BAXTER INTERNATIONAL INC
Form 10-Q
May 03, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2011

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

Commission file number 1-4448
BAXTER INTERNATIONAL INC.
(Exact name of registrant as specified in its charter)

Delaware	36-0781620
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
One Baxter Parkway, Deerfield, Illinois	60015-4633
(Address of principal executive offices)	(Zip Code)

847-948-2000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o

(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 o No þ

The number of shares of the registrant s Common Stock, par value $1.00 per share, outstanding as of April 28, 2011 was 570,377,620 shares.

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FORM 10-Q
For the quarterly period ended March 31, 2011
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Item 1. Financial Statements

Baxter International Inc.
Condensed Consolidated Statements of Income (Loss) (unaudited)
(in millions, except per share data)

	Three months ended March 31,	
	2011	2010
Net sales	$3,284	$2,927
Cost of sales	1,609	1,884
Gross margin	1,675	1,043
Marketing and administrative expenses	716	683
Research and development expenses	214	227
Net interest expense	10	19
Other expense, net	4	2
Income before income taxes	731	112
Income tax expense	154	172
Net income (loss)	577	(60)
Less: Noncontrolling interests	7	3
Net income (loss) attributable to Baxter International Inc. (Baxter)	$ 570	$ (63)
Net income (loss) attributable to Baxter per common share		
Basic	$ 0.99	$ (0.11)
Diluted	$ 0.98	$ (0.11)
Weighted-average number of common shares outstanding		
Basic	577	602
Diluted	581	602
Cash dividends declared per common share	$ 0.31	$ 0.29

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

Baxter International Inc.
Condensed Consolidated Balance Sheets (unaudited)
(in millions, except shares)

		March 31, 2011	December 31, 2010
Current assets	Cash and equivalents	$ 2,168	$ 2,685
	Accounts and other current receivables	2,399	2,265
	Inventories	2,517	2,371
	Prepaid expenses and other	677	668
	Total current assets	7,761	7,989
Property, plant and equipment, net		5,419	5,260
Other assets	Goodwill	2,060	2,015
	Other intangible assets, net	500	500
	Other	1,673	1,725
	Total other assets	4,233	4,240
Total assets		$ 17,413	$ 17,489
Current liabilities	Short-term debt	$ 14	$ 15
	Current maturities of long-term debt and lease obligations	9	9
	Accounts payable and accrued liabilities	3,866	4,017
	Total current liabilities	3,889	4,041
Long-term debt and lease obligations		4,351	4,363
Other long-term liabilities		2,202	2,289
Commitments and contingencies			
Equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2011 and 2010	683	683
	Common stock in treasury, at cost, 112,110,796 shares in 2011 and 102,761,588 shares in 2010	(6,127)	(5,655)
	Additional contributed capital	5,737	5,753
	Retained earnings	8,316	7,925
	Accumulated other comprehensive loss	(1,875)	(2,139)
	Total Baxter shareholders equity	6,734	6,567

Noncontrolling interests	237	229
Total equity	6,971	6,796
Total liabilities and equity	$ 17,413	$ 17,489

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

Baxter International Inc.
Condensed Consolidated Statements of Cash Flows (unaudited)
(in millions)

		Three months ended March 31,	
		2011	2010
Cash flows from operations	Net income (loss)	$ 577	$ (60)
	Adjustments		
	Depreciation and amortization	158	166
	Deferred income taxes	91	91
	Stock compensation	28	30
	Realized excess tax benefits from stock issued under employee benefit plans	(5)	(31)
	Infusion pump charge		588
	Other	8	9
	Changes in balance sheet items		
	Accounts and other current receivables	(68)	(33)
	Inventories	(61)	(94)
	Accounts payable and accrued liabilities	(135)	(101)
	Business optimization and infusion pump payments	(60)	(23)
	Other, including pension contributions	(162)	(263)
	Cash flows from operations	371	279
Cash flows from investing activities	Capital expenditures	(198)	(230)
	Acquisitions and investments	(14)	(234)
	Cash flows from investing activities	(212)	(464)
Cash flows from financing activities	Issuances of debt	2	602
	Payments of obligations	(3)	(13)
	Cash dividends on common stock	(180)	(174)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	134	171
	Purchases of treasury stock	(637)	(435)
	Other	(4)	(32)
	Cash flows from financing activities	(688)	119
Effect of currency exchange rate changes on cash and equivalents		12	(47)
Decrease in cash and equivalents		(517)	(113)

Cash and equivalents at beginning of period	2,685	2,786
Cash and equivalents at end of period	$2,168	$2,673

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

Baxter International Inc.
Notes to Condensed Consolidated Financial Statements (unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States have been condensed or omitted. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the company s Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Annual Report).

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

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

2. SUPPLEMENTAL FINANCIAL INFORMATION

Net pension and other postemployment benefits cost

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

	Three months ended March 31,	
(in millions)	2011	2010
Pension benefits		
Service cost	$ 28	$ 25
Interest cost	59	58
Expected return on plan assets	(76)	(71)
Amortization of net losses and other deferred amounts	44	31
Net periodic pension benefit cost	$ 55	$ 43
OPEB		
Service cost	$ 2	$ 1
Interest cost	7	8
Amortization of prior service credit and net loss	(1)	(1)
Net periodic OPEB cost	$ 8	$ 8

The company made discretionary cash contributions to its pension plan in the United States totaling $150 million and $300 million in the first quarters of 2011 and 2010, respectively.

Net interest expense

	Three months ended March 31,

(in millions)	2011	2010
Interest expense, net of capitalized interest	$ 22	$ 28
Interest income	(12)	(9)
Net interest expense	$ 10	$ 19

Comprehensive income (loss)

(in millions)	Three months ended March 31, 2011	2010
Comprehensive income (loss)	$842	$(317)
Less: Comprehensive income attributable to noncontrolling interests	8	2
Comprehensive income (loss) attributable to Baxter	$834	$(319)

The increase in comprehensive income attributable to Baxter in the first quarter of 2011 was principally due to the impact of a $588 million charge recorded in the first quarter of 2010 in connection with the recall of COLLEAGUE infusion pumps from the U.S. market, as well as favorable movements in currency translation adjustments (CTA). Refer to Note 3 for further information regarding the COLLEAGUE infusion pump charge.

Effective tax rate

The company s effective income tax rate was 21.1% and 153.6% in the first quarters of 2011 and 2010, respectively. The company s effective income tax rate differs from the U.S. federal statutory rate each year due to certain operations that are subject to tax incentives, state and local taxes, and foreign taxes that are different than the U.S. federal statutory rate. In addition, the effective tax rate can be impacted each period by discrete factors and events. The effective tax rate in the first quarter of 2010 was impacted by a $588 million charge principally related to the recall of COLLEAGUE infusion pumps from the U.S. market, for which there was no net tax benefit recognized, and a $39 million write-off of a deferred tax asset as a result of a change in the tax treatment of reimbursements under the Medicare Part D retiree prescription drug subsidy program under healthcare reform legislation enacted in the United States in 2010. Refer to Note 3 for further information regarding the COLLEAGUE charge.

Earnings (loss) per share

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

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

(in millions)	Three months ended March 31, 2011	2010
Basic shares	577	602
Effect of dilutive securities	4	
Diluted shares	581	602

The computation of diluted EPS excluded employee stock options to purchase 27 million and 16 million shares for the first quarters of 2011 and 2010, respectively, because their inclusion would have had an anti-dilutive effect on diluted EPS.

Inventories

(in millions)	March 31, 2011	December 31, 2010
Raw materials	$ 554	$ 536
Work in process	886	787
Finished goods	1,077	1,048
Inventories	$ 2,517	$ 2,371

Property, plant and equipment, net

(in millions)	March 31, 2011	December 31, 2010
Property, plant and equipment, at cost	$ 10,811	$ 10,591
Accumulated depreciation and amortization	(5,392)	(5,331)
Property, plant and equipment (PP&E), net	$ 5,419	$ 5,260

Goodwill

The following is a reconciliation of goodwill by business segment.

(in millions)	BioScience	Medical Products	Total
Balance as of December 31, 2010	$809	$ 1,206	$2,015
Additions		1	1
Currency translation and other adjustments	9	35	44
Balance as of March 31, 2011	$818	$ 1,242	$2,060

As of March 31, 2011, there were no accumulated goodwill impairment losses.

