BAXTER INTERNATIONAL INC
Form 10-K
February 21, 2013
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number 1-4448

Baxter International Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**36-0781620**
(State or Other Jurisdiction of Incorporation or Organization)	*(I.R.S. Employer Identification No.)*
One Baxter Parkway, Deerfield, Illinois	**60015**
(Address of Principal Executive Offices)	*(Zip Code)*

Registrant s telephone number, including area code 224.948.2000

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock, $1.00 par value	New York Stock Exchange
	Chicago Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ¨ No þ

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) Yes þ No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ¨
(Do not check if a smaller reporting company)	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No þ

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 29, 2012 (the last business day of the registrant s most recently completed second fiscal quarter), based on the per share closing sale price of $53.15 on that date and the assumption for the purpose of this computation only that all of the registrant s directors and executive officers are affiliates, was approximately $29 billion. There is no non-voting common equity held by non-affiliates of the registrant.

The number of shares of the registrant s common stock, $1.00 par value, outstanding as of January 31, 2013 was 545,928,648.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive 2013 proxy statement for use in connection with its Annual Meeting of Shareholders to be held on May 7, 2013 are incorporated by reference into Part III of this report.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

Item 1. ***Business.***

Company Overview

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. These products are used by hospitals, kidney dialysis centers, nursing homes, rehabilitation centers, doctors offices, clinical and medical research laboratories, and by patients at home under physician supervision. Baxter manufactures products in 27 countries and sells them in more than 100 countries.

Baxter International Inc. was incorporated under Delaware law in 1931. As used in this report, except as otherwise indicated in information incorporated by reference, Baxter International means Baxter International Inc. and Baxter, the company or the Company means Baxter International and its consolidated subsidiaries.

Business Segments and Products

The company s operations are comprised of the BioScience and Medical Products segments.

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; biosurgery products; and select vaccines.

The Medical Products 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. The business also provides products and services related to pharmacy compounding, drug formulation and packaging technologies. In addition, the Medical Products business provides products and services 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.

For financial information about Baxter s segments and principal product categories, see Note 14 in Item 8 of this Annual Report on Form 10-K.

Sales and Distribution

The company has its own direct sales force and also makes sales to and through independent distributors, drug wholesalers acting as sales agents and specialty pharmacy or other alternate site providers. In the United States, Cardinal Health, Inc. warehouses and ships a significant portion of the company s products through its distribution centers. These centers are generally stocked with adequate inventories to facilitate prompt customer service. Sales and distribution methods include frequent contact by sales representatives, automated communications via various electronic purchasing systems, circulation of catalogs and merchandising bulletins, direct-mail campaigns, trade publication presence and advertising.

International sales are made and products are distributed on a direct basis or through independent distributors or sales agents in more than 100 countries.

International Operations

Baxter products are manufactured and sold worldwide. The majority of the company s revenues are generated outside of the United States and geographic expansion remains a core component of the company s strategy.

Table of Contents

Baxter s international presence includes operations in Europe, Asia-Pacific, Latin America and Canada. The company is subject to certain risks inherent in conducting business outside the United States. For more information on these risks, see the information under the captions We are subject to risks associated with doing business globally and We are subject to foreign currency exchange risk in Item 1A of this Annual Report on Form 10-K, all of which information is incorporated herein by reference.

For financial information about foreign and domestic operations and geographic information, see Note 14 in Item 8 of this Annual Report on Form 10-K. For more information regarding foreign currency exchange risk, refer to the discussion under the caption entitled Financial Instrument Market Risk in Item 7 of this Annual Report on Form 10-K.

Contractual Arrangements

Substantial portions of the company s products are sold through contracts with customers, both within and outside the United States. Some of these contracts have terms of more than one year and place limits on the company s ability to increase prices. In the case of hospitals, governments and other facilities, these contracts may specify minimum quantities of a particular product or categories of products to be purchased by the customer.

In keeping with the increased emphasis on cost-effectiveness in healthcare delivery, many hospitals and other customers of medical products in the United States and in other countries have joined group purchasing organizations (GPOs), or formed integrated delivery networks (IDNs), to enhance purchasing power. GPOs and IDNs negotiate pricing arrangements with manufacturers and distributors, and the negotiated prices are made available to members. Baxter has purchasing agreements with several of the major GPOs in the United States. GPOs may have agreements with more than one supplier for certain products. Accordingly, in these cases, Baxter faces competition from other suppliers even where a customer is a member of a GPO under contract with Baxter.

Raw Materials

Raw materials essential to Baxter s business are purchased from numerous suppliers worldwide in the ordinary course of business. Although most of these materials are generally available, Baxter at times may experience shortages of supply. In an effort to manage risk associated with raw materials supply, Baxter works closely with its suppliers to help ensure availability and continuity of supply while maintaining high quality and reliability. The company also seeks to develop new and alternative sources of supply where beneficial to its overall raw materials procurement strategy. In order to produce plasma-based therapies, the company also collects plasma at numerous collection facilities in the United States and Europe. For more information on plasma collection, refer to the discussion under the caption The nature of producing plasma-based therapies may prevent us from timely responding to market forces and effectively managing our production capacity in Item 1A of this Annual Report on Form 10-K.

The company also utilizes long-term supply contracts with some suppliers to help maintain continuity of supply and manage the risk of price increases. Baxter is not always able to recover cost increases for raw materials through customer pricing due to contractual limits and market forces.

Competition and Healthcare Cost Containment

Baxter s BioScience and Medical Products businesses enjoy leading positions based on a number of competitive advantages. The BioScience business benefits from continued innovation in its products and therapies, consistency of its supply of products, and strong customer relationships. The Medical Products business benefits from the breadth and depth of its product offering, as well as strong relationships with customers, including hospitals, customer purchasing groups and pharmaceutical and biotechnology companies. The Medical Products business also benefits from its position as one of the world s leading manufacturers of PD products, as well as its

Table of Contents

strong relationships with customers and patients, including the many patients who self-administer the home-based therapy supplied by Baxter. Baxter as a whole benefits from efficiencies and cost advantages resulting from shared manufacturing facilities and the technological advantages of its products.

Although no single company competes with Baxter in all of its businesses, Baxter faces substantial competition in each of its segments from international and domestic healthcare and pharmaceutical companies of all sizes. BioScience continues to face competitors from pharmaceutical, biotechnology and other companies. Medical Products faces competition from medical device manufacturers and pharmaceutical companies. In addition, global and regional competitors continue to expand their manufacturing capacity for products and sales and marketing channels. Competition is primarily focused on cost-effectiveness, price, service, product performance, and technological innovation. There has been increasing consolidation in the company s customer base and by its competitors, which continues to result in pricing and market share pressures.

Global efforts toward healthcare cost containment continue to exert pressure on product pricing. Governments around the world use various mechanisms to control healthcare expenditures, such as price controls, product formularies (lists of recommended or approved products), and competitive tenders which require the submission of a bid to sell products. Sales of Baxter s products are dependent, in part, on the availability of reimbursement by government agencies and healthcare programs, as well as insurance companies and other private payors. In the United States, the federal and many state governments have adopted or proposed initiatives relating to Medicaid and other health programs that may limit reimbursement or increase rebates that Baxter and other providers are required to pay to the state. In addition to government regulation, managed care organizations in the United States, which include medical insurance companies, medical plan administrators, health-maintenance organizations, hospital and physician alliances and pharmacy benefit managers, continue to put pressure on the price and usage of healthcare products. Managed care organizations seek to contain healthcare expenditures, and their purchasing strength has been increasing due to their consolidation into fewer, larger organizations and a growing number of enrolled patients. Baxter faces similar issues outside of the United States. In Europe and Latin America, for example, the government provides healthcare at low cost to patients, and controls its expenditures by purchasing products through public tenders, regulating prices, setting reference prices in public tenders or limiting reimbursement or patient access to certain products.

Intellectual Property

Patents and other proprietary rights are essential to Baxter s business. Baxter relies on patents, trademarks, copyrights, trade secrets, know-how and confidentiality agreements to develop, maintain and strengthen its competitive position. Baxter owns a number of patents and trademarks throughout the world and has entered into license arrangements relating to various third-party patents and technologies. Products manufactured by Baxter are sold primarily under its own trademarks and trade names. Some products distributed by the company are sold under the company s trade names, while others are sold under trade names owned by its suppliers. Trade secret protection of unpatented confidential and proprietary information is also important to Baxter. The company maintains certain details about its processes, products and technology as trade secrets and generally requires employees, consultants, parties to collaboration agreements and other business partners to enter into confidentiality agreements.

Baxter s policy is to protect its products and technology through patents and trademarks on a worldwide basis. This protection is sought in a manner that balances the cost of such protection against obtaining the greatest value for the company. Baxter also recognizes the need to promote the enforcement of its patents and trademarks and takes commercially reasonable steps to enforce its patents and trademarks around the world against potential infringers, including judicial or administrative action where appropriate.

Baxter operates in an industry susceptible to significant patent litigation. At any given time, the company is involved as either a plaintiff or defendant in a number of patent infringement and other intellectual property-related actions. Such litigation can result in significant royalty or other payments or result in injunctions that can

Table of Contents

prevent the sale of products. For more information on patent and other litigation, see Note 13 in Item 8 of this Annual Report on Form 10-K.

Research and Development

Baxter s investment in research and development (R&D) is essential to its future growth and its ability to remain competitive in each of its business segments. Accordingly, Baxter continues to focus its investment in R&D programs to enhance future growth through clinical differentiation. Expenditures for Baxter s R&D activities were $1.2 billion in 2012, $946 million in 2011 and $915 million in 2010. These expenditures include costs associated with R&D activities performed at the company s R&D centers located around the world, which include facilities in Austria, Belgium, Japan and the United States, as well as in-licensing, milestone and reimbursement payments made to partners for R&D work performed at non-Baxter locations. Included in Baxter s R&D activities in 2012 were upfront payments of $113 million made during the year as the company entered into new collaboration arrangements.

The company s research efforts emphasize self-manufactured product development, and portions of that research relate to multiple product categories. Baxter supplements its own R&D efforts by acquiring various technologies and entering into development and other collaboration agreements with third parties. In July 2011, Baxter established Baxter Ventures, a strategic initiative to invest up to $200 million in early-stage companies developing products and therapies to accelerate innovation and growth for the company. For more information on the company s R&D activities, refer to the discussion under the caption entitled Strategic Objectives in Item 7 of this Annual Report on Form 10-K.

Quality Management

Baxter s success depends upon the quality of its products. Quality management plays an essential role in determining and meeting customer requirements, preventing defects, facilitating continuous improvement of the company s processes, products and services, and maintaining the integrity of the data that supports the safety and efficacy of the company s products. Baxter has one quality system deployed globally that enables the design, development, manufacturing, packaging, sterilization, handling, distribution and labeling of the company s products to ensure they conform to customer requirements. In order to continually improve the effectiveness and efficiency of the quality system, various measurements, monitoring and analysis methods such as management reviews, internal, external and vendor audits are employed at local and central levels.

Each product that Baxter markets is required to meet specific quality standards, both in packaging and in product integrity and quality. If either of those is determined to be compromised at any time, Baxter takes necessary corrective and preventive actions, such as notification of the customer of revised labeling, correction of the product at the customer location, withdrawal of the product from the market and other actions. For more information on corrective actions taken by Baxter, refer to the discussion under the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K.

Government Regulation

The operations of Baxter and many of the products manufactured or sold by the company are subject to extensive regulation by numerous government agencies, both within and outside the United States. The Food and Drug Administration (FDA) in the United States, the European Medicines Agency (EMA) in Europe, the State Food and Drug Administration (SFDA) in China and other government agencies inside and outside of the United States, administer requirements covering the testing, safety, effectiveness, manufacturing, labeling, promotion and advertising, distribution and post-market surveillance of Baxter s products. The company must obtain specific approval from FDA and non-U.S. regulatory authorities before it can market and sell most of its products in a particular country. Even after the company obtains regulatory approval to market a product, the product and the company s manufacturing processes and quality systems are subject to continued review by FDA and other

Table of Contents

regulatory authorities globally. State agencies in the United States also regulate the facilities, operations, employees, products and services of the company within their respective states. The company and its facilities are subject to periodic inspections and possible administrative and legal actions by FDA and other regulatory agencies inside and outside the United States. Such actions may include warning letters, product recalls or seizures, monetary sanctions, injunctions to halt manufacture and distribution of products, civil or criminal sanctions, refusal of a government to grant approvals or licenses, restrictions on operations or withdrawal of existing approvals and licenses. As situations require, the company takes steps to ensure safety and efficacy of its products, such as removing products found not to meet applicable requirements from the market and improving the effectiveness of quality systems. For more information on compliance actions taken by the company, refer to the discussion under the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K.

The company is also subject to various laws inside and outside the United States concerning our relationships with healthcare professionals and government officials, price reporting and regulation, the promotion, sales and marketing of our products and services, the importation and exportation of our products, the operation of our facilities and distribution of our products. In the United States, the company is subject to the oversight of FDA, Office of the Inspector General within the Department of Health and Human Services (OIG), the Center for Medicare/Medicaid Services (CMS), the Department of Justice (DOJ), Environmental Protection Agency, Department of Defense and Customs and Border Protection in addition to others. The company supplies products and services to healthcare providers that are reimbursed by federally funded programs such as Medicare. As a result, the company s activities are subject to regulation by CMS and enforcement by OIG and DOJ. In each jurisdiction outside the United States, the company s activities are subject to regulation by government agencies including the EMA in Europe, SFDA in China and other agencies in other jurisdictions. Many of the agencies enforcing these laws have increased their enforcement activities with respect to healthcare companies in recent years. These actions appear to be part of a general trend toward increased enforcement activity globally.

In March 2010, the Patient Protection and Affordable Care Act was enacted in the United States. While this legislation provides for a number of changes in how companies are compensated for providing healthcare products and services, many of these changes will be implemented by regulations which have yet to be established. For more information on the expected impact of healthcare reform on the company, refer to the information under the caption The implementation of healthcare reform in the United States may adversely affect our business in Item 1A of this Annual Report on Form 10-K all of which information is incorporated herein by reference.

Environmental policies of the company require compliance with all applicable environmental regulations and contemplate, among other things, appropriate capital expenditures for environmental protection.

Employees

As of December 31, 2012, Baxter employed approximately 51,000 people.

Available Information

Baxter makes available free of charge on its website at www.baxter.com its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission.

In addition, Baxter s Corporate Governance Guidelines, Code of Conduct, and the charters for the committees of Baxter s board of directors are available on Baxter s website at www.baxter.com under Corporate Governance and in print upon request by writing to: Corporate Secretary, Baxter International Inc., One Baxter Parkway,

Table of Contents

Deerfield, Illinois 60015. Information contained on Baxter s website shall not be deemed incorporated into, or to be a part of, this Annual Report on Form 10-K.

Item 1A. ***Risk Factors.***

In addition to the other information in this Annual Report on Form 10-K, shareholders or prospective investors should carefully consider the following risk factors. If any of the events described below occurs, our business, financial condition and results of operations and future growth prospects could suffer.

If we are unable to successfully introduce new products or fail to keep pace with advances in technology, our business, financial condition and results of operations could be adversely affected.

We need to successfully introduce new products to achieve our strategic business objectives. Product development requires substantial investment and there is inherent risk in the research and development process. A successful product development process depends on many factors, including our ability to properly anticipate and satisfy customer needs, adapt to new technologies, obtain regulatory approvals on a timely basis, demonstrate satisfactory clinical results, manufacture products in an economical and timely manner and differentiate our products from those of our competitors. If we cannot successfully introduce new products or adapt to changing technologies, our products may become obsolete and our revenue and profitability could suffer.

We are subject to a number of existing laws and regulations, non-compliance with which could adversely affect our business, financial condition and results of operations, and we are susceptible to a changing regulatory environment.

As a participant in the healthcare industry, our operations and products, and those of our customers, are regulated by numerous government agencies, both inside and outside the United States. The impact of this on us is direct, to the extent we are subject to these laws and regulations, and indirect in that in a number of situations, even though we may not be directly regulated by specific healthcare laws and regulations, our products must be capable of being used by our customers in a manner that complies with those laws and regulations.

