed. And of those that are, 75 percent are not receiving what we would consider adequate treatment. When I was growing up in the United States, treatment didn't exist. Clotting factor concentrates hadn't been invented. So many children simply died young or would grow up severely disabled. That's the cycle that we're trying to prevent in developing countries today. So the challenge becomes one of education and outreach. Then once this groundwork is laid, the focus becomes access to treatment, including affordability of therapy. From a safety perspective, 20 years ago the biggest challenge was viral contamination of therapies. That has now been dramatically reduced. Through the hard work of many, including the leadership

of companies like Baxter, this is no longer a threat to the patient population. Today, a bigger safety threat is inhibitor development, which is when the body rejects the clotting factor concentrate.

**Is inhibitor development a bigger problem today than in the past?**

I think it's becoming a more recognized problem. It's particularly significant for patients with severe hemophilia A. Anywhere from 20 to 40 percent of patients with severe hemophilia A in the world are at risk of developing an inhibitor during their lifetime. Baxter makes an effective therapy for inhibitor patients. Even better would be a way to prevent inhibitor development.

**What can companies like Baxter do to improve life for people with hemophilia and address disparities in care around the world?**

Most important is to take a long-term view of its partnership with the hemophilia community. Baxter has always demonstrated leadership in research and development to enhance current therapies. While we have wonderful therapies today, we still don't have a cure, and the therapies we have still require infusions two or three times a week, which can be costly. So we're still looking for enhanced therapies that would reduce the burden on daily living and make treatment more affordable and accessible for more patients in more parts of the world. Ongoing investment in evidence-based medicine is also crucial. We need to build a body of science that will identify optimal dosing protocols, improve treatment regimens and support comprehensive care.

## Patient Spotlight: Jhon Amaya Mendoza

Twelve-year-old Jhon Amaya Mendoza lives in the town of Barranquilla, in northern Colombia. When he was nine months old, he was diagnosed with hemophilia A, a lifetime condition in which his body does not produce enough "factor VIII," a blood protein critical to clotting. In 2009, Jhon began using ADVATE, the world's most chosen recombinant factor VIII therapy, to prevent spontaneous, uncontrolled bleeding.

Colombia is one of five additional countries in which ADVATE recombinant factor VIII therapy was approved in 2009. Geographic expansion is an important element of Baxter's growth strategy for the hemophilia business. At year-end, ADVATE recombinant factor VIII therapy was approved in 49 countries.

### Advancing New Treatments to Improve Patient Outcomes

Baxter continues to innovate to expand its leadership in developing products to treat bleeding and clotting disorders. These new treatments will address unmet market needs in the areas of improved efficacy, viral safety and compliance. A rigorous preclinical program focuses on development of a longer-acting recombinant factor VIII molecule, as well as non-intravenous hemophilia therapies.

In 2009, Baxter began clinical research on a potential oral therapy for patients with hemophilia. The compound, BAX513, was acquired from Avigen, Inc. in late 2008. It has been shown to improve blood coagulation in early preclinical models and is being investigated as adjunctive therapy for patients receiving factor concentrates.

Baxter also continues to make progress in its development of the first recombinant therapy for people with von Willebrand Disease (VWD). Patients with VWD lack sufficient amounts of normal von Willebrand factor (VWF), a protein critical to clotting. VWD is the most common inherited bleeding disorder, affecting one to two percent of both males and females. Baxter's recombinant VWF is the only recombinant replacement protein for VWD currently in clinical studies.

# A Conversation with Dr. Beatriz Tavares Costa Carvalho

## Leading Immunologist Discusses Diagnosis and Treatment of Primary Immune Deficiency

*In 2009, the first Jeffrey Modell Diagnostic Center for primary immune deficiency (PID) in Latin America opened in Brazil at the Federal University of São Paulo. Dr. Beatriz Tavares Costa Carvalho, adjunct professor of allergy, immunology and rheumatology for the pediatric department at the university, is a leading advocate for increased diagnosis and treatment of patients with PID, a genetic condition in which the body does not produce enough antibodies to fight infection.*


**What causes PID?**

It's a genetic disease. We call it primary immune deficiency but there are more than 200 different primary immune deficiency diseases. The parents are usually healthy because it's recessive. So the parents can be totally healthy yet be carrying the genes that would cause their offspring to have PID. This is one reason why it's hard to detect.

**What are the greatest challenges in treating patients with PID?**

The biggest challenge, before treatment, is diagnosing these patients. Many physicians in Brazil are not aware of PID. So increasing awareness is our major goal. We also have few laboratories that test for PID, making diagnosis even more difficult.

**How are you trying to raise awareness among physicians in Brazil?**

I've been involved with the Latin American Society for Immune Deficiency since its inception. We hold regular meetings and conferences at which we educate physicians on the warning signs and other information on PID. In 2001, I began coordinating an educational program on PID in Brazil. Also at that time, the Brazilian Group for Immune Deficiency was established and we formed a group of clinical immunologists that is increasing in number each year, resulting in increased PID diagnoses.

**What role will the new Jeffrey Modell Center play?**

The opening of the new Jeffrey Modell Center in Brazil, with support from Baxter, also will help us promote awareness of the disease. Baxter and the Jeffrey Modell Foundation (JMF) are long-standing partners in establishing diagnostic centers to raise awareness and increase diagnosis of PID globally. Baxter has sponsored a number of JMF centers worldwide, including providing a grant for the center in Brazil. The JMF diagnostic center in São Paulo is expected to be the first in a growing network of centers in Latin America focused on the diagnosis and treatment of people with PID.

**How long, from the onset of symptoms, does it usually take for a patient with PID to be diagnosed with this condition?**

It depends on the type of primary immune disease. For XLA (X-Linked Agammaglobulinemia), a primary immune disease specific to boys in which symptoms present very early in life, the mean delay in diagnosis in our clinic is about five years. For CVID

(common variable immune deficiency), in which symptoms often don't present themselves until the patient is an adult, the delay can vary from one to 15 years with a mean delay of seven years in our clinic. It's harder to diagnose PID in someone who has been normal and healthy their whole life, then suddenly gets recurrent infections, versus someone who, from the time they're born, gets sick all the time.

**Why does it take so long to diagnose PID?**

Everyone gets sick, so there needs to be an abnormal frequency of pneumonia, sinus infections, ear infections and other relatively common ailments before one would link these incidents with PID. Physician unawareness of PID also results in a high frequency of patients with "sequels," in which repetitive ailments cause increasing damage to the body that gets worse over time. Because these patients aren't being treated for PID, the frequency with which they're getting sick could lead to permanent damage. The most tragic case is when the person's condition gets so bad that they die before they are diagnosed.

**What is the economic case for better diagnosis and treatment of people with PID?**

When you misdiagnose a patient and provide inadequate therapies and drugs, the cost to the health system can be great due to emergency room visits, hospitalizations and so forth. If patients were diagnosed and treated earlier, fewer complications would arise.

## Patient Spotlight: Bas and Koen Iking

For the first five years of his life, Bas Iking was sick frequently. He had pneumonia several times. No one knew the cause until his brother Koen was born. At three months, Koen developed a fever that wouldn't go away. Doctors did a blood test and discovered his immune system lacked sufficient antibodies to fight infection. He was diagnosed with primary immune deficiency (PID). Bas was then tested and also diagnosed with PID.

Today, the brothers, both born and raised in the Netherlands, are 31 and 27 years old. Koen, an actor, lives in Amsterdam, and Bas, a chemistry teacher, in Amersfoort. Every four weeks, they get together at Bas's house and self-infuse KIOVIG Human Normal Immunoglobulin, which provides the immune globulins, or antibodies, they need to stay healthy. KIOVIG is marketed as GAMMAGARD LIQUID Immune Globulin Intravenous in the United States.

### Baxter Advances Studies on Use of IGIV to Treat Alzheimer's Disease

In 2009, Baxter advanced a Phase III clinical trial of GAMMAGARD LIQUID Immune Globulin Intravenous (IGIV) as a possible treatment for Alzheimer's disease. Building on earlier studies showing promising results, the latest trial will include 360 patients with mild to moderate Alzheimer's disease at more than 40 sites in the United States and Canada. Study results are expected in the latter half of 2012.

GAMMAGARD LIQUID IGIV therapy is a highly purified immunoglobulin preparation that contains a broad spectrum of antibodies. These include antibodies directed against a protein known as beta amyloid. A leading theory on the cause of Alzheimer's is that deposits of beta amyloid build up in the brain, disrupting nerve function. It is thought that antibodies in IGIV may be able to protect the brain from the toxic effects of beta amyloid.

Baxter also is in Phase III trials evaluating GAMMAGARD LIQUID IGIV therapy to treat multifocal motor neuropathy (MMN), a neurological disorder characterized by progressive limb weakness.


# A Conversation with Dr. Antonio Finelli

## Urologic Oncologist Discusses Use of FLOSEAL [Hemostatic Matrix] in Surgery

*Dr. Antonio Finelli is a urologist for the University Health Network in Ontario, Canada. The network consists of three hospitals: Toronto General Hospital, Princess Margaret Hospital and Toronto Western Hospital. Dr. Finelli's specialty is urologic oncology. Most of his work involves the surgical removal of cancerous tumors in urological organs. He uses Baxter's FLOSEAL as an adjunctive hemostatic agent to control bleeding in these procedures.*

**What kinds of surgeries do you perform as a urologic oncologist?**

For patients with cancer of the kidney, bladder, prostate or other urological organs, we either remove the entire organ, or if it's a small tumor, just part of the organ. The most common procedures I perform are radical prostatectomy and partial nephrectomy. A partial nephrectomy involves removal of a portion of the tumor-bearing kidney, as opposed to removal of the entire kidney, which is a radical nephrectomy. We aim to preserve kidney function in our patients, so we perform partial nephrectomy in as many cases as possible.

**Are these open or minimally invasive procedures?**

The majority of the surgery I do is minimally invasive, either laparoscopic or robot-assisted laparoscopic. During laparoscopy, you have several small ports going into the body that range from a half-centimeter to a centimeter in diameter. We introduce a camera through one, and long narrow instruments through the others. Surgery is then performed while viewing the monitor rather than the area of interest directly.

**What's involved in performing these procedures?**

Whether it's laparoscopic or open surgery, we must mobilize the entire kidney, clamp the artery and/or vein, excise the tumor and suture the major blood vessels. I then apply FLOSEAL to achieve hemostasis (stoppage of bleeding) of any remaining, active bleeding, irrigating away excess product before unclamping the blood supply. The kidney is a very vascular organ. Approximately 20 to 25 percent of your heart's output flows through the kidneys, which filter your blood. If you don't clamp the blood supply to the kidneys, it will bleed to the point of hemorrhage and the patient could die. In addition, the longer the kidney is clamped, the more kidney function is lost because there's no oxygen getting to the organ. Ideally we aim for a clamp time under 20 to 30 minutes. Thus, we strive to clamp the artery, excise the tumor, reconstruct the kidney and unclamp in 20 minutes to achieve the goals of cancer control, preservation of renal function and avoidance of complications such as hemorrhage or urine leak.

**What role does FLOSEAL [Hemostatic Matrix] play?**

FLOSEAL is applied to promote hemostasis during the surgery. One feature of the product that makes it effective is its consistency. Rather than coming out as a slimy liquid, it has a slurry consistency, such that it fills in all the little crevices where you wish to achieve hemostasis. It's also convenient because it's quick to prepare, basically premixed. Obviously its hemostatic properties are most important.

**When did you first start using the product?**

After my residency, I did a fellowship at the Cleveland Clinic, where I received advanced training in minimally invasive surgery. That's where I was introduced to FLOSEAL. I returned to Toronto and began my surgical practice at the University Health Network (Princess Margaret and Toronto General hospitals) at the University of Toronto. Once the product became available in Canada, I went out of my way to make sure we had FLOSEAL in our hospital. I wrote a proposal and cost-justification for it because of the value I think it provides when performing a hemostatic partial nephrectomy.

**How much does FLOSEAL [Hemostatic Matrix] reduce hemorrhaging compared to suturing alone?**

In more than one study, it's been demonstrated that if you use FLOSEAL in addition to sutures, bleeding can be controlled. In my experience and through discussion with other surgeons, the use of FLOSEAL has significantly reduced the risk of intra-operative hemorrhage in patients undergoing partial nephrectomy. The added hemostasis also allows one to move more efficiently through the excision and reconstruction, reducing warm ischemia time without increasing complications. Lastly, along with experience, it has facilitated the application of laparoscopy to more complex tumors.

### Innovation in BioSurgery

The products in Baxter's BioSurgery portfolio are biologics and devices used to stop bleeding and seal wounds in surgery. Research efforts combine these technologies with those of technology partner Kuros AG to develop products aimed at bone and soft-tissue repair.

A key technology from Baxter in these development efforts is ARTISS, a slow-setting fibrin sealant. In addition to demonstrating tissue-adherence properties in burn grafting, ARTISS has potential to be used as a delivery matrix to deliver growth factors or hormones to cells. While the growth hormones themselves are not proprietary, the technology provided by Kuros that is used to link them to the fibrin is. Baxter believes this technology has promise in a number of areas, including orthopedics.

Other research and development efforts in BioSurgery are focused on broadening indications for existing products such as TISSEEL fibrin sealant, COSEAL surgical sealant and ARTISS, and improving ease-of-use of these products. This includes prolonging room-temperature stability, expanding the range of formulations and introducing new delivery devices.


# A Conversation with Professor John Oxford

## World Renowned Influenza Virologist Discusses H1N1 Pandemic

*John Oxford is professor of virology at St. Bartholomew's and The London School of Medicine. His research in the pathogenicity of influenza has been featured in numerous scientific papers and media outlets throughout Europe and the United States. In this interview, he talks about the H1N1 pandemic, seasonal flu, Baxter's Vero cell technology and the future threat of emerging pathogens.*

**Without getting too technical, what's the difference between H1N1 and seasonal flu?**

They have a different genetic structure, for one thing. H1N1 is much more complicated genetically. The H1N1 virus has genes from pigs and birds as opposed to seasonal flu viruses, which are purely human in nature. H1N1 also appears to be more virulent and spreadable than seasonal flu. And, of course, last year the World Health Organization (WHO) declared H1N1 a pandemic, which occurs when a new flu virus emerges against which people appear to have no immunity, and which spreads at an abnormal rate across the human population.

**How important is early availability of vaccine during a pandemic?**

The earlier a vaccine is available, the better. You want to start getting people vaccinated as soon as possible. A few weeks can make all the difference between vaccinating people after or during the outbreak, and doing it beforehand. Of course, the more deadly the virus, the more important this is. In 1918, a global influenza pandemic killed as many as 100 million people worldwide. Currently, the H1N1 virus does not appear to be as deadly, although there have been numerous deaths reported, so we should not minimize its severity. With

people having no immunity against the virus, vaccination is still important, particularly among the most at-risk groups. These include people with chronic conditions such as obesity, diabetes, immune deficiencies and heart or lung problems, as well as certain age groups.

**With the world getting "smaller," with more people on the planet and increased air travel, are emerging pathogens a bigger threat today than in the past?**

Yes. There are more of us than ever before, and more animals and birds in the world than humans. These domesticated birds and animals are often the gateway for the movement of known and unknown viruses into the human population. You have to have a gateway. The destruction of forest areas, causing people to move into areas they wouldn't move into before, along with global travel, also create more opportunities for agents to emerge and then spread. But on a more positive note, we're also better prepared than we've been in the past.

**What's the difference between Baxter's H1N1 vaccine and others that you're familiar with?**

The biggest difference, of course, is that it is not egg-based. Most influenza vaccines have traditionally been produced in fertilized hens' eggs. Cell-based vaccine production has some advantages over traditional egg-based production methods.

**What are some of these advantages?**

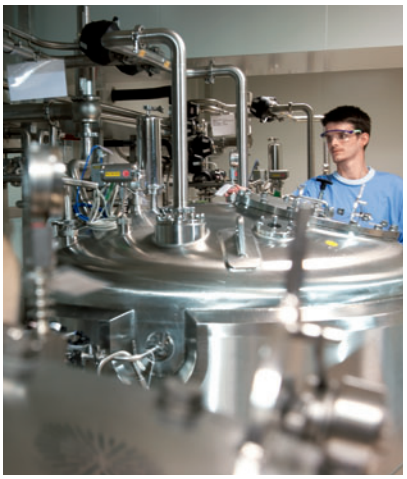
The big advantage is that, in theory anyway, it's faster to produce vaccine in cell culture than it is with fertilized hens' eggs. I think the purification is another big advantage. It's easier to purify a virus grown in cell culture than one grown in eggs. And, some people are allergic to eggs. So that's a third advantage.

**What else impresses you about Baxter's technology?**

I like the fact that Baxter's H1N1 vaccine is a whole virus vaccine. You also don't need any adjuvant, or chemical additives, with this vaccine. I believe that Baxter's Vero cell technology platform has potential beyond flu vaccine. You can grow other viruses on those Vero cells. So with a single platform, Baxter can contribute to society in ways beyond flu vaccine with this technology.

**What's your outlook on the future with regard to H1N1 and other emerging viral health threats?**

As I alluded to earlier, I think the future looks a little on the bleak side with regard to emergence. But I've been encouraged by some aspects of the international cooperation and collaboration this pandemic has brought about. Various companies like Baxter rushed to make this vaccine. There was cooperation between government labs, WHO and individual nations that we'd not seen since the smallpox eradication campaign. I think that's something we can build on in the future.



### CELVAPAN: Baxter's H1N1 Pandemic Vaccine

In 2009, Baxter received European Commission approval for its CELVAPAN H1N1 pandemic influenza vaccine. CELVAPAN is the first cell culture-based, non-adjuvanted, preservative-free pandemic influenza vaccine to receive marketing authorization in the European Union.

Baxter was able to develop and produce commercial quantities of the vaccine within 12 weeks of receiving the virus strain from the U.S. Centers for Disease Control and Prevention in May 2009.

The CELVAPAN vaccine is produced using Baxter's Vero cell technology, which is based on cell-culture manufacturing and other technical capabilities that offer advantages over egg-based vaccine production methods. These include more rapid production, which can be critical in the event of a pandemic. The vaccine is produced at Baxter's vaccine production facility in Bohumil, Czech Republic.

# A Conversation with Dr. Coburn Allen

## Investigator in Clinical Trial Discusses Subcutaneous Rehydration of Infants and Children

*Coburn H. Allen, MD, is assistant professor of pediatrics at Baylor College of Medicine in Houston, Texas. Dr. Allen, who specializes in emergency medicine and infectious diseases, was the principal investigator of the clinical trial on Recombinant Human Hyaluronidase-Enabled Subcutaneous Pediatric Rehydration, which was published in the October 5, 2009, issue of the pediatric journal,* Pediatrics.

**What causes dehydration in children?**

Most dehydration in children is due to viral gastrointestinal infections, the most common of which historically has been Rotavirus, which causes extreme diarrhea. Other common causes are respiratory infections that lead to poor intake of fluids, and overheated children, which we see a lot in summer.

**What is the typical treatment for a pediatric patient that shows up at the emergency room dehydrated?**

Typically, if it's mild to moderate dehydration, we try to rehydrate orally first, and might augment that with medications for nausea and vomiting. If that doesn't work or the child is more severely dehydrated, physicians have historically administered fluids intravenously. Traditionally, the more dehydrated the child, the more often physicians will opt for intravenous (IV) administration.

**What are some of the challenges in trying to give pediatric patients an IV?**

Children have more difficult venous access than adults because they have small, fragile veins that also are more "wiggly" and therefore are moving targets. In addition, children have a tendency to pull out their IVs and have a lot of fat in their subcutaneous space, often hiding their veins. In our ER, it takes an average of about 30 minutes and 2.2 sticks to get an IV in a child. And this isn't just dehydrated kids, but all pediatric patients. It's even more difficult to get IV access in a dehydrated child because their veins are even smaller because they're not full of fluid. This whole experience is probably the most painful thing the child will go through during their hospitalization. It often takes two or more people holding a child down to get IV access.

**How does the HYLENEX recombinant (hyaluronidase human injection) technology work?**

A parent comes in with a child suffering from dehydration. Often the child would receive fluids intravenously to rehydrate. This technology provides a subcutaneous alternative. We insert a small IV catheter in the upper back underneath the skin without looking for a vein. We just insert it in the subcutaneous space. Then we immediately inject the HYLENEX and within a minute or two begin the infusion of fluids. The HYLENEX makes the tissue beneath the skin more permeable, allowing the fluids to be readily absorbed into the bloodstream.

**Could you describe the first trial using HYLENEX recombinant (hyaluronidase human injection) to facilitate subcutaneous rehydration in children with mild to moderate dehydration?**

We took 51 children with mild to moderate dehydration and offered them this new technology after they were unable to adequately hydrate themselves orally. The vast majority were able to be hydrated in a very short period of time and the hydration's success rate compared favorably to previous trials of IV or oral rehydration. In most cases, the catheter was inserted within a minute and the infusion of fluids started within a couple of minutes, compared to 20 to 40 minutes to get IV fluids started. We were excited to see how simple, accepted and effective it was.

**What does the next trial seek to measure?**

The second trial does a direct comparison of this technique to IV therapy. As a researcher, I know that until you have head-to-head trials like this, you may not change people's minds about the safety, efficacy and acceptance of this technique.

**What exactly are you comparing head-to-head in this second trial?**

One thing we're measuring is if we can give comparable volumes of fluid with this technique. We're also comparing clinical effectiveness using a rehydration scale, or scoring system, that measures things like urine output, tear production, heart rate, alertness and other parameters. And we're asking a lot of questions of the clinicians and parents or caregivers about what they think of these techniques.

## Patient Spotlight: Mikai Hall

In March 2009, five-month-old Mikai Hall came down with a severe bout of stomach flu. Vomiting and diarrhea caused her to become dehydrated, requiring a visit to the emergency room at Children's Healthcare of Atlanta. At the hospital, Mikai's mother, Rekina, learned that Mikai needed intravenous (IV) fluids for rehydration. As a nurse, Rekina was uneasy. "I knew that sometimes it takes multiple needle sticks to insert and start an IV, especially when someone is dehydrated," Rekina says.

Dr. Philip Spandorfer, an emergency medicine physician at the hospital, told Rekina about HYLENEX recombinant (hyaluronidase human injection), which allows fluids to be administered subcutaneously, or under the skin, as an alternative to IV therapy. Rekina chose this approach. "I was able to hold Mikai in my arms as the needle was inserted under the skin in her back and fluids were administered. She actually fell asleep during the procedure."

When Mikai awoke, she was no longer fussy and started to produce tears and wet diapers — signs of rehydration. "If ever faced with this situation again, I would definitely opt for HYLENEX," Rekina says. "I'd also recommend it to other parents as an alternative to an IV."

### Baxter, Halozyme Pursue New Opportunities

HYLENEX recombinant (hyaluronidase human injection), indicated to increase the spreading and absorption of subcutaneously injected fluids and drugs in the body, is the result of a collaboration between Baxter and Halozyme Therapeutics, Inc. Baxter introduced the product for treatment of pediatric hydration in October 2009 and continues to support studies on its use in various clinical applications.

Baxter also has an agreement to apply Halozyme's proprietary Enhanze Technology to develop a subcutaneous route of administration for Baxter's GAMMAGARD LIQUID Immune Globulin Intravenous (IGIV). The registration study achieved full patient enrollment in July 2009 and should be completed by the end of 2010. Currently approved for administration through intravenous infusion, GAMMAGARD LIQUID IGIV therapy provides antibody-replacement for people with immune deficiencies.

# A Conversation with Dr. James Philip

## Leading Anesthesiologist Discusses Clinical and Economic Challenges in General Anesthesia

*James H. Philip, MEE, MD, CCE, is an anesthesiologist and director of anesthesia bioengineering for Brigham and Women's Hospital in Boston. He also is an associate professor of anaesthesia at Harvard Medical School. As an anesthesiologist and biomedical engineer, Dr. Philip understands the value of technology in improving the field of inhalation anesthetics, a $1.3 billion global market.*

**The safety of general anesthesia has been a concern over the years. How safe is general anesthesia today?**

In the 1980s, we came up with some new monitoring techniques to make general anesthesia safer. Before 1980, bad outcomes occurred in approximately one in every 3,000 patients. By 1990, it was reduced to one in 300,000 patients. By bad outcomes, I mean patients not waking up or waking up with some serious complication.

**What are the main clinical and economic challenges of practicing anesthesia today?**

The main clinical challenge is providing sick patients about to go through surgery with a general anesthetic that renders them capable of being operated on safely, then returning them to as close to normal as possible as quickly as possible. The economic challenge is that hospitals are exerting pressure on us to reduce the cost of anesthesia. But they're looking specifically at the cost of drug acquisition rather than the economic benefits of some agents that may result in better outcomes, such as shorter hospital stays, and the relationship between the anesthetic and time of recovery.

**What advantages do inhalation anesthetics provide over intravenous (IV) anesthetics?**

With IV anesthetics, it's more difficult to control the level of drug in the patient's blood, and they do not dissipate as quickly from the bloodstream, lengthening

recovery time. With inhaled anesthetics, the concentration of drug in the blood can be controlled on a breath-by-breath basis. Upon administration, the blood level rises almost immediately and the brain level just a few minutes later, so the patient is anesthetized in a very short period of time. When we turn that drug off – that is, stop delivery of the anesthetic – we get rapid reduction in the level of drug in the blood and brain, leading to rapid awakening.

**Baxter provides all three modern inhaled anesthetics – SUPRANE (desflurane, USP), sevoflurane and isoflurane. How do patient recovery times differ with each?**

Patient recovery is fastest with desflurane, followed by sevoflurane and isoflurane. With isoflurane, when we turn off the drug, the level in the patient's blood drops approximately 40 percent right away and continues to fall slowly thereafter. Within 15 minutes the patient will awaken to where we can remove whatever breathing assistance had been provided and take the patient to the post-anesthesia care unit. Sevoflurane and desflurane have lower solubility, so they have lower concentrations in the patient's blood, allowing patients to awaken and recover more quickly. After discontinuing sevoflurane, the blood level falls 55 percent, and with desflurane, it falls 65 percent. All of these are after a long period of anesthesia.

**So, when would you use each?**

If my goal is to give an anesthetic that will put a patient to sleep, wake him sometime thereafter, and get him home sometime thereafter, isoflurane is satisfactory for most procedures. If my goal is to get the patient back to normal more quickly, the less soluble the drug, the faster this will occur. Many people use isoflurane because it's cheapest. The problem is that it takes many hours for the patient to return to normal. Desflurane, on the other hand, leads to rapid awakening even after very long anesthesia. Desflurane can be administered at a lower fresh gas flow, resulting in lower cost of delivery. With isoflurane, anesthesia providers can use lower fresh gas flow, but if they do, they need to set the vaporizer to very high levels to offset the effect of high solubility, minimizing cost savings. And, they may still need to raise the fresh gas flow to maintain a proper level of anesthesia.

**What about sevoflurane?**

In the United States, because of some safety concerns, if you use sevoflurane, fresh gas flow cannot be less than two liters per minute for long procedures or one liter per minute for short procedures. But one advantage of sevoflurane is that it can be administered in high concentrations without any added IV drugs. Desflurane, for example, requires an IV induction prior to its use as the main anesthetic. Because of this, sevoflurane is particularly amenable to developing countries, where it can be the sole agent for many procedures. In some countries, however, the drug still has a premium on its cost, and for that reason, it has not reached a high level of use in these countries.

**Do you see developing countries ultimately moving to lower soluble agents like desflurane and sevoflurane?**

Yes. I think in all of these countries, clinicians recognize the advantage of these lower solubility drugs.


### SUPRANE: Baxter's Proprietary Inhalation Anesthetic

SUPRANE (desflurane, USP) is Baxter's proprietary inhalation anesthetic for general anesthesia. Its low solubility leads to a more rapid and complete recovery from anesthesia than with other anesthetic agents, providing the potential for safety benefits. A key safety benefit of SUPRANE (desflurane) is that it results in faster recovery of protective airway reflexes, leading to better airway protection and a reduction of potential respiratory complications.

Produced at Baxter's manufacturing facility in Guayama, Puerto Rico, SUPRANE (desflurane) is sold as a liquid but administered as a gas. A calibrated vaporizer converts the liquid into a carefully controlled concentration of gas to be inhaled by the patient prior to and during surgery. Launched in a number of new markets over the last three years, SUPRANE (desflurane) was registered in 76 countries at year-end 2009.

# A Conversation with Prof. Jacques Rigo

## Neonatologist Discusses Role of Parenteral Nutrition in Pediatric Patients

*Prof. Jacques Rigo, MD, PhD, heads the Department of Pediatrics/ Neonatal Unit at the Centre Hospitalier Universitaire Citadelle in Liege, Belgium. He also was the coordinating investigator in a clinical trial for a new pediatric triple-chamber container system for parenteral nutrition developed by Baxter. The product, designed to meet the specific needs of pediatric patients, was submitted for regulatory review in Europe in late 2009 and is expected to reach the marketplace in early 2011.*

**Could you describe the importance of parenteral nutrition in treating premature infants?**

As a neonatologist working in the intensive care unit, I have seen the survival rates of extremely low-birth-weight infants increase significantly in recent years. It is important that these infants receive proper nutrition to support normal growth and prevent the long-term effects of malnutrition during the early stage of life. Providing appropriate early nutrition enhances growth and neuro-development in very low-birth-weight infants. During the first few weeks of life in extremely low-birth-weight infants, there is some immaturity in the gastrointestinal tract, which makes it difficult to provide appropriate nutrition through oral feeding. Parenteral nutrition is necessary to ensure they receive the right nutrients for proper development.

**What other conditions would cause a child to need parenteral nutrition?**

Gastrointestinal diseases such as short bowel syndrome and others would be another reason you'd need parenteral nutrition. Cancer patients may not be able to receive appropriate nutrition orally and can suffer from malnutrition, so we'll often use parenteral nutrition to restore them to good nutritional status before surgery or chemotherapy.

**What is the value of ready-to-use nutrition solutions, like those provided in Baxter's triple-chamber container systems, compared to other ways of administering parenteral nutrition?**

Parenteral nutrition solution can be formulated on a daily basis according to what each patient needs in terms of volume, protein, glucose, lipids, minerals and electrolytes. The hospital pharmacy then prepares each individual solution. A ready-to-use solution with a standard composition made by the hospital pharmacy once a month is another option. This helps ensure compatibility of elements and reduces potential prescription errors. Baxter's triple-chamber system takes this safety and convenience further by offering a prefilled container system, with the protein, glucose and lipids already housed in separate compartments. The components are mixed with the break of a seal, ready to administer at the point of care. Baxter's multi-chamber system also is compatible with the addition of various supplements, such as vitamins, trace elements, electrolytes or minerals.

**What unmet needs will Baxter's new pediatric triple-chamber container system address?**

The dextrose, amino acid and lipid are specifically formulated to meet the needs of pre-term, neonate and older pediatric patients, and formulated to appropriate fluid concentrations, allowing clinicians to give the desired fluid volume and avoid fluid overload. This product is designed to provide, in a smaller volume, exactly the required nutrients for various categories of infants.

**Could you describe the clinical trial?**

The clinical trial for the new pediatric triple-chamber system tested its feasibility and use in the neonatal intensive care unit and for older infants. The growth rates we observed when administering this parenteral nutrition were very satisfactory. What I found most interesting, however, is that frequently when you introduce a new technique or product, clinicians sometimes reject it because it represents a change from their usual practice. In this case, they embraced it and appreciated its ease-of-use. When the trial was over, several nurses asked if it was possible to keep using it.

**What other potential benefits does the triple-chamber technology provide?**

One interesting feature is that you can mix just two of the chambers or all three. You can mix the glucose, the lipid and the amino acid, or you can just mix the glucose with the amino acid. In premature infants, sometimes the physician may decide not to provide lipid for a few days because of an infection or for some other reason. So the flexibility of the technology also has potential benefits for the infant.

## Patient Spotlight: Tim Weaver

Tim Weaver was born with Hirschsprung's disease. His gastrointestinal system did not develop properly, requiring surgery that left him with only 51 centimeters of bowel. Normal infants would have at least 150 centimeters. Unable to absorb sufficient nutrients orally, Tim had to be fed intravenously to survive. Baxter is a leading provider of this therapy, known as total parenteral nutrition (TPN).

"Tim would not be alive without TPN," says his mother, Ann. "He would not be here without this therapy."

Now 15, Tim is an honor student, plays tuba and bass guitar, goes to concerts, participates in sports and enjoys rooting for his favorite baseball team, the Chicago White Sox. But living with short bowel syndrome has not been easy. Tim has had multiple surgeries and hospitalizations stemming from his condition and continues to need TPN periodically. When he does, he often administers his Baxter TPN solutions at home.

"Thanks to this therapy, people like Tim can still thrive and lead active, productive and fulfilling lives," Ann says. "It's not just a therapy that extends life. It enables Tim to do most of the things he likes to do."

### OLIMEL: Baxter's Latest Triple-Chamber Container

In 2009, Baxter launched OLIMEL, the company's latest triple-chamber container system for parenteral nutrition, in France and Switzerland. The product will be launched in Austria, Germany, Sweden, the United Kingdom and other countries in 2010.

OLIMEL features a broad portfolio of formulations containing various nitrogen levels appropriate for specific patient groups, such as critical care patients, surgery patients and stable home patients, as such patients can have different nutritional needs. OLIMEL also is the only triple-chamber container whose olive oil-based lipid emulsion contains a high percentage of omega 9 fatty acids, which support immune function.

# A Conversation with Dr. Victor Rosenthal

## Pioneer in Infection Control Discusses Benefits of "Closed" versus "Open" IV Systems

*Victor D. Rosenthal, MD, MSc, CIC, is chairman and founder of the International Nosocomial Infection Control Consortium (INICC) in Argentina. He is perhaps best known as a pioneer in the development of studies showing how use of "closed" versus "open" intravenous systems can reduce central venous catheter-related bloodstream infections. Dr. Rosenthal's work has been instrumental in convincing a growing number of developing countries to convert to closed systems to reduce costs and save lives.*

**What is the prevalence of catheter-related bloodstream infections?**

In the United States, the rate of catheter-related bloodstream infection (CRBSI) in patients is around 2 per 1,000 central venous catheter (CVC) days. In developing countries, it's about 20, especially in intensive-care units. Much of this is due to the continued use of open intravenous (IV) systems in most developing countries. We've been able to show that using closed IV systems can reduce CRBSI rates, reducing mortality and infection-related costs.