Other intangible assets, net

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

(in millions)	Developed technology, including patents	Other	Total
March 31, 2011			
Gross other intangible assets	$ 926	$ 151	$1,077
Accumulated amortization	(533)	(75)	(608)
Other intangible assets, net	$ 393	$ 76	$ 469
December 31, 2010			
Gross other intangible assets	$ 916	$ 144	$1,060
Accumulated amortization	(522)	(69)	(591)
Other intangible assets, net	$ 394	$ 75	$ 469

The amortization expense for these intangible assets was $17 million in the first quarters of 2011 and 2010. The anticipated annual amortization expense for intangible assets recorded as of March 31, 2011 is $67 million in 2011,

$64 million in 2012, $62 million in 2013, $58 million in 2014, $57 million in 2015 and $53 million in 2016. Additionally, as of March 31, 2011 and December 31, 2010, the company had $31 million of intangible assets not subject to amortization, which included a trademark with an indefinite life and certain acquired in-process research and development (R&D) associated with products that have not yet received regulatory approval.

Variable interest entities

The condensed consolidated financial statements include the accounts of variable interest entities (VIEs) in which Baxter is the primary beneficiary. During the first quarter of 2011, the company did not enter into any new arrangements in which it determined that the company is the primary beneficiary of a VIE. As of March 31, 2011, the carrying amounts of the consolidated VIEs assets and liabilities were not material to Baxter s consolidated financial statements. Refer to Note 4 to the company s consolidated financial statements in the 2010 Annual Report for further information about the VIEs consolidated by the company.

Asset impairments

Baxter has made and continues to make significant investments in assets, including inventory and property, plant and equipment, which relate to potential new products or modifications to existing products. The company s ability to realize value from these investments is contingent on, among other things, regulatory approval and market

acceptance of these new or modified products. The company may not be able to realize the expected returns from these investments, potentially resulting in asset impairments in the future.

3. INFUSION PUMP AND BUSINESS OPTIMIZATION CHARGES

Infusion pump charges

In July 2005, the company stopped shipment of COLLEAGUE infusion pumps in the United States. Following a number of Class I recalls relating to the performance of the pumps, as well as the seizure litigation described in Note 6, on July 13, 2010, the U.S. Food and Drug Administration (FDA) issued a final order requiring the company to recall its approximately 200,000 COLLEAGUE infusion pumps then in use in the U.S. market. Pursuant to the terms of the order, Baxter is offering replacement infusion pumps or monetary consideration to owners of COLLEAGUE pumps and is executing the recall through July 13, 2012. Under the replacement option, customers may receive Sigma International General Medical Apparatus, LLC Spectrum infusion pumps in exchange for COLLEAGUE infusion pumps. Refer to Note 5 to the company s consolidated financial statements in the 2010 Annual Report for further information regarding the COLLEAGUE and SYNDEO infusion pumps.

In the first quarter of 2010, following the FDA s issuance of its initial order dated April 30, 2010, the company recorded a charge of $588 million in connection with this recall and other actions the company is undertaking outside of the United States. Of the total charge, $213 million was recorded as a reduction of net sales and $375 million was recorded in cost of sales. The amount recorded in net sales principally related to estimated cash payments to customers. Prior to the charge recorded in 2010, from 2005 through 2009, the company recorded charges and other costs totaling $337 million related to its COLLEAGUE and SYNDEO infusion pumps. It is possible that substantial additional cash and non-cash charges may be required in future periods based on new information, changes in estimates, the implementation of the recall in the United States, and other actions the company may be required to undertake in markets outside the United States.

In aggregate, these charges included $716 million of cash costs and $209 million principally related to asset impairments. The asset impairments related to inventory, lease receivables and other assets relating to the recalled pumps. The reserve for cash costs principally included an estimate of cash refunds or replacement infusion pumps that are being offered to current owners in exchange for their COLLEAGUE infusion pumps. Cash costs also included costs associated with the execution of the remediation and recall programs and customer accommodations. While the company continues to work to resolve the issues associated with COLLEAGUE infusion pumps globally, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, that sales of other products may not be adversely affected, or that additional regulation will not be introduced that may adversely affect the company s operations and consolidated financial statements.

The following table summarizes cash activity in the company s COLLEAGUE and SYNDEO infusion pump reserves through March 31, 2011.

(in millions)	
Charges and adjustments in 2005 through 2010	$ 716
Utilization in 2005 through 2010	(203)
Reserves as of December 31, 2010	513
Utilization	(29)
Reserves as of March 31, 2011	$ 484

The remaining infusion pump reserves are expected to be substantially utilized by the end of 2012.

Business optimization charges

In 2010 and 2009, the company recorded charges of $257 million and $79 million, respectively, primarily related to costs associated with optimizing its overall cost structure on a global basis, as the company streamlines its international operations, rationalizes its manufacturing facilities and enhances its general and administrative infrastructure. The charges included severance costs, as well as asset impairments and contract terminations associated with discontinued products and projects.

Included in the charges were cash costs of $253 million, principally pertaining to severance and other employee-related costs in Europe and the United States. Also included in the charges were asset impairments totaling $83 million, which related to fixed assets, inventory and other assets associated with discontinued products and projects.

Refer to the 2010 Annual Report for further information about these charges.

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

(in millions)	
Charges in 2010 and 2009	$253
Utilization in 2010 and 2009	(73)
Reserves as of December 31, 2010	180
Utilization	(31)
CTA	4
Reserves as of March 31, 2011	$153

The company believes that these reserves are adequate and expects that the reserves will be substantially utilized by the end of 2011. However, adjustments may be recorded in the future as the programs are completed.

4. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Securitization arrangement

For trade receivables originated in Japan, the company has entered into agreements with financial institutions in which the entire interest in and ownership of the receivable is sold. The company continues to service the receivables in its Japanese securitization arrangement. Servicing assets or liabilities are not recognized because the company receives adequate compensation to service the sold receivables. The Japanese securitization arrangement includes limited recourse provisions, which are not material.

The following is a summary of the activity relating to the securitization arrangement.

	Three months ended March 31,	
(in millions)	2011	2010
Sold receivables at beginning of period	$ 157	$ 147
Proceeds from sales of receivables	141	117
Cash collections (remitted to the owners of the receivables)	(158)	(142)
Effect of currency exchange rate changes	4	(2)
Sold receivables at end of period	$ 144	$ 120

Concentrations of credit risk

The company continues to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, that have experienced a deterioration in credit and economic conditions. While the economic downturn has not significantly impacted the company s ability to collect receivables, global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses. Global economic conditions and customer-specific factors may require the company to re-evaluate the collectibility of its receivables and the company could potentially incur additional credit losses.

Derivatives and hedging activities

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

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

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

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

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

Cash Flow Hedges

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

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

The notional amounts of foreign exchange contracts were $1.5 billion and $1.6 billion as of March 31, 2011 and December 31, 2010, respectively. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions as of March 31, 2011 is 18 months.

Fair Value Hedges

The company uses interest rate swaps to convert a portion of its fixed-rate debt into variable-rate debt. These instruments hedge the company s earnings from changes in the fair value of debt due to fluctuations in the designated benchmark interest rate. For each derivative instrument that is designated and effective as a fair value hedge, the gain or loss on the derivative is recognized immediately to earnings, and offsets the loss or gain on the underlying hedged item. Fair value hedges are classified in net interest expense, as they hedge the interest rate risk associated with certain of the company s fixed-rate debt.

The total notional amount of interest rate contracts designated as fair value hedges was $2.4 billion as of March 31, 2011 and $1.9 billion as of December 31, 2010.

Dedesignations

If it is determined that a derivative or nonderivative hedging instrument is no longer highly effective as a hedge, the company discontinues hedge accounting prospectively. If the company removes the cash flow hedge designation because the hedged forecasted transactions are no longer probable of occurring, any gains or losses are immediately reclassified from AOCI to earnings. Gains or losses relating to terminations of effective cash flow hedges in which the forecasted transactions are still probable of occurring are deferred and recognized consistent with the loss or income recognition of the underlying hedged items. If the company terminates a fair value hedge, an amount equal to the cumulative fair value adjustment to the hedged items at the date of termination is amortized to earnings over the remaining term of the hedged item. There were no hedge dedesignations in the first three months of 2011 or 2010 resulting from changes in the company s assessment of the probability that the hedged forecasted transactions would occur.

Undesignated Derivative Instruments

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

The total gross notional amount of undesignated derivative instruments was $423 million as of March 31, 2011 and $445 million as of December 31, 2010.

Gains and Losses on Derivative Instruments

The following table summarizes the gains and losses on the company s derivative instruments for the three months ended March 31, 2011 and 2010.

