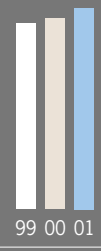
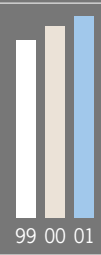
Building on a rich tradition of ground-breaking technologies, Baxter continues to pioneer advances that push the frontiers of medical science. All of these efforts support Baxter's vision of becoming the global leader in providing critical therapies for individuals with life-threatening conditions. They also provide the primary fuel for accelerating Baxter's growth in the years to come.

NET SALES [1]
($ in billions)



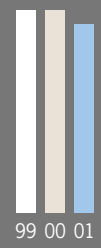
01	**$7.7**
00	$6.9
99	$6.4

NET INCOME [1,2]
($ in millions)



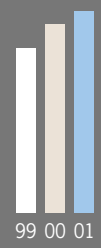
01	**$1,063**
00	$915
99	$779

OPERATIONAL CASH FLOW [1,3]
($ in millions)



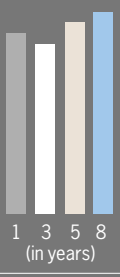
01	**$503**
00	$588
99	$588

STOCK PRICE
(as of December 31)



01	**$53.63**
00	$44.16
99	$30.03

COMPOUND ANNUAL RETURN
(through December 31, 2001)



8 yrs	**25%**
5 yrs	24%
3 yrs	22%
1 yr	23%

[1] *Excludes Edwards Lifesciences Corporation.*

[2] *Net Income excludes the cumulative effect of an accounting change, charges for in-process research and development and acquisition-related costs, and a special charge related to the Althane series dialyzers, as applicable in each year.*

[3] *See definition on page 33. This is not a measure defined by generally accepted accounting principles.*

This annual report contains forward-looking statements that may involve risks and uncertainties. Please see page 27 for more details.

DEAR FELLOW SHAREHOLDERS::

The year 2001 was very eventful for Baxter. In fact, I'm tempted to write a 30-page chairman's letter recounting all of the commitments we met, the milestones we achieved, and the numerous accomplishments of Baxter team members in bringing critical therapies to individuals worldwide. But I won't. You can read about our 2001 accomplishments elsewhere in this report. Instead, I will keep my operational summary to a minimum. The bottom line is, for the eighth consecutive year, we met all of our earnings and operational cash-flow commitments.

As shareholders of Baxter – and this includes more than 42,000 team members worldwide whose interests are aligned with all Baxter shareholders by virtue of a company-wide stock-option plan – this is *your* company. You *own* Baxter. In this letter, there are three areas I'd like to focus on: why I believe you can be *proud* to be a Baxter shareholder, why you can be very *excited* about our future, and why you can be *confident* in your investment in Baxter.

BE PROUD

Baxter's mission is to provide critical therapies to individuals with life-threatening conditions. This is an extremely important mission of which you can be very proud. In 2001, Baxter celebrated its 70th anniversary. During those 70 years, Baxter products, services and technologies saved and improved the lives of millions of individuals around the world. We pioneered most of these products and therapies, paving the way for people with kidney disease, hemophilia and other life-threatening conditions to lead productive and fulfilling lives. And, as you will read in the following pages, we continue to innovate and influence medical science.

You can be proud that our team members come to work every day knowing our mission, living it, and dedicating themselves to it. Much of what this company is all about was evidenced on September 11, 2001, a day none of us will ever forget. Baxter team members worldwide responded in remarkable ways to the immediate need for Baxter products such as blood bags, intravenous solutions and other critical items while overcoming significant transportation and logistical obstacles to provide uninterrupted service to patients and customers. We pulled out all the stops because that's what we do, each and every day.

Our team members' response to September 11 reflects Baxter's Shared Values, the foundation and principles by which all of us on the Baxter team operate. I've discussed our Shared Values in previous annual reports: being *respectful*, being *responsive*, and driving for the right *results*. These values are instilled within our Baxter culture, where all team members act with the highest degree of ethics and integrity in everything we do.

Sometimes doing the right thing is not easy. For example, last fall we learned that our dialyzers may have contributed to patient deaths in Spain, Croatia and other countries. We immediately discontinued producing the dialyzers and began working – and are continuing to work – with the appropriate government agencies and ministries of health to review the facts and compensate the families affected by this incident. Even one injury or death is one too many and we are deeply saddened by what occurred. Nonetheless, I am very proud of the way Baxter team members responded to this terrible tragedy.

Our values require us to be a leader in more ways than just with our products and services. During 2001, Baxter introduced a fourth goal for the company, in addition to our goals of becoming the Best Team in health care, the Best Partner to customers and patients, and the Best Investment for you, our shareholders. That goal is to be a Best Citizen. This is not a change in direction for Baxter. The components of being a Best Citizen – volunteerism, local community relations, environmental leadership, progressive work and life initiatives, diversity, philanthropy and others – already exist at Baxter. But an increased focus on global citizenship offers another opportunity to differentiate Baxter as a global leader.

I believe that the goal of being a Best Citizen includes a responsibility to take a position on key issues that make a difference in society. Health care is one issue in which others look to Baxter for leadership. Therefore, we must be willing to state what we believe as a company on health care-related issues. For example, Baxter has developed a very clear bioethics policy that spells out the principles and processes that govern our research-and-development efforts in biotechnology. This policy, along with other elements of our Best Citizen activities, are included in our annual Sustainability Report, which is available on the Internet at www.baxter.com/sustainability/index.html.

BE EXCITED

As a shareholder, why should you be excited about Baxter's future? Focus on two words: growth and technology. A growing and aging population continues to make health care one of the fastest-growing industries in the world, and the technologies Baxter has today and is developing for the future have the potential to meet some very significant and continually changing health-care needs.