The manufacture, distribution, marketing and use of our products are subject to extensive regulation and increased scrutiny by FDA and other regulatory authorities globally. Any new product must undergo lengthy and rigorous testing and other extensive, costly and time-consuming procedures mandated by FDA and foreign regulatory authorities. Changes to current products may be subject to vigorous review, including additional 510(k) and other regulatory submissions, and approvals are not certain. Our facilities must be approved and licensed prior to production and remain subject to inspection from time to time thereafter. Failure to comply with the requirements of FDA or other regulatory authorities, including a failed inspection or a failure in our adverse event reporting system, could result in adverse inspection reports, warning letters, product recalls or seizures, monetary sanctions, injunctions to halt the manufacture and distribution of products, civil or criminal sanctions, refusal of a government to grant approvals or licenses, restrictions on operations or withdrawal of existing approvals and licenses. Any of these actions could cause a loss of customer confidence in us and our products, which could adversely affect our sales. The requirements of regulatory authorities, including interpretative guidance, are subject to change and compliance with additional or changing requirements or interpretative guidance may subject the company to further review, result in product launch delays or otherwise increase our costs. For information on current regulatory issues affecting us, please refer to the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K. In connection with these issues, 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 other products may not be adversely affected, or that additional regulation will not be introduced that may adversely affect the company s operations and consolidated financial statements.

Table of Contents

The sales, marketing and pricing of products and relationships that pharmaceutical and medical device companies have with healthcare providers are under increased scrutiny by federal, state and foreign government agencies. Compliance with the Anti-Kickback Statute, False Claims Act, Food, Drug and Cosmetic Act (including as these laws relate to off-label promotion of products) and other healthcare related laws, as well as competition, data and patient privacy and export and import laws is under increased focus by the agencies charged with overseeing such activities, including FDA, OIG, DOJ and the Federal Trade Commission. The DOJ and the Securities and Exchange Commission have also increased their focus on the enforcement of the U.S. Foreign Corrupt Practices Act (FCPA), particularly as it relates to the conduct of pharmaceutical companies. The FCPA and similar anti-bribery laws generally prohibit companies and their employees, contractors or agents from making improper payments to government officials for the purpose of obtaining or retaining business. Healthcare professionals in many countries are employed by the government and consequently are considered government officials. Foreign governments have also increased their scrutiny of pharmaceutical companies sales and marketing activities and relationships with healthcare providers and competitive practices generally. The laws and standards governing the promotion, sale and reimbursement of our products and those governing our relationships with healthcare providers and governments can be complicated, are subject to frequent change and may be violated unknowingly. We have compliance programs in place, including policies, training and various forms of monitoring, designed to address these risks. Nonetheless, these programs and policies may not always protect us from conduct by individual employees that violate these laws. Violations, or allegations of violations, of these laws may result in large civil and criminal penalties, debarment from participating in government programs, diversion of management time, attention and resources and may otherwise have an adverse effect on our business, financial condition and results of operations. For more information related to the Company s ongoing government investigations, please refer to Note 13 in Item 8 of this Annual Report on Form 10-K.

The laws and regulations discussed above are broad in scope and subject to evolving interpretations, which could require us to incur substantial cost associated with compliance or to alter one or more of our sales and marketing practices and may subject us to enforcement actions which could adversely affect our business, financial condition and results of operations.

Issues with product quality could have an adverse effect upon our business, subject us to regulatory actions and cause a loss of customer confidence in us or our products.

Our success depends upon the quality of our products. Quality management plays an essential role in determining and meeting customer requirements, preventing defects, improving the company s products and services and maintaining the integrity of the data that supports the safety and efficacy of our products. Our future success depends on our ability to maintain and continuously improve our quality management program. While we have one quality system deployed globally that covers the lifecycle of our products, quality and safety issues may occur with respect to any of our products. A quality or safety issue may result in adverse inspection reports, warning letters, product recalls or seizures, monetary sanctions, injunctions to halt manufacture and distribution of products, civil or criminal sanctions, costly litigation, refusal of a government to grant approvals and licenses, restrictions on operations or withdrawal of existing approvals and licenses. An inability to address a quality or safety issue in an effective and timely manner may also cause negative publicity, a loss of customer confidence in us or our current or future products, which may result in the loss of sales and difficulty in successfully launching new products.

Unaffiliated third party suppliers provide a number of goods and services to our R&D, clinical and manufacturing organizations. Third party suppliers are required to comply with our quality standards. Failure of a third party supplier to provide compliant raw materials or supplies could result in delays, service interruptions or other quality related issues that may negatively impact our business results. In addition, some of the raw materials employed in our production processes are derived from human and animal origins, requiring robust controls to eliminate the potential for introduction of pathogenic agents or other contaminants.

For more information on regulatory matters currently affecting us, refer to the discussion under the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K.

Table of Contents

The implementation of healthcare reform in the United States may adversely affect our business.

The Patient Protection and Affordable Care Act (Act), which was signed into law in March 2010, includes several provisions which impact the company s businesses in the United States, including increased Medicaid rebates and an expansion of the 340B Drug Pricing Program which provides certain qualified entities, such as hospitals serving disadvantaged populations, with discounts on the purchase of drugs for outpatient use and an excise tax on the sale of certain drugs and medical devices. In 2011, the company became subject to a tax on the sales of its pharmaceutical products to the government. In 2013, the company will be required to pay a 2.3% tax on sales of certain of its medical devices. The impact of the increased Medicaid rebates and the expanded 340B Drug Pricing Program is largely expected to impact our BioScience business, while the additional taxes are expected to impact both of our business segments. We may also experience downward pricing pressure as the Act reduces Medicare and Medicaid payments to hospitals. While it is intended to expand health insurance coverage and increase access to medical care generally, the long-term impact of the Act on our business and the demand of our products is uncertain. Similarly, we cannot predict the impact of the additional regulations that need to be established to implement many of the Act s provisions.

If reimbursement for our current or future products is reduced or modified in the United States or abroad, our business could suffer.

Sales of our products depend, in part, on the extent to which the costs of our products are paid by both public and private payors. These payors include Medicare, Medicaid, and private health care insurers in the United States and foreign governments and third-party payors outside the United States. Public and private payors are increasingly challenging the prices charged for medical products and services. We may continue to experience continued downward pricing pressures from third-party payors which could result in an adverse effect on our business, financial condition and operational results.

Austerity measures or other reforms by foreign governments may limit, reduce or eliminate payments for our products and adversely affect both our pricing flexibility and demand for our products. Accordingly, reimbursement may not be available or sufficient to allow us to sell our products on a competitive basis. Legislation and regulations affecting reimbursement for our products may change at any time and in ways that may be adverse to us.

There is substantial competition in the product markets in which we operate and in the development of alliances with research, academic and governmental institutions.

Although no single company competes with us in all of our businesses, we face substantial competition in both of our segments from international and domestic healthcare and pharmaceutical companies of all sizes. Competition is primarily focused on cost-effectiveness, price, service, product performance, and technological innovation. Competition may increase further as additional companies begin to enter our markets or modify their existing products to compete directly with ours. If our competitors respond more quickly to new or emerging technologies and changes in customer requirements, our products may be rendered obsolete or non-competitive. If our competitors develop more effective or affordable products, or achieve earlier patent protection or product commercialization than we do, our operations will likely be negatively affected. If we are forced to reduce our prices due to increased competition, our business could become less profitable. The company s sales could be adversely affected if any of its contracts with GPOs, IDNs or other customers are terminated due to increased competition or otherwise.

We also face competition for marketing, distribution and collaborative development agreements, for establishing relationships with academic and research institutions, and for licenses to intellectual property. In addition, academic institutions, government agencies and other public and private research organizations may also conduct research, seek patent protection and establish collaborative arrangements for discovery, research, clinical development and marketing of products similar to ours. These companies and institutions compete with us in recruiting and retaining qualified scientific and management personnel as well as in acquiring technologies

Table of Contents

complementary to our programs. If we are unable to successfully compete with these companies and institutions, our business may suffer.

The nature of producing plasma-based therapies may prevent us from timely responding to market forces and effectively managing our production capacity.

The production of plasma-based therapies is a lengthy and complex process. Efforts to increase the collection of plasma or the production of plasma-based therapies may include the construction and regulatory approval of additional plasma collection facilities and/or plasma fractionation facilities, such as the Covington, Georgia facility, the site selection of which we announced in April 2012. The development of such facilities can be a lengthy regulatory and capital intensive process. As a result, our ability to match our collection and production of plasma-based therapies to market demand is imprecise and may result in a failure to meet the market demand for our plasma-based therapies or potentially an oversupply of inventory. Failure to meet market demand for our plasma-based therapies may result in customers transitioning to available competitive products resulting in a loss of segment share or customer confidence. In the event of an oversupply we may be forced to lower the prices we charge for some of our plasma-based therapies, close collection and processing facilities, record asset impairment charges or take other action which may adversely affect our business, financial condition and results of operations.

If we are unable to obtain sufficient components or raw materials on a timely basis or if we experience other manufacturing difficulties, our business may be adversely affected.

The manufacture of our products requires the timely delivery of sufficient amounts of quality components and materials. We manufacture our products in more than 50 manufacturing facilities around the world. We acquire our components and materials from many suppliers in various countries. We work closely with our suppliers to ensure the continuity of supply but we cannot guarantee these efforts will always be successful. Further, while efforts are made to diversify our sources of components and materials, in certain instances we acquire components and materials from a sole supplier. In addition, due to the regulatory environment in which we operate, we may be unable to quickly establish additional or replacement sources for some components or materials. A reduction or interruption in supply, and an inability to develop alternative sources for such supply, could adversely affect our ability to manufacture our products in a timely or cost-effective manner, and our ability to make product sales.

Many of our products are difficult to manufacture. This is due to the complex nature of manufacturing pharmaceuticals, including biologics, and devices, as well as the strict regulatory regime governing our manufacturing operations. Variations in the manufacturing process may result in production failures which could lead to launch delays, product shortage, unanticipated costs, lost revenues and damage to our reputation. A failure to identify and address manufacturing problems prior to the release of products to our customers may also result in a quality or safety issue of the type discussed above.

Several of our products are manufactured at a single manufacturing facility. Loss or damage to a manufacturing facility due to a natural disaster or otherwise could adversely affect our ability to manufacture sufficient quantities of key products to meet customer demand or contractual requirements which may result in a loss of revenue and other adverse business consequences. Because of the time required to approve and license a manufacturing facility a third party manufacturer may not be available on a timely basis to replace production capacity in the event we lose manufacturing capacity due to natural disaster, regulatory action or otherwise.

If we are unable to protect our patents or other proprietary rights, or if we infringe the patents or other proprietary rights of others, our competitiveness and business prospects may be materially damaged.

Patent and other proprietary rights are essential to our business. Our success depends to a significant degree on our ability to obtain and enforce patents and licenses to patent rights, both in the United States and in other

Table of Contents

countries. We cannot guarantee that pending patent applications will result in issued patents, that patents issued or licensed will not be challenged or circumvented by competitors, that our patents will not be found to be invalid or that the intellectual property rights of others will not prevent the company from selling certain products or including key features in the company s products.

The patent position of a healthcare company is often uncertain and involves complex legal and factual questions. Significant litigation concerning patents and products is pervasive in our industry. Patent claims include challenges to the coverage and validity of our patents on products or processes as well as allegations that our products infringe patents held by competitors or other third parties. A loss in any of these types of cases 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.

We also rely on trademarks, copyrights, trade secrets and know-how to develop, maintain and strengthen our competitive positions. Third parties may know, discover or independently develop equivalent proprietary information or techniques, or they may gain access to our trade secrets or disclose our trade secrets to the public. Misappropriation or other loss of our intellectual property would have an adverse effect on our competitive position and may cause us to incur substantial litigation costs.

If our business development activities are unsuccessful, our business could suffer and our financial performance could be adversely affected.

As part of our long-term strategy, we are engaged in business development activities including evaluating acquisitions, joint development opportunities, technology licensing arrangements and other opportunities. These activities may result in substantial investment of the company s resources. Our success developing products or expanding into new markets from such activities will depend on a number of factors, including our ability to find suitable opportunities for acquisition, investment or alliance; whether we are able to complete an acquisition, investment or alliance on terms that are satisfactory to us; the strength of the other company s underlying technology, products and ability to execute its business strategies; any intellectual property and litigation related to these products or technology; and our ability to successfully integrate the acquired company, business, product, technology or research into our existing operations, including the ability to adequately fund acquired in-process research and development projects. If we are unsuccessful in our business development activities, we may be unable to meet our financial targets and our financial performance could be adversely affected.

The proposed acquisition of Gambro AB may adversely affect our financial condition and our business.

In December 2012, we announced an agreement to purchase Gambro AB (Gambro). The closing of the transaction is subject to regulatory approvals (including multiple antitrust approvals) and other closing conditions. While the closing of the transaction is expected to occur at the end of the second quarter of 2013, there can be no assurance that the closing will in fact occur or that significant delays in closing the transaction will not result. A failure to close the transaction or significant delays in doing so may negatively impact the trading price of our common stock and our business, financial condition and results of operations. We expect to issue at least $3.0 billion of debt during the first half of 2013 to fund the planned acquisition of Gambro, which will significantly increase the company s outstanding debt. This additional indebtedness will require us to dedicate a portion of our cash flow to servicing this debt, thereby reducing the availability of cash to fund other business initiatives, including stock repurchases. We performed substantial due diligence in connection with this transaction but undiscovered and unanticipated risks and liabilities may emerge after the closing. The integration of Gambro s operations will require significant efforts, including the coordination of information technologies, research and development, sales, marketing, operations, manufacturing and finance. These efforts will result in additional expenses and involve significant amounts of management s time that cannot be dedicated to other projects. Our failure to successfully integrate Gambro s operations into our own could result in a failure to achieve expected synergies. A failure to achieve our strategic objectives with respect to the Gambro acquisition could result in slower growth, higher than expected costs, the closure of facilities, the recording of asset

Table of Contents

impairment charges and other actions which could adversely affect our business, financial condition and results of operations. For more information on this acquisition, see Note 2 in Item 8 of this Annual Report on Form 10-K.

We are subject to risks associated with doing business globally.

Our operations are subject to risks inherent in conducting business globally and under the laws, regulations and customs of various jurisdictions and geographies. These risks include changes in exchange controls and other governmental actions, loss of business in government and public tenders that are held annually in many cases, increasingly complex labor environments, availability of raw materials, changes in taxation, export control restrictions, changes in or violations of U.S. or local laws, including the FCPA and the United Kingdom Bribery Act, dependence on a few government entities as customers, pricing restrictions, economic and political instability (including instability as it relates to the Euro), disputes between countries, diminished or insufficient protection of intellectual property, and disruption or destruction of operations in a significant geographic region regardless of cause, including war, terrorism, riot, civil insurrection or social unrest. Failure to comply with, or material changes to, the laws and regulations that affect our global operations could have an adverse effect on our business, financial condition or results of operations.

We are subject to foreign currency exchange risk.

We generate the majority of our revenue outside the United States. As a result, our financial results may be adversely affected by fluctuations in foreign currency exchange rates. We cannot predict with any certainty changes in foreign currency exchange rates or our ability to mitigate these risks. A discussion of the financial impact of foreign exchange rate fluctuations, and the ways and extent to which we attempt to mitigate such impact, including the impact of restrictions on currency exchange imposed by the Venezuelan government, is contained under the caption Financial Instrument Market Risk in Item 7 of this Annual Report on Form 10-K.

Changes in tax laws or exposure to additional income tax liabilities may have a negative impact on our operating results.

Tax policy reform continues to be a topic of discussion in the United States. A significant change to the tax system in the United States, including changes to the taxation of international income, could have an adverse effect upon our results of operations. Because we operate in multiple income tax jurisdictions both inside and outside the United States, we are subject to tax audits in various jurisdictions. Tax authorities may disagree with certain positions we have taken and assess additional taxes. We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. However, we may not accurately predict the outcome of these audits, and as a result the actual outcome of these audits may have an adverse impact on our financial results. For more information on ongoing audits, see Note 12 in Item 8 of this Annual Report on Form 10-K.