	Gain (loss) recognized in OCI		Location of gain (loss) in income statement	Gain (loss) reclassified from AOCI into income	
(in millions)	2011	2010		2011	2010
Cash flow hedges					
Interest rate contracts	$	$ (7)	Net interest expense	$	$ 1
Foreign exchange contracts	(1)	(1)	Net sales	(1)	(1)
Foreign exchange contracts	(26)	14	Cost of sales	(5)	(5)
Foreign exchange contracts		37	Other expense, net		38
Total	$ (27)	$ 43		$ (6)	$ 33

	Location of gain (loss) in income statement	Gain (loss) recognized in income	
(in millions)		2011	2010
Fair value hedges			

Interest rate contracts	Net interest expense	$ (24)	$ 21
Undesignated derivative instruments			
Foreign exchange contracts	Other expense, net	$	$ (1)

For the company s fair value hedges, an equal and offsetting gain of $24 million and loss of $21 million were recognized in net interest expense in the first quarters of 2011 and 2010, respectively, as adjustments to the underlying hedged item, fixed-rate debt. Ineffectiveness related to the company s cash flow and fair value hedges for the first quarter of 2011 was not material.

As of March 31, 2011, $22 million of deferred, net after-tax losses on derivative instruments included in AOCI are expected to be recognized in earnings during the next 12 months, coinciding with when the hedged items are expected to impact earnings.

Fair Values of Derivative Instruments

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

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Other long-term assets	$114	Other long-term liabilities	$ 2
Foreign exchange contracts	Prepaid expenses and other	19	Accounts payable and accrued liabilities	22
Foreign exchange contracts	Other long-term assets	8	Other long-term liabilities	1
Total derivative instruments designated as hedges		$141		$25
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$
Total derivative instruments		$141		$25

The following table summarizes the classification and fair values of derivative instruments reported in the consolidated balance sheet as of December 31, 2010.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Other long-term assets	$136		
Foreign exchange contracts	Prepaid expenses and other	23	Accounts payable and accrued liabilities	$19
Foreign exchange contracts	Other long-term assets	8	Other long-term liabilities	2
Total derivative instruments designated as hedges		$167		$21

Undesignated derivative instruments

Foreign exchange contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$
Total derivative instruments		$167		$21

Fair value measurements

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

		Basis of fair value measurement		
(in millions)	Balance as of March 31, 2011	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 27	$	$ 27	$
Interest rate hedges	114		114	
Equity securities	17	17		
Total assets	$ 158	$ 17	$ 141	$
Liabilities				
Foreign currency hedges	$ 23	$	$ 23	$
Interest rate hedges	2		2	
Contingent payments related to acquisitions and investments	125			125
Total liabilities	$ 150	$	$ 25	$ 125

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2010	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 31	$	$ 31	$
Interest rate hedges	136		136	
Equity securities	18	18		
Total assets	$ 185	$ 18	$ 167	$
Liabilities				

Foreign currency hedges	$ 21	$	$ 21	$
Contingent payments related to acquisitions and investments	125			125
Total liabilities	$ 146	$	$ 21	$125

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The majority of the derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments. The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs are considered observable and vary depending on the type of derivative, and include contractual terms, interest rate yield curves, foreign exchange rates and volatility. The contingent payments are valued using a discounted cash flow technique that reflects management s expectations about probability of payment.
The following table is a reconciliation of the fair value measurements that use significant unobservable inputs (Level 3), which consist of contingent payments related to acquisitions and investments.

(in millions)

Fair value as of January 1, 2011	$125
Additions, net of payments	
Unrealized gain/loss recognized in earnings	
Fair value as of March 31, 2011	$125

As discussed further in Note 3, the company recorded an asset impairment charge related to the recall of COLLEAGUE infusion pumps from the U.S. market in the first quarter of 2010. As the assets had no alternative use and no salvage value, the fair value, measured using significant unobservable inputs (Level 3), was assessed to be zero.

Book Values and Fair Values of Financial Instruments

In addition to the financial instruments that the company is required to recognize at fair value on the condensed consolidated balance sheets, the company has certain financial instruments that are recognized at historical cost or some basis other than fair value. For these financial instruments, the following table provides the values recognized on the condensed consolidated balance sheets and the approximate fair values as of March 31, 2011 and December 31, 2010.

	Book values		Approximate fair values	
(in millions)	2011	2010	2011	2010
Assets				
Long-term insurance receivables	$ 37	$ 31	$ 36	$ 30
Investments	93	32	90	32
Liabilities				
Short-term debt	14	15	14	15
Current maturities of long-term debt and lease obligations	9	9	9	9
Other long-term debt and lease obligations	4,351	4,363	4,613	4,666
Long-term litigation liabilities	116	76	112	74

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

Investments principally represent held-to-maturity debt securities, as well as certain cost method investments. In the first quarter of 2011, as previously announced, certain past due receivables with the Greek government were converted into non-interest bearing bonds with maturities of one to three years. The fair value of these bonds, which are classified as held-to-maturity, was calculated using a discounted cash flow model that incorporates observable inputs, including interest rate yields. Refer to the 2010 Annual Report for more information on the Greek government s settlement plan. In determining the fair value of cost method investments, the company takes into consideration recent transactions, as well as the financial information of the investee.

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

5. COMMON STOCK

Stock-based compensation plans

Stock compensation expense totaled $28 million and $30 million in the first quarters of 2011 and 2010, respectively. Approximately 70% of stock compensation expense is classified in marketing and administrative expenses with the remainder classified in cost of sales and R&D expenses.

In March 2011, the company awarded its annual stock compensation grants, which consisted of 5.7 million stock options, 1.1 million restricted stock units (RSUs) and 436,000 performance share units (PSUs). Effective with this annual grant, the company changed the overall mix of stock compensation by reducing the number of options and PSUs granted and introducing RSUs for senior management and other option-eligible employees. Annual stock compensation grants for the company s officers continue to include only stock options and PSUs.

Stock Options

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

	Three months ended March 31,	
	2011	2010
Expected volatility	25%	22%
Expected life (in years)	5.0	4.5
Risk-free interest rate	2.2%	2.0%
Dividend yield	2.3%	2.0%
Fair value per stock option	$10	$10

The total intrinsic value of stock options exercised was $21 million and $60 million during the first quarters of 2011 and 2010, respectively.

As of March 31, 2011, $106 million of unrecognized compensation cost related to all unvested stock options is expected to be recognized as expense over a weighted-average period of 2.2 years.

Performance Share and Restricted Stock Units

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

	Three months ended March 31,	
	2011	2010
Baxter volatility	28%	26%
Peer group volatility	19% - 55%	20% - 59%
Correlation of returns	0.29 - 0.61	0.29 - 0.63
Risk-free interest rate	1.2%	1.3%
Fair value per PSU	$62	$64

The fair value per RSU is determined based on the quoted price of the company s common stock on the date of the grant.

As of March 31, 2011, unrecognized compensation cost related to all unvested PSUs of $47 million is expected to be recognized as expense over a weighted-average period of 2.1 years, and unrecognized compensation cost related to all unvested RSUs of $55 million is expected to be recognized as expense over a weighted-average period of 3.0 years.

Stock repurchases

As authorized by the board of directors, from time to time the company repurchases its stock depending upon the company s cash flows, net debt level and market conditions. During the three-month period ended March 31, 2011, the company repurchased 12.4 million shares for $637 million under the board of directors July 2009 $2.0 billion and December 2010 $2.5 billion share repurchase authorizations. As of March 31, 2011, $2.4 billion remained available under the December 2010 authorization. No shares remained available under the July 2009 authorization as of March 31, 2011.

6. LEGAL PROCEEDINGS

Baxter is involved in product liability, patent, commercial, and other legal matters that arise in the normal course of the company s business. The company records a liability when a loss is considered probable and the amount can be

reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded.

