

BOSTON SCIENTIFIC CORP  
Form 10-Q  
August 06, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended June 30, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

Commission File No. 1-11083

BOSTON SCIENTIFIC CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

04-2695240

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

300 BOSTON SCIENTIFIC WAY, MARLBOROUGH, MASSACHUSETTS 01752-1234

(Address of principal executive offices) (zip code)

(508) 683-4000

(Registrant's telephone number, including area code)

ONE BOSTON SCIENTIFIC PLACE, NATICK, MASSACHUSETTS 01760-1537

(Former name, former address and former fiscal year, if changed since last report)

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  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  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  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares outstanding as of July 31, 2014
Common Stock, \$.01 par value	1,325,707,830

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FINANCIAL INFORMATION

## ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

in millions, except per share data	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Net sales	\$1,873	\$1,809	\$3,647	\$3,570
Cost of products sold	563	530	1,100	1,108
Gross profit	1,310	1,279	2,547	2,462
Operating expenses:				
Selling, general and administrative expenses	743	661	1,409	1,292
Research and development expenses	206	223	397	427
Royalty expense	25	47	65	87
Amortization expense	109	101	218	204
Goodwill impairment charges	—	—	—	423
Intangible asset impairment charges	110	53	165	53
Contingent consideration expense (benefit)	(96 )	(18 )	(118 )	(41 )
Restructuring charges	15	26	35	36
Litigation-related charges (credits)	267	—	260	130
Gain on divestiture	—	(34 )	(12 )	(40 )
	1,379	1,059	2,419	2,571
Operating income (loss)	(69 )	220	128	(109 )
Other (expense) income:				
Interest expense	(53 )	(65 )	(108 )	(130 )
Other, net	18	(3 )	22	(3 )
Income (loss) before income taxes	(104 )	152	42	(242 )
Income tax expense (benefit)	(108 )	22	(95 )	(18 )
Net income (loss)	\$4	\$130	\$137	\$(224 )
Net income (loss) per common share — basic	\$0.00	\$0.10	\$0.10	\$(0.17 )
Net income (loss) per common share — assuming dilution	\$0.00	\$0.10	\$0.10	\$(0.17 )
Weighted-average shares outstanding				
Basic	1,323.2	1,343.5	1,322.4	1,347.7
Assuming dilution	1,345.0	1,358.6	1,347.1	1,347.7

See notes to the unaudited condensed consolidated financial statements.

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

(in millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013	June 30, 2014	2013
Net income (loss)	\$4	\$130	\$137	\$(224 )
Other comprehensive income (loss):				
Foreign currency translation adjustment	(2 )	(6 )	(8 )	(3 )
Net change in unrealized gains and losses on derivative financial instruments, net of tax	(28 )	43	(55 )	118
Net change in certain retirement plans	—	—	(1 )	—
Total other comprehensive income (loss)	(30 )	37	(64 )	115
Total comprehensive income (loss)	\$(26 )	\$167	\$73	\$(109 )

See notes to the unaudited condensed consolidated financial statements.

Table of ContentsBOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

in millions, except share and per share data	As of June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$357	\$217
Trade accounts receivable, net	1,287	1,307
Inventories	949	897
Deferred income taxes	320	288
Prepaid expenses and other current assets	301	302
Total current assets	3,214	3,011
Property, plant and equipment, net	1,534	1,546
Goodwill	5,735	5,693
Other intangible assets, net	5,659	5,950
Other long-term assets	335	371
<b>TOTAL ASSETS</b>	<b>\$16,477</b>	<b>\$16,571</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current debt obligations	\$3	\$3
Accounts payable	241	246
Accrued expenses	1,277	1,348
Other current liabilities	252	227
Total current liabilities	1,773	1,824
Long-term debt	4,252	4,237
Deferred income taxes	1,302	1,402
Other long-term liabilities	2,606	2,569
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$.01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, \$.01 par value - authorized 2,000,000,000 shares and issued 1,571,332,742 shares as of June 30, 2014 and 1,560,302,634 shares as of December 31, 2013	16	16
Treasury stock, at cost - 247,566,270 shares as of June 30, 2014 and 238,006,570 shares as of December 31, 2013	(1,717)	(1,592)
Additional paid-in capital	16,635	16,579
Accumulated deficit	(8,432)	(8,570)
Accumulated other comprehensive income (loss), net of tax	42	106
Total stockholders' equity	6,544	6,539
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$16,477</b>	<b>\$16,571</b>

See notes to the unaudited condensed consolidated financial statements.



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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

in millions	Six Months Ended June 30,	
	2014	2013
Cash provided by operating activities	\$483	\$584
Investing activities:		
Purchases of property, plant and equipment	(124	) (104
Proceeds from sale of property, plant and equipment	—	) 53
Purchases of privately held securities	(6	) (8
Purchase of notes receivable	(10	) (3
Proceeds from sales of publicly traded and privately held equity securities and collections of notes receivable	12	—
Payments for acquisitions of businesses, net of cash acquired	(72	) —
Payments for investments in companies and acquisitions of certain technologies	(1	) (7
Proceeds from business divestitures, net of costs	12	) 30
Cash used for investing activities	(189	) (39
Financing activities:		
Payment of contingent consideration	(15	) (15
Proceeds from borrowings on credit facilities	650	) 240
Payments on borrowings from credit facilities	(650	) (240
Payments for acquisitions of treasury stock	(125	) (200
Cash used to net share settle employee equity awards	(47	) (25
Proceeds from issuances of shares of common stock	33	) 19
Cash used for financing activities	(154	) (221
Effect of foreign exchange rates on cash	—	) (1
Net increase (decrease) in cash and cash equivalents	140	) 323
Cash and cash equivalents at beginning of period	217	) 207
Cash and cash equivalents at end of period	\$357	) \$530
Supplemental Information		
Non-cash operating activities:		
Stock-based compensation expense	\$53	) \$50
Fair value of contingent consideration recorded in purchase accounting	\$3	) \$—

See notes to the unaudited condensed consolidated financial statements.

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## NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

## NOTE A – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. For further information, refer to the consolidated financial statements and footnotes thereto included in Item 8 of our 2013 Annual Report on Form 10-K.

Additionally, certain prior year cash outflows from net share settling employee equity awards to satisfy their tax withholding requirement have been reclassified from an operating activity to a financing activity within our condensed consolidated statements of cash flows. Amounts reclassified from operating to financing activities on the cash flows were not material. In addition, we have reclassified certain other prior year amounts to conform to the current year presentation. Refer to Note L - Segment Reporting for more information.

## Subsequent Events

We evaluate events occurring after the date of our most recent accompanying unaudited condensed consolidated balance sheets for potential recognition or disclosure in our financial statements. We did not identify any material subsequent events requiring adjustment to our accompanying unaudited condensed consolidated financial statements (recognized subsequent events) for the three and six month periods ended June 30, 2014. Those items requiring disclosure (unrecognized subsequent events) in the financial statements have been disclosed accordingly. Refer to Note J - Commitments and Contingencies for more information.

## NOTE B – ACQUISITIONS

On May 7, 2014, we completed the acquisition of the remaining fully diluted equity of IoGyn, Inc. (IoGyn). Prior to the acquisition, we held approximately 28 percent minority interest in IoGyn in addition to notes receivable of approximately \$8 million. Total consideration was comprised of a net cash payment of \$65 million at closing to acquire the remaining 72 percent of IoGyn equity and repay outstanding debt. IoGyn has developed the Symphion™ System, a next generation system for hysteroscopic intrauterine tissue removal including fibroids (myomas) and polyps. In March 2014, IoGyn received U.S. FDA approval for the system, and we expect to launch the system in the United States in the second half of 2014. We will integrate the operations of the IoGyn business with our gynecological surgery business, which is part of our Urology and Women's Health division.

On May 15, 2014, we entered into a definitive agreement to acquire the Interventional Division of Bayer AG, for \$415 million in cash at closing. We expect to close this transaction in the second half of 2014, subject to customary closing conditions.

We did not close any material acquisitions during the first half of 2013.

## Purchase Price Allocation

We accounted for the acquisition of IoGyn as a business combination and, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification® (ASC) Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The components of the aggregate purchase price for the acquisition consummated in 2014 are as follows (in millions):

Cash, net of cash acquired	\$ 65
Fair value of prior interests	31
	\$ 96



We re-measured our previously held investments to their estimated acquisition-date fair value of \$31 million and recorded a gain of \$19 million in other, net, in the accompanying condensed consolidated statements of operations during the second quarter of 2014. We measured the fair values of the previously held investments based on the liquidation preferences and priority of the equity interests and debt, including accrued interest.

Total consideration for the 2014 acquisition included cash payments of \$65 million, net of cash acquired, at closing of the transaction.

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The following summarizes the aggregate purchase price allocation for the 2014 acquisition as of June 30, 2014 (in millions):

Goodwill	\$ 39	
Amortizable intangible assets	72	
Other net assets	(1	)
Deferred income taxes	(14	)
	\$ 96	

We allocated a portion of the purchase price to specific intangible asset categories as follows:

	Amount Assigned (in millions)	Weighted Average Amortization Period (in years)	Range of Risk- Adjusted Discount Rates used in Purchase Price Allocation
Amortizable intangible assets:			
Technology-related	\$ 71	14	14%
Other intangible assets	1	2	14%
	\$ 72		

Our technology-related intangible assets consist of technical processes, intellectual property, and institutional understanding with respect to products and processes that we will leverage in future products or processes and will carry forward from one product generation to the next. We used the income approach to derive the fair value of the technology-related intangible assets, and are amortizing them on a straight-line basis over their assigned estimated useful lives.

We believe that the estimated intangible asset values represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the assets. These fair value measurements are based on significant unobservable inputs, including management estimates and assumptions and, accordingly, are classified as Level 3 within the fair value hierarchy prescribed by ASC Topic 820, Fair Value Measurements and Disclosures.

We recorded the excess of the aggregate purchase price over the estimated fair values of the identifiable assets acquired as goodwill, which is not deductible for tax purposes. Goodwill was established due primarily to synergies expected to be gained from leveraging our existing operations as well as revenue and cash flow projections associated with future technologies, and has been allocated to our reportable segments based on the relative expected benefit. See Note D - Goodwill and Other Intangible Assets for more information related to goodwill allocated to our reportable segments.

#### Contingent Consideration

Certain of our acquisitions involve contingent consideration arrangements. Payment of additional consideration is generally contingent on the acquired company reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets and/or obtaining regulatory approvals. In accordance with U.S. GAAP, we recognize a liability equal to the fair value of the contingent payments we expect to make as of the acquisition date. We remeasure this liability each reporting period and record changes in the fair value through a separate line item within our consolidated statements of operations.

We recorded a net benefit related to the change in fair value of our contingent consideration liabilities of \$96 million in the second quarter of 2014, \$118 million in the first half of 2014, \$18 million in the second quarter of 2013, and \$41 million during the first half of 2013. We paid contingent consideration of \$3 million in the second quarter of 2014, \$15 million in the first half of 2014 and \$15 million during the second quarter and first half of 2013.



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Changes in the fair value of our contingent consideration liability were as follows (in millions):

Balance as of December 31, 2013	\$(501	)
Amounts recorded related to new acquisitions	(3	)
Other amounts recorded related to prior acquisitions	(1	)
Net fair value adjustments	118	
Payments made	15	
Balance as of June 30, 2014	\$(372	)

As of June 30, 2014, the maximum amount of future contingent consideration (undiscounted) that we could be required to pay was approximately \$2.2 billion.

Contingent consideration liabilities are remeasured to fair value each reporting period using projected revenues, discount rates, probabilities of payment and projected payment dates. The recurring Level 3 fair value measurements of our contingent consideration liability include the following significant unobservable inputs:

Contingent Consideration Liability	Fair Value as of June 30, 2014	Valuation Technique	Unobservable Input	Range
R&D, Regulatory and Commercialization-based Milestones	\$61 million	Probability Weighted Discounted Cash Flow	Discount Rate	0.9%-1.4%
			Probability of Payment	60% - 95%
			Projected Year of Payment	2014 - 2015
Revenue-based Payments	\$69 million	Discounted Cash Flow	Discount Rate	11.5% - 15%
			Probability of Payment	0% - 100%
			Projected Year of Payment	2014 - 2018
	\$242 million	Monte Carlo	Revenue Volatility	11% - 13%
			Risk Free Rate	LIBOR Term Structure
			Projected Year of Payment	2014-2018

Increases or decreases in the fair value of our contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing and amount of revenue estimates or in the timing or likelihood of achieving regulatory-, revenue- or commercialization-based milestones. Projected contingent payment amounts related to research and development, regulatory- and commercialization-based milestones and certain revenue-based milestones are discounted back to the current period using a discounted cash flow (DCF) model. Other revenue-based payments are valued using a Monte Carlo valuation model, which simulates future revenues during the earn-out period using management's best estimates. Projected revenues are based on our most recent internal operational budgets and long-range strategic plans. Increases in projected revenues and probabilities of payment may result in higher fair value measurements. Increases in discount rates and the time to payment may result in lower fair value measurements. Increases or decreases in any of those inputs in isolation may result in a significantly lower or higher fair value measurement.

**NOTE C – DIVESTITURES**

In January 2011, we closed the sale of our Neurovascular business to Stryker Corporation for a purchase price of \$1.500 billion in cash. We received \$1.450 billion during 2011, including an upfront payment of \$1.426 billion, and \$24 million which was placed into escrow and released throughout 2011 upon the completion of local closings in certain foreign jurisdictions. We received \$10 million during 2012, \$28 million during the second quarter of 2013 and we received the final \$12 million of consideration in January 2014. At the time of divestiture, due to our continuing involvement in the operations of the Neurovascular business following the transaction, the divestiture did not meet the criteria for presentation as a discontinued operation. Our sales related to our divested Neurovascular business have declined as the various transition services and supply agreements have terminated.

Revenue generated by the Neurovascular business was \$1 million in the second quarter of 2014, \$3 million in the first half of 2014, \$19 million in the second quarter of 2013, and \$55 million in the first half of 2013.



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## NOTE D – GOODWILL AND OTHER INTANGIBLE ASSETS

The gross carrying amount of goodwill and other intangible assets and the related accumulated amortization for intangible assets subject to amortization and accumulated write-offs of goodwill as of June 30, 2014 and December 31, 2013 are as follows:

(in millions)	As of June 30, 2014		December 31, 2013	
	Gross Carrying Amount	Accumulated Amortization/ Write-offs	Gross Carrying Amount	Accumulated Amortization/ Write-offs
Amortizable intangible assets				
Technology-related	\$8,252	\$(3,520)	\$8,272	\$(3,342)
Patents	522	(336)	513	(326)
Other intangible assets	847	(506)	845	(479)
	\$9,621	\$(4,362)	\$9,630	\$(4,147)
Unamortizable intangible assets				
Goodwill	\$15,635	\$(9,900)	\$15,593	\$(9,900)
Technology-related	197	—	197	—
	\$15,832	\$(9,900)	\$15,790	\$(9,900)

In addition, we had \$203 million and \$270 million of in-process research and development intangible assets as of June 30, 2014 and December 31, 2013, respectively.

The following represents our goodwill balance by global reportable segment:

(in millions)	Cardiovascular	Rhythm Management	MedSurg	Total
Balance as of December 31, 2013	\$3,252	\$294	\$2,147	\$5,693
Purchase price adjustments	—	(2)	—	(2)
Goodwill acquired	—	—	44	44
Goodwill written off	—	—	—	—
Other changes in carrying amount *	7	—	(7)	—
Balance as of June 30, 2014	\$3,259	\$292	\$2,184	\$5,735

\* In the first half of 2014, we reallocated \$7 million of goodwill between Cardiovascular and MedSurg as a result of the realignment of certain product lines from Endoscopy to Peripheral Interventions as of January 1, 2014.

## 2014 Goodwill Impairment Testing

We test our goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist.

In the second quarter of 2014, we performed our annual goodwill impairment test for all of our reporting units. In conjunction with our annual test, the fair value of each reporting unit exceeded its carrying value. As a result of the 2014 annual goodwill impairment test, we have identified our global Neuromodulation and global Electrophysiology reporting units as being at higher risk of potential failure of the first step of the goodwill impairment test in future reporting periods. Our global Neuromodulation reporting unit had excess fair value over carrying value of approximately 55 percent as of our annual test date and held \$1.356 billion of allocated goodwill as of June 30, 2014. Our global Electrophysiology reporting unit had excess fair value over carrying value of approximately 38 percent as of our annual test date and held \$292 million of allocated goodwill as of June 30, 2014. Our global Cardiac Rhythm Management (CRM) reporting unit had a fair value approximately equal to its carrying value; however, due to

goodwill impairment charges in prior years, no goodwill remains within our CRM reporting unit. Changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses could result in future impairments of goodwill within our reporting units including global CRM. Further, the recoverability of our CRM-related amortizable intangibles (\$4.236 billion globally as of June 30, 2014) is sensitive to future cash flow assumptions and our global CRM business performance. The \$4.236 billion of CRM-related amortizable intangibles are at higher risk of potential failure of the first step of the amortizable intangible recoverability test in future reporting periods. An impairment of a material portion of our CRM-related amortizable intangibles carrying value would occur if the second step of the amortizable intangible test is required in a future reporting period. Refer to Critical Accounting Policies and Estimates within our Management's

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Discussion and Analysis of Financial Condition and Results of Operations contained in Item 2 of this Quarterly Report on Form 10-Q for a discussion of key assumptions used in our testing.

On a quarterly basis, we monitor the key drivers of fair value to detect events or other changes that would warrant an interim impairment test of our goodwill and intangible assets. The key variables that drive the cash flows of our reporting units and amortizable intangibles are estimated revenue growth rates and levels of profitability. Terminal value growth rate assumptions, as well as the Weighted Average Cost of Capital (WACC) rate applied are additional key variables for reporting unit cash flows. These assumptions are subject to uncertainty, including our ability to grow revenue and improve profitability levels. Relatively small declines in the future performance and cash flows of a reporting unit or asset group or small changes in other key assumptions may result in the recognition of significant goodwill or intangible asset impairment charges. For example, keeping all other variables constant, an increase in the WACC applied of 100 basis points combined with a 150 basis point decrease in the terminal value growth rate would require that we perform the second step of the goodwill impairment test for both our global Electrophysiology and global Neuromodulation reporting units. The estimates used for our future cash flows and discount rates represent management's best estimates, which we believe to be reasonable, but future declines in business performance may impair the recoverability of our goodwill and intangible asset balances.

Future events that could have a negative impact on the levels of excess fair value over carrying value of our reporting units and/or amortizable intangible assets include, but are not limited to:

decreases in estimated market sizes or market growth rates due to greater-than-expected declines in procedural volumes, pricing pressures, reductions in reimbursement levels, product actions, and/or competitive technology developments;

declines in our market share and penetration assumptions due to increased competition, an inability to develop or launch new and next-generation products and technology features in line with our commercialization strategies, and market and/or regulatory conditions that may cause significant launch delays or product recalls;

decreases in our forecasted profitability due to an inability to successfully implement and achieve timely and sustainable cost improvement measures consistent with our expectations, increases in our market-participant tax rate, and/or changes in tax laws;

negative developments in intellectual property litigation that may impact our ability to market certain products or increase our costs to sell certain products;

the level of success of on-going and future research and development efforts, including those related to recent acquisitions, and increases in the research and development costs necessary to obtain regulatory approvals and launch new products;

the level of success in managing the growth of acquired companies, achieving sustained profitability consistent with our expectations, establishing government and third-party payer reimbursement, supplying the market, and increases in the costs and time necessary to integrate acquired businesses into our operations successfully;

changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses; and

increases in our market-participant risk-adjusted WACC.

Negative changes in one or more of these factors, among others, could result in additional impairment charges.





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## 2013 Charge

Following our reorganization from regions to global business units and our reallocation of goodwill on a relative fair value basis as of January 1, 2013, we conducted the first step of the goodwill impairment test for all global reporting units. As of January 1, 2013, the fair value of each global reporting unit exceeded its carrying value, with the exception of the global CRM reporting unit. In accordance with ASC Topic 350, Intangibles—Goodwill and Other (Topic 350) and our accounting policies, we tested the global CRM intangible assets and goodwill for impairment and recorded a non-cash goodwill impairment charge of \$423 million (\$422 million after-tax) to write down the goodwill to its implied fair value as of January 1, 2013 as a result of this analysis. The primary driver of this impairment charge was our reorganization from geographic regions to global business units as of January 1, 2013, which changed the composition of our reporting units. As a result of the reorganization, any goodwill allocated to the global CRM reporting unit was no longer supported by the cash flows of other businesses. Under our former reporting unit structure, the goodwill allocated to our regional reporting units was supported by the cash flows from all businesses in each international region. The hypothetical tax structure of the global CRM business and the global CRM business discount rate applied were also contributing factors to the goodwill impairment charge. Refer to Note D - Goodwill and Other Intangible Assets contained in Item 8 of our 2013 Annual Report filed on Form 10-K for details on the 2013 goodwill impairment charge.

The following is a rollforward of accumulated goodwill write-offs by global reportable segment:

(in millions)	Cardiovascular	Rhythm Management	MedSurg	Total
Accumulated write-offs as of December 31, 2013	\$(1,479 )	\$(6,960 )	\$(1,461 )	\$(9,900 )
Goodwill written off	—	—	—	—
Accumulated write-offs as of June 30, 2014	\$(1,479 )	\$(6,960 )	\$(1,461 )	\$(9,900 )

## Intangible Asset Impairment Testing

On a quarterly basis, we monitor for events or other potential indicators of an impairment that would warrant an interim impairment test of our intangible assets. Refer to Note D - Goodwill and Other Intangible Assets contained in Item 8 of our 2013 Annual Report on Form 10-K for a discussion of future events that would have a negative impact on the recoverability of our \$4.236 billion of CRM-related amortizable intangible assets. Our CRM-related amortizable intangible assets are at higher risk of potential failure of the first step of the amortizable intangible asset recoverability test in future reporting periods. An impairment of a material portion of our CRM-related amortizable intangible assets carrying value would likely occur if the second step of the amortizable intangible asset test is required in a future reporting period. Refer to Critical Accounting Policies and Estimates within our Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Item 7 of our 2013 Annual Report on Form 10-K for a discussion of key assumptions used in our testing.