As you will read in the following pages, we are pursuing technologies to inactivate known and even unknown pathogens in collected blood components before they enter the blood supply. We are developing new and better ways to deliver fluids and drugs to patients. We have added renal-related pharmaceuticals to our offering of products and therapies to treat kidney disease. We are expanding our industry-leading capabilities in recombinant manufacturing to bring much-needed clotting factor to the world's hemophilia community, and other recombinant proteins to treat a range of diseases in the future. I believe that our

unique and proprietary "Vero-cell" technology was one reason the U.S. government selected Baxter and our partner Acambis to produce enough smallpox vaccine to immunize the entire U.S. population. In addition, several other governments have expressed interest in our smallpox vaccine due to the threat of bioterrorism.

These are just a few of the areas in which Baxter is playing a leadership role. To get a broader picture, please see page 11. A few years ago you would not have seen an exciting, full and robust product pipeline in our annual report. We also did not have a "CSO" – a chief scientific officer – at Baxter. Now Norbert Riedel, as Baxter's CSO, is responsible for expanding and leveraging Baxter's core technical competencies across our businesses. He also will help bring greater clarity and focus to our key growth initiatives and continue to work with our scientific community to expand our product-development pipeline globally.

Another reason to be excited is our global presence, as growth in the world population will increasingly drive future health-care needs. The greatest population growth is occurring in developing countries, where many people with life-threatening diseases currently go untreated or are under-treated because these countries do not yet possess the resources to provide broad access to quality health care. As the economies of these countries continue to develop, their spending on health care will continue to increase. Given our global presence, we are uniquely positioned to meet these health-care needs around the world. Baxter has more facilities and team members outside the United States than in, with approximately 50 percent of our sales and more than 70 percent of our earnings generated outside the United States.

As Baxter's CEO, I realize that I am not the most objective person to discuss Baxter and our exciting prospects. But given the increasing demand for health care and our exciting portfolio of product-development opportunities, significant global presence and market positions, I am very excited about Baxter's future, and you should be too.

BE CONFIDENT

We have focused in recent years on improving our credibility and consistency in our financial performance, while investing significantly in developing and attracting what I believe is the best team in health care. Given this, as well as our discipline and focus, all of us on the Baxter team are confident that we can take advantage of the significant growth opportunities in health care and continue to generate significant shareholder value in the years ahead. We have generated a 25-percent compound annual return on your investment during the past eight years. Even in 2001, when the S&P 500 declined 12 percent, the S&P Healthcare Composite Index declined 11 percent and the Dow Jones Industrial Average declined 5 percent, Baxter generated a 23-percent return to Baxter shareholders.

As we look to 2002, I'd like to summarize our financial commitments. Here's what we expect to do:

- Accelerate sales growth to the low-teens.
- Grow earnings-per-share in the mid-teens.
- Generate operational cash flow of at least $500 million.

For the full year 2002, we expect to grow sales in the low-teens. This is our highest sales-growth rate in almost 20 years. I also expect our spending in R&D and capital expenditures in 2002 to be more than $1.3 billion – that's more than double what it was five to six years ago. It represents in excess of a 20-percent increase over 2001, and will help position Baxter for accelerated sales and earnings growth in the next several years. We will continue to focus on operational excellence and improve our operating margins, and we expect this balance between the short and long term to result in sustained earnings growth for our shareholders.

In summary, I hope my words here and the other information you glean from this report and other sources convince you that you can be proud, excited and confident to be a Baxter shareholder. This is a company that will focus on living our Shared Values and achieving our commitments and goals. We are in the right industry. We have the right team. We have the right competencies. If you want to invest in a company in a high-growth industry with a strong cost position and global leadership, that's Baxter! So stay tuned, because I truly believe the best is yet to come.

Best regards,

Harry M. Jansen Kraemer, Jr.
Chairman and Chief Executive Officer

Baxter takes pride in its record as a leading corporate citizen by setting new standards for environmental excellence and supporting a wide range of worthy causes. The Baxter International Foundation funds programs that improve the health and well-being of those less fortunate, particularly women, children and the elderly. Baxter provides product donations and emergency relief to war-torn areas and victims of natural disasters. Baxter also maintains the highest standards of ethics and integrity in its business practices and supports respect for the individual, work and life balance, and a safe and healthy work environment for team members worldwide.