Baxter has established reserves for certain of the matters discussed below. The company is not able to estimate the amount or range of any loss for certain of the legal contingencies for which there is no reserve or additional loss for

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

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

Patent litigation

Hemodialysis Litigation

Since April 2003, Baxter has been pursuing a patent infringement action against Fresenius Medical Care Holdings, Inc. for infringement of certain Baxter patents. The patents cover Fresenius 2008K hemodialysis instrument. In 2007, the court entered judgment in Baxter s favor holding the patents valid and infringed, and a jury assessed damages at $14 million for past sales only. In April 2008, the U.S.D.C. for the Northern District of California granted Baxter s motion for permanent injunction, granted Baxter s request for royalties on Fresenius sales of the 2008K hemodialysis machines during a nine-month transition period before the permanent injunction took effect, and granted a royalty on disposables. In September 2009, the appellate court affirmed Fresenius liability for infringing valid claims of Baxter s main patent, invalidated certain claims of other patents, and remanded the case to the district court to finalize the scope of the injunction and the amount of damages owed to Baxter. In November 2009, the appellate court denied Fresenius petition for re-hearing of the appeal. In January 2010, Fresenius consented to reentry of the injunction and sought a new trial to determine royalties, which the company is opposing. In March 2010, the United States Patent and Trademark Office s (USPTO) appellate board affirmed the previous determination by the USPTO patent examiner that the remaining patent was invalid. The board denied a request for reconsideration and the company has appealed the USPTO s decision to the same appellate court that affirmed the validity of the patent in September 2009. Fresenius has asked the trial court to stay further court proceedings during the pendency of the company s appeal of the USPTO s negative determination.

Product liability litigation

Heparin Litigation

In connection with the recall of heparin products in the United States, approximately 740 lawsuits have been filed alleging that plaintiffs suffered various reactions to a heparin contaminant, in some cases resulting in fatalities. In June 2008, a number of these federal cases were consolidated in the U.S.D.C. for the Northern District of Ohio for pretrial case management under the Multi District Litigation rules. In September 2008, a number of state court cases were consolidated in Cook County, Illinois for pretrial case management, with a scheduled trial date for the first of these cases in May 2011.

Propofol Litigation

The company is a defendant, along with others, in numerous lawsuits filed in state court in Las Vegas, Nevada. These lawsuits allege that health care workers improperly reused vials of propofol during endoscopy procedures, which resulted in the transmission of Hepatitis C to patients. These lawsuits allege that Teva Pharmaceuticals USA, Inc. (Teva) (as the manufacturer) and the company (as the distributor) improperly designed, manufactured and sold larger vials of propofol to these endoscopy centers. The first case went to trial against Teva and the company in April 2010. The jury awarded the plaintiffs $5 million in compensatory damages and $500 million in punitive damages ($356 million against Teva and $144 million against the company). Teva and the company have appealed this decision. Additionally, Baxter believes it is entitled to indemnity in these matters pursuant to an indemnity agreement entered into with Teva in 2009. The next trial is scheduled for July 2011.

Other

In October 2004, a purported class action was filed in the U.S.D.C. for the Northern District of Illinois against Baxter and its current Chief Executive Officer and then current Chief Financial Officer and their predecessors for

alleged violations of the Employee Retirement Income Security Act of 1974, as amended. Plaintiff alleges that these defendants, along with the Administrative and Investment Committees of the company s 401(k) plans, breached their fiduciary duties to the plan participants by offering Baxter common stock as an investment option in each of the plans during the period of January 2001 to October 2004. In March 2006, the trial court certified a class of plan participants who elected to acquire Baxter common stock through the plans between January 2001 and the present. Summary judgment in the company s favor was granted by the trial court in May 2010. The plaintiffs have appealed the decision to the U.S. Court of Appeals for the Seventh Circuit.

In May 2010, a shareholder derivative action was brought on behalf of the company in the Circuit Court of Lake County, Illinois against the company s board of directors, its Chief Executive Officer and its then current Chief Financial Officer and President of Medication Delivery. The complaint alleges that the defendants breached their fiduciary duties to the company in connection with addressing the COLLEAGUE infusion pump matter. Since October 2010, four additional derivative actions have been filed on behalf of the company against the company s board of directors and certain current and former executive officers in the U.S.D.C. for the Northern District of Illinois. In January 2011, the Lake County action was stayed at the request of the Federal Court plaintiffs. The complaints allege breach of fiduciary duties and substantial damage to the company arising from the manner in which the COLLEAGUE matter and other quality issues have been addressed under state law as well as in some cases violations of the federal securities laws. Plaintiffs seek monetary damages for the company and corporate governance reform and attorneys fees.

In September 2010, a purported class action was filed in the U.S.D.C. for the Northern District of Illinois against the company and certain of its current executive officers. The complaint alleges that, from September 17, 2009 to May 3, 2010, the defendants issued materially false and misleading statements regarding the company s plasma-based therapies business and the company s remediation of its COLLEAGUE infusion pumps causing the company s common stock to trade at artificially high levels. A similar suit was filed against the company and certain of its executive officers in the U.S.D.C. for the Northern District of Illinois in November 2010. These suits seek to recover the lost value of investors stock as damages. These suits have been consolidated for further proceedings.

In October 2005, the United States filed a complaint in the U.S.D.C. for the Northern District of Illinois to effect the seizure of COLLEAGUE and SYNDEO infusion pumps that were on hold in Northern Illinois. Customer-owned pumps were not affected. In June 2006, Baxter Healthcare Corporation entered into a Consent Decree for Condemnation and Permanent Injunction with the United States to resolve this seizure litigation. Pursuant to the Consent Decree, on July 13, 2010 the FDA issued a final order regarding the recall of the company s COLLEAGUE infusion pumps currently in use in the United States. The company is executing the recall through July 13, 2012 by offering its customers an option to replace their COLLEAGUE infusion pumps or receive monetary consideration. The company will permit lessees to terminate their leases without penalty and refund any prepaid, unused lease portion upon the return of the devices. Additional third-party claims may be filed in connection with the COLLEAGUE matter. In September 2009, the company received a subpoena from the Office of the United States Attorney for the Northern District of Illinois requesting production of documents relating to the COLLEAGUE infusion pump. The company is fully cooperating with the request.

The company is a defendant, along with others, in nineteen lawsuits brought in various U.S. federal courts alleging that Baxter and certain of its competitors conspired to restrict output and artificially increase the price of plasma-derived therapies since 2003. The complaints attempt to state a claim for class action relief and in some cases demand treble damages. These cases have been consolidated for pretrial proceedings before the U.S.D.C. for the Northern District of Illinois. In February 2011, the court denied the company s motion to dismiss certain of the claims and the parties are proceeding into discovery.

The company is a defendant, along with others, in less than a dozen lawsuits which allege that Baxter and other defendants manipulated product reimbursements by, among other things, reporting artificially inflated average wholesale prices (AWP) for Medicare and Medicaid eligible drugs. The cases have been consolidated for pretrial purposes before the U.S.D.C. for the District of Massachusetts. A class settlement resolving Medicare Part B claims and independent health plan claims against Baxter and others has been preliminarily approved by that court and final approval is expected in 2011. Baxter has also resolved a number of other AWP cases brought by state attorneys

general and other plaintiffs. A small number of lawsuits against Baxter brought by relators and state attorneys general remain which seek unspecified damages, injunctive relief, civil penalties, disgorgement, forfeiture and restitution. The company has received a letter request from the Office of the United States Attorney for the Eastern District of Pennsylvania to produce documents related to the company s contracting, marketing and promotional, and historical

government price reporting practices in the United States. In addition, the company received a request from the Office of the United States Attorney for the Northern District of California to produce documents related to the company s marketing and promotional practices, including relationships between the company and specialty pharmacies. The company is fully cooperating with both of these requests.

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

7. SEGMENT INFORMATION

Prior to 2011, the company operated in three segments: BioScience, Medication Delivery and Renal. The company has combined its former Medication Delivery and Renal businesses into a single global business unit to form the Medical Products business. Effective January 1, 2011, the company changed its segment presentation to reflect this new structure, and recast all prior periods presented to conform to the new presentation.

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

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

The **Medical Products** business manufactures intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, and inhalation anesthetics. The business also provides products and services related to pharmacy compounding, drug formulation and packaging technologies. In addition, the Medical Products business provides products and services to treat end-stage renal disease, or irreversible kidney failure. The business manufactures solutions and other products for peritoneal dialysis, a home-based therapy, and also distributes products for hemodialysis, which is generally conducted in a hospital or clinic. In May 2011, the company divested its U.S. generic injectables business. Refer to Note 8 for further information regarding this divestiture.

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

Certain items are maintained at the corporate level (Corporate) and are not allocated to a segment. They primarily include most of the company s debt and cash and equivalents and related net interest expense, certain foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the majority of the foreign currency hedging activities, corporate headquarters costs, stock compensation expense, certain non-strategic investments and related income and expense, certain employee benefit plan costs, certain nonrecurring gains and losses, deferred income taxes, certain litigation liabilities and related insurance receivables, and the revenues and costs related to the manufacturing, distribution and other transition agreements with Fenwal Inc. (Fenwal) in connection with the divestiture of the Transfusion Therapies (TT) business. Refer to Note 3 to the company s consolidated financial statements in the 2010 Annual Report for further information regarding the TT divestiture.