## 2014 Charges

During the second quarter of 2014, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our in-process research and development projects and core technology associated with certain of our acquisitions. Based on our impairment assessment, and lower expected future cash flows associated with our intangible assets, we recorded pre-tax impairment charges of \$110 million in the second quarter of 2014. As a result of changes in our clinical strategy and lower estimates of the European and global hypertension markets, and the resulting amount of future revenue and cash flows associated with the technology acquired from Vessix Vascular Inc. (Vessix), we recorded impairment charges of \$67 million related to technology intangible assets during the second quarter of 2014. In addition, in the second quarter of 2014, due to revised expectations and timing as a result of the announcement of an upcoming third FDA Circulatory System Devices Panel, we recorded impairment charges of \$35 million related to the in-process research and development intangible assets acquired from Atritech, Inc. (Atritech). We also recorded an

additional \$8 million intangible asset impairment charge associated with changes in the amount of the expected cash flows related to certain other acquired in-process research and development projects.

During the first quarter of 2014, as a result of lower estimates of the resistant hypertension market following the announcement of data from a competitor's clinical trial, we performed an interim impairment test of our in-process research and development projects and core technology associated with our acquisition of Vessix. The impairment assessments were based upon probability-weighted cash flows of potential future scenarios. Based on our impairment assessment, and lower expected future cash flows associated with our Vessix-related intangible assets, we recorded pre-tax impairment charges of \$55 million in the first quarter of 2014 to write-down the balance of these intangible assets to their fair value.

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## 2013 Charges

During the second quarter of 2013, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our in-process research and development projects associated with certain of our acquisitions. Based on the results of our impairment analysis, we revised our expectations of the market size related to Sadra Medical, Inc. (Sadra), and the resulting timing and amount of future revenue and cash flows associated with the technology acquired from Sadra. As a result of these changes, we recorded pre-tax impairment charges of \$51 million in the second quarter of 2013 to write-down the balance of these intangible assets to their fair value in each respective period. During the second quarter of 2013, we also recorded an additional \$2 million intangible asset impairment charge associated with changes in the amount of the expected cash flows related to certain other acquired in-process research and development projects.

We recorded these amounts in the intangible assets impairment caption in our accompanying unaudited condensed consolidated statements of operations.

The nonrecurring Level 3 fair value measurements of our intangible asset impairment analysis included the following significant unobservable inputs:

Intangible Asset	Valuation Date	Fair Value	Valuation Technique	Unobservable Input	Rate
In-Process R&D	June 30, 2014	\$7 million	Income Approach - Excess Earnings Method	Discount Rate	20%
In-Process R&D	June 30, 2014	\$76 million	Income Approach - Excess Earnings Method	Discount Rate	16.5%
Core Technology	June 30, 2014	\$8 million	Income Approach - Excess Earnings Method	Discount Rate	15%
In-Process R&D	March 31, 2014	\$6 million	Income Approach - Excess Earnings Method	Discount Rate	20%
Core Technology	March 31, 2014	\$64 million	Income Approach - Excess Earnings Method	Discount Rate	15%
In-Process R&D	June 30, 2013	\$178 million	Income Approach - Excess Earnings Method	Discount Rate	16.5%

## NOTE E – FAIR VALUE MEASUREMENTS

## Derivative Instruments and Hedging Activities

We develop, manufacture and sell medical devices globally and our earnings and cash flows are exposed to market risk from changes in foreign currency exchange rates and interest rates. We address these risks through a risk management program that includes the use of derivative financial instruments, and operate the program pursuant to

documented corporate risk management policies. We recognize all derivative financial instruments in our consolidated financial statements at fair value in accordance with ASC Topic 815, Derivatives and Hedging (Topic 815). In accordance with Topic 815, for those derivative instruments that are designated and qualify as hedging instruments, the hedging instrument must be designated, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. The accounting for changes in the fair value (i.e., gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Our derivative instruments do not subject our earnings or cash flows to material risk, as gains and losses on these derivatives generally offset losses and gains on the item being hedged. We do not enter into derivative transactions for speculative purposes and we do not have any non-derivative instruments that are designated as hedging instruments pursuant to Topic 815.

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### Currency Hedging

We are exposed to currency risk consisting primarily of foreign currency denominated monetary assets and liabilities, forecasted foreign currency denominated intercompany and third-party transactions and net investments in certain subsidiaries. We manage our exposure to changes in foreign currency exchange rates on a consolidated basis to take advantage of offsetting transactions. We use both derivative instruments (currency forward and option contracts), and non-derivative transactions (primarily European manufacturing and distribution operations) to reduce the risk that our earnings and cash flows associated with these foreign currency denominated balances and transactions will be adversely affected by foreign currency exchange rate changes.

#### Designated Foreign Currency Hedges

All of our designated currency hedge contracts outstanding as of June 30, 2014 and December 31, 2013 were cash flow hedges under Topic 815 intended to protect the U.S. dollar value of our forecasted foreign currency denominated transactions. We record the effective portion of any change in the fair value of foreign currency cash flow hedges in other comprehensive income (OCI) until the related third-party transaction occurs. Once the related third-party transaction occurs, we reclassify the effective portion of any related gain or loss on the foreign currency cash flow hedge to earnings. In the event the hedged forecasted transaction does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time. We had currency derivative instruments designated as cash flow hedges outstanding in the contract amount of \$2.642 billion as of June 30, 2014 and \$2.564 billion as of December 31, 2013.

We recognized net gains of \$22 million in earnings on our cash flow hedges during the second quarter of 2014 and \$43 million for the first half of 2014, as compared to net gains of \$6 million during the second quarter of 2013 and \$1 million for the first half of 2013. All currency cash flow hedges outstanding as of June 30, 2014 mature within 36 months. As of June 30, 2014, \$85 million of net gains, net of tax, were recorded in accumulated other comprehensive income (AOCI) to recognize the effective portion of the fair value of any currency derivative instruments that are, or previously were, designated as foreign currency cash flow hedges, as compared to net gains of \$139 million as of December 31, 2013. As of June 30, 2014, \$60 million of net gains, net of tax, may be reclassified to earnings within the next twelve months.

The success of our hedging program depends, in part, on forecasts of transaction activity in various currencies (primarily Japanese yen, Euro, British pound sterling, Australian dollar and Canadian dollar). We may experience unanticipated currency exchange gains or losses to the extent that there are differences between forecasted and actual activity during periods of currency volatility. In addition, changes in foreign currency exchange rates related to any unhedged transactions may impact our earnings and cash flows.

#### Non-designated Foreign Currency Contracts

We use currency forward contracts as a part of our strategy to manage exposure related to foreign currency denominated monetary assets and liabilities. These currency forward contracts are not designated as cash flow, fair value or net investment hedges under Topic 815; are marked-to-market with changes in fair value recorded to earnings; and are entered into for periods consistent with currency transaction exposures, generally less than one year. We had currency derivative instruments not designated as hedges under Topic 815 outstanding in the contract amount of \$2.114 billion as of June 30, 2014 and \$1.952 billion as of December 31, 2013.

### Interest Rate Hedging

Our interest rate risk relates primarily to U.S. dollar borrowings, partially offset by U.S. dollar cash investments. We have historically used interest rate derivative instruments to manage our earnings and cash flow exposure to changes in interest rates by converting floating-rate debt into fixed-rate debt or fixed-rate debt into floating-rate debt.

We designate these derivative instruments either as fair value or cash flow hedges under Topic 815. We record changes in the value of fair value hedges in interest expense, which is generally offset by changes in the fair value of the hedged debt obligation. Interest payments made or received related to our interest rate derivative instruments are included in interest expense. We record the effective portion of any change in the fair value of derivative instruments designated as cash flow hedges as unrealized gains or losses in OCI, net of tax, until the hedged cash flow occurs, at which point the effective portion of any gain or loss is reclassified to earnings. We record the ineffective portion of our cash flow hedges in interest expense. In the event the hedged cash flow does not occur, or it becomes no longer

probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time.

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In the fourth quarter of 2013, we entered into interest rate derivative contracts having a notional amount of \$450 million to convert fixed-rate debt into floating-rate debt, which we designated as fair value hedges, and had \$450 million outstanding as of June 30, 2014. We assessed at inception, and re-assess on an ongoing basis, whether the interest rate derivative contracts are highly effective in offsetting changes in the fair value of the hedged fixed-rate debt. During the second quarter of 2014 we recognized, in interest expense, a \$8 million loss on our hedged debt and a \$8 million gain on the related interest rate derivative contract. During the first half of 2014 we recognized, in interest expense, a \$18 million loss on our hedged debt and a \$18 million gain on the related interest rate derivative contract. In prior years, we terminated certain interest rate derivative contracts, including fixed-to-floating interest rate contracts, designated as fair value hedges, and floating-to-fixed treasury locks, designated as cash flow hedges. We are amortizing the gains and losses on these derivative instruments upon termination into earnings as a reduction of interest expense over the remaining term of the hedged debt, in accordance with Topic 815. The carrying amount of certain of our senior notes included unamortized gains of \$49 million as of June 30, 2014 and \$54 million as of December 31, 2013, and unamortized losses of \$2 million as of June 30, 2014 and \$2 million as of December 31, 2013, related to the fixed-to-floating interest rate contracts. In addition, we had pre-tax net gains within AOCI related to terminated floating-to-fixed treasury locks of \$2 million as of June 30, 2014 and \$3 million as of December 31, 2013. We recorded \$2 million during the second quarter of 2014 and \$4 million during the first half of 2014 as a reduction to interest expense, resulting from the amortization of previously terminated interest rate derivative contracts. As of June 30, 2014, \$9 million of pre-tax net gains may be reclassified to earnings within the next twelve months as a reduction to interest expense from amortization of our previously terminated interest rate derivative contracts.

**Counterparty Credit Risk**

We do not have significant concentrations of credit risk arising from our derivative financial instruments, whether from an individual counterparty or a related group of counterparties. We manage our concentration of counterparty credit risk on our derivative instruments by limiting acceptable counterparties to a diversified group of major financial institutions with investment grade credit ratings, limiting the amount of credit exposure to each counterparty, and by actively monitoring their credit ratings and outstanding fair values on an on-going basis. Furthermore, none of our derivative transactions are subject to collateral or other security arrangements and none contain provisions that are dependent on our credit ratings from any credit rating agency.

We also employ master netting arrangements that reduce our counterparty payment settlement risk on any given maturity date to the net amount of any receipts or payments due between us and the counterparty financial institution. Thus, the maximum loss due to counterparty credit risk is limited to the unrealized gains in such contracts net of any unrealized losses should any of these counterparties fail to perform as contracted. Although these protections do not eliminate concentrations of credit risk, as a result of the above considerations, we do not consider the risk of counterparty default to be significant.

**Fair Value of Derivative Instruments**

The following presents the effect of our derivative instruments designated as cash flow hedges under Topic 815 on our accompanying unaudited condensed consolidated statements of operations during the second quarter and first half of 2014 and 2013 (in millions):

	Amount of Pre-tax Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Pre-tax Gain (Loss) Reclassified from AOCI into Earnings (Effective Portion)	Location in Statement of Operations
Three Months Ended June 30, 2014			
Currency hedge contracts	\$ (20)	) \$ 22	Cost of products sold
	\$ (20)	) \$ 22	
Three Months Ended June 30, 2013			
Currency hedge contracts	\$ 76	\$ 6	Cost of products sold
	\$ 76	\$ 6	



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Six Months Ended June 30, 2014

Currency hedge contracts	\$ (40	) \$ 43	Cost of products sold
	\$ (40	) \$ 43	

Six Months Ended June 30, 2013

Currency hedge contracts	\$ 190	\$ 1	Cost of products sold
	\$ 190	\$ 1	

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The amount of gain (loss) recognized in earnings related to the ineffective portion of hedging relationships was de minimis for all periods presented.

Net gains and losses on currency hedge contracts not designated as hedging instruments were offset by net losses and gains from foreign currency transaction exposures, as shown in the following table:

in millions	Location in Statement of Operations	Three Months Ended		Six Months Ended		
		June 30, 2014	2013	June 30, 2014	2013	
Gain (loss) on currency hedge contracts	Other, net	\$(17	) \$29	\$(20	) \$54	
Gain (loss) on foreign currency transaction exposures	Other, net	14	(29	) 14	(56	)
Net foreign currency gain (loss)	Other, net	\$(3	) \$—	\$(6	) \$(2	)

Topic 815 requires all derivative instruments to be recognized at their fair values as either assets or liabilities on the balance sheet. We determine the fair value of our derivative instruments using the framework prescribed by ASC Topic 820, Fair Value Measurements and Disclosures (Topic 820), by considering the estimated amount we would receive or pay to transfer these instruments at the reporting date and by taking into account current interest rates, foreign currency exchange rates, the creditworthiness of the counterparty for assets, and our creditworthiness for liabilities. In certain instances, we may utilize financial models to measure fair value. Generally, we use inputs that include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; other observable inputs for the asset or liability; and inputs derived principally from, or corroborated by, observable market data by correlation or other means. As of June 30, 2014, we have classified all of our derivative assets and liabilities within Level 2 of the fair value hierarchy prescribed by Topic 820, as discussed below, because these observable inputs are available for substantially the full term of our derivative instruments.

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The following are the balances of our derivative assets and liabilities as of June 30, 2014 and December 31, 2013:

(in millions)	Location in Balance Sheet (1)	As of June 30, 2014	December 31, 2013
<b>Derivative Assets:</b>			
<b>Designated Hedging Instruments</b>			
Currency hedge contracts	Prepaid and other current assets	\$94	\$117
Currency hedge contracts	Other long-term assets	58	120
Interest rate contracts	Prepaid and other current assets	3	1
Interest rate contracts	Other long-term assets	10	—
		165	238
<b>Non-Designated Hedging Instruments</b>			
Currency hedge contracts	Prepaid and other current assets	15	27
<b>Total Derivative Assets</b>		<b>\$180</b>	<b>\$265</b>
<b>Derivative Liabilities:</b>			
<b>Designated Hedging Instruments</b>			
Currency hedge contracts	Other current liabilities	\$14	\$13
Currency hedge contracts	Other long-term liabilities	18	19
Interest rate contracts	Other long-term liabilities	—	8
		32	40
<b>Non-Designated Hedging Instruments</b>			
Currency hedge contracts	Other current liabilities	24	23
<b>Total Derivative Liabilities</b>		<b>\$56</b>	<b>\$63</b>

(1) We classify derivative assets and liabilities as current when the remaining term of the derivative contract is one year or less.

**Other Fair Value Measurements****Recurring Fair Value Measurements**

On a recurring basis, we measure certain financial assets and financial liabilities at fair value based upon quoted market prices, where available. Where quoted market prices or other observable inputs are not available, we apply valuation techniques to estimate fair value. Topic 820 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The categorization of financial assets and financial liabilities within the valuation hierarchy is based upon the lowest level of input that is significant to the measurement of fair value. The three levels of the hierarchy are defined as follows:

Level 1 – Inputs to the valuation methodology are quoted market prices for identical assets or liabilities.

Level 2 – Inputs to the valuation methodology are other observable inputs, including quoted market prices for similar assets or liabilities and market-corroborated inputs.

Level 3 – Inputs to the valuation methodology are unobservable inputs based on management's best estimate of inputs market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk.

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Assets and liabilities measured at fair value on a recurring basis consist of the following as of June 30, 2014 and December 31, 2013:

(in millions)	As of June 30, 2014				As of December 31, 2013			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
<b>Assets</b>								
Money market and government funds	\$28	\$—	\$—	\$28	\$38	\$—	\$—	\$38
Currency hedge contracts	—	167	—	167	—	264	—	264
Interest rate contracts	—	13	—	13	—	1	—	1
	\$28	\$180	\$—	\$208	\$38	\$265	\$—	\$303
<b>Liabilities</b>								
Currency hedge contracts	\$—	\$56	\$—	\$56	\$—	\$55	\$—	\$55
Accrued contingent consideration	—	—	372	372	—	—	501	501
Interest rate contracts	—	—	—	—	—	8	—	8
	\$—	\$56	\$372	\$428	\$—	\$63	\$501	\$564

Our investments in money market and government funds are generally classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices. These investments are classified as cash and cash equivalents within our accompanying unaudited condensed consolidated balance sheets, in accordance with U.S. GAAP and our accounting policies.

In addition to \$28 million invested in money market and government funds as of June 30, 2014, we had \$126 million in short-term time deposits and \$203 million in interest bearing and non-interest bearing bank accounts. In addition to \$38 million invested in money market and government funds as of December 31, 2013, we had \$31 million in short-term deposits and \$148 million in interest bearing and non-interest bearing bank accounts.

Our recurring fair value measurements using significant unobservable inputs (Level 3) relate solely to our contingent consideration liabilities. Refer to Note B - Acquisitions in this Quarterly Report on Form 10-Q, for a discussion of the changes in the fair value of our contingent consideration liabilities.

**Non-Recurring Fair Value Measurements**

We hold certain assets and liabilities that are measured at fair value on a non-recurring basis in periods subsequent to initial recognition. The fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. The aggregate carrying amount of our cost method investments was \$26 million as of June 30, 2014 and \$20 million as of December 31, 2013.

We recorded \$110 million of losses to adjust our intangible asset balances to their fair value during the second quarter of 2014 and \$165 million for the first half of 2014, as compared to losses of \$53 million during the second quarter of 2013 and \$476 million for the first half of 2013, which included \$423 million of losses to adjust our goodwill balances to their fair value. Refer to Note D - Goodwill and Other Intangible Assets in this Quarterly Report on Form 10-Q, for further information related to these charges and significant unobservable inputs (Level 3).

The fair value of our outstanding debt obligations was \$4.704 billion as of June 30, 2014 and \$4.602 billion as of December 31, 2013, which was determined by using primarily quoted market prices for our publicly registered senior notes, classified as Level 1 within the fair value hierarchy. Refer to Note F - Borrowings and Credit Arrangements in this Quarterly Report on Form 10-Q, for a discussion of our debt obligations.

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## NOTE F – BORROWINGS AND CREDIT ARRANGEMENTS

We had total debt of \$4.255 billion as of June 30, 2014 and \$4.240 billion as of December 31, 2013. The debt maturity schedule for the significant components of our debt obligations as of June 30, 2014 is as follows:

(in millions)	2014	2015	2016	2017	2018	Thereafter	Total
Senior notes	\$—	\$400	\$600	\$250	\$600	\$1,950	\$3,800
Term loan	—	—	80	80	240	—	400
	\$—	\$400	\$680	\$330	\$840	\$1,950	\$4,200

Note: The table above does not include unamortized discounts associated with our senior notes, or amounts related to interest rate contracts used to hedge the fair value of certain of our senior notes.

## Revolving Credit Facility

We maintain a \$2.000 billion revolving credit facility, maturing in April 2017, with a global syndicate of commercial banks. Eurodollar and multicurrency loans under this revolving credit facility bear interest at LIBOR plus an interest margin of between 0.875 percent and 1.475 percent, based on our corporate credit ratings and consolidated leverage ratio (1.275 percent as of June 30, 2014). In addition, we are required to pay a facility fee based on our credit ratings, consolidated leverage ratio, and the total amount of revolving credit commitments, regardless of usage, under the agreement (0.225 percent as of June 30, 2014). There were no amounts borrowed under our revolving credit facility as of June 30, 2014 or December 31, 2013.

Our revolving credit facility agreement in place as of June 30, 2014 requires that we maintain certain financial covenants, as follows:

	Covenant Requirement	Actual as of June 30, 2014
Maximum leverage ratio (1)	3.5 times	2.5 times
Minimum interest coverage ratio (2)	3.0 times	5.7 times

(1) Ratio of total debt to consolidated EBITDA, as defined by the credit agreement, for the preceding four consecutive fiscal quarters.

(2) Ratio of consolidated EBITDA, as defined by the credit agreement, to interest expense for the preceding four consecutive fiscal quarters.

The credit agreement provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, through the credit agreement maturity, of any non-cash charges and up to \$500 million in restructuring charges and restructuring-related expenses related to our current or future restructuring plans. As of June 30, 2014, we had \$181 million of the restructuring charge exclusion remaining. In addition, any cash litigation payments (net of any cash litigation receipts), as defined by the agreement, are excluded from the calculation of consolidated EBITDA and any new debt issued to fund any tax deficiency payments is excluded from consolidated total debt, as defined in the agreement, provided that the sum of any excluded net cash litigation payments and any new debt issued to fund any tax deficiency payments shall not exceed \$2.300 billion in the aggregate. As of June 30, 2014, we had approximately \$2.150 billion of the combined legal and debt exclusion remaining. As of and through June 30, 2014, we were in compliance with the required covenants.

Any inability to maintain compliance with these covenants could require us to seek to renegotiate the terms of our credit facilities or seek waivers from compliance with these covenants, both of which could result in additional borrowing costs. Further, there can be no assurance that our lenders would agree to such new terms or grant such waivers.

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### Term Loan

We had \$400 million outstanding under an unsecured term loan facility as of June 30, 2014 and December 31, 2013. Term loan borrowings under this facility bear interest at LIBOR plus an interest margin of between 1.0 percent and 1.75 percent (currently 1.5 percent), based on our corporate credit ratings and consolidated leverage ratio. The term loan borrowings are payable over a five-year period, with quarterly principal payments of \$20 million commencing in the first quarter of 2016 and the remaining principal amount due at the final maturity date in August 2018, and are repayable at any time without premium or penalty. Our term loan facility requires that we comply with certain covenants, including financial covenants with respect to maximum leverage and minimum interest coverage. The maximum leverage ratio requirement is 3.5 times and our actual leverage ratio as of June 30, 2014 is 2.5 times. The minimum interest coverage ratio requirement is 3.0 times and our actual interest coverage ratio as of June 30, 2014 is 5.7 times.

