BAXTER INTERNATIONAL INC
Form 10-Q
November 01, 2012
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2012

¨ **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	60015-4625
(Address of principal executive offices)	(Zip Code)

224-948-2000
(Registrant s telephone number, including area code)

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 the registrant has submitted electronically and posted on its corporate Web site, 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 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 Exchange Act).

Yes ¨ Noþ

The number of shares of the registrant s Common Stock, par value $1.00 per share, outstanding as of October 26, 2012 was 549,377,920 shares.

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BAXTER INTERNATIONAL INC.

FORM 10-Q

For the quarterly period ended September 30, 2012

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Baxter International Inc.

Condensed Consolidated Statements of Income (unaudited)

(in millions, except per share data)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net sales	$3,477	$3,479	$10,437	$10,299
Cost of sales	1,667	1,708	5,041	5,018
Gross margin	1,810	1,771	5,396	5,281
Marketing and administrative expenses	743	787	2,284	2,268
Research and development expenses	290	239	865	692
Net interest expense	25	14	65	39
Other (income) expense, net	(14)	4	(133)	21
Income before income taxes	766	727	2,315	2,261
Income tax expense	183	149	483	477
Net income	583	578	1,832	1,784
Less: Net income attributable to noncontrolling interests		2		23
Net income attributable to Baxter International Inc. (Baxter)	$ 583	$ 576	$ 1,832	$ 1,761
Net income attributable to Baxter per common share				
Basic	$ 1.07	$ 1.02	$ 3.32	$ 3.08
Diluted	$ 1.06	$ 1.01	$ 3.29	$ 3.06
Weighted-average number of common shares outstanding				
Basic	548	566	552	571
Diluted	552	571	556	575
Cash dividends declared per common share	$ 0.45	$ 0.31	$ 1.12	$ 0.93

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

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Baxter International Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three months ended September 30,		Nine months ended September 30,	
	2012	2011	2012	2011
Net income	$583	$578	$1,832	$1,784
Other comprehensive income (loss), net of tax:				
Currency translation adjustments, net of tax expense (benefit) of $18 and ($35) for the three months ended September 30, 2012 and 2011, respectively, and $20 and $4 for the nine months ended September 30, 2012 and 2011, respectively	180	(321)	(41)	9
Pension and other employee benefits, net of tax expense of $18 and $16 for the three months ended September 30, 2012 and 2011, respectively, and $57 and $45 for the nine months ended September 30, 2012 and 2011, respectively	28	34	101	78
Hedging activities, net of tax (benefit) expense of ($10) and $3 for the three months ended September 30, 2012 and 2011, respectively, and ($10) and ($3) for the nine months ended September 30, 2012 and 2011, respectively	(18)	5	(17)	(3)
Other, net of tax benefit of ($1) for both the three months ended September 30, 2012 and 2011, and ($1) and ($2) for the nine months ended September 30, 2012 and 2011, respectively	(2)	(1)	(1)	(3)
Total other comprehensive income (loss), net of tax	188	(283)	42	81
Comprehensive income	771	295	1,874	1,865
Less: Comprehensive (loss) income attributable to noncontrolling interests		(4)		14
Comprehensive income attributable to Baxter	$771	$299	$1,874	$1,851

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

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Baxter International Inc.

Condensed Consolidated Balance Sheets (unaudited)

(in millions, except shares)

		September 30, 2012	December 31, 2011
Current assets	Cash and equivalents	$ 3,191	$ 2,905
	Accounts and other current receivables, net	2,324	2,420
	Inventories	2,831	2,628
	Prepaid expenses and other	759	697
	Total current assets	9,105	8,650
Property, plant and equipment, net		5,862	5,525
Other assets	Goodwill	2,498	2,317
	Other intangible assets, net	867	826
	Other	1,493	1,755
	Total other assets	4,858	4,898
Total assets		$19,825	$19,073
Current liabilities	Short-term debt	$ 16	$ 256
	Current maturities of long-term debt and lease obligations	317	190
	Accounts payable and accrued liabilities	4,125	4,411
	Total current liabilities	4,458	4,857
Long-term debt and lease obligations		5,614	4,749
Other long-term liabilities		2,563	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, 134,886,054 shares in 2012 and 122,524,448 shares in 2011	(7,421)	(6,719)
	Additional contributed capital	5,774	5,783
	Retained earnings	10,642	9,429
	Accumulated other comprehensive loss	(2,549)	(2,591)
	Total Baxter shareholders equity	7,129	6,585
	Noncontrolling interests	61	243
	Total equity	7,190	6,828
Total liabilities and equity		$19,825	$19,073

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

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Baxter International Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

		Nine months ended September 30,	
		2012	2011
Cash flows from operations	Net income	$1,832	$1,784
	Adjustments		
	Depreciation and amortization	534	503
	Deferred income taxes	197	218
	Stock compensation	97	94
	Realized excess tax benefits from stock issued under employee benefit plans	(14)	(17)
	Other	(47)	103
	Changes in balance sheet items		
	Accounts and other current receivables, net	72	(102)
	Inventories	(136)	(272)
	Accounts payable and accrued liabilities	(282)	(90)
	Infusion pump and business optimization payments	(226)	(258)
	Other, including pension contributions	134	(38)
	Cash flows from operations	2,161	1,925
Cash flows from investing activities	Capital expenditures	(762)	(643)
	Acquisitions and investments	(495)	(229)
	Divestiture and other investing activities	86	106
	Cash flows from investing activities	(1,171)	(766)
Cash flows from financing activities	Issuances of debt	1,022	4
	Payments of obligations	(18)	(9)
	(Decrease) increase in debt with original maturities of three months or less, net	(250)	75
	Cash dividends on common stock	(558)	(534)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	307	405
	Purchases of treasury stock	(1,065)	(1,413)
	Other	(102)	(20)
	Cash flows from financing activities	(664)	(1,492)
Effect of currency exchange rate changes on cash and equivalents		(40)	(14)
Increase (decrease) in cash and equivalents		286	(347)
Cash and equivalents at beginning of period		2,905	2,685
Cash and equivalents at end of period		$3,191	$2,338

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

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Baxter International Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

1. BASIS OF PRESENTATION

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States have been condensed or omitted. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the company s Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Annual Report).

In the opinion of management, the unaudited interim condensed consolidated financial statements reflect all adjustments necessary for a fair statement of the interim periods. All such adjustments, unless otherwise noted herein, are of a normal, recurring nature. The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year.

The unaudited interim condensed consolidated financial statements include the accounts of variable interest entities (VIEs) in which Baxter is the primary beneficiary. In the second quarter of 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 September 30, 2012. Refer to Note 4 for additional information about the SIGMA option exercise and the 2011 Annual Report for further information about VIEs previously consolidated by the company.

2. SUPPLEMENTAL FINANCIAL INFORMATION

Net interest expense

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Interest expense, net of capitalized interest	$31	$23	$85	$67
Interest income	(6)	(9)	(20)	(28)
Net interest expense	$25	$14	$65	$39

Inventories

(in millions)	September 30, 2012	December 31, 2011
Raw materials	$ 693	$ 596
Work in process	963	923
Finished goods	1,175	1,109
Inventories	$2,831	$2,628

Property, plant and equipment, net

(in millions)	September 30, 2012	December 31, 2011
Property, plant and equipment, at cost	$11,539	$10,973

Accumulated depreciation and amortization	(5,677)	(5,448)
Property, plant and equipment (PP&E), net	$ 5,862	$ 5,525

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Sale of business

In May 2011, the company completed the divestiture of its U.S. multi-source generic injectables business to Hikma Pharmaceuticals PLC (Hikma). The consideration for the divestiture arrangement totaled $104 million, after closing-related adjustments. Hikma acquired Baxter s high-volume, multi-source generic injectable products in vials and ampoules, including chronic pain, anti-infective and anti-emetic products, along with a manufacturing facility located in Cherry Hill, New Jersey, and a warehouse and distribution center located in Memphis, Tennessee.

Net sales related to the U.S. multi-source generic injectables business, which were reported in the Medical Products segment prior to the divestiture, totaled $58 million in the first six months of 2011. Pre-tax earnings related to this business were not significant to Baxter s consolidated financial statements.

Asset impairments

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 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.

3. EARNINGS PER SHARE

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

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

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Basic shares	548	566	552	571
Effect of dilutive securities	4	5	4	4
Diluted shares	552	571	556	575

The effect of dilutive securities included unexercised stock options, unvested RSUs and contingently issuable shares related to unvested PSUs. The computation of diluted EPS excluded stock options to purchase 17 million and 18 million shares for the third quarters of 2012 and 2011, respectively, and 22 million and 18 million shares for the nine months ended September 30, 2012 and 2011, respectively, because their inclusion would have had an anti-dilutive effect on diluted EPS.

4. ACQUISITIONS AND INVESTMENTS

In the first nine months of 2012 and 2011, cash outflows related to acquisitions and investments totaled $495 million and $229 million, respectively. The company recorded charges related to business development activities of $128 million in the first nine months of 2012, which principally related to research and development (R&D) charges of $113 million associated with upfront payments made for the execution of collaboration agreements during the period, as discussed below. The upfront payments related to the collaboration agreements have been included in cash outflows related to acquisitions and investments for the first nine months of 2012, of which $58 million had previously been classified as cash flows from operations during the first half of the year.

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As of September 30, 2012, the company s consolidated balance sheet included contingent payment liabilities of $99 million related to acquisitions and investments. During the first nine months of 2012, the company recognized 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 7 for additional information.

Pro forma financial information has not been included because the acquisitions, individually and in the aggregate, did not have a material impact on the company s financial position or results of operations.

Onconova Therapeutics, Inc.

In September 2012, Baxter executed a licensing agreement with Onconova Therapeutics, Inc. (Onconova) for rigosertib, a novel targeted anti-cancer compound for the treatment of a group of rare hematologic malignancies called Myelodysplastic Syndromes, which is currently in a Phase III study, and pancreatic cancer, which is in a Phase II/III study. The agreement provides Baxter with commercialization rights for the compound in Europe. In the third quarter of 2012, Baxter recognized an R&D charge of $50 million related to an upfront cash payment associated with the execution of the agreement. Baxter may make additional payments of up to $515 million related to the achievement of pre-commercial development and regulatory milestones, in addition to future sales milestones and royalties.