**How do closed systems reduce risk of bloodstream infections?**

The risk of infections arises when contaminants are introduced into the system. Entry points include unfiltered air vents in administration sets, the tubing through which fluid flows from the IV container to the patient; stopcocks, which regulate the flow of fluid, and various connectors. By eliminating the need for unfiltered air vents and stopcocks, the risk can be significantly reduced. When IV solutions are administered via collapsible containers like Baxter's VIAFLEX, VIAFLO and AVIVA containers, air does not replace the fluid as it flows from the bag as it

does in glass or semi-rigid containers, which must be vented to enable the solution to flow properly. This reduces the potential of air contaminants getting into the solution. Baxter's V-Link IV connector, which has an antimicrobial coating on the device, could result in further reduction in pathogen contamination.

**How many countries still use open systems?**

Virtually all developing countries still use open systems between 60 and 100 percent of the time. There are two exceptions. In Brazil, it's now mandatory to use closed systems. In Colombia, it's recommended, although not mandated by law. Approximately 75 percent of Colombian hospitals now use closed systems. I wrote the guidelines for both governments following studies showing the impact of closed systems in reducing CRBSI rates.

**Why do so many countries still use open systems when there is research showing the benefits of closed systems?**

Research on closed systems is relatively new. Results of my first study, in Argentina, were published in 2004, just five years ago. That's a short time to convince the world of the benefits of closed systems. When Baxter introduced VIAFLEX, the first collapsible IV container, more than 30 years ago, it was a revolutionary advance that had a number of advantages over glass, the most obvious being that it was unbreakable. But its infection-control benefits went largely unnoticed. When I saw the product for the first time in 1999, I thought, "This is not a commodity. This is an infection-control device." The concept of closed system didn't exist. I thought, if this bag can reduce the CRBSI rate worldwide, people should know about it and should switch from open to closed systems. That's when I began my research.

**What are the key findings in these studies?**

With good infection-control practices, combined with use of closed systems, the CRBSI rate in developing countries is the same as in developed countries. I mentioned a rate of around 20 CRBSI per 1,000 CVC days in developing countries. With good infection-control practices, i.e., hand hygiene, full barrier protection and other measures, you can bring the CRBSI down to about 8, and then when you switch to a closed system, your rate is around 2.

**What countries are you currently focused on in your mission to prove the benefits of closed systems?**

I recently spent time in China, measuring the CRBSI rate in four different cities to increase awareness by Chinese hospitals and the government of the benefits of closed systems. As chairman of INICC, I have been meeting with the governments of different countries, writing national guidelines on infection control, always recommending use of closed systems. The last one I wrote was in Hong Kong, which was published in January 2009. The U.S. Centers for Disease Control and Prevention drafted preliminary guidelines on preventing CRBSI that did not mention open versus closed systems, so I asked them to add mandatory use of closed systems to their next version. If they agree, it would likely have an impact worldwide.

**Product Update: V-Link Device**

Two clinical studies are testing the effectiveness of Baxter's V-Link Luer Activated Device with VitalShield Protective Coating on patients. The device, launched in 2008, is the first antimicrobial needle-free intravenous connector and has been shown in laboratory studies to kill at least 99.99 percent of six common pathogens known to cause catheter-related bloodstream infections.

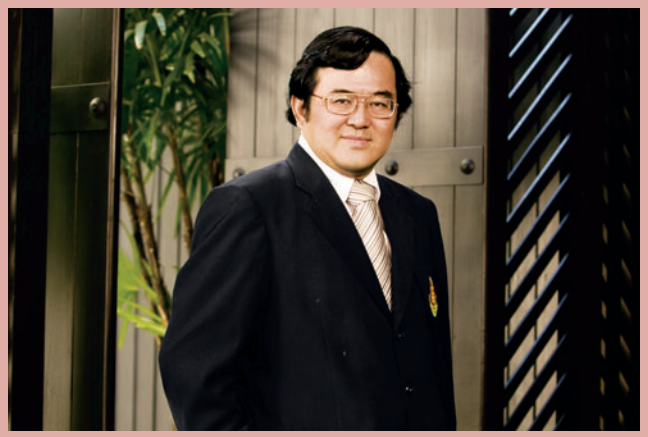
One study, at Emory University Hospitals in Atlanta, is expected to include 20,000 patients. The U.S. Centers for Disease Control and Prevention is collaborating on this study. In the United Kingdom, a study at Queen Elizabeth Hospital is part of a broader initiative by the U.K.'s National Health Service (NHS) to assess the effectiveness of infection-control technologies ranging from drugs to cleaning supplies. V-Link was the only medical device selected by the NHS.

The V-Link device has been launched in most regions of the world and was used by more than a million patients in 2009.

# A Conversation with Drs. Prateep Dhanakijcharoen and Dhavee Sirivongs

## Government Official and Nephrologist in Thailand Discuss Country's New PD First Policy

*In 2008, Thailand implemented a PD First policy, encouraging the use of peritoneal dialysis (PD) over hemodialysis (HD) to save costs, improve access and enhance quality of life for patients with end-stage renal disease (ESRD). In this interview, Dr. Prateep Dhanakijcharoen (top photo), deputy secretary general of the National Health Security Office (NHSO), and Dr. Dhavee Sirivongs (bottom photo), chief of nephrology at Khon Kaen University, discuss the policy's impact on treatment of ESRD patients in Thailand.*



**Could you please describe Thailand's PD First policy?**

*Dr. Dhanakijcharoen:* In 2002, Thailand introduced Universal Coverage, a healthcare reform scheme for all citizens not covered by the country's two existing healthcare schemes. Renal replacement therapy was not included in the scheme until January 2008, when the PD First policy was introduced. Now, all new and existing ESRD patients who receive continuous ambulatory peritoneal dialysis (CAPD) or a kidney transplant get full financial support from the NHSO, while new patients that insist on receiving HD must pay for their own therapy. Existing HD patients that wish to continue on HD are required to pay one-third of their treatment expenses.

*Dr. Sirivongs:* At this time, the PD First policy only supports CAPD, which is the manual form of PD, not automated peritoneal dialysis. For those patients who are not medically suitable for CAPD, doctors may put them on HD and the treatment costs are covered. All patients under this policy who are potential recipients of a kidney transplant are put on a waiting list.

**What led the government to adopt this policy?**

*Dr. Dhanakijcharoen:* There are several reasons. There are clinical benefits to PD in terms of fluid and waste removal and maintenance of hemoglobin levels in the body. As a home therapy, PD offers greater access to patients and reduces indirect costs to patients and their families, such as the cost of travel to and from dialysis centers. PD also requires less use of personnel and medical facilities than HD.

*Dr. Sirivongs:* PD therapy is easier. Patients can do it themselves after receiving training. We also are not a rich country. With PD, most of the expense is in the solutions, not equipment or medical staff. Under this policy, family members are happy to have their loved ones at home, and some patients can return to work full or part time and be viable, contributing members of society.

**What effect has the policy had on PD penetration in Thailand?**

*Dr. Sirivongs:* In October 2009, just 20 months after the policy was implemented, there were more than 4,600 new PD patients. PD penetration – the percentage of dialysis patients on PD – increased from 5 percent to 15 percent. We expect it to reach 20 percent, or about 6,400 PD patients, in 2010.

*Dr. Dhanakijcharoen:* Our goal is to increase PD penetration to 50 percent in the next five years.

**What other benefits do you see, or expect to result, from this program?**

*Dr. Dhanakijcharoen:* In addition to lower costs, clinical benefits and increased access to therapy, PD can provide a better quality of life for both patients and caregivers.

*Dr. Sirivongs:* In Thailand, the average patient's age is 48 years old. Effective home treatment enables these patients to continue to contribute to society and remain valuable members of their extended families. We in the nephrology community are grateful that the Thailand government recognizes the value of PD and the benefits it provides.

**What do you consider the key success factors of Thailand's PD First policy?**

*Dr. Sirivongs:* For a country to adopt such a policy and make it work, it requires that all people in the government and the nephrology community understand PD's benefits and the quality of treatment, in addition to the relative cost of the therapy.

*Dr. Dhanakijcharoen:* In Thailand, the NHSO, Ministry of Public Health, Nephrology Society of Thailand, patients and private organizations were 100 percent behind the PD First policy and gave their full support. This solidarity has been the biggest key to the success of the program.

## Patient Spotlight: Loreto Perez Saavedra

Loreto Perez Saavedra has end-stage renal disease, or irreversible kidney failure. She uses peritoneal dialysis (PD) to cleanse her blood of toxins, waste and excess fluid normally removed by healthy kidneys. She is one of a growing number of PD patients in Chile, where she lives in Santiago with her sister, father and three-year-old son, Diego.

Historically, Chile has had one of the lowest PD penetration rates in Latin America, with just 5 percent of dialysis patients on PD as opposed to conventional in-center hemodialysis. But this is changing as the Chilean government has come to recognize PD's advantages, opening up PD reimbursement in the public sector, with a mandate to increase PD penetration to 10 percent within the next year and more than 20 percent by 2015.

"As a home therapy, PD offers me the flexibility to spend time with my son and have a normal life," Loreto says. The daughter of a physician, Loreto plans to study kinesiology in college, with a dream to run a medical center of her own someday.

### Expanding Leadership in Home Dialysis

Baxter continues to make progress on the development of a home hemodialysis (HD) platform, which will expand its current leadership in home dialysis. The company expects to begin clinical trials on a new state-of-the-art home HD system in 2010 and launch the technology in selected markets by the end of 2011.

Already the world's leading provider of home dialysis products based on its leadership in peritoneal dialysis, Baxter plans to leverage its experience and infrastructure in serving home patients to achieve a competitive advantage in the home HD arena. Unlike most home HD offerings, which are essentially modified in-center devices, Baxter's technology will be uniquely tailored to meet the needs of home patients, emphasizing convenience and ease-of-use. The technology also has the potential to provide system-wide cost, clinical and quality-of-life advantages over in-center hemodialysis.

Baxter's home HD initiative is the result of a partnership between Baxter and DEKA Research and Development Corporation.

# A Conversation with Mindy Lubber

## Ceres President Discusses Role of Corporations in Meeting Sustainability Challenges

*Mindy Lubber is president of Ceres, a leading U.S. coalition of investors, environmental leaders and other public interest groups working to improve corporate environmental, social and governance practices. She also directs the Investor Network on Climate Risk, a network of more than 80 institutional investors representing more than $8 trillion in assets that coordinates U.S. investor responses to the financial risks and opportunities posed by climate change.*

**How do you define the term "sustainability"?**

Sustainability is about living our lives without compromising the ability of future generations to live theirs. It is about reducing our reliance on limited resources, and developing new, innovative technologies that support our economy and the environment so future generations can flourish.

**What do you consider the greatest sustainability challenges facing the world today?**

The future of our climate and energy systems is a real challenge and will be for decades to come. If we continue to increase our carbon emissions and exacerbate climate change, the impact will be profound. Water supply is another challenge. Right now we're seeing more droughts in more places than ever before. Without water, we can't run our factories or feed our children. Food shortages and how we deal with poverty in developing nations are other challenges.

**What do you think the greatest sustainability challenges will be five, 10 or 50 years from now?**

Climate change, energy, water, toxins and the related impact on food supply – these are key challenges we will be talking about for at least the next 10 to 20 years. Hopefully 50 years from now we'll have built a new energy system that's less polluting and not causing carbon emissions that are devastating to our economy and the environment. At the same time, I think new technology, while providing solutions to some problems, could create new problems. As the world continues to become more computerized, for example, how we dispose of or recycle these devices is an enormous issue.

**What role do you feel corporations can and/or should play in helping promote a more sustainable world, particularly from an environmental perspective?**

Companies need to view sustainability issues similarly to how they view other business risks and opportunities. Investors and business leaders are beginning to realize that there are financial impacts to climate change, water shortages and other sustainability risks just as there are to such bottom-line corporate issues as inflation, inventory or regulatory risks. Companies should focus on how to refine their products and operations to reduce their environmental impact, make their transportation systems more efficient and less wasteful, and demand these same performance standards of suppliers and peer companies.

**What benefits accrue to companies that implement sustainable practices?**

Companies can save millions of dollars by reducing waste and energy use. But it goes further than that. Sustainable practices can enhance a company's competitive positioning in the marketplace; it demonstrates industry leadership in concrete, measurable ways. We hear from dozens of companies that say when they've taken a leadership position on sustainability, their ability to hire and retain the best talent from the top business schools has risen dramatically.

**How does leadership in sustainability translate into long-term value for shareholders?**

Reducing costs on energy and resources, being more efficient, and having less destructive products and processes all can save money and create value for shareholders. Many investors are asking companies how they are addressing sustainability issues – what they are doing, what kind of goals they are setting, how they are reducing their carbon footprint and bringing their energy and water use down, and how they are addressing potential labor and human rights issues.

**What challenges do companies face in trying to balance their business needs with their sustainability efforts?**

Companies are struggling to figure out how to integrate sustainability into their operations. Those that do are more likely to be successful than those that ignore it. Integration is the key.

### Community Involvement: Healthcare, Education Key Areas of Focus

In 2009, The Baxter International Foundation – the philanthropic arm of Baxter – provided a grant to Project HOPE, an international nonprofit organization focused on improving health through education and humanitarian assistance. The grant was to support rehabilitation services for earthquake victims in Sichuan, China.

The foundation's strategy for funding disaster relief includes funding longer-term rebuilding needs. The Project HOPE grant is an example of this. Other grants focus on programs that increase access to healthcare, particularly for the disadvantaged and underserved, in communities where Baxter employees live and work.

Product donations, cash contributions and grants from Baxter and The Baxter International Foundation totaled more than $52 million in 2009. Other community needs on which Baxter is focused include education, especially math and science. Through Baxter's Science@Work program, more than 24,000 Chicago Public School students received biotechnology education in 2009.

### "Green Rankings" Place Baxter First in Healthcare Sector

Baxter's manufacturing facility in Sherbrooke, Quebec, was Canada's first manufacturing facility to receive carbon neutral certification in 2004. Since then, Baxter has purchased, planted and maintains nearly 6,000 trees in eastern Quebec to offset carbon dioxide emitted by the facility and produce clean air.

Driving reductions in its carbon footprint is one of Baxter's nine sustainability priorities. In addition to pursuing carbon neutrality for certain operations and products, the company's multifaceted approach includes minimizing energy use and cost, increasing use of renewable energy, emissions trading, goal-setting and performance measurement.

In 2009, *Newsweek* magazine released its inaugural Green Rankings of the 500 largest U.S. companies. Baxter ranked first in the healthcare equipment and services sector and 35th overall. *Newsweek* collaborated with three research partners to assess each company's greenhouse gas emissions, toxic waste emissions, natural resource use, environmental policies, management of environmental issues and regulatory compliance.

Baxter International Inc., through its subsidiaries, develops, manufactures and markets products that save and sustain the lives of people with hemophilia, immune disorders, infectious diseases, kidney disease, trauma, and other chronic and acute medical conditions.

As a global, diversified healthcare company, Baxter applies a unique combination of expertise in medical devices, pharmaceuticals and biotechnology to create products that advance patient care worldwide.

## BioScience

*Baxter's BioScience business is a leading manufacturer of recombinant and plasma-based proteins to treat hemophilia and other bleeding disorders; plasma-based therapies to treat immune deficiencies, alpha 1-antitrypsin deficiency, burns and shock, and other chronic and acute blood-related conditions; products for regenerative medicine, such as biosurgery products; and vaccines.*

2009 SALES: $5.6 BILLION

**Hemophilia Therapy**
Baxter is a leading manufacturer of antihemophilic clotting factors to treat hemophilia. This includes recombinant and plasma-based factor VIII – the clotting factor missing from the blood of people with hemophilia A – and a therapy for people that develop inhibitors against clotting factor.

**Immunoglobulin Therapy**
Baxter is a leading provider of liquid immune globulin intravenous (IGIV), an antibody-replacement therapy that bolsters the immune systems of people with immune disorders. Immunoglobulin therapies also are used to treat immune thrombocytopenic purpura, an immune disorder that results in low platelet counts.

**Critical Care Therapy**
Albumin is a plasma-volume expander used to treat burns and maintain adequate fluid volume in critically ill patients. Baxter is the only company to offer albumin in a flexible, plastic container, providing significant benefits to customers. Baxter also produces Protein C therapy to treat Protein C deficiency.

**Pulmonology Therapy**
People with alpha 1-antitrypsin (AAT) deficiency have reduced levels of a blood protein that protects the lungs. The condition can result in early onset emphysema and premature death. Baxter's plasma-based therapy raises the level of AAT in the blood.

**Regenerative Medicine**
Baxter produces plasma-based and synthetic proteins used to promote hemostasis and wound-sealing in surgery, and is developing products to facilitate tissue-regeneration.

**Vaccines**
Baxter provides vaccines for meningitis C and tick-borne encephalitis, and is developing vaccines for seasonal and pandemic flu. Baxter's Vero cell technology, used in flu vaccine production, provides benefits over more traditional egg-based vaccine production methods.

## Medication Delivery

*Baxter's Medication Delivery business manufactures products used in the delivery of fluids and drugs to patients. These include intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, and inhalation anesthetics, as well as products and services related to pharmacy compounding, drug formulation and packaging technologies.*

2009 SALES: $4.6 BILLION

**IV Solutions and Premixed Drugs**
Baxter is the world's leading manufacturer of commercially prepared IV solutions as well as frozen and ready-to-use premixed drugs in flexible IV containers. Baxter's portfolio of IV solutions and premixed drugs is the broadest in the industry.

**IV Infusion Pumps and Administration Sets**
IV infusion pumps and administration sets control the delivery of IV fluids and drugs to patients. Baxter provides infusion pumps used in hospitals and other acute-care settings, as well as portable devices used in oncology and pain management.

**Parenteral Nutrition Products**
Nutrition administered intravenously (parenteral nutrition) provides life-sustaining support for patients who cannot receive adequate nutrients through other means. Baxter provides solutions, container systems and admixing technology for parenteral nutrition.

**Anesthesia**
Baxter is a leading provider of inhaled anesthetics for general anesthesia, and the only company to offer all three modern inhaled anesthetics.

**Drug and Drug Formulation Technologies**
Baxter continues to advance the clinical and commercial development of innovative drug and drug formulation technologies, including a technology that offers a potential subcutaneous alternative to IV administration for patients.

**Pharma Partnering**
Baxter also applies its drug delivery expertise to contract manufacturing of prefilled injectable drugs in vials and syringes, lyophilized drugs, and biologics such as proteins and antibodies for biotechnology and pharmaceutical companies.

## Renal

*The Renal business provides products to treat end-stage renal disease, or irreversible kidney failure. It is a leading manufacturer of products for peritoneal dialysis (PD), a home therapy Baxter helped commercialize 30 years ago. Products include PD solutions and automated cyclers that provide therapy overnight. The business also distributes products for hemodialysis (HD), which generally takes place in a hospital or clinic.*

2009 SALES: $2.3 BILLION

**PD Solutions**
In PD, solution is administered into the abdominal cavity, where it draws waste and excess fluid across the peritoneal membrane, which serves as a natural filter. The solution is then drained and discarded. Baxter PD solutions provide unique clinical benefits, and include the industry's only non-glucose-based specialty solutions.

**CAPD Products**
In continuous ambulatory peritoneal dialysis (CAPD), patients manually infuse their PD solution and perform solution exchanges several times a day. Baxter provides products to make solution-exchanges easier for patients and reduce the chance of infections. These include "twin bag" systems that combine infusion and drainage in one closed system.

**APD Products**
In automated peritoneal dialysis (APD), a machine conducts solution-exchanges for the patient. Baxter provides cyclers that perform exchanges overnight while the patient sleeps. Their compact size and ease-of-use make them conducive to home therapy, and also are convenient for patients to take with them when they travel.

**HD Products**
In HD, blood is withdrawn from the arm or leg and pumped through an external filter, or dialyzer. The cleansed blood is then returned to the patient. Baxter distributes HD instruments and disposables, including dialyzers, to dialysis clinics.

**Continuous Renal Replacement Therapy**
Acute renal failure requires continuous renal replacement therapy (CRRT), typically performed 24 hours a day in the intensive care unit of a hospital. Baxter's Renal business provides machines, solutions, filters and other products used in CRRT.

# 2009 financial report

The following commentary should be read in conjunction with the consolidated financial statements and accompanying notes.

## EXECUTIVE OVERVIEW

### Description of the Company and Business Segments

Baxter International Inc. (Baxter or the company) develops, manufactures and markets products that save and sustain the lives of people with hemophilia, immune disorders, infectious diseases, kidney disease, trauma, and other chronic and acute medical conditions. As a global, diversified healthcare company, Baxter applies a unique combination of expertise in medical devices, pharmaceuticals and biotechnology to create products that advance patient care worldwide. The company operates in three segments. **BioScience** processes recombinant and plasma-based proteins to treat hemophilia and other bleeding disorders; plasma-based therapies to treat immune deficiencies, alpha 1-antitrypsin deficiency, burns and shock, and other chronic and acute blood-related conditions; products for regenerative medicine, such as biosurgery products; and vaccines. **Medication Delivery** manufactures intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, and inhalation anesthetics, as well as products and services related to pharmacy compounding, drug formulation and packaging technologies. **Renal** provides products to treat end-stage renal disease, or irreversible kidney failure. The business manufactures solutions and other products for peritoneal dialysis (PD), a home-based therapy, and also distributes products for hemodialysis (HD), which is generally conducted in a hospital or clinic.

Baxter has approximately 49,700 employees and conducts business in over 100 countries. The company generates approximately 60% of its revenues outside the United States, and maintains manufacturing and distribution facilities in a number of locations in the United States, Europe, Canada, Asia-Pacific and Latin America.

### Financial Results

Baxter's 2009 results reflect the company's success in driving growth through global expansion and leveraging the benefits of its diversified healthcare model, while increasing its investment in research and development (R&D). In 2009, the company achieved record net sales, earnings and cash flows from operations.

Baxter's global net sales totaled $12.6 billion in 2009, an increase of 2% over 2008, and included an unfavorable foreign currency impact of 5 percentage points. International sales totaled $7.2 billion and represented approximately 60% of the company's total sales in 2009. Contributing to the company's increased sales was the BioScience segment growth, driven by increased demand and improved pricing for GAMMAGARD LIQUID (marketed as KIOVIG in most markets outside the United States), the liquid formulation of the company's antibody-replacement therapy, IGIV (immune globulin intravenous), and certain other plasma protein products, and the continued increase in customer conversion to the company's advanced recombinant therapy, ADVATE [Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method]. In the Medication Delivery segment, excluding the impact of foreign currency, growth in the company's international pharmacy compounding and U.S. pharmaceutical partnering businesses contributed to the increase in sales, combined with increased demand for IV solutions and anesthesia products, including SUPRANE (desflurane) and sevoflurane, and increased demand and improved pricing for nutritional products. Also contributing to the increase in net sales, excluding the impact of foreign currency, were gains in the number of PD patients in the Renal segment, particularly in the United States, Latin America and Eastern Europe, with double-digit growth across Asia.

Baxter's net income for 2009 totaled $2.2 billion, or $3.59 per diluted share, increasing 9% and 14%, respectively, compared to the prior year. The increase in earnings in 2009 reflects the increased gross margin as a result of improved sales mix, manufacturing cost and yield improvements, as well as improved pricing. In 2009, R&D expenses totaled $917 million, a 6% increase over the prior year, and represented the highest level of R&D spending in the company's history. As further discussed below, results of operations for 2009 included charges associated with the company's SYNDEO PCA Syringe Pump and COLLEAGUE infusion pumps, the company's cost optimization efforts, and the discontinuation of the company's SOLOMIX drug delivery system in development. Results of operations for 2008 included charges associated with the company's COLLEAGUE infusion pumps, the discontinuation of the CLEARSHOT pre-filled syringe program and acquired in-process R&D (IPR&D).

The company's financial position remains strong, with cash flows from operations totaling $2.9 billion in 2009, an increase of $394 million over 2008. At December 31, 2009, Baxter had $2.8 billion in cash and equivalents, and the company's net debt (debt and lease obligations less cash and equivalents) represented 19% of shareholders' equity. In 2009, Baxter's cash outflows relating to acquisitions of and investments in businesses and technologies included a $100 million payment to Sigma International General Medical Apparatus, LLC (SIGMA) for the exclusive distribution of SIGMA's infusion pumps in the United States and international markets, a 40 percent equity stake in SIGMA, and an option to purchase the remaining portion of SIGMA. Additionally, in 2009 the company acquired certain assets of Edwards Lifesciences Corporation related to the hemofiltration business, also known as Continuous Renal Replacement Therapy (Edwards CRRT), for $56 million.

Capital investments totaled $1.0 billion in 2009 as the company continues to invest in capacity across its businesses to support future growth. These investments were focused on projects that enhance the company's cost structure and manufacturing capabilities across the three businesses, particularly as they relate to the company's nutritional, anesthesia and PD products, and plasma and recombinant manufacturing platforms. In addition, the company continues to invest to support its strategy of geographic expansion with select investments in growing markets, and continues to invest to support the company's ongoing strategic focus on R&D with the expansion of research facilities, pilot manufacturing sites and laboratories.

The company's strong cash flow generation also provided the company with the flexibility to continue to return value to its shareholders in the form of share repurchases and dividends. During 2009, the company repurchased 23 million shares of common stock for $1.2 billion, and paid cash dividends to its shareholders totaling $632 million. The company increased the quarterly dividend rate by 20% in late 2008 and by an additional 12% in late 2009.

### Strategic Objectives

Baxter remains focused on delivering sustainable growth and shareholder value, while making appropriate investments for the future. Baxter's diversified healthcare model, its broad portfolio of products that treat life-threatening acute or chronic conditions, and its global presence are core components of the company's strategy to achieve these objectives. Through continued innovation, investment and collaboration, Baxter seeks to advance new therapies, improve the safety and cost-effectiveness of treatments and expand access to care.

The company seeks to expand gross margins by improving product and business mix, pricing products appropriately, controlling costs and enhancing productivity throughout the company's global manufacturing footprint. As part of its approach to disciplined financial management, Baxter is focused on controlling general and administrative costs while continuing to invest in select marketing programs and promotional activities directed toward higher-growth and higher-margin products.

Strong cash flows generated by Baxter's core operations have allowed the company to increase its investment in its R&D pipeline. In 2009, the company advanced a number of Phase III clinical trials and numerous earlier stage clinical trials of therapies that have the potential to impact the treatment and delivery of care for chronic diseases like Alzheimer's disease, hemophilia, end-stage renal disease and immune deficiencies, as well as public health threats like pandemic and seasonal influenza. Refer to the R&D section below for more information on these activities. In 2010, the company will continue to invest in its R&D pipeline and pursue select business development initiatives, collaborations and alliances as part of the execution of its long-term growth strategy.

The company's ability to sustain long-term growth and successfully execute the strategies discussed above depends in part on the company's ability to manage the competitive landscape, the current challenges in the commercial and credit environment, and other risk factors described under the caption "Item 1A. Risk Factors" in the company's Annual Report on Form 10-K.

## RESULTS OF OPERATIONS

### Net Sales

| years ended December 31 (in millions) | 2009 | 2008 | 2007 | Percent change 2009 | Percent change 2008 |
|---|---|---|---|---|---|
| BioScience | **$ 5,573** | $ 5,308 | $ 4,649 | **5%** | 14% |
| Medication Delivery | **4,649** | 4,560 | 4,231 | **2%** | 8% |
| Renal | **2,266** | 2,306 | 2,239 | **(2%)** | 3% |
| Transition services to Fenwal Inc. | **74** | 174 | 144 | **(57%)** | 21% |
| **Total net sales** | **$12,562** | $12,348 | $11,263 | **2%** | 10% |

| years ended December 31 (in millions) | 2009 | 2008 | 2007 | Percent change 2009 | Percent change 2008 |
|---|---|---|---|---|---|
| United States | **$ 5,317** | $ 5,044 | $ 4,820 | **5%** | 5% |
| International | **7,245** | 7,304 | 6,443 | **(1%)** | 13% |
| **Total net sales** | **$12,562** | $12,348 | $11,263 | **2%** | 10% |

Foreign currency unfavorably impacted net sales by 5 percentage points in 2009 due to the strengthening of the U.S. Dollar relative to other currencies, including the Euro and the British Pound. Foreign currency favorably impacted net sales growth by 4 percentage points in 2008 principally due to the weakening of the U.S. Dollar relative to other currencies, including the Euro.

**BioScience** The following is a summary of sales by product category in the BioScience segment.

| | | | | Percent change | |
|---|---|---|---|---|---|
| years ended December 31 (in millions) | **2009** | 2008 | 2007 | **2009** | 2008 |
| Recombinants | **$2,058** | $1,966 | $1,714 | **5%** | 15% |
| Plasma Proteins | **1,338** | 1,219 | 1,015 | **10%** | 20% |
| Antibody Therapy | **1,368** | 1,217 | 985 | **12%** | 24% |
| Regenerative Medicine | **442** | 408 | 346 | **8%** | 18% |
| Transfusion Therapies | **—** | — | 79 | **—** | (100%) |
| Other | **367** | 498 | 510 | **(26%)** | (2%) |
| **Total net sales** | **$5,573** | $5,308 | $4,649 | **5%** | 14% |

Net sales in the BioScience segment increased 5% and 14% in 2009 and 2008, respectively (including an unfavorable foreign currency impact of 5 percentage points in 2009 and a favorable foreign currency impact of 3 percentage points in 2008). Sales growth in the BioScience segment in both years was driven by increased demand across a majority of the product categories and improved pricing for select products. Sales growth in the Recombinants product category in both 2009 and 2008 was the result of the continued adoption of the company's advanced recombinant therapy, ADVATE. Strong demand for FEIBA (an anti-inhibitor coagulant complex) and plasma-derived factor VIII, and improved pricing and increased demand for albumin drove sales growth in the Plasma Proteins product category in both years. Also contributing to the 2009 growth was increased market penetration in the United States of ARALAST [alpha 1-proteinase inhibitor (human)]. Antibody Therapy product category sales growth in both years was the result of improved pricing and increased demand for GAMMAGARD LIQUID therapy. Also contributing to the sales growth in both years was increased demand for the company's fibrin sealant product, FLOSEAL, in the Regenerative Medicine product category. Net sales in the company's Other product category declined in both years. In 2009, the addition of international sales of CELVAPAN H1N1 pandemic vaccine and increased sales of NEISVAC-C (for the prevention of meningitis C) were more than offset by lower international sales of FSME-IMMUN (a tick-borne encephalitis vaccine) and a reduction in pandemic influenza vaccine advance purchase agreements (APAs). In 2008, strong international sales of FSME-IMMUN and influenza vaccines, including approximately $50 million of revenue in 2008 relating to a large pandemic influenza vaccine APA, were more than offset by the negative impact related to the transfer of marketing and distribution rights for BENEFIX back to Wyeth effective June 30, 2007. Sales of BENEFIX were approximately $110 million in 2007. On February 28, 2007, the company sold substantially all of the assets and liabilities of the Transfusion Therapies (TT) business. Refer to Note 3 for additional information regarding the TT business.

**Medication Delivery** The following is a summary of sales by product category in the Medication Delivery segment.

| | | | | Percent change | |
|---|---|---|---|---|---|
| years ended December 31 (in millions) | **2009** | 2008 | 2007 | **2009** | 2008 |
| IV Therapies | **$1,562** | $1,575 | $1,402 | **(1%)** | 12% |
| Global Injectables | **1,701** | 1,584 | 1,504 | **7%** | 5% |
| Infusion Systems | **858** | 906 | 860 | **(5%)** | 5% |
| Anesthesia | **492** | 464 | 422 | **6%** | 10% |
| Other | **36** | 31 | 43 | **16%** | (28%) |
| **Total net sales** | **$4,649** | $4,560 | $4,231 | **2%** | 8% |

Net sales in the Medication Delivery segment increased 2% and 8% in 2009 and 2008, respectively (including an unfavorable foreign currency impact of 5 percentage points in 2009 and a favorable foreign currency impact of 3 percentage points in 2008). Excluding the impact of foreign currency, net sales in the IV Therapies product category grew in both years as a result of increased demand, particularly in international markets, and improved pricing in the United States, for IV solutions and nutritional products. Strong sales of select multi-source generic products and growth in the company's international pharmacy compounding and U.S. pharmaceutical partnering businesses drove double-digit sales growth in the Global Injectables product category in 2009, excluding the impact of foreign currency. In 2008, strong international sales in the pharmacy compounding business were partially offset by decreased sales of generic injectables, primarily driven by the decline in generic propofol and heparin sales. The decline in generic propofol sales was due to the transfer of marketing and distribution rights for propofol back to Teva Pharmaceutical Industries Ltd. effective July 1, 2007. Sales of propofol totaled approximately $40 million in 2007. The decline in heparin sales was due to the company's recall of heparin sodium injection products in the United States in 2008. Sales of these heparin products totaled approximately $30 million in 2007. In the Infusion Systems product category, sales declined in 2009 as a result of lower revenues from disposable tubing sets used in the administration of IV solutions and lower international sales of COLLEAGUE infusion pumps, partially offset by sales of SPECTRUM infusion pumps as a result of the 2009 distribution agreement with SIGMA. Sales growth in this product category in 2008 was due to increased international sales of COLLEAGUE infusion pumps and increased sales of disposable

tubing sets. Growth in both 2009 and 2008 in the Anesthesia product category was driven by increased sales of SUPRANE (desflurane) and sevoflurane. The company continues to benefit from its position as the only global supplier of all three modern inhaled anesthetics (SUPRANE, sevoflurane and isoflurane). Refer to Note 4 for additional information on the SIGMA arrangement and Note 11 for additional information regarding heparin.