### Senior Notes

We had senior notes outstanding of \$3.800 billion as of June 30, 2014 and December 31, 2013. Our senior notes are publicly registered securities, are redeemable prior to maturity and are not subject to any sinking fund requirements. Our senior notes are unsecured, unsubordinated obligations and rank on parity with each other. These notes are effectively junior to borrowings under our credit and security facility and liabilities of our subsidiaries (see Other Arrangements below).

### Other Arrangements

We also maintain a \$300 million credit and security facility secured by our U.S. trade receivables maturing in June 2015, subject to further extension. The credit and security facility requires that we maintain a maximum leverage covenant consistent with our revolving credit facility. The maximum leverage ratio requirement is 3.5 times and our actual leverage ratio as of June 30, 2014 is 2.5 times. We had no borrowings outstanding under this facility as of June 30, 2014 and December 31, 2013.

We have accounts receivable factoring programs in certain European countries that we account for as sales under ASC Topic 860, Transfers and Servicing. These agreements provide for the sale of accounts receivable to third parties, without recourse, of up to approximately \$309 million as of June 30, 2014. We have no retained interests in the transferred receivables, other than collection and administrative responsibilities and, once sold, the accounts receivable are no longer available to satisfy creditors in the event of bankruptcy. We de-recognized \$162 million of receivables as of June 30, 2014 at an average interest rate of 3.1 percent, and \$146 million as of December 31, 2013 at an average interest rate of 3.3 percent. Within Italy, Spain, Portugal and Greece, the number of days our receivables are outstanding has remained above historical levels. We believe we have adequate allowances for doubtful accounts related to our Italy, Spain, Portugal and Greece accounts receivable; however, we continue to monitor the European economic environment for any collectibility issues related to our outstanding receivables. During the first half of 2014, we received cash payments of approximately \$80 million related to a government-funded settlement of long outstanding receivables in Spain. As of June 30, 2014, our net receivables in these countries greater than 180 days past due totaled \$41 million, of which \$17 million were past due greater than 365 days.

In addition, we have uncommitted credit facilities with a commercial Japanese bank that provide for borrowings, promissory notes discounting and receivables factoring of up to 21.000 billion Japanese yen (approximately \$207 million as of June 30, 2014). We de-recognized \$150 million of notes receivable as of June 30, 2014 at an average interest rate of 2 percent and \$147 million of notes receivable as of December 31, 2013 at an average interest rate of 1.8 percent. De-recognized accounts and notes receivable are excluded from trade accounts receivable, net in the accompanying unaudited condensed consolidated balance sheets.

As of June 30, 2014 and December 31, 2013, we had outstanding letters of credit of \$78 million, which consisted primarily of bank guarantees and collateral for workers' compensation insurance arrangements. As of June 30, 2014 and December 31, 2013, none of the beneficiaries had drawn upon the letters of credit or guarantees; accordingly, we did not recognize a related liability for our outstanding letters of credit in our consolidated balance sheets as of June 30, 2014 or December 31, 2013. We believe we will generate sufficient cash from operations to fund these arrangements and intend to fund these arrangements without drawing on the letters of credit.

**NOTE G – RESTRUCTURING-RELATED ACTIVITIES**

On an ongoing basis, we monitor the dynamics of the economy, the healthcare industry, and the markets in which we compete. We continue to assess opportunities for improved operational effectiveness and efficiency, and better alignment of expenses with revenues, while preserving our ability to make the investments in research and development projects, capital and our people that we believe are essential to our long-term success. As a result of these assessments, we have undertaken various restructuring initiatives in order to enhance our growth potential and position us for long-term success. These initiatives are described below.

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## 2014 Restructuring Plan

On October 22, 2013, the Board of Directors approved, and we committed to, a restructuring initiative (the 2014 Restructuring plan). The 2014 Restructuring plan is intended to build on the progress we have made to address financial pressures in a changing global marketplace, further strengthen our operational effectiveness and efficiency and support new growth investments. Key activities under the plan include continued implementation of our ongoing Plant Network Optimization (PNO) strategy, continued focus on driving operational efficiencies and ongoing business and commercial model changes. The PNO strategy is intended to simplify our manufacturing plant structure by transferring certain production lines among facilities. Other activities involve rationalizing organizational reporting structures to streamline various functions, eliminate bureaucracy, increase productivity and better align resources to business strategies and marketplace dynamics. These activities were initiated in the fourth quarter of 2013 and are expected to be substantially completed by the end of 2015.

We estimate that the implementation of the 2014 Restructuring plan will result in total pre-tax charges of approximately \$175 million to \$225 million, and approximately \$160 million to \$210 million of these charges is estimated to result in cash outlays, of which we have made payments of \$39 million to date. We have recorded related costs of \$79 million since the inception of the plan, and recorded a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

The following table provides a summary of our estimates of costs associated with the 2014 Restructuring plan by major type of cost:

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	\$100 million to \$120 million
Other (1)	\$10 million to \$20 million
Restructuring-related expenses:	
Other (2)	\$65 million to \$85 million \$175 million to \$225 million

(1) Consists primarily of consultant fees and costs associated with contractual cancellations.

(2) Comprised of other costs directly related to the 2014 Restructuring plan, including program management, accelerated depreciation, and costs to transfer product lines among facilities.

## 2011 Restructuring Plan

On July 26, 2011, our Board of Directors approved, and we committed to, a restructuring initiative (the 2011 Restructuring plan) designed to strengthen operational effectiveness and efficiencies, increase competitiveness and support new investments, thereby increasing shareholder value. Key activities under the 2011 Restructuring plan included standardizing and automating certain processes and activities; relocating select administrative and functional activities; rationalizing organizational reporting structures; leveraging preferred vendors; and other efforts to eliminate inefficiency. Among these efforts, we expanded our ability to deliver best-in-class global shared services for certain functions and divisions at several locations in emerging markets. This action was intended to enable us to grow our global commercial presence in key geographies and take advantage of many cost-reducing and productivity-enhancing opportunities. In addition, we undertook efforts to streamline various corporate functions, eliminate bureaucracy, increase productivity and better align corporate resources to our key business strategies. On January 25, 2013, our Board of Directors approved, and we committed to, an expansion of the 2011 Restructuring plan (the Expansion). The Expansion was intended to further strengthen our operational effectiveness and efficiencies and support new investments. Activities under the 2011 Restructuring plan were initiated in the third quarter of 2011 and all activities, including those related to the Expansion, were substantially completed by the end of 2013.

The 2011 Restructuring plan, including the Expansion, is estimated to result in total pre-tax charges of approximately \$289 million to \$292 million, and approximately \$282 million to \$285 million of these charges is estimated to result



in cash outlays, of which we have made payments of \$282 million to date. We have recorded related costs of \$287 million since the inception of the plan, and recorded a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

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The following provides a summary of our expected total costs associated with the 2011 Restructuring plan, including the Expansion, by major type of cost:

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	\$138 million to \$141 million
Other (1)	\$112 million
Restructuring-related expenses:	
Other (2)	\$39 million
	\$289 million to \$292 million

(1) Includes primarily consulting fees, gains and losses on disposals of fixed assets and costs associated with contractual cancellations.

(2) Comprised of other costs directly related to the 2011 Restructuring plan, including the Expansion, such as program management, accelerated depreciation, retention and infrastructure-related costs.

**Plant Network Optimization Program**

In January 2009, our Board of Directors approved, and we committed to, a Plant Network Optimization program, intended to simplify our manufacturing plant structure by transferring certain production lines among facilities and by closing certain other facilities. The program was intended to improve our overall gross profit margins. Activities under the Plant Network Optimization program were initiated in the first quarter of 2009 and were substantially completed during 2012.

The Plant Network Optimization program resulted in total pre-tax charges of \$126 million, and resulted in cash outlays of \$103 million. We recorded a portion of these expenses as restructuring charges and the remaining portion through cost of products sold within our unaudited condensed consolidated statements of operations.

The following provides a summary of our costs associated with the Plant Network Optimization program by major type of cost:

Type of cost	Total amount incurred
Restructuring charges:	
Termination benefits	\$30 million
Restructuring-related expenses:	
Accelerated depreciation	\$22 million
Transfer costs (1)	\$74 million
	\$126 million

(1) Consists primarily of costs to transfer product lines among facilities, including costs of transfer teams, freight, idle facility and product line validations.

In the aggregate, we recorded net restructuring charges pursuant to our restructuring plans of \$15 million in the second quarter of 2014, \$26 million in the second quarter of 2013, \$35 million in the first half of 2014, and \$36 million in the first half of 2013. During the first half of 2013, our restructuring charges were partially offset by a \$19 million gain recognized on the sale of our Natick, Massachusetts headquarters. In addition, we recorded expenses within other lines of our accompanying unaudited condensed consolidated statements of operations related to our restructuring initiatives of \$10 million in the second quarter of 2014, \$5 million in the second quarter of 2013, \$18 million in the first half of 2014, and \$10 million in the first half of 2013.

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The following presents these costs (credits) by major type and line item within our accompanying unaudited condensed consolidated statements of operations, as well as by program:

Three Months Ended June 30, 2014

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	\$8	\$—	\$—	\$—	\$7	\$15
Restructuring-related expenses:						
Cost of products sold	—	—	4	—	—	4
Selling, general and administrative expenses	—	1	—	—	5	6
	—	1	4	—	5	10
	\$8	\$1	\$4	\$—	\$12	\$25

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2014 Restructuring plan	\$10	\$1	\$4	\$—	\$12	\$27
2011 Restructuring plan (including the Expansion)	(2 )	—	—	—	—	(2 )
	\$8	\$1	\$4	\$—	\$12	\$25

Three Months Ended June 30, 2013

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Net Gain on Fixed Asset Disposals	Other	Total
Restructuring charges	\$13	\$—	\$—	\$—	\$13	\$26
Restructuring-related expenses:						
Cost of products sold	—	—	—	—	—	—
Selling, general and administrative expenses	—	1	—	—	4	5
	—	1	—	—	4	5
	\$13	\$1	\$—	\$—	\$17	\$31

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Net Gain on Fixed Asset Disposals	Other	Total
2011 Restructuring plan (including the Expansion)	\$15	\$1	\$—	\$—	\$17	\$33
Plant Network Optimization program	(2 )	—	—	—	—	(2 )
	\$13	\$1	\$—	\$—	\$17	\$31

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## Six Months Ended June 30, 2014

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	\$19	\$—	\$—	\$—	\$16	\$35
Restructuring-related expenses:						
Cost of products sold	—	—	6	—	—	6
Selling, general and administrative expenses	—	2	—	—	10	12
	—	2	6	—	10	18
	\$19	\$2	\$6	\$—	\$26	\$53

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2014 Restructuring plan	\$19	\$2	\$6	\$—	\$23	\$50
2011 Restructuring plan (including the Expansion)	—	—	—	—	3	3
	\$19	\$2	\$6	\$—	\$26	\$53

## Six Months Ended June 30, 2013

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Net Gain on Fixed Asset Disposals	Other	Total
Restructuring charges	\$21	\$—	\$—	\$(16)	\$31	\$36
Restructuring-related expenses:						
Cost of products sold	—	—	—	—	—	—
Selling, general and administrative expenses	—	1	—	—	9	10
	—	1	—	—	9	10
	\$21	\$1	\$—	\$(16)	\$40	\$46

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Net Gain on Fixed Asset Disposals	Other	Total
2011 Restructuring plan (including the Expansion)	\$25	\$1	\$—	\$(16)	\$40	\$50
Plant Network Optimization program	(4)	—	—	—	—	(4)
	\$21	\$1	\$—	\$(16)	\$40	\$46

Termination benefits represent amounts incurred pursuant to our on-going benefit arrangements and amounts for “one-time” involuntary termination benefits, and have been recorded in accordance with ASC Topic 712, Compensation – Non-retirement Postemployment Benefits and ASC Topic 420, Exit or Disposal Cost Obligations (Topic 420). We expect to record additional termination benefits related to our restructuring initiatives in 2014 when we identify with more specificity the job classifications, functions and locations of the remaining head count to be eliminated. Other restructuring costs, which represent primarily consulting fees, are being recorded as incurred in accordance with Topic 420. Accelerated depreciation is being recorded over the adjusted remaining useful life of the related assets, and production line transfer costs are being recorded as incurred.

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As of June 30, 2014, we have incurred cumulative restructuring charges related to our 2014 Restructuring plan, 2011 Restructuring plan (including the Expansion), and Plant Network Optimization program of \$339 million and restructuring-related costs of \$153 million since we committed to each plan. The following presents these costs by major type and by plan:

(in millions)	2014 Restructuring plan	2011 Restructuring plan (including the Expansion)	Plant Network Optimization program	Total
Termination benefits	\$48	\$136	\$30	\$214
Fixed asset write-offs	—	(1)	—	(1)
Other	13	113	—	126
Total restructuring charges	61	248	30	339
Accelerated depreciation	2	5	22	29
Transfer costs	6	—	74	80
Other	10	34	—	44
Restructuring-related expenses	18	39	96	153
	\$79	\$287	\$126	\$492

We made cash payments of \$24 million in the second quarter of 2014 and \$53 million in the first half of 2014 associated with restructuring initiatives pursuant to these plans, and as of June 30, 2014, we had made total cash payments of \$424 million related to our 2014 Restructuring plan, 2011 Restructuring plan (including the Expansion), and Plant Network Optimization program since committing to each plan. These payments were made using cash generated from operations, and are comprised of the following:

(in millions)	2014 Restructuring plan	2011 Restructuring plan (including the Expansion)	Plant Network Optimization program	Total
Three Months Ended June 30, 2014				
Termination benefits	\$6	\$—	\$—	\$6
Transfer costs	4	—	—	4
Other	12	2	—	14
	\$22	\$2	\$—	\$24
Six Months Ended June 30, 2014				
Termination benefits	\$12	\$7	\$—	\$19
Transfer costs	6	—	—	6
Other	21	7	—	28
	\$39	\$14	\$—	\$53
Program to Date				
Termination benefits	\$12	\$131	\$30	\$173
Transfer costs	6	—	73	79
Other	21	151	—	172
	\$39	\$282	\$103	\$424

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Our restructuring liability is primarily comprised of accruals for termination benefits. The following is a rollforward of the termination benefit liability associated with our 2014 Restructuring plan and 2011 Restructuring plan (including the Expansion), which is reported as a component of accrued expenses included in our accompanying unaudited condensed balance sheets:

(in millions)	2014 Restructuring plan	2011 Restructuring plan (including the Expansion)	Total
Accrued as of December 31, 2013	\$29	\$12	\$41
Charges (credits)	19	—	19
Cash payments	(12	) (7	) (19
Other adjustments	—	—	—
Accrued as of June 30, 2014	\$36	\$5	\$41

In addition to our accrual for termination benefits, we had a \$5 million liability as of June 30, 2014 and an \$8 million liability as of December 31, 2013 for other restructuring-related items.

## NOTE H – SUPPLEMENTAL BALANCE SHEET INFORMATION

Components of selected captions in our accompanying unaudited condensed consolidated balance sheets are as follows:

Trade accounts receivable, net

(in millions)	As of June 30, 2014	December 31, 2013
Accounts receivable	\$1,403	\$1,419
Less: allowance for doubtful accounts	(80	) (81
Less: allowance for sales returns	(36	) (31
	\$1,287	\$1,307

The following is a rollforward of our allowance for doubtful accounts for the second quarter and first half of 2014 and 2013:

(in millions)	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Beginning balance	\$75	\$86	\$81	\$88
Charges to expenses	6	3	4	6
Utilization of allowances	(1	) (5	) (5	) (10
Ending balance	\$80	\$84	\$80	\$84

Inventories

(in millions)	As of June 30, 2014		December 31, 2013
Finished goods	\$634		\$598
Work-in-process	114		90
Raw materials	201		209
	\$949		\$897

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## Property, plant and equipment, net

(in millions)	As of June 30, 2014	December 31, 2013
Land	\$81	\$81
Buildings and improvements	950	917
Equipment, furniture and fixtures	2,554	2,461
Capital in progress	192	211
	3,777	3,670
Less: accumulated depreciation	2,243	2,124
	\$1,534	\$1,546

Depreciation expense was \$69 million for the second quarter of 2014, \$66 million for the second quarter of 2013, \$134 million for the first half of 2014, and \$127 million for the first half of 2013.

## Accrued expenses

(in millions)	As of June 30, 2014	December 31, 2013
Payroll and related liabilities	\$410	\$488
Accrued contingent consideration	181	148
Legal reserves	81	84
Other	605	628
	\$1,277	\$1,348

## Other long-term liabilities

(in millions)	As of June 30, 2014	December 31, 2013
Accrued income taxes	\$1,244	\$1,283
Legal reserves	745	523
Accrued contingent consideration	191	353
Other long-term liabilities	426	410
	\$2,606	\$2,569

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## Accrued warranties

We offer warranties on certain of our product offerings. The majority of our warranty liability as of June 30, 2014 related to implantable devices offered by our CRM business, which include defibrillator and pacemaker systems. Our CRM products come with a standard limited warranty covering the replacement of these devices. We offer a full warranty for a portion of the period post-implant, and a partial warranty over the substantial remainder of the useful life of the product. We estimate the costs that we may incur under our warranty programs based on the number of units sold, historical and anticipated rates of warranty claims and cost per claim, and record a liability equal to these estimated costs as cost of products sold at the time the product sale occurs. We reassess the adequacy of our recorded warranty liabilities on a quarterly basis and adjust these amounts as necessary. The current portion of our warranty accrual is included in other accrued expenses in the table above and the non-current portion of our warranty accrual is included in other long-term liabilities in the table above. Changes in our product warranty accrual during the first half of 2014 and 2013 consisted of the following (in millions):

	Six Months Ended	
	June 30,	
	2014	2013
Beginning Balance	\$28	\$26
Provision	2	5
Settlements/reversals	(6	) (6
Ending Balance	\$24	\$25

## NOTE I – INCOME TAXES

Our effective tax rates from continuing operations for the three months ended June 30, 2014 and June 30, 2013, were 103.8% and 14.3%, respectively. For the first half of 2014 and 2013 our effective tax rates from continuing operations were (222.5)% and 7.6%, respectively. The change in our reported tax rate for the second quarter and first half of 2014, as compared to the same periods in 2013, relates primarily to the impact of certain receipts and charges that are taxed at different rates than our effective tax rate, including intangible asset impairment charges, acquisition- and divestiture-related items, and litigation- and restructuring-related items. In addition, the reported tax rate in the second quarter of 2013 was also impacted by certain discrete tax items, including uncertain tax positions related to audit findings, while the first half of 2013 was favorably affected by discrete tax items that primarily related to the reinstatement of tax legislation that was retroactively applied, offset in part by the resolution of the uncertain tax positions related to audit settlements and findings.

As of June 30, 2014, we had \$1.039 billion of gross unrecognized tax benefits, of which a net \$929 million, if recognized, would affect our effective tax rate. As of December 31, 2013, we had \$1.069 billion of gross unrecognized tax benefits, of which a net \$939 million, if recognized, would affect our effective tax rate. During the first quarter of 2014, we received a Revenue Agent Report from the Internal Revenue Services (IRS) reflecting significant proposed audit adjustments for our 2008, 2009 and 2010 tax years based upon the same transfer pricing methodologies that are currently being contested in U.S. Tax Court for our tax years from 2001 to 2007. As with the prior years, we disagree with the transfer pricing methodologies being applied by the IRS and we expect to contest any adjustments received through applicable IRS and judicial procedures, as appropriate. We believe that our income tax reserves associated with these matters are adequate as of June 30, 2014. However, final resolution is uncertain and could have a material impact on our financial condition, results of operations, or cash flows. During the six months ended June 30, 2014, there were no other material changes to significant unresolved matters with the IRS or foreign tax authorities from what we disclosed in our 2013 Annual Report on Form 10-K.

We recognize interest and penalties related to income taxes as a component of income tax expense. We had \$431 million accrued for gross interest and penalties as of June 30, 2014 and \$402 million as of December 31, 2013. The increase in gross interest and penalties was \$29 million, recognized in our unaudited condensed consolidated statements of operations. We recognized net tax expense related to interest of \$10 million during the second quarter of 2014, \$11 million during the second quarter of 2013, \$19 million in the first half of 2014, and \$20 million in the first half of 2013.



It is reasonably possible that within the next 12 months we will resolve multiple issues including transfer pricing and transactional-related issues with foreign, federal and state taxing authorities, in which case we could record a reduction in our balance of unrecognized tax benefits of up to approximately \$12 million.

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NOTE J – COMMITMENTS AND CONTINGENCIES

The medical device market in which we primarily participate is largely technology driven. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. Over the years, there has been litigation initiated against us by others, including our competitors, claiming that our current or former product offerings infringe patents owned or licensed by them. Intellectual property litigation is inherently complex and unpredictable. In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of devices. These forces frequently drive settlement not only for individual cases, but also for a series of pending and potentially related and unrelated cases. Although monetary and injunctive relief is typically sought, remedies and restitution are generally not determined until the conclusion of the trial court proceedings and can be modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies.

During recent years, we successfully negotiated closure of several long-standing legal matters and have received favorable legal rulings in several other matters; however, there continues to be outstanding intellectual property litigation. Adverse outcomes in one or more of these matters could have a material adverse effect on our ability to sell certain products and on our operating margins, financial position, results of operations and/or liquidity.

In the normal course of business, product liability, securities and commercial claims are asserted against us. Similar claims may be asserted against us in the future related to events not known to management at the present time. We maintain an insurance policy providing limited coverage against securities claims, and we are substantially self-insured with respect to product liability claims and fully self-insured with respect to intellectual property infringement claims. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, securities and commercial litigation, and other legal proceedings in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations and/or liquidity.

In addition, like other companies in the medical device industry, we are subject to extensive regulation by national, state and local government agencies in the United States and other countries in which we operate. From time to time we are the subject of qui tam actions and governmental investigations often involving regulatory, marketing and other business practices. These qui tam actions and governmental investigations could result in the commencement of civil and criminal proceedings, substantial fines, penalties and administrative remedies and have a material adverse effect on our financial position, results of operations and/or liquidity.