In July 2012, Baxter acquired approximately 3 million shares of Onconova preferred stock for $50 million. Refer to Note 7 for additional information regarding this investment.

Chatham Therapeutics, LLC

In May 2012, Baxter executed an exclusive agreement with Chatham Therapeutics, LLC (Chatham), an affiliate of Asklepios BioPharmaceutical, Inc., for the development and commercialization of potential treatments for hemophilia B utilizing Chatham s gene therapy technology. Under the agreement, Baxter and Chatham will investigate Chatham s gene therapy technology through U.S.-based hemophilia B clinical trials and Baxter has global rights for the marketing and commercialization of new treatments. In the second quarter of 2012, Baxter recognized an R&D charge of $30 million related to upfront cash payments associated with the execution of the agreement. Baxter may make additional payments of up to $60 million over the next several years related to the achievement of development and commercial milestones. In addition, Baxter has certain responsibilities related to development and commercialization activities under the agreement.

SIGMA

In April 2012, the company exercised its option to purchase the remaining equity of SIGMA for a cash payment of $90 million. Since the 2009 acquisition of a 40% stake in SIGMA, the company has consolidated the financial statements of SIGMA, with the equity owned by existing SIGMA equity holders reported as noncontrolling interests. As a result, the exercise of the option was treated as an equity transaction and no additional assets were recognized by Baxter related to the additional ownership interest acquired. On the date of exercise, the carrying value of the noncontrolling interest was eliminated to reflect Baxter s change in ownership interest in SIGMA s equity and the carrying value of the call option was also eliminated. The exercise of the SIGMA purchase option had no direct impact on the company s results of operations, and the payment was classified as a financing activity on the consolidated statement of cash flows. Effective as of the date of the option exercise, 100% of SIGMA s pre-tax income has been reflected in the company s results of operations.

Refer to the 2011 Annual Report for further information regarding the company s 2009 agreement with SIGMA.

Momenta Pharmaceuticals, Inc.

In 2011, the company announced a global collaboration with Momenta Pharmaceuticals, Inc. (Momenta) to develop and commercialize follow-on biologic products, also known as biosimilars. Biosimilars replicate existing, branded biologics used in the treatment of a variety of diseases, including cancer, autoimmune disorders and other chronic conditions. In February 2012, Baxter made an upfront cash payment of $33 million to Momenta for the development of up to six follow-on compound products, which was recognized as an R&D charge. Baxter may make additional payments in excess of $100 million over the next several years contingent upon Baxter s exercise of options and the achievement of technical, development and regulatory milestones with respect to all six products. In addition, the arrangement includes specified funding by Baxter, as well as other responsibilities, relating to development and commercialization activities.

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Synovis Life Technologies, Inc.

In February 2012, the company acquired Synovis Life Technologies, Inc. (Synovis), a publicly-traded company which develops, manufactures and markets biological and mechanical products for soft tissue repair used in a variety of surgical procedures. Through the acquisition, Baxter has acquired product lines that primarily include medical devices used for soft tissue repair, including PERI-STRIPS DRY, TISSUE-GUARD and VERITAS Collagen Matrix. The addition of Synovis product lines complements and expands the portfolio of Baxter s regenerative medicine product line. Under the terms of the agreement, Baxter acquired Synovis shares at a price of $28 per common share outstanding. The total consideration, net of acquired cash, was $304 million.

The purchase price was allocated to other intangible assets of $115 million and other net assets of $28 million (including marketable securities of $45 million), with the purchase price in excess of net assets acquired of $161 million recorded as goodwill. Goodwill includes expected synergies and other benefits the company believes will result from the acquisition, including an expanded product portfolio and the impact of a larger sales force to support surgeons across a range of procedures. The goodwill is not deductible for tax purposes. The other intangible assets relate to developed technology and are being amortized on a straight-line basis over an estimated average useful life of 12 years.

The final allocation of the purchase price may result in an adjustment to the recognized amounts of assets and liabilities; however, no material adjustments are anticipated. The results of operations, assets and liabilities of Synovis are included in the BioScience segment, and the goodwill is also included in this reporting unit.

5. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Impairment tests for goodwill and intangible assets not subject to amortization are performed annually in the fourth quarter, or sooner if indicators of impairment exist. Intangible assets with finite useful lives are amortized on a straight-line basis over their estimated useful lives.

Goodwill

The following is a reconciliation of goodwill by business segment.

(in millions)	BioScience	Medical Products	Total
Balance as of December 31, 2011	$806	$1,511	$2,317
Additions	161	19	180
Currency translation and other adjustments	2	(1)	1
Balance as of September 30, 2012	$969	$1,529	$2,498

Goodwill additions in the first nine months of 2012 principally related to the first quarter acquisition of Synovis and an additional $19 million from the second quarter acquisition of the remaining equity of Laboratoire Fasonut, a privately-held French pharmaceutical company specializing in parenteral nutrition compounding for hospitals, in which Baxter had previously held a 20% equity interest. Refer to Note 4 for additional information regarding the Synovis acquisition. As of September 30, 2012, there were no accumulated goodwill impairment losses.

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Other intangible assets, net

The following is a summary of the company s intangible assets subject to amortization.

(in millions)	Developed technology, including patents	Other	Total
September 30, 2012			
Gross other intangible assets	$1,212	$281	$1,493
Accumulated amortization	(561)	(97)	(658)
Other intangible assets, net	$ 651	$184	$ 835
December 31, 2011			
Gross other intangible assets	$1,100	$276	$1,376
Accumulated amortization	(504)	(81)	(585)
Other intangible assets, net	$ 596	$195	$ 791

The amortization expense for these intangible assets was $26 million and $21 million in the three months ended September 30, 2012 and 2011, respectively, and $76 million and $58 million in the nine months ended September 30, 2012 and 2011, respectively. The anticipated annual amortization expense for intangible assets recorded as of September 30, 2012 is $102 million in 2012, $101 million in 2013, $98 million in 2014, $96 million in 2015, $93 million in 2016 and $75 million in 2017.

The increase in other intangible assets, net in the first nine months of 2012 was primarily related to the first quarter acquisition of Synovis. Refer to Note 4 for additional information regarding the Synovis acquisition.

Additionally, as of September 30, 2012 and December 31, 2011, the company had $32 million and $35 million, respectively, of intangible assets not subject to amortization, which included a trademark with an indefinite life and certain acquired in-process R&D associated with products that have not yet received regulatory approval.

6. INFUSION PUMP AND BUSINESS OPTIMIZATION CHARGES

Infusion pump charges

In July 2005, the company stopped shipment of COLLEAGUE infusion pumps in the United States. Following a number of Class I recalls relating to the performance of the pumps, as well as the seizure litigation described in Note 11, on July 13, 2010, the U.S. Food and Drug Administration (FDA) issued a final order requiring the company to recall its approximately 200,000 COLLEAGUE infusion pumps then in use in the U.S. market. Pursuant to the terms of the order, Baxter offered replacement infusion pumps or monetary consideration to owners of COLLEAGUE pumps and substantially completed the recall in July 2012.

In 2010, following the FDA s issuance of its initial order dated April 30, 2010, the company recorded a charge of $588 million in connection with this recall and other actions the company is undertaking outside of the United States. Of the total charge, $213 million was recorded as a reduction of net sales and $375 million was recorded in cost of sales. The amount recorded in net sales principally related to estimated cash payments to customers. Prior to the charge recorded in 2010, from 2005 through 2009, the company recorded charges and other costs totaling $337 million related to its COLLEAGUE and SYNDEO infusion pumps. In aggregate, the total charges incurred from 2005 through 2011 included $716 million of cash costs and $209 million principally related to asset impairments. The asset impairments related to inventory, lease receivables and other assets relating to the recalled pumps. The reserve for cash costs principally included an estimate of cash refunds or replacement infusion pumps that were offered to current owners in exchange for their COLLEAGUE infusion pumps. Cash costs also included costs associated with the execution of the remediation and recall programs and customer accommodations.

During the second quarter of 2012, the company recognized an adjustment of $37 million in cost of sales to reduce the COLLEAGUE infusion pump reserves as the company substantially completed its recall activities in the United States. The company also further refined the original expectations for cash and non-cash activities related to the recall and recorded a $63 million adjustment to increase reserves for cash costs with a corresponding decrease to

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non-cash reserves, which had no impact on the results of operations. The net impact of these adjustments to the estimates of cash and non-cash activities was an increase in cash reserves of $26 million during the second quarter of 2012.

The following table summarizes cash activity in the company s COLLEAGUE and SYNDEO infusion pump reserves through September 30, 2012.

(in millions)	
Charges and adjustments in 2005 through 2011	$ 716
Utilization in 2005 through 2011	(440)
Reserves as of December 31, 2011	276
Utilization	(159)
Other	26
Reserves as of September 30, 2012	$ 143

The company expects that reserves for remediation activities in the United States will be substantially utilized by the end of 2012, with remaining reserves related to remediation activities outside of the United States continuing to be utilized beyond 2012. The company believes that the remaining infusion pump reserves are adequate. However, additional adjustments may be recorded in the future as the programs are completed.

It is possible that substantial additional cash and non-cash charges may be required in future periods based on new information, changes in estimates, the completion of the implementation of the COLLEAGUE recall in the United States, and other actions the company may be required to undertake in markets outside the United States. While the company continues to work to resolve the 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, or that sales of other products may not be adversely affected.

Business optimization charges

In 2011 and 2010, the company recorded charges of $192 million and $257 million, respectively, primarily related to costs associated with optimizing its overall cost structure on a global basis, as the company streamlines its international operations, rationalizes its manufacturing facilities and enhances its general and administrative infrastructure.

The company s total charges relating to business optimization initiatives since 2009 included cash costs of $409 million, principally pertaining to severance and other employee-related costs in Europe and the United States. Also included in total charges were asset impairments totaling $119 million, which related to fixed assets, inventory and other assets associated with discontinued products and projects.