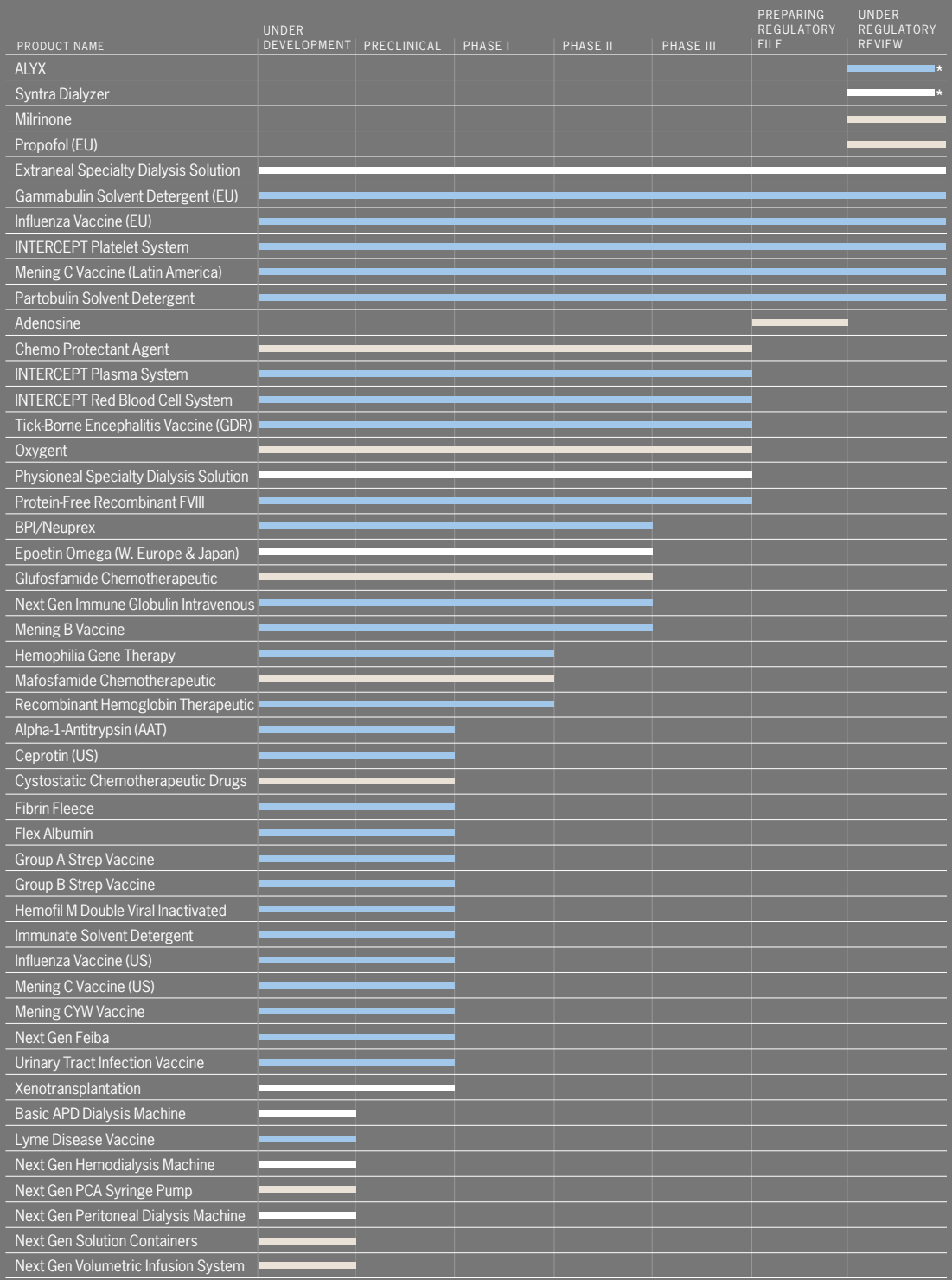
Baxter rose to the occasion to support victims of the September 11 terrorist attacks on the United States. The company increased production in anticipation of a critical need for intravenous (IV) products. Deliveries were made by helicopter and police escort to hospitals and trauma centers. Team members volunteered their time and supplied extra blood bags to blood centers to help them cope with the rush of blood donations. Others contacted dialysis centers and kidney patients treated at home to make sure they had adequate supplies, while many more overcame tremendous logistical constraints to get much-needed hemophilia products to patients worldwide.

	BUSINESS DESCRIPTION
BioScience 2001 Sales: $2.8 billion	Baxter introduced the first commercially produced Factor VIII concentrate to treat hemophilia in 1966. Today, Baxter is a leading producer of both plasma-based and recombinant clotting factors for hemophilia, as well as biopharmaceuticals used to treat immune deficiencies, cancer and other disorders. The business also develops biosurgery products, used for hemostasis, tissue-sealing and tissue-regeneration, and vaccines. Baxter also is a leading manufacturer of manual and automated blood-collection, processing and storage systems, used by hospitals, blood banks and plasma-collection centers to collect and process blood components for therapeutic use. Therapeutic blood components are used in surgery, cancer therapy and other critical therapies.
Medication Delivery 2001 Sales: $2.9 billion	Baxter was founded in 1931 as the first commercial manufacturer of intravenous (IV) solutions in glass bottles. Forty years later, the company set a new standard for IV therapy with the introduction of the first plastic IV containers. Today, Baxter manufactures a range of products that deliver fluids, therapies and medications to patients. IV solutions represent only 20 percent of Baxter's Medication Delivery sales, while 80 percent of the revenue comes from specialty products that include anesthetic agents, premixed drugs and drug-reconstitution systems, nutrition products and delivery devices. These products are used in combination for fluid replenishment, nutrition therapy, pain management, antibiotic therapy and chemotherapy.
Renal 2001 Sales: $1.9 billion	Baxter is a leading provider worldwide of products and services for the treatment of kidney disease. In 1956, the company pioneered hemodialysis (HD) with the introduction of the first widely available artificial kidney machine. Nearly 20 years later, Baxter introduced products and services for peritoneal dialysis (PD), a home-based therapy. Today, Baxter is the world's leading manufacturer of PD products, which include dialysis solutions, container systems and automated cyclers. Baxter also manufactures HD instruments and dialyzers. In addition, the company owns and operates dialysis clinics in partnership with local physicians outside the United States. In the United States, Baxter works with payers to provide disease-management services and with nephrologists to operate interventional outpatient centers.