We record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are probable and estimable. In accordance with ASC Topic 450, Contingencies, we accrue anticipated costs of settlement, damages, losses for general product liability claims and, under certain conditions, costs of defense, based on historical experience or to the extent specific losses are probable and estimable. Otherwise, we expense these costs as incurred. If the estimate of a probable loss is a range and no amount within the range is more likely, we accrue the minimum amount of the range.

Our accrual for legal matters that are probable and estimable was \$826 million as of June 30, 2014 and \$607 million as of December 31, 2013, and includes estimated costs of settlement, damages and defense. The increase in our legal accrual was primarily due to \$260 million of litigation-related charges during the first half of 2014. During the first half of 2013 we recorded \$130 million of litigation-related charges. We continue to assess certain litigation and claims to determine the amounts, if any, that management believes will be paid as a result of such claims and litigation and, therefore, additional losses may be accrued and paid in the future, which could materially adversely impact our operating results, cash flows and/or our ability to comply with our debt covenants.

In management's opinion, we are not currently involved in any legal proceedings other than those disclosed in our 2013 Annual Report on Form 10-K and our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014 and

those specifically identified below, which, individually or in the aggregate, could have a material adverse effect on our financial condition, operations and/or cash flows. Unless included in our legal accrual or otherwise indicated below, a range of loss associated with any individual material legal proceeding cannot be estimated.

#### Patent Litigation

On May 19, 2005, G. David Jang, M.D. filed suit against us alleging breach of contract relating to certain patent rights covering stent technology. The suit was filed in the U.S. District Court for the Central District of California seeking monetary damages and rescission of contract. After a Markman ruling relating to the Jang patent rights, Dr. Jang stipulated to the dismissal of certain

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claims alleged in the complaint with a right to appeal and the parties subsequently agreed to settle the other claims. In May 2007, Dr. Jang filed an appeal with respect to the remaining patent claims and in July 2008, the Court of Appeals vacated the District Court's consent judgment and remanded the case back to the District Court for further clarification. In August 2011, the District Court entered a stipulated judgment that we did not infringe the Jang patent. Dr. Jang filed an appeal on September 21, 2011 and on August 22, 2012, the Court of Appeals vacated the District Court's judgment and remanded the case to the District Court for further proceedings. On April 18, 2014, the case was stayed pending consideration of an interlocutory appeal.

On February 18, 2014, Atlas IP, LLC filed a complaint in the United States District Court for the Southern District of Florida alleging that the sale of our LATITUDE® Patient Management System and implantable devices that communicate with the LATITUDE® device infringe a patent owned by Atlas. On July 9, 2014, the District Court granted our motion to transfer venue to the United States District Court for the District of Minnesota.

## Product Liability Litigation

Fewer than ten individual lawsuits remain pending in various state and federal jurisdictions against Guidant Corporation (Guidant) alleging personal injuries associated with defibrillators or pacemakers involved in certain 2005 and 2006 product communications. Further, we are aware of approximately 30 Guidant product liability lawsuits pending in international jurisdictions associated with defibrillators or pacemakers, including devices involved in the 2005 and 2006 product communications. Six of these suits are pending in Canada and were filed as class actions, four of which are stayed pending the outcome of two lead class actions. On April 10, 2008, the Justice of Ontario Court certified a class of persons in whom defibrillators were implanted in Canada and a class of family members with derivative claims. On May 8, 2009, the Justice of Ontario Court certified a class of persons in whom pacemakers were implanted in Canada and a class of family members with derivative claims. In each case, these matters generally seek monetary damages from us. The parties in the defibrillator class action have reached an agreement in principle to settle the matter for approximately \$3 million. The presiding judge approved the settlement at a hearing on March 24, 2014. We paid the initial required payments during the second quarter of 2014 and expect to fund the publication of the settlement notice during the third quarter of 2014.

As of August 5, 2014, there were over 23,000 product liability cases or claims related to transvaginal surgical mesh products designed to treat stress urinary incontinence and pelvic organ prolapse pending against us. The cases are pending in various federal and state courts in the United States and include eight putative class actions. There were also less than 20 cases in Canada, inclusive of three putative class actions, and less than 10 claims in the United Kingdom. Generally, the plaintiffs allege personal injury associated with use of our transvaginal surgical mesh products. The plaintiffs assert design and manufacturing claims, failure to warn, breach of warranty, fraud, violations of state consumer protection laws and loss of consortium claims. Over 1,700 of the cases have been specially assigned to one judge in state court in Massachusetts. On February 7, 2012, the Judicial Panel on Multi-District Litigation (MDL) established MDL-2326 in the U.S. District Court for the Southern District of West Virginia and transferred the federal court transvaginal surgical mesh cases to MDL-2326 for coordinated pretrial proceedings. During the fourth quarter of 2013, we received written discovery requests from certain state attorneys general offices regarding our transvaginal surgical mesh products. We have responded to those requests. We have established a product liability accrual for known and estimated future cases and claims asserted against us as well as costs of defense thereof associated with our transvaginal surgical mesh products. While we believe that our accrual associated with this matter is adequate, changes to this accrual may be required in the future as additional information becomes available. We intend to vigorously contest the cases and claims asserted against us; however, the final resolution is uncertain and could have a material impact on our results of operations, financial condition and/or liquidity.

## Governmental Investigations and Qui Tam Matters

On May 5, 2014, we were served with a subpoena from the U.S. Department of Health and Human Services, Office of the Inspector General. The subpoena seeks information relating to the launch of the Cognis and Teligen line of devices in 2008, the performance of those devices from 2007 to 2009, and the operation of the Physician Guided Learning Program. We are cooperating with this request.

On July 11, 2014, we were served with a subpoena from the U.S. Attorney for the District of New Jersey. The subpoena seeks information relating to BridgePoint Medical, Inc., which we acquired in October 2012, including information relating to its sale of CrossBoss and Stingray products, educational and training activities that relate to those sales and our acquisition of BridgePoint Medical. We are cooperating with this request.

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Other Proceedings

On September 25, 2006, Johnson & Johnson filed a lawsuit against us, Guidant and Abbott Laboratories in the U.S. District Court for the Southern District of New York. The complaint alleges that Guidant breached certain provisions of the amended merger agreement between Johnson & Johnson and Guidant (Merger Agreement) as well as the implied duty of good faith and fair dealing. The complaint further alleges that Abbott and we tortiously interfered with the Merger Agreement by inducing Guidant's breach. The complaint seeks certain factual findings, damages in an amount no less than \$5.5 billion and attorneys' fees, costs, and interest. In August 2007, the judge dismissed the tortious interference claims against us and Abbott and the implied duty of good faith and fair dealing claim against Guidant. On June 20, 2011, Guidant filed a motion for summary judgment, and the hearing on this motion was held on July 25, 2012. On July 7, 2014, the judge denied Guidant's motion. The bench trial is scheduled to begin on November 20, 2014.

On September 28, 2011, we served a complaint against Mirowski Family Ventures LLC in the U.S. District Court for the Southern District of Indiana for a declaratory judgment that we have paid all royalties owed and did not breach any contractual or fiduciary obligations arising out of a license agreement. Mirowski answered and filed counterclaims requesting damages. On May 13, 2013, Mirowski Family Ventures served us with a complaint alleging breach of contract in Montgomery County Circuit Court, Maryland, and they amended this complaint on August 1, 2013. On July 29, 2013, the Indiana case was dismissed. On September 10, 2013, we removed the case to the United States District Court for the District of Maryland. On June 5, 2014, the District Court granted Mirowski's motion to remand the case to the Montgomery County Circuit Court and trial is scheduled to begin on September 2, 2014. Refer to Note I - Income Taxes for information regarding our tax litigation.

Matters Concluded Since December 31, 2013

On February 1, 2008, Wyeth Corporation (Wyeth) and Cordis Corporation filed an amended complaint for patent infringement against Abbott Laboratories, adding us and Boston Scientific Scimed, Inc. as additional defendants to the complaint. The suit alleged that the PROMUS® coronary stent system, supplied to us by Abbott, infringes three U.S. patents owned by Wyeth and licensed to Cordis. The suit was filed in the U.S. District Court for the District of New Jersey seeking monetary and injunctive relief. Wyeth and Cordis subsequently withdrew their infringement claim as to one of the patents, and the District Court found the remaining two patents invalid. Wyeth and Cordis filed an appeal and, on June 26, 2013, the Court of Appeals for the Federal Circuit affirmed the District Court's judgment in favor of Boston Scientific. On October 13, 2013, Wyeth's motion for rehearing or rehearing en banc was denied. The deadline for further appeals lapsed on January 13, 2014.

On May 25, 2010, G. David Jang, M.D. filed suit against Boston Scientific Scimed, Inc. and us alleging breach of contract relating to certain patent rights covering stent technology. In October 2011, the U.S. District Court for the District of Delaware entered judgment in favor of us on the pleadings. Dr. Jang filed an appeal on August 28, 2012. On September 5, 2013, the Court of Appeals for the Third Circuit vacated the ruling and remanded the case to the District Court. On March 31, 2014, the parties entered into a confidential settlement agreement. On April 2, 2014, the case was dismissed.

On May 16, 2013, Vascular Solutions, Inc. filed suit against us, alleging that our Guidezilla™ guide extension catheter infringes three U.S. patents owned by Vascular Solutions. The suit was filed in the U.S. District Court for the District of Minnesota seeking monetary and injunctive relief. On May 28, 2013, Vascular Solutions filed an amended complaint adding an allegation of copyright infringement. On June 10, 2013, Vascular Solutions filed a motion requesting a preliminary injunction. On July 11, 2013, we answered the amended complaint and filed a counterclaim against Vascular Solutions, alleging that its Guideliner™ guide extension catheter infringes a U.S. patent owned by us. On December 12, 2013, the District Court granted the motion for a preliminary injunction and on December 26, 2013, we filed an appeal. On April 15, 2014, the Court of Appeals for the Federal Circuit vacated the preliminary injunction. On July 30, 2014, we and Vascular Solutions entered into a confidential settlement agreement and the case will be dismissed.

On September 23, 2013, Kardiametrics, LLC filed a complaint in the United States District Court for the District of Delaware alleging that the sale of our FilterWire EZ Embolic Protection System, Sterling balloon catheters, Carotid NexStent and Carotid WallStent products infringe two patents owned by Kardiametrics. On January 24, 2014, we filed a motion to dismiss the case or, in the alternative, to stay the case pending an arbitration. On February 18, 2014, Kardiametrics dismissed its original complaint and filed a new complaint. On March 14, 2014, we filed a motion to dismiss the new case or, in the alternative, to stay the new case pending an arbitration. On May 28, 2014, Kardiametrics voluntarily dismissed its case.

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## NOTE K – WEIGHTED AVERAGE SHARES OUTSTANDING

(in millions)	Three Months Ended		Six Months Ended		
	June 30, 2014	2013	June 30, 2014	2013	
Weighted average shares outstanding - basic	1,323.2	1,343.5	1,322.4	1,347.7	
Net effect of common stock equivalents	21.8	15.1	24.7	—	*
Weighted average shares outstanding - assuming dilution	1,345.0	1,358.6	1,347.1	1,347.7	

\* We generated a net loss in the first half of 2013. Our weighted-average shares outstanding for earnings per share calculations exclude common stock equivalents of 14.0 million for the first half of 2013 due to our net loss position in this period.

Weighted average shares outstanding, assuming dilution, excludes the impact of 13 million stock options for the second quarter of 2014, 16 million stock options for the second quarter of 2013, 13 million stock options for the first half of 2014, and 25 million stock options for the first half of 2013, due to the exercise prices of these stock options being greater than the average fair market value of our common stock during the period.

We issued approximately one million shares of our common stock in the second quarter of 2014, one million shares of our common stock in the second quarter of 2013, 11 million shares of our common stock in the first half of 2014, and nine million shares of our common stock in the first half of 2013, following the exercise or vesting of underlying stock options or deferred stock units, or purchases under our employee stock purchase plans. We did not repurchase any shares of our common stock during the second quarter of 2014. We repurchased 13 million shares of our common stock during the second quarter of 2013 for approximately \$100 million, 10 million shares of our common stock during the first half of 2014 for approximately \$125 million, and 26 million shares of our common stock during the first half of 2013 for approximately \$200 million, pursuant to our authorized repurchase programs as discussed in Note L – Stockholders' Equity to our audited financial statements contained in Item 8 of our 2013 Annual Report filed on Form 10-K.

## NOTE L – SEGMENT REPORTING

Effective as of January 1, 2013, we reorganized our business from geographic regions to fully operationalized global business units. Following the reorganization, based on information regularly reviewed by our chief operating decision maker, we have three reportable segments comprised of: Cardiovascular, Rhythm Management, and MedSurg. Our reportable segments represent an aggregate of operating segments.

Each of our reportable segments generates revenues from the sale of medical devices. We measure and evaluate our reportable segments based on segment net sales and operating income, excluding the impact of changes in foreign currency and sales from divested businesses. Sales generated from reportable segments and divested businesses, as well as operating results of reportable segments and corporate expenses, are based on internally-derived standard currency exchange rates, which may differ from year to year, and do not include intersegment profits. We restated segment information for the prior period based on our internally-derived standard currency exchange rates used for the current period in order to remove the impact of foreign currency exchange fluctuation and for the realignment of certain product lines from Endoscopy to Peripheral Interventions as of January 1, 2014. We exclude from segment operating income certain corporate-related expenses and certain charges or credits that our chief operating decision maker considers to be non-recurring and/or non-operational, such as amounts related to goodwill and other intangible asset impairment charges; acquisition-, divestiture-, restructuring- and litigation-related charges and credits; and amortization expense. Although we exclude these amounts from segment operating income, they are included in reported consolidated operating income (loss) and are included in the reconciliation below.



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A reconciliation of the totals reported for the reportable segments to the applicable line items in our accompanying unaudited condensed consolidated statements of operations is as follows:

(in millions)	Three Months Ended		Six Months Ended	
	June 30, 2014	2013 (restated)	June 30, 2014	2013 (restated)
Net sales				
Interventional Cardiology	\$528	\$521	\$1,029	\$1,019
Peripheral Interventions	210	204	414	397
Cardiovascular	738	725	1,443	1,416
Cardiac Rhythm Management	495	476	959	951
Electrophysiology	55	36	113	70
Rhythm Management	550	512	1,072	1,021
Endoscopy	334	320	650	620
Urology and Women's Health	133	124	259	241
Neuromodulation	114	111	223	200
MedSurg	581	555	1,132	1,061
Net sales allocated to reportable segments	1,869	1,792	3,647	3,498
Sales generated from divested businesses	1	19	3	55
Impact of foreign currency fluctuations	3	(2	) (3	) 17
	\$1,873	\$1,809	\$3,647	\$3,570
Income (loss) before income taxes				
Cardiovascular	\$193	\$182	\$364	\$340
Rhythm Management	67	56	133	113
MedSurg	175	171	343	311
Operating income allocated to reportable segments	435	409	840	764
Corporate expenses and currency exchange	(64	) (48	) (115	) (89
Goodwill and other intangible asset impairment charges; and acquisition-, divestiture-, restructuring-, and litigation related charges or credits	(331	) (40	) (379	) (580
Amortization expense	(109	) (101	) (218	) (204
Operating income (loss)	(69	) 220	128	(109
Other expense, net	(35	) (68	) (86	) (133
Income (loss) before income taxes	\$(104	) \$152	\$42	\$(242

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## NOTE M – CHANGES IN OTHER COMPREHENSIVE INCOME

The following table provides the reclassifications out of other comprehensive income for the three and six months ended June 30, 2014 and June 30, 2013. Amounts in the chart below are presented net of tax.

## Three Months Ended June 30, 2014

(in millions)	Foreign currency translation adjustments	Unrealized gains/losses on derivative financial instruments	Defined benefit pension items / Other	Total
Balance as of March 31, 2014	\$(22)	\$114	\$(20)	\$72
Other comprehensive income (loss) before reclassifications	(2)	(13)	—	(15)
Amounts reclassified from accumulated other comprehensive income	—	(15)	—	(15)
Net current-period other comprehensive income	(2)	(28)	—	(30)
Balance as of June 30, 2014	\$(24)	\$86	\$(20)	\$42

## Three Months Ended June 30, 2013

(in millions)	Foreign currency translation adjustments	Unrealized gains/losses on derivative financial instruments	Defined benefit pension items / Other	Total
Balance as of March 31, 2013	\$(23)	\$109	\$(41)	\$45
Other comprehensive income (loss) before reclassifications	(6)	47	—	41
Amounts reclassified from accumulated other comprehensive income	—	(4)	—	(4)
Net current-period other comprehensive income	(6)	43	—	37
Balance as of June 30, 2013	\$(29)	\$152	\$(41)	\$82

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## Six Months Ended June 30, 2014

(in millions)	Foreign currency translation adjustments	Unrealized gains/losses on derivative financial instruments	Defined benefit pension items / Other	Total
Balance as of December 31, 2013	\$(16)	\$141	\$(19)	\$106
Other comprehensive income (loss) before reclassifications	(8)	(27)	(1)	(36)
Amounts reclassified from accumulated other comprehensive income	—	(28)	—	(28)
Net current-period other comprehensive income	(8)	(55)	(1)	(64)
Balance as of June 30, 2014	\$(24)	\$86	\$(20)	\$42

## Six Months Ended June 30, 2013

(in millions)	Foreign currency translation adjustments	Unrealized gains/losses on derivative financial instruments	Defined benefit pension items / Other	Total
Balance as of December 31, 2012	\$(26)	\$34	\$(41)	\$(33)
Other comprehensive income (loss) before reclassifications	(3)	118	—	115
Amounts reclassified from accumulated other comprehensive income	—	—	—	—
Net current-period other comprehensive income	(3)	118	—	115
Balance as of June 30, 2013	\$(29)	\$152	\$(41)	\$82

The income tax impact of the amounts in other comprehensive income for unrealized gains/losses on derivative financial instruments before reclassifications was a benefit of \$7 million in the second quarter of 2014, an expense of \$26 million in the second quarter of 2013, a benefit of \$13 million in the first half of 2014, and an expense of \$71 million in the first half of 2013. The gains and losses on derivative financial instruments reclassified were reduced by income tax impacts of \$8 million in the second quarter of 2014, \$2 million in the second quarter of 2013, \$16 million in the first half of 2014, and there was zero impact in the first half of 2013. Refer to Note E – Fair Value Measurements in this Quarterly Report on Form 10-Q for further detail on the reclassifications related to derivatives.

## NOTE N – NEW ACCOUNTING PRONOUNCEMENTS

## Standards Implemented

## ASC Update No. 2013-11

In July 2013, the FASB issued ASC Update No. 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. Update No. 2013-11 requires that entities present an unrecognized tax benefit, or portion of an unrecognized tax benefit, as a reduction to a deferred tax asset in the financial statements for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, with certain exceptions. We adopted Update No. 2013-11 beginning in our first quarter ended March 31, 2014. The adoption of Update No. 2013-11 did not impact our results of operations or financial position.



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Standards to be Implemented

ASC Update No. 2014-08

In April 2014, the FASB issued ASC Update No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity. Update No. 2014-08 changed the criteria for reporting discontinued operations and enhanced convergence of the FASB's and the International Accounting Standard Board's (IASB) reporting requirements for discontinued operations. We are required to apply this amendment, prospectively to: (1) all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014 and interim periods within those years and (2) all businesses that, on acquisition, are classified as held for sale that occur within annual periods beginning on or after December 15, 2014 and interim periods within those years. The adoption of Update No. 2014-08 is not expected to have a material impact on our financial position or results of operations.

ASC Update No. 2014-09

In May 2014, the FASB issued ASC Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). Update No. 2014-09 provides enhancements to the quality and consistency of how revenue is reported while also improving comparability in the financial statements of companies using International Financial Reporting Standards and U.S. GAAP. The core principle requires entities to recognize revenue in a manner that depicts the transfer of goods or services to customers in amounts that reflect the consideration an entity expects to be entitled to in exchange for those goods or services. We are required to apply Update No. 2014-09 for annual periods beginning after December 15, 2016 and early application is not permitted. We are in the process of determining the effect, if any, that the adoption of this standard will have on our financial position or results of operations.

ASC Update No. 2014-10

In June 2014, the FASB issued ASC Update No. 2014-10, Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation. The amendments remove the definition of a development stage entity from the Master Glossary of the Accounting Standards Codification, thereby removing the financial reporting distinction between development stage entities and other reporting entities. The amendments also eliminate an exception provided to development stage entities in Topic 810, Consolidation, for determining whether an entity is a variable interest entity on the basis of the amount of investment equity that is at risk. The elimination of the exception may change the consolidation analysis, consolidation decision, and disclosure requirements for a reporting entity that has an interest in an entity in the development stage. We are required to apply Update No. 2014-10 for annual reporting periods beginning after December 15, 2014, and interim periods within those years. The adoption of Update No. 2014-10 is not expected to have a material impact on our financial position or results of operations.

ASC Update No. 2014-11

In June 2014, the FASB issued ASC Update No. 2014-11, Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures. Update No. 2014-11 changes the accounting for repurchase-to-maturity transactions and repurchase financings and expands disclosure requirements. The amendments (1) require entities to account for repurchase-to-maturity transactions as secured borrowings, (2) eliminate accounting guidance on linked repurchase financing transactions, and (3) expand disclosure requirements related to certain transfers of financial assets that are accounted for as sales and certain transfers accounted for as secured borrowings. Update No. 2014-11 also clarifies that repurchase and securities lending transactions that do not meet all of the criteria in ASC 860-10-40-5 should be accounted for as secured borrowings. We are required to apply the accounting changes and disclosure for certain transactions accounted for as a sale for periods beginning after December 15, 2014 and early application is not permitted. The disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and for interim periods within those years. The disclosures are not required to be presented for comparative periods before the effective date. The adoption of Update No. 2014-11 is not expected to have a material impact on our financial position or results of operations.