Refer to the 2011 Annual Report for further information about these charges.

The following table summarizes cash activity in the reserves related to the company s business optimization initiatives.

(in millions)	
Charges in 2009 through 2011	$ 409
Utilization in 2009 through 2011	(183)
Currency translation adjustments (CTA)	(1)
Reserves as of December 31, 2011	225
Utilization	(67)
CTA	(3)
Reserves as of September 30, 2012	$ 155

The reserves are expected to be substantially utilized by the end of 2013. The company believes that these reserves are adequate. However, adjustments may be recorded in the future as the programs are completed.

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7. DEBT, FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Securitization arrangement

The following is a summary of the activity relating to the company s securitization arrangement in Japan.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Sold receivables at beginning of period	$ 154	$ 148	$ 160	$ 157
Proceeds from sales of receivables	161	155	461	443
Cash collections (remitted to the owners of the receivables)	(161)	(161)	(465)	(464)
Effect of currency exchange rate changes		7	(2)	13
Sold receivables at end of period	$ 154	$ 149	$ 154	$ 149

The net losses relating to the sales of receivables were immaterial for each period. Refer to the 2011 Annual Report for further information regarding the company s securitization agreements.

Significant debt issuances

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 will be used for general corporate purposes, including capital expenditures associated with previously announced plans to expand capacity to support longer-term growth of the company s plasma-based treatments.

Credit facilities and commercial paper

As of September 30, 2012 and December 31, 2011, there were no outstanding borrowings under the company s credit facilities. Refer to Note 6 to the company s consolidated financial statements in the 2011 Annual Report for further discussion of the company s credit facilities.

During the nine months ended September 30, 2012, the company had net cash outflows of $250 million related to the issuance and payoff of commercial paper. The company did not have any commercial paper outstanding as of September 30, 2012.

Concentrations of credit risk

The company invests excess cash in certificates of deposit or money market funds and diversifies the concentration of cash among different financial institutions. With respect to financial instruments, where appropriate, the company has diversified its selection of counterparties, and has arranged collateralization and master-netting agreements to minimize the risk of loss.

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 September 30, 2012, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $424 million (of which $69 million related to Greece).

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. Global economic conditions, governmental actions and customer-specific factors may require the company to re-evaluate the collectibility of its receivables and the company could potentially incur additional credit losses. These conditions may also impact the stability of the Euro.

Derivatives and hedging activities

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.

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

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

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

All derivative instruments are recognized as either assets or liabilities at fair value in the condensed 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.

Cash Flow Hedges

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

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 other comprehensive income (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 relate to forecasted third-party sales denominated in foreign currencies, forecasted intercompany sales denominated in foreign currencies, and anticipated issuances of debt, respectively.

The notional amounts of foreign exchange contracts were $1.5 billion as of both September 30, 2012 and December 31, 2011. The notional amounts of interest rate contracts outstanding were $250 million and $200 million as of September 30, 2012 and December 31, 2011, respectively. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions as of September 30, 2012 is 15 months.

Fair Value Hedges

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

The total notional amount of interest rate contracts designated as fair value hedges was $500 million as of September 30, 2012 and $675 million as of December 31, 2011.

Dedesignations

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

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the forecasted transactions are still probable of occurring are deferred and recognized consistent with the loss or income 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. In the first nine months of 2012 and 2011, the company terminated $175 million and $1.5 billion, respectively, of interest rate contracts that had been designated as fair value hedges, which resulted in net gains of $21 million and $95 million, respectively, that have been deferred and are being amortized as a reduction of net interest expense over the remaining term of the underlying debt. There were no hedge dedesignations in the first nine months of 2012 or 2011 resulting from changes in the company s assessment of the probability that the hedged forecasted transactions would occur.

Undesignated Derivative Instruments

The company uses forward contracts to hedge earnings from the effects of foreign exchange relating to certain of the company s intercompany and third-party receivables and payables denominated in a foreign currency. These derivative instruments are generally not formally designated as hedges, and the change in fair value, which substantially offsets the change in book value of the hedged items, is recorded directly to other (income) expense, net. The terms of these instruments generally do not exceed one month.

The total gross notional amount of undesignated derivative instruments was $336 million as of September 30, 2012 and $346 million as of December 31, 2011.

Gains and Losses on Derivative Instruments

The following table summarizes the income statement locations and the gains and losses on the company s derivative instruments for the three months ended September 30, 2012 and 2011.

(in millions)	Gain (loss) recognized in OCI 2012	2011	Location of gain (loss) in income statement	Gain (loss) reclassified from AOCI into income 2012	2011
Cash flow hedges					
Interest rate contracts	$ (3)	$(8)	Net interest expense	$	$
Foreign exchange contracts	(1)	(1)	Net sales	(1)	
Foreign exchange contracts	(20)	7	Cost of sales	5	(10)
Total	$(24)	$(2)		$ 4	$(10)

(in millions)	Location of gain (loss) in income statement	Gain (loss) recognized in income 2012	2011
Fair value hedges			
Interest rate contracts	Net interest expense	$ 5	$ 53
Undesignated derivative instruments			
Foreign exchange contracts	Other (income) expense, net	$ (2)	$ 2

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The following table summarizes the income statement locations and gains and losses on the company s derivative instruments for the nine months ended September 30, 2012 and 2011.

(in millions)	Loss recognized in OCI 2012	Loss recognized in OCI 2011	Location of gain (loss) in income statement	Gain (loss) reclassified from AOCI into income 2012	Gain (loss) reclassified from AOCI into income 2011
Cash flow hedges					
Interest rate contracts	$(12)	$ (8)	Net interest expense	$	$
Foreign exchange contracts	(2)		Net sales	(2)	(1)
Foreign exchange contracts	(11)	(24)	Cost of sales	4	(25)
Total	$(25)	$(32)		$ 2	$(26)

(in millions)	Location of gain (loss) in income statement	Gain (loss) recognized in income 2012	Gain (loss) recognized in income 2011
Fair value hedges			
Interest rate contracts	Net interest expense	$ 15	$ 65
Undesignated derivative instruments			
Foreign exchange contracts	Other (income) expense, net	$(13)	$ (6)

For the company s fair value hedges, equal and offsetting losses of $5 million and $15 million were recognized in net interest expense in the third quarter and first nine months of 2012, respectively, and equal and offsetting losses of $53 million and $65 million were recognized in net interest expense in the third quarter and first nine months of 2011, respectively, as adjustments to the underlying hedged item, fixed-rate debt. Ineffectiveness related to the company s cash flow and fair value hedges for the nine months ended September 30, 2012 was not material.

As of September 30, 2012, $9 million of deferred, net after-tax losses on derivative instruments included in AOCI are expected to be recognized in earnings during the next 12 months, coinciding with when the hedged items are expected to impact earnings.

Fair Values of Derivative Instruments

The following table summarizes the classification and fair values of derivative instruments reported in the condensed consolidated balance sheet as of September 30, 2012.

(in millions)	Derivatives in asset positions Balance sheet location	Derivatives in asset positions Fair value	Derivatives in liability positions Balance sheet location	Derivatives in liability positions Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$23
Interest rate contracts	Other long-term assets	72	Other long-term liabilities	
Foreign exchange contracts	Prepaid expenses and other	22	Accounts payable and accrued liabilities	9
Foreign exchange contracts	Other long-term assets	2	Other long-term liabilities	1
Total derivative instruments designated as hedges		$96		$33
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$	Accounts payable	$ 1

		and accrued liabilities
Total derivative instruments	$96	$34

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The following table summarizes the classification and fair values of derivative instruments reported in the condensed consolidated balance sheet as of December 31, 2011.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Other long-term assets	$ 77	Other long-term liabilities	$11
Foreign exchange contracts	Prepaid expenses and other	54	Accounts payable and accrued liabilities	3
Foreign exchange contracts	Other long-term assets	1	Other long-term liabilities	
Total derivative instruments designated as hedges		$132		$14
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$ 1
Total derivative instruments		$132		$15

Fair value measurements

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

		Basis of fair value measurement		
(in millions)	Balance as of September 30, 2012	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 24	$	$ 24	$
Interest rate hedges	72		72	
Available-for-sale securities				
Equity securities	17	17		
Municipal securities	4		4	
Corporate bonds	7		7	
Preferred stock	52			52
Foreign government debt securities	16		16	
Total assets	$192	$17	$123	$ 52
Liabilities				
Foreign currency hedges	$ 11	$	$ 11	$
Interest rate hedges	23		23	
Contingent payments related to acquisitions and investments	99			99
Total liabilities	$133	$	$ 34	$ 99

Basis of fair value measurement

(in millions)	Balance as of December 31, 2011	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 55	$	$ 55	$
Interest rate hedges	77		77	
Available-for-sale securities				
Equity securities	21	21		
Total assets	$153	$21	$132	$
Liabilities				
Foreign currency hedges	$ 4	$	$ 4	$
Interest rate hedges	11		11	
Contingent payments related to acquisitions and investments	234			234
Total liabilities	$249	$	$ 15	$234

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The majority of the

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derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments. The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs are considered observable and vary depending on the type of derivative, and include contractual terms, interest rate yield curves, foreign exchange rates and volatility. The fair values of municipal securities, corporate bonds, and foreign government debt securities are obtained from pricing services or broker/dealers who use proprietary pricing applications, which include observable market information for like or same securities. The preferred stock is valued based upon recent transactions, as well as the financial information of the investee. The contingent payments are valued using a discounted cash flow technique that reflects management s expectations about probability of payment, which can range from 0 to 100 percent. Significant increases or decreases in the probability of payment would result in an increase or decrease, respectively, in the fair value.

At September 30, 2012, the company held available-for-sale equity securities that had an amortized cost basis and fair value of $13 million and $17 million, respectively, with $4 million of cumulative unrealized gains. At December 31, 2011, the amortized cost basis and fair value of the available-for-sale equity securities was $14 million and $21 million, respectively, with $7 million in cumulative unrealized gains.

In July 2012, Baxter acquired approximately 3 million shares of Onconova preferred stock for $50 million. The preferred stock included a redemption right for Baxter and the company has classified the investment as an available-for-sale debt security.