GROWTH STRATEGY	PRODUCT DEVELOPMENT
Baxter's strategy for increasing growth in its BioScience business includes: expanding manufacturing capacity to meet current and future demand, which today for most products far exceeds supply; penetrating new markets outside North America and Europe, which currently account for more than 80 percent of sales; making acquisitions and forming other alliances and partnerships to bring new and complementary technologies and product platforms to Baxter; expanding the use of current products through additional indications and establishing new standards of care; and introducing new products to encompass additional therapies. In transfusion therapies, the focus remains on increasing production and blood safety through advanced automation, leukoreduction and pathogen inactivation.	In 2001, Baxter received European licensure for Ceprotin, a new protein C concentrate used to treat congenital protein C deficiency. Recombinant proteins in development include a protein-free-method recombinant Factor VIII, alpha-1-antitrypsin to treat emphysema and asthma, and recombinant hemoglobin. Baxter also began clinical trials on a Factor VIII gene therapy last year with its partner GenStar. In the area of vaccines, Baxter received additional approvals for its NeisVac-C vaccine for meningitis C in 2001. The company also is developing cell-culture-derived vaccines for influenza, smallpox and other diseases. Also in 2001, Baxter applied for FDA approval on its ALYX automated blood component collection system and filed in Europe for approval of the INTERCEPT Blood System for platelets.
Baxter continues to participate in the consolidation of the global marketplace for medication-delivery products, particularly in developing markets. Baxter expects to accelerate growth through expansion of its higher-margin specialty products outside the United States, building on its strong base in IV solutions. The company continues to broaden its portfolio of new products and technologies for medication delivery through internal development, acquisitions and alliances. Baxter also leverages its strengths in anesthesia, drug delivery and infusion systems to provide customers with innovative solutions at all points of care. In 2001, Baxter's oncology business was expanded with the acquisition of ASTA Medica Oncology, a German-based manufacturer of chemotherapy drugs.	Baxter is developing a next-generation volumetric infusion system with enhanced features and continues to expand its line of drug-delivery platforms. In 2001, Baxter acquired Cook Pharmaceutical Solutions, adding the capability to formulate and package injectable drugs in vials and syringes, and licensed RTP Pharma's proprietary Nanoedge technology to develop injectable formulations of insoluble medications. Baxter signed 18 new agreements with pharmaceutical companies in 2001 to package their drugs in Baxter's systems, and launched generic propofol, an injectable anesthetic, in the United Kingdom. The company also has several nutraceuticals in the pipeline and continues to pursue new film technologies for manufacturing IV containers and sets without polyvinyl chloride.
Baxter is growing its presence in renal care by addressing the needs of kidney-disease patients over their lifetime of care – from initial diagnosis through dialysis and organ replacement. Baxter's "integrated care" strategy looks at that spectrum of care and considers where it makes sense for Baxter to participate. For example, in 2001, Baxter acquired the assets and exclusive rights to a proprietary recombinant drug for the treatment of anemia. The company also conducted a landmark clinical trial with evidence suggesting broader applicability for PD therapy, which could yield a shift in practice patterns that could expand use of PD over time. Other growth will come through continued product innovation, e-health initiatives, additional acquisitions and alliances, and further expansion in developing markets.	Innovation remains key to Baxter's continued leadership and growth in renal care, with several new product launches planned in 2002. These include Baxter's first synthetic HD dialyzer, called Syntra, and new HD instruments for self-care centers, the home and the acute-care setting. Also in 2002, the company plans to introduce new and improved approaches to PD that provide unique patient benefits. Baxter expects to receive approval from the U.S. Food and Drug Administration for Extraneal PD solution. Baxter also will be launching HomeChoice Pediatric, an updated automated PD machine designed for patients who require lower volumes of fluid, particularly children. The system offers new safety features and makes the dialysis process even more convenient for pediatric patients and their parents.

Baxter's expertise in solutions, devices, pharmaceuticals and biopharmaceuticals is unique and differentiates us in the health-care industry. This expertise, along with our core competencies, supports our innovative, global product development and creates significant growth opportunities. The key to success is listening to our patients and customers, observing technological advances and determining requirements over the next five, 10 and 20 years. We are extremely well-positioned to meet these requirements through our R&D, strategic alliances and an innovative network of academic partnerships.

Norbert Riedel, Ph.D.
Chief Scientific Officer



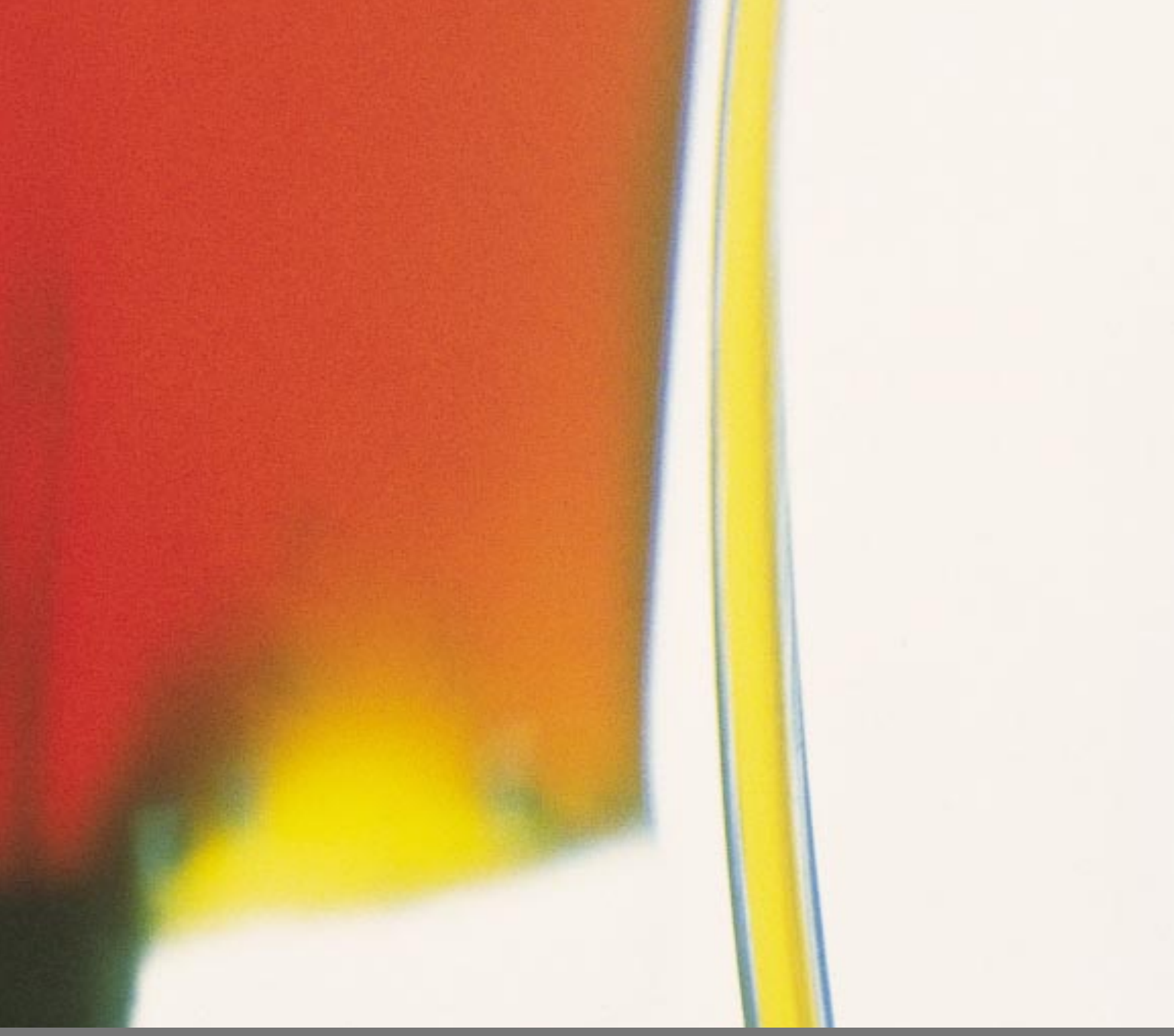
Notes:
Regulatory clinical status as of December 31, 2001.