**Renal** The following is a summary of sales by product category in the Renal segment.

| | | | | Percent change | |
|---|---|---|---|---|---|
| years ended December 31 (in millions) | **2009** | 2008 | 2007 | **2009** | 2008 |
| PD Therapy | **$1,856** | $1,862 | $1,791 | **—** | 4% |
| HD Therapy | **410** | 444 | 448 | **(8%)** | (1%) |
| **Total net sales** | **$2,266** | $2,306 | $2,239 | **(2%)** | 3% |

Net sales in the Renal segment decreased 2% in 2009 and increased 3% in 2008 (including an unfavorable foreign currency impact of 6 percentage points in 2009 and a favorable foreign currency impact of 5 percentage points in 2008). Excluding the impact of foreign currency, net sales in the PD Therapy product category grew in 2009 as the result of gains in the number of PD patients, particularly in the United States, Latin America and Eastern Europe, with double-digit growth across Asia. Penetration of PD Therapy products continues to be strong in emerging markets where many people with end-stage renal disease have historically been under-treated. Excluding the impact of foreign currency, net sales in the PD Therapy product category declined in 2008 as gains in the number of PD patients in Asia (particularly in China), Central and Eastern Europe and the United States were more than offset by the impact of a government tender loss in Mexico in the first quarter of 2008. The 2008 impact of the lost Mexican tender was estimated to be approximately $100 million. Excluding the impact of foreign currency, net sales in the HD Therapy product category were flat in 2009 and declined in 2008 as lower saline sales in both years were offset in 2009 by sales related to the company's acquisition of Edwards CRRT and, in 2008, partially offset by higher revenues from the company's Renal Therapy Services (RTS) business, which operates dialysis centers in partnership with local physicians in select countries. Refer to Note 4 for additional information regarding the acquisition of Edwards CRRT.

**Transition Services to Fenwal Inc.** Net sales in this category represent revenues associated with manufacturing, distribution and other services provided by the company to Fenwal Inc. (Fenwal) subsequent to the divestiture of the TT business on February 28, 2007. Revenues declined in 2009 as certain of the transition services agreements terminated in 2008. See Note 3 for additional information regarding the TT business divestiture.

## Gross Margin and Expense Ratios

| years ended December 31 (as a percent of net sales) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Gross margin | **51.9%** | 49.6% | 49.0% |
| Marketing and administrative expenses | **21.7%** | 21.8% | 22.4% |

Gross Margin

The increase in gross margin in 2009 and 2008 was principally driven by improvements in sales mix across all three segments, manufacturing cost and yield improvements, as well as improved pricing for select products. Contributing to the gross margin improvement was the continued customer conversion to ADVATE therapy, increased demand and improved pricing for GAMMAGARD LIQUID therapy and certain other plasma protein and nutritional products; and increased demand for IV solutions, global injectables and anesthesia products. Partially offsetting the gross margin improvement was the unfavorable impact of lower FSME-IMMUN vaccine revenues.

Included in the company's gross margin in 2009, 2008 and 2007 were $27 million, $125 million and $14 million, respectively, of charges and other costs related to COLLEAGUE infusion pumps and the SYNDEO PCA Syringe Pump. Also included in gross margin in 2009 was $30 million of the company's $79 million cost optimization charge recognized in the fourth quarter, which relates to actions the company is taking to optimize its overall cost structure on a global basis. These charges decreased the gross margin by approximately 0.5, 1.1 and 0.1 percentage points in 2009, 2008 and 2007, respectively. Refer to Note 5 for additional information on these charges and costs.

Marketing and Administrative Expenses

The marketing and administrative expense ratio declined in 2009 and 2008. The ratio in both years was favorably impacted by leverage from higher sales and stronger cost controls, partially offset by spending relating to new marketing programs. Unfavorably impacting the marketing and administrative expense ratio in 2009 was $49 million of the company's $79 million cost optimization charge recognized in the fourth quarter, as discussed in Note 5. Foreign currency had an unfavorable impact on the marketing and administrative expense ratio in 2009 and a favorable impact in 2008. Also unfavorably impacting the marketing and administrative expense ratio in 2007 was a charge of $56 million to establish reserves related to the average wholesale pricing (AWP) litigation, as discussed in Note 11. These charges increased the marketing and administrative expense ratio by

approximately 0.3 and 0.5 percentage points in 2009 and 2007, respectively.

Pension Plan Costs

Fluctuations in pension plan costs impacted the company's gross margin and expense ratios. Pension plan costs increased $18 million in 2009 and decreased $15 million in 2008, as detailed in Note 9. The $18 million increase in 2009 was principally due to an increase in loss amortization related to asset performance and demographic experience, partially offset by the impact of the company's contributions to its pension plans and higher interest rates used to discount the plans' projected benefit obligations. The $15 million decrease in 2008 was principally due to an increase in the interest rate used to discount the plans' projected benefit obligations and lower loss amortization related to asset performance from prior years, partially offset by the impact of changes to certain other assumptions.

Costs of the company's pension plans are expected to increase from $155 million in 2009 to approximately $176 million in 2010, principally due to lower interest rates used to discount the plans' projected benefit obligations and an increase in loss amortization related to asset performance, partially offset by the impact of a $300 million discretionary cash contribution made to the pension plan in the United States in January 2010. Refer to the Liquidity and Capital Resources section below for further information on the funding of pension plans. For the domestic plans, the discount rate will decrease to 6.05% from 6.5% and the expected return on plan assets will remain at 8.5% for 2010. Refer to the Critical Accounting Policies section below for a discussion of how the pension plan assumptions are developed, mortality tables are selected, and actuarial losses are amortized, and the impact of these factors on pension plan cost.

## Research and Development

| | | | | Percent change | |
|---|---|---|---|---|---|
| years ended December 31 (in millions) | **2009** | 2008 | 2007 | **2009** | 2008 |
| Research and development expenses | **$917** | $868 | $760 | **6%** | 14% |
| as a percent of net sales | **7.3%** | 7.0% | 6.7% | | |

R&D expenses increased in both 2009 and 2008, reflecting the company's continued focus on innovation and investments across its business portfolio to advance and expand its product pipeline. Foreign currency had a favorable impact on R&D expense growth in 2009 and an unfavorable impact in 2008.

In 2009, the company had a number of product launches and continued to make progress with respect to its internal R&D pipeline and R&D collaborations with partners. Key developments included the following:

Product Approvals and Launches

- Marketing authorization from the European Commission for CELVAPAN H1N1 pandemic vaccine using Baxter's Vero cell technology; CELVAPAN H1N1 is the first cell culture-based and non-adjuvanted pandemic influenza vaccine to receive marketing authorization in the European Union;
- Launch of HYLENEX recombinant (hyaluronidase human injection) in the United States for use in pediatric rehydration; providing a subcutaneous alternative to IV administration of fluids;
- Launch of OLIMEL, the company's latest triple-chamber container system for parenteral nutrition, in certain European markets; and
- Launch of ADVATE and RECOMBINATE therapies and sevoflurane in additional international markets.

Other Developments

- Completion of the seasonal influenza Phase III confirmatory study in healthy adults in the United States;
- Completed enrollment in the first Phase III trial combining GAMMAGARD LIQUID therapy with ENHANZE, Halozyme Therapeutics, Inc.'s (Halozyme) proprietary drug delivery technology, for the subcutaneous delivery of IGIV for patients with primary immune deficiency, which could allow patients to administer their dose of IGIV once monthly at home;
- Expanded the patient enrollment in a Phase III clinical trial evaluating the use of GAMMAGARD LIQUID therapy for the treatment of mild-to-moderate Alzheimer's disease;
- Expanded the patient enrollment in a Phase I clinical trial evaluating the safety and tolerability of recombinant von Willebrand factor for the treatment of von Willebrand disease, the most common type of inherited bleeding disorder;
- Initiation of a Phase III clinical trial evaluating the use of ARTISS [Fibrin Sealant (Human)] in facial surgery in the United States; ARTISS is the first and only slow-setting fibrin sealant indicated for use in adhering skin grafts in adult and pediatric burn patients;
- Filing of an Investigational Device Exemption with the U.S. Food and Drug Administration (FDA) to begin a clinical trial to collect safety and effectiveness data required for a 501(k) application for a home HD system; and
- Initiation of a Phase III clinical trial evaluating TISSEEL [Fibrin Sealant] as a hemostatic agent in vascular surgery; these studies are being conducted for submission to the FDA to support a broad hemostatic indication for this product in the United States.

R&D expenses in 2008 included IPR&D charges totaling $19 million principally related to an in-licensing agreement with Innocoll Pharmaceuticals Ltd. (Innocoll). R&D expenses in 2007 included IPR&D charges totaling $50 million, related to a collaboration with HHD, LLC (HHD) and DEKA Products Limited Partnership and DEKA Research and Development Corp. (collectively, DEKA); arrangements with Halozyme; a distribution agreement with Nycomed Pharma AS

(Nycomed); and an amendment of the company's collaboration with Nektar Therapeutics (Nektar). Refer to Note 4 for more information regarding the 2008 agreement with Innocoll, as well as the investments made in 2007.

### Restructuring Charge

In 2007, the company recorded a restructuring charge of $70 million principally associated with the consolidation of certain commercial and manufacturing operations outside of the United States. Based on a review of current and future capacity needs, the company decided to integrate several facilities to reduce the company's cost structure and optimize operations, principally in the Medication Delivery segment. Refer to Note 5 for additional information, including details regarding reserve utilization.

### Net Interest Expense

Net interest expense increased $22 million in 2009, principally due to the impact of lower interest rates on interest income. Also contributing to the increase in net interest expense in 2009 was the impact of a higher average net debt balance due to the February 2009 issuance of $350 million of senior unsecured notes due 2014 and the August 2009 issuance of $500 million of senior unsecured notes due 2019. Net interest expense increased $54 million in 2008, principally due to lower interest income resulting from lower U.S. interest rates and a lower average cash balance, a higher average debt balance and the termination of the company's cross-currency swap agreements. The higher average debt balance in 2008 was principally due to the December 2007 issuance of $500 million of senior unsecured notes due 2037 and the May 2008 issuance of $500 million of senior unsecured notes due 2018. Refer to Note 2 for a summary of the components of net interest expense for the three years ended December 31, 2009.

### Other Expense, Net

Other expense, net was $45 million in 2009, $26 million in 2008 and $18 million in 2007. Refer to Note 2 for a table that details the components of other expense, net for the three years ended December 31, 2009. Other expense, net in each year included amounts relating to equity method investments and foreign currency fluctuations, principally relating to intercompany receivables, payables and loans denominated in a foreign currency. In 2009, other expense, net included a charge of $54 million associated with the discontinuation of the company's SOLOMIX drug delivery system in development. In 2008, other expense, net included a charge of $31 million associated with the discontinuation of the company's CLEARSHOT pre-filled syringe program and $16 million of income related to the finalization of the net assets transferred in the TT divestiture. In 2007, other expense, net included a gain on the sale of the TT business of $58 million less a charge of $35 million associated with severance and other employee-related costs. Refer to Note 3 for further information regarding the divestiture and Note 5 for further information on the SOLOMIX and CLEARSHOT charges.

### Pre-Tax Income

Refer to Note 12 for a summary of financial results by segment. Certain items are maintained at the company's corporate level and are not allocated to a segment. The following is a summary of significant factors impacting the segments' financial results.

**BioScience** Pre-tax income increased 5% in 2009 and 21% in 2008. The primary drivers of the increase in pre-tax income in both years were continued gross margin expansion driven by strong sales of higher-margin products, fueled principally by the continued customer adoption of ADVATE therapy and increased demand and improved pricing for GAMMAGARD LIQUID therapy and certain other plasma protein products, as well as continued manufacturing improvements. Partially offsetting the growth in both years was increased R&D spending and, in 2009, the unfavorable impact of lower FSME-IMMUN vaccine sales. Foreign currency had an unfavorable impact on 2009 growth and a favorable impact on 2008 growth.

**Medication Delivery** Pre-tax income increased 28% in 2009 and decreased 15% in 2008. Included in pre-tax income in 2009, 2008 and 2007, and impacting the earnings trend, were $27 million, $125 million and $14 million, respectively, of charges and other costs relating to the COLLEAGUE and SYNDEO infusion pumps, as discussed above. Also included in the pre-tax income in 2009 was a $54 million charge related to the discontinuation of the company's SOLOMIX drug delivery system in development. Included in pre-tax income in 2008 was a $31 million charge related to the discontinuation of the CLEARSHOT pre-filled syringe program. Aside from the impact of these items, pre-tax earnings in 2009 and 2008 benefited from gross margin improvements resulting from favorable product mix, principally from increased sales of IV solutions, global injectables, anesthesia and nutritional products. Partially offsetting these increases in 2008 were increased spending on R&D and the unfavorable impact of competition for the company's generic products. Foreign currency had an unfavorable impact on growth in 2009 and a favorable impact on growth in 2008. Refer to Note 5 for further information on the infusion pump, SOLOMIX and CLEARSHOT charges.

**Renal** Pre-tax income decreased 4% in 2009 and 17% in 2008. The pre-tax earnings declined in both years principally due to increased R&D spending, including the development of home HD therapy, and in 2008, the loss of a PD tender in Mexico. The Renal segment's revenues are generated principally outside the United States, and foreign currency had an unfavorable impact in 2009 and a favorable impact in 2008 to pre-tax income.

**Other** As mentioned above, certain income and expense amounts are not allocated to a segment. These amounts are detailed in the table in Note 12 and include net interest expense, certain foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the majority of the foreign currency hedging activities, corporate headquarters costs, stock compensation expense, income and expense related to certain non-strategic investments, certain employee benefit plan costs, certain nonrecurring gains and losses, certain charges (such as cost optimization, restructuring, certain litigation-related and certain IPR&D charges), and the revenues and costs related to the manufacturing, distribution and other transition agreements with Fenwal.

Refer to the previous discussions for further information regarding net interest expense, the cost optimization and restructuring charges, IPR&D charges, the charge associated with the AWP litigation, the net divestiture gain and ongoing arrangements with Fenwal related to the sale of the TT business and Note 8 for further information regarding stock compensation expense.

### Income Taxes

Effective Income Tax Rate

The effective income tax rate was 19% in 2009, 18% in 2008 and 19% in 2007. The company anticipates that the effective income tax rate, calculated in accordance with generally accepted accounting principles (GAAP), will be approximately 19% to 19.5% in 2010, excluding any impact from additional audit developments or other special items.

The company's effective tax rate differs from the U.S. federal statutory rate each year due to certain operations that are subject to tax incentives, state and local taxes and foreign taxes that are different than the U.S. federal statutory rate. In addition, as discussed further below, the company's effective income tax rate can be impacted in each year by discrete factors or events. Refer to Note 10 for further information regarding the company's income taxes.

2009

The effective tax rate for 2009 was impacted by greater income in jurisdictions with higher tax rates, partially offset by $51 million of income tax benefit from planning that accessed foreign tax losses.

2008

The effective tax rate for 2008 was impacted by $29 million of valuation allowance reductions on net operating loss carryforwards in foreign jurisdictions due to profitability improvements, $8 million of income tax benefit related to the extension of R&D tax credits in the United States and $14 million of additional U.S. income tax expense related to foreign earnings which are no longer considered indefinitely reinvested outside of the United States because the company planned to remit these earnings to the United States in the foreseeable future.

2007

The effective tax rate for 2007 was impacted by a $38 million net reduction of the valuation allowance on net operating loss carryforwards primarily due to profitability improvements in a foreign jurisdiction, a $12 million reduction in tax expense due to legislation reducing corporate income tax rates in Germany, the extension of tax incentives, and the settlement of tax audits in jurisdictions outside of the United States. Partially offsetting these items was $82 million of U.S. income tax expense related to foreign earnings which are no longer considered permanently reinvested outside of the United States because the company planned to remit these earnings to the United States in the foreseeable future.

Uncertain Tax Positions

Baxter expects to reduce the amount of its liability for uncertain tax positions within the next 12 months by $302 million due principally to the expiration of certain statutes of limitations related to tax benefits recorded in respect of losses from restructuring certain international operations and the settlements of certain multi-jurisdictional transfer pricing issues. While the final outcome of these matters is inherently uncertain, the company believes it has made adequate tax provisions for all years subject to examination.

### Income and Earnings per Diluted Share Amounts

Net income attributable to Baxter was $2.2 billion in 2009, $2.0 billion in 2008 and $1.7 billion in 2007. The corresponding net earnings per diluted share were $3.59 in 2009, $3.16 in 2008 and $2.61 in 2007. The significant factors and events causing the net changes from 2008 to 2009 and from 2007 to 2008 are discussed above.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash Flows from Operations

Cash flows from operations increased in both 2009 and 2008, totaling $2.9 billion in 2009, $2.5 billion in 2008 and $2.3 billion in 2007. The increases in cash flows in 2009 and 2008 were primarily due to higher earnings (before non-cash items) and the other factors discussed below. Included in cash flows from operations were outflows of $96 million in 2009 and $112 million in 2008 related to realized excess tax benefits from stock issued under employee benefit plans. Realized excess tax benefits are required to be presented in the consolidated statements of cash flows as an outflow within the operating section and an inflow within the financing section.

Accounts Receivable

Cash outflows relating to accounts receivable increased in 2009 and decreased in 2008. Days sales outstanding increased from 50.6 days at December 31, 2008 to 51.2 days at December 31, 2009, primarily due to the geographic mix of sales, an increase in collection periods in certain international locations and a decrease in factoring of receivables, partially offset by improved collection periods in the United States. The decrease in cash outflows from accounts receivables in 2008 was primarily due to an improvement in the collection of receivables in the United States and in certain international locations.

Inventories

Cash outflows from inventories decreased in 2009 and 2008. The following is a summary of inventories at December 31, 2009 and 2008, as well as inventory turns for 2009, 2008 and 2007, by segment. Inventory turns for the year are calculated as the annualized fourth quarter cost of sales divided by the year-end inventory balance.

| (in millions, except inventory turn data) | Inventories | | Inventory turns | | |
|---|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 | 2007 |
| BioScience | **$1,592** | $1,346 | **1.41** | 1.46 | 1.61 |
| Medication Delivery | **705** | 771 | **4.62** | 3.68 | 3.26 |
| Renal | **257** | 227 | **4.32** | 4.53 | 4.81 |
| Other | **3** | 17 | **—** | — | — |
| **Total company** | **$2,557** | $2,361 | **2.53** | 2.48 | 2.53 |

Inventories increased $196 million in 2009, with more than half of the increase related to the impact of foreign currency. The higher inventory turns for the total company were principally due to increased sales in the Medication Delivery segment, partially offset by an increase in plasma-related inventories in the BioScience segment.

Other

Cash flows related to liabilities, restructuring payments and other increased in 2009. This increase was principally driven by the timing of payments of trade accounts payable and income taxes payable, partially offset by contributions to the company's pension plans of $170 million in 2009 compared to $287 million in 2008. Cash flows decreased in 2008 principally due to contributions to the company's pension plans, the timing of payments of trade accounts payable and income taxes payable, and increased payments related to the company's restructuring programs. Included in both 2008 and 2007 were cash outflows related to the settlement of mirror cross-currency swaps, which resulted in operating cash inflows of $12 million in 2008 compared to $31 million of cash outflows in 2007. There were no settlements of cross-currency swaps during 2009.

## Cash Flows from Investing Activities

Capital Expenditures

Capital expenditures totaled $1.0 billion in 2009, $954 million in 2008 and $692 million in 2007. The investments in 2009 were focused on projects that enhance the company's cost structure and manufacturing capabilities across the three businesses, particularly as it relates to the company's nutritional, anesthesia and PD products and plasma and recombinant manufacturing platforms. In addition, the company continues to invest to support its strategy of geographic expansion with select investments in growing markets, and continues to invest to support the company's ongoing strategic focus on R&D with the expansion of research facilities, pilot manufacturing sites and laboratories.

The company makes investments in capital expenditures at a level sufficient to support the strategic and operating needs of the businesses, and continues to improve capital allocation discipline in making investments to enhance long-term growth. The company expects to invest approximately $1 billion in capital expenditures in 2010.

Acquisitions of and Investments in Businesses and Technologies

Net cash outflows relating to acquisitions of and investments in businesses and technologies were $156 million in 2009, $99 million in 2008 and $112 million in 2007. The cash outflows in 2009 principally related to a $100 million payment for the exclusive distribution of SIGMA's infusion pumps in the United States and international markets, a 40 percent equity stake in SIGMA and an option to purchase the remaining portion of SIGMA. Additionally, in 2009 the company acquired Edwards CRRT, for $56 million. The cash outflows in 2008 principally related to an IV solutions business in China, the company's in-licensing agreement to market and distribute Innocoll's gentamicin surgical implant in the United States, the acquisition of certain technology applicable to the BioScience business, payments related to the company's agreements with Nycomed and Nektar, and certain smaller acquisitions and investments. The cash outflows in 2007 principally related to a new arrangement and the expansion of the company's existing agreements with Halozyme and the company's collaboration with DEKA. Refer to Note 4 for further information regarding these investments.

Divestitures and Other

Net cash inflows relating to divestitures and other activities were $24 million in 2009, $60 million in 2008 and $499 million in 2007. Cash inflows in 2009 and 2008 principally consisted of cash collections from customers relating to previously securitized receivables under the company's European receivables securitization facility. In 2007, the company purchased the third party interest in previously sold receivables under the facility, resulting in net cash outflows of $157 million. Cash inflows in 2007 included $421 million of cash proceeds from the divestiture of the TT business. The $421 million represented the $473 million total cash received upon divestiture less the $52 million prepayment related to the manufacturing, distribution and other transition agreements, which was classified in the operating section of the consolidated statement of cash flows. Cash inflows in 2009, 2008 and 2007 also included normal collections on retained interests associated with securitization arrangements.

## Cash Flows from Financing Activities

Debt Issuances, Net of Payments of Obligations

Debt issuances, net of payments of obligations, were net inflows totaling $473 million in 2009 compared to net outflows totaling $79 million in 2008 and $51 million in 2007. Included in these totals in 2008 and 2007 were $540 million and $303 million, respectively, of cash outflows related to the settlement of cross-currency swap agreements, resulting in the termination of the company's remaining net investment hedges. There were no settlements of cross-currency swap agreements in 2009.

The company issued $350 million of senior unsecured notes, which mature in March 2014 and bear a 4.0% coupon rate in February 2009 and $500 million of senior unsecured notes, which mature in August 2019 and bear a 4.5% coupon rate in August 2009. In May 2008, the company issued $500 million of senior unsecured notes, maturing in June 2018 and bearing a 5.375% coupon rate. In addition, during 2008, the company issued commercial paper, of which $200 million was outstanding as of December 31, 2008, with a weighted-average interest rate of 2.55%. In December 2007, the company issued $500 million of senior unsecured notes, maturing in December 2037 and bearing a 6.25% coupon rate. The net proceeds from these issuances were used for general corporate purposes, including the repayment of $200 million of outstanding commercial paper in 2009 and for the settlement of cross-currency swaps in 2008. In 2009, the company repaid approximately $160 million of outstanding borrowings related to the company's Euro-denominated credit facility (further discussed below). The company repaid its 5.196% notes, which approximated $250 million, upon their maturity in February 2008.

Other Financing Activities

Cash dividend payments totaled $632 million in 2009, $546 million in 2008 and $704 million in 2007. Beginning in 2007, the company converted from an annual to a quarterly dividend and increased the dividend by 15% on an annualized basis, to $0.1675 per share per quarter. The cash dividend payments in 2007 included the payments of the 2006 annual dividend and three 2007 quarterly dividends. In November 2007, the board of directors declared a quarterly dividend of $0.2175 per share ($0.87 per share on an annualized basis),

representing an increase of 30% over the previous quarterly rate. In November 2008, the board of directors declared a quarterly dividend of $0.26 per share ($1.04 per share on an annualized basis), representing an increase of 20% over the previous quarterly rate of $0.2175 per share. In November 2009, the board of directors declared a quarterly dividend of $0.29 per share ($1.16 per share on an annualized basis), which was paid on January 5, 2010 to shareholders of record as of December 10, 2009. This dividend represented an increase of 12% over the previous quarterly rate of $0.26 per share.

Proceeds and realized excess tax benefits from stock issued under employee benefit plans totaled $381 million in 2009, $680 million in 2008 and $639 million in 2007. The decrease in 2009 was due to a decrease in stock option exercises. The increase in 2008 was primarily due to increased participation in the company's employee stock purchase plan and an increase in realized excess tax benefits from stock issued under employee benefit plans, partially offset by a decrease in stock option exercises.

As authorized by the board of directors, the company repurchases its stock from time to time depending on the company's cash flows, net debt level and market conditions. The company purchased 23 million shares for $1.2 billion in 2009, 32 million shares for $2.0 billion in 2008 and 34 million shares for $1.9 billion in 2007. In March 2008, the board of directors authorized the repurchase of up to $2.0 billion of the company's common stock. There is no remaining availability under the March 2008 authorization as of December 31, 2009. In July 2009, the board of directors authorized the repurchase of up to an additional $2.0 billion of the company's common stock. At December 31, 2009, $1.95 billion remained available under the July 2009 authorization.

### Credit Facilities, Access to Capital, Credit Ratings and Net Investment Hedges

Credit Facilities

The company's primary revolving credit facility has a maximum capacity of $1.5 billion and matures in December 2011. The company also maintains a Euro-denominated credit facility with a maximum capacity of approximately $435 million at December 31, 2009, which matures in January 2013. As of December 31, 2008, there was $164 million outstanding under the Euro-denominated credit facility, with a weighted-average interest rate of 3.4%. In 2009, the company repaid the outstanding Euro-denominated credit facility borrowings. As of December 31, 2009, there were no outstanding borrowings under either of the two outstanding facilities. The company's facilities enable the company to borrow funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net-debt-to-capital ratio. At December 31, 2009, the company was in compliance with the financial covenants in these agreements. The non-performance of any financial institution supporting either of the credit facilities would reduce the maximum capacity of these facilities by each institution's respective commitment. The company also maintains other credit arrangements, as described in Note 6.

Access to Capital

The company intends to fund short-term and long-term obligations as they mature through cash on hand, future cash flows from operations or by issuing additional debt or common stock. The company had $2.8 billion of cash and equivalents at December 31, 2009. The company invests its excess cash in certificates of deposit and money market funds, and diversifies the concentration of cash among different financial institutions.

The company's ability to generate cash flows from operations, issue debt or enter into other financing arrangements on acceptable terms could be adversely affected if there is a material decline in the demand for the company's products or in the solvency of its customers or suppliers, deterioration in the company's key financial ratios or credit ratings or other significantly unfavorable changes in conditions. However, the company believes it has sufficient financial flexibility in the future to issue debt, enter into other financing arrangements and attract long-term capital on acceptable terms to support the company's growth objectives.

While the current economic downturn has not meaningfully impacted the company's ability to collect receivables, the company continues to do business with certain foreign governments which have recently experienced credit rating downgrades and may become unable to pay for the company's products or services.

Credit Ratings

The company's credit ratings at December 31, 2009 were as follows.

| | Standard & Poor's | Fitch | Moody's |
|---|---|---|---|
| Ratings | | | |
| Senior debt | A+ | A | A3 |
| Short-term debt | A1 | F1 | P2 |
| Outlook | Positive | Stable | Stable |

There were no changes to the company's credit ratings in 2009.

If Baxter's credit ratings or outlooks were to be downgraded, the company's financing costs related to its credit arrangements and any future debt issuances could be unfavorably impacted. However, any future credit rating downgrade or change in outlook would not affect the company's ability to draw on its credit facilities, and would not result in an acceleration of the scheduled maturities of any of the company's outstanding debt, unless, with respect to certain debt instruments, preceded by a change in control of the company.

Net Investment Hedges

In 2008, the company terminated its remaining net investment hedge portfolio and no longer has any outstanding net investment hedges. The company historically hedged the net assets of certain of its foreign operations using a combination of foreign currency denominated debt and cross-currency swaps. In 2004, the company reevaluated its net investment hedge strategy and elected to reduce the use of these instruments as a risk management tool. As part of the change in strategy the company executed offsetting, or mirror, cross-currency swaps relating to over half of the existing portfolio that effectively fixed the net amount that the company would ultimately pay to settle the cross-currency swap agreements subject to this strategy. The net after-tax losses related to net investment hedge instruments recorded in other comprehensive income were $33 million and $48 million in 2008 and 2007, respectively.

When the cross-currency swaps are settled, the cash flows are reported within the financing section of the consolidated statement of cash flows. When the mirror swaps are settled, the cash flows are reported in the operating section of the consolidated statement of cash flows. Of the $528 million of net settlement payments in 2008, $540 million of cash outflows were included in the financing section and $12 million of cash inflows were included in the operating section. Of the $334 million of settlement payments in 2007, $303 million of cash outflows were included in the financing section and $31 million of cash outflows were included in the operating section.

## Contractual Obligations

As of December 31, 2009, the company had contractual obligations (excluding accounts payable, accrued liabilities (other than the current portion of unrecognized tax benefits) and contingent liabilities) payable or maturing in the following periods.

| (in millions) | Total | Less than one year | One to three years | Three to five years | More than five years |
|---|---|---|---|---|---|
| Short-term debt | $ 29 | $ 29 | $ — | $ — | $ — |
| Long-term debt and capital lease obligations, including current maturities | 4,079 | 682 | 168 | 362 | 2,867 |
| Interest on short- and long-term debt and capital lease obligations[1] | 1,703 | 143 | 244 | 235 | 1,081 |
| Operating leases | 802 | 163 | 253 | 192 | 194 |
| Other long-term liabilities[2] | 789 | — | 175 | 73 | 541 |
| Purchase obligations[3] | 1,425 | 620 | 468 | 200 | 137 |
| Unrecognized tax benefits[4] | 302 | 302 | — | — | — |
| Contractual obligations | $9,129 | $1,939 | $1,308 | $1,062 | $4,820 |

[1] Interest payments on debt and capital lease obligations are calculated for future periods using interest rates in effect at the end of 2009. Projected interest payments include the related effects of interest rate and cross-currency swap agreements. Certain of these projected interest payments may differ in the future based on changes in floating interest rates, foreign currency fluctuations or other factors or events. The projected interest payments only pertain to obligations and agreements outstanding at December 31, 2009. Refer to Notes 6 and 7 for further discussion regarding the company's debt instruments and related cross-currency and interest rate agreements outstanding at December 31, 2009.

[2] The primary components of other long-term liabilities in the company's consolidated balance sheet are liabilities relating to pension and other postemployment benefit plans, cross-currency swaps, foreign currency hedges, litigation and certain income tax-related liabilities. The company projected the timing of the future cash payments based on contractual maturity dates (where applicable) and estimates of the timing of payments (for liabilities with no contractual maturity dates). The actual timing of payments could differ from the estimates.

The company contributed $170 million, $287 million and $47 million to its defined benefit pension plans in 2009, 2008 and 2007, respectively. Most of the company's plans are funded. The timing of funding in the future is uncertain and is dependent on future movements in interest rates and investment returns, changes in laws and regulations, and other variables. Therefore, the table above excludes pension plan cash outflows. Refer to the discussion below regarding the Pension Protection Act of 2006. The pension plan balance included in other long-term liabilities (and excluded from the table above) totaled $1.1 billion at December 31, 2009.

[3] Includes the company's significant contractual unconditional purchase obligations. For cancelable agreements, includes any penalty due upon cancellation. These commitments do not exceed the company's projected requirements and are in the normal course of business. Examples include firm commitments for raw material purchases, utility agreements and service contracts.

[4] Due to the uncertainty related to the timing of the reversal of uncertain tax positions, the long-term liability relating to unrecognized tax benefits of $94 million at December 31, 2009 has been excluded from the table above.

## Off-Balance Sheet Arrangements

Baxter periodically enters into off-balance sheet arrangements where economical and consistent with the company's business strategy. Certain contingencies arise in the normal course of business, and are not recorded in the consolidated balance sheet in accordance with GAAP (such as contingent joint development and commercialization arrangement payments). Also, upon resolution of uncertainties, the company may incur charges in excess of presently established liabilities for certain matters (such as contractual indemnifications). The following is a summary of significant off-balance sheet arrangements and contingencies.

### Receivable Securitizations

Where economical, the company has entered into agreements with various financial institutions in which the entire interest in and ownership of the receivable is sold, principally consisting of trade receivables originated in Japan. The company had also entered into agreements in which undivided interests in certain pools of receivables were sold, principally consisting of hardware lease receivables originated in the United States and trade receivables originated in Europe. Refer to Note 7 for a description of these arrangements. The Japanese securitization arrangement includes limited recourse provisions, which are not material to the consolidated financial statements.

### Joint Development and Commercialization Arrangements

In the normal course of business, Baxter enters into joint development and commercialization arrangements with third parties, sometimes with companies in which the company has invested. The arrangements vary but generally provide that Baxter will receive certain rights to manufacture, market or distribute a specified technology or product under development in exchange for up-front

payments and contingent payments relating to the achievement of specified pre-clinical, clinical, regulatory approval or sales milestones. At December 31, 2009, the unfunded milestone payments under these arrangements totaled $812 million. This total excludes any contingent royalties. Based on the company's projections, any contingent payments made in the future will be more than offset over time by the estimated net future cash flows relating to the rights acquired for those payments. The majority of the contingent payments relate to arrangements in the BioScience segment. Refer to Note 6 for further information.

### Indemnifications

During the normal course of business, Baxter makes indemnities, commitments and guarantees pursuant to which the company may be required to make payments related to specific transactions. Indemnifications include: (i) intellectual property indemnities to customers in connection with the use, sale or license of products and services; (ii) indemnities to customers in connection with losses incurred while performing services on their premises; (iii) indemnities to vendors and service providers pertaining to claims based on negligence or willful misconduct; and (iv) indemnities involving the representations and warranties in certain contracts. In addition, under Baxter's Amended and Restated Certificate of Incorporation, and consistent with Delaware General Corporation Law, the company has agreed to indemnify its directors and officers for certain losses and expenses upon the occurrence of prescribed events. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum potential for future payments that the company could be obligated to make. To help address some these risks, the company maintains various insurance coverages. Based on historical experience and evaluation of the agreements, the company does not believe that any significant payments related to its indemnifications will result, and therefore the company has not recorded any associated liabilities.