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 first quarter of 2012, the company recorded a loss of $5 million in other (income) expense, net related to the write-down of the fair value of the original Greek government bonds of $21 million to the fair value of the new bonds of $16 million. 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 and recognized a realized loss of $3 million in other (income) expense, net. Refer to the 2011 Annual Report and below for more information on the company s Greek debt holdings.

In February 2012, as a result of the company s acquisition of Synovis, the company acquired marketable securities, which included municipal securities, corporate bonds, and U.S. government agency issues, which have been classified as available-for-sale, with primarily all of these securities maturing within one year. The amortized cost and fair value of the marketable securities as of September 30, 2012 was approximately $11 million. The company received proceeds of $34 million from the maturity of certain of these securities in the first nine months of 2012.

At September 30, 2012, the cumulative unrealized gains for the company s available-for-sale debt securities were $1 million.

The following table is a reconciliation of the fair value measurements that use significant unobservable inputs (Level 3), which consist of contingent payments related to acquisitions and investments and preferred stock.

(in millions)	Contingent payments	Preferred stock
Fair value as of December 31, 2011	$ 234	$
Purchases		50
Payments	(35)	
Gains recognized in earnings	(100)	
CTA		2
Fair value as of September 30, 2012	$ 99	$52

The company s payments related to milestones associated with the SIGMA agreement in the first half of 2012. As discussed in Note 4, the gains recognized in earnings included $53 million in the first quarter of 2012 and $38 million in the second quarter of 2012 related to the reduction of the contingent payment liabilities for certain milestones associated with the 2011 acquisition of Prism and the 2010 acquisition of ApaTech, respectively. Both gains were reported in other (income) expense, net. The contingent liabilities were reduced based on updated information indicating that the probability of achieving certain milestones was lower than previously expected. The company also evaluated the long-lived assets (including other intangible assets) related to both the Prism and ApaTech acquisitions for impairment and, based on projections of undiscounted cash flows, the company determined that no impairment existed.

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Book Values and Fair Values of Financial Instruments

In addition to the financial instruments that the company is required to recognize at fair value on the condensed consolidated balance sheets, the company has certain financial instruments that are recognized at historical cost or some basis other than fair value. For these financial instruments, the following table provides the values recognized on the condensed consolidated balance sheets and the approximate fair values as of September 30, 2012 and December 31, 2011.

	Book values		Approximate fair values	
(in millions)	2012	2011	2012	2011
Assets				
Long-term insurance receivables	$ 4	$ 15	$ 4	$ 15
Investments	37	85	39	94
Liabilities				
Short-term debt	16	256	16	256
Current maturities of long-term debt and lease obligations	317	190	320	190
Long-term debt and lease obligations	5,614	4,749	6,308	5,312
Long-term litigation liabilities	31	63	31	62

The following table summarizes the bases used to measure the approximate fair value of the financial instruments as of September 30, 2012.

		Basis of fair value measurement		
(in millions)	Balance as of September 30, 2012	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Long-term insurance receivables	$ 4	$	$ 4	$
Investments	39		17	22
Total assets	$ 43	$	$ 21	$22
Liabilities				
Short-term debt	$ 16	$	$ 16	$
Current maturities of long-term debt and lease obligations	320		320	
Long-term debt and lease obligations	6,308		6,308	
Long-term litigation liabilities	31		31	
Total liabilities	$6,675	$	$6,675	$

The estimated fair values of long-term insurance receivables and long-term litigation liabilities were computed by discounting the expected cash flows based on currently available information, which in many cases does not include final orders or settlement agreements. The discount factors used in the calculations reflect the non-performance risk of the insurance providers and the company, respectively.

Investments in 2012 principally included certain cost method investments and held-to-maturity debt securities. The decrease in investments in the first nine months of 2012 primarily related to the first quarter 2012 restructuring of the company s Greek government bonds and subsequent classification as available-for-sale, as discussed above, and the sale of the company s common stock investment in Enobia Pharma Corporation (Enobia), which the company originally purchased in 2011.

Investments in 2011 principally included held-to-maturity debt securities, as well as certain cost method investments. In the third quarter of 2011, Baxter made an $18 million investment in Enobia, which was classified as a cost method investment. In the first quarter of 2011, certain past due receivables with the Greek government were converted into non-interest bearing bonds with maturities of one to three years. The fair

value of these bonds, which were classified as held-to-maturity, was calculated using a discounted cash flow model that incorporated observable inputs, including interest rate yields.

Refer to the 2011 Annual Report for more information on the Greek government s settlement plan.

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The fair value of held-to-maturity debt securities is calculated using a discounted cash flow model that incorporates observable inputs, including interest rate yields, which represents a Level 2 basis of fair value measurement. In determining the fair value of cost method investments, the company takes into consideration recent transactions, as well as the financial information of the investee, which represents a Level 3 basis of fair value measurement.

The estimated fair values of current and long-term debt were computed by multiplying price by the notional amount of the respective debt instrument. Price is calculated using the stated terms of the respective debt instrument and yield curves commensurate with the company s credit risk.

8. SHAREHOLDERS EQUITY

Stock-based compensation

Stock compensation expense totaled $34 million and $33 million for the three months ended September 30, 2012 and 2011, respectively, and $97 million and $94 million for the nine months ended September 30, 2012 and 2011, respectively. Over 70% of stock compensation expense is classified in marketing and administrative expenses with the remainder classified in cost of sales and R&D expenses.

In March 2012, the company awarded its annual stock compensation grants, which consisted of 5.9 million stock options, 866,000 RSUs and 415,000 PSUs. Stock compensation grants made in the second and third quarters of 2012 were not material.

Stock Options

The fair value of stock options is determined using the Black-Scholes model. Effective with the March 2012 stock compensation grant, the company s expected volatility assumption is based on a weighted-average of the historical volatility of Baxter s stock and the implied volatility from traded options on Baxter s stock, with historical volatility more heavily weighted.

The weighted-average assumptions used in estimating the fair value of stock options granted during the period, along with the weighted-average grant-date fair values, were as follows.

	Nine months ended September 30,	
	2012	2011
Expected volatility	25%	25%
Expected life (in years)	5.5	5.0
Risk-free interest rate	1.0%	2.2%
Dividend yield	2.3%	2.3%
Fair value per stock option	$10	$10

The total intrinsic value of stock options exercised was $34 million and $23 million during the third quarters of 2012 and 2011, respectively, and $67 million and $85 million during the nine months ended September 30, 2012 and 2011, respectively.

As of September 30, 2012, the unrecognized compensation cost related to all unvested stock options of $68 million is expected to be recognized as expense over a weighted-average period of 1.9 years.

Restricted Stock and Performance Share Units

The fair value of RSUs is determined based on the quoted price of the company s common stock on the date of the grant. As of September 30, 2012, the unrecognized compensation cost related to all unvested RSUs of $69 million is expected to be recognized as expense over a weighted-average period of 2.4 years.

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The fair value of PSUs is determined using a Monte Carlo model. The assumptions used in estimating the fair value of PSUs granted during the period, along with the grant-date fair values, were as follows.

	Nine months ended September 30,			
	2012		2011	
Baxter volatility	24%		28%	
Peer group volatility	14%	50%	19%	55%
Correlation of returns	0.26	0.54	0.29	0.61
Risk-free interest rate	0.4%		1.2%	
Fair value per PSU	$72		$62	

As of September 30, 2012, the unrecognized compensation cost related to all unvested PSUs of $29 million is expected to be recognized as expense over a weighted-average period of 1.8 years.

Dividends

Cash dividend payments totaled $558 million and $534 million in the first nine months of 2012 and 2011, respectively. The increase in cash dividend payments between periods was primarily due to the November 2011 increase of 8% in the quarterly dividend rate, partially offset by the impact of a lower number of common shares outstanding as a result of the company s stock repurchase program. In July 2012, the board of directors declared a quarterly dividend of $0.45 per share, which was paid on October 1, 2012 to shareholders of record on September 7, 2012. This dividend represented an increase of approximately 34% over the previous quarterly rate.

Stock repurchases

As authorized by the board of directors, the company repurchases its stock depending upon the company s cash flows, net debt level and market conditions. In July 2012, the board of directors approved a new share repurchase authorization of up to $2.0 billion of the company s common stock. No repurchases have been made under this authorization as of September 30, 2012. During the three- and nine-month periods ended September 30, 2012, the company repurchased 1.9 million shares and 18.9 million shares for $105 million and $1.1 billion, respectively, under the December 2010 $2.5 billion share repurchase authorization. As of September 30, 2012, $348 million remained available under the December 2010 authorization.

9. RETIREMENT AND OTHER BENEFIT PROGRAMS

The following is a summary of net periodic benefit cost relating to the company s pension and other postemployment benefit (OPEB) plans.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Pension benefits				
Service cost	$ 28	$ 28	$ 83	$ 84
Interest cost	58	60	176	178
Expected return on plan assets	(72)	(76)	(216)	(228)
Amortization of net losses and other deferred amounts	52	44	156	132
Net periodic pension benefit cost	$ 66	$ 56	$ 199	$ 166
OPEB				
Service cost	$ 2	$ 2	$ 5	$ 5
Interest cost	8	7	22	21
Amortization of net loss and prior service credit	1	(1)	5	(2)
Net periodic OPEB cost	$ 11	$ 8	$ 32	$ 24

In the first quarter of 2011, the company made a discretionary cash contribution to its pension plan in the United States totaling $150 million.

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On August 31, 2012, Baxter announced an offer to terminated-vested participants in the U.S. pension plan (approximately 16,000 participants) to pay a lump-sum payment which would fully settle the company s pension plan obligation to these participants. Eligible participants have until mid-November 2012 to accept the offer and payments are expected to be made in December 2012. Any settlement charge associated with the offer is expected to be recognized during the fourth quarter of 2012 upon payout to electing participants. The settlement charge will be dependent upon the final acceptance rate by eligible participants and other factors contributing to the re-measurement of U.S. pension plan assets and obligations, including discount rate. The company estimates that it could incur a settlement charge of up to $400 million in the company s results of operations, with a maximum payout of up to $820 million from plan assets, in the fourth quarter of 2012.