This pipeline excludes vaccine partnerships with Acambis and other early-stage programs.

*ALYX and Syntra Dialyzer have filed for 510k approval.

MAKING BLOOD SAFER

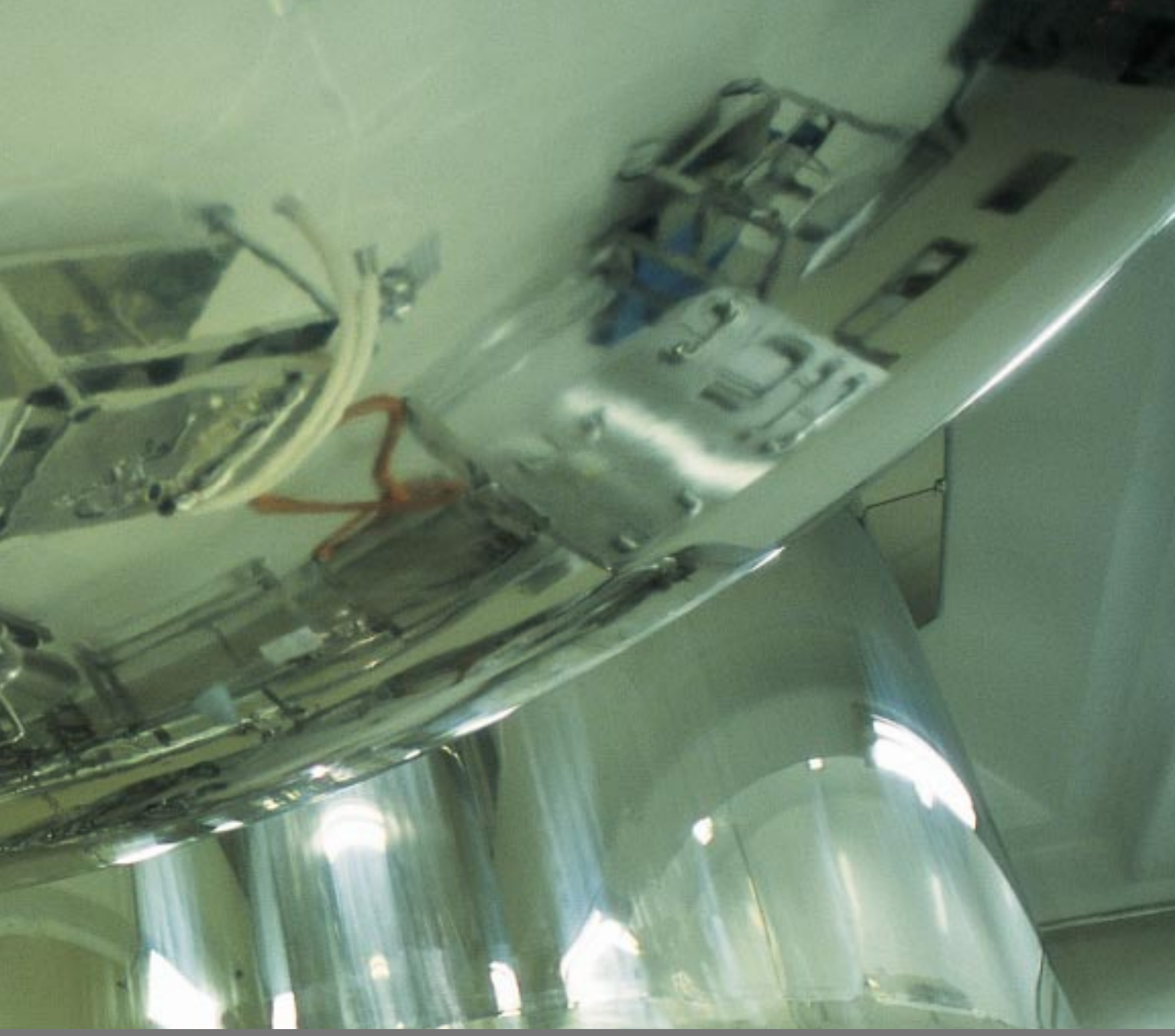
After nearly a decade of development, Baxter expects to introduce a revolutionary technology for inactivating known and potentially unknown viruses, bacteria and parasites that may be present in collected blood components. Called the INTERCEPT Blood System, the technology is designed to significantly reduce the risk of disease transmission to blood-transfusion recipients. The INTERCEPT Blood System is the result of a partnership between Baxter and California-based Cerus Corporation, which developed the chemistry – called "Helinx technology" – that drives the system. The backbone of the Helinx technology consists of two compounds – one for the treatment of platelets and plasma and the other for red blood cells – that bond to nucleic acids (DNA and RNA) and prevent their replication. An infectious agent inactivated this way can no longer make proteins, reproduce or cause disease. This approach has the potential to inactivate a broad spectrum of organisms, including hepatitis B, hepatitis C and the



AIDS viruses. The INTERCEPT process offers a significant advantage over current methods of infectious-disease testing, in which a specific test must be performed to detect each infectious agent in a unit of blood. While such testing has resulted in a significant reduction of transfusion-transmitted disease, it does not detect every unit of blood capable of causing disease. In addition, such testing is useful only for organisms for which a specific test has been developed. Because the Helinx technology works at the nucleic-acid level, it is designed to have the potential to inactivate infectious agents containing DNA or RNA even before they can be recognized by conventional testing. The INTERCEPT Blood System is not intended to replace existing screening tests but to supplement them. Baxter has applied for approval and expects to introduce the INTERCEPT system for platelets in 2002.