Included in the Medical Products segment s pre-tax loss in the first quarter of 2010 was a charge of $588 million related to the recall of COLLEAGUE infusion pumps from the U.S. market. Refer to Note 3 for further information regarding the COLLEAGUE infusion pump charge.

Financial information for the company s segments is as follows.

(in millions)	Three months ended March 31, 2011	2010
Net sales		
BioScience	$1,408	$1,362
Medical Products	1,868	1,553
Transition services to Fenwal	8	12
Total	$3,284	$2,927
Pre-tax income (loss)		
BioScience	$ 579	$ 554
Medical Products	356	(257)
Total pre-tax income from segments	$ 935	$ 297

Transition services to Fenwal represent revenues associated with manufacturing, distribution and other services provided by the company to Fenwal subsequent to the divestiture of the TT business in 2007.
The following is a reconciliation of segment pre-tax income to income before income taxes per the condensed consolidated statements of income (loss).

(in millions)	Three months ended March 31, 2011	2010
Total pre-tax income from segments	$ 935	$ 297
Unallocated amounts		
Stock compensation	(28)	(30)
Net interest expense	(10)	(19)
Certain foreign currency fluctuations and hedging activities	(3)	9
Other Corporate items	(163)	(145)
Income before income taxes	$ 731	$ 112

8. SUBSEQUENT EVENTS

Acquisition of Prism Pharmaceuticals

In April 2011, the company entered into a definitive agreement to acquire privately-held Prism Pharmaceuticals, Inc., a specialty pharmaceutical company. As a result of this acquisition, Baxter will acquire NEXTERONE (amiodarone HCI), an antiarrhythmic agent used for ventricular tachyarrhythmias, or fast forms of irregular heartbeat. The NEXTERONE product portfolio includes the first and only ready-to-use premixed intravenous bag formulations, as well as vials and a pre-filled syringe, all of which have received FDA approval. This acquisition will expand Baxter s existing portfolio of premixed drugs and solutions for use in the acute care setting. Total consideration of up to $338 million will consist of an upfront cash payment of $170 million at closing and contingent payments of up to $168 million, which are associated with the achievement of specified sales milestones. The transaction is expected to

close in the second quarter of 2011, subject to customary closing conditions including applicable regulatory approvals. The agreement is not expected to have a material impact on Baxter s 2011 financial statements.

Divestiture of Generic Injectables Business

In May 2011, the company completed the divestiture of its U.S. generic injectables business to Hikma Pharmaceuticals PLC (Hikma). The consideration for the divestiture arrangement totaled approximately $112 million, subject to closing adjustments. Hikma acquired Baxter s high-volume, generic injectable products in vials and ampoules, including chronic pain, anti-infective and anti-emetic products, along with a manufacturing facility located in Cherry Hill, New Jersey, and a warehouse and distribution center located in Memphis, Tennessee. Refer to the 2010 Annual Report for further information about this divestiture.

Net sales relating to the generic injectables business, which were reported in the Medical Products segment, were $38 million and $40 million in the first quarters of 2011 and 2010, respectively.

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

Refer to the company s Annual Report on Form 10-K for the year ended December 31, 2010 (2010 Annual Report) for management s discussion and analysis of the financial condition and results of operations of the company. The following is management s discussion and analysis of the financial condition and results of operations of the company for the three months ended March 31, 2011.

RESULTS OF OPERATIONS

NET SALES

(in millions)	Three months ended March 31, 2011	2010	Percent change
BioScience	$1,408	$1,362	3%
Medical Products	1,868	1,553	20%
Transition services to Fenwal Inc.	8	12	(33%)
Total net sales	$3,284	$2,927	12%

(in millions)	Three months ended March 31, 2011	2010	Percent change
International	$1,862	$1,847	1%
United States	1,422	1,080	32%
Total net sales	$3,284	$2,927	12%

Foreign currency had no impact on net sales growth for the total company in the first quarter of 2011, as the strengthening of the U.S. Dollar relative to the Euro was offset by the weakening of the U.S. Dollar relative to other currencies.

Total net sales growth in the first quarter of 2011 was impacted by 7 percentage points due to the company s first quarter 2010 charge related to the recall of COLLEAGUE infusion pumps from the U.S. market. The $588 million charge, which was included in the Medical Products segment, reduced net sales by $213 million. Refer to Note 3 for further information regarding the COLLEAGUE infusion pump charge.

BioScience

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

(in millions)	Three months ended March 31, 2011	2010	Percent change
Recombinants	$ 512	$ 510	
Plasma Proteins	308	292	5%
Antibody Therapy	374	322	16%

Regenerative Medicine	140	119	18%
Other	74	119	(38%)
Total net sales	$1,408	$1,362	3%

Net sales in the BioScience segment increased 3% during the first quarter of 2011 (including a 1 percentage point unfavorable impact from foreign currency). The principal drivers were the following:

In the Recombinants product category, the impact of continued customer adoption of the company s advanced recombinant therapy, ADVATE [Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method] was offset by lower tender sales in the United Kingdom and the unfavorable impact of foreign currency.

Sales growth in the Plasma Proteins product category reflected increased demand for plasma-derived factor VIII, albumin and FEIBA (an anti-inhibitor coagulant complex) in the United States and Europe.

Sales growth in the Antibody Therapy product line was due to increased sales of GAMMAGARD LIQUID [Immune Globulin Intravenous (Human)] (marketed as KIOVIG outside of the United States), the liquid formulation of the antibody-replacement therapy IGIV (immune globulin intravenous), driven by strong demand resulting from a competitor being out of the market during the first quarter. This performance was partially offset by pricing actions implemented by the company, beginning in the second quarter of 2010. Also impacting sales growth in the first quarter were lower WinRho SDF [Rho(D) Immune Globulin Intravenous (Human)] sales due to the termination of a distribution agreement effective July 1, 2010.

Revenues in Regenerative Medicine increased due to sales of ACTIFUSE (a silicate substituted calcium phosphate synthetic bone graft material) as a result of the company s first quarter 2010 acquisition of ApaTech Limited (ApaTech), as well as increased sales of the company s fibrin sealant product, FLOSEAL.

Sales in the Other product category declined as a result of a reduction in sales of CELVAPAN H1N1 pandemic vaccine and NEISVAC-C (for the prevention of meningitis C) in international markets.

Medical Products

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

	Three months ended March 31,		Percent
(in millions)	2011	2010	change
Renal	$ 587	$ 584	1%
Global Injectables	517	451	15%
IV Therapies	428	391	9%
Infusion Systems	211	(4)	N/M
Anesthesia	118	127	(7%)
Other	7	4	75%
Total net sales	$1,868	$1,553	20%

Net sales in the Medical Products segment increased 20% in the first quarter of 2011 (including a 1 percentage point favorable impact from foreign currency). The principal drivers were the following:

In the Renal product line, the favorable impact of foreign currency and growth in the number of peritoneal dialysis (PD) patients in Asia, Latin America and the United States were partially offset by PD patient losses in the United States to another provider and lower sales of hemodialysis products.

Within the Global Injectables product category, sales growth was driven by increased revenues in the company s pharmaceutical partnering and international pharmacy compounding businesses, as well as strong demand for certain enhanced packaging products and select multi-source generic products in the United States.

In May 2011, the company divested its U.S. generic injectables business. Refer to Note 8 for further information regarding this divestiture.

IV Therapies sales growth was driven by increased demand for intravenous solutions and nutritional products, particularly due to market share gains in the United States resulting from new group purchasing organization contracts and competitor supply issues, as well as greater customer adoption of CLINIMIX sulfite-free (Amino Acid in Dextrose) Injections, a proprietary dual-chamber parenteral nutrition therapy.

In the Infusion Systems product category, net sales increased principally as a result of the impact of the $213 million charge in the first quarter of 2010 related to the recall of COLLEAGUE infusion pumps, as well as increased sales of Sigma International General Medical Apparatus, LLC (SIGMA) Spectrum infusion pumps.

The sales decline in the Anesthesia product category was due to a reduction in wholesaler inventory levels, as well as competitive pricing pressures related to generic sevoflurane.

Transition services to Fenwal Inc.

Net sales in this category represent revenues associated with manufacturing, distribution and other services provided by the company to Fenwal Inc. (Fenwal) subsequent to the divestiture of the Transfusion Therapies (TT) business in 2007. Refer to Note 3 to the company s consolidated financial statements in the 2010 Annual Report for additional information regarding the TT divestiture.