10. INCOME TAXES

The company s effective income tax rate was 23.9% and 20.5% in the third quarters of 2012 and 2011, respectively, and 20.9% and 21.1% in the nine-month periods ended September 30, 2012 and 2011, respectively. The company s effective income 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, the effective income tax rate can be impacted each period by discrete factors and events.

The increase in the effective income tax rate in the three-month period ended September 30, 2012 was due to a change in the earnings mix from lower to higher tax rate jurisdictions compared to the prior year period and a nonrecurring tax benefit from the third quarter 2011 charge of $79 million related to the resolution of litigation pertaining to average wholesale prices (AWP) and certain rebate and discount adjustments related to historical price reporting submissions.

The decrease in the effective income tax rate in the nine-month period ended September 30, 2012 was principally due to 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 and ApaTech, respectively, for which there was no tax charge. Also contributing to the decrease in effective income tax rate was a cost of sales reduction of $37 million in the second quarter of 2012 for an adjustment to the COLLEAGUE infusion pumps reserves as the company substantially completed the recall in the United States, for which there was no tax charge. The factors identified above were partially offset by the impact of a change in the earnings mix from lower to higher tax rate jurisdictions compared to the prior year period and a nonrecurring prior year tax benefit from the third quarter 2011 charge of $79 million, as described above.

11. LEGAL PROCEEDINGS

Baxter is involved in product liability, patent, commercial, and other legal matters that arise in the normal course of the company s business. The company records a liability when a loss is considered probable and the amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded. As of September 30, 2012, the company s total recorded reserves with respect to legal matters were $124 million and the total related receivables were $36 million.

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

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

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Patent litigation

Hemodialysis Litigation

Since April 2003, Baxter has been pursuing a patent infringement action against Fresenius Medical Care Holdings, Inc. for infringement of certain Baxter patents. The patents cover Fresenius 2008K hemodialysis instrument. In 2007, the court entered judgment in Baxter s favor holding the patents valid and infringed, and a jury assessed damages at $14 million for past sales only. In April 2008, the U.S.D.C. for the Northern District of California granted Baxter s motion for permanent injunction, granted Baxter s request for royalties on Fresenius sales of the 2008K hemodialysis machines during a nine-month transition period before the permanent injunction took effect, and granted a royalty on disposables. In September 2009, the appellate court affirmed Fresenius liability for infringing valid claims of Baxter s main patent, invalidated certain claims of other patents, and remanded the case to the district court to finalize the scope of the injunction and the amount of damages owed to Baxter. After a hearing in December 2011, the district court entered an order in March 2012 awarding Baxter $9.3 million in royalties, which are in addition to the past damages and interest of $20 million owed by Fresenius to Baxter. In March 2010, the United States Patent and Trademark Office s (USPTO) appellate board affirmed the previous determination by the USPTO patent examiner that the remaining patent was invalid. The board denied a request for reconsideration and the company has appealed the USPTO s decision to the same appellate court that affirmed the validity of the patent in September 2009. The appellate hearing was held in February 2012 and the court affirmed the USPTO s rejection. Baxter s petition for a rehearing was denied.

Product liability litigation

Heparin Litigation

In connection with the recall of heparin products in the United States, approximately 400 lawsuits are pending alleging that plaintiffs suffered various reactions to a heparin contaminant, in some cases resulting in fatalities. In June 2008, a number of the federal cases related to this matter were consolidated in the U.S.D.C. for the Northern District of Ohio for pretrial case management under the Multi District Litigation rules. In September 2008, a number of state court cases were consolidated in Cook County, Illinois for pretrial case management. In June 2011, the first of the state court cases resulted in a verdict in favor of the plaintiffs with an award of $625,000 in compensatory damages. In July 2011, the federal court ruled in Baxter s favor on certain motions for summary judgment. As of October 2012, the majority of the cases related to this matter have either been settled or dismissed.

General litigation

Baxter is a defendant in a number of suits alleging that certain of the company s current and former executive officers and its board of directors failed to adequately oversee the operations of the company and issued materially false and misleading statements regarding the company s plasma-based therapies business, the company s remediation of its COLLEAGUE infusion pumps, its heparin product, and other quality issues. Plaintiffs allege this action damaged the company and its shareholders by resulting in a decline in stock price in the second quarter of 2010, payment of excess compensation to the board of directors and certain of the company s current and former executive officers, and other damage to the company. In September 2012, a federal court dismissed a consolidated derivative suit pending in the U.S.D.C. for the Northern District of Illinois, and in October 2012 the plaintiffs appealed this dismissal to the U.S. Court of Appeals for the Seventh Circuit. An action pending in the Circuit Court of Lake County, Illinois has been stayed pending the outcome of the federal action. In addition, a consolidated alleged class action is pending in the U.S.D.C. for the Northern District of Illinois against the company and certain of its current executive officers seeking to recover the lost value of investors stock. In January 2012, the court denied the company s motion to dismiss certain of the claims related to the class action suits. In April 2012, the court granted the company s motion to certify an appeal of that decision to the U.S. Court of Appeals for the Seventh Circuit, however that motion was denied by the appellate court in June 2012.

The company is a defendant, along with others, in a number of lawsuits consolidated for pretrial proceedings in the U.S.D.C. for the Northern District of Illinois alleging that Baxter and certain of its competitors conspired to restrict output and artificially increase the price of plasma-derived therapies since 2003. The complaints attempt to state a claim for class action relief and in some cases demand treble damages. In February 2011, the court denied the company s motion to dismiss certain of the claims and the parties are proceeding with discovery. In January 2012, the court granted the company s motion to dismiss certain federal claims brought by indirect purchasers. The trial court returned the remaining indirect purchaser claims to the court of original jurisdiction (U.S.D.C. for the Northern District of California) in August 2012.

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Other

In October 2005, the United States filed a complaint in the U.S.D.C. for the Northern District of Illinois to effect the seizure of COLLEAGUE and SYNDEO infusion pumps that were on hold in Northern Illinois. Customer-owned pumps were not affected. In June 2006, Baxter Healthcare Corporation entered into a Consent Decree for Condemnation and Permanent Injunction with the United States to resolve this seizure litigation. Pursuant to the Consent Decree, on July 13, 2010 the 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; however additional dialogue and agreement is required with the FDA to formally close the recall. Additional claims may be raised in connection with the COLLEAGUE matter by the United States or other third parties.

In March 2012, the company received a subpoena from the SEC requesting the production of documents and other records related to the company s accounting treatment, financial reporting and disclosures relating to the remediation and recall of the company s COLLEAGUE and SYNDEO infusion pumps. The company is fully cooperating with this investigation.

The company has received an inquiry from the U.S. Department of Justice and the SEC requesting that the company provide information about its business activities in a number of countries. The company is fully cooperating with the agencies and understands that this inquiry is part of a broader review of industry practices for compliance with the U.S. Foreign Corrupt Practices Act.

12. SEGMENT INFORMATION

Baxter s two segments, BioScience and Medical Products, are both strategic businesses that are managed separately because each business develops, manufactures and markets distinct products and services. The segments and a description of their products and services are as follows.

The **BioScience** business processes recombinant and plasma-based proteins to treat hemophilia and other bleeding disorders; plasma-based therapies to treat immune deficiencies, alpha-1 antitrypsin deficiency, burns and shock, and other chronic and acute blood-related conditions; products for regenerative medicine, such as biosurgery products; and 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, a home-based therapy, and also distributes products for hemodialysis, which is generally conducted in a hospital or clinic. In May 2011, the company divested its U.S. multi-source generic injectables business. Refer to Note 2 for further information regarding this divestiture.

Also included in the Medical Products business are revenues and costs related to the manufacturing, distribution and other transition agreements with Fenwal Inc. related to the 2007 divestiture of the Transfusion Therapies business. Post-divestiture revenues associated with these transition agreements, which had previously been reported at the corporate level (Corporate) and not allocated to a segment, totaled $12 million for both the third quarters of 2012 and 2011, and $27 million and $30 million in the first nine months of 2012 and 2011, respectively. The prior period segment presentation has been recast to conform to the current period presentation.

The company uses more than one measurement and multiple views of data to measure segment performance and to allocate resources to the segments. However, the dominant measurements are consistent with the company s condensed consolidated financial statements and, accordingly, are reported on the same basis in this report. The company evaluates the performance of its segments and allocates resources to them primarily based on pre-tax income along with cash flows and overall economic returns. Intersegment sales are generally accounted for at amounts comparable to sales to unaffiliated customers, and are eliminated in consolidation.

Certain items are maintained at Corporate and are not allocated to a segment. They primarily include most of the company s debt and cash and equivalents and related net interest expense, certain foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the

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majority of the foreign currency hedging activities, corporate headquarters costs, stock compensation expense, certain non-strategic investments and related income and expense, certain employee benefit plan costs, certain nonrecurring gains and losses, the AWP litigation and historical price reporting charge, deferred income taxes, and certain litigation liabilities and related receivables.

Included in the BioScience segment s pre-tax income in the first nine months of 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 milestones associated with the 2010 acquisition of ApaTech.

Included in the Medical Products segment s pre-tax income in the first nine months of 2012 was a gain of $53 million related to the reduction of a 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.

Financial information for the company s segments is as follows.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Net sales				
BioScience	$1,522	$1,517	$ 4,550	$ 4,478
Medical Products	1,955	1,962	5,887	5,821
Total net sales	$3,477	$3,479	$10,437	$10,299
Pre-tax income				
BioScience	$ 537	$ 584	$ 1,605	$ 1,784
Medical Products	388	403	1,214	1,158
Total pre-tax income from segments	$ 925	$ 987	$ 2,819	$ 2,942

The following is a reconciliation of segment pre-tax income to income before income taxes per the condensed consolidated statements of income.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2012	2011	2012	2011
Total pre-tax income from segments	$ 925	$ 987	$2,819	$2,942
Unallocated amounts				
Stock compensation	(34)	(33)	(97)	(94)
Net interest expense	(25)	(14)	(65)	(39)
Certain foreign currency fluctuations and hedging activities	13	(5)	33	(21)
AWP litigation and historical price reporting charge		(79)		(79)
Other Corporate items	(113)	(129)	(375)	(448)
Income before income taxes	$ 766	$ 727	$2,315	$2,261

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Refer to the company s Annual Report on Form 10-K for the year ended December 31, 2011 (2011 Annual Report) for management s discussion and analysis of the financial condition and results of operations of the company. The following is management s discussion and analysis of the financial condition and results of operations of the company for the three and nine months ended September 30, 2012.