NOVEL COMPOUNDS IN RENAL CARE

Baxter will continue to bring new products to market to expand its leadership in renal care, including novel drug compounds to address significant medical issues facing people with kidney disease. For example, in 2001, Baxter acquired the assets and exclusive worldwide rights to a technology for a unique and proprietary recombinant erythropoietin (epo) drug for treating anemia. It represents the company's first entry into the pharmaceutical arena related to treating kidney disease and associated illnesses. Erythropoietin is a hormone produced by healthy kidneys that stimulates the production of red blood cells. When kidneys are not functioning well, they may not be able to produce enough erythropoietin, causing red blood cell levels to drop, leading to anemia. Baxter's drug, known as Epoetin Omega, has physiochemical characteristics that are distinctly different from other epo drugs on the market. Combined with Baxter's expertise in drug-delivery systems and manufacturing of recombinant proteins, the epo

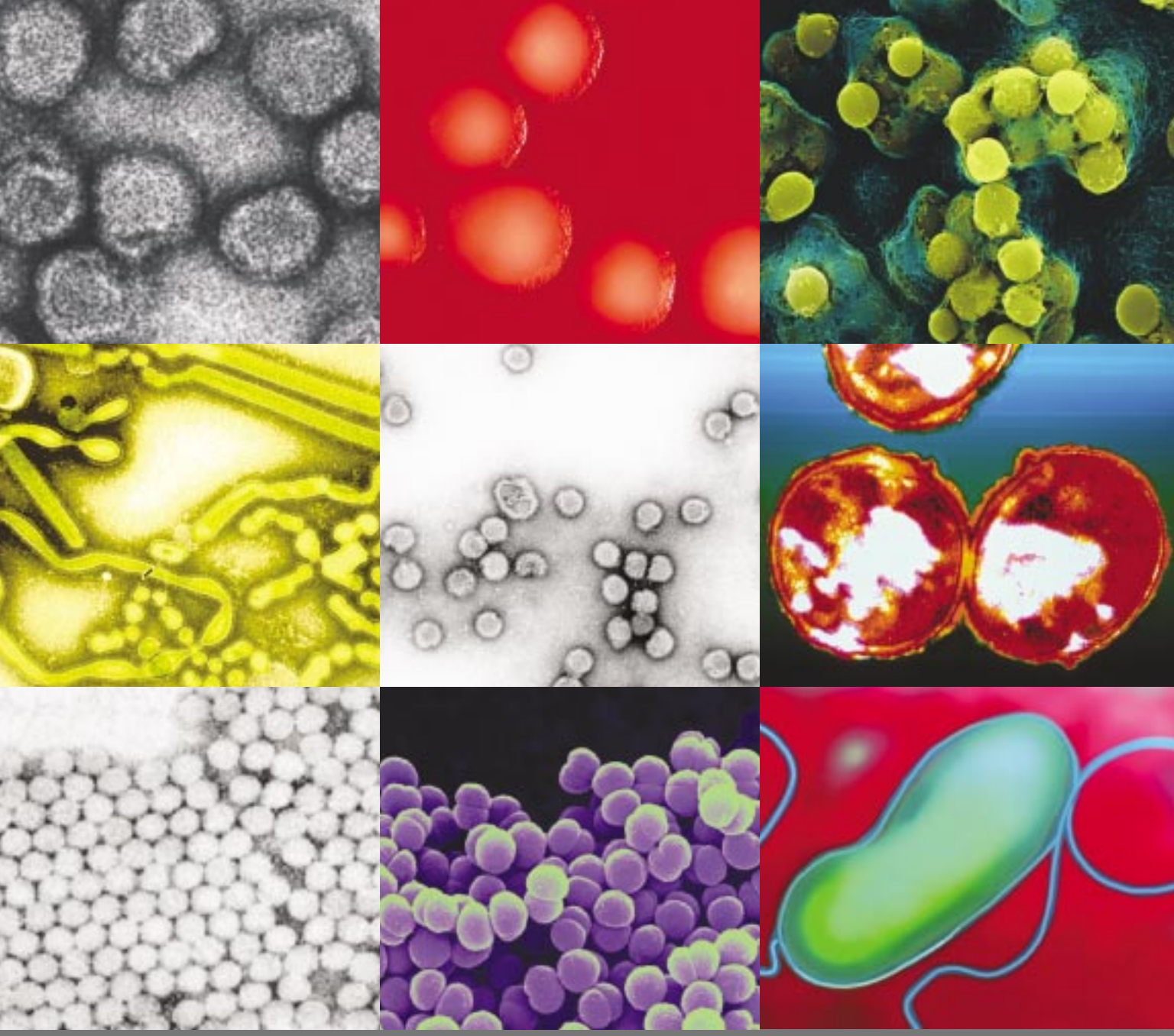


market represents a significant growth opportunity for Baxter. In addition, in 2002, the company plans to introduce Extraneal peritoneal dialysis (PD) solution in the United States. Introduced in Europe in 1997, Extraneal is used today by more than a third of Baxter's European PD patients. It offers patients the potential for increased ultrafiltration – the removal of fluid from the bloodstream during dialysis. Fluid removal is the cornerstone of dialysis therapy, as it is one of the primary functions of healthy kidneys. Extraneal uses a novel osmotic agent rather than standard glucose to remove fluid in greater amounts over a "long-dwell" period, which refers to the amount of time dialysis solution remains in the abdominal cavity during PD therapy. Baxter will continue to build on its rich history of innovation in renal care to bring to market novel drug compounds, solutions and other technologies to improve the treatment of people with kidney disease.