### Legal Contingencies

Refer to Note 11 for a discussion of the company's legal contingencies. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established liabilities. While the liability of the company in connection with the claims cannot be estimated with any certainty, and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company's results of operations and cash flows for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company's consolidated financial position. While the company believes that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

### Funding of Pension and Other Postemployment Benefit Plans

The company's funding policy for its pension plans is to contribute amounts sufficient to meet legal funding requirements, plus any additional amounts that the company may determine to be appropriate considering the funded status of the plans, tax deductibility, the cash flows generated by the company and other factors. Volatility in the global financial markets could have an unfavorable impact on future funding requirements. The company is not legally obligated to fund its principal plans in the United States and Puerto Rico in 2010. The company continually reassesses the amount and timing of any discretionary contributions. The company expects to make cash contributions to its pension plans of at least $335 million in 2010, which includes a $300 million discretionary cash contribution made to its pension plan in the United States in January 2010. The company expects to have net cash outflows relating to its other postemployment benefit (OPEB) plan of approximately $25 million in 2010.

The table below details the funded status percentage of the company's pension plans as of December 31, 2009, including certain plans that are unfunded in accordance with the guidelines of the company's funding policy outlined above. The table excludes the $300 million discretionary cash contribution made to the pension plan in the United States in January 2010. Refer to Note 9 for further information.

| | United States and Puerto Rico | | International | | |
|---|---|---|---|---|---|
| as of December 31, 2009 (in millions) | Qualified plans | Nonqualified plan | Funded plans | Unfunded plans | Total |
| Fair value of plan assets | $2,356 | n/a | $ 466 | n/a | $2,822 |
| Projected benefit obligation | 2,984 | $145 | 599 | $237 | 3,965 |
| Funded status percentage | 79% | n/a | 78% | n/a | 71% |

The Pension Protection Act of 2006 (PPA) was signed into law on August 17, 2006. It is likely that the PPA will accelerate minimum funding requirements in the future.

### Insurance Coverage

The company discontinued its practice of buying product liability insurance coverage effective May 1, 2007. The unavailability of insurance coverage with meaningful limits at a reasonable cost reflects current trends in product liability insurance for healthcare manufacturing companies generally. The company continues to evaluate available coverage levels and costs as market conditions change. The company's net income and cash flows may be adversely affected in the future as a result of losses sustained.

## FINANCIAL INSTRUMENT MARKET RISK

The company operates on a global basis, and is exposed to the risk that its earnings, cash flows and shareholders' equity could be adversely impacted by fluctuations in foreign exchange and interest rates. The company's hedging policy attempts to manage these risks to an acceptable level based on the company's judgment of the appropriate trade-off between risk, opportunity and costs. Refer to Note 7 for further information regarding the company's financial instruments and hedging strategies.

### Currency Risk

The company is primarily exposed to foreign exchange risk with respect to recognized assets and liabilities, forecasted transactions and net assets denominated in the Euro, Japanese Yen, British

Pound, Australian Dollar, Canadian Dollar, Brazilian Real and Colombian Peso. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative financial instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and shareholders' equity volatility relating to foreign exchange. Financial market and currency volatility may reduce the benefits of the company's natural hedges and limit the company's ability to cost-effectively hedge these exposures.

The company uses options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions denominated in foreign currencies and recognized assets and liabilities. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions at December 31, 2009 is 12 months. The company also enters into derivative instruments to hedge certain intercompany and third-party receivables and payables and debt denominated in foreign currencies. The company historically hedged certain of its net investments in international affiliates, using a combination of debt denominated in foreign currencies and cross-currency swap agreements. As further discussed in Note 7, in 2008, the company terminated all of its remaining net investment hedges.

Currency restrictions enacted in Venezuela require Baxter to obtain approval from the Venezuelan government to exchange Venezuelan Bolivars for U.S. Dollars and requires such exchange to be made at the official exchange rate established by the government. On January 8, 2010, the Venezuelan government devalued the official exchange rate of 2.15 relative to the U.S. Dollar. The official exchange rate for imported goods classified as essential, such as food and medicine, was changed to 2.6, while the rate for payments for non-essential goods was changed to 4.3. The company expects that the majority of its products imported into Venezuela will be classified as essential goods and qualify for the 2.6 rate. The 4.3 rate was used for the translation of the company's Venezuelan subsidiary at December 31, 2009, because this is the rate at which dividends are expected to be remitted if and when such dividends are approved by the Venezuelan government. As of January 1, 2010, Venezuela has been designated as a highly inflationary economy under GAAP and as a result, the functional currency of the company's subsidiary in Venezuela will be the U.S. Dollar. The devaluation of the Venezuelan Bolivar and designation of Venezuela as highly inflationary is not expected to have a material impact on the financial results of the company. As of December 31, 2009, the company's subsidiary in Venezuela had net assets of $20 million denominated in the Venezuelan Bolivar. In 2009, net sales in Venezuela represented less than 1% of Baxter's total net sales.

As part of its risk-management program, the company performs sensitivity analyses to assess potential changes in the fair value of its foreign exchange instruments relating to hypothetical and reasonably possible near-term movements in foreign exchange rates. A sensitivity analysis of changes in the fair value of foreign exchange option, forward and cross-currency swap contracts outstanding at December 31, 2009, while not predictive in nature, indicated that if the U.S. Dollar uniformly fluctuated unfavorably by 10% against all currencies, on a net-of-tax basis, the net liability balance of $69 million with respect to those contracts, which principally related to a hedge of U.S. Dollar-denominated debt issued by a foreign subsidiary, would increase by $69 million. A similar analysis performed with respect to option and forward contracts outstanding at December 31, 2008 indicated that, on a net-of-tax basis, the net asset balance of $40 million would decrease by $65 million, resulting in a net liability position.

The sensitivity analysis model recalculates the fair value of the foreign exchange option, forward and cross-currency swap contracts outstanding at December 31, 2009 by replacing the actual exchange rates at December 31, 2009 with exchange rates that are 10% unfavorable to the actual exchange rates for each applicable currency. All other factors are held constant. 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. The analyses also disregard the offsetting change in value of the underlying hedged transactions and balances.

### Interest Rate and Other Risks

The company is also exposed to the risk that its earnings and cash flows could be adversely impacted by fluctuations in interest rates. The company's policy is to manage interest costs using a mix of fixed- and floating-rate debt that the company believes is appropriate. To manage this mix in a cost-efficient manner, the company periodically enters into interest rate swaps in which the company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional amount. The company also periodically uses forward-starting interest rate swaps and treasury rate locks to hedge the risk to earnings associated with fluctuations in interest rates relating to anticipated issuances of term debt.

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 52 basis-point increase in interest rates (approximately 10% of the company's weighted-average interest rate during 2009) affecting the company's financial instruments, including debt obligations and related derivatives, would have an immaterial effect on the company's 2009, 2008 and 2007 earnings and on the fair value of the company's fixed-rate debt as of the end of each fiscal year.

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

With respect to the company's investments in affiliates, the company 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.

## CHANGES IN ACCOUNTING STANDARDS

### Business Combinations

On January 1, 2009, the company adopted a new accounting standard which changes the accounting for business combinations in a number of significant respects. The key changes include the expansion of transactions that qualify as business combinations, the capitalization of IPR&D as an indefinite-lived asset, the recognition of certain acquired contingent assets and liabilities at fair value, the expensing of acquisition costs, the expensing of costs associated with restructuring the acquired company, the recognition of contingent consideration at fair value on the acquisition date, the recognition of post-acquisition date changes in deferred tax asset valuation allowances and acquired income tax uncertainties as income tax expense or benefit, and the expansion of disclosure requirements. This standard was applicable for acquisitions made by the company on or after January 1, 2009, including the April 2009 consolidation of SIGMA and the August 2009 acquisition of certain assets of Edwards CRRT. Refer to Note 4 for further information regarding SIGMA and Edwards CRRT.

### Noncontrolling Interests

On January 1, 2009, the company adopted a new accounting standard which changes the accounting and reporting of noncontrolling interests (historically referred to as minority interests). The standard requires that noncontrolling interests be presented in the consolidated balance sheets within equity, but separate from Baxter shareholders' equity, and that the amount of consolidated net income attributable to Baxter and to the noncontrolling interests be clearly identified and presented in the consolidated statements of income. Any losses in excess of the noncontrolling interest's equity interest continue to be allocated to the noncontrolling interest. Purchases or sales of equity interests that do not result in a change of control are accounted for as equity transactions. Upon a loss of control the interest sold, as well as any interest retained, is measured at fair value, with any gain or loss recognized in earnings. In partial acquisitions, when control is obtained, 100% of the assets and liabilities, including goodwill, are recognized at fair value as if the entire target company had been acquired. The new standard was applied prospectively as of January 1, 2009, except for the presentation and disclosure requirements, which have been applied retrospectively for prior periods presented. Prior to the adoption of the new standard, the noncontrolling interests' share of net income was included in other expense, net in the consolidated statements of income and the noncontrolling interests' equity was included in other long-term liabilities in the consolidated balance sheets. The accounting related provisions of the new accounting standard did not have a material impact on the consolidated financial statements.

### Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) issued two updates to the Accounting Standards Codification related to revenue recognition. The first update eliminates the requirement that all undelivered elements in an arrangement with multiple deliverables have objective and reliable evidence of fair value before revenue can be recognized for items that have been delivered. The update also no longer allows use of the residual method when allocating consideration to deliverables. Instead, arrangement consideration is to be allocated to deliverables using the relative selling price method, applying a selling price hierarchy. Vendor specific objective evidence (VSOE) of selling price should be used if it exists. Otherwise, third party evidence (TPE) of selling price should be used. If neither VSOE nor TPE is available, the company's best estimate of selling price should be used. The second update eliminates tangible products from the scope of software revenue recognition guidance when the tangible products contain software components and non-software components that function together to deliver the tangible products' essential functionality. Both updates require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010, with prospective application for new or materially modified arrangements or retrospective application permitted. Early adoption is permitted. The same transition method and period of adoption must be used for both updates. The company adopted these updates in 2009, prospectively applying them to arrangements entered into or materially modified on or after January 1, 2009. The early adoption of these updates did not have a material impact on the company's consolidated financial statements and did not result in a change in its previously reported quarterly consolidated financial statements.

## CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with GAAP requires the company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of the company's significant accounting policies is included in Note 1. Certain of the company's accounting policies are considered critical because these policies are the most important to the depiction of the company's financial statements and require significant, difficult or complex judgments by the company, often requiring the use of estimates about the effects of matters that are inherently uncertain. Actual results that differ from the company's estimates could have an unfavorable effect on the company's results of operations and financial position. The company applies estimation methodologies consistently from year to year. Other than changes required due to the issuance of new accounting pronouncements, there have been no significant changes in the company's application of its critical accounting policies during 2009. The company's critical accounting policies have been reviewed with the Audit Committee of the Board of Directors. The following is a summary of accounting policies that the company considers critical to the consolidated financial statements.

### Revenue Recognition and Related Provisions and Allowances

The company's policy is to recognize revenues from product sales and services when earned. Specifically, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred (or services have been rendered), the price is fixed or determinable, and collectibility is reasonably assured. The shipping terms for the majority of the company's revenue arrangements are FOB destination. The recognition of revenue is delayed if there are

significant post-delivery obligations, such as training, installation or other services.

The company sometimes enters into arrangements in which it commits to delivering multiple products or services to its customers. In these cases, total arrangement consideration is allocated to the deliverables based on their relative selling prices. Then the allocated consideration is recognized as revenue in accordance with the principles described above. Selling prices are determined by applying a selling price hierarchy. Selling prices are determined using VSOE, if it exists. Otherwise, selling prices are determined using TPE. If neither VSOE nor TPE is available, the company uses its best estimate of selling prices.

Provisions for discounts, rebates to customers, chargebacks to wholesalers, and returns are provided for at the time the related sales are recorded, and are reflected as a reduction of sales. These estimates are reviewed periodically and, if necessary, revised, with any revisions recognized immediately as adjustments to sales.

The company periodically and systematically evaluates the collectibility of accounts receivable and determines the appropriate reserve for doubtful accounts. In determining the amount of the reserve, the company considers historical credit losses, the past-due status of receivables, payment history and other customer-specific information, and any other relevant factors or considerations. Because of the nature of the company's customer base and the company's credit and collection policies and procedures, write-offs of accounts receivable have historically not been significant (generally less than 2% of gross receivables).

The company also provides for the estimated costs that may be incurred under its warranty programs when the cost is both probable and reasonably estimable, which is at the time the related revenue is recognized. The cost is determined based on actual company experience for the same or similar products as well as other relevant information. Estimates of future costs under the company's warranty programs could change based on developments in the future. The company is not able to estimate the probability or amount of any future developments that could impact the reserves, but believes presently established reserves are adequate.

### Pension and OPEB Plans

The company provides pension and other postemployment benefits to certain of its employees. These employee benefit expenses are reported in the same line items in the consolidated income statement as the applicable employee's compensation expense. The valuation of the funded status and net benefit cost for the plans are calculated using actuarial assumptions. These assumptions are reviewed annually, and revised if appropriate. The significant assumptions include the following:

- interest rates used to discount pension and OPEB plan liabilities;
- the long-term rate of return on pension plan assets;
- rates of increases in employee compensation (used in estimating liabilities);
- anticipated future healthcare costs (used in estimating the OPEB plan liability); and
- other assumptions involving demographic factors such as retirement, mortality and turnover (used in estimating liabilities).

Selecting assumptions involves an analysis of both short-term and long-term historical trends and known economic and market conditions at the time of the valuation (also called the measurement date). The use of different assumptions would result in different measures of the funded status and net cost. Actual results in the future could differ from expected results. The company is not able to estimate the probability of actual results differing from expected results, but believes its assumptions are appropriate.

The company's key assumptions are listed in Note 9. The most critical assumptions relate to the plans covering U.S. and Puerto Rico employees, because these plans are the most significant to the company's consolidated financial statements.

Discount Rate Assumption

For the U.S. and Puerto Rico plans, at the measurement date (December 31, 2009), the company used a discount rate of 6.05% and 5.95% to measure its benefit obligations for the pension plans and OPEB plan, respectively. This discount rate will be used in calculating the net periodic benefit cost for these plans for 2010. The company used a broad population of approximately 260 Aa-rated corporate bonds as of December 31, 2009 to determine the discount rate assumption. All bonds were denominated in U.S. dollars, with a minimum amount outstanding of $50 million. This population of bonds was narrowed from a broader universe of over 500 Moody's Aa rated, non-callable (or callable with make-whole provisions) bonds by eliminating the top 10th percentile and bottom 40th percentile to adjust for any pricing anomalies and to represent the bonds Baxter would most likely select if it were to actually annuitize its pension and OPEB plan liabilities. This portfolio of bonds was used to generate a yield curve and associated spot rate curve, to discount the projected benefit payments for the U.S. and Puerto Rico plans. The discount rate is the single level rate that produces the same result as the spot rate curve.

For plans in Canada, Japan, the United Kingdom and the Eurozone, the company uses a method essentially the same as that described for the U.S. and Puerto Rico plans. For the company's other international plans, the discount rate is generally determined by reviewing country- and region-specific government and corporate bond interest rates.

To understand the impact of changes in discount rates on pension and OPEB plan cost, the company performs a sensitivity analysis. Holding all other assumptions constant, for each 50 basis point (i.e., one-half of one percent) increase (decrease) in the discount rate, global pre-tax pension and OPEB plan cost would decrease (increase) by approximately $32 million.

Return on Plan Assets Assumption

In measuring net periodic cost for 2009, the company used a long-term expected rate of return of 8.5% for the pension plans covering U.S. and Puerto Rico employees. This assumption will also be used to measure net pension cost for 2010. This assumption is not applicable to the company's OPEB plan because it is not funded.

The company establishes the long-term asset return assumption based on a review of historical compound average asset returns, both company-specific and relating to the broad market (based on the company's asset allocation), as well as an analysis of current market and economic information and future expectations. The current asset return assumption is supported by historical market experience for both the company's actual and targeted asset allocation. In calculating net pension cost, the expected return on assets is applied to a calculated value of plan assets, which recognizes changes in the fair value of plan assets in a systematic manner over five years. The difference between this expected return and the actual return on plan assets is a component of the total net unrecognized gain or loss and is subject to amortization in the future.

To understand the impact of changes in the expected asset return assumption on net cost, the company performs a sensitivity analysis. Holding all other assumptions constant, for each 50 basis point increase (decrease) in the asset return assumption, global pre-tax pension plan cost would decrease (increase) by approximately $15 million.

Other Assumptions

The company used the Retirement Plan 2000 mortality table to calculate the pension and OPEB plan benefit obligations for its plans in the United States and Puerto Rico. For all other pension plans, the company utilized country and region-specific mortality tables to calculate the plans' benefit obligations. The company periodically analyzes and updates its assumptions concerning demographic factors such as retirement, mortality and turnover, considering historical experience as well as anticipated future trends.

The assumptions relating to employee compensation increases and future healthcare costs are based on historical experience, market trends, and anticipated future company actions. Refer to Note 9 for information regarding the sensitivity of the OPEB plan obligation and the total of the service and interest cost components of OPEB plan cost to potential changes in future healthcare costs.

### Legal Contingencies

The company is involved in product liability, patent, commercial, regulatory and other legal proceedings that arise in the normal course of business. Refer to Note 11 for further information. The company records a liability when a loss is considered probable and the amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded. The company has established reserves for certain of its legal matters. The company is not able to estimate the amount or range of any loss for certain of the legal contingencies for which there is no reserve or additional loss for matters already reserved. The company also records any insurance recoveries that are probable of occurring. At December 31, 2009 total legal liabilities were $112 million and total insurance receivables were $96 million.

The company's loss estimates are generally developed in consultation with outside counsel and are based on analyses of potential results. With respect to the recording of any insurance recoveries, after completing the assessment and accounting for the company's legal contingencies, the company separately and independently analyzes its insurance coverage and records any insurance recoveries that are probable of occurring at the gross amount that is expected to be collected. In performing the assessment, the company reviews available information, including historical company-specific and market collection experience for similar claims, current facts and circumstances pertaining to the particular insurance claim, the financial viability of the applicable insurance company or companies, and other relevant information.

While the liability of the company in connection with the claims cannot be estimated with any certainty, and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company's results of operations and cash flows for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company's consolidated financial position. While the company believes it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

### Inventories

The company values its inventories at the lower of cost, determined using the first-in, first-out method, or market value. Market value for raw materials is based on replacement costs and market value for work in process and finished goods is based on net realizable value. The company reviews inventories on hand at least quarterly and records provisions for estimated excess, slow-moving and obsolete inventory, as well as inventory with a carrying value in excess of net realizable value. The regular and systematic inventory valuation reviews include a current assessment of future product demand, anticipated release of new products into the market (either by the company or its competitors), historical experience and product expiration. Uncertain timing of product approvals, variability in product launch strategies, product recalls and variation in product utilization all impact the estimates related to inventory valuation. Additional inventory provisions may be required if future demand or market conditions are less favorable than the company has estimated. The company is not able to estimate the probability of actual results differing from expected results, but believes its estimates are appropriate.

### Deferred Tax Asset Valuation Allowances and Reserves for Uncertain Tax Positions

The company maintains valuation allowances unless it is more likely than not that all or a portion of the deferred tax asset will be realized. Changes in valuation allowances are included in the company's tax provision in the period of change. In determining whether a valuation allowance is warranted, the company evaluates factors such as prior earnings history, expected future earnings, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. The realizability assessments made at a given balance sheet date are subject to change in the future, particularly if earnings of a subsidiary are significantly higher or lower than expected, or if the company takes

operational or tax planning actions that could impact the future taxable earnings of a subsidiary.

In the normal course of business, the company is audited by federal, state and foreign tax authorities, and is periodically challenged regarding the amount of taxes due. These challenges relate to the timing and amount of deductions and the allocation of income among various tax jurisdictions. The company believes the company's tax positions comply with applicable tax law and the company intends to defend its positions. In evaluating the exposure associated with various tax filing positions, the company records reserves for uncertain tax positions in accordance with GAAP, based on the technical support for the positions, the company's past audit experience with similar situations, and potential interest and penalties related to the matters. The company's effective tax rate in a given period could be impacted if, upon final resolution with taxing authorities, the company prevailed in positions for which reserves have been established, or was required to pay amounts in excess of established reserves.

### Fair Value Measurements of Financial Assets and Liabilities

On January 1, 2008, the company adopted the new accounting standard for financial assets and financial liabilities recognized or disclosed at fair value in the consolidated financial statements on a recurring basis and on January 1, 2009, the company adopted the new accounting standard for nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis.

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The majority of the derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments. The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs, which are observable, depend on the type of derivative, and include contractual terms, counterparty credit risk, interest rate yield curves, foreign exchange rates and volatility. Refer to the Financial Instrument Market Risk section above for disclosures regarding sensitivity analyses performed by the company and Note 7 for further information regarding the company's financial instruments.

In addition, the company's pension plan assets and contingent payments associated with business combinations are valued at fair value on a recurring basis. The valuation of pension assets, which are recorded net of the plan's liabilities, depends on the type of security the plan holds. Principally, the securities are valued using quoted prices in active markets or pricing matrices or models that incorporate observable market data inputs. Refer to the Pension and OPEB Plans section above and Note 9 for further information on the company's pension plans. Contingent payments are valued using a discounted cash flow technique that reflects management's expectations about probability of payment. Refer to Note 4 for further information on the company's contingent payments relating to acquisitions.

### Valuation of Intangible Assets, Including IPR&D

The company acquires intangible assets and records them at fair value. Valuations are generally completed for business acquisitions using a discounted cash flow analysis, incorporating the stage of completion. The most significant estimates and assumptions inherent in the discounted cash flow analysis include the amount and timing of projected future cash flows, the discount rate used to measure the risks inherent in the future cash flows, the assessment of the asset's life cycle, and the competitive and other trends impacting the asset, including consideration of technical, legal, regulatory, economic and other factors. Each of these factors and assumptions can significantly affect the value of the intangible asset.

Acquired IPR&D is the value assigned to acquired technology or products under development which have not received regulatory approval and have no alternative future use.

Beginning in 2009, as discussed further above, the company adopted a new accounting standard for accounting for business combinations. Under the new accounting standard, acquired IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset and is no longer expensed at the time of the acquisition. Development costs incurred after the acquisition are expensed as incurred. Upon receipt of regulatory approval of the related technology or product, the indefinite-lived intangible asset is then accounted for as a finite-lived intangible asset and amortized on a straight-line basis over its estimated useful life. If the R&D project is abandoned, the indefinite-lived asset is charged to expense.

IPR&D acquired in transactions that are not business combinations is expensed immediately. For such transactions, payments made to third parties subsequent to regulatory approval are capitalized and amortized over the remaining useful life of the related asset, and are classified as intangible assets.

Due to the inherent uncertainty associated with R&D projects, there is no assurance that actual results will not differ materially from the underlying assumptions used to prepare discounted cash flow analyses, nor that the R&D project will result in a successful commercial product.

### Impairment of Assets

Goodwill is subject to impairment reviews annually, and whenever indicators of impairment exist. Intangible assets other than goodwill and other long-lived assets (such as fixed assets) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Refer to Note 1 for further information. The company's impairment reviews are based on an estimated future cash flow approach that requires significant judgment with respect to future volume, revenue and expense growth rates, changes in working capital use, foreign currency exchange rates, the selection of an appropriate discount rate, asset groupings, and other assumptions and estimates. The estimates and assumptions used are consistent with the company's business plans and a market participant's views of the company and similar companies. The use of alternative estimates and assumptions could increase or decrease the estimated fair values of the assets, and

potentially result in different impacts to the company's results of operations. Actual results may differ from the company's estimates.

### Stock-Based Compensation Plans

Stock-based compensation cost is estimated at the grant date based on the fair value of the award, and the cost is recognized as expense ratably over the substantive vesting period. Determining the appropriate fair value model to use requires judgment. Determining the assumptions that enter into the model is highly subjective and also requires judgment. The company's stock compensation costs principally relate to awards of stock options, and the significant assumptions include long-term projections regarding stock price volatility, employee exercise, post-vesting termination, and pre-vesting forfeiture behaviors, interest rates and dividend yields.

The company uses the Black-Scholes model for estimating the fair value of stock options. The company's expected volatility assumption is based on an equal weighting of the historical volatility of Baxter's stock and the implied volatility from traded options on Baxter's stock. The expected life assumption is primarily based on historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield reflects historical experience as well as future expectations over the expected life of the option. The forfeiture rate used to calculate compensation expense is primarily based on historical pre-vesting employee forfeiture patterns. In finalizing its assumptions, the company also reviews comparable companies' assumptions, as available in published surveys and in publicly available financial filings.

The pre-vesting forfeitures assumption is ultimately adjusted to the actual forfeiture rate. Therefore, changes in the forfeitures assumption would not impact the total amount of expense ultimately recognized over the vesting period. Estimated forfeitures are reassessed each period based on historical experience and current projections for the future.

The use of different assumptions would result in different amounts of stock compensation expense. The fair value of an option is particularly impacted by the expected volatility and expected life assumptions. To understand the impact of changes in these assumptions on the fair value of an option, the company performs sensitivity analyses. Holding all other variables constant, if the expected volatility assumption used in valuing the stock options granted in 2009 was increased by 100 basis points (i.e., one percent), the fair value of a stock option relating to one share of common stock would increase by approximately 3%, from $11.68 to $12.07. Holding all other variables constant (including the expected volatility assumption), if the expected life assumption used in valuing the stock options granted in 2009 was increased by one year, the fair value of a stock option relating to one share of common stock would increase by approximately 8%, from $11.68 to $12.61.

The company began granting performance share units (PSUs) in 2007. PSUs are earned by comparing the company's growth in shareholder value relative to a performance peer group over a three-year period. Based on the company's relative performance, the recipient of a PSU may earn a total award ranging from 0% to 200% of the initial grant. The fair value of a PSU is estimated by the company at the grant date using a Monte Carlo model. A Monte Carlo model uses stock price volatility and other variables to estimate the probability of satisfying the market conditions and the resulting fair value of the award. The three primary inputs for the Monte Carlo model are the risk-free rate, volatility of returns and correlation of returns. The determination of the risk-free rate is similar to that described above relating to the valuation of stock options. The expected volatility and correlation assumptions are based on historical information.

The company is not able to estimate the probability of actual results differing from expected results, but believes the company's assumptions are appropriate, based upon the requirements of accounting standards for stock compensation and the company's historical and expected future experience.

### Hedging Activities

As further discussed in Note 7 and in the Financial Instrument Market Risk section above, the company uses derivative instruments to hedge certain risks. As Baxter operates on a global basis, there is a risk to earnings associated with foreign exchange relating to the company's recognized assets and liabilities and forecasted transactions denominated in foreign currencies. Compliance with accounting standards for derivatives and hedging activities and the company's hedging policies require the company to make judgments regarding the probability of anticipated hedged transactions. In making these estimates and assessments of probability, the company analyzes historical trends and expected future cash flows and plans. The estimates and assumptions used are consistent with the company's business plans. If the company were to make different assessments of probability or make the assessments during a different fiscal period, the company's results of operations for a given period would be different.

## NEW ACCOUNTING STANDARDS

Transfers of Financial Assets

In June 2009, the FASB issued a new accounting standard relating to the accounting for transfers of financial assets. The new standard eliminates the concept of a qualifying special-purpose entity and clarifies existing GAAP as it relates to determining whether a transferor has surrendered control over transferred financial assets. The standard limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements presented and/or when the transferor has continuing involvement with the transferred financial asset. The standard also requires enhanced disclosures about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. It is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2009, with early adoption prohibited. The new standard will be applied prospectively, except for the disclosure requirements, which will be applied retrospectively for all periods presented. The new standard, which is effective for the company as of January 1, 2010, is not expected to have a material impact on the company's consolidated financial statements.

Variable Interest Entities

In June 2009, the FASB issued a new standard that changes the consolidation model for variable interest entities (VIEs). The new standard requires an enterprise to qualitatively assess the determination of the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and has the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. The standard requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. The standard expands the disclosure requirements for enterprises with a variable interest in a VIE. It is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2009, with early adoption prohibited. The new standard, which is effective for the company as of January 1, 2010, is not expected to have material impact on the company's consolidated financial statements.

## CERTAIN REGULATORY MATTERS

In July 2005, the company stopped shipment of COLLEAGUE infusion pumps in the United States. Following a number of Class I recalls (recalls at the highest priority level for the FDA) relating to the performance of the pumps, as well as the seizure litigation described in Note 11, the company entered into a Consent Decree in June 2006. Additional Class I recalls related to remediation and repair and maintenance activities were addressed by the company in 2007 and 2009. The Consent Decree provides for reviews of the company's facilities, processes and controls by the company's outside expert, followed by the FDA. In December 2007, following the outside expert's review, the FDA conducted inspections and remains in a dialogue with the company. As discussed in Note 11, the company received a subpoena from the Office of the United States Attorney of the Northern District of Illinois relating to the COLLEAGUE infusion pump in September 2009. As discussed in Note 5, the company has recorded a number of charges in connection with its COLLEAGUE infusion pumps. It is possible that substantial additional charges, including significant asset impairments, related to COLLEAGUE may be required in future periods, based on new information, changes in estimates, and modifications to the current remediation plan.

In the first quarter of 2008, the company identified an increasing level of allergic-type and hypotensive adverse reactions occurring in patients using its heparin sodium injection products in the United States. The company initiated a field corrective action with respect to the products; however, due to users' needs for the products, the company and the FDA concluded that public health considerations warranted permitting selected dosages of the products to remain in distribution for use where medically necessary until alternate sources became available in the quarter, at which time the company's products were removed from distribution.

In January 2010, the company received a Warning Letter from the FDA regarding observations made by the agency following inspections of the company's manufacturing facility in Lessines, Belgium. The Warning Letter identifies a number of issues associated with certain fill and finish processes and controls relating to GAMMAGARD LIQUID therapy. The company is working with the FDA to address these issues.

While the company continues to work to resolve the issues described above, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, that sales of any other product may not be adversely affected, or that additional legislation or regulation will not be introduced that may adversely affect the company's operations. Please see "Item 1A. Risk Factors" in the company's Annual Report on Form 10-K for additional discussion of regulatory matters.

## FORWARD-LOOKING INFORMATION

This annual report includes forward-looking statements, including statements with respect to accounting estimates and assumptions, future litigation outcomes, the company's efforts to remediate its infusion pumps and other regulatory matters, expectations with respect to restructuring programs (including expected cost savings), strategic plans, product and business mix, promotional efforts, geographic expansion, sales and pricing forecasts, credit exposure to foreign governments, expectations with respect to business development activities, potential developments with respect to credit and credit ratings, interest expense in 2010, estimates of liabilities, ongoing tax audits and related tax provisions, deferred tax assets, future pension plan contributions, costs, rates of return and minimum funding requirements, expectations with respect to the company's exposure to foreign currency risk, the company's internal R&D pipeline, future capital and R&D expenditures, the sufficiency of the company's financial flexibility and the adequacy of credit facilities and reserves, the effective tax rate in 2010, and all other statements that do not relate to historical facts. The statements are based on assumptions about many important factors, including assumptions concerning:

- demand for and market acceptance risks for new and existing products, such as ADVATE and IGIV, and other therapies;
- the company's ability to identify business development and growth opportunities for existing products;
- product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, sanctions, seizures, litigation, or declining sales;
- future actions of the FDA or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale or result in seizures, injunctions, monetary sanctions or criminal or civil liabilities, including any sanctions available under the Consent Decree entered into with the FDA concerning the COLLEAGUE and SYNDEO infusion pumps;
- foreign currency fluctuations, particularly due to reduced benefits from the company's natural hedges and limitations on the ability to cost-effectively hedge resulting from financial market and currency volatility;
- fluctuations in supply and demand for plasma protein products;
- reimbursement or rebate policies of government agencies and private payers;
- changes in healthcare legislation and regulation, including through healthcare reform in the United States or globally, which may affect pricing, reimbursement or other elements of the company's business;
- production yields, regulatory clearances and customers' final purchase commitments with respect to the company's pandemic vaccine;
- product development risks, including satisfactory clinical performance, the ability to manufacture at appropriate scale, and the general unpredictability associated with the product development cycle;
- the ability to enforce the company's patent rights or patents of third parties preventing or restricting the company's manufacture, sale or use of affected products or technology;
- the impact of geographic and product mix on the company's sales;
- the impact of competitive products and pricing, including generic competition, drug reimportation and disruptive technologies;
- inventory reductions or fluctuations in buying patterns by wholesalers or distributors;
- the availability and pricing of acceptable raw materials and component supply;
- global regulatory, trade and tax policies;
- any changes in law concerning the taxation of income, including income earned outside the United States;
- actions by tax authorities in connection with ongoing tax audits;
- the company's ability to realize the anticipated benefits of restructuring and optimization initiatives;
- the company's ability to realize the anticipated benefits from its joint product development and commercialization arrangements, including the SIGMA transaction;
- changes in credit agency ratings;
- any impact of the commercial and credit environment on the company and its customers and suppliers; and
- other factors identified elsewhere in the company's Annual Report on Form 10-K, including those factors described under the caption "Item 1A. Risk Factors" and other filings with the Securities and Exchange Commission, all of which are available on the company's website.

Actual results may differ materially from those projected in the forward-looking statements. The company does not undertake to update its forward-looking statements.

## Management's Responsibility for Consolidated Financial Statements

Management is responsible for the preparation of the company's consolidated financial statements and related information appearing in this report. Management believes that the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements reasonably present the company's financial position, results of operations and cash flows in conformity with accounting principles generally accepted in the United States of America. Management has also included in the company's consolidated financial statements amounts that are based on estimates and judgments, which it believes are reasonable under the circumstances.