GROSS MARGIN AND EXPENSE RATIOS

	Three months ended March 31,		
(as a percentage of net sales)	2011	2010	Change
Gross margin	51.0%	35.6%	15.4 pts
Marketing and administrative expenses	21.8%	23.3%	(1.5 pts)

Gross Margin

Included in the company s gross margin percentage in the first quarter of 2010 was a $588 million charge related to the recall of COLLEAGUE infusion pumps from the U.S. market, which unfavorably impacted gross margin by 16.3 percentage points. Refer to Note 3 for further information on the COLLEAGUE charge.

In the first quarter of 2011, sales growth for select higher margin products in the BioScience and Medical Products segments and the favorable impact of foreign currency were more than offset by lower prices for certain plasma protein (including Antibody Therapy) products, cost inefficiencies driven by lower volume throughput for plasma-based therapies during 2010, lower sales of high margin vaccines, and costs associated with manufacturing issues at the company s Castlebar, Ireland facility.

Marketing and Administrative Expenses

The decrease in the marketing and administrative expense ratio in 2011 was principally due to the charge to net sales related to the recall of COLLEAGUE infusion pumps, which unfavorably impacted the marketing and administrative expense ratio in the first quarter of 2010 by 1.5 percentage points. In the first quarter of 2011, the favorable impact of the company s business optimization initiatives and continued focus on controlling discretionary spending was offset by increased spending relating to certain marketing and promotional programs and increased pension expense. Also unfavorably impacting the expense ratio in 2011 was the pharmaceutical products tax, which became effective in the first quarter of 2011 under healthcare reform legislation enacted in the United States in the first quarter of 2010.

RESEARCH AND DEVELOPMENT

	Three months ended March 31,		Percent
(in millions)	2011	2010	change
Research and development expenses	$214	$227	(6%)
As a percentage of net sales	6.5%	7.8%	

Research and development (R&D) expenses decreased by $13 million in the first quarter of 2011 as the result of the completion of clinical work on late-stage programs, lower milestone payments to partners and efforts to reposition projects to gain organizational efficiencies, as well as the impact of foreign currency. The first quarter of 2010 charge to net sales related to the recall of COLLEAGUE infusion pumps unfavorably impacted the R&D expense ratio by 0.6 percentage points in the prior year. The company continues to invest in all key R&D programs across the product pipeline. Refer to the 2010 Annual Report for a discussion of the company s R&D pipeline.

NET INTEREST EXPENSE

Net interest expense was $10 million and $19 million in the first quarters of 2011 and 2010, respectively. The decrease in the first three months of 2011 was principally driven by lower interest rates on outstanding debt and an increase in interest income.

OTHER EXPENSE, NET

Other expense, net was $4 million and $2 million in the first quarters of 2011 and 2010, respectively. Included in other expense, net were amounts related to foreign currency fluctuations, principally relating to intercompany receivables, payables and loans denominated in a foreign currency.

PRE-TAX INCOME

Refer to Note 7 for a summary of financial results by segment. The following is a summary of significant factors impacting the segments financial results.

BioScience

Pre-tax income increased 5% in the first quarter of 2011. The impact of strong sales of certain higher-margin products and a reduction in R&D expenses, as further discussed above, were partially offset by lower pricing for certain plasma protein (including Antibody Therapy) products, cost inefficiencies driven by lower volume throughput for plasma-based therapies during 2010, lower sales of high margin vaccines, increased spending on marketing and promotional programs, and the pharmaceutical products tax that became effective in the first quarter of 2011.

Medical Products

Pre-tax income in the first quarter of 2011 was $356 million, compared to a pre-tax loss in the first quarter of 2010 of $257 million. Included in the pre-tax loss in the prior year was a $588 million charge related to the recall of COLLEAGUE infusion pumps from the U.S. market. Pre-tax income in the first quarter of 2011 benefited from strong sales growth and favorable product mix, which was partially offset by costs associated with manufacturing issues at the company s Castlebar, Ireland facility and the pharmaceutical products tax that became effective in the first quarter of 2011.

Other

Certain items are maintained at the company s corporate level and are not allocated to the segments. These amounts are detailed in the table in Note 7 and primarily include most of the company s debt and cash and equivalents and related net interest expense, certain foreign currency fluctuations (principally relating to intercompany receivables, payables and loans denominated in a foreign currency) and the majority of the foreign currency hedging activities, corporate headquarters costs, stock compensation expense, certain non-strategic investments and related income and expense, certain employee benefit plan costs, certain nonrecurring gains and losses, deferred income taxes, certain litigation liabilities and related insurance receivables, and the revenues and costs related to the manufacturing, distribution and other transition agreements with Fenwal. Refer to Note 5 regarding stock compensation expense, and the previous discussion for further information regarding net interest expense.

INCOME TAXES

The company s effective income tax rate was 21.1% and 153.6% in the first quarter of 2011 and 2010, respectively. The company s effective income tax rate differs from the U.S. federal statutory rate each year due to certain operations that are subject to tax incentives, state and local taxes, and foreign taxes that are different than the U.S. federal statutory rate. In addition, the effective tax rate can be impacted each period by discrete factors and events. The effective tax rate in the first quarter of 2010 was impacted by a $588 million charge principally related to the recall of COLLEAGUE infusion pumps from the U.S. market, for which there was no net tax benefit recognized, and a $39 million write-off of a deferred tax asset as a result of a change in the tax treatment of reimbursements under the Medicare Part D retiree prescription drug subsidy program under healthcare reform legislation enacted in the United States in 2010. Refer to Note 3 for further information regarding the COLLEAGUE charge.

The company anticipates that the effective tax rate for the full-year 2011 will be approximately 21.0% to 21.5%, excluding the impact of audit developments and other special items.

INCOME (LOSS) AND EARNINGS (LOSS) PER DILUTED SHARE

Net income attributable to Baxter was $570 million, or $0.98 per diluted share, for the first quarter of 2011 compared to net loss attributable to Baxter of $63 million, or $0.11 per diluted share, in the prior year quarter. The significant factors and events contributing to the changes are discussed above.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

Cash flows from operations

Cash flows from operations increased during the first quarter of 2011 as compared to the prior year, totaling $371 million in 2011 and $279 million in 2010. The increase in cash flows from operations was primarily due to higher earnings (before non-cash items) and the other factors discussed below.

Accounts Receivable

Cash flows relating to accounts receivable decreased during the first quarter of 2011 as compared to the prior year. Days sales outstanding increased from 52.5 days as of December 31, 2010 to 56.0 days as of March 31, 2011 due to longer collection periods in certain international markets and, to a lesser extent, in the United States.

Inventories

Cash outflows relating to inventories decreased in 2011 as compared to the prior year. The following is a summary of inventories as of March 31, 2011 and December 31, 2010, as well as annualized inventory turns for the first quarters of 2011 and 2010, by segment.

	Inventories		Annualized inventory turns for the three months ended March 31,	
(in millions, except inventory turn data)	March 31, 2011	December 31, 2010	2011	2010
BioScience	$1,547	$1,455	1.37	1.29
Medical Products	969	914	4.15	5.77
Other	1	2		
Total company	$2,517	$2,371	2.44	2.93

Lower inventory turns in the Medical Products segment and the total company were principally due to the impact of the first quarter 2010 charge related to the recall of COLLEAGUE infusion pumps, which increased the Medical Products and total company turns in the first quarter of 2010 by 2.01 and 0.69 turns, respectively. Inventory turns in the first quarter of 2011 were favorably impacted by increased sales in BioScience and Medical Products, as well as a reduction in plasma-related inventories in the BioScience segment.

Other

Cash outflows related to liabilities, business optimization and infusion pump payments, and other decreased in the first quarter of 2011 as compared to the prior year. The impact of lower discretionary cash contributions to the company s pension plan in the United States, which were $150 million and $300 million in the first quarters of 2011 and 2010, respectively, was partially offset by higher cash outflows relating to the company s business optimization initiatives and the execution of the COLLEAGUE infusion pump recall. Refer to Note 3 for further information regarding the business optimization initiatives and the COLLEAGUE infusion pump recall.

Cash flows from investing activities

Capital Expenditures

Capital expenditures decreased by $32 million in the first quarter of 2011, from $230 million in 2010 to $198 million in 2011. The company s investments in capital expenditures are focused on projects that enhance the company s cost structure and manufacturing capabilities and support the company s strategy of geographic expansion with select investments in growing markets. In addition, the company continues to invest to support the company s ongoing strategic focus on R&D with the expansion of research facilities, pilot manufacturing sites and laboratories. Capital expenditures also included the company s multi-year initiative to implement a global enterprise resource planning system that will consolidate and standardize business processes, data and systems.