NEW WAYS TO DELIVER DRUGS

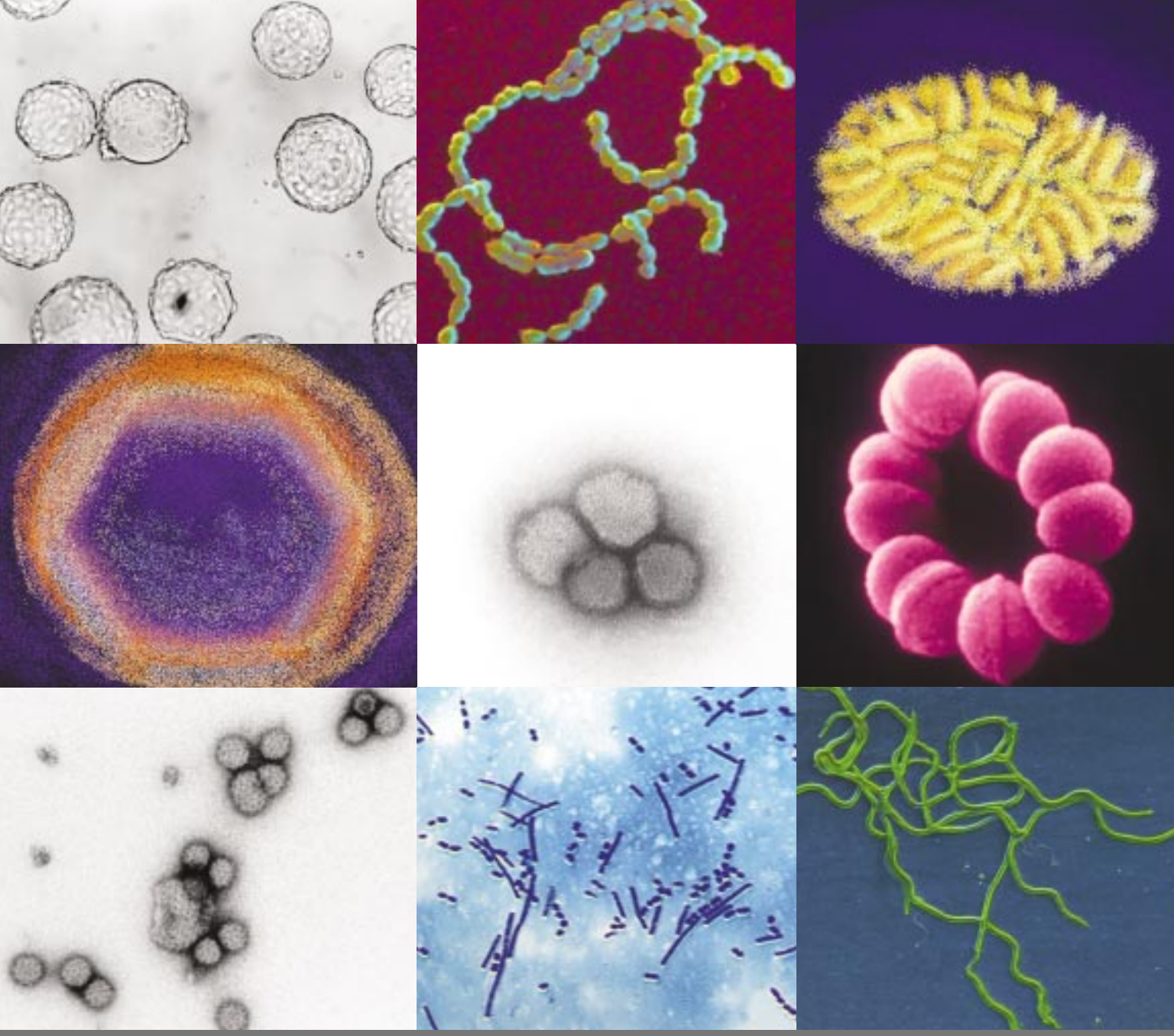
For more than three decades, Baxter has been at the forefront of providing safe, convenient and cost-effective ways to deliver drugs to patients. The company was a pioneer in forming alliances with pharmaceutical companies to formulate and package their drugs in intravenous (IV) solution containers. These include frozen premixed drugs for compounds that are not stable at room temperature, ambulatory drug-delivery systems and other platforms. Baxter currently provides approximately 43 different compounds in ready-to-use or ready-to-mix formulations. Driven by an increase in the number of new biotechnology-derived drugs and less invasive routes of administration in alternate sites of care, the options for delivering drugs are expanding even further. Baxter continues to pioneer new drug-delivery platforms offering increased value to pharmaceutical partners and patients worldwide through internal development, acquisitions and alliances. In 2001, Baxter acquired Cook Pharmaceutical Solutions,

a manufacturer of pre-filled syringes used to inject drugs intramuscularly and subcutaneously (under the skin). Cook provides a number of sterile product dosage forms such as suspensions and freeze-dried (lyophilized) powders. Also in 2001, Baxter signed an exclusive agreement with RTP Pharma Inc. to use RTP's insoluble drug formulation technology to develop injectable formulations for insoluble medications. Drug molecules that can't be dissolved in water represent one of the biggest challenges to developing new pharmaceutical products for injectable administration. Many otherwise promising compounds never reach the market due to challenges with insolubility, while other drugs are marketed as sub-optimal formulations. RTP Pharma's technology, including its proprietary Nanoedge technology, will provide opportunities to overcome these challenges across a broad range of drug classes.