PricewaterhouseCoopers LLP, an independent registered public accounting firm, has audited the company's consolidated financial statements in accordance with the standards established by the Public Company Accounting Oversight Board and provides an opinion on whether the consolidated financial statements present fairly, in all material respects, the financial position, results of operations and cash flows of the company.

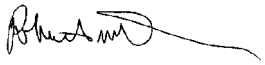
## Management's Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. The company's internal control over financial reporting is a process designed under the supervision of the principal executive and financial officers, and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

Management performed an assessment of the effectiveness of the company's internal control over financial reporting as of December 31, 2009. In making this assessment, management used the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on that assessment under the framework in *Internal Control-Integrated Framework*, management concluded that the company's internal control over financial reporting was effective as of December 31, 2009. The effectiveness of the company's internal control over financial reporting as of December 31, 2009 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report which appears herein.

Robert L. Parkinson, Jr.
Chairman of the Board and
Chief Executive Officer



Robert M. Davis
Corporate Vice President and
Chief Financial Officer

To the Board of Directors and Shareholders of Baxter International Inc.:

In our opinion, the accompanying consolidated balance sheets and related consolidated statements of income, of cash flows and of changes in equity and comprehensive income present fairly, in all material respects, the financial position of Baxter International Inc. and its subsidiaries at December 31, 2009 and December 31, 2008, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included 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. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP
Chicago, Illinois
February 22, 2010

## Consolidated Balance Sheets

| as of December 31 (in millions, except share information) | | 2009 | 2008 |
|---|---|---|---|
| **Current Assets** | Cash and equivalents | **$ 2,786** | $ 2,131 |
| | Accounts and other current receivables | **2,302** | 1,980 |
| | Inventories | **2,557** | 2,361 |
| | Short-term deferred income taxes | **226** | 251 |
| | Prepaid expenses and other | **400** | 425 |
| | **Total current assets** | **8,271** | 7,148 |
| **Property, Plant and Equipment, Net** | | **5,159** | 4,609 |
| **Other Assets** | Goodwill | **1,825** | 1,654 |
| | Other intangible assets, net | **513** | 390 |
| | Other | **1,586** | 1,604 |
| | **Total other assets** | **3,924** | 3,648 |
| | **Total assets** | **$17,354** | $15,405 |
| **Current Liabilities** | Short-term debt | **$ 29** | $ 388 |
| | Current maturities of long-term debt and lease obligations | **682** | 6 |
| | Accounts payable and accrued liabilities | **3,753** | 3,241 |
| | **Total current liabilities** | **4,464** | 3,635 |
| **Long-Term Debt and Lease Obligations** | | **3,440** | 3,362 |
| **Other Long-Term Liabilities** | | **2,030** | 2,117 |
| **Commitments and Contingencies** | | | |
| **Equity** | Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2009 and 2008 | **683** | 683 |
| | Common stock in treasury, at cost, 82,523,243 shares in 2009 and 67,501,988 shares in 2008 | **(4,741)** | (3,897) |
| | Additional contributed capital | **5,683** | 5,533 |
| | Retained earnings | **7,343** | 5,795 |
| | Accumulated other comprehensive loss | **(1,777)** | (1,885) |
| | **Total Baxter International Inc. (Baxter) shareholders' equity** | **7,191** | 6,229 |
| | **Noncontrolling interests** | **229** | 62 |
| | **Total equity** | **7,420** | 6,291 |
| | **Total liabilities and equity** | **$17,354** | $15,405 |

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

| years ended December 31 (in millions, except per share data) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Net sales** | **$12,562** | $12,348 | $11,263 |
| Cost of sales | **6,037** | 6,218 | 5,744 |
| Gross margin | **6,525** | 6,130 | 5,519 |
| Marketing and administrative expenses | **2,731** | 2,698 | 2,521 |
| Research and development expenses | **917** | 868 | 760 |
| Restructuring charge | **—** | — | 70 |
| Net interest expense | **98** | 76 | 22 |
| Other expense, net | **45** | 26 | 18 |
| Income before income taxes | **2,734** | 2,462 | 2,128 |
| Income tax expense | **519** | 437 | 407 |
| Net income | **2,215** | 2,025 | 1,721 |
| Less: Net income attributable to noncontrolling interests | **10** | 11 | 14 |
| **Net income attributable to Baxter** | **$ 2,205** | $ 2,014 | $ 1,707 |
| **Net income attributable to Baxter per common share** | | | |
| Basic | **$ 3.63** | $ 3.22 | $ 2.65 |
| Diluted | **$ 3.59** | $ 3.16 | $ 2.61 |
| **Weighted-average number of common shares outstanding** | | | |
| Basic | **607** | 625 | 644 |
| Diluted | **614** | 637 | 654 |
| **Cash dividends declared per common share** | **$ 1.070** | $ 0.913 | $ 0.720 |

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

## Consolidated Statements of Cash Flows

| years ended December 31 (in millions) (brackets denote cash outflows) | | 2009 | 2008 | 2007 |
|---|---|---|---|---|
| **Cash Flows from Operations** | Net income | **$ 2,215** | $ 2,025 | $ 1,721 |
| | Adjustments | | | |
| | Depreciation and amortization | **638** | 631 | 581 |
| | Deferred income taxes | **267** | 280 | 126 |
| | Stock compensation | **140** | 146 | 136 |
| | Realized excess tax benefits from stock issued under employee benefit plans | **(96)** | (112) | — |
| | Infusion pump charges | **27** | 125 | — |
| | Exit and other charges | **133** | 31 | 70 |
| | Acquired in-process research and development | **—** | 19 | 61 |
| | Average wholesale pricing litigation charge | **—** | — | 56 |
| | Other | **1** | 40 | (19) |
| | Changes in balance sheet items | | | |
| | Accounts and other current receivables | **(167)** | (98) | (278) |
| | Inventories | **(60)** | (163) | (211) |
| | Accounts payable and accrued liabilities | **(85)** | (239) | 1 |
| | Restructuring payments | **(45)** | (50) | (27) |
| | Other | **(59)** | (120) | 88 |
| | **Cash flows from operations** | **2,909** | 2,515 | 2,305 |
| **Cash Flows from Investing Activities** | Capital expenditures (including additions to the pool of equipment placed with or leased to customers of $119 in 2009, $146 in 2008 and $166 in 2007) | **(1,014)** | (954) | (692) |
| | Acquisitions of and investments in businesses and technologies | **(156)** | (99) | (112) |
| | Divestitures and other | **24** | 60 | 499 |
| | **Cash flows from investing activities** | **(1,146)** | (993) | (305) |
| **Cash Flows from Financing Activities** | Issuances of debt | **872** | 671 | 584 |
| | Payments of obligations | **(199)** | (950) | (635) |
| | (Decrease) increase in debt with original maturities of three months or less, net | **(200)** | 200 | — |
| | Cash dividends on common stock | **(632)** | (546) | (704) |
| | Proceeds and realized excess tax benefits from stock issued under employee benefit plans | **381** | 680 | 639 |
| | Purchases of treasury stock | **(1,216)** | (1,986) | (1,855) |
| | Other | **(18)** | — | — |
| | **Cash flows from financing activities** | **(1,012)** | (1,931) | (1,971) |
| **Effect of Foreign Exchange Rate Changes on Cash and Equivalents** | | **(96)** | 1 | 25 |
| **Increase (Decrease) in Cash and Equivalents** | | **655** | (408) | 54 |
| **Cash and Equivalents at Beginning of Year** | | **2,131** | 2,539 | 2,485 |
| **Cash and Equivalents at End of Year** | | **$ 2,786** | $ 2,131 | $ 2,539 |
| **Other supplemental information** | | | | |
| Interest paid, net of portion capitalized | | **$ 113** | $ 159 | $ 119 |
| Income taxes paid | | **$ 246** | $ 247 | $ 304 |

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

| as of and for the years ended December 31 (in millions) | 2009 Shares | 2009 Amount | 2008 Shares | 2008 Amount | 2007 Shares | 2007 Amount |
|---|---|---|---|---|---|---|
| **Common Stock** | | | | | | |
| Balance, beginning and end of year | **683** | **$ 683** | 683 | $ 683 | 683 | $ 683 |
| **Common Stock in Treasury** | | | | | | |
| Beginning of year | **68** | **(3,897)** | 50 | (2,503) | 33 | (1,433) |
| Purchases of common stock | **23** | **(1,216)** | 32 | (1,986) | 34 | (1,855) |
| Stock issued under employee benefit plans and other | **(8)** | **372** | (14) | 592 | (17) | 785 |
| End of year | **83** | **(4,741)** | 68 | (3,897) | 50 | (2,503) |
| **Additional Contributed Capital** | | | | | | |
| Beginning of year | | **5,533** | | 5,297 | | 5,177 |
| Stock issued under employee benefit plans and other | | **150** | | 236 | | 120 |
| End of year | | **5,683** | | 5,533 | | 5,297 |
| **Retained Earnings** | | | | | | |
| Beginning of year | | **5,795** | | 4,379 | | 3,271 |
| Net income attributable to Baxter | | **2,205** | | 2,014 | | 1,707 |
| Cash dividends declared on common stock | | **(648)** | | (571) | | (463) |
| Stock issued under employee benefit plans and other | | **(9)** | | — | | (136) |
| Adjustment to change measurement date for certain employee benefit plans, net of tax benefit of ($15) | | **—** | | (27) | | — |
| End of year | | **7,343** | | 5,795 | | 4,379 |
| **Accumulated Other Comprehensive Loss** | | | | | | |
| Beginning of year | | **(1,885)** | | (940) | | (1,426) |
| Other comprehensive income (loss) attributable to Baxter | | **108** | | (957) | | 486 |
| Adjustment to change measurement date for certain employee benefit plans, net of tax expense of $8 | | **—** | | 12 | | — |
| End of year | | **(1,777)** | | (1,885) | | (940) |
| **Total Baxter shareholders' equity** | | **$ 7,191** | | $ 6,229 | | $ 6,916 |
| **Noncontrolling Interests** | | | | | | |
| Beginning of year | | **$ 62** | | $ 91 | | $ 79 |
| Net income attributable to noncontrolling interests | | **10** | | 11 | | 14 |
| Other comprehensive income (loss) attributable to noncontrolling interests | | **3** | | (14) | | 12 |
| Additions (reductions) in noncontrolling ownership interests, net | | **160** | | (20) | | (7) |
| Other activity with noncontrolling interests | | **(6)** | | (6) | | (7) |
| End of year | | **$ 229** | | $ 62 | | $ 91 |
| **Total equity** | | **$ 7,420** | | $ 6,291 | | $ 7,007 |
| **Comprehensive Income** | | | | | | |
| Net income | | **$ 2,215** | | $ 2,025 | | $ 1,721 |
| Other comprehensive income (loss), net of tax: | | | | | | |
| Currency translation adjustments, net of tax expense (benefit) of $98 in 2009, ($125) in 2008 and $89 in 2007 | | **197** | | (370) | | 259 |
| Pension and other employee benefits, net of tax (benefit) expense of ($18) in 2009, ($319) in 2008 and $144 in 2007 | | **(54)** | | (591) | | 266 |
| Hedges of net investments in foreign operations, net of tax benefit of ($19) in 2008 and ($27) in 2007 | | **—** | | (33) | | (48) |
| Other hedging activities, net of tax (benefit) expense of ($1) in 2009, $2 in 2008 and $6 in 2007 | | **(36)** | | 25 | | 23 |
| Marketable equity securities, net of tax expense of $2 in 2009 and tax benefit of ($1) in each of 2008 and 2007 | | **4** | | (2) | | (2) |
| Total other comprehensive income (loss), net of tax | | **111** | | (971) | | 498 |
| Comprehensive income | | **2,326** | | 1,054 | | 2,219 |
| Less: Comprehensive income (loss) attributable to noncontrolling interests | | **13** | | (3) | | 26 |
| **Comprehensive income attributable to Baxter** | | **$ 2,313** | | $ 1,057 | | $ 2,193 |

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

## NOTE 1
## SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Nature of Operations
Baxter International Inc. (Baxter or the company) develops, manufactures and markets products that save and sustain the lives of people with hemophilia, immune disorders, infectious diseases, kidney disease, trauma, and other chronic and acute medical conditions. As a global, diversified healthcare company, Baxter applies a unique combination of expertise in medical devices, pharmaceuticals and biotechnology to create products that advance patient care worldwide. The company operates in three segments, which are described in Note 12.

### Use of Estimates
The preparation of the financial statements in conformity with generally accepted accounting principles (GAAP) requires the company 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 and its majority-owned subsidiaries, any minority-owned subsidiaries that Baxter controls, and variable interest entities (VIEs) in which Baxter is the primary beneficiary, after elimination of intercompany transactions.

### Revenue Recognition
The company recognizes revenues from product sales and services when earned. Specifically, revenue is recognized when persuasive evidence of an 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 to the customer. The shipping terms for the majority of the company's revenue arrangements are FOB destination. The recognition of revenue is delayed if there are significant post-delivery obligations, such as training, installation or other services. Provisions for discounts, rebates to customers, chargebacks to wholesalers and returns are provided for at the time the related sales are recorded, and are reflected as a reduction of net sales.

The company sometimes enters into arrangements in which it commits to delivering multiple products or services to its customers. In these cases, total arrangement consideration is allocated to the deliverables based on their relative selling prices. Then the allocated consideration is recognized as revenue in accordance with the principles described above. Selling prices are determined by applying a selling price hierarchy. Selling prices are determined using vendor specific objective evidence (VSOE), if it exists. Otherwise, selling prices are determined using third party evidence (TPE). If neither VSOE nor TPE is available, the company uses its best estimate of selling prices.

### Allowance for Doubtful Accounts
In the normal course of business, the company provides credit to its customers, performs credit evaluations of these customers and maintains reserves for potential credit losses. In determining the amount of the allowance for doubtful accounts, the company considers, among other items, historical credit losses, the past due status of receivables, payment histories and other customer-specific information. Receivables are written off when the company determines they are uncollectible. Credit losses, when realized, have been within the range of the company's allowance for doubtful accounts. The allowance for doubtful accounts was $118 million at December 31, 2009 and $103 million at December 31, 2008.

### Product Warranties
The company provides for the estimated costs relating to product warranties at the time the related revenue is recognized. The cost is determined based on actual company experience for the same or similar products, as well as other relevant information. Product warranty liabilities are adjusted based on changes in estimates.

### Cash and Equivalents
Cash and equivalents include cash, certificates of deposit and money market funds with an original maturity of three months or less.

### Inventories

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Raw materials | **$ 598** | $ 600 |
| Work in process | **842** | 737 |
| Finished goods | **1,117** | 1,024 |
| Inventories | **$2,557** | $2,361 |

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 market value for work in process and finished goods is based on net realizable value. The inventory amounts above are stated net of reserves for excess and obsolete inventory, which totaled $273 million at December 31, 2009 and $247 million at December 31, 2008.

### Property, Plant and Equipment, Net

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Land | **$ 163** | $ 154 |
| Buildings and leasehold improvements | **1,921** | 1,743 |
| Machinery and equipment | **5,962** | 5,425 |
| Equipment with customers | **1,039** | 916 |
| Construction in progress | **975** | 783 |
| Total property, plant and equipment, at cost | **10,060** | 9,021 |
| Accumulated depreciation and amortization | **(4,901)** | (4,412) |
| Property, plant and equipment (PP&E), net | **$ 5,159** | $ 4,609 |

Depreciation and amortization expense is calculated using 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 (including any renewal periods, if appropriate)

or the asset, whichever is shorter. Baxter capitalizes in machinery and equipment certain computer software and software development costs incurred in connection with developing or obtaining software for internal use. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software. Straight-line and accelerated methods of depreciation are used for income tax purposes. Depreciation and amortization expense was $557 million in 2009, $553 million in 2008 and $501 million in 2007. Repairs and maintenance expense was $251 million in 2009, $242 million in 2008 and $227 million in 2007.

### Acquisitions

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 is allocated to the net assets acquired based on estimates of their fair values at the date of the acquisition. Contingent consideration is recognized at the estimated fair value on the acquisition date. Any purchase price in excess of these net assets is recorded as goodwill. The allocation of purchase price in certain cases may be subject to revision based on the final determination of fair values.

### Research and Development

Research and development (R&D) costs are expensed as incurred. Acquired in-process R&D (IPR&D) is the value assigned to acquired technology or products under development which have not received regulatory approval and have no alternative future use. Valuations are generally completed for business acquisitions using a discounted cash flow analysis, incorporating the stage of completion. The most significant estimates and assumptions inherent in a discounted cash flow analysis include the amount and timing of projected future cash flows, the discount rate used to measure the risks inherent in the future cash flows, the assessment of the asset's life cycle, and the competitive and other trends impacting the asset, including consideration of technical, legal, regulatory, economic and other factors. Each of these factors can significantly affect the value of the IPR&D.

Payments made to third parties subsequent to regulatory approval are capitalized and amortized over the remaining useful life of the related asset, and are classified as intangible assets.

Beginning in 2009, as discussed further below, the company adopted a new accounting standard for accounting for business combinations. Under the new accounting standard, acquired IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset and is no longer expensed at the time of the acquisition. Development costs incurred after the acquisition are expensed as incurred. Upon receipt of regulatory approval of the related technology or product, the indefinite-lived intangible asset is then accounted for as a finite-lived intangible asset and amortized on a straight-line basis over its estimated useful life. If the R&D project is abandoned, the indefinite-lived asset is charged to expense.

### Impairment Reviews

Goodwill

Goodwill is not amortized, but is subject to an impairment review annually and whenever indicators of impairment exist. An impairment would occur if the carrying amount of a reporting unit exceeded the fair value of that reporting unit. The company measures goodwill for impairment based on its reportable segments, which are BioScience, Medication Delivery and Renal. An impairment charge would be recorded for the difference between the carrying value and the present value of estimated future cash flows discounted using a risk-free market rate adjusted for a market participant's view of similar companies and perceived risks in the cash flows, which represents the estimated fair value of the reporting unit.

Other Long-Lived Assets

The company reviews the carrying amounts of long-lived assets other than goodwill for potential impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Examples of such a change in circumstances include a significant decrease in market price, a significant adverse change in the extent or manner in which an asset is being used, or a significant adverse change in the legal or business climate. In evaluating recoverability, the company groups assets and liabilities at the lowest level such that the identifiable cash flows relating to the group are largely independent of the cash flows of other assets and liabilities. The company then compares the carrying amounts of the assets or asset groups with the related estimated undiscounted future cash flows. In the event impairment exists, an impairment charge would be recorded as the amount by which the carrying amount of the asset or asset group exceeds the fair value. Depending on the asset and the availability of information, fair value may be determined by reference to estimated selling values of assets in similar condition, or by using a discounted cash flow model. In addition, the remaining amortization period for the impaired asset would be reassessed and, if necessary, revised.

### Earnings Per Share

The numerator for both basic and diluted earnings per share (EPS) is net income attributable to Baxter. The denominator for basic EPS is the weighted-average number of common shares outstanding during the period. The dilutive effect of outstanding employee stock options, performance share units, restricted stock units and restricted stock is reflected in the denominator for diluted EPS using the treasury stock method.

The following is a reconciliation of basic shares to diluted shares.

| years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Basic shares | **607** | 625 | 644 |
| Effect of dilutive securities | **7** | 12 | 10 |
| Diluted shares | **614** | 637 | 654 |

The computation of diluted EPS excluded employee stock options to purchase 16 million, 8 million and 11 million shares in 2009, 2008 and 2007, respectively, because the assumed proceeds were greater than the average market price of the company's common stock, resulting in an anti-dilutive effect on diluted EPS.

### Shipping and Handling Costs

Shipping costs, which are costs incurred to physically move product from Baxter's premises to the customer's premises, are classified as marketing and administrative expenses. Handling costs, which are

costs incurred to store, move and prepare products for shipment, are classified as cost of sales. Approximately $220 million in 2009, $237 million in 2008 and $231 million in 2007 of shipping costs were classified in marketing and administrative expenses.

### Income Taxes

Deferred taxes are recognized for the future tax effects of temporary differences between financial and income tax reporting based on enacted tax laws and rates. The company maintains valuation allowances unless it is more likely than not that all or a portion of the deferred tax asset will be realized. With respect to uncertain tax positions, the company determines whether the position is more likely than not to be sustained upon examination, based on the technical merits of the position. Any tax position that meets the more-likely-than-not recognition threshold is measured and recognized in the consolidated financial statements at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The liability relating to uncertain tax positions is classified as current in the consolidated balance sheets to the extent the company anticipates making a payment within one year. Interest and penalties associated with income taxes are classified in the income tax expense line in the consolidated statements of income and were not material.

### Foreign Currency Translation

Currency translation adjustments (CTA) related to foreign operations are principally included in other comprehensive income (OCI). For foreign operations in highly inflationary economies, translation gains and losses are included in other expense, net, and were not material.

### Accumulated Other Comprehensive Income

Comprehensive income includes all changes in shareholders' equity that do not arise from transactions with shareholders, and consists of net income, CTA, pension and other employee benefits, realized net losses on hedges of net investments in foreign operations, unrealized gains and losses on cash flow hedges and unrealized gains and losses on unrestricted available-for-sale marketable equity securities. The net-of-tax components of accumulated other comprehensive income (AOCI), a component of shareholders' equity, were as follows.

| as of December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| CTA | **$ 164** | $ (30) | $ 326 |
| Pension and other employee benefits | **(1,188)** | (1,134) | (555) |
| Hedges of net investments in foreign operations | **(757)** | (757) | (724) |
| Other hedging activities | **3** | 39 | 14 |
| Marketable equity securities | **1** | (3) | (1) |
| Accumulated other comprehensive loss | **$(1,777)** | $(1,885) | $(940) |

### Derivatives and Hedging Activities

All derivative instruments are recognized as either assets or liabilities at fair value in the consolidated balance sheets and are classified as short-term or long-term based on the scheduled maturity of the instrument. Based upon the exposure being hedged, the company designates its hedging instruments as cash flow or fair value hedges.

For each derivative instrument that is designated and effective as a cash flow hedge, the gain or loss on the derivative is accumulated in AOCI and then recognized in earnings consistent with the underlying hedged item. Option premiums or net premiums paid are initially recorded as assets and reclassified to OCI over the life of the option, and then recognized in earnings consistent with the underlying hedged item. Cash flow hedges are classified in other expense, net, cost of sales, and net interest expense, and primarily relate to a hedge of U.S. Dollar-denominated debt issued by a foreign subsidiary, forecasted intercompany sales denominated in foreign currencies and anticipated issuances of debt, respectively.

For each derivative instrument that is designated and effective as a fair value hedge, the gain or loss on the derivative is recognized immediately to earnings, and offsets the gain or loss on the underlying hedged item. Fair value hedges are classified in net interest expense, as they hedge the interest rate risk associated with certain of the company's fixed-rate debt.

For each derivative or nonderivative instrument that is designated and effective as a hedge of a net investment in a foreign operation, the gain or loss is recorded in OCI, with any hedge ineffectiveness recorded immediately in net interest expense. As with CTA, upon sale or liquidation of an investment in a foreign entity, the amount attributable to that entity and accumulated in AOCI would be removed from AOCI and reported as part of the gain or loss in the period during which the sale or liquidation of the investment occurs.

For derivative instruments that are not designated as hedges, the change in fair value, which substantially offsets the change in book value of the hedged items, is recorded directly to other expense, net.

If it is determined that a derivative or nonderivative hedging instrument is no longer highly effective as a hedge, the company discontinues hedge accounting prospectively. If the company removes the cash flow hedge designation because the hedged forecasted transactions are no longer probable of occurring, any gains or losses are immediately reclassified from AOCI to earnings. Gains or losses relating to terminations of effective cash flow hedges in which the forecasted transactions are still probable of occurring are deferred and recognized consistent with the income or loss recognition of the underlying hedged items. If the company terminates a fair value hedge, an amount equal to the cumulative fair value adjustment to the hedged items at the date of termination is amortized to earnings over the remaining term of the hedged item.

Derivatives, including those that are not designated as a hedge, are principally classified in the operating section of the consolidated statements of cash flows, in the same category as the related consolidated balance sheet account. With respect to the company's net investment hedges, cross-currency swap agreements that included a financing element at inception were classified in the financing section of the consolidated statements of cash flows when settled and cross-currency swap agreements that did not include a financing element at inception were classified in the operating section.

Refer to Note 7 for information regarding the company's derivative and hedging activities.

## Reclassifications

Certain reclassifications have been made to conform the prior period consolidated financial statements and notes to the current period presentation, including reclassifications related to the company's adoption of a new accounting standard related to noncontrolling interests.

## Changes in Accounting Standards

### Business Combinations

On January 1, 2009, the company adopted a new accounting standard which changes the accounting for business combinations in a number of significant respects. The key changes include the expansion of transactions that qualify as business combinations, the capitalization of IPR&D as an indefinite-lived asset, the recognition of certain acquired contingent assets and liabilities at fair value, the expensing of acquisition costs, the expensing of costs associated with restructuring the acquired company, the recognition of contingent consideration at fair value on the acquisition date, the recognition of post-acquisition date changes in deferred tax asset valuation allowances and acquired income tax uncertainties as income tax expense or benefit, and the expansion of disclosure requirements. This standard was applicable for acquisitions made by the company on or after January 1, 2009, including the April 2009 consolidation of Sigma International General Medical Apparatus, LLC (SIGMA) and the August 2009 acquisition of certain assets of Edwards Lifesciences Corporation (Edwards CRRT) related to the hemofiltration business, also known as Continuous Renal Replacement Therapy (CRRT). Refer to Note 4 for further information regarding SIGMA and Edwards CRRT.

### Noncontrolling Interests

On January 1, 2009, the company adopted a new accounting standard which changes the accounting and reporting of noncontrolling interests (historically referred to as minority interests). The standard requires that noncontrolling interests be presented in the consolidated balance sheets within equity, but separate from Baxter shareholders' equity, and that the amount of consolidated net income attributable to Baxter and to the noncontrolling interests be clearly identified and presented in the consolidated statements of income. Any losses in excess of the noncontrolling interest's equity interest continue to be allocated to the noncontrolling interest. Purchases or sales of equity interests that do not result in a change of control are accounted for as equity transactions. Upon a loss of control the interest sold, as well as any interest retained, is measured at fair value, with any gain or loss recognized in earnings. In partial acquisitions, when control is obtained, 100% of the assets and liabilities, including goodwill, are recognized at fair value as if the entire target company had been acquired. The new standard was applied prospectively as of January 1, 2009, except for the presentation and disclosure requirements, which have been applied retrospectively for prior periods presented. Prior to the adoption of the new standard, the noncontrolling interests' share of net income was included in other expense, net in the consolidated statements of income and the noncontrolling interests' equity was included in other long-term liabilities in the consolidated balance sheets. The accounting related provisions of the new accounting standard did not have a material impact on the consolidated financial statements.

### Revenue Recognition

In October 2009, the Financial Accounting Standards Board (FASB) issued two updates to the Accounting Standards Codification related to revenue recognition. The first update eliminates the requirement that all undelivered elements in an arrangement with multiple deliverables have objective and reliable evidence of fair value before revenue can be recognized for items that have been delivered. The update also no longer allows use of the residual method when allocating consideration to deliverables. Instead, arrangement consideration is to be allocated to deliverables using the relative selling price method, applying a selling price hierarchy. VSOE of selling price should be used if it exists. Otherwise, TPE of selling price should be used. If neither VSOE nor TPE is available, the company's best estimate of selling price should be used. The second update eliminates tangible products from the scope of software revenue recognition guidance when the tangible products contain software components and non-software components that function together to deliver the tangible products' essential functionality. Both updates require expanded qualitative and quantitative disclosures and are effective for fiscal years beginning on or after June 15, 2010, with prospective application for new or materially modified arrangements or retrospective application permitted. Early adoption is permitted. The same transition method and period of adoption must be used for both updates. The company adopted these updates in 2009, prospectively applying them to arrangements entered into or materially modified on or after January 1, 2009. The early adoption of these updates did not have a material impact on the company's consolidated financial statements and did not result in a change in its previously reported quarterly consolidated financial statements.

### Other

Refer to Note 6 for disclosures provided in connection with a new accounting and disclosure standard related to collaborative arrangements. Refer to Note 7 for disclosures provided in connection with a new disclosure standard related to derivative and hedging activities and the fair value of financial instruments. Refer to Note 9 for disclosures provided in connection with a new disclosure standard related to defined benefit pension plan assets.

## New Accounting Standards

### Transfers of Financial Assets

In June 2009, the FASB issued a new accounting standard relating to the accounting for transfers of financial assets. The new standard eliminates the concept of a qualifying special-purpose entity and clarifies existing GAAP as it relates to determining whether a transferor has surrendered control over transferred financial assets. The standard limits the circumstances in which a financial asset, or portion of a financial asset, should be derecognized when the transferor has not transferred the entire original financial asset to an entity that is not consolidated with the transferor in the financial statements presented and/or when the transferor has continuing involvement with the transferred financial asset. The standard also requires enhanced disclosures about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. It is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2009, with early adoption

prohibited. The new standard will be applied prospectively, except for the disclosure requirements, which will be applied retrospectively for all periods presented. The new standard, which is effective for the company as of January 1, 2010, is not expected to have a material impact on the company's consolidated financial statements.

Variable Interest Entities

In June 2009, the FASB issued a new standard that changes the consolidation model for VIEs. The new standard requires an enterprise to qualitatively assess the determination of the primary beneficiary of a VIE as the enterprise that has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and has the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the VIE. The standard requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. The standard expands the disclosure requirements for enterprises with a variable interest in a VIE. It is effective for fiscal years, and interim periods within those fiscal years, beginning after November 15, 2009, with early adoption prohibited. The new standard, which is effective for the company as of January 1, 2010, is not expected to have material impact on the company's consolidated financial statements.

## NOTE 2
## SUPPLEMENTAL FINANCIAL INFORMATION

### Goodwill and Other Intangible Assets

Goodwill

The following is a summary of the activity in goodwill by segment.

| (in millions) | BioScience | Medication Delivery | Renal | Total |
|---|---|---|---|---|
| December 31, 2007 | $587 | $ 948 | $155 | $1,690 |
| Additions | 11 | 13 | 8 | 32 |
| CTA | (13) | (44) | (11) | (68) |
| December 31, 2008 | **585** | **917** | **152** | **1,654** |
| Additions | **—** | **89** | **29** | **118** |
| CTA | **10** | **37** | **6** | **53** |
| December 31, 2009 | **$595** | **$1,043** | **$187** | **$1,825** |

Additional goodwill recognized in 2009 principally related to the consolidation of SIGMA within the Medication Delivery segment and the acquisition of Edwards CRRT within the Renal segment. See Note 4 for further information regarding SIGMA and Edwards CRRT. As of December 31, 2009, there were no accumulated goodwill impairment losses.

Other Intangible Assets, Net

Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives are not material to the company. The following is a summary of the company's intangible assets subject to amortization.

| (in millions) | Developed technology, including patents | Other | Total |
|---|---|---|---|
| December 31, 2009 | | | |
| Gross other intangible assets | **$ 904** | **$125** | **$1,029** |
| Accumulated amortization | **(489)** | **(58)** | **(547)** |
| Other intangible assets, net | **$ 415** | **$ 67** | **$ 482** |
| December 31, 2008 | | | |
| Gross other intangible assets | $ 777 | $117 | $ 894 |
| Accumulated amortization | (444) | (67) | (511) |
| Other intangible assets, net | $ 333 | $ 50 | $ 383 |

The amortization expense for intangible assets was $63 million in 2009, $53 million in 2008 and $57 million in 2007. At December 31, 2009, the anticipated annual amortization expense for intangible assets recorded as of December 31, 2009 is $66 million in 2010, $62 million in 2011, $59 million in 2012, $56 million in 2013 and $52 million in 2014.

### Other Long-Term Assets

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Deferred income taxes | **$1,095** | $1,132 |
| Insurance receivables | **49** | 58 |
| Other long-term receivables | **66** | 87 |
| Other | **376** | 327 |
| Other long-term assets | **$1,586** | $1,604 |

### Accounts Payable and Accrued Liabilities

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Accounts payable, principally trade | **$ 807** | $ 829 |
| Income taxes payable | **375** | 255 |
| Deferred income taxes | **482** | 265 |
| Common stock dividends payable | **174** | 161 |
| Employee compensation and withholdings | **494** | 478 |
| Property, payroll and certain other taxes | **201** | 177 |
| Other | **1,220** | 1,076 |
| Accounts payable and accrued liabilities | **$3,753** | $3,241 |

### Other Long-Term Liabilities

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Pension and other employee benefits | **$1,688** | $1,595 |
| Litigation reserves | **45** | 63 |
| Other | **297** | 459 |
| Other long-term liabilities | **$2,030** | $2,117 |

### Net Interest Expense

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Interest costs | **$145** | $165 | $ 136 |
| Interest costs capitalized | **(28)** | (17) | (12) |
| Interest expense | **117** | 148 | 124 |
| Interest income | **(19)** | (72) | (102) |
| Net interest expense | **$ 98** | $ 76 | $ 22 |

### Other Expense, Net

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Equity method investments | **$ 12** | $ 14 | $ 13 |
| Foreign exchange | **(51)** | (29) | 3 |
| Securitization and factoring arrangements | **11** | 19 | 14 |
| Impairment charges | **54** | 31 | — |
| Gain on sale of Transfusion Therapies business, related charges and adjustments | **—** | (16) | (23) |
| Other | **19** | 7 | 11 |
| Other expense, net | **$ 45** | $ 26 | $ 18 |

## NOTE 3
## SALE OF TRANSFUSION THERAPIES BUSINESS

On February 28, 2007, the company divested substantially all of the assets and liabilities of its Transfusion Therapies (TT) business to an affiliate of TPG Capital, L.P. (TPG) for $540 million. TPG acquired the net assets of the TT business, including its product portfolio of manual and automated blood-collection products and storage equipment, as well as five manufacturing facilities, and established the new company as Fenwal Inc. (Fenwal). Cash proceeds were $473 million, representing the $540 million net of certain items, principally international receivables that were retained by the company post-divestiture.