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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

Boston Scientific Corporation is a worldwide developer, manufacturer and marketer of medical devices that are used in a broad range of interventional medical specialties. Our mission is to transform lives through innovative medical solutions that improve the health of patients around the world. Our products and technologies are used to diagnose or treat a wide range of medical conditions, including heart, digestive, pulmonary, vascular, urological, women's health, and chronic pain conditions. We continue to innovate in these areas and are intent on extending our innovations into new geographies and high-growth adjacency markets.

Financial Summary

Three Months Ended June 30, 2014

Our net sales for the second quarter of 2014 were \$1.873 billion, as compared to net sales of \$1.809 billion for the second quarter of 2013, an increase of \$64 million, or four percent. Excluding the impact of changes in foreign currency exchange rates, which had a \$5 million positive impact on our second quarter 2014 net sales as compared to the same period in the prior year, and the decrease in net sales from divested businesses of \$18 million, our net sales increased \$77 million, or four percent.<sup>1</sup> Refer to Quarterly Results and Business Overview for a discussion of our net sales by global business.

Our reported net income for the second quarter of 2014 was \$4 million, or \$0.00 per share. Our reported results for the second quarter of 2014 included intangible asset impairment charges, acquisition- and divestiture-related net credits, litigation-related net charges, restructuring and restructuring-related charges, discrete tax items, and amortization expense totaling \$281 million (after-tax), or \$0.21 per share. Excluding these items, net income for the second quarter of 2014 was \$285 million, or \$0.21 per share.<sup>1</sup> Our reported net income for the second quarter of 2013 was \$130 million, or \$0.10 per share. Our reported results for the second quarter of 2013 included intangible asset impairment charges, acquisition- and divestiture-related net credits, restructuring and restructuring-related charges, and amortization expense totaling \$117 million (after-tax), or \$0.08 per share. Excluding these items, net income for the second quarter of 2013 was \$247 million, or \$0.18 per share.<sup>1</sup>

<sup>1</sup> Sales growth rates that exclude the impact of sales from divested businesses and/or changes in foreign currency exchange rates and net income and net income per share excluding certain items required by GAAP are not prepared in accordance with U.S. GAAP. Refer to Additional Information for a discussion of management's use of these non-GAAP financial measures.

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The following is a reconciliation of results of operations prepared in accordance with U.S. GAAP to those adjusted results considered by management. Refer to Quarterly Results and Business Overview for a discussion of each reconciling item:

in millions, except per share data	Three Months Ended June 30, 2014			Impact per share
	Pre-Tax	Tax Impact	After-Tax	
GAAP net income (loss)	\$(104	) \$108	\$4	\$0.00
Non-GAAP adjustments:				
Intangible asset impairment charges	110	(19	) 91	0.07
Acquisition- and divestiture-related net credits	(91	) (1	) (92	) (0.07
Restructuring and restructuring-related net charges	25	(6	) 19	0.01
Discrete tax items	—	(2	) (2	) 0.00
Litigation-related net charges	267	(100	) 167	0.13
Amortization expense	109	(11	) 98	0.07
Adjusted net income	\$316	\$(31	) \$285	\$0.21

in millions, except per share data	Three Months Ended June 30, 2013			Impact per share
	Pre-Tax	Tax Impact	After-Tax	
GAAP net income (loss)	\$152	\$(22	) \$130	\$0.10
Non-GAAP adjustments:				
Intangible asset impairment charges	53	(8	) 45	0.03
Acquisition- and divestiture-related net credits	(44	) 7	(37	) (0.03
Restructuring and restructuring-related net charges	31	(8	) 23	0.02
Amortization expense	101	(15	) 86	0.06
Adjusted net income	\$293	\$(46	) \$247	\$0.18

Cash provided by operating activities was \$286 million in the second quarter of 2014, as compared to \$396 million in the second quarter of 2013. As of June 30, 2014, we had total debt of \$4.255 billion, cash and cash equivalents of \$357 million and working capital of \$1.441 billion. Refer to Liquidity and Capital Resources for further discussion.

## Six Months Ended June 30, 2014

Our net sales for the first half of 2014 were \$3.647 billion, as compared to net sales of \$3.570 billion for the first half of 2013, an increase of \$77 million, or two percent. Excluding the impact of changes in foreign currency exchange rates, which had a \$20 million negative impact on our net sales for the six months ended June 30, 2014 as compared to the same period in the prior year, and the decrease in net sales from divested businesses of \$52 million, our net sales increased \$149 million, or four percent.<sup>1</sup> Refer to Quarterly Results and Business Overview for a discussion of our net sales by global business.

Our reported net income for the first half of 2014 was \$137 million, or \$0.10 per share. Our reported results for the first half of 2014 included intangible asset impairment charges, acquisition- and divestiture-related net credits, litigation-related net charges, restructuring and restructuring-related charges, discrete tax items, and amortization expense totaling \$416 million (after-tax), or \$0.31 per share. Excluding these items, net income for the first half of 2014 was \$553 million, or \$0.41 per share.<sup>1</sup> Our reported net loss for the first half of 2013 was \$224 million or \$0.17 per share, driven primarily by a goodwill impairment charge related to our global Cardiac Rhythm Management (CRM) business unit. Our reported results for the first half of 2013 included goodwill and intangible asset impairment charges, acquisition- and divestiture-related net credits, restructuring and restructuring-related and litigation-related net charges, and amortization expense totaling \$695 million (after-tax), or \$0.52 per share. Excluding these items, net income for the first half of 2013 was \$471 million, or \$0.35 per share.<sup>1</sup>



<sup>1</sup> Sales growth rates that exclude the impact of sales from divested businesses and/or changes in foreign currency exchange rates and net income and net income per share excluding certain items required by GAAP are not prepared in accordance with U.S. GAAP. Refer to Additional Information for a discussion of management's use of these non-GAAP financial measures.

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The following is a reconciliation of results of operations prepared in accordance with U.S. GAAP to those adjusted results considered by management. Refer to Quarterly Results and Business Overview for a discussion of each reconciling item:

in millions, except per share data	Six Months Ended June 30, 2014			Impact per share
	Pre-Tax	Tax Impact	After-Tax	
GAAP net income (loss)	\$42	\$95	\$137	\$0.10
Non-GAAP adjustments:				
Intangible asset impairment charges	165	(25 )	140	0.10
Acquisition- and divestiture-related net credits	(118 )	(2 )	(120 )	(0.09 )
Restructuring and restructuring-related net charges	53	(13 )	40	0.03
Discrete tax items	—	—	—	0.00
Litigation-related net charges	260	(99 )	161	0.12
Amortization expense	218	(23 )	195	0.15
Adjusted net income	\$620	\$(67 )	\$553	\$0.41

in millions, except per share data	Six Months Ended June 30, 2013			Impact per share
	Pre-Tax	Tax Impact	After-Tax	
GAAP net income (loss)	\$(242 )	\$18	\$(224 )	\$(0.17 )
Non-GAAP adjustments:				
Goodwill impairment charge	423	(2 )	421	0.31 *
Intangible asset impairment charges	53	(8 )	45	0.03 *
Acquisition- and divestiture-related net credits	(72 )	10	(62 )	(0.05 )*
Restructuring and restructuring-related net charges	46	(12 )	34	0.03 *
Litigation-related charges	130	(48 )	82	0.06 *
Amortization expense	204	(29 )	175	0.14 *
Adjusted net income	\$542	\$(71 )	\$471	\$0.35

\*Assumes dilution of 14.0 million shares for the six months ended June 30, 2013 for all or a portion of these non-GAAP adjustments.

Cash provided by operating activities was \$483 million in the first half of 2014, as compared to \$584 million in the first half of 2013. During the first half of 2014, we used \$125 million of cash generated from operations to repurchase approximately 10 million shares of our common stock.

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## Quarterly Results and Business Overview

## Net Sales

The following table provides our worldwide net sales by business and the relative change on an as reported and constant currency basis, both excluding and including divested businesses. The constant currency growth rates in the tables below can be recalculated from our net sales presented in Note L – Segment Reporting to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q. Net sales that exclude the impact of changes in foreign currency exchange rates are not financial measures prepared in accordance with U.S. GAAP and should not be considered in isolation from, or as a replacement for, the most directly comparable GAAP financial measure. Refer to Additional Information for a further discussion of management's use of this non-GAAP financial measure.

(in millions)	Three Months Ended		Change		Constant	
	June 30, 2014	2013 (restated)	As Reported Currency Basis		Currency Basis	
Interventional Cardiology	\$528	\$520	2	%	1	%
Peripheral Interventions	211	204	3	%	3	%
Cardiovascular	739	724	2	%	2	%
Cardiac Rhythm Management	497	475	5	%	4	%
Electrophysiology	56	36	55	%	54	%
Rhythm Management	553	511	8	%	7	%
Endoscopy	333	320	4	%	4	%
Urology and Women's Health	133	124	7	%	7	%
Neuromodulation	114	111	3	%	3	%
MedSurg	580	555	5	%	5	%
Subtotal Core Businesses	1,872	1,790	5	%	4	%
Divested Businesses	1	19	(93	)%	(93	)%
Worldwide	\$1,873	\$1,809	4	%	4	%

We restated segment information for the prior period to reflect the realignment of certain product lines from Endoscopy to Peripheral Interventions as of January 1, 2014.

Growth rates are based on actual, non-rounded amounts and may not recalculate precisely.

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(in millions)	Six Months Ended		Change		Constant	
	June 30, 2014	2013 (restated)	As Reported Currency Basis	%	Currency Basis	%
Interventional Cardiology	\$ 1,025	\$ 1,025	0	%	1	%
Peripheral Interventions	414	400	3	%	4	%
Cardiovascular	1,439	1,425	1	%	2	%
Cardiac Rhythm Management	963	953	1	%	1	%
Electrophysiology	114	71	61	%	60	%
Rhythm Management	1,077	1,024	5	%	5	%
Endoscopy	647	624	4	%	5	%
Urology and Women's Health	258	242	7	%	8	%
Neuromodulation	223	200	12	%	12	%
MedSurg	1,128	1,066	6	%	7	%
Subtotal Core Businesses	3,644	3,515	4	%	4	%
Divested Businesses	3	55	(94	) %	(94	) %
Worldwide	\$ 3,647	\$ 3,570	2	%	2	%

We restated segment information for the prior period to reflect the realignment of certain product lines from Endoscopy to Peripheral Interventions as of January 1, 2014.

Growth rates are based on actual, non-rounded amounts and may not recalculate precisely.

#### Cardiovascular

##### Interventional Cardiology

Our Interventional Cardiology division develops, manufactures and markets technologies for diagnosing and treating coronary artery disease and other cardiovascular disorders. Product offerings include coronary stents, including drug-eluting and bare metal stent systems, balloon catheters, rotational atherectomy systems, guide wires, guide catheters, embolic protection devices, crossing and re-entry devices for the treatment of chronically occluded coronary vessels, diagnostic catheters used in percutaneous transluminal coronary angioplasty procedures, and intravascular ultrasound (IVUS) imaging systems. We also offer structural heart products in certain international markets, which include a device for transcatheter aortic valve replacement and a device designed to close the left atrial appendage.

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Our worldwide net sales of Interventional Cardiology products were \$528 million in the second quarter of 2014, or approximately 28 percent of our consolidated net sales in the second quarter of 2014. Our worldwide net sales of Interventional Cardiology products increased \$8 million, or two percent, in the second quarter of 2014, as compared to the same period in 2013. Excluding the impact of changes in foreign currency exchange rates, which had a \$1 million positive impact on our Interventional Cardiology net sales in the second quarter of 2014, as compared to the same period in the prior year, net sales of these products increased \$7 million, or one percent. This increase was primarily related to sales of our Promus PREMIER™ Stent System in the U.S., our structural heart products in international markets, including the Lotus™ transcatheter aortic valve replacement system and the WATCHMAN® left atrial appendage closure device, along with operational growth in our other cardiology product lines. The Lotus™ Valve System consists of a stent-mounted tissue valve prosthesis and catheter delivery system for guidance and placement of the valve. In April 2013, we completed enrollment in the REPRISE II clinical trial to evaluate the safety and performance of the Lotus™ Valve System. In October 2013, we received CE Mark approval and launched the Lotus™ Valve System in Europe. The WATCHMAN® left atrial appendage closure technology is the first device studied in a randomized clinical trial to offer an alternative to anticoagulant drugs, and is marketed in CE Mark and other international countries. In the U.S., we completed the 18 month follow-up PREVAIL trial and final 5 year follow-up in the PROTECT AF trial to evaluate the safety and efficacy of the WATCHMAN® device in patients with nonvalvular atrial fibrillation versus long-term warfarin therapy and are working towards FDA approval of the device. During the second quarter of 2014, we were informed by the FDA that another Circulatory System Devices Panel would be convened in October 2014 to review the WATCHMAN® clinical evidence. As a result, our goal for U.S. FDA approval and launch of this technology is now the first half of 2015. Due to the revised expectations and timing for the U.S. launch, we recorded impairment charges related to the WATCHMAN® device in-process research and development intangible assets during the second quarter of 2014. Refer to Intangible Asset Impairment Charges for further details.

Our coronary stent system sales represent a significant portion of our Interventional Cardiology net sales. The following are the components of our worldwide coronary stent system sales:

(in millions)	Three Months Ended			Three Months Ended		
	June 30, 2014			June 30, 2013		
	U.S.	International	Total	U.S.	International	Total
Drug-eluting	\$127	\$171	\$298	\$117	\$170	\$287
Bare-metal	4	8	12	5	12	17
	\$131	\$179	\$310	\$122	\$182	\$304

Our worldwide net sales of coronary stent systems increased \$6 million, or two percent, in the second quarter of 2014, as compared to the same period in 2013. Excluding the impact of changes in foreign currency exchange rates, which had a \$1 million negative impact on our coronary stent system net sales in the second quarter of 2014, compared to the same period in the prior year, net sales of these products increased \$7 million, or two percent. This increase was primarily related to market share gains due to the ongoing worldwide roll-out of our Promus PREMIER™ Everolimus-Eluting Platinum Chromium Coronary Stent System and increases in market-wide procedural volumes partially offset by average selling price declines in the drug-eluting stent (DES) market.

In May 2014 we launched our Promus PREMIER™ Everolimus-Eluting Platinum Chromium Coronary Stent System in Japan, following regulatory approval by the Japanese Ministry of Health, Labor and Welfare (MHLW). We had previously launched this technology in Europe and select other geographies during the first quarter of 2013, and in the U.S. during the fourth quarter of 2013. The Promus PREMIER™ Stent System is designed to provide physicians improved drug-eluting stent performance in treating patients with coronary artery disease, featuring unique customized platinum chromium alloy stent architecture and an enhanced stent delivery system. We also market our next generation SYNERGY™ Everolimus-Eluting Platinum Chromium Coronary Stent System in select European and other CE Mark countries, which features an ultra-thin abluminal (outer) bioabsorbable polymer coating. During the first half of 2014, we continued to expand our commercial launch of this technology in Europe. We have completed patient enrollment in the EVOLVE II clinical trial, which is designed to further assess the safety and effectiveness of the SYNERGY Stent System and support U.S. Food and Drug Administration and Japanese regulatory approvals for

this technology.

Peripheral Interventions (PI)

Our PI product offerings include stents, balloon catheters, wires, peripheral embolization devices and other devices used to diagnose and treat peripheral vascular disease. Our worldwide net sales of these products were \$211 million in the second quarter of 2014, as compared to \$204 million in the second quarter of 2013, an increase of \$7 million, or three percent. Excluding the impact of changes in foreign currency exchange rates, which had a \$1 million positive impact on our PI net sales in the second quarter of 2014, as compared to the same period in the prior year, net sales of these products increased \$6 million, or three percent. The

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year-over-year increase in worldwide PI net sales was primarily driven by growth in our core PI franchise as the result of new product launches in stents, balloons and chronic total occlusions (CTO) devices, which we expect to continue to drive our future growth in PI.

During the fourth quarter of 2012, we completed the acquisition of Vessix, a developer of catheter-based renal denervation systems for the treatment of resistant hypertension. Through the acquisition of Vessix, we added a second generation, highly differentiated technology to our hypertension strategy and launched this technology in Europe in May 2013. We have seen a slowdown in the resistant hypertension market in Europe following the failure of a competitor's large randomized clinical trial, which was announced during the first quarter of 2014. During the second quarter of 2014, based on a careful examination of the available data, we determined we would not pursue a global pivotal trial as previously designed. As a result of changes in our clinical strategy and lower estimates of the European and global hypertension markets, we reduced our expectations for future revenue and recorded impairment charges related to the Vessix technology intangible assets during the first and second quarter of 2014. Refer to Intangible Asset Impairment Charges for further details.

## Rhythm Management

## Cardiac Rhythm Management (CRM)

Our CRM division develops, manufactures and markets a variety of implantable devices including implantable cardioverter defibrillator (ICD) systems and pacemaker systems that monitor the heart and deliver electricity to treat cardiac abnormalities. Worldwide net sales of our CRM products of \$497 million in the second quarter of 2014 represented approximately 27 percent of our consolidated net sales for the second quarter of 2014. Our worldwide CRM net sales increased \$22 million, or five percent, in the second quarter of 2014, as compared to the same period in the prior year. Excluding the impact of changes in foreign currency exchange rates, which had a \$3 million positive impact on our second quarter 2014 CRM net sales, as compared to the same period in the prior year, our CRM net sales increased \$19 million, or four percent.

The following are the components of our worldwide CRM net sales:

(in millions)	Three Months Ended			Three Months Ended		
	June 30, 2014			June 30, 2013		
	U.S.	International	Total	U.S.	International	Total
ICD systems	\$223	\$132	\$355	\$213	\$129	\$342
Pacemaker systems	67	75	142	69	64	133
CRM products	\$290	\$207	\$497	\$282	\$193	\$475

The increase in our worldwide CRM net sales during the second quarter of 2014 as compared to the second quarter of 2013 was principally the result of increases in our denovo ICD market share as a result of our subcutaneous implantable cardioverter defibrillator (S-ICD) technology and our new line of defibrillators; partially offset by lower volumes of replacement procedures and implantable cardiac resynchronization therapy defibrillator (CRT-D) market share losses in certain regions. In February 2014, our European business initiated the full launch of our new X4 line of quadripolar CRT-D systems, including the AUTOGEN™ X4, DYNAGEN™ X4, and INOGEN™ X4 cardiac resynchronization therapy defibrillators (CRT-Ds), a suite of ACUITY™ X4 quadripolar LV leads and the ACUITY™ PRO lead delivery system. In addition, in April 2014, we received FDA approval for the DYNAGEN™ MINI and INOGEN™ MINI ICDs, the smallest fully-powered standard longevity ICDs on the market, as well as the DYNAGEN™ X4 and INOGEN™ X4 CRT-Ds. These new defibrillators were launched in the U.S. during the second quarter. During the second quarter of 2012, we completed the acquisition of Cameron Health, Inc. (Cameron). Cameron developed the world's first and only commercially available subcutaneous implantable cardioverter defibrillator, the S-ICD® System, which we believe is a differentiated technology that will provide us the opportunity to both increase our market share in the existing ICD market and expand that market over time. The S-ICD® System has received CE Mark and FDA approval. We became supply constrained in early March 2013 and were only able to provide a very limited supply of S-ICD® systems during the second and third quarters of 2013, and during the fourth quarter of 2013, we resumed our launch of our S-ICD® System.

Our worldwide pacemaker system sales increased during the second quarter of 2014 as compared to the second quarter of 2013 primarily due to the launch of our magnetic resonance imaging (MRI) compatible pacemaker system in Japan during the first quarter of 2014; and revenue growth in Europe related to our Ingevity family of MRI compatible pacing leads. Ingevity™ MRI pacing leads are part of the ImageReady™ MR-conditional pacemaker system, which includes VITALIO™ MRI, FORMIO™ MRI, ADVANTIO™ MRI and INGENIO™ MRI pulse generators. When used with the LATTITUDE™ NXT Patient Management



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System, these devices wirelessly monitor patients for conditions such as atrial arrhythmias. We commenced the U.S. Investigational Device Exemption (IDE) trial for the Ingevity™ MRI pacing lead during February 2013.

### Electrophysiology

Our Electrophysiology business develops less-invasive medical technologies used in the diagnosis and treatment of rate and rhythm disorders of the heart. Our leading products include the Blazer™ line of ablation catheters, designed to deliver enhanced performance, responsiveness and durability. Our Blazer™ line includes our next generation Blazer™ Prime ablation catheter, and our Blazer™ open-irrigated catheter, launched in select European countries in the second quarter of 2010. Worldwide net sales of our Electrophysiology products were \$56 million in the second quarter of 2014 as compared to \$36 million in the second quarter of 2013, an increase of \$20 million. Excluding the impact of changes in foreign currency exchange rates, which had a \$1 million positive impact on our Electrophysiology net sales in the second quarter of 2014, as compared to the same period in the prior year, net sales of these products increased \$19 million, or 54 percent. The increase was a result of our acquisition of the electrophysiology business of C.R. Bard Inc. (Bard EP), which we completed on November 1, 2013.

We believe that the acquisition of Bard EP brings a strong commercial team and complementary portfolio of ablation catheters, diagnostic tools, and electrophysiology recording systems, and will allow us to better serve the global Electrophysiology market through a more comprehensive portfolio offering and sales infrastructure. During the second quarter of 2014, we recorded \$24 million of revenue from Bard EP sales.

During the fourth quarter of 2012, we completed the acquisition of Rhythmia Medical, Inc. (Rhythmia), a developer of next-generation mapping and navigation solutions for use in cardiac catheter ablations and other electrophysiology procedures, including atrial fibrillation and atrial flutter. We received CE Mark approval for the Rhythmia technology during the second quarter of 2013 and received FDA approval during July 2013. We expect to initiate a limited launch of the Rhythmia next-generation mapping and navigation system in the second half of 2014.

We believe that the Rhythmia and Bard EP acquisitions, as well as our other expected product launches, will help to position us to participate more competitively in the growing Electrophysiology market.