We may experience difficulties implementing our new global enterprise resource planning system.

We are engaged in a multi-year implementation of a new global enterprise resource planning system (ERP). The ERP is designed to accurately maintain the company s books and records and provide information important to the operation of the business to the company s management team. The company s ERP will continue to require significant investment of human and financial resources. In implementing the ERP, we may experience significant delays, increased costs and other difficulties. Any significant disruption or deficiency in the design and implementation of the ERP could adversely affect our ability to process orders, ship product, send invoices and track payments, fulfill contractual obligations or otherwise operate our business. While we have invested significant resources in planning and project management, significant implementation issues may arise.

Table of Contents

We are increasingly dependent on information technology systems and infrastructure.

We increasingly rely upon technology systems and infrastructure. Our technology systems are potentially vulnerable to breakdown or other interruption by fire, power loss, system malfunction, unauthorized access and other events. Likewise, data privacy breaches by employees and others with permitted access to our systems may pose a risk that sensitive data may be exposed to unauthorized persons or to the public. While we have invested heavily in the protection of data and information technology and in related training, there can be no assurance that our efforts will prevent significant breakdowns, breaches in our systems or other cyber incidents that could have a material adverse effect upon our reputation, business, operations or financial condition of the company. In addition, significant implementation issues may arise as we continue to consolidate and outsource certain computer operations and application support activities.

If we fail to attract and retain key employees our business may suffer.

Our ability to compete effectively depends on our ability to attract and retain key employees, including people in senior management, sales, marketing and research positions. Competition for top talent in healthcare can be intense. Our ability to recruit and retain such talent will depend on a number of factors, including hiring practices of our competitors, compensation and benefits, work location, work environment and industry economic conditions. If we cannot effectively recruit and retain qualified employees, our business could suffer.

We are subject to a number of pending lawsuits.

We are a defendant in a number of pending lawsuits. In addition, we may be named as a defendant in future patent, product liability or other lawsuits. These current and future matters may result in a loss of patent protection, reduced revenue, significant liabilities and diversion of our management s time, attention and resources. Given the uncertain nature of litigation generally, we are not able in all cases to estimate the amount or range of loss that could result from an unfavorable outcome in these current matters. In view of these uncertainties, the outcome of these matters may result in charges in excess of any established reserves, and, to the extent available, liability insurance. We also continue to be self-insured with respect to product liability claims. The absence of third-party insurance coverage for current or future claims increases our potential exposure to unanticipated claims and adverse decisions. Protracted litigation, including any adverse outcomes, may have an adverse impact on the business, operations or financial condition of the company. Even claims without merit could subject us to adverse publicity and require us to incur significant legal fees. See Note 13 in Item 8 of this Annual Report on Form 10-K for more information regarding current lawsuits.

Current or worsening economic conditions may adversely affect our business and financial condition.

The company s ability to generate cash flows from operations could be affected if there is a material decline in the demand for the company s products, in the solvency of its customers or suppliers, or deterioration in the company s key financial ratios or credit ratings. Current or worsening economic conditions may adversely affect the ability of our customers (including governments) to pay for our products and services, and the amount spent on healthcare generally. This could result in a decrease in the demand for our products and services, declining cash flows, longer sales cycles, slower adoption of new technologies and increased price competition. These conditions may also adversely affect certain of our suppliers, which could cause a disruption in our ability to produce our products. We continue to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, that have experienced deterioration in credit and economic conditions. As of December 31, 2012, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $385 million (of which $66 million is related to Greece). The global economic conditions and governmental actions in these and other countries may continue to result in delays in the collection of receivables and require us to re-evaluate the collectibility and valuation of our receivables which could result in additional credit losses. These conditions may also impact the stability of the Euro. For more information on accounts receivable and credit matters with respect to certain of these countries, refer to the discussion under the caption entitled Credit Facilities, Access to Capital and Credit Ratings in Item 7 of this Annual Report on Form 10-K.

Table of Contents

Item 1B. ***Unresolved Staff Comments.***
None.

Item 2. ***Properties.***
The company s corporate offices are owned and located at One Baxter Parkway, Deerfield, Illinois 60015.

Baxter owns or has long-term leases on all of its manufacturing facilities. The company maintains 16 manufacturing facilities in the United States and its territories, including three in Puerto Rico. The company also manufactures in Australia, Austria, Belgium, Brazil, Canada, Chile, China, Colombia, Costa Rica, the Czech Republic, Germany, India, Ireland, Italy, Japan, Malta, Mexico, the Philippines, Poland, Saudi Arabia, Singapore, Spain, Switzerland, Tunisia, Turkey and the United Kingdom. The company s principal manufacturing facilities by segment are listed below:

Business	Location	Owned/Leased
BioScience		
	Orth, Austria	Owned
	Vienna, Austria	Owned
	Lessines, Belgium	Owned
	Hayward, California	Leased
	Los Angeles, California	Owned
	Thousand Oaks, California	Owned
	Bohumil, Czech Republic	Owned
	Pisa, Italy	Owned
	Rieti, Italy	Owned
	Woodlands, Singapore	Owned/Leased(1)
	Neuchatel, Switzerland	Owned
	Elstree, United Kingdom	Leased
Medical Products		
	Mountain Home, Arkansas	Owned
	Toongabbie, Australia	Owned
	Lessines, Belgium	Owned
	Sao Paulo, Brazil	Owned
	Alliston, Canada	Owned
	Guangzhou, China	Owned(2)
	Shanghai, China	Owned
	Suzhou, China	Owned
	Cali, Colombia	Owned
	Englewood, Colorado	Leased
	Cartago, Costa Rica	Owned
	Halle, Germany	Owned
	Round Lake, Illinois	Owned
	Bloomington, Indiana	Owned/Leased(3)
	Castlebar, Ireland	Owned
	Grosotto, Italy	Owned
	Miyazaki, Japan	Owned
	Cuernavaca, Mexico	Owned
	Cleveland, Mississippi	Leased
	Medina, New York	Leased
	North Cove, North Carolina	Owned
	Aibonito, Puerto Rico	Leased

Table of Contents

Business	Location	Owned/Leased
Medical Products	Guayama, Puerto Rico	Owned
	Jayuya, Puerto Rico	Leased
	Woodlands, Singapore	Owned/Leased(1)
	Sabinanigo, Spain	Owned
	San Vittore, Switzerland	Owned
	Liverpool, United Kingdom	Owned
	Thetford, United Kingdom	Owned

(1) Baxter owns the facility located at Woodlands, Singapore and leases the property upon which it rests. This facility is shared between the Medical Products and BioScience businesses.

(2) The Guangzhou, China facility is owned by a joint venture in which Baxter owns a majority share.

(3) The Bloomington, Indiana location includes both owned and leased facilities.

The company also owns or operates shared distribution facilities throughout the world. In the United States and Puerto Rico, there are 11 shared distribution facilities with the principal facilities located in Memphis, Tennessee; Catano, Puerto Rico; North Cove, North Carolina; and Round Lake, Illinois. Internationally, we have more than 100 shared distribution facilities located in Argentina, Australia, Austria, Belgium, Brazil, Brunei, Canada, Chile, China, Colombia, Costa Rica, the Czech Republic, Ecuador, France, Germany, Greece, Guatemala, Hong Kong, India, Indonesia, Ireland, Italy, Japan, Korea, Malaysia, Mexico, New Zealand, Panama, Peru, the Philippines, Poland, Portugal, Russia, Singapore, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, the United Arab Emirates, the United Kingdom, Venezuela and Vietnam.

The company continually evaluates its plants and production lines and believes that its current facilities plus any planned expansions are generally sufficient to meet its expected needs and expected near-term growth. Expansion projects and facility closings will be undertaken as necessary in response to market needs.

Item 3. ***Legal Proceedings.***

Incorporated by reference to Note 13 in Item 8 of this Annual Report on Form 10-K.

Item 4. ***Mine Safety Disclosures.***

Not Applicable.

Executive Officers of the Registrant

Robert L. Parkinson, Jr., age 62, is Chairman and Chief Executive Officer of Baxter, having served in that capacity since April 2004. Prior to joining Baxter, Mr. Parkinson was Dean of Loyola University Chicago School of Business Administration and Graduate School of Business from 2002 to 2004. He retired from Abbott Laboratories in 2001 following a 25-year career, having served in a variety of domestic and international management and leadership positions, including as President and Chief Operating Officer. Mr. Parkinson also serves on the Board of Directors of Chicago-based Northwestern Memorial HealthCare, as Chairman of the Board of Northwestern Lake Forest Hospital, and as Vice-Chairman of the Loyola University Chicago Board of Trustees.

Phillip L. Batchelor, age 51, is Corporate Vice President, Quality and Regulatory Affairs, having served in that capacity since February 2013. Mr. Batchelor served as Corporate Vice President, Quality from April 2010 to February 2013 and as Vice President for BioScience Global Operations from April 2005 to April 2010. Prior to that, Mr. Batchelor served in a variety of positions with Baxter in quality management and manufacturing.

14

Table of Contents

Michael J. Baughman, age 48, is Corporate Vice President and Controller, having served in that capacity since May 2006. Mr. Baughman joined Baxter in 2003 as Vice President of Corporate Audit and was appointed Controller in March 2005. Before joining Baxter, Mr. Baughman spent 16 years at PricewaterhouseCoopers LLP, in roles of increasing responsibility, which included audit partner and partner in the firm s mergers and acquisitions practice.

Jean-Luc Butel, age 56, is Corporate Vice President and President, International, having served in that capacity since February 2012. From August 2003 to February 2012, Mr. Butel held various positions with Medtronic, Inc., the most recent of which was Executive Vice President and Group President, International. Prior to Medtronic, Mr. Butel served as President of Independence Technology, a Johnson & Johnson company, after serving in a variety of leadership roles at Becton, Dickinson Company from 1991 to 1999.

Robert M. Davis, age 46, is Corporate Vice President and President, Medical Products, having served in that capacity since October 2010. From May 2006 to July 2010, Mr. Davis served as Corporate Vice President and Chief Financial Officer and from July to October 2010, he was Corporate Vice President and President, Renal. Prior to joining Baxter as Treasurer in 2004, Mr. Davis was with Eli Lilly and Company from 1990.

Ludwig N. Hantson, Ph.D., age 50, is Corporate Vice President and President, BioScience, having served in that capacity since October 2010. Dr. Hantson joined Baxter in May 2010 as Corporate Vice President and President, International. From 2001 to May 2010, Dr. Hantson held various positions at Novartis Pharmaceuticals Corporation, the most recent of which was Chief Executive Officer, Pharma North America. Prior to Novartis, Dr. Hantson spent 13 years with Johnson & Johnson in roles of increasing responsibility in marketing and clinical research and development.

Robert J. Hombach, age 47, is Corporate Vice President and Chief Financial Officer, having served in that capacity since July 2010. From February 2007 to March 2011, Mr. Hombach also served as Treasurer and from December 2004 to February 2007, he was Vice President of Finance, Europe. Prior to that, Mr. Hombach served in a number of finance positions of increasing responsibility in the planning, manufacturing, operations and treasury areas at Baxter.

Jeanne K. Mason, *Ph.D.,* age 57, is Corporate Vice President, Human Resources. Prior to joining Baxter in May 2006, Dr. Mason was with General Electric from 1988, holding various leadership positions, the most recent of which was with GE Insurance Solutions, a primary insurance and reinsurance business, where she was responsible for global human resource functions.

David P. Scharf, age 45, is Corporate Vice President and General Counsel, having served in that capacity since August 2009. Mr. Scharf joined Baxter in July 2005 and served in a number of positions, including Deputy General Counsel and Corporate Secretary. Prior to joining Baxter, Mr. Scharf was with Guidant Corporation from 2002, in roles of increasing responsibility.

All executive officers hold office until the next annual election of officers and until their respective successors are elected and qualified.

Table of Contents

PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***
The following table includes information about the company s common stock repurchases during the three-month period ended December 31, 2012.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased(1)(2)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs(1)(2)	Approximate Dollar Value of Shares that may yet be Purchased Under the Program(2)
October 1, 2012 through October 31, 2012	1,015,000	$61.23	1,015,000	
November 1, 2012 through November 30, 2012	3,655,900	$65.06	3,655,900	
December 1, 2012 through December 31, 2012	1,736,900	$65.88	1,736,900	
Total	6,407,800	$64.67	6,407,800	$ 1,933,526,858

(1) In December 2010, the company announced that its board of directors authorized the company to repurchase up to $2.5 billion of its common stock on the open market or in private transactions. During the fourth quarter of 2012, the company repurchased 5.4 million shares for $348 million under this program. There was no remaining availability under this authorization at December 31, 2012.

(2) In July 2012, the company announced that its board of directors authorized the company to repurchase up to $2.0 billion of its common stock on the open market or in private transactions. During the fourth quarter of 2012, the company repurchased 1.0 million shares for $66 million under this program. The remaining authorization under this program totaled approximately $1.9 billion at December 31, 2012. This program does not have an expiration date.

Additional information required by this item is incorporated by reference to Note 16 in Item 8 of this Annual Report on Form 10-K.

Table of Contents

Item 6. ***Selected Financial Data.***

as of or for the years ended December 31		**2012[1,6]**	2011[2,6]	2010[3,6]	2009[4,6]	2008[5,6]
Operating Results	Net sales	**$ 14,190**	13,893	12,843	12,562	12,348
(in millions)	Net income attributable to Baxter[7]	**$ 2,326**	2,224	1,420	2,205	2,014
	Depreciation and amortization	**$ 712**	670	685	638	631
	Research and development expenses	**$ 1,156**	946	915	917	868
Balance Sheet and	Capital expenditures	**$ 1,161**	960	963	1,014	954
Cash Flow Information	Total assets	**$ 20,390**	19,073	17,489	17,354	15,405
(in millions)	Long-term debt and lease obligations	**$ 5,580**	4,749	4,363	3,440	3,362
Common Stock Information	Average number of common shares outstanding (in millions)[8]	**551**	569	590	607	625
	Net income attributable to Baxter per common share					
	Basic	**$ 4.22**	3.91	2.41	3.63	3.22
	Diluted	**$ 4.18**	3.88	2.39	3.59	3.16
	Cash dividends declared per common share	**$ 1.570**	1.265	1.180	1.070	0.913
	Year-end market price per common share	**$ 66.66**	49.48	50.62	58.68	53.59
Other Information	Total shareholder return[9]	**38.3%**	0.0%	(11.6%)	11.6%	(6.3%)
	Common shareholders of record at year-end	**42,067**	43,534	43,715	48,286	48,492

[1] Net income attributable to Baxter included a charge totaling $170 million primarily related to the settlement of certain pension obligations in the United States, a $150 million business optimization charge, business development charges totaling $128 million (including $113 million in R&D charges for collaboration agreements), a benefit of $91 million related to the reduction of certain contingent payment liabilities, and a net benefit of $23 million primarily related to an adjustment to the COLLEAGUE infusion pump reserves.

[2] Net income attributable to Baxter included a $192 million business optimization charge, a $79 million charge related to litigation and certain historical rebate and discount adjustments, and charges totaling $103 million principally related to the write-down of Greek government bonds and a contribution to the Baxter International Foundation.

[3] Net income attributable to Baxter included a $588 million charge related to the recall of COLLEAGUE infusion pumps. The charge impacted net sales by $213 million. Net income attributable to Baxter also included a $257 million business optimization charge, a $112 million impairment charge associated with the company s divestiture of its U.S. multi-source generic injectables business, a $62 million litigation-related charge, a $39 million charge to write off a deferred tax asset, business development charges of $34 million and a $28 million charge to write down accounts receivable in Greece.

[4] Net income attributable to Baxter included a $79 million business optimization charge, an impairment charge of $54 million and a charge of $27 million relating to infusion pumps.

[5] Net income 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 in-process research and development.

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

[7] Excludes net income attributable to noncontrolling interests of $32 million, $7 million, $10 million, and $11 million in 2011, 2010, 2009, and 2008, respectively.