Acquisitions and Investments

Cash outflows relating to acquisitions and investments of $234 million in the first quarter of 2010 related to the acquisition of ApaTech, an orthobiologic products company based in the United Kingdom. Refer to the 2010 Annual Report for further information about this acquisition.

Cash flows from financing activities

Debt Issuances, Net of Payments of Obligations

Net cash outflows related to debt and other financing obligations totaled $1 million in the first quarter of 2011, as compared to net cash inflows of $589 million in the first quarter of 2010. In March 2010, the company issued $600 million of senior unsecured notes, with $300 million maturing in March 2013 and bearing a 1.8% coupon rate, and $300 million maturing in March 2020 and bearing a 4.25% coupon rate. The net proceeds from this issuance were used for general corporate purposes, including the refinancing of indebtedness.

Other Financing Activities

Cash dividend payments totaled $180 million and $174 million in the first quarters of 2011 and 2010, respectively. The increase in cash dividend payments was primarily due to a 7% increase in the quarterly dividend rate compared to the prior year, partially offset by the impact of a lower number of common shares outstanding as a result of the company s stock repurchase programs. In February 2011, the board of directors declared a quarterly dividend of $0.31 per share, which was paid on April 1, 2011 to shareholders of record as of March 10, 2011.

Proceeds and realized excess tax benefits from stock issued under employee benefit plans decreased by $37 million, from $171 million in the first quarter of 2010 to $134 million in the first quarter of 2011, due to a decrease in stock option exercises.

Stock repurchases totaled $637 million and $435 million in the first quarters of 2011 and 2010, respectively. As authorized by the board of directors, from time to time the company repurchases its stock depending upon the company s cash flows, net debt level and market conditions. In July 2009 and December 2010, the board of directors authorized repurchases of up to $2.0 billion and $2.5 billion, respectively, of the company s common stock. As of March 31, 2011, $2.4 billion remained available under the December 2010 authorization. There was no remaining availability under the July 2009 authorization.

CREDIT FACILITIES, ACCESS TO CAPITAL AND CREDIT RATINGS

Credit facilities

The company s primary revolving credit facility has a maximum capacity of $1.5 billion and matures in December 2011. The company also maintains a credit facility denominated in Euros with a maximum capacity of approximately $427 million as of March 31, 2011, which matures in January 2013. These facilities enable the company to borrow funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net-debt-to-capital ratio. As of March 31, 2011, the company was in compliance with the financial covenants in these agreements. There were no borrowings outstanding under either of the two outstanding facilities as of March 31, 2011. The non-performance of any financial institution supporting the credit facility would reduce the maximum capacity of these facilities by each institution s respective commitment. Refer to Note 6 to the company s consolidated financial statements in the 2010 Annual Report for further discussion of the company s credit facilities.

Access to capital

The company intends to fund short-term and long-term obligations as they mature through cash on hand, future cash flows from operations or by issuing additional debt or common stock. The company had $2.2 billion of cash and equivalents as of March 31, 2011. The company invests its excess cash in certificates of deposit and money market funds, and diversifies the concentration of cash among different financial institutions.

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

The company continues to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, that have experienced a deterioration in credit and economic conditions. While the economic downturn has not significantly impacted the company s ability to collect receivables, global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses. Global economic conditions and customer-specific factors may require the company to re-evaluate the collectibility of its receivables and the company could potentially incur additional credit losses.

Credit ratings

There were no changes in the company s credit ratings in the first three months of 2011. Refer to the 2010 Annual Report for further discussion of the company s credit ratings.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of the company s significant accounting policies is included in Note 1 to the company s consolidated financial statements in the 2010 Annual Report. Certain of the company s accounting policies are considered critical, as these policies are the most important to the depiction of the company s financial statements and require significant, difficult or complex judgments, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in the Management s Discussion and Analysis of Financial Condition and Results of Operations section in the 2010 Annual Report. There have been no significant changes in the company s application of its critical accounting policies during the first quarter of 2011.

LEGAL CONTINGENCIES

Refer to Note 6 for a discussion of the company s legal contingencies. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established liabilities. While the liability of the company in connection with certain claims cannot be estimated with any certainty, and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company s results of operations and cash flows for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company s consolidated financial position. While the company believes that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

CERTAIN REGULATORY MATTERS

In July 2005, the company stopped shipment of COLLEAGUE infusion pumps in the United States. Following a number of Class I recalls (recalls at the highest priority level for the U.S. Food and Drug Administration (FDA)) relating to the performance of the pumps, as well as the seizure litigation described in Note 6, the company entered into a Consent Decree in June 2006. Additional Class I recalls related to remediation and repair and maintenance activities were addressed by the company in 2007 and 2009. Pursuant to the Consent Decree, in July 2010 the FDA issued a final order regarding the recall of the company s COLLEAGUE infusion pumps currently in use in the United States. The company is executing the recall over the two years following the final order by offering its customers an option to replace their COLLEAGUE infusion pumps or receive monetary consideration. Under the replacement option, the company s customers may receive SIGMA Spectrum infusion pumps in exchange for their COLLEAGUE

infusion pumps. Alternatively, COLLEAGUE pump owners may receive the lesser of the pump s depreciated value, which will be no less than $1,500 per single-channel pump and $3,000 per triple-channel pump,

or the purchase price. The company will permit lessees to terminate their leases without penalty and will refund any prepaid, unused lease portion upon the return of the devices. As discussed in Note 3, following the FDA s issuance of its initial order dated April 30, 2010, the company recorded a charge in the first quarter of 2010 related to the FDA s order and other actions the company is undertaking outside the United States, in addition to a number of earlier charges in connection with its COLLEAGUE infusion pumps. As discussed in Note 6, the company received a subpoena from the Office of the United States Attorney for the Northern District of Illinois relating to the COLLEAGUE infusion pump in September 2009. It is possible that substantial additional cash and non-cash charges, including significant asset impairments related to the COLLEAGUE infusion pumps and related businesses, may be required in future periods based on new information, changes in estimates, the implementation of the recall in the United States, and other actions the company may be required to undertake in markets outside of the United States.

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

In January 2011, the company received a Warning Letter from the San Juan District Office of the FDA in connection with inspections of its Guayama and Jayuya, Puerto Rico facilities. The Warning Letter pertains to violations of Current Good Manufacturing Practices and the distribution of materials intended to assist customers with the use of certain nutrition products. Concerns about how the company investigates issues and reports relevant information to the FDA are also addressed. The company is working with the FDA to resolve these matters.

In January 2011, the European Medicines Agency (EMA) announced the review of Dianeal, Extraneal and Nutrineal peritoneal dialysis solutions manufactured in the company s Castlebar, Ireland facility due to the potential presence of endotoxins in certain batches. The EMA has recommended that the company s manufacturing facilities located in Canada, Poland and Turkey be included in the existing marketing authorizations for these products to ensure sufficient supply of these products in the European Union. The company is working with the EMA to resolve these matters.

While the company continues to work to resolve the issues described above, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, that sales of other products may not be adversely affected, or that additional regulation will not be introduced that may adversely affect the company s operations and consolidated financial statements. Please see Item 1A of the company s 2010 Annual Report for additional discussion of regulatory matters.