### MedSurg

#### Endoscopy

Our Endoscopy business develops and manufactures devices to treat a variety of medical conditions including diseases of the digestive and pulmonary systems. Our worldwide net sales of these products were \$333 million for the second quarter of 2014, as compared to \$320 million in the second quarter of 2013, an increase of \$13 million, or four percent. Changes in foreign currency exchange rates did not materially affect our worldwide Endoscopy net sales in the second quarter of 2014, as compared to the second quarter of 2013. The increase in net sales was the result of growth across several of our key product franchises, including our biliary device franchise driven by the continued growth of our Expect™ Endoscopic Ultrasound Aspiration Needle; our hemostasis franchise on the continued adoption and utilization of our Resolution Clip for gastrointestinal bleeding; and our Polypectomy franchise in which growth was driven by the sales of our Twister® Plus rotatable retrieval device.

#### Urology and Women's Health

Our Urology and Women's Health business develops and manufactures devices to treat various urological and gynecological disorders. Our worldwide net sales of these products were \$133 million in the second quarter of 2014, as compared to \$124 million in the second quarter of 2013, an increase of approximately \$9 million, or seven percent. Changes in foreign currency exchange rates did not materially affect our worldwide Urology and Women's Health net sales in the second quarter of 2014, as compared to the second quarter of 2013. The increase in worldwide Urology and Women's Health net sales was primarily due to recent product launches and growth in the international business as a result of our global commercial expansion. We believe that our Urology and Women's Health business will continue to grow as a result of recent product launches in the U.S. and our continued expansion of the global footprint of this business.

On May 7, 2014, we completed the acquisition of the remaining fully diluted equity of IoGyn. IoGyn has developed the Symphion™ System, a next generation system for hysteroscopic intrauterine tissue removal including fibroids (myomas) and polyps. In March 2014, IoGyn received U.S. FDA approval for the system, and we expect to launch the system in the United States in the second half of 2014. We will integrate the operations of the IoGyn business with our gynecological surgery business, which is part of our Urology and Women's Health division.

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## Neuromodulation

Our Neuromodulation business offers the Precision® and Precision Spectra™ Spinal Cord Stimulation (SCS) systems, used for the management of chronic pain. Our worldwide net sales of Neuromodulation products were \$114 million in the second quarter of 2014, as compared to \$111 million in the second quarter of 2013, an increase of \$3 million, or three percent. Changes in foreign currency exchange rates did not materially affect our Neuromodulation net sales in the second quarter of 2014, as compared to the same period in the prior year. The revenue growth in our Neuromodulation business was primarily a result of sales of our Precision Spectra System. The Precision Spectra System is the world's first and only SCS system with 32 contacts and 32 dedicated power sources and is designed to provide improved pain relief to a wide range of patients who suffer from chronic pain. Significant changes to Medicare reimbursement for physician office trialing of spinal cord stimulation (SCS) systems went into effect January 1, 2014, resulting in slower trialing volumes, which are typically a leading indicator of total SCS market growth. Due to the higher prior year growth connected with the 2013 launch of Precision Spectra™ and current year changes in reimbursement, our growth rate in Neuromodulation slowed during the second quarter of 2014. As physicians adjust their practice patterns, we believe the market may slow this year to reflect the new reimbursement environment.

During the third quarter of 2012, we received CE Mark approval for use of our Vercise™ Deep Brain Stimulation (DBS) System for the treatment of Parkinson's disease in Europe, and we began our U.S. pivotal trial for the treatment of Parkinson's disease during the second quarter of 2013. During the fourth quarter of 2013, we received CE Mark approval for use of our Vercise™ DBS System for the treatment of intractable primary and secondary dystonia. We believe we have an exciting opportunity in DBS with the Vercise™ DBS System, which is designed to selectively stimulate targeted areas of the brain to customize therapy for patients and minimize side effects of unwanted stimulation.

## Emerging Markets

As part of our strategic imperatives to drive global expansion, described in our 2013 Annual Report on Form 10-K, we are seeking to grow net sales and market share by expanding our global presence, including in Emerging Markets. We define Emerging Markets as including certain developing countries that we believe have strong growth potential based on their economic conditions, healthcare sectors, and our global capabilities, which currently include 20 countries. We are seeking to expand our presence and strengthen relationships in order to grow net sales and market share within our Emerging Markets, and we have increased our investment in infrastructure in these countries in order to maximize opportunities. Our Emerging Markets revenue grew 10 percent on a reported basis and was approximately 10 percent of our consolidated net sales in the second quarter of 2014.

## Gross Profit

Our gross profit was \$1.310 billion for the second quarter of 2014, \$1.279 billion for the second quarter of 2013, \$2.547 billion for the first half of 2014, and \$2.462 billion for the first half of 2013. As a percentage of net sales, our gross profit decreased to 69.9 percent in the second quarter of 2014, as compared to 70.7 percent in the second quarter of 2013 and increased to 69.8 percent for the first half of 2014, as compared to 69.0 percent for the first half of 2013. The following is a reconciliation of our gross profit margins and a description of the drivers of the change from period to period:

	Three Months	Six Months	
Gross profit margin - period ended June 30, 2013	70.7	%69.0	%
Manufacturing cost reductions	2.2	1.7	
Neurovascular divestiture	0.5	0.8	
PROMUS® supply true-up	(0.9)	) (0.4	)
Sales pricing and mix	(2.0)	) (1.3	)
All other, including other inventory charges, other period expense and net impact of foreign currency	(0.6	) —	
Gross profit margin - period ended June 30, 2014	69.9	%69.8	%

The primary factors contributing to the decrease in our gross profit margin during the second quarter of 2014, as compared to the same period in 2013, were the negative impacts of pricing related primarily to sales of our drug-eluting stent and CRM products, as well as changes in the mix of our product sales. In addition, during the second quarter of 2013 we recorded a credit to cost of products sold related to the final retroactive pricing adjustment pursuant to our PROMUS® supply arrangement with Abbott for historical purchases of PROMUS® stent systems. Partially offsetting these factors was positive impact of cost reductions as a result of our restructuring and other process improvement programs. Our gross profit margin was also positively impacted by lower sales related to our divested businesses, as these sales are at significantly lower gross profit margins.

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The increase in our gross profit margin for the first half of 2014, as compared to the first half of 2013, primarily resulted from the positive impacts of lower sales related to our divested businesses, as these sales are at significantly lower gross profit margins, as well as manufacturing cost reductions as a result of our restructuring and other process improvement programs. Partially offsetting these factors was the negative impact of pricing related primarily to sales of our drug-eluting stent and CRM products, as well as changes in the mix of our product sales. In addition, during the second quarter of 2013, we recorded a credit to cost of products sold related to the final retroactive pricing adjustment pursuant to our PROMUS® supply arrangement with Abbott for historical purchases of PROMUS® stent systems.

**Operating Expenses**

The following table provides a summary of certain of our operating expenses:

	Three Months Ended June 30,			Six Months Ended June 30,				
	2014	2013		2014	2013			
(in millions)	\$	% of Net Sales	\$	% of Net Sales	\$	% of Net Sales		
Selling, general and administrative expenses	743	39.7 %	661	36.5 %	1,409	38.6 %	1,292	36.2 %
Research and development expenses	206	11.0 %	223	12.3 %	397	10.9 %	427	12.0 %
Royalty expense	25	1.3 %	47	2.6 %	65	1.8 %	87	2.4 %

**Selling, General and Administrative (SG&A) Expenses**

In the second quarter of 2014, our SG&A expenses increased \$82 million, or 12 percent, as compared to the second quarter of 2013, and were 320 basis points higher as a percentage of net sales. This increase was driven primarily by SG&A increases related to business combinations that we have completed over the last several years, product launches and other commercial programs, and our expansion efforts in emerging markets, partially offset by declines in spending as a result of our restructuring and other cost reduction initiatives.

In the first half of 2014, our SG&A expenses increased \$117 million, or nine percent, as compared to the first half of 2013, and were 240 basis points higher as a percentage of net sales. This increase was driven primarily by SG&A increases related to business combinations that we have completed over the last several years, product launches and other commercial programs, and our expansion efforts in emerging markets, partially offset by declines in spending as a result of our restructuring and other cost reduction initiatives.

**Research and Development (R&D) Expenses**

In the second quarter of 2014, our R&D expenses decreased \$17 million, or eight percent, as compared to the second quarter of 2013, and were 130 basis points lower as a percentage of net sales. The decrease was due primarily to the benefits from our initiatives to transform our research and development efforts to be more effective and cost efficient, as well as the timing of certain R&D programs.

In the first half of 2014, our R&D expenses decreased \$30 million, or seven percent, as compared to the first half of 2013, and were 110 basis points lower as a percentage of net sales. The decrease was due primarily to the benefits from our initiatives to transform our research and development efforts to be more effective and cost efficient, as well as the timing of certain R&D programs.

We remain committed to advancing medical technologies and investing in meaningful research and development projects across our businesses in order to maintain a healthy pipeline of new products that we believe will contribute to profitable sales growth.

**Royalty Expense**

In the second quarter of 2014, our royalty expense decreased \$22 million, or 47 percent, as compared to the second quarter of 2013, and was 130 basis points lower as a percentage of net sales. This decrease relates primarily to a renegotiation of a royalty agreement in the second quarter of 2014 that resulted in a lower royalty rate structure and was retroactive to the beginning of 2014.



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In the first half of 2014, our royalty expense decreased \$22 million, or 25 percent, as compared to the first half of 2013, and was 60 basis points lower as a percentage of net sales. This decrease relates primarily to a renegotiation of a royalty agreement in the second quarter of 2014 that resulted in a lower royalty rate structure and was retroactive to the beginning of 2014.

### Amortization Expense

Our amortization expense was \$109 million in the second quarter of 2014, as compared to \$101 million in the second quarter of 2013, and \$218 million in the first half of 2014, as compared to \$204 million in the first half of 2013. This increase was due primarily to amortizable intangible assets acquired during the second half of 2013. Amortization expense is excluded by management for purposes of evaluating operating performance.

### Goodwill Impairment Charge

#### 2013 Charge

Following our reorganization from regions to global business units and our reallocation of goodwill on a relative fair value basis as of January 1, 2013, we conducted the first step of the goodwill impairment test for all global reporting units. As of January 1, 2013, the fair value of each global reporting unit exceeded its carrying value, with the exception of the global Cardiac Rhythm Management (CRM) reporting unit. In accordance with ASC Topic 350, Intangibles—Goodwill and Other (Topic 350) and our accounting policies, we tested the global CRM intangible assets and goodwill for impairment and recorded a non-cash goodwill impairment charge of \$423 million (\$422 million after-tax) to write down the goodwill to its implied fair value as of January 1, 2013 as a result of this analysis. The primary driver of this impairment charge was our reorganization from geographic regions to global business units as of January 1, 2013, which changed the composition of our reporting units. As a result of the reorganization, any goodwill allocated to the global CRM reporting unit was no longer supported by the cash flows of other businesses. Under our former reporting unit structure, the goodwill allocated to our regional reporting units was supported by the cash flows from all businesses in each international region. The hypothetical tax structure of the global CRM business and the global CRM business discount rate applied were also contributing factors to the goodwill impairment charge. Refer to Note D - Goodwill and Other Intangible Assets contained in Item 8 of our 2013 Annual Report on Form 10-K for details on the 2013 goodwill impairment charge. Goodwill impairment charges do not impact our debt covenants or our cash flows, and are excluded by management for purposes of evaluating operating performance.

#### Intangible Asset Impairment Charges

#### 2014 Charges

During the second quarter of 2014, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our in-process research and development projects and core technology associated with certain of our acquisitions. Based on our impairment assessment, and lower expected future cash flows associated with our intangible assets, we recorded pre-tax impairment charges of \$110 million in the second quarter of 2014. As a result of changes in our clinical strategy and lower estimates of the European and global hypertension markets, and the resulting amount of future revenue and cash flows associated with the technology acquired from Vessix, we recorded impairment charges of \$67 million related to technology intangible assets during the second quarter of 2014. In addition, due to revised expectations and timing as a result of the upcoming third FDA Circulatory System Devices Panel, we recorded impairment charges of \$35 million related to the Atritech in-process research and development intangible assets during the second quarter of 2014. We also recorded an additional \$8 million intangible asset impairment charge associated with changes in the amount of the expected cash flows related to certain other acquired in-process research and development projects.

During the first quarter of 2014, as a result of lower estimates of the resistant hypertension market following the announcement of data from a competitor's clinical trial, we performed an interim impairment test of our in-process research and development projects and core technology associated with our acquisition of Vessix. The impairment assessments were based upon probability-weighted cash flows of potential future scenarios. Based on our impairment

assessment, and lower expected future cash flows associated with our Vessix-related intangible assets, we recorded pre-tax impairment charges of \$55 million in the first quarter of 2014 to write-down the balance of these intangible assets to their fair value.



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### 2013 Charges

During the second quarter of 2013, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our in-process research and development projects associated with certain of our acquisitions. Based on the results of our impairment analysis, we revised our expectations of the market size related to Sadra Medical, Inc. (Sadra), and the resulting timing and amount of future revenue and cash flows associated with the technology acquired from Sadra. As a result of these changes, we recorded pre-tax impairment charges of \$51 million in the second quarter of 2013 to write-down the balance of these intangible assets to their fair value in each respective period. During the second quarter of 2013, we also recorded an additional \$2 million intangible asset impairment charge associated with changes in the amount of the expected cash flows related to certain other acquired in-process research and development projects.

We recorded these amounts in the intangible assets impairment caption in our accompanying unaudited condensed consolidated statements of operations. Intangible asset impairment charges do not impact our debt covenants or our cash flows, and are excluded by management for purposes of evaluating operating performance.

### Contingent Consideration Expense

Certain of our acquisitions involve contingent consideration arrangements. Payment of additional consideration is generally contingent on the acquired company reaching certain performance milestones, including attaining specified revenue levels, achieving product development targets and/or obtaining regulatory approvals. In accordance with U.S. GAAP, we recognize a liability equal to the fair value of the contingent payments we expect to make as of the acquisition date. We re-measure this liability each reporting period and record changes in the fair value through a separate line item within our consolidated statements of operations. Increases or decreases in the fair value of the contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing and amount of revenue estimates or in the timing or likelihood of achieving regulatory, revenue or commercialization-based milestones.

We recorded net benefits related to the change in fair value of our contingent consideration liabilities of \$96 million and \$118 million in the second quarter and first half of 2014, respectively, and net benefits of \$18 million and \$41 million during the second quarter and first half of 2013, respectively. Contingent consideration expense is excluded by management for purposes of evaluating operating performance.

### Restructuring Charges and Restructuring-related Activities

#### 2014 Restructuring Plan

On October 22, 2013, our Board of Directors approved, and we committed to, a restructuring initiative (the 2014 Restructuring plan). The 2014 Restructuring plan is intended to build on the progress we have made to address financial pressures in a changing global marketplace, further strengthen our operational effectiveness and efficiency and support new growth investments. Key activities under the plan include continued implementation of our ongoing Plant Network Optimization (PNO) strategy, continued focus on driving operational efficiencies and ongoing business and commercial model changes. The PNO strategy is intended to simplify our manufacturing plant structure by transferring certain production lines among facilities. Other activities involve rationalizing organizational reporting structures to streamline various functions, eliminate bureaucracy, increase productivity and better align resources to business strategies and marketplace dynamics. These activities were initiated in the fourth quarter of 2013 and are expected to be substantially completed by the end of 2015.

We estimate that the 2014 Restructuring plan will reduce gross annual pre-tax operating expenses by approximately \$150 million to \$200 million exiting 2015, and we expect a substantial portion of the savings to be reinvested in strategic growth initiatives. We estimate that the implementation of the 2014 Restructuring plan will result in total pre-tax charges of approximately \$175 million to \$225 million, of which approximately \$160 million to \$210 million is expected to result in future cash outlays.

In the aggregate, we recorded net restructuring charges pursuant to our restructuring plans of \$15 million in the second quarter of 2014, \$26 million in the second quarter of 2013, \$35 million in the first half of 2014, and \$36 million in the

first half of 2013. In addition, we recorded expenses within other lines of our accompanying unaudited condensed consolidated statements of operations related to our restructuring initiatives of \$10 million in the second quarter of 2014, \$5 million in the second quarter of 2013, \$18 million in the first half of 2014, and \$10 million in the first half of 2013. Restructuring and restructuring-related costs are excluded by management for purposes of evaluating operating performance.

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We made cash payments of \$53 million during the first half of 2014 associated with our restructuring initiatives. We made cash payments of \$71 million, and received \$53 million of cash proceeds on facility and fixed asset sales, associated with our restructuring initiatives during the first half of 2013.

See Note G - Restructuring Related Activities to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for additional details related to our restructuring plans.

Litigation-related charges and credits

We recorded litigation-related net charges of \$267 million in the second quarter of 2014 and \$260 million in the first half of 2014. We recorded no net litigation-related charges in the second quarter of 2013 and \$130 million in the first half of 2013. These charges and credits are excluded by management for purposes of evaluating operating performance. Refer to Note J – Commitments and Contingencies to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for discussion of our material legal proceedings.

Gain on divestiture

In January 2011, we closed the sale of our Neurovascular business to Stryker Corporation for a purchase price of \$1.500 billion, \$1.450 billion of which we received at closing. We recorded a gain of \$34 million in the second quarter of 2013, \$12 million in the first half of 2014, and \$40 million in the first half of 2013 related to this divestiture. Divestiture-related gains or charges are excluded by management for purposes of evaluating operating performance. See Note C - Divestitures to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for additional information.

Interest Expense

Our interest expense was \$53 million in the second quarter of 2014 and \$108 million in the first half of 2014, as compared to \$65 million in the second quarter of 2013 and \$130 million in the first half of 2013. The decrease in our interest expense is primarily related to the refinancing of our public debt in the third quarter of 2013 and our interest rate derivative instruments, which we entered in the fourth quarter of 2013. These instruments have a notional amount of \$450 million and convert fixed-rate debt into floating-rate debt. Our average borrowing rate was 4.8 percent in the second quarter of 2014 and first half of 2014, as compared to 5.7 percent in the second quarter and first half of 2013. Refer to Liquidity and Capital Resources and Note E - Fair Value Measurements and Note F – Borrowings and Credit Arrangements to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for information regarding our debt obligations and related derivative instruments and hedging activities.

Other, net

Our other, net reflected income of \$18 million in the second quarter of 2014, expense of \$3 million in the second quarter of 2013, income of \$22 million in the first half of 2014, and expense of \$3 million in the first half of 2013. The following are the components of other, net:

(in millions)	Three Months Ended		Six Months Ended		
	June 30,	June 30,	June 30,	June 30,	
	2014	2013	2014	2013	
Interest income	\$1	\$3	\$2	\$5	
Foreign currency losses	(3	) —	(6	) (2	)
Net gains (losses) on investments	23	(3	) 29	(3	)
Other income (expense), net	(3	) (3	) (3	) (3	)
	\$18	\$(3	) \$22	\$(3	)

During the second quarter of 2014, we recognized gains of \$19 million associated with the acquisition of IoGyn, Inc. related to previously held investments. Refer to Note B – Acquisitions to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for information regarding the IoGyn acquisition.

Tax Rate

Our effective tax rates from continuing operations for the three months ended June 30, 2014 and June 30, 2013, were 103.8% and 14.3%, respectively. For the first half of 2014 and 2013 our effective tax rates from continuing operations were (222.5)% and 7.6%, respectively. The change in our reported tax rate for the second quarter and first half of 2014, as compared to the same

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periods in 2013, relates primarily to the impact of certain receipts and charges that are taxed at different rates than our effective tax rate, including intangible asset impairment charges, acquisition- and divestiture-related items, and litigation- and restructuring-related items. In addition, the reported tax rate in the second quarter of 2013 was also impacted by certain discrete tax items, including uncertain tax positions related to audit findings, while the first half of 2013 was favorably affected by discrete tax items that primarily related to the reinstatement of tax legislation that was retroactively applied, offset in part by the resolution of the uncertain tax positions related to audit settlements and findings.

During the first quarter of 2014, we received a Revenue Agent Report from the Internal Revenue Services (IRS) reflecting significant proposed audit adjustments for our 2008, 2009 and 2010 tax years based upon the same transfer pricing methodologies that are currently being contested in U.S. Tax Court for our tax years from 2001 to 2007. As with the prior years, we disagree with the transfer pricing methodologies being applied by the IRS and we expect to contest any adjustments received through applicable IRS and judicial procedures, as appropriate. We believe that our income tax reserves associated with these matters are adequate as of June 30, 2014. However, final resolution is uncertain and could have a material impact on our financial condition, results of operations, or cash flows. During the six months ended June 30, 2014, there were no other material changes to significant unresolved matters with the IRS or foreign tax authorities from what we disclosed in our 2013 Annual Report on Form 10-K.

#### Critical Accounting Policies and Estimates

Our financial results are affected by the selection and application of accounting policies and methods. There were no material changes in the six months ended June 30, 2014 to the application of critical accounting policies and estimates as described in our 2013 Annual Report on Form 10-K.

#### Goodwill Valuation

We allocate any excess purchase price over the fair value of the net tangible and identifiable intangible assets acquired in a business combination to goodwill. When allocating goodwill from business combinations to our reporting units, we assign goodwill to the reporting units that we expect to benefit from the respective business combination at the time of acquisition. We assess goodwill for impairment at the reporting unit level, which is defined as an operating segment or one level below an operating segment, referred to as a component. We test our goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. In performing the assessment, we utilize the two-step approach prescribed under ASC Topic 350, Intangibles-Goodwill and Other.

For our 2014 and our 2013 goodwill impairment testing, we used only the income approach, specifically the discounted cash flow (DCF) method, to derive the fair value of each of our reporting units in preparing our goodwill impairment assessments. This approach calculates fair value by estimating the after-tax cash flows attributable to a reporting unit and then discounting these after-tax cash flows to a present value using a risk-adjusted discount rate. We selected this method as being the most meaningful in preparing our goodwill assessments because we believe the income approach most appropriately measures our income producing assets. We have considered using the market approach and cost approach but concluded they are not appropriate in valuing our reporting units given differences in our reporting units' mix of currently marketed products, market shares, future product launch cadence, and expected profitability levels that render the market comparisons less relevant for application of the market approach and the inability to replicate the value of the specific technology-based assets within our reporting units for application of the cost approach. Therefore, we believe that the income approach represents the most appropriate valuation technique for which sufficient data is available to determine the fair value of our reporting units.