[8] Excludes common stock equivalents.

[9] Represents the total of appreciation (decline) in market price plus cash dividends declared on common shares.

Table of Contents

Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations.***

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), 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.

The company operates in two 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; biosurgery products; and select vaccines. **Medical Products** 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 provides products and services related to pharmacy compounding, drug formulation and packaging technologies. In addition, the Medical Products business provides products and services 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 51,000 employees and conducts business in over 100 countries. The company generates approximately 60% of its revenues outside the United States, and maintains over 50 manufacturing facilities and over 100 distribution facilities in the United States, Europe, Asia-Pacific, Latin America and Canada.

Financial Results

Baxter s 2012 results reflect the company s success from a financial, operational and strategic perspective, as the company was able to generate sales growth and improved profitability through disciplined execution of the company s strategies. Despite a challenging global macroeconomic environment in 2012, Baxter was able to strengthen its core portfolio by expanding access and increasing standards of care globally while also advancing the product pipeline through record research and development (R&D) spending and executing multiple business development initiatives.

Baxter s global net sales totaled $14.2 billion in 2012, an increase of 2% over 2011, including an unfavorable foreign currency impact of 3 percentage points. International sales totaled $8.1 billion, a decrease of 1% compared to 2011, including an unfavorable foreign currency impact of 5 percentage points. Sales in the United States totaled $6.1 billion in 2012, an increase of 6% over 2011.

Baxter s net income for 2012 totaled $2.3 billion, or $4.18 per diluted share, compared to $2.2 billion, or $3.88 per diluted share, in the prior year. Net income in 2012 included certain items which reduced income before income taxes by $334 million and net income by $190 million, or $0.35 per diluted share, as further discussed in the Results of Operations section below. Net income in 2011 included certain items which reduced income before income taxes by $374 million and net income by $247 million, or $0.43 per diluted share, as further discussed in the Results of Operations section below. Excluding these special items in both years, Baxter s adjusted net income in 2012 was $2.5 billion, which represents an increase of 2% over 2011, while adjusted earnings per diluted share of $4.53 increased 5% from $4.31 in 2011. Adjusted net income and adjusted earnings per diluted

Table of Contents

share, each excluding special items, are non-GAAP (generally accepted accounting principles) financial measures. The company believes that these non-GAAP measures, when used in conjunction with results presented in accordance with GAAP, may provide a more complete understanding of the company s operations and may facilitate a fuller analysis of the company s results of operations, particularly in evaluating performance from one period to another.

Baxter s financial results included R&D expenses totaling $1.2 billion in 2012, which reflects the acceleration of R&D spending to drive late-stage development programs through product approvals in both developed and emerging markets, while also focusing on enhancing the company s early-stage and exploratory R&D. During the year, the company obtained regulatory approvals for new products or new indications of existing products that will improve clinical outcomes for patients and provide quality-of-life benefits, while also initiating and advancing a number of clinical trials that have the potential to impact the treatment and delivery of care for various chronic diseases, such as hemophilia, and certain forms of cancer. Additionally, the increase in R&D spending reflects upfront payments made during the year as the company entered into new collaboration arrangements and re-aligned certain of the company s R&D activities. Refer to the discussion below for further information regarding R&D activity in 2012.

The company s financial position remains strong, with cash flows from operations totaling $3.1 billion in 2012. The company has continued to execute on its disciplined capital allocation framework, which was designed to optimize shareholder value creation through targeted capital investments, share repurchases and dividends, as well as acquisitions and other business development initiatives as discussed in Strategic Objectives below.

Capital investments totaled $1.2 billion in 2012 as the company continues to invest across its businesses to support future growth, including additional investments in support of new and existing product capacity expansions in the BioScience segment. The company s investments in capital expenditures in 2012 were focused on projects that improve the company s cost structure and manufacturing capabilities and support its strategy of geographic expansion with select investments in growing markets.

The company also continued to return value to its shareholders in the form of share repurchases and dividends. During 2012, the company repurchased 25 million shares of common stock for $1.5 billion, and paid cash dividends to its shareholders totaling $804 million.

Strategic Objectives

Baxter continues to focus on several key objectives to successfully execute its long-term strategy to achieve sustainable growth and deliver shareholder value. 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. During 2012, the company further defined its strategic objectives by identifying four key strategic growth vectors: advancing the core portfolio globally, driving innovation through the R&D pipeline, enhancing growth with acquisitions and collaborations, and developing unique public-private partnerships.

Advancing the Core Portfolio Globally

Baxter is well-positioned in the market, despite challenging global economic conditions, due to the breadth and diversity of the company s portfolio, which will serve as a solid foundation for future growth. In the BioScience business, the company s products treat bleeding disorders and a range of immune and neurological disorders, both of which are under-diagnosed and under-treated globally. The Medical Products business offers innovative products for treatment of end-stage renal disease and other therapies and technologies supporting the work of hospital pharmacies and serving the needs of patients in acute care settings.

While Baxter is a leader in several of the markets noted above, there is significant potential to expand across the company s core portfolio by ensuring improved access to Baxter s portfolio, bringing the benefits of these products to more patients globally. The starting point for this growth will be through geographic expansion, new

Table of Contents

indications, broader access, increased diagnosis, and differentiated value. 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.

Baxter has focused on increasing access to plasma-based treatments as a key area to advance the company s core portfolio. With demand for plasma-based products growing, in 2012 Baxter initiated construction of a new, state-of-the-art plasma fractionation facility in Covington, Georgia. The expected capital investment of over $1 billion over five years will add up to three million liters of annual fractionation capacity to Baxter s existing production levels, and will provide the flexibility to support further expansion in the future. Commercial operation of the new facility is expected to begin in 2018.

Baxter also maintains focus on continued international penetration for many of our products, including bringing new recombinant therapy options to more hemophilia patients worldwide. In 2012, Baxter announced the approval in China of ADVATE [Recombinant Human Coagulation Factor VIII for injection] for the control and prophylaxis of bleeding episodes in individuals with hemophilia A (congenital factor VIII deficiency). Refer to the discussion below for additional information on recent ADVATE developments.

Additionally, Baxter has expanded its offerings to hospital pharmacies through the launch of new products and expansion of existing products into new markets. The company s portfolio includes premixed parenteral, or intravenous, nutrition products; premixed drugs; IV infusion pumps and administration sets; inhaled anesthetics, and other specialty pharmaceuticals. Baxter launched a line of triple-chamber parenteral nutrition systems in 2011 with NUMETA (emulsion for infusion), which became available in several countries in 2012, particularly throughout Europe. During 2012, the company introduced its latest triple-chamber system for adults, OLIMEL (Amino Acids, Dextrose and Lipids, with/without Electrolytes), into new markets in Asia-Pacific, Europe and Latin America.

Driving Innovation through the R&D Pipeline

R&D innovation and scientific productivity continue to be key strategic priorities for Baxter. Key developments in 2012 included the following:

Expanding portfolio with new product launches in key geographic regions:

- Regulatory approval in China for ADVATE for the control and prophylaxis of bleeding episodes in individuals with hemophilia A, with an expected product launch in 2013. With this action, ADVATE is now approved in over 50 countries worldwide;
- Approval of OLIMEL in Asia-Pacific, Europe, Latin America and Canada and NUMETA (pediatric nutritional emulsion for infusion) in select European countries;
- U.S. Food and Drug Administration (FDA) approval of GAMMAGARD LIQUID [Immune Globulin Infusion (Human)] 10% as a treatment for multifocal motor neuropathy (MMN), the first immunoglobulin treatment approved for MMN patients in the United States;
- FDA approval of TISSEEL [Fibrin Sealant] to include the indication for general hemostasis in surgery when control of bleeding by standard surgical techniques is ineffective or impractical;
- Regulatory approval in Europe for VEPACEL, a pre-pandemic influenza vaccine against the H5N1 subtype of influenza A (commonly known as bird or avian flu), in all European Union Member States; and
- FDA approval and launch of a new 4000 IU dosage strength of ADVATE [Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method]. As the only company to offer a 4000 IU dosage strength, Baxter provides the convenience of a single vial dosing opportunity for many adult patients.

20

Table of Contents

Products in late-stage development:

- Initiation of a second, confirmatory Phase III trial of Baxter s clinical program evaluating the use of its GAMMAGARD LIQUID 10% (marketed as KIOVIG outside the United States and Canada), for the treatment of mild to moderate Alzheimer s disease, and

- Initiation of a Phase III pivotal clinical trial to evaluate the efficacy and safety of adult autologous (an individual s own) CD34+ stem cells primarily to increase exercise capacity and secondarily to reduce chest pain frequency in patients with otherwise unmanageable heart disease, based on a biological regenerative approach.

Increasing R&D investment in key focus areas:

- Completion of a Phase I clinical trial of the company s lead investigational candidate, BAX 855, a longer-acting (PEGylated) form of a full-length recombinant factor VIII (rFVIII) protein, to assess the frequency of infusions in previously treated patients with severe hemophilia A;

- Completion of the first U.S. study of the company s home HD system and initiation of a nocturnal in-center trial in Canada. Data from both trials will support the company s submission for CE Mark in Europe in 2013;

- Submission of a biologics license application to FDA for approval of BAX 326, a recombinant factor IX (rFIX) protein being investigated for the treatment and prophylaxis of bleeding episodes for patients over 12 years of age with hemophilia B; and

- Initiation of a Phase I clinical trial for patients with malignant solid tumors evaluating a fully-human, recombinant anti-MIF (anti-macrophage migration inhibitory factor) monoclonal antibody with potential to be a new therapeutic agent in treatment of cancer.

Enhancing Growth with Acquisitions and Collaborations

Baxter has accelerated its pace of acquisitions and collaborations in recent years. Key developments in 2012 included the following:

- The acquisition of Synovis Life Technologies, Inc. (Synovis), a publicly-traded company that provides biological and mechanical products for soft tissue repair used in a variety of surgical procedures, which complements and expands the portfolio of Baxter s biosurgery products;

- The exercise of an option to purchase the remaining equity of Sigma International General Medical Apparatus, LLC (SIGMA), which culminated the relationship that began in 2009 when Baxter acquired a 40% stake in SIGMA and became the exclusive global distributor of SIGMA s smart infusion pump technology;

- The execution of a European licensing agreement with Onconova Therapeutics, Inc. (Onconova) for rigosertib, a novel targeted anti-cancer compound currently in a Phase III study for the treatment of a group of rare hematologic malignancies called Myelodysplastic Syndromes and a Phase II/III study for pancreatic cancer, with Baxter obtaining commercialization rights in Europe for these indications;

The execution of an exclusive agreement with Chatham Therapeutics, LLC (Chatham) for the development and commercialization of potential treatments for hemophilia B utilizing Chatham s gene therapy technology; and

The commencement of activities under the collaboration agreement with Momenta Pharmaceuticals, Inc. (Momenta) to develop and commercialize up to six follow-on biologic products, also known as biosimilars, which replicate existing, branded biologics used in the treatment of a number of diseases, including cancer, autoimmune disorders and other chronic conditions. The company selected three products under the collaboration agreement during 2012.

Table of Contents

Baxter also continues to benefit from the integration of prior year acquisitions, including the 2011 acquisition of Baxa Corporation (Baxa), a privately-held company that manufactures and markets devices, systems and software for the safe and efficient preparation, handling, packaging and administration of fluid medications. The acquisition complements Baxter s existing portfolio of nutrition and drug delivery systems and provides Baxter with a comprehensive solution to fulfill the majority of patients nutritional requirements and increase efficiency in the pharmacy.

In 2012, Baxter began to make equity investments in companies developing high-potential technologies through Baxter Ventures, a strategic initiative established in 2011 to invest in early-stage companies developing products and therapies to accelerate innovation and growth for the company.

The company expects to continue to further supplement its internal R&D activities and pursue accelerated growth by fully capitalizing on Baxter s diversified healthcare model with its investment in other business development opportunities, including acquisitions, collaborations and alliances, that complement our current businesses, enhance our portfolio, and leverage our core strengths.

Gambro AB

In December 2012, Baxter entered into a definitive agreement to acquire Gambro AB (Gambro), a privately held dialysis product company based in Lund, Sweden. Gambro is a global medical technology company focused on developing, manufacturing and supplying dialysis products and therapies for patients with acute or chronic kidney disease. The transaction will provide Baxter with a broad and complementary dialysis product portfolio, while further advancing the company s geographic footprint in the dialysis business. In addition, the company will augment its pipeline by adding Gambro s next-generation monitors, dialyzers, devices and dialysis solutions. Under the terms of the agreement, Baxter will provide total consideration of approximately $4 billion for the acquisition, including pre-acquisition debt. The transaction is expected to close at the end of the second quarter of 2013, subject to regulatory approvals and other closing conditions.

The company plans to issue at least $3.0 billion of debt during the first half of 2013 to fund the planned acquisition of Gambro, which will significantly increase the company s outstanding debt. As a result, stock repurchases in 2013 are expected to decline from 2012 and 2011 levels. Additionally, the acquisition of Gambro is expected to have a dilutive impact on earnings in 2013 of $0.10 to $0.15 per diluted share, assuming the transaction closes at the end of the second quarter of 2013.

Inspiration BioPharmaceuticals, Inc. / Ipsen Pharma S.A.S.

In January 2013, Baxter agreed to acquire the investigational hemophilia compound OBI-1 and related assets from Inspiration BioPharmaceuticals, Inc. (Inspiration), as well as certain other OBI-1 related assets, including manufacturing operations, from Ipsen Pharma S.A.S. in conjunction with Inspiration s ongoing bankruptcy proceedings. OBI-1 is a recombinant porcine factor VIII (rpFVIII) being investigated for treatment of bleeding in people with acquired hemophilia A and congenital hemophilia A patients with inhibitors, and is currently in Phase III clinical studies.

Under the terms of the agreement, Baxter will make an upfront payment of $50 million for the OBI-1 assets, including the manufacturing operations. In the future, Baxter may make payments of up to $20 million based on regulatory approval of the acquired hemophilia A indication in the United States and first additional country. Additional payments may be due upon approval of additional indications, through net sales payments, and as sales milestones when sales exceed $100 million. The transaction is subject to regulatory approval and is currently under review by the Federal Trade Commission.

Table of Contents

Public-Private Partnerships

In addition to the company s business development activities, Baxter is focused on pursuing innovation through unique business models and the development of public-private partnerships. During 2012, the company entered into the following public-private partnerships:

- An exclusive 20-year partnership with Hemobrás to provide hemophilia patients in Brazil greater access to recombinant factor VIII (rFVIII) therapy for the treatment of hemophilia A. Through this innovative partnership, Baxter will be the exclusive provider of Brazil s recombinant FVIII treatment over the next 10 years, while the companies work together on the technology transfer to support development of local manufacturing capacity. Baxter will receive cash payments for product it supplies to Hemobrás and, following completion of the technology transfer, royalties on recombinant FVIII produced by Hemobrás;

- A 10-year contract manufacturing agreement with Sanquin Blood Supply Foundation of the Netherlands to enhance supply of plasma-derived treatments for immune disorders, hemophilia, trauma and other critical conditions (with production scheduled to begin in 2014); and

- A partnership with China s National Institute of Hospital Administration under the Ministry of Health to help improve access to PD in China s rural communities.

In addition to the above public-private partnerships, in 2012 Baxter also started construction of a new PD manufacturing facility in Thailand, supporting the country s efforts to reinforce PD as its first-line dialysis treatment.

Responsible Corporate Citizen

The company strives for continued growth and profitability, while maintaining and accelerating its focus on acting as a responsible corporate citizen. At Baxter, sustainability means creating a lasting social, environmental and economic value by addressing the needs of the company s wide-ranging stakeholder base.

Baxter s comprehensive sustainability program is focused on areas where the company is uniquely positioned to make a positive impact. Baxter and the Baxter International Foundation provide financial support and product donations in support of critical needs, from assisting underserved communities to providing emergency relief for countries experiencing natural disasters.