FORWARD-LOOKING INFORMATION

This quarterly report includes forward-looking statements, including statements with respect to accounting estimates and assumptions, including those made in connection with the charges related to the recall of the company s COLLEAGUE infusion pumps, litigation related matters including outcomes, the company s efforts to recall and remediate its COLLEAGUE infusion pumps and other regulatory matters, credit exposure to foreign governments, the impact of the acquisition of Prism Pharmaceuticals, contingent payments, estimates of liabilities, expectations with respect to the company s hedging activities including its exposure to financial market volatility and foreign currency risk, future capital and R&D expenditures, the sufficiency of the company s financial flexibility and the adequacy of credit facilities and reserves, the effective tax rate in 2011, and all other statements that do not relate to historical facts. The statements are based on assumptions about many important factors, including assumptions concerning:

demand for and market acceptance risks for new and existing products, such as ADVATE and plasma-based therapies (including Antibody Therapy), and other therapies;

fluctuations in supply and demand and the pricing of plasma-based therapies;

healthcare reform legislation in the United States including its effect on pricing, reimbursement, taxation and rebate policies;

future actions of governmental authorities and other third parties including third party payers as healthcare reform legislation and other similar measures are implemented in the United States and globally;

additional legislation, regulation and other governmental pressures in the United States or globally, which may affect pricing, reimbursement, taxation and rebate policies of government agencies and private payers or other elements of the company s business;

the company s ability to identify business development and growth opportunities for new and existing products;

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

future actions of the FDA, EMA or any other regulatory body or government authority that could delay, limit or suspend product development, manufacturing or sale or result in seizures, injunctions, monetary sanctions or criminal or civil liabilities, including any sanctions available under the Consent Decree entered into with the FDA concerning the COLLEAGUE and SYNDEO infusion pumps;

implementation of the FDA s final July 2010 order to recall all of the company s COLLEAGUE infusion pumps currently in use in the United States as well as any additional actions required globally;

the company s ability to fulfill demand for SIGMA s Spectrum infusion pump;

foreign currency fluctuations, particularly due to reduced benefits from the company s natural hedges and limitations on the ability to cost-effectively hedge resulting from financial market and currency volatility;

product development risks, including satisfactory clinical performance, the ability to manufacture at appropriate scale, and the general unpredictability associated with the product development cycle;

the ability to enforce the company s patent rights or patents of third parties preventing or restricting the company s manufacture, sale or use of affected products or technology;

the impact of geographic and product mix on the company s sales;

the impact of competitive products and pricing, including generic competition, drug reimportation and disruptive technologies;

inventory reductions or fluctuations in buying patterns by wholesalers or distributors;

the availability and pricing of acceptable raw materials and component supply;

global regulatory, trade and tax policies;

any changes in law concerning the taxation of income, including income earned outside the United States;

actions by tax authorities in connection with ongoing tax audits;

the company s ability to realize the anticipated benefits of restructuring and optimization initiatives;

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

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

changes in credit agency ratings;

any impact of the commercial and credit environment on the company and its customers and suppliers; and

other factors identified elsewhere in this report and other filings with the Securities and Exchange Commission, including those factors described in Item 1A in the company s Form 10-K for the year ended December 31, 2010, all of which are available on the company s website.

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

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Currency Risk

The company is primarily exposed to foreign exchange risk with respect to recognized assets and liabilities, forecasted transactions and net assets denominated in the Euro, Japanese Yen, British Pound, Australian Dollar, Canadian Dollar, Brazilian Real and Colombian Peso. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative financial instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and shareholders equity volatility relating to foreign exchange. Financial market and currency volatility may reduce the benefits of the company s natural hedges and limit the company s ability to cost-effectively hedge these exposures. The company uses options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions denominated in foreign currencies and recognized assets and liabilities. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions as of March 31, 2011 is 18 months. The company also uses derivative instruments to hedge certain intercompany and third-party receivables and payables and debt denominated in foreign currencies.

Currency restrictions enacted in Venezuela require Baxter to obtain approval from the Venezuelan government to exchange Venezuelan Bolivars for U.S. Dollars and requires such exchange to be made at the official exchange rate established by the government. On January 8, 2010, the Venezuelan government devalued the official exchange rate of 2.15 relative to the U.S. Dollar. The official exchange rate for imported goods classified as essential, such as food and medicine, was changed to 2.6, while the rate for payments for non-essential goods was changed to 4.3. In 2010, the majority of the company s products imported into Venezuela were classified as essential goods. Effective January 1, 2011, the Venezuela government devalued the official currency for imported goods classified as essential to 4.3. Since January 1, 2010, Venezuela has been designated as a highly inflationary economy and as a result, the functional currency of the company s subsidiary in Venezuela became the U.S. Dollar. The devaluation of the Venezuelan Bolivar and designation of Venezuela as highly inflationary did not have a material impact on the financial results of the company.

As part of its risk-management program, the company performs sensitivity analyses to assess potential changes in the fair value of its foreign exchange instruments relating to hypothetical and reasonably possible near-term movements in foreign exchange rates.

A sensitivity analysis of changes in the fair value of foreign exchange option and forward contracts outstanding as of March 31, 2011, while not predictive in nature, indicated that if the U.S. Dollar uniformly fluctuated unfavorably by 10% against all currencies, on a net-of-tax basis, the net asset balance of $2 million with respect to those contracts would decrease by $39 million, resulting in a net liability position.

The sensitivity analysis model recalculates the fair value of the foreign exchange option and forward contracts outstanding as of March 31, 2011 by replacing the actual exchange rates as of March 31, 2011 with exchange rates that are 10% unfavorable to the actual exchange rates for each applicable currency. All other factors are held constant. The sensitivity analysis disregards the possibility that currency exchange rates can move in opposite directions and that gains from one currency may or may not be offset by losses from another currency. The analysis also disregards the offsetting change in value of the underlying hedged transactions and balances.

Interest Rate and Other Risks

Refer to the caption Interest Rate and Other Risks in the Financial Instrument Market Risk section of the company s 2010 Annual Report. There were no significant changes during the quarter ended March 31, 2011.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Baxter carried out an evaluation, under the supervision and with the participation of its Disclosure Committee and management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Baxter s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of March 31, 2011. Based on that evaluation the Chief Executive Officer and Chief Financial Officer concluded that the company s disclosure controls and procedures were effective as of March 31, 2011.

Changes in Internal Control over Financial Reporting

In the second quarter of 2010, the company began the implementation of a new global enterprise resource planning system. In addition, the company is consolidating and outsourcing certain computer operations and application support activities. These multi-year initiatives will be conducted in phases and include modifications to the design and operation of controls over financial reporting. The company is testing internal controls over financial reporting for design effectiveness prior to implementation of each phase, and has monitoring controls in place over the implementation of these changes. There have been no other changes in Baxter s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, Baxter s internal control over financial reporting.

Review by Independent Registered Public Accounting Firm

Reviews of the interim condensed consolidated financial information included in this Quarterly Report on Form 10-Q for the three months ended March 31, 2011 and 2010 have been performed by PricewaterhouseCoopers LLP, the company s independent registered public accounting firm. Its report on the interim condensed consolidated financial information follows. This report is not considered a report within the meaning of Sections 7 and 11 of the Securities Act of 1933 and therefore, the independent accountants liability under Section 11 does not extend to it.

Report of Independent Registered Public Accounting Firm

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

We have reviewed the accompanying condensed consolidated balance sheet of Baxter International Inc. and its subsidiaries as of March 31, 2011 and the related condensed consolidated statements of income (loss) for each of the three-month periods ended March 31, 2011 and 2010 and the condensed consolidated statements of cash flows for the three-month periods ended March 31, 2011 and 2010. These interim financial statements are the responsibility of the company s management.

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

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

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2010, and the related consolidated statements of income, of cash flows and of changes in equity and comprehensive income for the year then ended, and in our report dated February 23, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2010, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Chicago, Illinois

May 3, 2011

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information in Part I, Item 1, Note 6 is incorporated herein by reference.

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

The following table includes information about the company s common stock repurchases during the three-month period ended March 31, 2011.

Issuer Purchases of Equity Securities

Period	Total number of shares purchased(1)(2)	Average price paid per share	Total number of shares purchased as part of publicly announced programs(1)(2)	Approximate dollar value of shares that may yet be purchased under the program(2)
January 1, 2011 through January 31, 2011	2,106,200	$ 50.14	2,106,200	
February 1, 2011 through February 28, 2011	5,924,923	$ 50.63	5,924,923	
March 1, 2011 through March 31, 2011	4,416,600	$ 52.44	4,416,600	
Total	12,447,723	$ 51.19	12,447,723	$ 2,359,153,603

(1) In July 2009, the company announced that its board of directors authorized the company to repurchase up to $2.0 billion of its common stock on the open market or in private transactions. During the first quarter of 2011, the company repurchased approximately 9.7 million shares for $496 million under this program. No shares remained available under this authorization as of March 31, 2011.

(2) In December 2010, the company announced that its board of directors authorized the company to repurchase up to $2.5 billion of its common stock on the open market or in private transactions. During the first quarter of 2011, the company repurchased approximately 2.7 million shares for $141 million under this program. This program does not have an expiration date.

Item 6. Exhibits
Exhibit Index:

Exhibit Number	Description
10.1	Baxter International Inc. Equity Plan Adopted as of March 4, 2011
15	Letter Re Unaudited Interim Financial Information
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document

* Furnished herewith

Signature

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

BAXTER INTERNATIONAL INC.
(Registrant)

Date: May 3, 2011

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