In applying the income approach to our accounting for goodwill, we make assumptions about the amount and timing of future expected cash flows, terminal value growth rates and appropriate discount rates. The amount and timing of future cash flows within our DCF analysis is based on our most recent operational budgets, long range strategic plans and other estimates. The terminal value growth rate is used to calculate the value of cash flows beyond the last projected period in our DCF analysis and reflects our best estimates for stable, perpetual growth of our reporting units. We use estimates of market-participant risk-adjusted Weighted Average Cost of Capital (WACC) as a basis for determining the discount rates to apply to our reporting units' future expected cash flows. In addition, for purposes of

performing our goodwill impairment tests, assets and liabilities, including corporate assets, which relate to a reporting unit's operations, and would be considered in determining its fair value, are allocated to the individual reporting units. We allocate assets and liabilities not directly related to a specific reporting unit, but from which the reporting unit benefits, based primarily on the respective revenue contribution of each reporting unit.

If the carrying value of a reporting unit exceeds its fair value, we then perform the second step of the goodwill impairment test to measure the amount of impairment loss, if any. The second step of the goodwill impairment test compares the estimated fair value of a reporting unit's goodwill to its carrying value. If we were unable to complete the second step of the test prior to the issuance of our financial statements and an impairment loss was probable and could be reasonably estimated, we would recognize our best

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estimate of the loss in our current period financial statements and disclose that the amount is an estimate. We would then recognize any adjustment to that estimate in subsequent reporting periods, once we have finalized the second step of the impairment test.

Although we use consistent methodologies in developing the assumptions and estimates underlying the fair value calculations used in our impairment tests, these estimates are uncertain by nature and can vary from actual results. The use of alternative valuation assumptions, including estimated revenue projections, growth rates, cash flows and discount rates could result in different fair value estimates.

In the second quarter of 2014, we performed our annual goodwill impairment test for all of our reporting units. In conjunction with our annual test, the fair value of each reporting unit exceeded its carrying value. As a result of the 2014 annual goodwill impairment test, we have identified our global Neuromodulation and global Electrophysiology reporting units as being at higher risk of potential failure of the first step of the goodwill impairment test in future reporting periods. Our global Neuromodulation reporting unit had excess fair value over carrying value of approximately 55 percent and held \$1.356 billion of allocated goodwill as of June 30, 2014. Our global Electrophysiology reporting unit had excess fair value over carrying value of approximately 38 percent and held \$292 million of allocated goodwill as of June 30, 2014. Our global CRM reporting unit had a fair value approximately equal to its carrying value; however, due to goodwill impairment charges in prior years, no goodwill remains within our CRM reporting unit. Changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses could result in future impairments of goodwill within our reporting units including global CRM. Further, the recoverability of our CRM-related amortizable intangibles (\$4.236 billion globally as of June 30, 2014) is sensitive to future cash flow assumptions and our global CRM business performance. The \$4.236 billion of CRM-related amortizable intangibles are at higher risk of potential failure of the first step of the amortizable intangible recoverability test in future reporting periods. An impairment of a material portion of our CRM-related amortizable intangibles carrying value would occur if the second step of the amortizable intangible test is required in a future reporting period.

On a quarterly basis, we monitor the key drivers of fair value to detect events or other changes that would warrant an interim impairment test of our goodwill and intangible assets. The key variables that drive the cash flows of our reporting units and amortizable intangibles are estimated revenue growth rates and levels of profitability. Terminal value growth rate assumptions, as well as the WACC rate applied are additional key variables for reporting unit cash flows. These assumptions are subject to uncertainty, including our ability to grow revenue and improve profitability levels. Relatively small declines in the future performance and cash flows of a reporting unit or asset group or small changes in other key assumptions may result in the recognition of significant asset impairment charges. For example, keeping all other variables constant, an increase in the WACC applied of 100 basis points combined with a 150 basis point decrease in the terminal value growth rate would require that we perform the second step of the goodwill impairment test for both our global Electrophysiology and global Nueromodulation reporting units. The estimates used for our future cash flows and discount rates represent management's best estimates, which we believe to be reasonable, but future declines in business performance may impair the recoverability of our goodwill and intangible asset balances.

Future events that could have a negative impact on the levels of excess fair value over carrying value of our reporting units and/or amortizable intangible assets include, but are not limited to:

- decreases in estimated market sizes or market growth rates due to greater-than-expected declines in procedural volumes, pricing pressures, reductions in reimbursement levels, product actions, and/or competitive technology developments;
- declines in our market share and penetration assumptions due to increased competition, an inability to develop or launch new and next-generation products and technology features in line with our commercialization strategies, and

market and/or regulatory conditions that may cause significant launch delays or product recalls;

decreases in our forecasted profitability due to an inability to successfully implement and achieve timely and sustainable cost improvement measures consistent with our expectations, increases in our market-participant tax rate, and/or changes in tax laws;

negative developments in intellectual property litigation that may impact our ability to market certain products or increase our costs to sell certain products;

the level of success of on-going and future research and development efforts, including those related to recent acquisitions, and increases in the research and development costs necessary to obtain regulatory approvals and launch new products;

the level of success in managing the growth of acquired companies, achieving sustained profitability consistent with our expectations, establishing government and third-party payer reimbursement, supplying the market, and increases in the costs and time necessary to integrate acquired businesses into our operations successfully;

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• changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses; and

• increases in our market-participant risk-adjusted WACC.

Negative changes in one or more of these factors, among others, could result in additional impairment charges.

**Liquidity and Capital Resources**

As of June 30, 2014, we had \$357 million of cash and cash equivalents on hand, comprised of \$28 million invested in money market and government funds, \$126 million invested in short-term time deposits, and \$203 million in interest bearing and non-interest bearing bank accounts. We invest excess cash on hand in short-term financial instruments that earn market interest rates while mitigating principal risk through instrument and counterparty diversification, as well as what we believe to be prudent instrument selection. We limit our direct exposure to securities in any one industry or issuer. We also have full access to our \$2.000 billion revolving credit facility and our \$300 million credit and security facility secured by our U.S. trade receivables, both described below.

The following provides a summary and description of our net cash inflows (outflows) for the six months ended June 30, 2014 and 2013:

(in millions)	Six Months Ended	
	June 30, 2014	2013
Cash provided by operating activities	\$483	\$584
Cash used for investing activities	(189	) (39
Cash used for financing activities	(154	) (221

**Operating Activities**

During the first half of 2014, we generated \$483 million from operating activities, as compared to \$584 million during the first half of 2013, a decrease of \$101 million or 17 percent. This decrease was primarily the result of increases in our inventory levels, as well as a litigation-related cash receipt in the first half of 2013, partially offset by reductions in our accounts receivable due to a government funded settlement of outstanding receivables in Spain of \$80 million during the first quarter of 2014.

**Investing Activities**

During the first half of 2014, cash used for investing activities included \$72 million of payments for acquisitions of businesses, net of cash acquired. Cash used for investing activities also included purchases of property, plant and equipment of \$124 million. This was partially offset by proceeds from our divested businesses of \$12 million. During the first half of 2013, cash used for investing activities included \$15 million of payments to acquire certain technologies and privately-held securities. Cash used for investing activities also included purchases of property, plant and equipment of \$104 million that were partially offset by \$53 million of proceeds received from the sale of our Natick, Massachusetts headquarters in March 2013.

In addition, in May 2014 we announced that we had entered into a definitive agreement to acquire the Interventional Division of Bayer AG for \$415 million in cash at closing. We expect to close this transaction in the second half of 2014, subject to customary closing conditions.

**Financing Activities**

Our cash flows from financing activities reflect issuances and repayments of debt, payments of acquisition-related contingent consideration, proceeds from and cash used to net share settle stock issuances related to our equity incentive programs and repurchases of common stock pursuant to our authorized repurchase programs, discussed in Note L - Stockholders' Equity to our consolidated financial statements included in Item 8 of our 2013 Annual Report on Form 10-K. During the first half of 2014, we repurchased 10 million shares of our common stock for approximately \$125 million, pursuant to our authorized repurchase programs. During the first half of 2013, we

repurchased 26 million shares of our common stock for approximately \$200 million.

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## Debt

We hold investment-grade ratings with all three major credit-rating agencies. We believe our investment grade credit profile reflects the size and diversity of our product portfolio, our share position in several of our served markets, our strong cash flow, our solid financial fundamentals and our financial strategy. We had total debt of \$4.255 billion as of June 30, 2014 and \$4.240 billion as of December 31, 2013. The debt maturity schedule for the significant components of our debt obligations as of June 30, 2014 is as follows:

(in millions)	2014	2015	2016	2017	2018	Thereafter	Total
Senior notes	\$—	\$400	\$600	\$250	\$600	\$1,950	\$3,800
Term Loan	—	—	80	80	240	—	400
	\$—	\$400	\$680	\$330	\$840	\$1,950	\$4,200

Note: The table above does not include unamortized discounts associated with our senior notes, or amounts related to terminated interest rate contracts used to hedge the fair value of certain of our senior notes.

## Revolving Credit Facility

We maintain a \$2.000 billion revolving credit facility, maturing in April 2017, with a global syndicate of commercial banks. Eurodollar and multicurrency loans under this revolving credit facility bear interest at LIBOR plus an interest margin of between 0.875 percent and 1.475 percent, based on our corporate credit ratings and consolidated leverage ratio (1.275 percent as of June 30, 2014). In addition, we are required to pay a facility fee based on our credit ratings, consolidated leverage ratio, and the total amount of revolving credit commitments, regardless of usage, under the agreement (0.225 percent as of June 30, 2014). There were no amounts borrowed under our revolving credit facility as of June 30, 2014 or December 31, 2013.

Our revolving credit facility agreement requires that we maintain certain financial covenants, as follows:

	Covenant Requirement	Actual as of June 30, 2014
Maximum leverage ratio (1)	3.5 times	2.5 times
Minimum interest coverage ratio (2)	3.0 times	5.7 times

(1) Ratio of total debt to consolidated EBITDA, as defined by the credit agreement, for the preceding four consecutive fiscal quarters.

(2) Ratio of consolidated EBITDA, as defined by the credit agreement, to interest expense for the preceding four consecutive fiscal quarters.

The credit agreement provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, through the credit agreement maturity, of any non-cash charges and up to \$500 million in restructuring charges and restructuring-related expenses related to our current or future restructuring plans. As of June 30, 2014, we had \$181 million of the restructuring charge exclusion remaining. In addition, any cash litigation payments (net of any cash litigation receipts), as defined by the agreement, are excluded from the calculation of consolidated EBITDA and any new debt issued to fund any tax deficiency payments is excluded from consolidated total debt, as defined in the agreement, provided that the sum of any excluded net cash litigation payments and any new debt issued to fund any tax deficiency payments shall not exceed \$2.300 billion in the aggregate. As of June 30, 2014, we had approximately \$2.150 billion of the combined legal and debt exclusion remaining. As of and through June 30, 2014, we were in compliance with the required covenants.

Any inability to maintain compliance with these covenants could require us to seek to renegotiate the terms of our credit facilities or seek waivers from compliance with these covenants, both of which could result in additional borrowing costs. Further, there can be no assurance that our lenders would agree to such new terms or grant such waivers.

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Term Loan

We had \$400 million outstanding under an unsecured term loan facility as of June 30, 2014 and December 31, 2013. Term loan borrowings under this facility bear interest at LIBOR plus an interest margin of between 1.0 percent and 1.75 percent (currently 1.5 percent), based on our corporate credit ratings and consolidated leverage ratio. The term loan borrowings are payable over a five-year period, with quarterly principal payments of \$20 million commencing in the first quarter of 2016 and the remaining principal amount due at the final maturity date in August 2018, and are repayable at any time without premium or penalty. Our term loan facility requires that we comply with certain covenants, including financial covenants with respect to maximum leverage and minimum interest coverage. The maximum leverage ratio requirement is 3.5 times and our actual leverage ratio as of June 30, 2014 is 2.5 times. The minimum interest coverage ratio requirement is 3.0 times and our actual interest coverage ratio as of June 30, 2014 is 5.7 times.

Senior Notes

We had senior notes outstanding of \$3.800 billion as of June 30, 2014 and December 31, 2013. Our senior notes are publicly registered securities, are redeemable prior to maturity and are not subject to any sinking fund requirements. Our senior notes are unsecured, unsubordinated obligations and rank on parity with each other. These notes are effectively junior to borrowings under our credit and security facility and liabilities of our subsidiaries (see Other Arrangements below).

Other Arrangements

We also maintain a \$300 million credit and security facility secured by our U.S. trade receivables maturing in June 2015, subject to further extension. The credit and security facility requires that we maintain a maximum leverage covenant consistent with our revolving credit facility. The maximum leverage ratio requirement is 3.5 times and our actual leverage ratio as of June 30, 2014 is 2.5 times. We had no borrowings outstanding under this facility as of June 30, 2014 and December 31, 2013.

We have accounts receivable factoring programs in certain European countries that we account for as sales under ASC Topic 860, Transfers and Servicing. These agreements provide for the sale of accounts receivable to third parties, without recourse, of up to approximately \$309 million as of June 30, 2014. We have no retained interests in the transferred receivables, other than collection and administrative responsibilities and, once sold, the accounts receivable are no longer available to satisfy creditors in the event of bankruptcy. We de-recognized \$162 million of receivables as of June 30, 2014 at an average interest rate of 3.1 percent, and \$146 million as of December 31, 2013 at an average interest rate of 3.3 percent. Within Italy, Spain, Portugal and Greece the number of days our receivables are outstanding has remained above historical levels. We believe we have adequate allowances for doubtful accounts related to our Italy, Spain, Portugal and Greece accounts receivable; however, we continue to monitor the European economic environment for any collectibility issues related to our outstanding receivables. During the first half of 2014, we received cash payments of approximately \$80 million related to a government-funded settlement of long outstanding receivables in Spain. As of June 30, 2014, our net receivables in these countries greater than 180 days past due totaled \$41 million, of which \$17 million were past due greater than 365 days.

In addition, we have uncommitted credit facilities with a commercial Japanese bank that provide for borrowings, promissory notes discounting and receivables factoring of up to 21.0 billion Japanese yen (approximately \$207 million as of June 30, 2014). We de-recognized \$150 million of notes receivable as of June 30, 2014 at an average interest rate of 2.0 percent and \$147 million of notes receivable as of December 31, 2013 at an average interest rate of 1.8 percent. De-recognized accounts and notes receivable are excluded from trade accounts receivable, net in the accompanying unaudited condensed consolidated balance sheets.

As of June 30, 2014 and December 31, 2013, we had outstanding letters of credit of \$78 million, which consisted primarily of bank guarantees and collateral for workers' compensation insurance arrangements. As of June 30, 2014 and December 31, 2013, none of the beneficiaries had drawn upon the letters of credit or guarantees; accordingly, we did not recognize a related liability for our outstanding letters of credit in our consolidated balance sheets as of June 30, 2014 or December 31, 2013. We believe we will generate sufficient cash from operations to fund these arrangements and intend to fund these arrangements without drawing on the letters of credit.



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### Equity

During the first half of 2014 and 2013, we received \$33 million and \$19 million, respectively, in proceeds from stock issuances related to our stock option and employee stock purchase plans. Proceeds from the exercise of employee stock options and employee stock purchases vary from period to period based upon, among other factors, fluctuations in the trading price of our common stock and in the exercise and stock purchase patterns of employees. We repurchased 10 million shares of our common stock during the first half of 2014 for \$125 million and 26 million shares of our common stock during the first half of 2013 for \$200 million, pursuant to our authorized repurchase programs discussed in Note L - Stockholders' Equity to our consolidated financial statements included in Item 8 of our 2013 Annual Report on Form 10-K. As of June 30, 2014, we had \$535 million remaining authorization under our 2013 share repurchase program.

Stock-based compensation expense related to our stock ownership plans was approximately \$53 million for the first half of 2014 and \$50 million for the first half of 2013.

### Contractual Obligations and Commitments

Certain of our acquisitions involve the payment of contingent consideration. See Note B - Acquisitions to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for further details regarding the estimated potential amount of future contingent consideration we could be required to pay associated with our acquisitions. There have been no other material changes to our contractual obligations and commitments as reported in our 2013 Annual Report filed on Form 10-K.

### Legal Matters

The medical device market in which we primarily participate is largely technology driven. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. Over the years, there has been litigation initiated against us by others, including our competitors, claiming that our current or former product offerings infringe patents owned or licensed by them. Intellectual property litigation is inherently complex and unpredictable. In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of devices. These forces frequently drive settlement not only for individual cases, but also for a series of pending and potentially related and unrelated cases. Although monetary and injunctive relief is typically sought, remedies and restitution are generally not determined until the conclusion of the trial court proceedings and can be modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies.

During recent years, we successfully negotiated closure of several long-standing legal matters and have received favorable legal rulings in several other matters; however, there continues to be outstanding intellectual property litigation. Adverse outcomes in one or more of these matters could have a material adverse effect on our ability to sell certain products and on our operating margins, financial position, results of operations and/or liquidity.

In the normal course of business, product liability, securities and commercial claims are asserted against us. Similar claims may be asserted against us in the future related to events not known to management at the present time. We maintain an insurance policy providing limited coverage against securities claims, and we are substantially self-insured with respect to product liability claims and fully self-insured with respect to intellectual property infringement claims. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, securities and commercial litigation, and other legal proceedings in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations and/or liquidity.

In addition, like other companies in the medical device industry, we are subject to extensive regulation by national, state and local government agencies in the United States and other countries in which we operate. From time to time we are the subject of qui tam actions and governmental investigations often involving regulatory, marketing and other business practices. These qui tam actions and governmental investigations could result in the commencement of civil and criminal proceedings, substantial fines, penalties and administrative remedies and have a material adverse effect on our financial position, results of operations and/or liquidity.

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Our accrual for legal matters that are probable and estimable was \$826 million as of June 30, 2014 and \$607 million as of December 31, 2013, and includes estimated costs of settlement, damages and defense. We continue to assess certain litigation and claims to determine the amounts, if any, that management believes will be paid as a result of such claims and litigation and, therefore, additional losses may be accrued and paid in the future, which could materially adversely impact our operating results, cash flows and/or our ability to comply with our debt covenants. See further discussion of our material legal proceedings in Note J – Commitments and Contingencies to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q and in Note K – Commitments and Contingencies to our audited financial statements contained in Item 8 of our 2013 Annual Report on Form 10-K.

### Recent Accounting Pronouncements

Information regarding new accounting pronouncements is included in Note N - New Accounting Pronouncements to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q.

### Additional Information

#### Use of Non-GAAP Financial Measures

To supplement our unaudited condensed consolidated financial statements presented on a GAAP basis, we disclose certain non-GAAP financial measures, including adjusted net income and adjusted net income per share that exclude certain amounts, and revenue growth rates that exclude the impact of changes in foreign currency exchange rates. These non-GAAP financial measures are not in accordance with generally accepted accounting principles in the United States.

The GAAP financial measure most directly comparable to adjusted net income is GAAP net income and the GAAP financial measure most directly comparable to adjusted net income per share is GAAP net income per share. To calculate revenue growth rates that exclude the impact of changes in foreign currency exchange rates, we convert actual net sales from local currency to U.S. dollars using constant foreign currency exchange rates in the current and prior period. The GAAP financial measure most directly comparable to this non-GAAP financial measure is growth rate percentages using net sales on a GAAP basis. Reconciliations of each of these non-GAAP financial measures to the corresponding GAAP financial measure are included elsewhere in this Quarterly Report on Form 10-Q.

Management uses these supplemental non-GAAP financial measures to evaluate performance period over period, to analyze the underlying trends in our business, to assess our performance relative to our competitors, and to establish operational goals and forecasts that are used in allocating resources. In addition, management uses these non-GAAP financial measures to further its understanding of the performance of our operating segments. The adjustments excluded from our non-GAAP financial measures are consistent with those excluded from our operating segments' measures of net sales and profit or loss. These adjustments are excluded from the segment measures that are reported to our chief operating decision maker that are used to make operating decisions and assess performance.

We believe that presenting adjusted net income, adjusted net income per share, and revenue growth rates that exclude certain amounts and/or the impact of changes in foreign currency exchange rates, in addition to the corresponding GAAP financial measures, provides investors greater transparency to the information used by management for its financial and operational decision-making and allows investors to see our results “through the eyes” of management. We further believe that providing this information assists our investors in understanding our operating performance and the methodology used by management to evaluate and measure such performance.

Adjusted net income, adjusted net income per share and revenue growth rates that exclude certain amounts and/or the impact of changes in foreign currency exchange rates are not in accordance with U.S. GAAP and should not be



considered in isolation from or as a replacement for the most directly comparable GAAP financial measures. Further, other companies may calculate these non-GAAP financial measures differently than we do, which may limit the usefulness of those measures for comparative purposes.

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The following is an explanation of each of the adjustments that management excluded as part of these non-GAAP financial measures for the three and six months ended June 30, 2014 and 2013, as well as reasons for excluding each of these individual items:

Adjusted Net Income and Adjusted Net Income per Share

Goodwill and other intangible asset impairment charges - This amount represents (a) non-cash write-downs of certain intangible asset balances in the second quarter of 2014; (b) non-cash write-downs of certain intangible asset balances in the first quarter of 2014; (c) non-cash write-downs of certain intangible asset balances in the second quarter of 2013; and (d) a non-cash write-down of our goodwill balance attributable to our global Cardiac Rhythm Management reporting unit in the first quarter of 2013. We remove the impact of non-cash impairment charges from our operating performance to assist in assessing our cash generated from operations. We believe this is a critical metric for us in measuring our ability to generate cash and invest in our growth. Therefore, these charges are excluded from management's assessment of operating performance and are also excluded for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance and a comparison to our past operating performance, particularly in terms of liquidity.