During 2007, the company recorded a net gain on the sale of the TT business of $58 million. Of the net cash proceeds, $52 million was allocated to transition agreements to provide post-divestiture manufacturing, distribution and support services to Fenwal because these agreements provide for below-market consideration for those services. In 2008, the company recorded an income adjustment to the gain of $16 million as a result of the finalization of the net assets transferred in the divestiture. In connection with the TT divestiture, the company recorded a $35 million charge in 2007 principally associated with severance and other employee-related costs. Reserve utilization through December 31, 2009 was $25 million. The reserve is expected to be substantially utilized by the end of 2010.

TT business sales included in the BioScience segment totaled $79 million in 2007 through the February 28 sale date. Post-divestiture revenue associated with the transition agreements with Fenwal totaled $74 million, $174 million and $144 million in 2009, 2008 and 2007, respectively. Included in the post-divestiture revenue were $3 million, $25 million and $23 million in 2009, 2008 and 2007, respectively, of deferred revenue related to the transition agreements, and as of December 31, 2009, substantially all of the deferred revenue has been recognized.

The gain on the sale of the TT business and the related charges and adjustments were recorded in other expense, net in the consolidated statements of income. These amounts along with the post-divestiture revenues were reported at the corporate headquarters level and were not allocated to a segment.

## NOTE 4
## ACQUISITIONS OF AND INVESTMENTS IN BUSINESSES AND TECHNOLOGIES

In 2009, 2008 and 2007, cash outflows related to the acquisitions of and investments in businesses and technologies totaled $156 million, $99 million and $112 million, respectively. The following are the more significant acquisitions and investments, including licensing agreements that require significant contingent milestone payments, entered into in 2009, 2008 and 2007.

### 2009

SIGMA

In April 2009, the company entered into an exclusive three-year distribution agreement with SIGMA covering the United States and international markets. The agreement, which enables Baxter to immediately provide SIGMA's SPECTRUM large volume infusion pumps to customers, as well as future products under development, complements Baxter's infusion systems portfolio and next generation technologies. The arrangement also included a 40% equity stake in SIGMA, and an option to purchase the remaining equity of SIGMA, exercisable at any time over a three-year term. The arrangement included a $100 million up-front payment and additional payments of up to $130 million for the exercise of the purchase option as well as for SIGMA's achievement of specified regulatory and commercial milestones.

Because Baxter's option to purchase the remaining equity of SIGMA limits the ability of the existing equity holders to participate significantly in SIGMA's profits and losses, and because the existing equity holders have the ability to make decisions about SIGMA's activities that have a significant effect on SIGMA's success, the company concluded that SIGMA is a VIE. Baxter is the primary beneficiary of the VIE due to its exposure to the majority of SIGMA's expected losses or expected residual returns and the relationship between Baxter and SIGMA created by the exclusive distribution agreement, and the significance of that agreement. Accordingly, the company consolidated the financial statements of SIGMA beginning in April 2009 (the acquisition date), with the fair value of the equity owned by the existing SIGMA equity holders reported as noncontrolling interests. The creditors of SIGMA do not have recourse to the general credit of Baxter.

The following table summarizes the preliminary allocation of fair value related to the arrangement at the acquisition date.

| (in millions) | |
|---|---|
| **Assets** | |
| Goodwill | $ 87 |
| IPR&D | 24 |
| Other intangible assets | 94 |
| Purchase option (other long-term assets) | 111 |
| Other assets | 30 |
| **Liabilities** | |
| Contingent payments | 62 |
| Other liabilities | 25 |
| **Noncontrolling interests** | 159 |

The amount allocated to IPR&D is being accounted for as an indefinite-lived intangible asset until regulatory approval or discontinuation. The other intangible assets primarily relate to developed technology and are being amortized on a straight-line basis over an estimated average useful life of eight years. The fair value of the purchase option was estimated using the Black-Scholes model, and the fair value of the noncontrolling interests was estimated using a discounted cash flow model. The contingent payments of up to $70 million associated with SIGMA's achievement of specified regulatory and commercial milestones were recorded at their estimated fair value of $62 million. As of December 31, 2009, the estimated fair value of the contingent payments was $59 million, with the change in the estimated fair value since inception principally due to Baxter's payment of $5 million for the achievement of a commercial milestone in 2009. Other changes in the estimated fair value of the contingent payments are being recognized immediately in earnings. The results of operations and assets and liabilities of SIGMA are included in the Medication Delivery segment, and the goodwill is included in this reporting unit. The goodwill is deductible for tax purposes. The pro forma impact of the arrangement with SIGMA was not significant to the results of operations of the company.

Edwards CRRT

In August 2009, the company acquired Edwards CRRT. CRRT provides a method of continuous yet adjustable fluid removal that can gradually remove excess fluid and waste products that build up with the acute impairment of kidney function, and is usually administered in an intensive care setting in the hospital. The acquisition expands Baxter's existing CRRT business into new markets. The purchase price of $56 million was primarily allocated to other intangible assets and goodwill. The identified intangible assets of $28 million consisted of customer relationships and developed technology and are being amortized on a straight-line basis over an estimated average useful life of eight years. The goodwill of $28 million is deductible for tax purposes. Baxter will pay Edwards up to an additional $9 million in purchase price based on revenue objectives which are expected to be achieved over the next two years, and such contingent purchase price was recorded at its estimated fair value on the acquisition date. The results of operations and assets and liabilities of Edwards CRRT are included in the Renal segment, and the goodwill is included in this reporting unit. The pro forma impact of the Edwards CRRT acquisition was not significant to the results of operations of the company.

**2008 and 2007**

In 2008 and 2007, the company recorded IPR&D charges of $19 million and $50 million, respectively, relating to up-front obligations for technology that had not received regulatory approval and had no alternative future use.

The IPR&D charge in 2008 principally related to an in-licensing agreement with Innocoll Pharmaceuticals Ltd. (Innocoll), a division of Innocoll, Inc., granting Baxter exclusive rights to market and distribute Innocoll's gentamicin surgical implant in the United States.

The IPR&D charge in 2007 principally related to a collaboration for the development of a home hemodialysis (HD) machine, as further discussed below. The charge also included costs associated with an in-licensing agreement with Nycomed Pharma AS (Nycomed) that grants Baxter exclusive rights to market and distribute Nycomed's TACHOSIL surgical patch in the United States; an amendment to the company's exclusive R&D, license and manufacturing agreement with Nektar Therapeutics (Nektar), expanding its existing BioScience business relationship to include the use of Nektar's proprietary PEGylation technology in the development of longer-acting forms of blood clotting proteins; and an in-licensing arrangement with Halozyme Therapeutics, Inc. (Halozyme) to apply Halozyme's ENHANZE technology to the development of a subcutaneous route of administration for Baxter's liquid formulation of IGIV (immune globulin intravenous).

In connection with the arrangements with Innocoll, Nycomed, Nektar and Halozyme, the company may be required to make additional payments of up to $220 million based on the successful completion of specified development, regulatory and sales milestones, in addition to, in certain cases, royalty payments on future sales of the related products. See Note 6 for further information regarding the company's contingent milestone payment arrangements.

HHD/DEKA

In August 2007, the company entered into a collaboration with HHD, LLC (HHD) and DEKA Products Limited Partnership and DEKA Research and Development Corp. (collectively, DEKA) for the development of a home HD machine.

In connection with this Renal segment collaboration, the company purchased an option for $25 million to acquire the assets of HHD, and is reimbursing HHD for R&D services performed by DEKA, as well as other of HHD's costs associated with developing the home HD machine. Pursuant to the option agreement with HHD, as amended, the company can exercise the option at any time between the effective date of the agreement and the earlier of U.S. Food and Drug Administration (FDA) approval of the product for home use or June 30, 2011. The company may be required to pay $18 million in advance of the exercise of the option, as specified in the amended agreement. Upon exercise of the option, the company would pay an additional $16 million (or $34 million in total to exercise the option), as well as additional payments of up to approximately $5 million based on contractual relationships between HHD and third parties. Because the company is the primary beneficiary of the risks and rewards of HHD's activities, the company is consolidating the financial results of HHD from the date of the option purchase.

HHD's assets and technology had not yet received regulatory approval and no alternative future use had been identified. In conjunction with the execution of the option agreement with HHD and the related payment of $25 million, the company recognized a net IPR&D charge of $25 million in 2007. The project was principally valued through discounted cash flow analysis, utilizing the income approach.

## NOTE 5
## INFUSION PUMP, EXIT AND OTHER CHARGES

Baxter has made and continues to make significant investments in assets, including inventory and PP&E, which relate to potential new products or modifications to existing products. The company's ability to realize value from these investments is contingent on, among other things, regulatory approval and market acceptance of these new products. The company may not be able to realize the expected returns from these investments, potentially resulting in asset impairments in the future.

### Infusion Pump Charges

The company remains in active dialogue with the FDA regarding various matters with respect to the company's COLLEAGUE infusion pumps, including the company's remediation plan and reviews of the company's facilities, processes and quality controls by the company's outside expert pursuant to the requirements of the company's Consent Decree. The outcome of these discussions with the FDA is uncertain and may impact the nature and timing of the company's actions and decisions with respect to the COLLEAGUE pump. The company's estimates of the costs related to these matters are based on the current remediation plan and information currently available. It is possible that substantial additional charges, including significant asset impairments, related to COLLEAGUE may be required in future periods, based on new information, changes in estimates, and modifications to the current remediation plan.

While the company continues to work to resolve the issues associated with COLLEAGUE infusion pumps, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, that sales of any other product may not be adversely affected, or that additional legislation or regulation will not be introduced that may adversely affect the company's operations and consolidated financial statements.

#### COLLEAGUE and SYNDEO Infusion Pumps

The company recorded charges and other costs of $27 million, $125 million, $14 million, $94 million and $77 million in 2009, 2008, 2007, 2006 and 2005, respectively, related to issues associated with its COLLEAGUE and SYNDEO infusion pumps.

The company stopped shipment of COLLEAGUE infusion pumps in July 2005 in the United States. Following a number of Class I recalls (recalls at the highest priority level for the FDA) relating to the performance of the pumps, as well as the seizure litigation described in Note 11, the company entered into a Consent Decree in June 2006. Additional Class I recalls related to remediation and repair and maintenance activities were addressed by the company in 2007 and 2009. The Consent Decree provides for reviews of the company's facilities, processes and controls by the company's outside expert, followed by the FDA. In December 2007, following the outside expert's review, the FDA conducted its inspection and remains in a dialogue with the company with respect to observations from its inspection as well as the validation of modifications to the pump required to remediate certain of the pumps.

Included in the 2005 charge was $4 million relating to asset impairments and $73 million for cash costs, representing an estimate of the cash expenditures for the materials, labor and freight costs expected to be incurred to remediate the design issues. Included in the 2006 charge was $3 million relating to asset impairments and $73 million for cash costs, which related to additional customer accommodations and adjustments to the previously established reserves for remediation costs based on further definition of the potential remediation requirements and the company's experience remediating pumps outside of the United States. Also, in 2006, the company recorded an additional $18 million of expense, of which $7 million related to asset impairments and $11 million related to additional warranty and other commitments made to customers. The $14 million of costs recorded in 2007 represented changes in estimates relating to the previously established reserves for cash costs based on the company's experience executing the remediation plan.

As a result of delays in the remediation plan, principally due to additional software modifications, validation, evaluation and testing required to remediate the pumps, and other changes in the estimated costs to execute the remediation plan, the company recorded a charge associated with the COLLEAGUE infusion pump of $53 million in the first quarter of 2008. This charge consisted of $39 million for cash costs and $14 million principally relating to asset impairments. The reserve for cash costs principally related to customer accommodations, including extended warranties, and other costs associated with these delays.

In the third quarter of 2008, as a result of the company's decision to upgrade the global pump base to a standard software platform and other changes in the estimated costs to execute the remediation plan, the company recorded a charge of $72 million. This charge consisted of $46 million for cash costs and $26 million principally relating to asset impairments and inventory used in the remediation plan. The reserve for cash costs primarily consisted of costs associated with the deployment of the new software and additional repair and warranty costs.

In 2009, the company recorded a charge of $27 million related to planned retirement costs associated with SYNDEO and additional costs related to the COLLEAGUE infusion pump. This charge consisted of $14 million for cash costs and $13 million related to asset impairments. The reserve for cash costs primarily related to customer accommodations and additional warranty costs.

The charges were recorded in cost of sales in the company's consolidated statements of income, and were included in the Medication Delivery segment's pre-tax income.

The following summarizes cash activity in the company's COLLEAGUE and SYNDEO infusion pump reserves through December 31, 2009.

| (in millions) | |
|---|---|
| 2005 and 2006 Charges | $157 |
| Utilization in 2005 and 2006 | (46) |
| December 31, 2006 | 111 |
| Utilization | (55) |
| Adjustments | 14 |
| December 31, 2007 | 70 |
| Charges | 85 |
| Utilization | (40) |
| December 31, 2008 | **115** |
| Charges | **14** |
| Utilization | **(30)** |
| December 31, 2009 | **$ 99** |

The ultimate timing of the utilization of the reserves is uncertain.

### Exit and Other Charges

2009 Cost Optimization Charge

In 2009, the company recorded a charge of $79 million related to costs associated with optimizing its overall cost structure on a global basis. The charge included severance costs and asset impairments associated with the discontinuation of certain insignificant products and projects, the termination of which will not have a material impact on the company's future results of operations.

Included in the charge was $69 million of cash costs, principally pertaining to severance and other employee-related costs associated with the elimination of less than 2% of the company's workforce. Also included in the charge were asset impairments of $10 million, relating to inventory and fixed assets associated with discontinued products and projects.

Of the total charge, $30 million was recorded in cost of sales and $49 million was recorded in marketing and administrative expenses. The charge was recorded at the corporate level and was not allocated to a segment. Reserve utilization through December 31, 2009 was $5 million. The reserve is expected to be substantially utilized by the end of 2010.

SOLOMIX Drug Delivery System

During 2009, the company recorded a $54 million charge associated with the discontinuation of the company's SOLOMIX drug delivery system in development based on technical issues which negatively impacted the expected profitability of the product. Substantially all of the charge related to asset impairments, principally to write off equipment intended to be used to manufacture the SOLOMIX drug delivery system. The charge was recorded in other expense, net in the company's consolidated statement of income, and was included in the Medication Delivery segment's pre-tax income.

CLEARSHOT Pre-Filled Syringes

During 2008, the company recorded a $31 million charge related to the company's decision to discontinue its CLEARSHOT pre-filled syringe program based on management's assessment of the market demand and expected profitability for this product. Substantially all of the charge related to asset impairments, principally to write off equipment used to manufacture the CLEARSHOT syringes. The charge was recorded in other expense, net in the company's consolidated statement of income, and was included in the Medication Delivery segment's pre-tax income.

2007 Restructuring Charge

In 2007, the company recorded a restructuring charge of $70 million principally associated with the consolidation of certain commercial and manufacturing operations outside of the United States. Based on a review of current and future capacity needs, the company decided to integrate several facilities to reduce the company's cost structure and optimize operations, principally in the Medication Delivery segment. Included in the charge was $17 million related to asset impairments, principally to write down PP&E based on market data for the assets. Also included in the charge was $53 million for cash costs, principally pertaining to severance and other employee-related costs associated with the elimination of approximately 1% of the company's total workforce. Reserve utilization related to the 2007 program was $22 million, $14 million and $5 million in 2009, 2008 and 2007, respectively. As of the end of 2009, the 2007 restructuring reserve has been substantially utilized.

2004 Restructuring Charge

In 2004, the company recorded a restructuring charge of $543 million principally associated with the company's decision to implement actions to reduce the company's overall cost structure and to drive sustainable improvements in financial performance. Included in the 2004 charge was $196 million relating to asset impairments, almost all of which was to write down PP&E. Also included in the 2004 charge was $347 million for cash costs, principally pertaining to severance and other employee-related costs. Reserve utilization related to the 2004 program was $5 million, $28 million and $22 million in 2009, 2008 and 2007, respectively. As of the end of 2009, the 2004 restructuring reserve has been substantially utilized.

## NOTE 6
## DEBT, CREDIT FACILITIES, AND COMMITMENTS AND CONTINGENCIES

### Debt Outstanding

At December 31, 2009 and 2008, the company had the following debt outstanding.

| as of December 31 (in millions) | Effective interest rate[1] | 2009[2] | 2008[2] |
|---|---|---|---|
| 4.75% notes due 2010 | 4.9% | **$ 500** | $ 499 |
| Variable-rate loan due 2010 | 0.8% | **180** | 177 |
| Variable-rate loan due 2012 | 0.6% | **157** | 155 |
| 4.0% notes due 2014 | 4.2% | **350** | — |
| 4.625% notes due 2015 | 4.8% | **641** | 675 |
| 5.9% notes due 2016 | 6.0% | **615** | 661 |
| 5.375% notes due 2018 | 5.5% | **499** | 499 |
| 4.5% notes due 2019 | 4.7% | **498** | — |
| 6.625% debentures due 2028 | 6.7% | **136** | 154 |
| 6.25% notes due 2037 | 6.3% | **499** | 499 |
| Other | — | **47** | 49 |
| Total debt and capital lease obligations | | **4,122** | 3,368 |
| Current portion | | **(682)** | (6) |
| Long-term portion | | **$3,440** | $3,362 |

[1] Excludes the effect of related interest rate swaps, as applicable.

[2] Book values include discounts, premiums and adjustments related to hedging instruments, as applicable.

In addition, as further discussed below, the company had short-term debt totaling $29 million at December 31, 2009 and $388 million at December 31, 2008.

### Significant Debt Issuances

In February 2009, the company issued $350 million of senior unsecured notes, maturing in March 2014 and bearing a 4.0% coupon rate. In August 2009, the company issued $500 million of senior unsecured notes, maturing in August 2019 and bearing a 4.5% coupon rate. In May 2008, the company issued $500 million of senior unsecured notes, maturing in June 2018 and bearing a 5.375% coupon rate. In December 2007, the company issued $500 million of senior unsecured notes, maturing in December 2037, and bearing a 6.25% coupon rate. The notes are redeemable, in whole or in part, at the company's option, subject to a make-whole redemption premium. In addition, during 2008, the company issued commercial paper, of which $200 million was outstanding as of December 31, 2008, with a weighted-average interest rate of 2.55%. There was no commercial paper outstanding as of December 31, 2009.

The net proceeds of the debt issuances noted above were used for general corporate purposes, including the repayment of $200 million of outstanding commercial paper in 2009 and for the settlement of cross-currency swaps in 2008. See Note 7 for further information regarding the settlement of cross-currency swaps. The debt instruments include certain covenants, including restrictions relating to the company's creation of secured debt.

### Future Minimum Lease Payments and Debt Maturities

| as of and for the years ended December 31 (in millions) | Operating leases | Debt maturities and capital leases |
|---|---|---|
| 2010 | $163 | $ 682 |
| 2011 | 138 | 7 |
| 2012 | 115 | 161 |
| 2013 | 100 | 4 |
| 2014 | 92 | 358 |
| Thereafter | 194 | 2,867 |
| Total obligations and commitments | 802 | 4,079 |
| Interest on capital leases, discounts and premiums, and adjustments relating to hedging instruments | n/a | 43 |
| Long-term debt and lease obligations | $802 | $4,122 |

### Credit Facilities

The company had $2.8 billion of cash and equivalents at December 31, 2009. The company's primary revolving credit facility has a maximum capacity of $1.5 billion and matures in December 2011. As of December 31, 2009, there were no outstanding borrowings under this facility. The company also maintains a Euro-denominated credit facility with a maximum capacity of approximately $435 million at December 31, 2009, which matures in January 2013. As of December 31, 2009, there were no outstanding borrowings under this facility. As of December 31, 2008, there was $164 million outstanding under this facility, which was repaid in 2009. The company's facilities enable the company to borrow funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net-debt-to-capital ratio. At December 31, 2009, the company was in compliance with the financial covenants in these agreements. The non-performance of any financial institution supporting either of the credit facilities would reduce the maximum capacity of these facilities by each institution's respective commitment.

The company also maintains other credit arrangements, which totaled $454 million at December 31, 2009 and $409 million at December 31, 2008. Borrowings outstanding under these facilities totaled $29 million at December 31, 2009 and $24 million at December 31, 2008.

### Leases

The company leases certain facilities and equipment under capital and operating leases expiring at various dates. The leases generally provide for the company to pay taxes, maintenance, insurance and certain other operating costs of the leased property. Most of the operating leases contain renewal options. Operating lease rent expense was $172 million in 2009, $161 million in 2008 and $157 million in 2007.

### Collaborative Arrangements

On January 1, 2009, the company adopted a new accounting standard related to collaborative arrangements, which was required to be applied retrospectively to all periods presented for all collaborative arrangements existing as of the effective date. The adoption of this new standard did not result in a change to the company's historical consolidated financial statements.

In the normal course of business, Baxter enters into collaborative arrangements with third parties. Certain of these collaborative arrangements include joint operating activities involving active participation by both partners, where both Baxter and the other entity are exposed to risks and rewards dependent on the commercial success of the activity. These collaborative arrangements exist in all three of the company's segments, take a number of forms and structures, principally pertain to the joint development and commercialization of new products, and are designed to enhance and expedite long-term sales and profitability growth.

The collaborative arrangements can broadly be grouped into two categories: those relating to new product development, and those relating to existing commercial products.

New Product Development Arrangements

The company's joint new product development and commercialization arrangements generally provide that Baxter license certain rights to manufacture, market or distribute a specified technology or product under development. Baxter's consideration for the rights generally consists of some combination of up-front payments, ongoing R&D cost reimbursements, royalties, and contingent payments relating to the achievement of specified pre-clinical, clinical, regulatory approval or sales milestones. Joint steering committees often exist to manage the various stages and activities of the arrangement. Control over the R&D activities may be shared or may be performed by Baxter. Baxter generally controls the commercialization phase, sometimes purchasing raw materials from the collaboration partner.

During the development phase, Baxter's R&D costs are expensed as incurred. These costs may include R&D cost reimbursements to the partner, as well as up-front and milestone payments to the partner prior to the date the product receives regulatory approval. Milestone payments made to the partner subsequent to regulatory approval are capitalized as other intangible assets and amortized to cost of sales over the estimated useful life of the related asset. Royalty payments are expensed as cost of sales when they become due and payable. Any purchases of raw materials from the partner during the development stage are expensed as R&D, while such purchases during the commercialization phase are capitalized as inventory and recognized as cost of sales when the related finished products are sold. Baxter generally records the amount invoiced to the third-party customer for the finished product as sales, as Baxter is the principal and primary obligor in the arrangement.

Payments to collaborative partners classified in cost of sales were not significant in 2009, 2008 and 2007. Payments to collaborative partners classified in R&D expense were 6%, 7% and 8% of total R&D expense in 2009, 2008 and 2007, respectively. The payments principally related to the development of tissue repair products, longer-acting forms of blood clotting proteins to treat hemophilia and a home HD device.

Commercial Product Arrangements

The company's commercial product collaborative arrangements generally provide for a sharing of manufacturing, marketing or distribution activities between Baxter and the partner, along with a sharing of the related profits. The nature and split of the shared activities varies, sometimes split by type of activity and sometimes split by geographic area.

The entity that invoices the third-party customer is generally the principal and primary obligor in the arrangement and therefore records the invoiced amount as a sale. Cost-sharing payments are generally recorded in cost of sales. Baxter's payments to partners under these types of arrangements were less than 1% of total cost of sales in 2009, 2008 and 2007.

## Other Commitments and Contingencies

Joint Development and Commercialization Arrangements

In addition to the new product development arrangements discussed above, the company has entered into certain other arrangements which include contingent milestone payments. At December 31, 2009, the company's unfunded milestone payments associated with all of its arrangements totaled $812 million. This total excludes any contingent royalties. Based on the company's projections, any contingent payments made in the future will be more than offset over time by the estimated net future cash flows relating to the rights acquired for those payments. The majority of the contingent payments relate to arrangements in the BioScience segment. Included in the total are contingent milestone payments of $220 million relating to arrangements entered into during 2008 and 2007 that are discussed in Note 4. Aside from the items discussed in Note 4, significant collaborations relate to the development of hard and soft tissue-repair products to position the company to enter the orthobiologic market, the development of longer-acting forms of blood clotting proteins to treat hemophilia A and other arrangements.

Indemnifications

During the normal course of business, Baxter makes indemnities, commitments and guarantees pursuant to which the company may be required to make payments related to specific transactions. Indemnifications include: (i) intellectual property indemnities to customers in connection with the use, sales or license of products and services; (ii) indemnities to customers in connection with losses incurred while performing services on their premises; (iii) indemnities to vendors and service providers pertaining to claims based on negligence or willful misconduct; and (iv) indemnities involving the representations and warranties in certain contracts. In addition, under Baxter's Amended and Restated Certificate of Incorporation, and consistent with Delaware General Corporation Law, the company has agreed to indemnify its directors and officers for certain losses and expenses upon the occurrence of certain prescribed events. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum potential for future payments that the company could be obligated to make. To help address some of these risks, the company maintains various insurance coverages. Based on historical experience and evaluation of the agreements, the company does not believe that any significant payments related to its indemnifications will result, and therefore the company has not recorded any associated liabilities.

Legal Contingencies

Refer to Note 11 for a discussion of the company's legal contingencies.

## NOTE 7
## FINANCIAL INSTRUMENTS AND RELATED FAIR VALUE MEASUREMENTS

### Receivable Securitizations

Where economical, the company has entered into agreements with various financial institutions in which the entire interest in and ownership of the receivable is sold, principally consisting of trade receivables originated in Japan. The company had also entered into agreements in which undivided interests in certain pools of receivables were sold, principally consisting of hardware lease receivables originated in the United States and trade receivables originated in Europe.

In November 2007, the company purchased the third party interest in the previously sold receivables under the company's European securitization facility, resulting in a net cash outflow of $157 million, consisting of $225 million of receivables and $68 million of retained interests. The $157 million net cash outflow was classified as an investing activity in the consolidated statement of cash flows. Subsequent cash collections from customers relating to these receivables are also classified in the investing section of the consolidated statements of cash flows, and totaled $14 million, $46 million and $161 million for the years ended 2009, 2008 and 2007, respectively. The European facility matured in November 2007 and was not renewed.

The U.S. securitization facility matured in December 2007 and was not renewed. The company continues to service the receivables in its Japanese securitization arrangements. Servicing assets or liabilities are not recognized because the company receives adequate compensation to service the sold receivables. The Japanese securitization arrangement includes limited recourse provisions, which are not material.

The securitization arrangements resulted in net cash outflows of $7 million, $3 million and $240 million (of which $225 million was classified as an investing activity and $15 million as an operating activity in the consolidated statement of cash flows) in 2009, 2008 and 2007, respectively. A summary of the securitization activity is as follows.

| as of and for the years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Sold receivables at beginning of year | **$ 154** | $ 129 | $ 348 |
| Proceeds from sales of receivables | **535** | 467 | 1,395 |
| Purchase of interest in receivables in the European securitization facility | **—** | — | (225) |
| Cash collections (remitted to the owners of the receivables) | **(542)** | (470) | (1,410) |
| Foreign exchange | **—** | 28 | 21 |
| Sold receivables at end of year | **$ 147** | $ 154 | $ 129 |

The net gains and losses relating to the sales of receivables were immaterial for each year.

### Concentrations of Risk

The company invests excess cash in certificates of deposit or money market funds and 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.

While the current economic downturn has not meaningfully impacted the company's ability to collect receivables, the company continues to do business with certain foreign governments which have recently experienced credit rating downgrades and may become unable to pay for our products or services.

### Foreign Currency and Interest Rate Risk Management

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 foreign exchange and interest rates. The company's hedging policy attempts to manage these risks to an acceptable level based on the company's judgment of the appropriate trade-off between risk, opportunity and costs.

The company is primarily exposed to foreign exchange risk with respect to recognized assets and liabilities, forecasted transactions and net assets denominated in the Euro, Japanese Yen, British Pound, Australian Dollar, Canadian Dollar, Brazilian Real and Colombian Peso. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and equity volatility resulting from foreign exchange. Market volatility and currency fluctuations may reduce the benefits of the company's natural hedges and limit the company's ability to cost-effectively hedge these exposures.

The company is also exposed to the risk that its earnings and cash flows could be adversely impacted by fluctuations in interest rates. The company's policy is to manage interest costs using a mix of fixed- and floating-rate debt that the company believes is appropriate. To manage this mix in a cost-efficient manner, the company periodically enters into interest rate swaps in which the company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional amount.

The company does not hold any instruments for trading purposes and none of the company's outstanding derivative instruments contain credit-risk-related contingent features.

#### Cash Flow Hedges

The company may use options, including collars and purchased options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions denominated in foreign currencies and recognized assets and liabilities. The company periodically uses forward-starting interest rate swaps and treasury rate locks to hedge the risk to earnings associated with movements in interest rates relating to anticipated issuances of debt. Certain other firm commitments and forecasted transactions are also periodically hedged. Cash flow hedges primarily relate to forecasted intercompany sales denominated in foreign

currencies, a hedge of U.S. Dollar-denominated debt issued by a foreign subsidiary and anticipated issuances of debt.

The notional amounts of foreign exchange contracts, cross-currency swaps (used to hedge U.S. Dollar-denominated debt issued by a foreign subsidiary) and interest rate contracts were $1.2 billion, $500 million and $200 million, respectively, as of December 31, 2009.

The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions at December 31, 2009 is 12 months.

Fair Value Hedges

The company uses interest rate swaps to convert a portion of its fixed-rate debt into variable-rate debt. These instruments hedge the company's earnings from changes in the fair value of debt due to fluctuations in the designated benchmark interest rate.

The total notional amount of interest rate contracts designated as fair value hedges was $1.6 billion as of December 31, 2009.

Dedesignations

In 2009, the company terminated $500 million of its interest rate contracts, resulting in a net gain of $10 million that was deferred in AOCI.

Undesignated Derivative Instruments

The company uses forward contracts to hedge earnings from the effects of foreign exchange relating to certain of the company's intercompany and third-party receivables and payables denominated in a foreign currency. These derivative instruments are generally not formally designated as hedges and the terms of these instruments generally do not exceed one month.

The total notional amount of undesignated derivative instruments was $222 million as of December 31, 2009.

Gains and Losses on Derivative Instruments

The following tables summarize the income statement classification and gains and losses on the company's derivative instruments for the year ended December 31, 2009.

| (in millions) | Gain (loss) recognized in OCI | Location of gain (loss) in the income statement | Gain (loss) reclassified from AOCI into the income statement |
|---|---|---|---|
| **Cash flow hedges** | | | |
| Interest rate contracts | $ 78 | Net interest expense | $ (3) |
| Foreign exchange contracts | (3) | Net sales | 5 |
| Foreign exchange contracts | (53) | Cost of sales | 43 |
| Foreign exchange contracts | (42) | Other expense, net | (28) |
| Total | $(20) | | $ 17 |

| (in millions) | Location of loss in the income statement | Loss recognized in the income statement |
|---|---|---|
| **Fair value hedges** | | |
| Interest rate contracts | Net interest expense | $(80) |
| **Undesignated derivative instruments** | | |
| Foreign exchange contracts | Other expense, net | $(47) |

The net loss recognized in OCI for cash flow hedges resulted in a tax benefit of $1 million that is not reflected in the table above. For the company's fair value hedges, equal and offsetting gains of $80 million were recognized in net interest expense in 2009 as adjustments to the underlying hedged item, fixed-rate debt. Ineffectiveness related to the company's cash flow and fair value hedges for the year ended December 31, 2009 was not material.

The following table summarizes net-of-tax activity in AOCI, a component of shareholders' equity, related to the company's cash flow hedges.

| as of and for the years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Accumulated other comprehensive income (loss) balance at beginning of year | **$ 39** | $ 14 | $ (9) |
| (Loss) gain in fair value of derivatives during the year | **(19)** | 93 | (43) |
| Amount reclassified to earnings during the year | **(17)** | (68) | 66 |
| Accumulated other comprehensive income balance at end of year | **$ 3** | $ 39 | $ 14 |

As of December 31, 2009, $10 million of deferred, net after-tax losses on derivative instruments included in AOCI are expected to be recognized in earnings during the next 12 months, coinciding with when the hedged items are expected to impact earnings.

Fair Values of Derivative Instruments

The following table summarizes the classification and fair value amounts of derivative instruments reported in the consolidated balance sheet as of December 31, 2009.

| | Derivatives in asset positions | | Derivatives in liability positions | |
|---|---|---|---|---|
| (in millions) | Balance sheet location | Fair value | Balance sheet location | Fair value |
| **Derivative instruments designated as hedges** | | | | |
| Interest rate contracts | Prepaid expenses and other | $ 25 | Other long-term liabilities | $ 1 |
| Interest rate contracts | Other long-term assets | 60 | | |
| Foreign exchange contracts | Prepaid expenses and other | 20 | Accounts payable and accrued liabilities | 112 |
| Total derivative instruments designated as hedges | | $105 | | $113 |
| **Undesignated derivative instruments** | | | | |
| Foreign exchange contracts | Prepaid expenses and other | $ — | Accounts payable and accrued liabilities | $ — |
| Total derivative instruments | | $105 | | $113 |

Hedges of Net Investments in Foreign Operations

In 2008, the company terminated its remaining net investment hedge portfolio and no longer has any outstanding net investment hedges. The company historically hedged the net assets of certain of its foreign operations using a combination of foreign currency denominated debt and cross-currency swaps. In 2004, the company reevaluated its net investment hedge strategy and elected to reduce the use of these instruments as a risk management tool. As part of the change in strategy, the company executed offsetting, or mirror, cross-currency swaps relating to over half of the existing portfolio that effectively fixed the net amount that the company would ultimately pay to settle the cross-currency swap agreements subject to this strategy. The net after-tax losses related to net investment hedge instruments recorded in OCI were $33 million and $48 million in 2008 and 2007, respectively.