RESULTS OF OPERATIONS

NET SALES

	Three months ended September 30,		Percent change		Nine months ended September 30,		Percent change	
(in millions)	2012	2011	At actual currency rates	At constant currency rates	2012	2011	At actual currency rates	At constant currency rates
BioScience	$1,522	$1,517	0%	5%	$ 4,550	$ 4,478	2%	5%
Medical Products	1,955	1,962	0%	4%	5,887	5,821	1%	4%
Total net sales	$3,477	$3,479	0%	5%	$10,437	$10,299	1%	4%

	Three months ended September 30,		Percent change		Nine months ended September 30,		Percent change	
(in millions)	2012	2011	At actual currency rates	At constant currency rates	2012	2011	At actual currency rates	At constant currency rates
International	$1,964	$2,076	(5%)	2%	$ 5,953	$ 6,056	(2%)	3%
United States	1,513	1,403	8%	8%	4,484	4,243	6%	6%
Total net sales	$3,477	$3,479	0%	5%	$10,437	$10,299	1%	4%

Foreign currency unfavorably impacted net sales by 5 and 3 percentage points in the third quarter and first nine months of 2012, respectively, primarily due to the strengthening of the U.S. Dollar relative to the Euro. Excluding the impact of foreign currency, total net sales growth was 5% and 4% in the third quarter and first nine months of 2012, respectively, primarily driven by improved sales volumes (demand). The recent acquisitions of Synovis Life Technologies, Inc. (Synovis) and Baxa Corporation (Baxa) contributed approximately 2 percentage points towards sales growth during both periods. These contributions were partially offset during the first nine months of 2012 by the divestiture of the U.S. multi-source generic injectables business in 2011, which unfavorably impacted sales growth by approximately 1 percentage point.

International sales, excluding the impact of foreign currency, increased by 2% and 3% during the three- and nine-month periods ended September 30, 2012, respectively, as sales growth in many countries in Latin America and Asia Pacific offset softness in mature European markets. Sales in the United States increased by 8% and 6% during the three- and nine-month periods ended September 30, 2012, respectively, driven by growth across several product categories in both segments.

The comparisons presented at constant currency rates reflect comparative local currency sales at the prior period 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 (generally accepted accounting principles) 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.

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BioScience

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

	Three months ended September 30,		Percent change		Nine months ended September 30,		Percent change	
(in millions)	2012	2011	At actual currency rates	At constant currency rates	2012	2011	At actual currency rates	At constant currency rates
Recombinants	$ 555	$ 552	1%	5%	$1,653	$1,634	1%	4%
Antibody Therapy	404	380	6%	9%	1,168	1,135	3%	5%
Plasma Proteins	337	372	(9%)	(4%)	1,017	1,043	(2%)	1%
Regenerative Medicine	165	143	15%	20%	493	430	15%	18%
Other	61	70	(13%)	0%	219	236	(7%)	0%
Total net sales	$1,522	$1,517	0%	5%	$4,550	$4,478	2%	5%

Net sales in the BioScience segment were flat during the three-month period ending September 30, 2012 and increased 2% during the nine-month period ending September 30, 2012 (including a 5 and 3 percentage point unfavorable impact from foreign currency in the three- and nine-month periods ending September 30, 2012, respectively). Excluding the impact of foreign currency, the principal drivers were the following:

In the Recombinants product category, sales growth in both periods was driven primarily by strong U.S. demand for the company s advanced recombinant therapy, ADVATE, partially offset by lower Australian tender sales.

In the Antibody Therapy product category, sales increased in both periods as a result of continued demand in the United States for the company s intravenous (IV) and subcutaneous immunoglobulin therapies, known as GAMMAGARD LIQUID [Immune Globulin Intravenous (Human)] (marketed as KIOVIG outside of the United States), the liquid formulation of the antibody replacement therapy. Also contributing to sales growth in both periods was the favorable impact from pricing benefits related to shifts in geographic mix as the company optimizes its global supply in light of the planned facility shutdown during the second half of 2012. Sales growth was partially offset in both periods by the return of a competitor to the market in 2012.

Sales in the Plasma Proteins product category were favorably impacted in both periods by stronger U.S. sales of FEIBA (an inhibitor bypass therapy), driven by increased demand, higher sales of alpha-1 products (for treatment of hereditary emphysema), and improved international sales of albumin. These impacts were more than offset during the third quarter of 2012, and partially offset during the first nine months of 2012, by lower tender sales of FEIBA and plasma-derived FVIII, primarily in Brazil and Europe.

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

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Medical Products

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

	Three months ended September 30,		Percent change		Nine months ended September 30,		Percent change	
(in millions)	2012	2011	At actual currency rates	At constant currency rates	2012	2011	At actual currency rates	At constant currency rates
Renal	$ 629	$ 646	(3%)	2%	$1,852	$1,866	(1%)	2%
Global Injectables	509	494	3%	7%	1,553	1,517	2%	4%
IV Therapies	479	453	6%	12%	1,430	1,333	7%	11%
Infusion Systems	186	222	(16%)	(14%)	603	666	(9%)	(8%)
Anesthesia	135	129	5%	9%	405	390	4%	6%
Other	17	18	(6%)	(11%)	44	49	(10%)	(12%)
Total net sales	$1,955	$1,962	0%	4%	$5,887	$5,821	1%	4%

Net sales in the Medical Products segment were flat during the three-month period ended September 30, 2012 and increased 1% during the nine-month period ended September 30, 2012 (including a 4 and 3 percentage point unfavorable impact from foreign currency in the three- and nine-month periods ended September 30, 2012, respectively). Excluding the impact of foreign currency, the principal drivers were the following:

In the Renal product category, the favorable impact of continued growth in the number of peritoneal dialysis patients in Asia, Latin America and the United States for both periods was partially offset by lower sales of hemodialysis products.

Sales growth in the Global Injectables product category for both periods was driven primarily by improved pricing in the United States on select injectable therapeutics, particularly cyclophosphamide (a generic oncology drug) and improved sales in the pharmaceutical partnering and pharmacy compounding businesses, in addition to the favorable contribution from the fourth quarter 2011 acquisition of Baxa. Partially offsetting this growth in the nine-month period ended September 30, 2012 was an unfavorable impact of 5 percentage points from the second quarter 2011 divestiture of the U.S. multi-source generic injectables business.

IV Therapies sales growth in both periods was driven primarily by strong sales of nutrition products, including the favorable impact of the Baxa acquisition, and an increase in demand for IV solutions, particularly in the United States.

In the Infusion Systems product category, sales declined in both periods due to lower global sales of access sets used in the administration of IV solutions and, during the third quarter of 2012, lower sales of Spectrum infusion pumps. Both of these impacts were related to COLLEAGUE infusion pump recall activities in the United States.

Sales growth in the Anesthesia product category for both periods was driven primarily by improved international growth from increased penetration of SUPRANE (desflurane) and generic sevoflurane, particularly in Europe and Asia.

The Other product category includes revenues of $12 million for both the third quarters of 2012 and 2011 and $27 million and $30 million for the nine-month periods ended September 30, 2012 and 2011, respectively, associated with 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.

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GROSS MARGIN AND EXPENSE RATIOS

	Three months ended September 30,			Nine months ended September 30,		
(as a percentage of net sales)	2012	2011	Change	2012	2011	Change
Gross margin	52.1%	50.9%	1.2 pts	51.7%	51.3%	0.4 pts
Marketing and administrative expenses	21.4%	22.6%	(1.2 pts)	21.9%	22.0%	(0.1 pts)

Gross Margin

The gross margin percentage for the nine-month period ended September 30, 2012 included a net benefit from reserve adjustments of $23 million primarily related to an adjustment to the COLLEAGUE infusion pump reserves as the company substantially completed the recall in the United States. The reserve adjustments favorably impacted the current year-to-date gross margin percentage by 0.2 percentage points. Refer to Note 6 for further information regarding the COLLEAGUE infusion pump reserves.

Additionally, the gross margin percentage improved in both periods as a result of sales growth in higher margin products in the BioScience segment, the favorable impact of foreign currency and the resolution of prior year manufacturing issues at the company s Castlebar, Ireland facility. The improved gross margin percentages for both periods were partially offset by margin dilution from business development activities, increased pension expense and austerity measures.

Marketing and Administrative Expenses

The marketing and administrative expense ratio in both the third quarter and first nine months of 2011 included the third quarter 2011 charge of $79 million related to the resolution of litigation pertaining to average wholesale prices (AWP) and certain rebate and discount adjustments related to historical price reporting submissions, which unfavorably impacted the marketing and administrative expense ratio by 2.2 and 0.7 percentage points for the third quarter and first nine months of 2011, respectively.

Excluding the impact of the AWP litigation and historical price reporting charge in 2011, the marketing and administrative expenses ratio for the three- and nine-month periods ended September 30, 2012 increased primarily due to incremental expenses from the operations of Baxa and Synovis, an increase in pension expense, increased spending on marketing and promotional programs, and, during the first nine months of 2012, acquisition-related expenses. The factors identified above were partially offset by the company s continued focus on controlling discretionary spending and savings from the company s business optimization initiatives.