Baxter s priorities also include sound environmental stewardship. Throughout 2012 the company continued to implement a range of water conservation strategies and facility-based energy saving initiatives. In the area of product stewardship and life cycle management, Baxter is pursuing efforts such as sustainable design and reduced packaging. Baxter is also responding to the challenges of climate change through innovative greenhouse gas emissions-reduction programs, such as shifting to less carbon-intensive energy sources and modes of product transport.

Risk Factors

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 within an increasingly competitive and regulated environment and to address the other risk factors described in Item 1A of this Annual Report on Form 10-K.

Table of Contents

RESULTS OF OPERATIONS

Special Items

The company s results of operations included special items that have been excluded from its non-GAAP measures provided in the Financial Results section above. The following table provides a summary of the impact of special items on the company s results of operations for 2012, 2011, and 2010.

				Percent change	
years ended December 31 (in millions)	**2012**	2011	2010	**2012**	2011
Net sales	**$ 14,190**	$ 13,893	$ 12,843	**2%**	8%
COLLEAGUE infusion pump items			213		
Adjusted net sales	**$ 14,190**	$ 13,893	$ 13,056	**2%**	6%
Gross margin	**$ 7,301**	$ 7,046	$ 5,958	**4%**	18%
COLLEAGUE infusion pump items	**(23)**		588		
Business optimization charges (including certain asset impairments)	**62**	95	132		
Business development charges	**6**				
Adjusted gross margin	**$ 7,346**	$ 7,141	$ 6,678	**3%**	7%
% of Adjusted net sales	**51.8%**	51.4%	51.1%	**0.4 pts**	0.3 pts
Marketing and administrative expenses	**$ 3,324**	$ 3,154	$ 2,907	**5%**	8%
Business optimization charges (including certain asset impairments)	**(60)**	(97)	(125)		
Business development charges	**(9)**				
Pension-related items	**(170)**				
AWP litigation and historical rebate and discount items		(79)			
Asset impairment and other charges		(41)	(28)		
Adjusted marketing and administrative expenses	**$ 3,085**	$ 2,937	$ 2,754	**5%**	7%
% of Adjusted net sales	**21.7%**	21.1%	21.1%	**0.6 pts**	0 pts
Research and development expenses	**$ 1,156**	$ 946	$ 915	**22%**	3%
Business optimization charges (including certain asset impairments)	**(28)**				
Business development charges	**(113)**		(34)		
Adjusted research and development expenses	**$ 1,015**	$ 946	$ 881	**7%**	7%
% of Adjusted net sales	**7.2%**	6.8%	6.7%	**0.4 pts**	0.1 pts
Other (income) expense, net	**$ (155)**	$ 83	$ 159	**N/M**	N/M
Gains on the reduction of contingent payment liabilities	**91**				
Asset impairment and other charges		(62)	(112)		
Litigation-related charges			(62)		
Adjusted other (income) expense, net	**$ (64)**	$ 21	$ (15)	**N/M**	N/M

Income tax expense	**$ 563**	$ 553	$ 463	**2%**	19%
Special items	**144**	127	135		
Adjusted income tax expense	**$ 707**	$ 680	$ 598	**4%**	14%
% of Adjusted pre-tax income	**21.9%**	21.4%	20.1%	**0.5 pts**	1.3 pts

The company believes that these non-GAAP measures, when used in conjunction with results presented in accordance with GAAP, may provide a more complete understanding of the company s operations and may facilitate a fuller analysis of the company s results of operations, particularly in evaluating performance from one period to another.

Table of Contents

In 2012 and 2010, the company s results were impacted by certain items related to the recall of the company s COLLEAGUE infusion pumps from the U.S. market and other actions the company is taking outside of the United States. In 2010, the company recorded a $588 million charge related to the COLLEAGUE infusion pump recall, with $213 million recorded as a reduction of net sales and $375 million recorded in cost of sales. In 2012, the company recognized a net benefit of $23 million in cost of sales primarily related to an adjustment to the COLLEAGUE infusion pump reserve when the company substantially completed its recall activities in the United States. Refer to Note 6 for further information regarding the COLLEAGUE infusion pump charge and related reserve adjustment.

In 2012, 2011 and 2010, the company s results were impacted by costs associated with actions implemented by the company to optimize its overall cost structure on a global basis. These actions included streamlining the company s international operations, rationalizing its manufacturing facilities, improving its general and administrative infrastructure, and, in 2012, re-aligning certain R&D activities. The company recorded pre-tax business optimization charges of $150 million, $192 million, and $257 million in 2012, 2011, and 2010, respectively, which impacted cost of sales, marketing and administrative expenses, and, in 2012, R&D expenses. Refer to Note 6 for further information regarding these charges.

In 2012, the company also recorded pre-tax charges of $170 million primarily related to pension settlement charges and other pension-related items, and business development charges of $128 million principally related to upfront payments for collaboration agreements. Also included in 2012 results were gains of $53 million in the first quarter of 2012 and $38 million in the second quarter of 2012 for the reduction of certain contingent payment liabilities related to the prior acquisitions of Prism Pharmaceuticals, Inc. (Prism) and ApaTech Limited (ApaTech), respectively. Refer to Note 11 for further information regarding the pension settlement charges, Note 4 for further information regarding the business development charges, and Note 8 for further information regarding the gains from reductions of contingent payment liabilities.

In 2011, the company also recorded pre-tax charges of $79 million related to the resolution of litigation pertaining to average wholesale prices (AWP) and certain historical rebate and discount adjustments, $62 million in asset impairments primarily related to the write-down of Greek government bonds, and $41 million principally related to a contribution to the Baxter International Foundation.

In 2010, the company also recorded a $112 million impairment charge associated with the company s divestiture of its U.S. multi-source generic injectables business, a $62 million litigation-related charge, a $39 million charge to write off a deferred tax asset, business development charges of $34 million and a $28 million charge to write down accounts receivable in Greece.

Table of Contents

Net Sales

years ended December 31 (in millions)	2012	2011	2010	Percent change at actual currency rates 2012	Percent change at actual currency rates 2011	Percent change at constant currency rates 2012	Percent change at constant currency rates 2011
BioScience	**$ 6,237**	$ 6,053	$ 5,640	**3%**	7%	**6%**	5%
Medical Products	**7,953**	7,840	7,203	**1%**	9%	**4%**	6%
Total net sales	**$ 14,190**	$ 13,893	$ 12,843	**2%**	8%	**5%**	6%

years ended December 31 (in millions)	2012	2011	2010	Percent change at actual currency rates 2012	Percent change at actual currency rates 2011	Percent change at constant currency rates 2012	Percent change at constant currency rates 2011
United States	**$ 6,056**	$ 5,709	$ 5,264	**6%**	8%	**6%**	8%
International	**8,134**	8,184	7,579	**(1%)**	8%	**4%**	4%
Total net sales	**$ 14,190**	$ 13,893	$ 12,843	**2%**	8%	**5%**	6%

Foreign currency unfavorably impacted net sales by 3 percentage points in 2012 principally due to the strengthening of the U.S. Dollar relative to the Euro. Foreign currency favorably impacted net sales by 2 percentage points in 2011, principally due to the weakening of the U.S. Dollar relative to the Euro, the Australian Dollar and the Japanese Yen. Excluding the impact of foreign currency, total net sales growth was 5% and 6% in 2012 and 2011, respectively, primarily driven by improved sales volumes (demand).

In 2012, the recent acquisitions of Synovis and Baxa contributed 2 percentage points towards sales growth during 2012. Total net sales growth in 2011 was favorably impacted by 2 percentage points due to the COLLEAGUE infusion pump charge, which reduced net sales in the Medical Products segment in 2010 by $213 million. Additionally, included in net sales in the Medical Products segment were sales of $58 million and $198 million in 2011 and 2010, respectively, related to the U.S. multi-source generic injectables business, which was divested by the company in the first half of 2011. The divestiture of this business unfavorably impacted total net sales growth by 1 percentage point in both 2012 and 2011. Refer to Note 2 for further information regarding this divestiture, Note 4 for further information regarding the Synovis and Baxa acquisitions, and Note 6 for further information regarding the COLLEAGUE infusion pump charge.

The comparisons presented at constant currency rates reflect comparative local currency sales at the prior year s foreign exchange rates. This measure provides information on the change in net sales assuming that foreign currency exchange rates had not changed between the prior and the current period. The company believes that the non-GAAP measure of change in net sales at constant currency rates, when used in conjunction with the GAAP measure of change in net sales at actual currency rates, may provide a more complete understanding of the company s operations and can facilitate a fuller analysis of the company s results of operations, particularly in evaluating performance from one period to another.

Table of Contents

BioScience

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

years ended December 31 (in millions)	2012	2011	2010	Percent change At actual currency rates 2012	At actual currency rates 2011	At constant currency rates 2012	At constant currency rates 2011
Recombinants	**$ 2,234**	$ 2,212	$ 2,095	**1%**	6%	**4%**	3%
Antibody Therapy	**1,593**	1,541	1,354	**3%**	14%	**5%**	13%
Plasma Proteins	**1,464**	1,440	1,368	**2%**	5%	**4%**	5%
Regenerative Medicine	**673**	580	527	**16%**	10%	**19%**	8%
Other	**273**	280	296	**(3%)**	(6%)	**5%**	(15%)
Total BioScience net sales	**$ 6,237**	$ 6,053	$ 5,640	**3%**	7%	**6%**	5%

Net sales in the BioScience segment increased 3% and 7% in 2012 and 2011, respectively (with an unfavorable foreign currency impact of 3 percentage points in 2012 and a favorable foreign currency impact of 2 percentage points in 2011). Excluding the impact of foreign currency, the principal drivers impacting net sales were the following:

In the Recombinants product category, sales growth in both years was driven primarily by strong U.S. demand for the company s advanced recombinant therapy, ADVATE. Sales growth was partially offset by lower tender sales in Australia in 2012 and in the United Kingdom in 2011.

In the Antibody Therapy product category, sales increased in both years primarily as a result of demand in the United States for GAMMAGARD LIQUID, the liquid formulation of the antibody replacement therapy. Also contributing to sales growth in 2012 was the favorable impact from pricing benefits related to shifts in geographic mix as the company optimized its global supply in light of a planned, temporary facility shutdown during the second half of 2012. Sales growth in 2011 was favorably impacted by incremental volume resulting from a competitor being out of the market, while the return of the competitor to the market partially offset sales growth in 2012.

Sales in the Plasma Proteins product category were favorably impacted in both years by strong demand for FEIBA (an anti-inhibitor bypass therapy). Also contributing to sales growth in 2012 were improved sales of alpha-1 products (for treatment of hereditary emphysema) and higher international sales of albumin. Sales growth in 2011 was also driven by improved demand for plasma-derived factor VIII after a reduction in sales in 2010.

In the Regenerative Medicine product category, sales in 2012 increased primarily as a result of the first quarter 2012 acquisition of Synovis, a biological and mechanical products company. Also contributing to sales growth in both years was increased global demand for the company s surgical sealants, including FLOSEAL and TISSEEL. Partially offsetting this growth in both years were lower U.S. sales of ACTIFUSE bone void filler products.

In the Other product category, sales growth in 2012 was primarily driven by higher international sales of FSME-IMMUN (a tick-borne encephalitis vaccine) and milestone payments related to ongoing collaborations with governments on the development of influenza vaccines. In 2011, strong sales of FSME-IMMUN driven by strong international demand were more than offset by lower influenza revenues, as the first quarter of 2010 benefited from sales of CELVAPAN H1N1 pandemic vaccine.

27

Table of Contents

Medical Products

The following is a summary of net sales by product category in the Medical Products segment.

				Percent change			
				At actual currency rates		At constant currency rates	
years ended December 31 (in millions)	**2012**	2011	2010	**2012**	2011	**2012**	2011
Renal	**$ 2,527**	$ 2,530	$ 2,389	**0%**	6%	**2%**	2%
Global Injectables	**2,075**	2,004	1,891	**4%**	6%	**5%**	3%
IV Therapies	**1,930**	1,802	1,678	**7%**	7%	**10%**	5%
Infusion Systems	**813**	901	655	**(10%)**	38%	**(9%)**	35%
Anesthesia	**545**	537	525	**1%**	2%	**3%**	1%
Other	**63**	66	65	**(5%)**	2%	**(9%)**	2%
Total Medical Products net sales	**$ 7,953**	$ 7,840	$ 7,203	**1%**	9%	**4%**	6%

Net sales in the Medical Products segment increased 1% and 9% in 2012 and 2011, respectively (with an unfavorable foreign currency impact of 3 percentage points in 2012 and a favorable foreign currency impact of 3 percentage points in 2011). Excluding the impact of foreign currency, the principal drivers impacting net sales were the following:

In the Renal product category, the favorable impact from continued growth in the number of PD patients in Asia, Latin America and the United States for both years was partially offset by lower sales of HD products.

Sales growth in the Global Injectables product category in 2012 was primarily driven by a price increase for cyclophosphamide (a generic oncology drug) in the United States. Sales in both years benefited from improved sales in the pharmaceutical partnering and pharmacy compounding businesses, in addition to the favorable contribution from the fourth quarter 2011 acquisition of Baxa. The 2011 divestiture of the U.S. multi-source generic injectables business unfavorably impacted total net sales growth by 3 and 9 percentage points during 2012 and 2011, respectively.

IV Therapies sales growth in both years was driven by increased demand for IV solutions and strong sales of nutrition products, including the favorable impact, particularly in 2012, of the Baxa acquisition. Also contributing to growth in 2011 were market share gains in the United States, partially as a result of competitor supply issues.

In the Infusion Systems product category, sales declined during 2012 due to lower global sales of access sets used in the administration of IV solutions and lower sales of SIGMA Spectrum infusion pumps, both of which were related to COLLEAGUE infusion pump recall activities in the United States which were substantially completed in July of 2012. Sales growth in 2011 reflected increased sales of SIGMA Spectrum infusion pumps, partially offset by lower global sales of access sets in the second half of the year. Sales growth in 2011 was also favorably impacted by 33 percentage points as a result of the COLLEAGUE infusion pump charge in 2010.

Within the Anesthesia product category, sales growth in both years was driven primarily by improved international growth from increased penetration of SUPRANE (desflurane) and generic sevoflurane, particularly in Europe and Asia. Sales growth in both years was partially offset by lower demand for inhaled anesthetics in the United States, as well as competitive pricing pressures for generic sevoflurane.

The Other product category includes revenues of $38 million, $36 million and $46 million for 2012, 2011 and 2010, respectively, associated with the manufacturing, distribution and other services provided by the company to Fenwal Inc. subsequent to the divestiture of the Transfusion Therapies business in 2007, which had previously been reported separately.

Table of Contents

Gross Margin and Expense Ratios

years ended December 31 (as a percent of net sales)	**2012**	2011	2010	Change **2012**	Change 2011
Gross margin	**51.5%**	50.7%	46.4%	**0.8 pts**	4.3 pts
Marketing and administrative expenses	**23.4%**	22.7%	22.6%	**0.7 pts**	0.1 pts

Gross Margin

The special items identified above had an unfavorable impact of 0.3, 0.7 and 4.7 percentage points on the gross margin percentage in 2012, 2011, and 2010, respectively. Refer to the Special Items caption above for additional detail.

In addition to the impact of the special items, the gross margin percentage in 2012 improved compared to 2011 due to the benefit from sales growth in higher margin products in the BioScience segment, the resolution of prior year manufacturing issues at the company s Castlebar, Ireland facility, and a modest favorable impact of foreign currency. These improvements in gross margin were partially offset by margin dilution from business development activities, increased pension plan costs and government austerity measures.

In addition to the impact of the special items, the gross margin percentage in 2011 improved compared to 2010 as a result of the benefit from a favorable business mix due to sales growth of select higher margin products in the BioScience and Medical Products segments, as well as the favorable impact of the divestiture of the lower margin U.S. multi-source generic injectables business. Refer to Note 2 for further information regarding the divestiture. Partially offsetting these improvements were costs associated with manufacturing issues at the Castlebar, Ireland facility and an increase in pension plan costs in 2011.