When the cross-currency swaps were settled, the cash flows were reported within the financing section of the consolidated statement of cash flows. When the mirror swaps were settled, the cash flows were reported in the operating section of the consolidated statement of cash flows. Of the $528 million of net settlement payments in 2008, $540 million of cash outflows were included in the financing section and $12 million of cash inflows were included in the operating section. Of the $334 million of settlement payments in 2007, $303 million of cash outflows were included in the financing section and $31 million of cash outflows were included in the operating section.

## Fair Value Measurements

On January 1, 2008, the company adopted a new accounting standard relating to assets and liabilities that are measured at fair value on a recurring basis. The standard clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. On January 1, 2009, the company completed the adoption of the accounting standard for fair value measurements as it related to nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis.

The fair value hierarchy under the accounting standard for fair value measurements consists of the following three levels:

- Level 1 — Quoted prices in active markets that the company has the ability to access for identical assets or liabilities;
- Level 2 — Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market; and
- Level 3 — Valuations using significant inputs that are unobservable in the market and include the use of judgment by the company's management about the assumptions market participants would use in pricing the asset or liability.

The following table summarizes the bases used to measure financial assets and liabilities that are carried at fair value on a recurring basis in the consolidated balance sheets.

| | | Basis of fair value measurement | | |
|---|---|---|---|---|
| (in millions) | Balance at December 31, 2009 | Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
| **Assets** | | | | |
| Foreign currency hedges | $ 20 | $ — | $ 20 | $ — |
| Interest rate hedges | 85 | — | 85 | — |
| Equity securities | 13 | 13 | — | — |
| Total assets | $118 | $13 | $105 | $ — |
| **Liabilities** | | | | |
| Foreign currency hedges | $112 | $ — | $112 | $ — |
| Interest rate hedges | 1 | — | 1 | — |
| Contingent payments related to SIGMA | 59 | — | — | 59 |
| Total liabilities | $172 | $ — | $113 | $59 |

| (in millions) | Balance at December 31, 2008 | Basis of fair value measurement: Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|---|
| **Assets** | | | | |
| Foreign currency hedges | $148 | $— | $148 | $— |
| Interest rate hedges | 140 | — | 140 | — |
| Equity securities | 14 | 14 | — | — |
| Total assets | $302 | $14 | $288 | $— |
| **Liabilities** | | | | |
| Foreign currency hedges | $ 77 | $— | $ 77 | $— |
| Interest rate hedges | 43 | — | 43 | — |
| Total liabilities | $120 | $— | $120 | $— |

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The majority of the derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments. The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs are considered observable and vary depending on the type of derivative, and include contractual terms, interest rate yield curves, foreign exchange rates and volatility. The contingent payments are valued using a discounted cash flow technique that reflects managements' expectations about probability of payment.

Refer to Note 4 for further information regarding changes in fair value of the contingent payments related to SIGMA. Refer to Note 9 for fair value disclosures related to the company's pension plans.

As discussed further in Note 5, the company recorded asset impairment charges related to SYNDEO, SOLOMIX and its cost optimization efforts in 2009. As the assets had no alternative use and no salvage value, the fair value, measured using significant unobservable inputs (Level 3), was assessed to be zero.

Book Values and Fair Values of Financial Instruments

In addition to the financial instruments that the company is required to recognize at fair value on the consolidated balance sheets, the company has certain financial instruments that are recognized at historical cost or some basis other than fair value. For these financial instruments, the following table provides the value recognized on the consolidated balance sheets and the approximate fair value.

| as of December 31 (in millions) | Book values 2009 | Book values 2008 | Approximate fair values 2009 | Approximate fair values 2008 |
|---|---|---|---|---|
| **Assets** | | | | |
| Long-term insurance receivables | **$ 49** | $ 58 | **$ 47** | $ 54 |
| Cost basis investments | **31** | 20 | **31** | 20 |
| **Liabilities** | | | | |
| Short-term debt | **29** | 388 | **29** | 388 |
| Current maturities of long-term debt and lease obligations | **682** | 6 | **697** | 6 |
| Other long-term debt and lease obligations | **3,440** | 3,362 | **3,568** | 3,409 |
| Long-term litigation liabilities | **45** | 63 | **44** | 60 |

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, which in many cases does not include final orders or settlement agreements. The discount factors used in the calculations reflect the non-performance risk of the insurance providers and the company, respectively. The estimated fair values of current and long-term debt and lease obligations were computed by multiplying price by the notional amount of the respective debt instrument. Price is calculated using the stated terms of the respective debt instrument and yield curves commensurate with the company's credit risk. In determining the fair value of cost method investments, the company takes into consideration recent transactions, as well as the financial information of the investee. The carrying values of the other financial instruments approximate their fair values due to the short-term maturities of most of these assets and liabilities.

## NOTE 8
## COMMON AND PREFERRED STOCK

### Stock-Based Compensation

The company's stock-based compensation generally includes stock options, performance share units (PSUs), restricted stock units (RSUs) and purchases under employee stock purchase plans. Shares issued relating to the company's stock-based plans are generally issued out of treasury stock. As of December 31, 2009, approximately 28 million authorized shares are available for future awards under the company's stock-based compensation plans. The following is a summary of the company's significant stock compensation plans.

Stock Compensation Expense

Stock compensation expense recognized in the consolidated statements of income was $140 million, $146 million and $136 million in 2009, 2008 and 2007, respectively. The related tax benefit recognized was $40 million, $46 million and $46 million in 2009, 2008 and 2007, respectively.

Stock compensation expense is recorded at the corporate level and is not allocated to a segment. Approximately three-quarters of stock compensation expense is classified in marketing and administrative expenses, with the remainder classified in cost of sales and R&D expenses. Costs capitalized in the consolidated balance sheet at December 31, 2009 were not significant.

Stock compensation expense is based on awards expected to vest, and therefore has been reduced by estimated forfeitures. Forfeitures are required to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

Stock Options

Stock options are granted to employees and non-employee directors with exercise prices at least equal to 100% of the market value on the date of grant. Beginning in 2007, stock options granted generally vest in one-third increments over a three-year period. Options granted prior to 2007 generally cliff-vest 100% three years from the grant date. Stock options granted to non-employee directors generally cliff-vest 100% one year from the grant date. Stock options granted typically have a contractual term of 10 years. The grant-date fair value, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the substantive vesting period.

The fair value of stock options is determined using the Black-Scholes model. The weighted-average assumptions used in estimating the fair value of stock options granted during each year, along with the weighted-average grant-date fair values, were as follows.

| years ended December 31 | **2009** | 2008 | 2007 |
|---|---|---|---|
| Expected volatility | **30%** | 24% | 23% |
| Expected life (in years) | **4.5** | 4.5 | 4.5 |
| Risk-free interest rate | **1.8%** | 2.4% | 4.5% |
| Dividend yield | **2.0%** | 1.5% | 1.2% |
| Fair value per stock option | **$12** | $12 | $13 |

The company's expected volatility assumption is based on an equal weighting of the historical volatility of Baxter's stock and the implied volatility from traded options on Baxter's stock. The expected life assumption is primarily based on the vesting terms of the stock option, historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield reflects historical experience as well as future expectations over the expected life of the option.

The following table summarizes stock option activity for the year ended December 31, 2009 and stock option information at December 31, 2009.

| (options and aggregate intrinsic values in thousands) | Options | Weighted-average exercise price | Weighted-average remaining contractual term (in years) | Aggregate intrinsic value |
|---|---|---|---|---|
| Outstanding at January 1, 2009 | 44,027 | $44.13 | | |
| Granted | 6,885 | 52.45 | | |
| Exercised | (6,368) | 38.45 | | |
| Forfeited | (1,405) | 53.45 | | |
| Outstanding at December 31, 2009 | 43,139 | $46.00 | 5.7 | $549,542 |
| Vested or expected to vest as of December 31, 2009 | 42,265 | $45.83 | 5.7 | $545,320 |
| Exercisable at December 31, 2009 | 29,684 | $42.26 | 4.5 | $488,259 |

The aggregate intrinsic value in the table above represents the difference between the exercise price and the company's closing stock price on the last trading day of the year. The total intrinsic value of options exercised was $108 million, $328 million and $294 million in 2009, 2008 and 2007, respectively.

As of December 31, 2009, $78 million of unrecognized compensation cost related to stock options is expected to be recognized as expense over a weighted-average period of approximately 1.7 years.

PSUs

In 2007, the company restructured its annual equity awards stock compensation program for senior management to include PSUs with market-based conditions rather than RSUs. This change reflects the company's view that as senior management has more responsibility for the company's performance, the payout of a portion of their equity awards should be completely "at-risk". The company also changed the overall mix of stock compensation, from a weighting of 70% stock options and 30% RSUs, to 50% stock options and 50% PSUs. The mix of stock options was adjusted downward in order to reflect the market shift away from stock options in favor of alternative performance-based awards. Certain members of senior management received a one-time transitional award of RSUs in 2007 as part of their annual equity awards.

The payout resulting from the vesting of the PSUs is based on Baxter's growth in shareholder value versus the growth in shareholder value of the healthcare companies in Baxter's peer group during the three-year performance period commencing with the year in which the PSUs are granted. Depending on Baxter's growth in shareholder value relative to the peer group, a holder of PSUs is entitled to receive a number of shares of common stock equal to a percentage, ranging from 0% to 200%, of the PSUs granted. The grant-date fair value, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the substantive vesting period.

The fair value of PSUs is determined using a Monte Carlo model. A Monte Carlo model uses stock price volatility and other variables to estimate the probability of satisfying the market conditions and the resulting fair value of the award. The assumptions used in estimating

the fair value of PSUs granted during each year, along with the fair values, were as follows.

| years ended December 31 | 2009 | 2008 | 2007 |
|---|---|---|---|
| Expected volatility | **25%** | 20% | 18% |
| Peer group volatility | **20%-59%** | 12%-37% | 13%-39% |
| Correlation of returns | **0.30-0.61** | 0.12-0.40 | 0.09-0.34 |
| Risk-free interest rate | **1.6%** | 1.9% | 4.5% |
| Fair value per PSU | **$65** | $67 | $67 |

The company granted approximately 580,000, 650,000 and 780,000 PSUs in 2009, 2008 and 2007, respectively. Pre-tax unrecognized compensation cost related to all unvested PSUs of $32 million at December 31, 2009 is expected to be recognized as expense over a weighted-average period of 1.6 years.

The following table summarizes nonvested PSU activity for the year ended December 31, 2009.

| (share units in thousands) | Share units | Weighted-average grant-date fair value |
|---|---|---|
| Nonvested PSUs at January 1, 2009 | 1,370 | $66.74 |
| Granted | 582 | 65.37 |
| Vested | (717) | 66.71 |
| Forfeited | (111) | 66.27 |
| Nonvested PSUs at December 31, 2009 | 1,124 | $66.10 |

RSUs

The company periodically grants RSUs to employees and non-employee directors for recognition and retention purposes. RSUs principally vest in one-third increments over a three-year period. However, awards for non-employee directors vest one year from the grant date. The grant-date fair value, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the substantive vesting period. Prior to 2007, the company granted restricted stock to non-employee directors, which also vested one year from the grant date.

The fair value of RSUs is determined based on the number of shares granted and the quoted price of the company's common stock on the date of grant.

The following table summarizes nonvested RSU activity for the year ended December 31, 2009.

| (share units in thousands) | Share units | Weighted-average grant-date fair value |
|---|---|---|
| Nonvested RSUs at January 1, 2009 | 655 | $50.19 |
| Granted | 112 | 52.51 |
| Vested | (368) | 44.21 |
| Forfeited | (32) | 55.58 |
| Nonvested RSUs at December 31, 2009 | 367 | $56.41 |

As of December 31, 2009, $9 million of unrecognized compensation cost related to RSUs is expected to be recognized as expense over a weighted-average period of approximately 1.9 years. The weighted-average grant-date fair value of RSUs in 2009, 2008 and 2007 was $52.51, $62.55 and $52.41, respectively. The fair value of RSUs and restricted stock vested in 2009, 2008 and 2007 was $19 million, $34 million and $26 million, respectively.

Employee Stock Purchase Plans

Nearly all employees are eligible to participate in the company's employee stock purchase plans (ESPPs). Effective January 1, 2008, the ESPPs were amended and restated as a result of the company's periodic reassessment of the nature and level of employee benefits.

For subscriptions beginning on or after January 1, 2008, the employee purchase price is 85% of the closing market price on the purchase date. For subscriptions that began on or after April 1, 2005 through the end of 2007, the employee purchase price was 95% of the closing market price on the purchase date.

No compensation expense was recognized for subscriptions that began on or after April 1, 2005 through the end of 2007. The company is recognizing compensation expense relating to subscriptions beginning on or after January 1, 2008.

During 2009, 2008 and 2007, the company issued approximately 875,000, 727,000 and 193,000 shares, respectively, under employee stock purchase plans. The number of shares under subscription at December 31, 2009 totaled approximately 1.4 million.

Realized Excess Income Tax Benefits and the Impact on the Statement of Cash Flows

Realized excess tax benefits associated with stock compensation are presented in the consolidated statement of cash flows as an outflow within the operating section and an inflow within the financing section. Realized excess tax benefits from stock-based compensation were $96 million in 2009 and $112 million in 2008. No income tax benefits were realized from stock-based compensation during 2007. The company uses the alternative transition method for calculating the tax effects of stock-based compensation, and applies the tax law ordering approach.

### Stock Repurchase Programs

As authorized by the board of directors, the company repurchases its stock from time to time depending on the company's cash flows, net debt level and market conditions. The company purchased 23 million shares for $1.2 billion in 2009, 32 million shares for $2.0 billion in 2008 and 34 million shares for $1.9 billion in 2007. In March 2008, the board of directors authorized the repurchase of up to $2.0 billion of the company's common stock. There is no remaining availability under the March 2008 authorization as of December 31, 2009. In July 2009, the board of directors authorized the repurchase of up to an additional $2.0 billion of the company's common stock. At December 31, 2009, $1.95 billion remained available under the July 2009 authorization.

### Cash Dividends

Beginning in 2007, the company converted from an annual to a quarterly dividend and increased the dividend by 15% on an annualized basis, to $0.1675 per share per quarter. In November 2007, the board of directors declared a quarterly dividend of $0.2175 per share ($0.87 per share on an annualized basis), representing an increase of 30% over the previous quarterly rate. In November 2008, the board of directors declared a quarterly dividend

of $0.26 per share ($1.04 per share on an annualized basis), representing an increase of 20% over the previous quarterly rate. In November 2009, the board of directors declared a quarterly dividend of $0.29 per share ($1.16 per share on an annualized basis), which was paid on January 5, 2010 to shareholders of record as of December 10, 2009. This dividend represented an increase of 12% over the previous quarterly rate of $0.26 per share.

## NOTE 9
## RETIREMENT AND OTHER BENEFIT PROGRAMS

The company sponsors a number of qualified and nonqualified pension plans for eligible employees. The company also sponsors certain unfunded contributory healthcare and life insurance benefits for substantially all domestic retired employees.

As required by a new accounting standard, on December 31, 2008, the company changed the measurement date for its defined benefit pension and other postemployment benefit (OPEB) plans from September 30 to December 31, the company's fiscal year-end. The company elected to use the 15-month remeasurement approach, whereby a net-of-tax decrease to retained earnings of $27 million was recognized on December 31, 2008 equal to three-fifteenths of the net cost determined for the period from September 30, 2007 to December 31, 2008. The adjustment resulted in a net-of-tax increase to AOCI of $12 million. The remaining twelve-fifteenths of the net cost was recognized as expense in 2008 as part of the net periodic benefit cost.

### Reconciliation of Pension and OPEB Plan Obligations, Assets and Funded Status

The benefit plan information in the table below pertains to all of the company's pension and OPEB plans, both in the United States and in other countries.

| | Pension benefits | | OPEB | |
|---|---|---|---|---|
| as of and for the years ended December 31 (in millions) | **2009** | 2008 | **2009** | 2008 |
| **Benefit obligations** | | | | |
| Beginning of period | **$ 3,475** | $ 3,307 | **$ 477** | $ 479 |
| Effect of eliminating early measurement date | **—** | 39 | **—** | 3 |
| Service cost | **87** | 86 | **5** | 5 |
| Interest cost | **219** | 202 | **30** | 30 |
| Participant contributions | **8** | 8 | **13** | 12 |
| Actuarial loss (gain) | **268** | 53 | **24** | (17) |
| Benefit payments | **(151)** | (153) | **(33)** | (35) |
| Foreign exchange and other | **59** | (67) | **(10)** | — |
| End of period | **3,965** | 3,475 | **506** | 477 |
| **Fair value of plan assets** | | | | |
| Beginning of period | **2,381** | 2,998 | **—** | — |
| Effect of eliminating early measurement date | **—** | 33 | **—** | — |
| Actual return on plan assets | **377** | (744) | **—** | — |
| Employer contributions | **170** | 287 | **20** | 23 |
| Participant contributions | **8** | 8 | **13** | 12 |
| Benefit payments | **(151)** | (153) | **(33)** | (35) |
| Foreign exchange and other | **37** | (48) | **—** | — |
| End of period | **2,822** | 2,381 | **—** | — |
| Funded status at December 31 | **$(1,143)** | $(1,094) | **$(506)** | $(477) |
| **Amounts recognized in the consolidated balance sheets** | | | | |
| Noncurrent asset | **$ 20** | $ 7 | **$ —** | $ — |
| Current liability | **(16)** | (15) | **(25)** | (25) |
| Noncurrent liability | **(1,147)** | (1,086) | **(481)** | (452) |
| Net liability recognized at December 31 | **$(1,143)** | $(1,094) | **$(506)** | $(477) |

Accumulated Benefit Obligation Information

The pension obligation information in the table above represents the projected benefit obligation (PBO). The PBO incorporates assumptions relating to future compensation levels. The accumulated benefit obligation (ABO) is the same as the PBO except that it includes no assumptions relating to future compensation levels. The ABO for all of the company's pension plans was $3.6 billion and $3.0 billion at the 2009 and 2008 measurement dates, respectively.

The information in the funded status table above represents the totals for all of the company's pension plans. The following is information relating to the individual plans in the funded status table above that have an ABO in excess of plan assets.

| (in millions) | **2009** | 2008 |
|---|---|---|
| ABO | **$3,392** | $3,017 |
| Fair value of plan assets | **2,520** | 2,168 |

The following is information relating to the individual plans in the funded status table above that have a PBO in excess of plan assets (many of which also have an ABO in excess of assets, and are therefore also included in the table directly above).

| (in millions) | **2009** | 2008 |
|---|---|---|
| PBO | **$3,845** | $3,424 |
| Fair value of plan assets | **2,682** | 2,323 |

### Expected Net Pension and OPEB Plan Payments for the Next 10 Years

| (in millions) | Pension benefits | OPEB |
|---|---|---|
| 2010 | $ 162 | $ 25 |
| 2011 | 168 | 28 |
| 2012 | 184 | 30 |
| 2013 | 196 | 31 |
| 2014 | 212 | 32 |
| 2015 through 2019 | 1,281 | 180 |
| Total expected net benefit payments for next 10 years | $2,203 | $326 |

The expected net benefit payments above reflect the company's share of the total net benefits expected to be paid from the plans' assets (for funded plans) or from the company's assets (for unfunded plans). The total expected OPEB benefit payments for the next ten years are net of approximately $56 million of expected federal subsidies relating to the Medicare Prescription Drug, Improvement and Modernization Act, including $3 million, $4 million, $5 million, $5 million and $5 million in each of the years 2010, 2011, 2012, 2013 and 2014, respectively.

### Amounts Recognized in AOCI

The pension and OPEB plans' gains or losses, prior service costs or credits, and transition assets or obligations not yet recognized in net periodic benefit cost are recognized on a net-of-tax basis in AOCI and will be amortized from AOCI to net periodic benefit cost in the future. The following is a summary of the pre-tax losses included in AOCI at December 31, 2009 and December 31, 2008.

| (in millions) | Pension benefits | OPEB |
|---|---|---|
| Actuarial loss | **$1,731** | **$ 75** |
| Prior service cost (credit) and transition obligation | **4** | **(15)** |
| Total pre-tax loss recognized in AOCI at December 31, 2009 | **$1,735** | **$ 60** |
| Actuarial loss | $1,674 | $ 52 |
| Prior service cost (credit) and transition obligation | 4 | (7) |
| Total pre-tax loss recognized in AOCI at December 31, 2008 | $1,678 | $ 45 |

Refer to Note 1 for the net-of-tax balances included in AOCI as of each of the year-end dates. The following is a summary of the net-of-tax amounts recorded in OCI relating to pension and OPEB plans.

| years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| (Charge) credit arising during the year, net of tax (benefit) expense of ($53) in 2009, ($348) in 2008 and $106 in 2007 | **$(116)** | $(641) | $200 |
| Amortization of loss to earnings, net of tax benefit of $35 in 2009, $29 in 2008 and $38 in 2007 | **62** | 50 | 66 |
| Pension and other employee benefits (charge) credit | **$ (54)** | $(591) | $266 |

The OCI activity for pension and OPEB plans related almost entirely to actuarial gains and losses. Activity relating to prior service costs and credits and transition obligations was insignificant.

### Amounts Expected to be Amortized From AOCI to Net Periodic Benefit Cost in 2010

With respect to the AOCI balance at December 31, 2009, the following is a summary of the pre-tax amounts expected to be amortized to net periodic benefit cost in 2010.

| (in millions) | Pension benefits | OPEB |
|---|---|---|
| Actuarial loss | $126 | $ 2 |
| Prior service cost (credit) and transition obligation | 1 | (7) |
| Total pre-tax amount expected to be amortized from AOCI to net pension and OPEB cost in 2010 | $127 | $(5) |

### Net Periodic Benefit Cost

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Pension benefits** | | | |
| Service cost | **$ 87** | $ 86 | $ 86 |
| Interest cost | **219** | 202 | 185 |
| Expected return on plan assets | **(250)** | (230) | (216) |
| Amortization of net loss and other deferred amounts | **99** | 79 | 97 |
| Net periodic pension benefit cost | **$ 155** | $ 137 | $ 152 |
| **OPEB** | | | |
| Service cost | **$ 5** | $ 5 | $ 6 |
| Interest cost | **30** | 30 | 30 |
| Amortization of prior service costs and other deferred amounts | **(2)** | — | 5 |
| Net periodic OPEB cost | **$ 33** | $ 35 | $ 41 |

### Weighted-Average Assumptions Used in Determining Benefit Obligations at the Measurement Date

| | Pension benefits | | OPEB | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| **Discount rate** | | | | |
| U.S. and Puerto Rico plans | **6.05%** | 6.50% | **5.95%** | 6.50% |
| International plans | **4.81%** | 5.17% | **n/a** | n/a |
| **Rate of compensation increase** | | | | |
| U.S. and Puerto Rico plans | **4.50%** | 4.50% | **n/a** | n/a |
| International plans | **3.58%** | 3.57% | **n/a** | n/a |
| **Annual rate of increase in the per-capita cost** | **n/a** | n/a | **7.00%** | 7.50% |
| Rate decreased to | **n/a** | n/a | **5.00%** | 5.00% |
| by the year ended | **n/a** | n/a | **2014** | 2014 |

The assumptions above, which were used in calculating the December 31, 2009 measurement date benefit obligations, will be used in the calculation of net periodic benefit cost in 2010.

### Weighted-Average Assumptions Used in Determining Net Periodic Benefit Cost

| | Pension benefits | | | OPEB | | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2009 | 2008 | 2007 |
| **Discount rate** | | | | | | |
| U.S. and Puerto Rico plans | **6.50%** | 6.35% | 6.00% | **6.50%** | 6.30% | 6.00% |
| International plans | **5.17%** | 5.10% | 4.48% | **n/a** | n/a | n/a |
| **Expected return on plan assets** | | | | | | |
| U.S. and Puerto Rico plans | **8.50%** | 8.50% | 8.50% | **n/a** | n/a | n/a |
| International plans | **7.44%** | 7.00% | 7.50% | **n/a** | n/a | n/a |
| **Rate of compensation increase** | | | | | | |
| U.S. and Puerto Rico plans | **4.50%** | 4.50% | 4.50% | **n/a** | n/a | n/a |
| International plans | **3.57%** | 3.69% | 3.64% | **n/a** | n/a | n/a |
| **Annual rate of increase in the per-capita cost** | **n/a** | n/a | n/a | **7.50%** | 8.00% | 9.00% |
| Rate decreased to | **n/a** | n/a | n/a | **5.00%** | 5.00% | 5.00% |
| by the year ended | **n/a** | n/a | n/a | **2014** | 2014 | 2011 |

The company establishes the expected return on plan assets assumption primarily based on a review of historical compound average asset returns, both company-specific and relating to the broad market (based on the company's asset allocation), as well as an analysis of current market and economic information and future expectations. The company plans to continue to use an 8.50% assumption for its U.S. and Puerto Rico plans for 2010.

### Effect of a One-Percent Change in Assumed Healthcare Cost Trend Rate on the OPEB Plan

| years ended December 31 (in millions) | One percent increase | | One percent decrease | |
|---|---|---|---|---|
| | **2009** | 2008 | **2009** | 2008 |
| Effect on total of service and interest cost components of OPEB cost | **$ 4** | $ 5 | **$ 4** | $ 4 |
| Effect on OPEB obligation | **$58** | $52 | **$49** | $44 |

### Pension Plan Assets

An investment committee of members of senior management is responsible for supervising, monitoring and evaluating the invested assets of the company's funded pension plans. The investment committee, which meets at least quarterly, abides by documented policies and procedures relating to investment goals, targeted asset allocations, risk management practices, allowable and prohibited investment holdings, diversification, use of derivatives, the relationship between plan assets and benefit obligations, and other relevant factors and considerations.

The investment committee's documented goals and guidelines include the following.

- Ability to pay all benefits when due;
- Targeted long-term performance expectations relative to applicable market indices, such as Standard & Poor's, Russell, MSCI EAFE, and other indices;
- Targeted asset allocation percentage ranges (summarized below), and periodic reviews of these allocations;
- Diversification of assets among third-party investment managers, and by geography, industry, stage of business cycle and other measures;
- Specified investment holding and transaction prohibitions (for example, private placements or other restricted securities, securities that are not traded in a sufficiently active market, short sales, certain derivatives, commodities and margin transactions);
- Specified portfolio percentage limits on holdings in a single corporate or other entity (generally 5%, except for holdings in U.S. government or agency securities);
- Specified average credit quality for the fixed-income securities portfolio (at least A- by Standard & Poor's or A3 by Moody's);
- Specified portfolio percentage limits on foreign holdings; and
- Periodic monitoring of investment manager performance and adherence to the Investment Committee's policies.

Plan assets are invested using a total return investment approach whereby a mix of equity securities, debt securities and other investments are used to preserve asset values, diversify risk and exceed the planned benchmark investment return. Investment strategies and asset allocations are based on consideration of plan liabilities, the plans' funded status and other factors, such as the plans' demographics and liability durations. Investment performance is reviewed by the investment committee on a quarterly basis and asset allocations are reviewed at least annually.

Plan assets are managed in a balanced portfolio comprised of two major components: equity securities and fixed income securities. The target allocations for plan assets are 60 percent in equity securities and 40 percent in fixed income securities and other holdings. The documented policy includes an allocation range based on each individual investment type within the major components that allows for a variance from the target allocations of approximately 10 percentage points. Equity securities primarily include large-cap and mid-cap securities in the United States, common/collective trust funds, mutual funds, and partnership investments. Fixed income securities and other holdings primarily include cash, money market funds with an original maturity of three months or less, U.S. and foreign government and governmental agency issues, corporate bonds, municipal securities, derivative contracts and asset-backed securities.

The following table summarizes the bases used to measure the pension plan assets and liabilities that are carried at fair value on a recurring basis.

| (in millions) | Balance at December 31, 2009 | Basis of fair value measurement: Quoted prices in active markets for identical assets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|---|---|---|---|---|
| **Assets** | | | | |
| Fixed income securities | | | | |
| Cash and cash equivalents | $ 97 | $ 5 | $ 92 | $ – |
| U.S. government and government agency issues | 261 | – | 261 | – |
| Corporate bonds | 466 | – | 466 | – |
| Equity securities | | | | |
| Common stock | 1,210 | 1,209 | 1 | – |
| Mutual funds | 230 | 230 | – | – |
| Common/collective trust funds | 351 | – | 348 | 3 |
| Partnership investments | 144 | – | – | 144 |
| Other holdings | 63 | – | 61 | 2 |
| Collateral held on loaned securities | 332 | – | 332 | – |
| **Liabilities** | | | | |
| Collateral to be paid on loaned securities | (332) | (173) | (159) | – |
| Fair value of pension plan assets | $2,822 | $1,271 | $1,402 | $149 |

The following is a reconciliation of changes in fair value measurements that used significant unobservable inputs (Level 3).

| (in millions) | Total | Common/ collective trust funds | Partnership investments | Other holdings |
|---|---|---|---|---|
| Balance at December 31, 2008 | $143 | $ 3 | $138 | $ 2 |
| Actual return on plan assets still held at year end | 3 | — | 3 | — |
| Actual return on plan assets sold during the year | (3) | — | (3) | — |
| Purchases, sales and settlements | 6 | — | 6 | — |
| Balance at December 31, 2009 | $149 | $ 3 | $144 | $ 2 |

The assets and liabilities of the company's pension plans are valued using the following valuation methods:

| Investment category | Valuation methodology |
|---|---|
| Cash and cash equivalents | Values are based on cost, including the effects of foreign currency, which approximates fair value |
| U.S. government and government agency issues | Values are based on reputable pricing vendors, who typically use pricing matrices or models that use observable inputs |
| Corporate bonds | Values are based on reputable pricing vendors, who typically use pricing matrices or models that use observable inputs |
| Common stock | Values are based on the closing prices on the valuation date in an active market on national and international stock exchanges |
| Mutual funds | Values are based on the net asset value of the units held in the respective fund which are obtained from national and international exchanges |
| Common/collective trust funds | Values are based on the net asset value of the units held at year end |
| Partnership investments | Values are based on the estimated fair value of the participation by the company in the investment as determined by the general partner or investment manager of the respective partnership |
| Other holdings | The value of these assets vary by investment type, but primarily are determined by reputable pricing vendors, who use pricing matrices or models that use observable inputs |
| Collateral held on loaned securities | Values are based on the net asset value per unit of the fund in which the collateral is invested |
| Collateral to be paid on loaned securities | Values are based on the fair value of the underlying securities loaned on the valuation date |

### Expected Pension and OPEB Plan Funding

The company's funding policy for its pension plans is to contribute amounts sufficient to meet legal funding requirements, plus any additional amounts that the company may determine to be appropriate considering the funded status of the plans, tax deductibility, the cash flows generated by the company, and other factors. Volatility in the global financial markets could have an unfavorable impact on future funding requirements. The company has no obligation to fund its principal plans in the United States and Puerto Rico in 2010. The company continually reassesses the amount and timing of any discretionary contributions. The company expects to make cash contributions to its pension plans of at least $335 million in 2010, which includes a $300 million discretionary cash contribution made to its pension plan in the United States in January 2010. The company expects to have net cash outflows relating to its OPEB plan of approximately $25 million in 2010.

The table below details the funded status percentage of the company's pension plans as of December 31, 2009, including certain plans that are unfunded in accordance with the guidelines of the company's funding policy outlined above. The table excludes the $300 million discretionary cash contribution made to the pension plan in the United States in January 2010.

| | United States and Puerto Rico | | International | | |
|---|---|---|---|---|---|
| as of December 31, 2009 (in millions) | Qualified plans | Nonqualified plan | Funded plans | Unfunded plans | Total |
| Fair value of plan assets | $2,356 | n/a | $ 466 | n/a | $2,822 |
| PBO | 2,984 | $145 | 599 | $237 | 3,965 |
| Funded status percentage | 79% | n/a | 78% | n/a | 71% |

The Pension Protection Act of 2006 (PPA) was signed into law on August 17, 2006. It is likely that the PPA will accelerate minimum funding requirements in the future.

### Amendments to Defined Benefit Pension Plans

In 2006, the company amended its U.S. qualified defined benefit pension plan and U.S. qualified defined contribution plan, and in 2007, amended its Puerto Rico defined benefit pension plan, such that employees hired on or after the amendment dates are not eligible to participate in the pension plans but receive a higher level of company contributions in the defined contribution plans.

### U.S. Defined Contribution Plan

Most U.S. employees are eligible to participate in a qualified defined contribution plan. Company contributions were $40 million in 2009, $36 million in 2008 and $26 million in 2007.

## NOTE 10
## INCOME TAXES

### Income Before Income Tax Expense by Category

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| United States | **$ 445** | $ 262 | $ 96 |
| International | **2,289** | 2,200 | 2,032 |
| Income before income taxes | **$2,734** | $2,462 | $2,128 |

### Income Tax Expense

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Current | | | |
| United States | | | |
| Federal | **$ 67** | $ — | $ 7 |
| State and local | **(4)** | 2 | 1 |
| International | **189** | 155 | 273 |
| Current income tax expense | **252** | 157 | 281 |
| Deferred | | | |
| United States | | | |
| Federal | **186** | 174 | 196 |
| State and local | **24** | 29 | 24 |
| International | **57** | 77 | (94) |
| Deferred income tax expense | **267** | 280 | 126 |
| Income tax expense | **$519** | $437 | $407 |

### Deferred Tax Assets and Liabilities

| as of December 31 (in millions) | 2009 | 2008 |
|---|---|---|
| Deferred tax assets | | |
| Accrued expenses | **$ 173** | $ 190 |
| Retirement benefits | **570** | 549 |
| Alternative minimum tax credit | **67** | 71 |
| Tax credits and net operating losses | **254** | 433 |
| Asset basis differences | **—** | 46 |
| Valuation allowances | **(144)** | (140) |
| Total deferred tax assets | **920** | 1,149 |
| Deferred tax liabilities | | |
| Subsidiaries' unremitted earnings | **177** | 159 |
| Asset basis differences | **31** | — |
| Other | **5** | 21 |
| Total deferred tax liabilities | **213** | 180 |
| Net deferred tax asset | **$ 707** | $ 969 |

At December 31, 2009, the company had U.S. operating loss carryforwards totaling $14 million and foreign tax credit carryforwards totaling $84 million. The operating loss carryforwards expire between 2020 and 2022. The foreign tax credits principally expire in 2018. At December 31, 2009, the company had foreign net operating loss carryforwards totaling $554 million. Of this amount, $35 million expires in 2010, $7 million expires in 2011, $7 million expires in 2012, $12 million expires in 2013, $12 million expires in 2014, $5 million expires in 2015, $37 million expires after 2015 and $439 million has no expiration date. Realization of these operating loss and tax credit carryforwards depends on generating sufficient taxable income in future periods. A valuation allowance of $144 million and $140 million was recorded at December 31, 2009 and December 31, 2008, respectively, to reduce the deferred tax assets associated with net operating loss and tax credit carryforwards, as well as amortizable assets in loss entities, because the company does not believe it is more likely than not that these assets will be fully realized prior to expiration.