RESEARCH AND DEVELOPMENT

	Three months ended September 30,			Nine months ended September 30,		
(in millions)	2012	2011	Percent change	2012	2011	Percent change
Research and development expenses	$ 290	$ 239	21%	$ 865	$ 692	25%
As a percentage of net sales	8.3%	6.9%		8.3%	6.7%	

Research and development (R&D) expenses increased in both periods, primarily due to the third quarter 2012 R&D charge of $50 million associated with the company s collaboration with Onconova Therapeutics, Inc. (Onconova), the second quarter 2012 R&D charge of $30 million associated with the company s collaboration with Chatham Therapeutics, LLC (Chatham) and the first quarter 2012 R&D charge of $33 million associated with the company s collaboration with Momenta Pharmaceuticals, Inc. (Momenta). Refer to Note 4 for further information regarding these collaborations.

Additionally, the company continues to invest in a number of R&D programs across the product pipeline, including a variety of earlier-stage initiatives, while also reaching certain milestone achievements resulting in additional R&D spending, particularly during the first nine months of 2012. Refer to the 2011 Annual Report for a discussion of the company s R&D pipeline.

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NET INTEREST EXPENSE

Net interest expense was $25 million and $14 million in the third quarters of 2012 and 2011, respectively, and $65 million and $39 million in the first nine months of 2012 and 2011, respectively. The increase during both periods was principally driven by the issuances of $500 million 1.85% senior unsecured notes in December 2011, $700 million 2.40% senior unsecured notes in August 2012, and $300 million 3.65% senior unsecured notes in August 2012, the termination of interest rate swap agreements, and lower interest income.

OTHER (INCOME) EXPENSE, NET

Other (income) expense, net was $14 million of income and $4 million of expense during the third quarters of 2012 and 2011, respectively, and $133 million of income and $21 million of expense during the first nine months of 2012 and 2011, respectively. Other (income) expense, net included gains of $53 million and $38 million related to the reduction of certain contingent payment liabilities associated with the prior acquisitions of Prism Pharmaceuticals, Inc. (Prism) and ApaTech Limited (ApaTech), respectively, during the first half of 2012. Additionally, other (income) expense, net included the benefit from a net loss attributable to noncontrolling interests of $24 million during the first nine months of 2012, which was prospectively classified as other (income) expense, net effective January 1, 2012.

Also included in other (income) expense, net were amounts related to foreign currency fluctuations, principally relating to intercompany receivables, payables and loans denominated in a foreign currency.

PRE-TAX INCOME

Refer to Note 12 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 8% and 10% in the third quarter and first nine months of 2012, respectively. Included in pre-tax income during the first nine months of 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 milestones associated with the 2010 acquisition of ApaTech.

Excluding the impact of the above items, pre-tax income was flat in the third quarter and declined in the first nine months of 2012. Contributing to the decrease in pre-tax income during the nine-month period was an additional increase in spending on R&D driven by funding of key programs and the achievement of certain milestones, spending on new marketing and promotional programs, and the unfavorable impact of foreign currency. These factors were partially offset by sales growth of certain higher margin products.

Medical Products

Pre-tax income decreased 4% in the third quarter of 2012 and increased 5% in the first nine months of 2012. Included in pre-tax income during the first nine months of 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.

Excluding the impact of the above items, pre-tax income during both periods declined compared to the prior periods due to increases in marketing and administrative expenses, the unfavorable impact of foreign currency, and in the nine-month period, increases in R&D spending. Partially offsetting these factors was the favorable impact of the resolution of prior year manufacturing issues at the company s Castlebar, Ireland facility.

Other

Certain items are maintained at the company s corporate level and are not allocated to the segments. These amounts are detailed in the table in Note 12 and primarily include most of the company s debt and cash and equivalents and related net interest expense, certain foreign currency fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the majority of the foreign currency hedging activities,

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corporate headquarters costs, stock compensation expense, certain non-strategic investments and related income and expense, certain employee benefit plan costs, certain nonrecurring gains and losses, the AWP litigation and historical price reporting charge, deferred income taxes, and certain litigation liabilities and related insurance receivables. Refer to Note 8 regarding stock compensation expense and the previous discussion for further information regarding net interest expense.

INCOME TAXES

The company s effective income tax rate was 23.9% and 20.5% in the third quarters of 2012 and 2011, respectively, and 20.9% and 21.1% in the nine-month periods ended September 30, 2012 and 2011, respectively. The company s effective income 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, the effective income tax rate can be impacted each period by discrete factors and events.

The increase in the effective income tax rate in the three-month period ended September 30, 2012 was due to a change in the earnings mix from lower to higher tax rate jurisdictions compared to the prior year period and a nonrecurring tax benefit from the third quarter 2011 charge of $79 million related to resolution of litigation pertaining to AWP and certain rebate and discount adjustments related to historical price reporting submissions.

The decrease in the effective income tax rate in the nine-month period ended September 30, 2012 was principally due to 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 and ApaTech, respectively, for which there was no tax charge. Also contributing to the decrease in the effective income tax rate was a cost of sales reduction of $37 million in the second quarter of 2012 for an adjustment to the COLLEAGUE infusion pumps reserves as the company substantially completed the recall in the United States, for which there was no tax charge. The factors identified above were partially offset by the impact of a change in the earnings mix from lower to higher tax rate jurisdictions compared to the prior year period and a nonrecurring prior year tax benefit from the third quarter 2011 charge of $79 million, as described above.

The company anticipates that the effective income tax rate for the full-year 2012 will be approximately 22%, excluding the impact of audit developments, discrete items and other special items.

INCOME AND EARNINGS PER DILUTED SHARE

Net income attributable to Baxter was $583 million and $576 million for the three months ended September 30, 2012 and 2011, respectively, and $1.8 billion for both nine-month periods ended September 30, 2012 and 2011. Net income attributable to Baxter per diluted share was $1.06 and $1.01 for the three months ended September 30, 2012 and 2011, respectively, and $3.29 and $3.06 for the nine months ended September 30, 2012 and 2011, respectively. The significant factors and events contributing to the changes are discussed above. Also, net income per diluted share was positively impacted by the repurchase of 1.9 million and 18.9 million shares during the three months and nine months ended September 30, 2012, respectively. Refer to Note 8 for further information regarding the company s stock repurchases.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

Cash flows from operations

Cash flows from operations increased during the first nine months of 2012 as compared to the prior year, totaling $2.2 billion in 2012 and $1.9 billion in 2011. The change in cash flows from operations was impacted by the factors discussed below, as well as the unfavorable impact of lower earnings (before non-cash items and adjustments). Other non-cash items and adjustments of $47 million in the first nine months of 2012 included 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 the first nine months of 2012 was $113 million in R&D charges associated with upfront payments made for the execution of collaboration agreements during the period, which have been included in cash flows from investing activities. The company had previously classified $58 million of these upfront payments as cash flows from operations during the first half of 2012.

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Accounts Receivable

Cash flows relating to accounts receivable increased during the first nine months of 2012 as compared to the prior year period primarily due to the collection of past due receivables from Spain and Portugal. Days sales outstanding increased to 57.0 days as of September 30, 2012 from 53.5 days as of December 31, 2011, primarily due to longer collection periods and an unfavorable impact of foreign currency, partially offset by collections of past due balances in Spain and Portugal during the first nine months of 2012.

Inventories

Cash outflows relating to inventories decreased in 2012 as compared to the prior year. The following is a summary of inventories as of September 30, 2012 and December 31, 2011, as well as annualized inventory turns for the third quarters of 2012 and 2011, by segment.

	Inventories		Annualized inventory turns for the three months ended September 30,	
(in millions, except inventory turn data)	September 30, 2012	December 31, 2011	2012	2011
BioScience	$1,745	$1,627	1.36	1.50
Medical Products	1,086	1,001	3.68	4.07
Total company	$2,831	$2,628	2.25	2.48

Inventory turns for the BioScience segment for the three months ended September 30, 2012 were unfavorably impacted by higher levels of plasma protein-related inventories to replenish and build inventory for future growth and the planned facility shutdown in the second half of 2012. Inventory turns for the Medical Products segment were unfavorably impacted by additional inventory levels related to the Baxa acquisition and higher Spectrum infusion pump inventories.

Other

Cash outflows related to accounts payable and accrued liabilities were $282 million in the first nine months of 2012 compared to $90 million in the first nine months of 2011, with the increase primarily driven by the timing of payments to certain suppliers and others, payroll timing and increased litigation-related payments.

Payments related to the execution of the COLLEAGUE infusion pump recall and the company s business optimization initiatives decreased from $258 million in the first nine months of 2011 to $226 million in the first nine months of 2012 as the company substantially 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 $134 million from changes in other balance sheet items during the nine months ended September 30, 2012, compared to an unfavorable impact of $38 million during the nine months ended September 30, 2011. This change was principally due to the impact of a discretionary cash contribution of $150 million in the first quarter of 2011 to the company s pension plan in the United States.

Cash flows from investing activities

Capital Expenditures

Capital expenditures increased by $119 million in the first nine months of 2012, from $643 million in 2011 to $762 million in 2012, with the increase primarily driven by additional investments in support of new and existing product capacity expansions in the BioScience segment. The company s investments in capital expenditures are focused on 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. The groundbreaking for construction on the facility began in August 2012, and the facility will 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 the company s 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 that will consolidate and standardize business processes, data and systems.

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Acquisitions and Investments

Cash outflows for acquisitions and investments of $495 million in the first nine months of 2012 included a cash outflow of $304 million associated with the first quarter acquisition of Synovis and the third quarter investment of $50 million in the preferred stock of Onconova. Refer to Note 4 for further information about the Synovis acquisition and the Onconova investment. Also included in cash outflows related to acquisitions and investments in the first nine months of 2012 were upfront payments of $113 million made to execute collaboration agreements during the period, as discussed in Note 4, of which $58 million had previously been classified in cash flows from operations during the first half of 2012.

Cash outflows in the first nine months of 2011 primarily related to a cash outflow of $170 million associated with the acquisition of Prism.

Divestiture and Other Investing Activities

Divestiture and other investing activities cash inflows of $86 million during the first nine months of 2012 primarily related to proceeds of $48 million from the sale and maturity of available-for-sale securities (including the sale of Greek government bonds in the second quarter of 2012) and $19 million from the sale of the common stock of Enobia Pharma Corporation in the first quarter of 2012.