Marketing and Administrative Expenses

The special items identified above had an unfavorable impact of 1.7, 1.6 and 1.5 percentage points on the marketing and administrative expenses ratio in 2012, 2011, and 2010, respectively. Refer to the Special Items caption above for additional detail.

In addition to the unfavorable impact of the special items, the marketing and administrative expenses ratio in 2012 increased as a result of incremental expenses from the operations of Baxa and Synovis, acquisition-related expenses, additional spending on marketing and promotional programs, and an increase in pension plan costs as described below. These factors were partially offset by savings from the company s business optimization initiatives and the company s continued focus on controlling discretionary spending.

Excluding the impact of the special items, the ratio in 2011 was flat to 2010 as the favorable impact of leverage from higher sales and the company s focus on controlling discretionary spending was fully offset by increased spending relating to certain marketing and promotional programs and increased pension plan costs, as described below.

Pension Plan Costs

Fluctuations in pension plan costs impacted the company s gross margin and expense ratios. Pension plan costs increased $211 million in 2012 and $53 million in 2011, as detailed in Note 11. The 2012 pension plan costs included settlement charges of $168 million primarily related to the settlement of certain U.S. pension obligations. The increase in both 2012 and 2011 was also driven by lower interest rates used to discount the plans projected benefit obligations and an increase in amortization of actuarial losses. The increases in 2012 and 2011 were partially offset by the favorable impact of additional returns on assets due to discretionary cash contributions of $150 million and $350 million made to the pension plan in the United States in 2011 and 2010, respectively.

Table of Contents

Excluding the settlement charge discussed above, costs of the company s pension plans are expected to increase from $266 million in 2012 to approximately $330 million in 2013, principally due to lower interest rates used to discount the plans projected benefit obligations, a decrease in the expected return on plan assets assumption, and an increase in amortization of actuarial losses. The amortization of deferred losses is expected to increase in 2013 to $245 million from $209 million in 2012, and will be partially offset by the impact of the immediate recognition of deferred losses of $168 million in 2012 associated with the settlement of certain plan obligations. Refer to Note 11 for further information on the pension plans.

Research and Development

				Percent change	
years ended December 31 (in millions)	**2012**	2011	2010	**2012**	2011
Research and development expenses	**$1,156**	$946	$915	**22%**	3%
as a percent of net sales	**8.1%**	6.8%	7.1%		

R&D expenses increased in both 2012 and 2011. In addition to the special items identified above, R&D expenses also increased in both years as the company continued to invest in a number of late-stage R&D programs across its product pipeline, while reaching certain milestone achievements resulting in additional R&D spending in 2012. Refer to the discussion under Strategic Objectives above for additional detail.

Net Interest Expense

Net interest expense increased by $33 million in 2012 and decreased by $33 million in 2011. The increase in 2012 was principally driven by an increase in debt from the issuances of $500 million 1.85% senior unsecured notes in December 2011, and $700 million 2.40% senior unsecured notes and $300 million 3.65% senior unsecured notes in August 2012, as well as lower interest income. The decrease in 2011 was principally due to an increase in interest income and the impact of lower weighted-average interest rates due to the maturity of Baxter s 4.75% $500 million notes in October 2010. Refer to Note 2 for a summary of the components of net interest expense for 2012, 2011 and 2010.

Other (Income) Expense, Net

Other (income) expense, net was $155 million of income in 2012, and $83 million and $159 million of expense in 2011 and 2010, respectively. Refer to Note 2 for a table that details the components of other (income) expense, net for the three years ended December 31, 2012. Other (income) 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.

During 2012, other (income) expense, net included gains of $53 million and $38 million for the reduction of certain contingent payment liabilities related to the prior acquisitions of Prism and ApaTech, respectively. Additionally, other (income) expense, net included the benefit from a net loss attributable to noncontrolling interests of $28 million in 2012, which was prospectively classified as other (income) expense, net effective January 1, 2012.

During 2011, other (income) expense, net included asset impairment charges totaling $62 million primarily related to the write-down of Greek government bonds. Included in other (income) expense, net in 2010 was an impairment charge of $112 million associated with the company s divestiture of its U.S. multi-source generic injectables business and a charge of $62 million associated with litigation related to the company s 2008 recall of its heparin sodium injection products in the United States.

Table of Contents

Pre-Tax Income

Refer to Note 14 for a summary of financial results by segment. The following is a summary of significant factors impacting the segments financial results.

BioScience

Pre-tax income decreased 4% in 2012 and increased 8% in 2011. Included in pre-tax income during 2012 were business development charges of $123 million, primarily related to R&D charges of $50 million, $30 million and $33 million associated with the company s collaborations with Onconova, Chatham and Momenta, respectively, and a gain of $38 million related to the reduction of a contingent payment liability for certain milestones associated with the 2010 acquisition of ApaTech.

Excluding the impact of the above items, pre-tax income in 2012 declined by 1% as sales growth of certain higher margin products was more than offset by an increase in spending on R&D driven by funding of key programs and the achievement of certain milestones, increased spending on new marketing and promotional programs, and the unfavorable impact of foreign currency.

During 2011, sales growth for certain higher margin products and improved margins on plasma-based therapies were partially offset by an increase in spending on new marketing and promotional programs. Also contributing to the increase in pre-tax income were lower inventory reserves related to vaccine products in 2011.

Medical Products

Pre-tax income increased 5% and 130% in 2012 and 2011, respectively. Included in pre-tax income in 2012 was a gain of $53 million related to the reduction of the contingent payment liability for certain milestones associated with the 2011 acquisition of Prism and a net benefit from reserve adjustments of $23 million, which primarily related to an adjustment to the COLLEAGUE infusion pump reserves. Included in pre-tax income in 2010 was a charge of $588 million related to the recall of COLLEAGUE infusion pumps from the U.S. market, the U.S. multi-source generic injectables business impairment charge of $112 million, and a charge of $62 million associated with litigation related to the company s 2008 recall of its heparin sodium injection products in the United States.

Excluding the impact of the above items from 2012, pre-tax income in 2012 was flat to 2011 as the favorable impact of the resolution of prior year manufacturing issues at the company s Castlebar, Ireland facility was offset by increases in R&D spending, increases in marketing and administrative expenses, and the unfavorable impact of foreign currency.

In addition to the favorable impact of the above items from 2010, pre-tax income in 2011 also benefited from sales growth for certain higher margin products, partially offset by increased R&D spending and costs associated with manufacturing issues at the company s Castlebar, Ireland facility.

Other

Certain income and expense amounts are not allocated to a segment. These amounts are detailed in the table in Note 14 and primarily include net interest expense, certain foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in foreign currency) and certain foreign currency hedging activities, corporate headquarters costs, stock compensation expense, income and expense related to certain non-strategic investments, certain employee benefit plan costs (including the 2012 pension settlement charges), certain nonrecurring gains and losses, certain charges (such as the business optimization, AWP litigation and historical price reporting, asset impairment, and certain business development charges), and contributions to the Baxter International Foundation.

Table of Contents

Income Taxes

Effective Income Tax Rate

The effective income tax rate was 20% in both 2012 and 2011, and 25% in 2010. The company anticipates that the effective income tax rate, calculated in accordance with GAAP, will be approximately 22% in 2013, excluding any impact from additional audit developments or other special items. On January 2, 2013, the President signed the American Taxpayer Relief Act of 2012. The company does not expect the enacted legislation to materially impact its effective income tax rate.

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 12 for further information regarding the company s income taxes.

Factors impacting the company s effective tax rate in 2012 were gains of $53 million and $38 million for the reduction of certain contingent payment liabilities related to the prior acquisitions of Prism and ApaTech, respectively, for which there were no tax charges. Also impacting the effective tax rate was a cost of sales reduction of $37 million for an adjustment to the COLLEAGUE infusion pump reserves when the company substantially completed the recall in the United States in 2012, for which there was no tax charge. These items were offset by a change in the earnings mix from lower tax to higher tax rate jurisdictions compared to the prior year period.

The decrease in the effective tax rate in 2011 was primarily related to tax benefits from the business optimization charge, the AWP litigation and historical price reporting charge, and other charges in 2011 which were incurred in jurisdictions with rates higher than the effective rate. Also impacting the comparison of 2011 to 2010 were certain items that drove the 2010 rate higher including a charge of $588 million in 2010 related to the recall of COLLEAGUE infusion pumps from the U.S. market for which there was no net tax benefit recognized, a $39 million write-off of a deferred tax asset in 2010 as a result of a change in the tax treatment of reimbursements under the Medicare Part D retiree prescription drug subsidy program under healthcare reform legislation enacted in the United States, and $34 million of business development charges in 2010 for which the tax benefit was lower than the U.S. statutory rate.

Uncertain Tax Positions

Baxter expects to reduce the amount of its liability for uncertain tax positions within the next 12 months by $299 million due principally to the resolution of certain multi-jurisdictional transfer pricing issues and the resolution of tax contingencies in certain foreign jurisdictions. 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

Net income attributable to Baxter was $2.3 billion in 2012, $2.2 billion in 2011 and $1.4 billion in 2010. The corresponding net earnings per diluted share were $4.18 in 2012, $3.88 in 2011 and $2.39 in 2010. The significant factors and events causing the net changes from 2011 to 2012 and from 2010 to 2011 are discussed above. Additionally, net income attributable to Baxter per diluted share was positively impacted by the repurchase of 25 million shares in 2012 and 30 million shares in both 2011 and 2010. Refer to Note 10 for further information regarding the company s stock repurchases.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows from Operations

Cash flows from operations totaled $3.1 billion in 2012, $2.8 billion in 2011 and $3.0 billion in 2010. The increase in cash flows in 2012 from 2011 was primarily due to the factors discussed below and was partially

Table of Contents

offset by lower earnings (before non-cash items and adjustments). Other non-cash items and adjustments of $42 million in 2012 included non-cash gains of $91 million from the reduction of certain contingent payment liabilities from prior acquisitions. Also included in other non-cash items and adjustments in 2012 was $113 million in R&D charges associated with upfront payments made for the execution of 2012 collaboration agreements, which have been included in cash flows from investing activities. The decrease in cash flows in 2011 compared to 2010 was primarily due to the factors discussed below and was partially offset by higher earnings (before non-cash items and adjustments).

Accounts Receivable

Cash flows relating to accounts receivable increased during 2012 and decreased during 2011. Days sales outstanding were 53.3 days, 53.5 days and 52.5 days for 2012, 2011 and 2010, respectively. The decrease in 2012 was due to collections of certain past due balances in Europe, partially offset by longer collection periods in the United States and the unfavorable impact of foreign currency. The increase in 2011 was primarily due to longer collection periods in certain international markets and the geographic mix of sales.

Inventories

Cash outflows for inventories decreased in 2012 and increased in 2011. The following is a summary of inventories at December 31, 2012 and 2011, as well as inventory turns by segment for 2012, 2011 and 2010. Inventory turns for the year are calculated as the annualized fourth quarter cost of sales divided by the year-end inventory balance.

	Inventories		Inventory turns		
(in millions, except inventory turn data)	**2012**	2011	**2012**	2011	2010
BioScience	**$ 1,745**	$ 1,627	**1.48**	1.52	1.90
Medical Products	**1,058**	1,001	**4.25**	4.52	4.85
Total company	**$ 2,803**	$ 2,628	**2.52**	2.66	3.04

The increase in inventories in 2012 was principally due to higher levels of plasma protein-related inventories in the BioScience segment to replenish and build inventory for future growth, as well as higher inventories of SIGMA Spectrum infusion pumps and additional inventory levels related to Baxa operations in the Medical Products segment.

Inventory turns for the total company in 2012 were unfavorably impacted by the increase in inventories and the lower business optimization charge recorded in cost of sales in 2012 as compared to 2011. Of the total charge, $62 million was recorded in cost of sales in 2012 compared to $95 million in 2011. The business optimization charges in 2012 and 2011 impacted inventory turns by 0.09 and 0.15, respectively. The lower inventory turns for the total company in 2011 were driven by the increase in inventories and the impact of the lower 2011 business optimization charge recorded in cost of sales in 2011 as compared to 2010. Refer to Note 6 for further information regarding these charges.

Other

Payments related to the execution of the COLLEAGUE infusion pump recall and the company s business optimization initiatives increased $237 million in 2011 and decreased $64 million in 2012 as the company completed its recall activities in the United States in July 2012. Refer to Note 6 for further information regarding the COLLEAGUE infusion pump recall and the business optimization initiatives.

Cash flows from operations were favorably impacted by $138 million from changes in other balance sheet items during 2012, compared to $8 million during 2011. This change was principally due to the impact of a discretionary cash contribution of $150 million to the company s pension plan in the United States in 2011. Cash contributions to the company s pension plans totaled $78 million, $251 million and $416 million in 2012, 2011

Table of Contents

and 2010, respectively, and included discretionary cash contributions to the company s U.S. pension plan of $150 million and $350 million in 2011 and 2010, respectively.

Cash Flows from Investing Activities

Capital Expenditures

Capital expenditures totaled $1.2 billion in 2012, $960 million in 2011 and $963 million in 2010. The company s investments in capital expenditures in 2012 were primarily driven by additional investments in support of new and existing product capacity expansions in the BioScience segment. The company also invested in projects that enhance the company s cost structure and manufacturing capabilities and support the company s strategy of geographic expansion with select investments in growing markets.

In April 2012, the company announced the selection of a site in Covington, Georgia for a new manufacturing facility to support longer-term growth of the company s plasma-based treatments. Construction of the facility began in August 2012, and the facility is expected to start commercial production in 2018. Baxter plans to invest more than $1 billion over the next five years in the facility.

In addition, the company continues to invest to support an ongoing strategic focus on R&D with the expansion of facilities, pilot manufacturing sites and laboratories. Capital expenditures also included the company s multi-year initiative to implement a global enterprise resource planning system designed to consolidate and standardize business processes, data and systems.

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 $1.7 billion in capital expenditures in 2013, with the increase primarily driven by expected capital expenditures related to the construction of the facility in Covington, Georgia, and Gambro-related expenditures.

Acquisitions and Investments

Net cash outflows related to acquisitions and investments were $515 million in 2012, $590 million in 2011 and $319 million in 2010. Cash outflows in 2012 included $304 million associated with the acquisition of Synovis, $19 million related to the acquisition of Laboratoire Fasonut, and $50 million for an investment in the preferred stock of Onconova. Also included in cash outflows related to acquisitions and investments in 2012 were upfront payments of $113 million made to execute collaboration agreements during the period. Refer to Note 4 for further information about these acquisitions and investments.

The cash outflows in 2011 principally included $360 million related to the acquisition of Baxa (which excludes a working capital adjustment received in 2012) and $170 million associated with the acquisition of Prism, as well as an $18 million payment to exercise an option related to the company s collaboration agreement for the development of a home HD machine. Also included in cash outflows in 2011 were $18 million related to an investment in the common stock of Enobia Pharma Corporation (Enobia) and a $10 million payment related to the arrangement with Ceremed, Inc. Refer to Note 4 for further information about the Baxa and Prism acquisitions and Note 8 for further information about the investment in Enobia.

The cash outflows in 2010 principally included $235 million related to the acquisition of ApaTech. Also included in net cash outflows in 2010 were payments of $30 million related to the licensing and acquisition of hemophilia-related intellectual property and other assets from Archemix Corp., $28 million related to a manufacturing, supply and distribution agreement with Kamada Ltd. for GLASSIA [Alpha1-Proteinase Inhibitor (Human)] (for treatment of hereditary emphysema), and $18 million related to the company s collaboration agreement for the development of a home HD machine.

Table of Contents

Divestitures and Other Investing Activities

Net cash inflows relating to divestitures and other investing activities were $107 million in 2012, $123 million in 2011 and $18 million in 2010. Cash inflows in 2012 primarily related to proceeds of $59 million from the sale and maturity of available-for-sale securities (including the sale of Greek government bonds) and $19 million from the sale of the common stock of Enobia.

Cash inflows in 2011 principally consisted of proceeds associated with the company s divestiture of its U.S. multi-source generic injectables business in May 2011. Cash inflows in 2010 principally consisted of proceeds from the divestiture of certain Renal Therapy Services centers in Australia.