Acquisition and divestiture-related charges (credits) - These adjustments consist of (a) contingent consideration fair value adjustments; (b) due diligence, other fees and exit costs; and (c) separation costs and gains primarily associated with the sale of our Neurovascular business in January 2011. The contingent consideration adjustments represent accounting adjustments to state contingent consideration liabilities at their estimated fair value. These adjustments can be highly variable depending on the assessed likelihood and amount of future contingent consideration payments. Due diligence, other fees and exit costs include legal, tax, severance and other expenses associated with prior and potential future acquisitions and divestitures that can be highly variable and not representative of on-going operations. Separation costs and gains on the sale of a business unit primarily represent those associated with the Neurovascular divestiture and are not representative of on-going operations. Accordingly, management excluded these amounts for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance and a comparison to our past operating performance.

Restructuring and restructuring-related costs (credits) - These adjustments represent primarily severance and other direct costs associated with our 2014 Restructuring program and 2011 Restructuring program. These costs are excluded by management in assessing our operating performance, as well as from our operating segments' measures of profit and loss used for making operating decisions and assessing performance. Accordingly, management excluded these costs for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance and a comparison to our past operating performance.

Litigation-related net charges (credits) - These adjustments include certain significant product liability and other litigation-related charges and credits. These amounts are excluded by management in assessing our operating performance, as well as from our operating segments' measures of profit and loss used for making operating decisions and assessing performance. Accordingly, management excluded these amounts for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance and a comparison to our past operating performance.

Discrete tax items - These items represent adjustments of certain tax positions, which were initially established in prior periods as a result of intangible asset impairment charges; or acquisition-, divestiture-, restructuring- or litigation-related charges or credits. These adjustments do not reflect expected on-going operating results.

Accordingly, management excluded these amounts for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance and a comparison to our past operating performance.

Amortization expense - Amortization expense is a non-cash expense and does not impact our liquidity or compliance with the covenants included in our credit facility agreement. Management removes the impact of amortization from our operating performance to assist in assessing our cash generated from operations. We believe this is a critical metric for measuring our ability to generate cash and invest in our growth. Therefore, amortization expense is excluded from management's assessment of operating performance and is also excluded from our operating segments' measures of profit and loss used for making operating decisions and assessing performance. Accordingly,

management has excluded amortization expense for purposes of calculating these non-GAAP financial measures to facilitate an evaluation of our current operating performance, particularly in terms of liquidity.

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### Revenue Growth Rates Excluding the Impact of Sales from Divested Businesses and/or Changes in Foreign Currency Exchange Rates

Sales from divested businesses and/or changes in foreign currency exchange rates - Sales from divested businesses are primarily associated with the Neurovascular divestiture and are not representative of on-going operations. The impact of changes in foreign currency exchange rates is highly variable and difficult to predict. Accordingly, management excludes the impact of sales from divested businesses and/or changes in foreign currency exchange rates for purposes of reviewing revenue growth rates to facilitate an evaluation of our current operating performance and a comparison to our past operating performance.

### Safe Harbor for Forward-Looking Statements

Certain statements that we may make from time to time, including statements contained in this Quarterly Report on Form 10-Q and information incorporated by reference herein, constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements may be identified by words like “anticipate,” “expect,” “project,” “believe,” “plan,” “may,” “estimate,” “intend” and similar words. These forward-looking statements are based on our beliefs, assumptions and estimates using information available to us at the time and are not intended to be guarantees of future events or performance. These forward-looking statements include, among other things, statements regarding our financial performance; our business and results of operations; our business strategy and related financial returns; our growth initiatives, including our emerging markets strategy and investments; acquisitions and related payments, the timing of acquisitions and the integration and impact of acquired businesses and technologies; the timing and impact of our restructuring and plant network optimization initiatives, including expected costs and cost savings; our cash flow and use thereof; our outstanding accounts receivable in Europe; the impact of changes in foreign currency exchange rates; changes in the market and our market share for our businesses; procedural volumes and pricing pressures; competitive pressures facing our businesses; clinical trials, including timing and results; our warranty programs; our product portfolio; product development and iterations; new and existing product launches, including their timing and acceptance, and their impact on the market, our market share and our business; expanding our global footprint; competitive product launches; product performance and our ability to gain a competitive advantage; the strength of our technologies and pipeline; regulatory approvals, including their timing; our regulatory and quality compliance; expected research and development efforts and the allocation of research and development expenditures; our sales and marketing strategy; reimbursement practices; the ability of our suppliers and sterilizers to meet our requirements; our ability to meet customer demand; goodwill and other intangible asset impairment analysis and charges; our fair value measurements; the effect of new accounting pronouncements on our financial results; the impact of healthcare reform legislation and new and proposed tax laws; the outcome and timing of transfer pricing and transactional-related matters pending before taxing authorities; our tax position and income tax reserves and our ability to realize all of our deferred tax assets; the outcome and impact of intellectual property, qui tam actions, governmental investigations and proceedings and litigation matters; adequacy of our reserves; the drivers and impact of our investment ratings; anticipated expenses and capital expenditures and our ability to finance them; and our ability to meet the financial covenants contained in our credit facilities, or to renegotiate the terms of or obtain waivers for compliance with those covenants. If our underlying assumptions turn out to be incorrect, or if certain risks or uncertainties materialize, actual results could vary materially from the expectations and projections expressed or implied by our forward-looking statements. As a result, readers are cautioned not to place undue reliance on any of our forward-looking statements. Except as required by law, we do not intend to update any forward-looking statements even if new information becomes available or other events occur in the future.

The forward-looking statements in this Quarterly Report on Form 10-Q are based on certain risks and uncertainties, including the risk factors described in “Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q, “Part I, Item 1A. Risk Factors” in our 2013 Annual Report on Form 10-K and the specific risk factors discussed below and in connection with forward-looking statements throughout this Quarterly Report on Form 10-Q, which could cause actual results to

vary materially from the expectations and projections expressed or implied by our forward-looking statements. These factors, in some cases, have affected and in the future could affect our ability to implement our business strategy and may cause actual results to differ materially from those contemplated by the forward-looking statements. These additional factors include, among other things, future political, economic, competitive, reimbursement and regulatory conditions; new product introductions; demographic trends; intellectual property; litigation and governmental investigations; financial market conditions; and future business decisions made by us and our competitors, all of which are difficult or impossible to predict accurately and many of which are beyond our control. We caution each reader of this Quarterly Report on Form 10-Q to consider carefully these factors.

The following are some of the important risk factors that could cause our actual results to differ materially from our expectations in any forward-looking statements. For further discussion of these and other risk factors, see “Item 1A. Risk Factors” of this Quarterly Report on Form 10-Q and “Part I, Item 1A. Risk Factors” in our 2013 Annual Report on Form 10-K.

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### Our Businesses

• Our ability to increase CRM net sales, including for both new and replacement units, expand the market and capture market share;

• The volatility of the coronary stent market and our ability to increase our drug-eluting stent systems net sales, including with respect to our SYNERGY™, PROMUS® Element™ and Promus PREMIER™ stent systems, and capture market share;

• The on-going impact on our business, including CRM and coronary stent businesses, of physician alignment to hospitals, governmental investigations and audits of hospitals, and other market and economic conditions on the overall number of procedures performed, including with respect to the drug-eluting coronary stent market the average number of stents used per procedure, and average selling prices;

• Competitive offerings and related declines in average selling prices for our products, particularly our drug-eluting coronary stent systems and our CRM products;

• The performance of, and physician and patient confidence in, our products and technologies, including our coronary drug-eluting stent systems and CRM products, or those of our competitors;

• The impact and outcome of ongoing and future clinical trials, including coronary stent and CRM clinical trials, and market studies undertaken by us, our competitors or other third parties, or perceived product performance of our or our competitors' products;

• Variations in clinical results, reliability or product performance of our and our competitor's products;

• Our ability to timely and successfully acquire or develop, launch and supply new or next-generation products and technologies worldwide and across our businesses in line with our commercialization strategies, including our S-ICD® system and the pending acquisition of the Interventional Division of Bayer AG;

• The effect of consolidation and competition in the markets in which we do business, or plan to do business;

• Disruption in the manufacture or supply of certain components, materials or products, or the failure to timely secure alternative manufacturing or additional or replacement components, materials or products;

• Our ability to retain and attract key personnel, including in our cardiology and CRM sales force and other key cardiology and CRM personnel;

- The impact of enhanced requirements to obtain regulatory approval in the United States and around the world, including the associated timing and cost of product approval; and

• The impact of increased pressure on the availability and rate of third-party reimbursement for our products and procedures in the United States and around the world, including with respect to the timing and costs of creating and expanding markets for new products and technologies.

### Regulatory Compliance and Litigation

• The impact of healthcare policy changes and legislative or regulatory efforts in the United States and around the world to modify product approval or reimbursement processes, including a trend toward demonstrating clinical outcomes,

comparative effectiveness and cost efficiency, as well as the impact of other healthcare reform legislation;

Risks associated with our regulatory compliance and quality systems and activities in the United States and around the world, including meeting regulatory standards applicable to manufacturing and quality processes;

Our ability to minimize or avoid future field actions or FDA warning letters relating to our products and processes and the on-going inherent risk of potential physician advisories related to medical devices;

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The impact of increased scrutiny of and heightened global regulatory enforcement facing the medical device industry arising from political and regulatory changes, economic pressures or otherwise, including under U.S. Anti-Kickback Statute, U.S. False Claims Act and similar laws in other jurisdictions; U.S. Foreign Corrupt Practices Act (FCPA) and/or similar laws in other jurisdictions, and U.S. and foreign export control, trade embargo and custom laws;

The effect of our litigation and risk management practices, including self-insurance, and compliance activities on our loss contingencies, legal provision and cash flows;

The impact of, diversion of management attention as a result of, and costs to cooperate with, litigate and/or resolve, governmental investigations and our class action, product liability, contract and other legal proceedings; and

Risks associated with a failure to protect our intellectual property rights and the outcome of patent litigation.

### Innovation and Certain Growth Initiatives

The timing, size and nature of our strategic growth initiatives and market opportunities, including with respect to our internal research and development platforms and externally available research and development platforms and technologies, and the ultimate cost and success of those initiatives and opportunities;

Our ability to complete planned clinical trials successfully, obtain regulatory approvals and launch new and next generation products in a timely manner consistent with cost estimates, including the successful completion of in-process projects from in-process research and development;

Our ability to identify and prioritize our internal research and development project portfolio and our external investment portfolio on profitable revenue growth opportunities as well as to keep them in line with the estimated timing and costs of such projects and expected revenue levels for the resulting products and technologies;

Our ability to successfully develop, manufacture and market new products and technologies in a timely manner and the ability of our competitors and other third parties to develop products or technologies that render our products or technologies noncompetitive or obsolete;

- The impact of our failure to succeed at or our decision to discontinue, write-down or reduce the funding of any of our research and development projects, including in-process projects from in-process research and development, in our growth adjacencies or otherwise;

Dependence on acquisitions, alliances or investments to introduce new products or technologies and to enter new or adjacent growth markets, and our ability to fund them or to fund contingent payments with respect to those acquisitions, alliances and investments; and

The failure to successfully integrate and realize the expected benefits from the strategic acquisitions, alliances and investments we have consummated or may consummate in the future.

### International Markets

Our dependency on international net sales to achieve growth, including in emerging markets;

The impact of changes in our international structure and leadership;

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Risks associated with international operations and investments, including the timing and collectibility of customer payments, political and economic conditions, protection of our intellectual property, compliance with established and developing U.S. and foreign legal and regulatory requirements, including FCPA and similar laws in other jurisdictions and U.S. and foreign export control, trade embargo and custom laws, as well as changes in reimbursement practices and policies;

Our ability to maintain or expand our worldwide market positions in the various markets in which we compete or seek to compete, including through investments in product diversification and emerging markets such as Brazil, Russia, India and China;

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Our ability to execute and realize anticipated benefits from our investments in emerging markets; and

The potential effect of foreign currency fluctuations and interest rate fluctuations on our net sales, expenses and resulting margins.

### Liquidity

Our ability to generate sufficient cash flow to fund operations, capital expenditures, global expansion initiatives, litigation settlements, share repurchases and strategic investments and acquisitions as well as maintaining our investment grade ratings and managing our debt levels and covenant compliance;

Our ability to access the public and private capital markets when desired and to issue debt or equity securities on terms reasonably acceptable to us;

The unfavorable resolution of open tax matters, exposure to additional tax liabilities and the impact of changes in U.S. and international tax laws;

The impact of examinations and assessments by domestic and international taxing authorities on our tax provision, financial condition or results of operations;

The impact of goodwill and other intangible asset impairment charges, including on our results of operations; and

Our ability to collect outstanding and future receivables and/or sell receivables under our factoring programs.

### Cost Reduction and Optimization Initiatives

Risks associated with significant changes made or expected to be made to our organizational and operational structure, pursuant to our 2014 Restructuring plan, 2011 Restructuring plan as expanded as well as any further restructuring or optimization plans we may undertake in the future, and our ability to recognize benefits and cost reductions from such programs; and

Business disruption and employee distraction as we execute our global compliance program, restructuring and optimization plans and divestitures of assets or businesses and implement our other strategic and cost reduction initiatives.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We develop, manufacture and sell medical devices globally and our earnings and cash flows are exposed to market risk from changes in currency exchange rates and interest rates. We address these risks through a risk management program that includes the use of derivative financial instruments. We operate the program pursuant to documented corporate risk management policies. We do not enter derivative transactions for speculative purposes. Gains and losses on derivative financial instruments substantially offset losses and gains on underlying hedged exposures. Furthermore, we manage our exposure to counterparty risk on derivative instruments by entering into contracts with a diversified group of major financial institutions and by actively monitoring outstanding positions. Our currency risk consists primarily of foreign currency denominated firm commitments, forecasted foreign currency denominated intercompany and third-party transactions and net investments in certain subsidiaries. We use both nonderivative (primarily European manufacturing and distribution operations) and derivative instruments to manage our earnings and cash flow exposure to changes in currency exchange rates. We had currency derivative instruments outstanding in the contract amount of \$4.756 billion as of June 30, 2014 and \$4.516 billion as of December 31, 2013. We recorded \$167 million of other assets and \$56 million of other liabilities to recognize the fair value of these

derivative instruments as of June 30, 2014, as compared to \$264 million of other assets and \$55 million of other liabilities as of December 31, 2013. A ten percent appreciation in the U.S. dollar's value relative to the hedged currencies would increase the derivative instruments' fair value by \$281 million as of June 30, 2014 and \$257 million as of December 31, 2013. A ten percent depreciation in the U.S. dollar's value relative to the hedged currencies would decrease the derivative instruments' fair value by \$344 million as of June 30, 2014 and by \$314 million as of December 31, 2013. Any increase or decrease in the fair value of our currency exchange rate sensitive derivative instruments would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying asset, liability or forecasted transaction, resulting in minimal impact on our consolidated statements of operations.

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Our interest rate risk relates primarily to U.S. dollar borrowings partially offset by U.S. dollar cash investments. We have historically used interest rate derivative instruments to manage our earnings and cash flow exposure to changes in interest rates. We entered into interest rate derivative contracts having a notional amount of \$450 million in the fourth quarter of 2013 to convert fixed-rate debt associated with certain of our senior notes into floating-rate debt. As of June 30, 2014, we recorded \$13 million of other assets to recognize the fair value of these derivative instruments. As of December 31, 2013, we recorded \$1 million of other assets and \$8 million of other liabilities to recognize the fair value of these derivative instruments. A one-percentage point increase in interest rates would have decreased the derivative instruments' fair value by \$37 million as of June 30, 2014, and by \$41 million as of December 31, 2013. A one-percentage point decrease in interest rates would have increased the derivative instruments' fair value by \$40 million as of June 30, 2014, and by \$37 million as of December 31, 2013. As of June 30, 2014, \$3.390 billion of our outstanding debt obligations were at fixed interest rates, representing approximately 80 percent of our total debt. See Note E – Fair Value Measurements to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q for further information regarding our derivative financial instruments.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer (CEO), and our Chief Financial Officer (CFO), evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2014 pursuant to Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act). Disclosure controls and procedures are designed to ensure that material information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such material information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. Based on their evaluation, our CEO and CFO concluded that, as of June 30, 2014, our disclosure controls and procedures were effective.

**Changes in Internal Control Over Financial Reporting**

During the quarter ended June 30, 2014, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II  
OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note I – Income Taxes and Note J – Commitments and Contingencies to our unaudited condensed consolidated financial statements contained in Item 1 of this Quarterly Report on Form 10-Q, which is incorporated herein by reference.

ITEM 1A. RISK FACTORS

In addition to the other information set forth below and other information contained elsewhere in this report, you should carefully consider the factors discussed in “Part I, Item 1A. Risk Factors” in our 2013 Annual Report filed on Form 10-K, which could materially affect our business, financial condition or future results.

We rely on the proper function, availability and security of information technology systems to operate our business and a cyber-attack or other breach of these systems could have a material adverse effect on our business, financial condition or results of operations.

We rely on information technology systems to process, transmit, and store electronic information in our day-to-day operations. Similar to other large multi-national companies, the size and complexity of our information technology systems makes them vulnerable to a cyber-attack, malicious intrusion, breakdown, destruction, loss of data privacy, or other significant disruption. Our information systems require an ongoing commitment of significant resources to maintain, protect, and enhance existing systems and develop new systems to keep pace with continuing changes in information processing technology, evolving systems and regulatory standards, the increasing need to protect patient and customer information, and changing customer patterns. In addition, third parties may attempt to hack into our products to obtain data relating to patients with our products or our proprietary information. Any failure by us to maintain or protect our information technology systems and data integrity, including from cyber-attacks, intrusions or other breaches, could result in the unauthorized access to patient data and personally identifiable information, theft of intellectual property or other misappropriation of assets, or otherwise compromise our confidential or proprietary information and disrupt our operations. Any of these events, in turn, may cause us to lose existing customers, have difficulty preventing, detecting, and controlling fraud, have disputes with customers, physicians, and other health care professionals, be subject to legal claims and liability, have regulatory sanctions or penalties imposed, have increases in operating expenses, incur expenses or lose revenues as a result of a data privacy breach or theft of intellectual property, or suffer other adverse consequences, any of which could have a material adverse effect on our business, financial condition or results of operations.

We may record future goodwill impairment charges or other asset impairment charges related to one or more of our global reporting units, which could materially adversely impact our results of operations.

We test our goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. We assess goodwill for impairment at the reporting unit level and, in evaluating the potential for impairment of goodwill, we make assumptions regarding estimated revenue projections, growth rates, cash flows and discount rates. Effective as of January 1, 2013, we reorganized our business from geographic regions to fully operationalized global business units. Our reorganization changed our reporting structure and changed the composition of our reporting units for goodwill impairment testing purposes. Following our reorganization from geographic regions to global business units and our reallocation of goodwill on a relative fair value basis, in the first quarter of 2013, as a result of our new organizational structure, we recorded a non-cash goodwill impairment charge of \$423 million to write-down the goodwill to its implied fair value as of January 1, 2013.

We have identified our global Neuromodulation and global Electrophysiology reporting units as being at higher risk of potential failure of the first step of the goodwill impairment test in future reporting periods. Our global

Neuromodulation reporting unit had excess fair value over carrying value of approximately 55 percent and held \$1.356 billion of allocated goodwill as of June 30, 2014. Our global Electrophysiology reporting unit had excess fair value over carrying value of approximately 38 percent and held \$292 million of allocated goodwill as of June 30, 2014. Our global CRM reporting unit had a fair value approximately equal to its carrying value; however, due to goodwill impairment charges in prior years, no goodwill remains within our CRM reporting unit. Changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or business could result in future impairments of goodwill within our reporting units including global CRM. Further, the recoverability of our CRM-related amortizable intangibles (\$4.236 billion globally as of June 30, 2014) is sensitive to future cash flow assumptions and our global CRM business performance. The \$4.236 billion of CRM-related amortizable intangibles are at higher risk of potential failure of the first step of the amortizable intangible recoverability test in future reporting periods. An

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impairment of a material portion of our CRM-related amortizable intangibles carrying value would occur if the second step of the amortizable intangible test is required in a future reporting period.

On a quarterly basis, we monitor the key drivers of fair value to detect events or other changes that would warrant an interim impairment test of our goodwill and intangible assets. Relatively small declines in the future performance and cash flows of a reporting unit or asset group, changes in our reporting units or in the structure of our business as a result of future reorganizations, acquisitions or divestitures of assets or businesses, or small changes in other key assumptions, may result in the recognition of significant asset impairment charges, which could have a material adverse impact on our results of operations.

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## ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table provides information with respect to purchases by Boston Scientific Corporation of equity securities that are registered by us pursuant to Section 12 of the Exchange Act during the three months ended June 30, 2014:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs *	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs *
04/01/14 - 04/30/14	—	\$—	—	\$534,535,954
05/01/14 - 05/31/14	—	\$—	—	\$534,535,954
06/01/14 - 06/30/14	—	\$—	—	\$534,535,954
Total	—	\$—	—	\$534,535,954

\* On January 25, 2013, our Board of Directors approved a new program authorizing the repurchase of up to \$1.000 billion of our common stock. As of June 30, 2014, we had approximately \$535 million remaining available under our 2013 share repurchase program.



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ITEM 6. EXHIBITS (\* documents filed with this report, \*\* documents furnished with this report, # compensatory plans or arrangements)

10.1\* Boston Scientific Corporation 2006 Global Employee Stock Ownership Plan, as amended and restated, effective July 1, 2014 #

31.1\* Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2\* Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1\*\* Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Chief Executive Officer

32.2\*\* Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Executive Vice President and Chief Financial Officer

101\* Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013, (ii) the Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2014 and 2013, (iii) the Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013, (iv) the Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013 and (v) the notes to the Condensed Consolidated Financial Statements.

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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 on August 6, 2014.

BOSTON SCIENTIFIC CORPORATION

By: /s/ Daniel J. Brennan

Name: Daniel J. Brennan  
Title: Executive Vice President and  
Chief Financial Officer