Divestiture and other investing activities cash inflows during the first nine months of 2011 included $104 million of cash proceeds associated with the company s divestiture of its U.S. multi-source generic injectables business in the second quarter of 2011. Refer to Note 2 for further information about this divestiture.

Cash flows from financing activities

Debt Issuances, Net of Payments of Obligations

Net cash inflows related to debt and other financing obligations totaled $754 million in the first nine months of 2012 and 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. Net cash inflows related to debt and other financing obligations totaled $70 million in the first nine months of 2011.

Other Financing Activities

Cash dividend payments totaled $558 million and $534 million in the first nine months of 2012 and 2011, respectively. The increase in cash dividend payments between periods was primarily due to the November 2011 increase of 8% in the quarterly dividend rate, partially offset by the impact of a lower number of common shares outstanding as a result of the company s stock repurchase program. In July 2012, the board of directors declared a quarterly dividend of $0.45 per share, which was paid on October 1, 2012 to shareholders of record on September 7, 2012. This dividend represented an increase of approximately 34% over the previous quarterly rate.

Proceeds and realized excess tax benefits from stock issued under employee benefit plans decreased by $98 million, from $405 million in the first nine months of 2011 to $307 million in the first nine months of 2012, primarily due to a decrease in stock option exercises during the period.

Stock repurchases totaled $1.1 billion and $1.4 billion in the first nine months of 2012 and 2011, respectively. As authorized by the board of directors, the company repurchases its stock depending upon the company s cash flows, net debt level and market conditions. In December 2010, the board of directors authorized repurchases of up to $2.5 billion of the company s common stock. As of September 30, 2012, $348 million remained available under the December 2010 authorization. In July 2012, the board of directors approved a new share repurchase authorization of up to $2.0 billion of the company s common stock. No repurchases have been made under the July 2012 authorization as of September 30, 2012.

Also included in financing activities for the nine months of 2012 was a payment of $90 million for the exercise of the SIGMA purchase option in the second quarter of 2012. Refer to Note 4 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 $393 million as of September 30, 2012, which matures in January 2013. These facilities enable the company to borrow

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funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net-debt-to-capital ratio. As of September 30, 2012, the company was in compliance with the financial covenants in these agreements. There were no borrowings outstanding under either of the two outstanding facilities as of September 30, 2012. 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. Refer to Note 6 to the company s consolidated financial statements in the 2011 Annual Report for further discussion of the company s credit facilities.

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 $3.2 billion of cash and equivalents as of September 30, 2012. The company invests its excess cash in certificates of deposit and money market funds, and diversifies the concentration of cash among different financial institutions. While the company s cash positions fluctuate, a significant portion of the company s cash and equivalents is generally held in foreign jurisdictions. However, the company has adequate cash available to meet operating requirements in each jurisdiction in which the company operates.

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

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 September 30, 2012, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $424 million (of which $69 million related to Greece).

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. Global economic conditions, governmental actions and customer-specific factors may require the company to re-evaluate the collectibility of its receivables and the company could potentially incur additional credit losses. These conditions may also impact the stability of the Euro.

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 7 for further information.

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Credit ratings

There were no changes in the company s credit ratings in the first nine months of 2012. Refer to the 2011 Annual Report for further discussion of the company s credit ratings.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management 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 to the company s consolidated financial statements in the 2011 Annual Report. Certain of the company s accounting policies are considered critical, as these policies are the most important to the depiction of the company s financial statements and require significant, difficult or complex judgments, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in the Management s Discussion and Analysis of Financial Condition and Results of Operations section in the 2011 Annual Report. 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 the first nine months of 2012.

LEGAL CONTINGENCIES

Refer to Note 11 for a discussion of the company s legal contingencies. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established liabilities. While the liability of the company in connection with 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 that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

CERTAIN REGULATORY MATTERS

In July 2010, the U.S. Food and Drug Administration (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; however additional dialogue and agreement is required with the FDA to formally close the recall.

In June 2010, the company received a Warning Letter from the 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 the FDA. The company is working with the FDA to resolve this matter.

Please see Item 1A of the company s 2011 Annual Report on Form 10-K for additional discussion of regulatory matters.

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FORWARD-LOOKING INFORMATION

This quarterly report includes forward-looking statements, including statements with respect to accounting estimates and assumptions, litigation-related matters including outcomes, credit exposure to foreign governments, contingent payments, estimates of liabilities, the company s exposure to financial market volatility and foreign currency and interest rate risks, business development activities, future capital and R&D expenditures, the sufficiency of the company s financial flexibility, the adequacy of credit facilities and reserves, the company s lump-sum offer to settle certain U.S. pension obligations, the effective tax rate in 2012, and all other statements that do not relate to historical facts. The statements are based on assumptions about many important factors, including assumptions concerning:

- demand for and market acceptance risks 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 payers, as healthcare reform and other similar measures are implemented in the United States and globally;
- the company s ability to identify business development and growth opportunities;
- product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, sanctions, seizures, litigation, or declining sales;
- future actions of the FDA, the European Medicines Agency or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale of product or result in seizures, injunctions, monetary sanctions or criminal or civil liabilities;
- completion of the FDA s final July 2010 order to recall all of the company s COLLEAGUE infusion pumps in the United States as well as any additional actions required globally;
- 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;

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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, government collaborations, and other business development activities;

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 report and other filings with the Securities and Exchange Commission, including those factors described in Item 1A in the company s Form 10-K for the year ended December 31, 2011, 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.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Currency Risk

The company is primarily exposed to foreign exchange risk with respect to recognized assets and liabilities, forecasted transactions and net assets denominated in the Euro, Japanese Yen, British Pound, Australian Dollar, Canadian Dollar, Brazilian Real and Colombian Peso. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative financial instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and shareholders equity volatility relating to foreign exchange. Financial market and currency volatility may 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 as of September 30, 2012 is 15 months. The company also enters into derivative instruments to hedge certain intercompany and third-party receivables and payables and debt denominated in foreign currencies.

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. 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 September 30, 2012, the company s subsidiary in Venezuela had net assets of $33 million denominated in the Venezuelan Bolivar. In 2012, net sales in Venezuela represented less than 1% of Baxter s total net sales.

As part of its risk-management program, the company performs a sensitivity analysis 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 September 30, 2012, while not predictive in nature, indicated that if the U.S. Dollar uniformly fluctuated unfavorably by 10% against all currencies, on a net-of-tax basis, the net asset balance of $8 million would decrease by $50 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 September 30, 2012 by replacing the actual exchange rates at September 30, 2012 with exchange rates that are 10% unfavorable to the actual exchange rates for each applicable currency. All other factors are held constant. The sensitivity analysis disregards 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 analysis also disregards the offsetting change in value of the underlying hedged transactions and balances.

Interest Rate and Other Risks

Refer to the caption Interest Rate and Other Risks in the Financial Instrument Market Risk section of the company s 2011 Annual Report. There were no significant changes during the quarter ended September 30, 2012.

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Baxter carried out an evaluation, under the supervision and with the participation of its Disclosure Committee and management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Baxter s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of September 30, 2012. Based on that evaluation the Chief Executive Officer and Chief Financial Officer concluded that the company s disclosure controls and procedures were effective as of September 30, 2012.

Changes in Internal Control over Financial Reporting

In the second quarter of 2010, the company began the implementation of a new global enterprise resource planning system. In addition, the company is consolidating and outsourcing certain computer operations and application support activities. These multi-year initiatives will be conducted in phases and include modifications to the design and operation of controls over financial reporting. The company is testing internal controls over financial reporting for design effectiveness prior to implementation of each phase, and has monitoring controls in place over the implementation of these changes. There have been no other changes in Baxter s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2012 that have materially affected, or are reasonably likely to materially affect, Baxter s internal control over financial reporting.

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Review by Independent Registered Public Accounting Firm

A review of the interim condensed consolidated financial information included in this Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2012 and 2011 has been performed by PricewaterhouseCoopers LLP, the company s independent registered public accounting firm. Its report on the interim condensed consolidated financial information follows. This report is not considered a report within the meaning of Sections 7 and 11 of the Securities Act of 1933 and therefore, the independent accountants liability under Section 11 does not extend to it.

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Report of Independent Registered Public Accounting Firm

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

We have reviewed the accompanying condensed consolidated balance sheet of Baxter International Inc. and its subsidiaries as of September 30, 2012, and the related condensed consolidated statements of income for the three-month and nine-month periods ended September 30, 2012 and 2011, the condensed consolidated statements of comprehensive income for the three-month and nine-month periods ended September 30, 2012 and 2011 and the condensed consolidated statement of cash flows for the nine-month periods ended September 30, 2012 and 2011. These interim financial statements are the responsibility of the company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2011, and the related consolidated statements of income, of cash flows and of changes in equity and comprehensive income for the year then ended, and in our report dated February 23, 2012, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2011, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chicago, Illinois

November 1, 2012

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information in Part I, Item 1, Note 11 is incorporated herein by reference.

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Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table includes information about the company s common stock repurchases during the three-month period ended September 30, 2012.

Issuer Purchases of Equity Securities

Period	Total number of shares purchased(1)	Average price paid per share	Total number of shares purchased as part of publicly announced program(1)	Approximate dollar value of shares that may yet be purchased under the programs(1)(2)
July 1, 2012 through July 31, 2012	1,013,600	$54.21	1,013,600	
August 1, 2012 through August 31, 2012	535,600	$58.65	535,600	
September 1, 2012 through September 30, 2012	317,000	$58.63	317,000	
Total	1,866,200	$56.23	1,866,200	$2,348,073,612

(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 third quarter of 2012, the company repurchased 1.9 million shares for $105 million under this program. The remaining authorization under this program totaled approximately $348 million as of September 30, 2012. This program does not have an expiration date.

(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. No repurchases were made under this program during the third quarter of 2012. This program does not have an expiration date.

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Item 6. Exhibits

Exhibit Index:

Exhibit Number	Description
15	Letter Re Unaudited Interim Financial Information
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BAXTER INTERNATIONAL INC.
(Registrant)

Date: November 1, 2012

By: /s/ Robert J. Hombach
Robert J. Hombach
Corporate Vice President and Chief Financial Officer (duly authorized officer and principal financial officer)