The company will continue to evaluate the need for additional valuation allowances and, as circumstances change, the valuation allowance may change.

### Income Tax Expense Reconciliation

| years ended December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| Income tax expense at U.S. statutory rate | **$ 957** | $ 862 | $ 745 |
| Operations subject to tax incentives | **(433)** | (402) | (438) |
| State and local taxes | **26** | 20 | 11 |
| Foreign tax (benefit) expense | **(56)** | (26) | 25 |
| Tax on repatriations of foreign earnings | **—** | 14 | 82 |
| Tax settlements | **(4)** | (23) | (19) |
| Valuation allowance reductions, net | **—** | (29) | (38) |
| Other factors | **29** | 21 | 39 |
| Income tax expense | **$ 519** | $ 437 | $ 407 |

The company recorded a tax charge of $90 million to the CTA component of OCI during 2009 relating to 2009 earnings outside the United States that are not deemed indefinitely reinvested. The company will continue to evaluate whether to indefinitely reinvest earnings in certain foreign jurisdictions as it continues to analyze the company's global financial structure. Currently, management intends to continue to reinvest past earnings in several jurisdictions outside of the United States for the foreseeable future, and therefore has not recognized U.S. income tax expense on these earnings. U.S. federal and state income taxes, net of applicable credits, on these foreign unremitted earnings of $6.8 billion as of December 31, 2009, would be approximately $2.1 billion. As of December 31, 2008 the foreign unremitted earnings and U.S. federal and state income tax amounts were $5.7 billion and $1.7 billion, respectively.

### Effective Income Tax Rate

The effective income tax rate was 19% in 2009, 18% in 2008 and 19% in 2007. As detailed in the income tax expense reconciliation table above, the company's effective tax rate differs from the U.S. federal statutory rate each year due to certain operations that are subject to tax incentives, state and local taxes, and foreign taxes that are

different than the U.S. federal statutory rate. The effective tax rate for 2009 was impacted by greater income in jurisdictions with higher tax rates, partially offset by $51 million of income tax benefit from planning that accessed foreign tax losses.

### Unrecognized Tax Benefits

The company classifies interest and penalties associated with income taxes in the income tax expense line in the consolidated statements of income. Interest and penalties recorded during 2009, 2008 and 2007 were not material. The liability recorded at December 31, 2009 and 2008 related to interest and penalties was $41 million and $40 million, respectively.

The following is a reconciliation of the company's unrecognized tax benefits for the years ended December 31, 2009, 2008 and 2007.

| as of and for the years ended (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Balance at beginning of the year | **$509** | $490 | $481 |
| Increase associated with tax positions taken during the current year | **7** | 15 | 26 |
| (Decrease) increase associated with tax positions taken during a prior year | **(26)** | 34 | 6 |
| Settlements | **(22)** | (23) | (15) |
| Decrease associated with lapses in statutes of limitations | **(10)** | (7) | (8) |
| Balance at end of the year | **$458** | $509 | $490 |

Of the gross unrecognized tax benefits, $396 million and $437 million were recognized as liabilities in the consolidated balance sheets as of December 31, 2009 and 2008, respectively.

None of the positions included in the liability for uncertain tax positions related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility. Also, the reduction of the unrecognized tax benefits in each year did not significantly affect the company's effective tax rate.

### Tax Incentives

The company has received tax incentives in Puerto Rico, Switzerland, and certain other taxing jurisdictions outside the United States. The financial impact of the reductions as compared to the U.S. federal statutory rate is indicated in the income tax expense reconciliation table above. The tax reductions as compared to the local statutory rate favorably impacted earnings per diluted share by $0.50 in 2009, $0.45 in 2008 and $0.51 in 2007. The Puerto Rico grant provides that the company's manufacturing operations will be partially exempt from local taxes until the year 2013. The Switzerland grant provides that the company's manufacturing operations will be partially exempt from local taxes until the year 2014. Baxter received an extension of its Swiss grant whereby the company's manufacturing operations will be partially exempt from local taxes starting in 2014 and continuing through 2017. The tax incentives in the other jurisdictions continue until at least 2011.

### Examinations of Tax Returns

As of December 31, 2009, Baxter had ongoing audits in the United States, Canada, Germany and Italy as well as bilateral Advance Pricing Agreement proceedings that the company voluntarily initiated between the U.S. government and the government of Switzerland with respect to intellectual property, product, and service transfer pricing arrangements. Baxter expects to settle these proceedings within the next 12 months. Baxter expects to reduce the amount of its liability for uncertain tax positions within the next 12 months by $302 million due principally to the expiration of certain statutes of limitations related to tax benefits taken in respect of losses from restructuring certain international operations and the settlements of certain multi-jurisdictional transfer pricing issues. While the final outcome of these matters is inherently uncertain, the company believes it has made adequate tax provisions for all years subject to examination.

## NOTE 11
## LEGAL PROCEEDINGS

Baxter is involved in product liability, patent, commercial, and other legal proceedings that arise in the normal course of the company's business. The company records a liability when a loss is considered probable and the amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded.

Baxter has established reserves for certain of the matters discussed below. The company is not able to estimate the amount or range of any loss for certain of the legal contingencies for which there is no reserve or additional loss for matters already reserved. While the liability of the company in connection with the claims cannot be estimated with any certainty and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company's results of operations and cash flows for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company's consolidated financial position. While the company believes that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

In addition to the matters described below, the company remains subject to other potential administrative and legal actions. With respect to regulatory matters, these actions may lead to product recalls, injunctions to halt manufacture and distribution, and other restrictions on the company's operations and monetary sanctions. With respect to intellectual property, the company may be exposed to significant litigation concerning the scope of the company's and others' rights. Such litigation could result in a loss of patent protection or the ability to market products, which could lead to a significant loss of sales, or otherwise materially affect future results of operations.

### Patent Litigation

Sevoflurane Litigation

Since 2000, Baxter's generic sevoflurane has been the subject of several patent infringement actions initiated by Abbott Laboratories and Central Glass Company. The initial lawsuit in the United States was resolved in Baxter's favor in 2007 by the Court of Appeals for the Federal Circuit's decision that the asserted patent was invalid. In 2009,

a lawsuit filed in Japan was also resolved in Baxter's favor by the appellate court's determination that Baxter's generic sevoflurane did not infringe the Japanese patent at issue.

Related actions remain pending in the U.S. and Colombia. A patent infringement action is pending in the U.S.D.C. for the Northern District of Illinois on a second patent owned by Abbott and Central Glass. In September 2009, the District Court granted summary judgment of non-infringement in favor of Baxter. Abbott has requested reconsideration of this ruling. In 2007, Abbott brought a patent infringement action against Baxter in the Cali Circuit Court of Colombia based on a Colombian counterpart patent, and obtained an injunction preliminarily prohibiting the approval of Baxter's generic sevoflurane in Colombia during the pendency of the infringement suit. In May 2008, the Court issued a decision maintaining the injunction, but suspending it during an appeal of the Court's decision, which appeal is pending.

Peritoneal Dialysis Litigation

In October 2006, Baxter Healthcare Corporation, a direct wholly-owned subsidiary of Baxter, and DEKA Products Limited Partnership (DEKA) filed a patent infringement lawsuit against Fresenius Medical Care Holdings, Inc. and Fresenius USA, Inc. The complaint alleges that Fresenius' sale of the Liberty Cycler peritoneal dialysis systems and related disposable items and equipment infringes nine U.S. patents, which are owned by Baxter or exclusively licensed in the peritoneal dialysis field to Baxter from DEKA. The case is pending in the U.S.D.C. for the Northern District of California with a trial anticipated in mid-2010.

Hemodialysis Litigation

Since April 2003, Baxter has been pursuing a patent infringement action against Fresenius Medical Care Holdings, Inc. for infringement of certain Baxter patents. The patents cover Fresenius' 2008K hemodialysis instrument. In 2007, the court entered judgment in Baxter's favor holding the patents valid and infringed, and a jury assessed damages at $14 million for past sales only. On April 4, 2008, the U.S.D.C. for the Northern District of California granted Baxter's motion for permanent injunction, granted Baxter's request for royalties on Fresenius' sales of the 2008K hemodialysis machines during a nine-month transition period before the permanent injunction took effect, and granted a royalty on disposables. On September 10, 2009, the appellate court affirmed Fresenius' liability for infringing valid claims of Baxter's main patent, invalidated certain claims of other patents, and remanded the case to the district court to finalize the scope of the injunction and the amount of damages owed to Baxter. In November 2009, the appellate court denied Fresenius' petition for re-hearing of the appeal. In January 2010, Fresenius consented to reentry of the injunction and a hearing on the royalty rate is expected to be set for the second quarter of 2010.

### Other

In October 2004, a purported class action was filed in the U.S.D.C. for the Northern District of Illinois against Baxter and its current Chief Executive Officer and then current Chief Financial Officer and their predecessors for alleged violations of the Employee Retirement Income Security Act of 1974, as amended. Plaintiff alleges that these defendants, along with the Administrative and Investment Committees of the company's 401(k) plans, breached their fiduciary duties to the plan participants by offering Baxter common stock as an investment option in each of the plans during the period of January 2001 to October 2004. In March 2006, the trial court certified a class of plan participants who elected to acquire Baxter common stock through the plans between January 2001 and the present. In April 2008, the Court of Appeals for the Seventh Circuit denied Baxter's interlocutory appeal and upheld the trial court's denial of Baxter's motion to dismiss. On September 28, 2009, the trial court partially granted Baxter's motion for judgment on the pleadings, dismissing claims related to the 2004 time-frame. Fact discovery has been completed in this matter and expert discovery is proceeding. A trial date is currently scheduled for April 2010.

On October 12, 2005 the United States filed a complaint in the U.S.D.C. for the Northern District of Illinois to effect the seizure of COLLEAGUE and SYNDEO infusion pumps that were on hold in Northern Illinois. Customer-owned pumps were not affected. On June 29, 2006, Baxter Healthcare Corporation entered into a Consent Decree for Condemnation and Permanent Injunction with the United States to resolve this seizure litigation. Additional third-party claims may be filed in connection with the COLLEAGUE matter. In September 2009, the company received a subpoena from the Office of the United States Attorney of the Northern District of Illinois requesting production of documents relating to the COLLEAGUE infusion pump. The company is fully cooperating with the request.

The company is a defendant, along with others, in eleven lawsuits brought in various U.S. federal courts alleging that Baxter and certain of its competitors conspired to restrict output and artificially increase the price of plasma-derived therapies since 2004. The complaints attempt to state a claim for class action relief and in some cases demand treble damages. These cases have been consolidated for pretrial proceedings before the U.S.D.C. for the Northern District of Illinois.

In connection with the recall of heparin products in the United States, approximately 650 lawsuits, some of which are purported class actions, have been filed alleging that plaintiffs suffered various reactions to a heparin contaminant, in some cases resulting in fatalities. In June 2008, a number of these federal cases were consolidated in the U.S.D.C. for the Northern District of Ohio for pretrial case management under the Multi District Litigation rules. A trial date for the first of these cases is scheduled for early 2011. In September 2008, a number of state court cases were consolidated in Cook County, Illinois for pretrial case management, with a scheduled trial date for the first of these cases in January 2011. Discovery is ongoing with respect to these matters.

The company is a defendant, along with others, in less than a dozen lawsuits which allege that Baxter and other defendants manipulated product reimbursements by, among other things, reporting artificially inflated average wholesale prices for Medicare and Medicaid eligible drugs. The cases have been consolidated for pretrial purposes before the U.S.D.C. for the District of Massachusetts. In April 2008, the court preliminarily approved a class settlement resolving Medicare Part B claims and independent health plan claims against Baxter and others, which had previously been reserved for by the company. Final

approval of this settlement is expected in the first quarter of 2010. Baxter has also resolved a number of other cases brought by state attorneys general and other plaintiffs. A small number of lawsuits against Baxter brought by relators, state attorneys general and New York entities remain which seek unspecified damages, injunctive relief, civil penalties, disgorgement, forfeiture and restitution. Various state and federal agencies are conducting civil investigations into the marketing and pricing practices of Baxter and others with respect to Medicare and Medicaid reimbursement. These investigations may result in additional cases being filed.

Baxter currently is a defendant in a number of lawsuits and subject to additional claims brought by individuals who have hemophilia and their families, all seeking damages for injuries allegedly caused by anti-hemophilic factor concentrates VIII or IX derived from human blood plasma (factor concentrates) processed by the company and other acquired entities from the late 1970s to the mid-1980s. The typical case or claim alleges that the individual was infected with the HIV or HCV virus by factor concentrates that contained one or both viruses. None of these cases involves factor concentrates currently processed by the company. Baxter and other defendants have announced a settlement offer with respect to these claims. The fully reserved settlement is contingent on receiving acceptance from a significant percentage of the claimants by early 2010.

## NOTE 12
## SEGMENT INFORMATION

Baxter operates in three segments, each of which is a strategic business that is managed separately because each business develops, manufactures and markets distinct products and services. The segments and a description of their products and services are as follows:

The **BioScience** business processes recombinant and plasma-based proteins to treat hemophilia and other bleeding disorders; plasma-based therapies to treat immune deficiencies, alpha 1-antitrypsin deficiency, burns and shock, and other chronic and acute blood-related conditions; products for regenerative medicine, such as biosurgery products; and vaccines.

The **Medication Delivery** business manufactures intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, and inhalation anesthetics, as well as products and services related to pharmacy compounding, drug formulation and packaging technologies.

The **Renal** business provides products to treat end-stage renal disease, or irreversible kidney failure. The business manufactures solutions and other products for peritoneal dialysis, a home-based therapy, and also distributes products for hemodialysis, which is generally conducted in a hospital or clinic.

The company uses 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 in this report. The company evaluates the performance of its segments and allocates resources to them primarily based on pre-tax 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 in Note 1.

Certain items are maintained at the corporate level (Corporate) and are not allocated to a segment. They primarily include most of the company's debt and cash and equivalents and related net interest expense, certain foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the majority of the foreign currency hedging activities, corporate headquarters costs, stock compensation expense, certain non-strategic investments and related income and expense, certain employee benefit plan costs, certain nonrecurring gains and losses, certain IPR&D charges, certain other charges (such as cost optimization, restructuring and certain litigation-related charges), deferred income taxes, certain litigation liabilities and related insurance receivables, and the revenues and costs related to the manufacturing, distribution and other transition agreements with Fenwal. All of the company's Other net sales in the table below relate to the agreements with Fenwal. With respect to depreciation and amortization and expenditures for long-lived assets, the difference between the segment totals and the consolidated totals principally relate to assets maintained at Corporate.

In 2009, the $79 million charge related to the company's cost optimization efforts, as further discussed in Note 5, was not allocated to a segment. Significant charges not allocated to a segment in 2008 included IPR&D charges of $12 million related to the company's in-licensing agreement with Innocoll, as further discussed in Note 4, and $7 million related to the acquisition of certain technology applicable to the BioScience business. Significant charges not allocated to a segment in 2007 included a charge of $56 million related to average wholesale pricing litigation, as further discussed in Note 11, a restructuring charge of $70 million, as further discussed in Note 5, and IPR&D charges totaling $61 million, including $50 million further discussed in Note 4.

Included in the Medication Delivery segment's pre-tax income in 2009, 2008 and 2007 were $27 million, $125 million and $14 million, respectively, of charges and costs relating to COLLEAGUE and SYNDEO infusion pumps, a charge of $54 million in 2009 associated with the discontinuation of the company's SOLOMIX drug delivery system in development and an impairment charge of $31 million in 2008 associated with the discontinuation of the CLEARSHOT pre-filled syringe program, as further discussed in Note 5.

## Segment Information

| as of and for the years ended December 31 (in millions) | BioScience | Medication Delivery | Renal | Other | Total |
|---|---|---|---|---|---|
| **2009** | | | | | |
| Net sales | **$5,573** | **$4,649** | **$2,266** | **$ 74** | **$12,562** |
| Depreciation and amortization | **181** | **277** | **110** | **70** | **638** |
| Pre-tax income (loss) | **2,283** | **759** | **307** | **(615)** | **2,734** |
| Assets | **5,093** | **5,629** | **1,935** | **4,697** | **17,354** |
| Capital expenditures | **397** | **291** | **189** | **137** | **1,014** |
| 2008 | | | | | |
| Net sales | $5,308 | $4,560 | $2,306 | $ 174 | $12,348 |
| Depreciation and amortization | 177 | 271 | 115 | 68 | 631 |
| Pre-tax income (loss) | 2,174 | 591 | 319 | (622) | 2,462 |
| Assets | 4,344 | 5,051 | 1,613 | 4,397 | 15,405 |
| Capital expenditures | 298 | 352 | 134 | 170 | 954 |
| 2007 | | | | | |
| Net sales | $4,649 | $4,231 | $2,239 | $ 144 | $11,263 |
| Depreciation and amortization | 157 | 242 | 114 | 68 | 581 |
| Pre-tax income (loss) | 1,802 | 694 | 384 | (752) | 2,128 |
| Assets | 4,158 | 5,182 | 1,644 | 4,310 | 15,294 |
| Capital expenditures | 172 | 303 | 109 | 108 | 692 |

## Pre-Tax Income Reconciliation

| years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| Total pre-tax income from segments | **$3,349** | $3,084 | $2,880 |
| Unallocated amounts | | | |
| Net interest expense | **(98)** | (76) | (22) |
| Certain foreign exchange fluctuations and hedging activities | **102** | 57 | (5) |
| Stock compensation | **(140)** | (146) | (136) |
| Cost optimization and restructuring charges | **(79)** | — | (70) |
| Average wholesale pricing litigation charge | **—** | — | (56) |
| IPR&D | **—** | (19) | (61) |
| Other Corporate items | **(400)** | (438) | (402) |
| Consolidated income before income taxes | **$2,734** | $2,462 | $2,128 |

## Assets Reconciliation

| as of December 31 (in millions) | **2009** | 2008 |
|---|---|---|
| Total segment assets | **$12,657** | $11,008 |
| Cash and equivalents | **2,786** | 2,131 |
| Deferred income taxes | **1,320** | 1,383 |
| Insurance receivables | **96** | 87 |
| PP&E, net | **365** | 359 |
| Other Corporate assets | **130** | 437 |
| Consolidated total assets | **$17,354** | $15,405 |

## Geographic Information

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

| years ended December 31 (in millions) | **2009** | 2008 | 2007 |
|---|---|---|---|
| **Net sales** | | | |
| United States | **$ 5,317** | $ 5,044 | $ 4,820 |
| Europe | **4,181** | 4,386 | 3,845 |
| Asia-Pacific | **1,613** | 1,444 | 1,224 |
| Latin America | **990** | 1,001 | 950 |
| Canada | **461** | 473 | 424 |
| Consolidated net sales | **$12,562** | $12,348 | $11,263 |

| as of December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Total assets** | | | |
| United States | **$ 6,628** | $ 6,765 | $ 6,544 |
| Europe | **7,825** | 5,935 | 6,358 |
| Asia-Pacific | **1,313** | 1,416 | 1,089 |
| Latin America | **1,377** | 1,054 | 1,080 |
| Canada | **211** | 235 | 223 |
| Consolidated total assets | **$17,354** | $15,405 | $15,294 |

| as of December 31 (in millions) | 2009 | 2008 | 2007 |
|---|---|---|---|
| **PP&E, net** | | | |
| United States | **$2,026** | $1,987 | $1,838 |
| Austria | **811** | 650 | 608 |
| Other countries | **2,322** | 1,972 | 2,041 |
| Consolidated PP&E, net | **$5,159** | $4,609 | $4,487 |

### Significant Product Sales

The following is a summary of net sales as a percentage of consolidated net sales for the company's principal product categories.

| years ended December 31 | 2009 | 2008 | 2007 |
|---|---|---|---|
| Recombinants | **16%** | 16% | 15% |
| PD Therapy | **15%** | 15% | 16% |
| Global Injectables[1] | **14%** | 13% | 13% |
| IV Therapies[2] | **12%** | 13% | 12% |
| Antibody Therapy | **11%** | 10% | 9% |
| Plasma Proteins[3] | **11%** | 10% | 9% |

[1] Primarily consists of the company's enhanced packaging, premixed drugs, pharmacy compounding, pharmaceutical partnering business and generic injectables.

[2] Principally includes IV solutions and nutritional products.

[3] Includes plasma-derived hemophilia (FVII, FVIII and FEIBA), albumin and other plasma-based products.

## NOTE 13
## 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 | Full year |
|---|---|---|---|---|---|
| **2009** | | | | | |
| Net sales | **$ 2,824** | **$ 3,123** | **$ 3,145** | **$3,470** | **$12,562** |
| Gross margin | **1,488** | **1,638** | **1,632** | **1,767** | **6,525** |
| Net income attributable to Baxter[1] | **516** | **587** | **530** | **572** | **2,205** |
| Earnings per common share[1] | | | | | |
| Basic | **0.84** | **0.97** | **0.88** | **0.95** | **3.63** |
| Diluted | **0.83** | **0.96** | **0.87** | **0.94** | **3.59** |
| Dividends declared | **0.26** | **0.26** | **0.26** | **0.29** | **1.07** |
| Market price | | | | | |
| High | **60.50** | **52.96** | **58.53** | **59.50** | **60.50** |
| Low | **48.57** | **46.41** | **52.34** | **53.92** | **46.41** |
| 2008 | | | | | |
| Net sales | $ 2,877 | $ 3,189 | $ 3,151 | $3,131 | $12,348 |
| Gross margin | 1,380 | 1,627 | 1,521 | 1,602 | 6,130 |
| Net income attributable to Baxter[2] | 429 | 544 | 472 | 569 | 2,014 |
| Earnings per common share[2] | | | | | |
| Basic | 0.68 | 0.87 | 0.76 | 0.92 | 3.22 |
| Diluted | 0.67 | 0.85 | 0.74 | 0.91 | 3.16 |
| Dividends declared | 0.2175 | 0.2175 | 0.2175 | 0.26 | 0.9125 |
| Market price | | | | | |
| High | 64.91 | 63.94 | 71.15 | 67.30 | 71.15 |
| Low | 55.41 | 59.33 | 63.83 | 48.50 | 48.50 |

[1] The third quarter of 2009 included a $54 million charge associated with the discontinuation of the company's SOLOMIX drug delivery system in development and a $27 million charge primarily related to planned retirement costs associated with the SYNDEO PCA Syringe Pump. The fourth quarter of 2009 included a $79 million charge related to the company's cost optimization efforts. Refer to Note 5 for further information regarding these charges.

[2] The first quarter of 2008 included a $53 million charge related to the COLLEAGUE infusion pump. The third quarter of 2008 included a $72 million charge related to COLLEAGUE infusion pumps, a $31 million impairment charge associated with the discontinuation of the CLEARSHOT pre-filled syringe program and a $12 million IPR&D charge. Refer to Notes 4 and 5 for further information regarding these charges. The fourth quarter of 2008 included a $7 million IPR&D charge.

Baxter common stock is listed on the New York, Chicago and SIX Swiss stock exchanges. The New York Stock Exchange is the principal market on which the company's common stock is traded. At January 31, 2010, there were 48,489 holders of record of the company's common stock.

## Board of Directors

**Walter E. Boomer**
Former Chairman and Chief Executive Officer
Rogers Corporation

**Blake E. Devitt**
Former Senior Audit Partner and Director,
Pharmaceutical and Medical Device Industry Practice
Ernst & Young LLP

**John D. Forsyth**
Chairman and Chief Executive Officer
Wellmark Blue Cross and Blue Shield

**Gail D. Fosler**
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The Conference Board

**James R. Gavin III, M.D., Ph.D.**
Chief Executive Officer and Chief Medical Officer
Healing Our Village, Inc.

**Peter S. Hellman**
Former President and Chief Financial and Administrative Officer
Nordson Corporation

**Wayne T. Hockmeyer, Ph.D.**
Founder and Former Chairman of the Board
MedImmune, Inc.

**Joseph B. Martin, M.D., Ph.D.**
Professor of Neurobiology and
Former Dean of the Faculty of Medicine
Harvard Medical School

**Robert L. Parkinson, Jr.**
Chairman and Chief Executive Officer
Baxter International Inc.

**Carole J. Shapazian**
Former Executive Vice President
Maytag Corporation

**Thomas T. Stallkamp**
Industrial Partner
Ripplewood Holdings L.L.C.

**Kees J. Storm**
Former Chairman of the Executive Board
AEGON N.V. (The Netherlands)

**Albert P.L. Stroucken**
Chairman, President and Chief Executive Officer
Owens-Illinois, Inc.

## Executive Management

**Carlos Alonso**
President, Latin America

**Joy A. Amundson***
President, BioScience

**Peter J. Arduini***
President, Medication Delivery

**Michael J. Baughman**
Controller

**Robert M. Davis***
Chief Financial Officer

**J. Michael Gatling***
Vice President, Manufacturing

**Robert J. Hombach**
Treasurer

**Mary Kay Ladone**
Vice President, Investor Relations

**Gerald Lema**
President, Asia Pacific

**Jeanne K. Mason, Ph.D.***
Vice President, Human Resources

**Bruce McGillivray***
President, Renal

**Peter Nicklin**
President, Europe

**Robert L. Parkinson, Jr.***
Chairman and Chief Executive Officer

**Norbert G. Riedel, Ph.D.***
Chief Scientific Officer

**David P. Scharf ***
General Counsel

**Stephanie A. Shinn**
Corporate Secretary

**Karenann K. Terrell***
Chief Information Officer

**Cheryl L. White***
Vice President, Quality

* executive officer

### Corporate Headquarters
Baxter International Inc.
One Baxter Parkway
Deerfield, IL 60015-4633
Telephone: (847) 948-2000
Website: www.baxter.com

### Annual Meeting
The 2010 Annual Meeting of Shareholders will be held on Tuesday, May 4, at 9:00 a.m. at Corporate Headquarters, located at One Baxter Parkway, Deerfield, Illinois. If you plan to attend the Annual Meeting, please review the information regarding attendance contained in the 2010 Proxy Statement.

### Stock Exchange Listings
The New York Stock Exchange is the principal market on which the company's common stock is traded (Ticker Symbol: BAX). The company's common stock is also listed on the Chicago and SIX Swiss stock exchanges.

### Transfer Agent and Registrar
Correspondence concerning Baxter International Inc. common stock holdings, lost or missing certificates or dividend checks, duplicate mailing or changes of address should be directed to:

Baxter International Inc. Common Stock
Computershare Trust Company, N.A.
P.O. Box 43069
Providence, RI 02940-3069
Telephone: (888) 359-8645
Hearing Impaired Telephone: (800) 952-9245
Website: www.computershare.com

### Dividend Reinvestment
The company offers an automatic dividend-reinvestment program to all holders of Baxter International Inc. common stock. The company has appointed Computershare Trust Company, N.A. to administer the program.

### Independent Registered Public Accounting Firm
PricewaterhouseCoopers LLP, Chicago, IL

### Information Resources
Please visit Baxter's website for information on the company and its products and services.

Information regarding corporate governance at Baxter, including Baxter's code of conduct, ethics and compliance standards for Baxter's suppliers, and the charters for the required committees of Baxter's board of directors, is available on Baxter's website at www.baxter.com under "Corporate Governance".

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

Mary Kay Ladone
Vice President, Investor Relations
Telephone: (847) 948-3371
Fax: (847) 948-4498

Clare Trachtman
Manager, Investor Relations
Telephone: (847) 948-3085
Fax: (847) 948-4498

### Customer Inquiries
Customers who would like general information about Baxter's products and services may call the Center for One Baxter toll free in the United States at (800) 422-9837 or by dialing (847) 948-4770.

### Form 10-K and Other Reports
A paper copy of the company's Form 10-K for the year ended December 31, 2009, may be obtained without charge by writing to Baxter International Inc., Investor Relations, One Baxter Parkway, Deerfield, IL 60015-4633. A copy of the company's Form 10-K and other filings with the U.S. Securities and Exchange Commission (SEC) may be obtained from the SEC's website at www.sec.gov or the company's website at www.baxter.com.

### Trademarks
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## Five-Year Summary of Selected Financial Data

| as of or for the years ended December 31 | | 2009[1,6] | 2008[2,6] | 2007[3,6] | 2006[4,6] | 2005[5,6] |
|---|---|---|---|---|---|---|
| **Operating Results** (in millions) | Net sales | **$12,562** | 12,348 | 11,263 | 10,378 | 9,849 |
| | Income from continuing operations attributable to Baxter[7] | **$ 2,205** | 2,014 | 1,707 | 1,398 | 958 |
| | Depreciation and amortization | **$ 638** | 631 | 581 | 575 | 580 |
| | Research and development expenses | **$ 917** | 868 | 760 | 614 | 533 |
| **Balance Sheet and Cash Flow Information** (in millions) | Capital expenditures | **$ 1,014** | 954 | 692 | 526 | 444 |
| | Total assets | **$17,354** | 15,405 | 15,294 | 14,686 | 12,727 |
| | Long-term debt and lease obligations | **$ 3,440** | 3,362 | 2,664 | 2,567 | 2,414 |
| **Common Stock Information** | Average number of common shares outstanding (in millions)[8] | **607** | 625 | 644 | 651 | 622 |
| | Income from continuing operations attributable to Baxter per common share | | | | | |
| | Basic | **$ 3.63** | 3.22 | 2.65 | 2.15 | 1.54 |
| | Diluted | **$ 3.59** | 3.16 | 2.61 | 2.13 | 1.52 |
| | Cash dividends declared per common share | **$ 1.070** | 0.913 | 0.720 | 0.582 | 0.582 |
| | Year-end market price per common share | **$ 58.68** | 53.59 | 58.05 | 46.39 | 37.65 |
| **Other Information** | Total shareholder return[9] | **11.6%** | (6.3%) | 26.8% | 24.8% | 10.7% |
| | Common shareholders of record at year-end | **48,286** | 48,492 | 47,661 | 49,097 | 58,247 |

[1] Income from continuing operations attributable to Baxter included a $79 million cost optimization charge, an impairment charge of $54 million and a charge of $27 million relating to infusion pumps.

[2] Income from continuing operations attributable to Baxter included charges of $125 million relating to infusion pumps, an impairment charge of $31 million and charges totaling $19 million relating to acquired in-process and collaboration research and development (IPR&D).

[3] Income from continuing operations attributable to Baxter included a restructuring charge of $70 million, a charge of $56 million relating to litigation and IPR&D charges of $61 million.

[4] Income from continuing operations attributable to Baxter included a charge of $76 million relating to infusion pumps.

[5] Income from continuing operations attributable to Baxter included a benefit of $109 million relating to restructuring charge adjustments, charges of $126 million relating to infusion pumps, and a charge of $50 million relating to the exit of hemodialysis instrument manufacturing.

[6] Refer to the notes to the consolidated financial statements for information regarding other charges and income items.

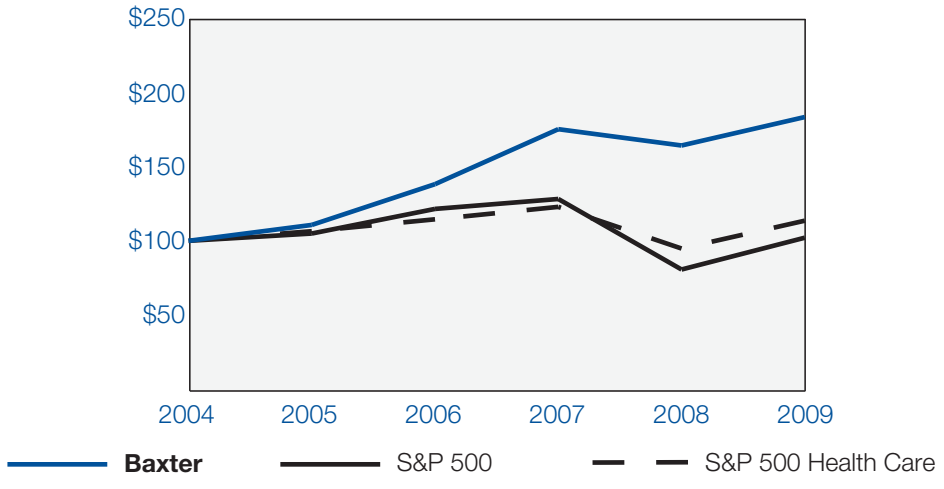
[7] Excludes income from continuing operations attributable to noncontrolling interests of $10 million, $11 million, $14 million, $14 million and $21 million for 2009, 2008, 2007, 2006 and 2005, respectively.

[8] Excludes common stock equivalents.

[9] Represents the total of appreciation (decline) in market price plus cash dividends declared on common shares.

## Performance Graph

The following graph compares the change in Baxter's cumulative total shareholder return on its common stock with the Standard & Poor's 500 Composite Index and the Standard & Poor's 500 Health Care Index as of December 31 of each year.



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Baxter

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Deerfield, Illinois 60015

www.baxter.com

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