Cash Flows from Financing Activities

Debt Issuances, Net of Payments of Obligations

Net cash inflows related to debt and other financing obligations were $765 million in 2012, $733 million in 2011, and $91 million in 2010. Net cash inflows in 2012 primarily related to the issuance of $1.0 billion of senior notes in August 2012, partially offset by the repayment of outstanding commercial paper, as further described in Note 7.

In August 2012, the company issued $1.0 billion of senior notes, with $700 million maturing in August 2022 and bearing a 2.40% coupon rate, and $300 million maturing in August 2042 and bearing a 3.65% coupon rate. The net proceeds of the debt issuance are being used for general corporate purposes, which includes capital expenditures associated with previously announced plans to expand capacity to support longer-term growth of the company s plasma-based treatments, including with respect to the Covington, Georgia facility.

In December 2011, the company issued $500 million of senior notes, maturing in January 2017 and bearing a 1.85% coupon rate. In addition, during 2011, the company issued and redeemed commercial paper, of which $250 million was outstanding as of December 31, 2011, with a weighted-average interest rate of 0.24%. In March 2010, the company issued $600 million of senior notes, with $300 million maturing in March 2013 and bearing a 1.8% coupon rate and $300 million maturing in March 2020 and bearing a 4.25% coupon rate. The net proceeds from these issuances were used for general corporate purposes, including in some cases the refinancing of indebtedness.

In 2010, the company repaid $500 million of its 4.75% notes and settled related cross-currency swaps, both upon their maturity in October 2010, resulting in a cash outflow of $545 million.

The company s debt instruments discussed above are unsecured and include certain covenants, including restrictions relating to the company s creation of secured debt.

Other Financing Activities

Cash dividend payments totaled $804 million in 2012, $709 million in 2011 and $688 million in 2010. In November 2012, the board of directors declared a quarterly dividend of $0.45 per share ($1.80 per share on an annualized basis), which was paid on January 3, 2013 to shareholders of record as of December 7, 2012. In July 2012, the board of directors declared a quarterly dividend of $0.45 per share ($1.80 per share on an annualized basis), which represented an increase of 34% over the previous quarterly rate. In November 2011, the board of directors declared a quarterly dividend of $0.335 per share ($1.34 per share on an annualized basis), which represented an increase of 8% over the previous quarterly rate.

Proceeds and realized excess tax benefits from stock issued under employee benefit plans totaled $512 million, $448 million and $381 million in 2012, 2011 and 2010, respectively. The increase in 2012 was mainly due to increases in stock option exercises and the weighted-average exercise price. In 2011, an increase in stock option exercises and the weighted-average exercise price was partially offset by a decrease in realized excess tax benefits. Realized excess tax benefits, which were $24 million in 2012, $21 million in 2011 and $41 million in

Table of Contents

2010, are presented in the consolidated statements of cash flows as an outflow in the operating section and an inflow in the financing section.

As authorized by the board of directors, the company repurchases its stock depending on the company s cash flows, net debt level and market conditions. The company repurchased 25 million shares for $1.5 billion in 2012, 30 million shares for $1.6 billion in 2011 and 30 million shares for $1.5 billion in 2010. In December 2010, the board of directors authorized the repurchase of up to $2.5 billion of the company s common stock, which was fully utilized as of December 31, 2012. In July 2012, the board of directors authorized the repurchase of up to an additional $2.0 billion of the company s common stock and $1.9 billion remained available as of December 31, 2012. The company expects to incur significant debt in 2013 related to the planned acquisition of Gambro and, as a result, stock repurchases in 2013 are expected to decline from 2012 and 2011 levels.

Also included in financing activities in 2012 was a payment of $90 million for the exercise of the SIGMA purchase option. Refer to Note 2 for additional information.

Credit Facilities, Access to Capital and Credit Ratings

Credit Facilities

The company s primary revolving credit facility has a maximum capacity of $1.5 billion and matures in June 2015. The company also maintains a Euro-denominated credit facility with a maximum capacity of approximately $389 million at December 31, 2012. In 2012, the company amended this facility to extend the maturity date to October 2013. As of December 31, 2012 and 2011, there were no outstanding borrowings under either of these facilities. The company s facilities enable the company to borrow funds on an unsecured basis at variable interest rates (determined, in part, by the company s credit ratings) and contain various covenants, including a maximum net-debt-to-capital ratio. At December 31, 2012, 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.

In January 2013, Baxter entered into an agreement related to a 364-day bridge loan facility with a maximum capacity of $3.1 billion in connection with the planned acquisition of Gambro. The terms of the bridge loan facility are substantially similar to the terms of the company s primary revolving credit facility. The company intends to finance the transaction with off-shore cash and the issuance of at least $3.0 billion of debt. The company does not anticipate utilizing the bridge loan facility.

The company also maintains other credit arrangements, as described in Note 7.

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. The company had $3.3 billion of cash and equivalents at December 31, 2012, with adequate cash available to meet operating requirements in each jurisdiction in which the company operates. 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 plans to issue at least $3.0 billion of debt during the first half of 2013 to fund the planned acquisition of Gambro, which will significantly increase the company s outstanding debt.

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 to issue debt, enter into other financing arrangements and attract long-term capital on acceptable terms to support the company s growth objectives.

Table of Contents

The company continues to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, that have experienced a deterioration in credit and economic conditions. As of December 31, 2012, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $385 million (of which $66 million related to Greece). The company s net accounts receivable from the public sector for the countries identified above decreased by $139 million during 2012 primarily as a result of the collection of certain past due receivables in Spain. While the economic downturn has not significantly impacted the company s ability to collect receivables, global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses.

With respect to the Greek government bonds, the company collected $17 million in December 2011 upon the maturity of the first tranche of the bonds. However, as a result of continued economic uncertainty and ongoing Greek government negotiations regarding the settlement terms for outstanding bonds, the company recorded an impairment charge of $41 million in 2011 to reduce the remaining Greek government bonds held by the company to estimated fair value. The estimated fair value of these bonds was calculated using a discounted cash flow model that incorporated observable inputs, including interest rate yields. In March 2012, the company s Greek government debt holdings were restructured into new Greek government bonds with a notional amount of $24 million ranging in maturity from 11 to 30 years, and European Financial Stability Facility (EFSF) bonds with a notional amount of $11 million maturing in one to two years. In the second quarter of 2012, the company sold all of its Greek government and EFSF bond holdings, from which the company received $14 million in proceeds. Refer to Note 8 for further information.

The company also previously recorded a charge of $28 million in 2010 to write down its accounts receivable in Greece principally as a result of the Greek government s announcement of a plan to convert certain past due receivables into non-interest bearing bonds with maturities of one to three years.

Credit Ratings

The company s credit ratings at December 31, 2012 were as follows.

	Standard & Poor s	Fitch	Moody s
Ratings			
Senior debt	A	A	A3
Short-term debt	A1	F1	P2
Outlook	Stable	Negative	Negative

In 2012, Standard & Poor s downgraded the company s senior debt ratings by one notch from A+ to A, and both Fitch and Moody s changed their outlook from Stable to Negative. These downgrades were a result of the company s December 2012 announcement of the proposed acquisition of Gambro and the plans to fund the acquisition with at least $3.0 billion of debt, which would significantly increase the company s debt level.

If Baxter s credit ratings or outlooks were to be further 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.

Table of Contents

Contractual Obligations

As of December 31, 2012, the company had contractual obligations, excluding accounts payable and accrued liabilities (other than the current portion of unrecognized tax benefits), 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	$ 27	$ 27	$	$	$
Long-term debt and capital lease obligations, including current maturities	5,757	323	1,205	1,276	2,953
Interest on short- and long-term debt and capital lease obligations[1]	1,984	210	372	274	1,128
Operating leases	816	181	274	210	151
Other long-term liabilities[2]	1,114		313	112	689
Purchase obligations[3]	1,455	744	542	150	19
Unrecognized tax benefits[4]	299	299			
Contractual obligations[5]	$ 11,452	$ 1,784	$ 2,706	$ 2,022	$ 4,940

[1] Interest payments on debt and capital lease obligations are calculated for future periods using interest rates in effect at the end of 2012. Projected interest payments include the related effects of interest rate 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, 2012. Refer to Note 7 and Note 8 for further discussion regarding the company s debt instruments and related interest rate agreements outstanding at December 31, 2012.

[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, litigation, foreign currency hedges, 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 $78 million, $251 million and $416 million to its defined benefit pension plans in 2012, 2011 and 2010, 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. The pension plan balance included in other long-term liabilities (and excluded from the table above) totaled $1.7 billion at December 31, 2012.

[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 $218 million at December 31, 2012 has been excluded from the table above.

[5] Excludes contingent liabilities, including contingent milestone payments of $1.5 billion associated with joint development and commercialization arrangements and contingent payments of $305 million associated with acquisitions, as well as the company s unfunded

commitment at December 31, 2012 of $37 million as a limited partner in an investment company. These amounts have been excluded from the contractual obligations above due to uncertainty regarding the timing and amount of future payments. Refer to Note 9 and Note 4 for additional information regarding these commitments.

Table of Contents

Off-Balance Sheet Arrangements

Baxter periodically enters into off-balance sheet arrangements. 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). For a discussion of the company s significant off-balance sheet arrangements, refer to Note 9 for information regarding joint development and commercialization arrangements and indemnifications, Note 8 regarding receivable securitizations and Note 13 regarding legal contingencies.

FINANCIAL INSTRUMENT MARKET RISK

The company operates on a global basis and is exposed to the risk that its earnings, cash flows and equity could be adversely impacted by fluctuations in 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 8 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, Colombian Peso, and Swedish Krona. 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 limit the company s ability to cost-effectively hedge these exposures.

The company may use 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, 2012 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. In December 2012, the company entered into option contracts with a total notional amount of $2.8 billion to hedge anticipated foreign currency cash outflows associated with the planned acquisition of Gambro. These contracts are not formally designated as hedges and mature in June 2013. Changes in the fair value of these contracts are recognized immediately in earnings and may be significant, subjecting the company s earnings to additional volatility.

Currency restrictions enacted in Venezuela require Baxter to obtain approval from the Venezuelan government to exchange Venezuelan Bolivars for U.S. Dollars and require 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. In 2010, the majority of the company s products imported into Venezuela were classified as essential goods and qualified for the 2.6 rate. Effective January 1, 2011, the Venezuelan government devalued the official currency for imported goods classified as essential to 4.3. Since 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 is the U.S. Dollar. The devaluation of the Venezuelan Bolivar and designation of Venezuela as highly inflationary did not have a material impact on the financial results of the company. As of December 31, 2012, the company s subsidiary in Venezuela had net assets of $35 million denominated in the Venezuelan Bolivar. In 2012, net sales in Venezuela represented less than 1% of Baxter s

Table of Contents

total net sales. Effective February 8, 2013, the Venezuelan government devalued the official exchange rate from 4.3 to 6.3, which is not expected to have a material impact on the financial results of the company.

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 and forward contracts outstanding at December 31, 2012, while not predictive in nature, indicated that if the U.S. Dollar uniformly weakened by 10% against all currencies, on a net-of-tax basis, the net asset balance of $37 million with respect to those contracts would increase by $10 million. A similar analysis performed with respect to option and forward contracts outstanding at December 31, 2011 indicated that, on a net-of-tax basis, the net asset balance of $32 million would decrease by $44 million, resulting in a net liability position.

The sensitivity analysis model recalculates the fair value of the foreign exchange option and forward contracts outstanding at December 31, 2012 by replacing the actual exchange rates at December 31, 2012 with exchange rates that are 10% weaker compared 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 32 basis-point increase in interest rates (approximately 10% of the company s weighted-average interest rate during 2012) affecting the company s financial instruments, including debt obligations and related derivatives, would have an immaterial effect on the company s 2012, 2011 and 2010 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 8, 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

Refer to Note 1 for information on changes in accounting standards.

Table of Contents

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 2012. 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. Refer to Note 1 for additional information regarding the company s accounting policy for revenue recognition, including the company s accounting for arrangements in which it commits to delivering multiple products or services to its customers.

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.

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 Other Postemployment Benefit (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 periodic 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).

Table of Contents

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 11. 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, 2012), the company used a discount rate of 3.95% and 4.00% to measure its benefit obligations for the pension plans and OPEB plan, respectively. These discount rates will be used in calculating the net periodic benefit cost for these plans for 2013. The company used a broad population of approximately 320 Aa-rated corporate bonds as of December 31, 2012 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 $52 million.

Return on Plan Assets Assumption

In measuring net periodic cost for 2012, the company used a long-term expected rate of return of 7.75% for the pension plans covering U.S. and Puerto Rico employees. For measuring the net periodic benefit cost for these plans for 2013, this assumption will decrease to 7.50%. 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 $18 million.

Table of Contents

Other Assumptions

The company used the RP 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 11 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 13 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, 2012, total legal liabilities were $113 million and total related receivables were $33 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 certain 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.

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

Table of Contents

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 results of operations and 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.

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 and consideration of market participant assumptions. 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 and assumptions can significantly affect the value of the intangible asset.

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.

Acquired IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset. 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.

R&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 and other indefinite-lived intangible assets are subject to impairment reviews annually, and whenever indicators of impairment exist. Intangible assets with definite lives 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

Table of Contents

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 primarily relate to awards of stock options, restricted stock units (RSUs), and performance share units (PSUs). The company uses the Black-Scholes model for estimating the fair value of stock options, and 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 fair value of RSUs is equal to the quoted price of the company s common stock on the date of grant. The company uses a Monte Carlo model for estimating the fair value of PSUs, and significant inputs include the risk-free rate, volatility of returns and correlation of returns. Refer to Note 10 for additional information.

CERTAIN REGULATORY MATTERS

In July 2010, FDA issued a final order regarding the recall of the company s COLLEAGUE infusion pumps then in use in the United States. The company substantially completed the recall in July 2012 and FDA closed the recall in November 2012.

In June 2010, the company received a Warning Letter from FDA in connection with an inspection of its Renal business s McGaw Park, Illinois headquarters facility. The Warning Letter pertains to the processes by which the company analyzes and addresses product complaints through corrective and preventative actions, and reports relevant information to FDA. The company is working with FDA to resolve this matter.

Please see Item 1A of this Annual Report on Form 10-K for additional discussion of regulatory matters and how they may impact the company.

FORWARD-LOOKING INFORMATION

This annual report includes forward-looking statements, including statements regarding accounting estimates and assumptions, litigation-related matters including outcomes, future regulatory filings and the company s R&D pipeline, strategic objectives, credit exposure to foreign governments, potential developments with respect to credit ratings, investment of foreign earnings, estimates of liabilities including those related to uncertain tax positions, contingent payments, future pension plan contributions, costs, discount rates and rates of return, the company s exposure to financial market volatility and foreign currency and interest rate risk, geographic expansion, business development activities, the pending Gambro acquisition, including its expected closing, financing and financial impact, future capital and R&D expenditures, including with respect to the Covington, Georgia facility, future stock repurchases and debt issuances, the impact of healthcare reform, the sufficiency of the company s facilities and financial flexibility, the adequacy of credit facilities, tax provisions and reserves, the effective tax rate in 2013, the impact on the company of recent tax legislation and all other statements that do not relate to historical facts. The statements are based on assumptions about many important factors, including:

- demand for and market acceptance risks for and competitive pressures related to new and existing products, such as ADVATE and plasma-based therapies (including Antibody Therapy), and other therapies;
- fluctuations in supply and demand and the pricing of plasma-based therapies;
- the impact of U.S. healthcare reform and other similar actions undertaken by foreign governments with respect to pricing, reimbursement, taxation and rebate policies;
- additional legislation, regulation and other governmental pressures in the United States or globally, which may affect pricing, reimbursement, taxation and rebate policies of government agencies and private payers or other elements of the company s business;
- future actions of third parties, including third-party payors, as healthcare reform and other similar measures are implemented in the United States and globally;

Table of Contents

the company s ability to identify business development and growth opportunities;

receipt of regulatory approvals and satisfaction of closing conditions related to the pending Gambro acquisition;

product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, sanctions, seizures, litigation, or declining sales;

future actions of FDA, EMA or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale or result in seizures, recalls, injunctions, monetary sanctions or criminal or civil liabilities;

fluctuations in foreign exchange and interest rates;

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 its business optimization and transformation initiatives;

the successful implementation of the company s global enterprise resource planning system;

the company s ability to realize the anticipated benefits from its joint product development and commercialization arrangements, including governmental collaborations;

changes in credit agency ratings;

the impact of global economic conditions on the company and its customers and suppliers, including foreign governments in certain countries in which the company operates; and

other factors identified elsewhere in this Annual Report on Form 10-K including those factors described in Item 1A 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.

Item 7A. ***Quantitative and Qualitative Disclosures About Market Risk.***

Incorporated by reference to the section entitled Financial Instrument Market Risk in Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Annual Report on Form 10-K.

Table of Contents

Item 8. ***Financial Statements and Supplementary Data.***

CONSOLIDATED BALANCE SHEETS

as of December 31 (in millions, except share information)		**2012**	2011
Current Assets	Cash and equivalents	**$ 3,270**	$ 2,905
	Accounts and other current receivables, net	**2,425**	2,420
	Inventories	**2,803**	2,628
	Short-term deferred income taxes	**344**	295
	Prepaid expenses and other	**418**	402
	Total current assets	**9,260**	8,650
Property, Plant and Equipment, Net		**6,098**	5,525
Other Assets	Goodwill	**2,502**	2,317
	Other intangible assets, net	**814**	826
	Other	**1,716**	1,755
	Total other assets	**5,032**	4,898
	Total assets	**$ 20,390**	$ 19,073
Current Liabilities	Short-term debt	**$ 27**	$ 256
	Current maturities of long-term debt and lease obligations	**323**	190
	Accounts payable and accrued liabilities	**4,409**	4,411
	Total current liabilities	**4,759**	4,857
Long-Term Debt and Lease Obligations		**5,580**	4,749
Other Long-Term Liabilities		**3,073**	2,639
Commitments and Contingencies			
Equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2012 and 2011	**683**	683
	Common stock in treasury, at cost, 137,281,399 shares in 2012 and 122,524,448 shares in 2011	**(7,592)**	(6,719)
	Additional contributed capital	**5,769**	5,783
	Retained earnings	**10,888**	9,429
	Accumulated other comprehensive loss	**(2,810)**	(2,591)
	Total Baxter International Inc. (Baxter) shareholders equity	**6,938**	6,585
	Noncontrolling interests	**40**	243
	Total equity	**6,978**	6,828
	Total liabilities and equity	**$ 20,390**	$ 19,073

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

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

years ended December 31 (in millions, except per share data)	**2012**	2011	2010
Net sales	**$ 14,190**	$ 13,893	$ 12,843
Cost of sales	**6,889**	6,847	6,885
Gross margin	**7,301**	7,046	5,958
Marketing and administrative expenses	**3,324**	3,154	2,907
Research and development expenses	**1,156**	946	915
Net interest expense	**87**	54	87
Other (income) expense, net	**(155)**	83	159
Income before income taxes	**2,889**	2,809	1,890
Income tax expense	**563**	553	463
Net income	**2,326**	2,256	1,427
Less: Net income attributable to noncontrolling interests		32	7
Net income attributable to Baxter	**$ 2,326**	$ 2,224	$ 1,420
Net income attributable to Baxter per common share			
Basic	**$ 4.22**	$ 3.91	$ 2.41
Diluted	**$ 4.18**	$ 3.88	$ 2.39
Weighted-average number of common shares outstanding			
Basic	**551**	569	590
Diluted	**556**	573	594

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

Table of Contents

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

years ended December 31 (in millions)	**2012**	2011	2010
Net income	**$ 2,326**	$ 2,256	$ 1,427
Other comprehensive loss, net of tax:			
Currency translation adjustments, net of tax expense (benefit) of $22 in 2012, ($12) in 2011 and ($5) in 2010	**(98)**	(205)	(342)
Pension and other employee benefits, net of tax benefit of ($1) in 2012, ($151) in 2011 and ($32) in 2010	**(111)**	(263)	(57)
Hedging activities, net of tax (benefit) expense of ($6) in 2012, $5 in 2011 and ($2) in 2010	**(7)**	5	(6)
Other, net of tax (benefit) expense of ($2) in 2012, $1 in 2011 and $2 in 2010	**(3)**	1	3
Total other comprehensive loss, net of tax	**(219)**	(462)	(402)
Comprehensive income	**2,107**	1,794	1,025
Less: Comprehensive income attributable to noncontrolling interests		22	6
Comprehensive income attributable to Baxter	**$ 2,107**	$ 1,772	$ 1,019

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

Table of Contents

CONSOLIDATED STATEMENTS OF CASH FLOWS

years ended December 31 (in millions) (brackets denote cash outflows)		2012	2011	2010
Cash Flows from Operations	Net income	**$ 2,326**	$ 2,256	$ 1,427
	Adjustments			
	Depreciation and amortization	**712**	670	685
	Deferred income taxes	**(17)**	172	76
	Stock compensation	**130**	119	120
	Realized excess tax benefits from stock issued under employee benefit plans	**(24)**	(21)	(41)
	Infusion pump charge			588
	Business optimization charges	**150**	192	257
	Asset impairment and other charges		182	140
	Pension settlement charges	**168**		
	Litigation-related charge			62
	Other	**(42)**	32	57
	Changes in balance sheet items			
	Accounts and other current receivables, net	**(41)**	(229)	(122)
	Inventories	**(129)**	(315)	20
	Accounts payable and accrued liabilities	**18**	98	26
	Infusion pump and business optimization payments	**(283)**	(347)	(110)
	Other	**138**	8	(182)
	Cash flows from operations	**3,106**	2,817	3,003
Cash Flows from Investing Activities	Capital expenditures (including additions to the pool of equipment placed with or leased to customers of $150 in 2012, $155 in 2011 and $112 in 2010)	**(1,161)**	(960)	(963)
	Acquisitions and investments	**(515)**	(590)	(319)
	Divestitures and other investing activities	**107**	123	18
	Cash flows from investing activities	**(1,569)**	(1,427)	(1,264)
Cash Flows from Financing Activities	Issuances of debt	**1,037**	506	658
	Payments of obligations	**(22)**	(23)	(567)
	(Decrease) increase in debt with original maturities of three months or less, net	**(250)**	250	
	Cash dividends on common stock	**(804)**	(709)	(688)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	**512**	448	381
	Purchases of treasury stock	**(1,480)**	(1,583)	(1,453)
	Other	**(108)**	(26)	(47)
	Cash flows from financing activities	**(1,115)**	(1,137)	(1,716)
Effect of Foreign Exchange Rate Changes on Cash and Equivalents		**(57)**	(33)	(124)
Increase (Decrease) in Cash and Equivalents		**365**	220	(101)
Cash and Equivalents at Beginning of Year		**2,905**	2,685	2,786

Cash and Equivalents at End of Year	**$ 3,270**	$ 2,905	$ 2,685
Other supplemental information			
Interest paid, net of portion capitalized	**$ 135**	$ 88	$ 112
Income taxes paid	**$ 415**	$ 357	$ 353

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

Table of Contents

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

as of and for the years ended December 31 (in millions)	**2012** **Shares**	**2012** **Amount**	2011 Shares	2011 Amount	2010 Shares	2010 Amount
Common Stock						
Balance, beginning and end of year	**683**	**$ 683**	683	$ 683	683	$ 683
Common Stock in Treasury						
Beginning of year	**123**	**(6,719)**	103	(5,655)	83	(4,741)
Purchases of common stock	**25**	**(1,480)**	30	(1,583)	30	(1,453)
Stock issued under employee benefit plans and other	**(11)**	**607**	(10)	519	(10)	539
End of year	**137**	**(7,592)**	123	(6,719)	103	(5,655)
Additional Contributed Capital						
Beginning of year		**5,783**		5,753		5,683
Stock issued under employee benefit plans and other		**17**		30		70
Exercise of SIGMA purchase option		**(31)**				
End of year		**5,769**		5,783		5,753
Retained Earnings						
Beginning of year		**9,429**		7,925		7,343
Net income attributable to Baxter		**2,326**		2,224		1,420
Dividends declared on common stock		**(866)**		(719)		(695)
Stock issued under employee benefit plans		**(1)**		(1)		(143)
End of year		**10,888**		9,429		7,925
Accumulated Other Comprehensive Loss						
Beginning of year		**(2,591)**		(2,139)		(1,777)
Other comprehensive loss attributable to Baxter		**(219)**		(452)		(362)
End of year		**(2,810)**		(2,591)		(2,139)
Total Baxter shareholders equity		**$ 6,938**		$ 6,585		$ 6,567
Noncontrolling Interests						
Beginning of year		**$ 243**		$ 229		$ 229
Elimination of SIGMA noncontrolling ownership interest		**(159)**				
Change in noncontrolling interests		**(44)**		14		
End of year		**$ 40**		$ 243		$ 229
Total equity		**$ 6,978**		$ 6,828		$ 6,796

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

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Baxter International Inc. (Baxter or the company), 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. The company operates in two segments, BioScience and Medical Products, which are described in Note 14.

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. During 2012, the company exercised its option to purchase the remaining equity of Sigma International General Medical Apparatus, LLC (SIGMA), which Baxter previously consolidated as the primary beneficiary of the VIE. The company did not enter into any new arrangements in which it determined that it was the primary beneficiary of a VIE, and there were no VIEs consolidated by the company as of December 31, 2012. Refer to Note 2 for additional information about the SIGMA option exercise.

Certain reclassifications have been made to conform the prior period consolidated financial statements to the current period presentation.

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 to gross sales to arrive at 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.

Table of Contents

Accounts Receivable and 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. The allowance for doubtful accounts was $127 million at December 31, 2012 and $128 million at December 31, 2011.

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)	**2012**	2011
Raw materials	**$ 765**	$ 596
Work in process	**898**	923
Finished goods	**1,140**	1,109
Inventories	**$ 2,803**	$ 2,628

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 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.

Property, Plant and Equipment, Net

as of December 31 (in millions)	**2012**	2011
Land	**$ 190**	$ 184
Buildings and leasehold improvements	**2,181**	2,099
Machinery and equipment	**6,691**	6,384
Equipment with customers	**1,295**	1,205
Construction in progress	**1,512**	1,101
Total property, plant and equipment, at cost	**11,869**	10,973
Accumulated depreciation and amortization	**(5,771)**	(5,448)
Property, plant and equipment (PP&E), net	**$ 6,098**	$ 5,525

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

Table of Contents

used for income tax purposes. Depreciation and amortization expense was $597 million in 2012, $572 million in 2011 and $592 million in 2010. Repairs and maintenance expense was $297 million in 2012, $269 million in 2011 and $254 million in 2010.

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. Subsequent changes to the fair value of contingent payments are recognized in earnings. 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 during the measurement period, which may be up to one year from the acquisition date.

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 and consideration of market participant assumptions. 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.

Acquired IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset. 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, subject to impairment reviews as discussed below. If the R&D project is abandoned, the indefinite-lived asset is charged to expense.

R&D acquired in transactions that are not business acquisitions is expensed immediately. 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.

Collaborative Arrangements

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 both 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 company s joint 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 upfront 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 inventories from the collaboration partner.

Table of Contents

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 upfront and milestone payments made 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 inventory 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 2012, 2011 and 2010. Payments to collaborative partners classified in R&D expenses were $138 million, $18 million and $52 million in 2012, 2011 and 2010, respectively. In 2012, the payments related primarily to upfront payments for the business development arrangements described in Note 4. In 2011 and 2010, the payments primarily related to the development of longer-acting forms of blood clotting proteins to treat hemophilia and a home hemodialysis (HD) device. Payments in 2010 also related to the development of tissue repair products under a collaboration agreement which was terminated in 2011.

Business Optimization Charges

The company records liabilities for costs associated with exit or disposal activities in the period in which the liability is incurred. Employee termination costs are primarily recorded when actions are probable and estimable. Costs for one-time termination benefits in which the employee is required to render service until termination in order to receive the benefits are recognized ratably over the future service period. Refer to the discussion below regarding the accounting for asset impairment charges.

Impairment Reviews

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. Additionally, Baxter has made and continues to make significant investments related to business development activities, which result in the acquisition of certain intangible assets and other long-lived assets. The company s ability to realize value from these investments is contingent on, among other things, regulatory approvals, market acceptance of these new or modified products, and realization of synergies associated with business acquisitions. The company may not be able to realize the expected returns from these investments, potentially resulting in asset impairments in the future.

Goodwill

Goodwill is not amortized, but is subject to an impairment review annually and whenever indicators of impairment exist. Goodwill would be impaired if the carrying amount of a reporting unit exceeded the fair value of that reporting unit, calculated as the present value of estimated 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. The implied fair value of goodwill is then determined by subtracting the fair value of all identifiable net assets other than goodwill from the fair value of the reporting unit, with an impairment charge recorded for the excess, if any, of carrying amount of goodwill over the implied fair value.

The company assesses goodwill for impairment based on its reporting units, which are the same as its operating segments, which are BioScience and Medical Products. As of December 31, 2012, the date of the company s annual impairment review, the fair values of the company s reporting units were substantially in excess of their carrying values. Baxter s market capitalization as of December 31, 2012 was approximately $36 billion.

Table of Contents

Intangible Assets Not Subject to Amortization

Indefinite-lived intangible assets, such as trademarks with indefinite lives and certain acquired IPR&D, are subject to an impairment review annually and whenever indicators of impairment exist. Indefinite-lived intangible assets would be impaired if the carrying amount of the asset exceeded the fair value of the asset.

Other Long-Lived Assets

The company reviews the carrying amounts of long-lived assets, other than goodwill and intangible assets not subject to amortization, for potential impairment when 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 is 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.

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 $265 million in 2012, $260 million in 2011 and $233 million in 2010 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 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.

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 (income) expense, net, and were not material in 2012, 2011 and 2010.

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.

Table of Contents

For each derivative instrument that is designated and effective as a cash flow hedge, the gain or loss on the derivative is accumulated in accumulated other comprehensive income (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 net sales, cost of sales, and net interest expense, and primarily related to forecasted third-party sales denominated in foreign currencies, 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 loss or gain 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 derivative instruments that are not designated as hedges, the change in fair value is recorded directly to other (income) 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.

Refer to the Foreign Currency and Interest Rate Risk Management section of Note 8 for further information regarding the company s derivative and hedging activities.

Changes in Accounting Standards

On January 1, 2012, the company adopted a new accounting standard which eliminated the company s previous election to present other comprehensive income within the consolidated statements of changes in equity, and provided the option to present the components of net income and other comprehensive income either as one continuous statement of comprehensive income or as two separate but consecutive statements. The standard is reflected in the company s consolidated statements of comprehensive income, presented as a separate consecutive statement to the consolidated statements of income, and was retrospectively applied to all prior periods presented.

NOTE 2

SUPPLEMENTAL FINANCIAL INFORMATION

Other Long-Term Assets

as of December 31 (in millions)	**2012**	2011
Deferred income taxes	**$ 1,156**	$ 1,123
Other long-term receivables	**154**	195
Other	**406**	437
Other long-term assets	**$ 1,716**	$ 1,755

57

Table of Contents

Accounts Payable and Accrued Liabilities

as of December 31 (in millions)	2012	2011
Accounts payable, principally trade	**$ 766**	$ 795
Income taxes payable	**451**	353
Deferred income taxes	**878**	738
Common stock dividends payable	**246**	188
Employee compensation and withholdings	**567**	517
Property, payroll and certain other taxes	**152**	150
Infusion pump reserves	**37**	202
Business optimization reserves	**151**	176
Accrued rebates	**291**	267
Other	**870**	1,025
Accounts payable and accrued liabilities	**$ 4,409**	$ 4,411

Other Long-Term Liabilities

as of December 31 (in millions)	2012	2011
Pension and other employee benefits	**$ 2,427**	$ 1,920
Litigation reserves	**32**	63
Infusion pump reserves	**90**	74
Business optimization reserves	**69**	