AN OUNCE OF PREVENTION

It's been said that prevention is the best cure. Such is the philosophy behind Baxter's increasing investment in vaccines. Vaccines represent a $7-billion global market that is expected to grow 13 percent annually over the next five years. Baxter continues to expand its technological and manufacturing capabilities in vaccines production. The company has developed a new platform for manufacturing vaccines using a proprietary protein- and serum-free "Vero-cell" culture process. Virus vaccine production was previously carried out mainly in specific pathogen-free eggs or primary cell culture. Among the disadvantages of this process are the risk of contamination, high production costs and long production cycles. The new Vero-cell methodology is used in Baxter's newest vaccine, the first tissue culture-derived influenza vaccine, as well as the smallpox vaccine that the company is



developing with its partner Acambis. Baxter's new vaccines manufacturing plants in Europe will produce the company's new Vero-cell-based influenza vaccine, and with multiple production suites, could ultimately be used for the production of other vaccines and biological products. Overall, Baxter has more than a dozen vaccines in its pipeline, with active programs to develop vaccines for a broad range of chronic diseases, including urinary tract infection, rheumatic fever and meningitis, as well as traveler's vaccines. Baxter's core capability in recombinant manufacturing will provide the company with a significant advantage in the development of future vaccines. It is estimated that more than 80 percent of all future vaccines will be produced using advanced cell-culture technologies or recombinant technologies.

LEADER IN RECOMBINANT PROTEIN PRODUCTION

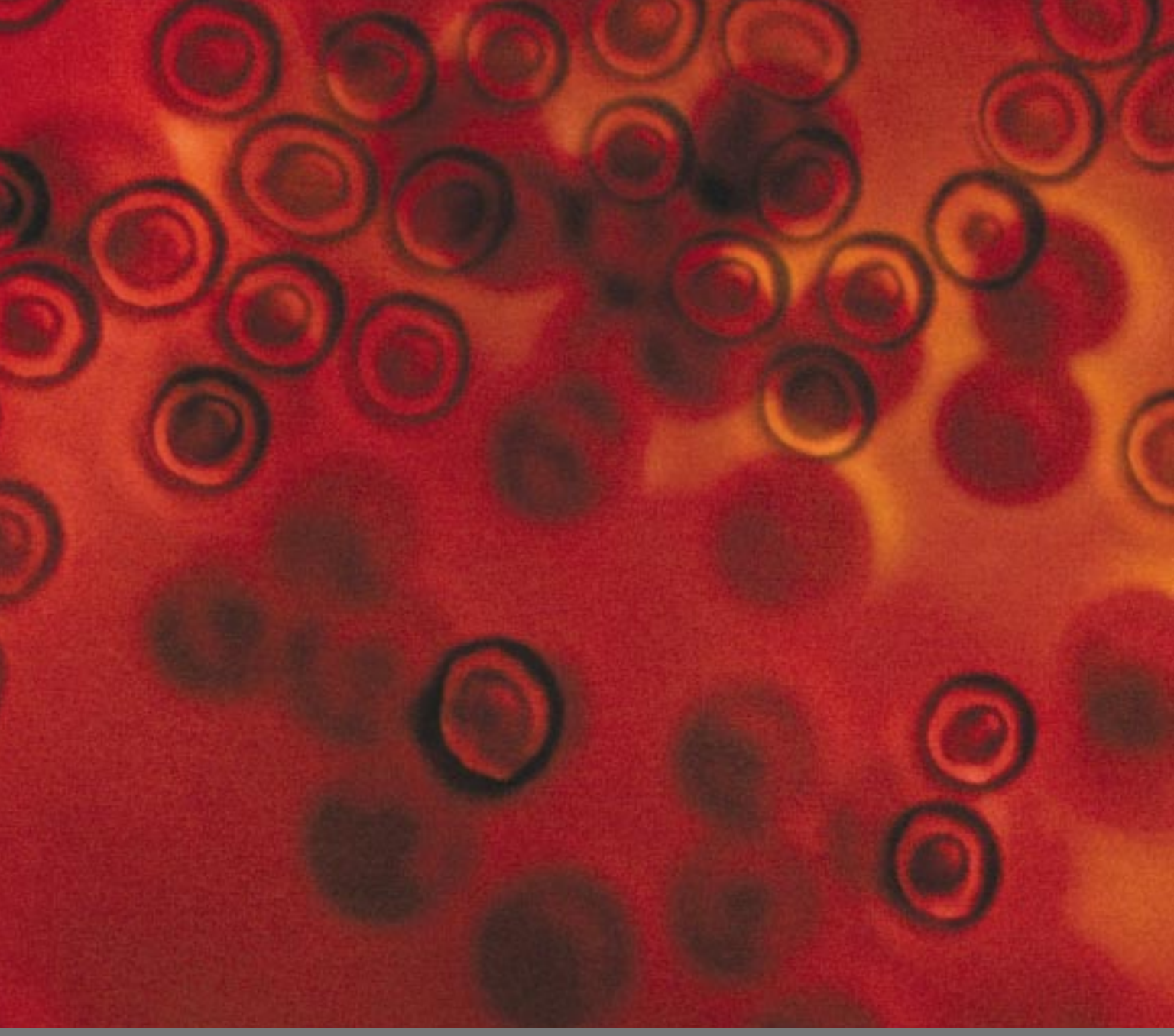
Recombinant protein production is a core competency of Baxter that provides a foundation for continued growth and innovation in biotechnology products. Baxter's Recombinate Antihemophilic Factor (rAHF) was the industry's first genetically engineered, or "recombinant," Factor VIII product for hemophilia. Its production starts with a single genetically engineered Chinese Hamster Ovary (CHO) cell into which a copy of the human gene responsible for producing Factor VIII – the clotting factor missing from the blood of most people with hemophilia – is inserted. As these cells are grown in stainless-steel tanks, or "bioreactors," they produce large quantities of Factor VIII. Monoclonal antibodies are used to separate the Factor VIII from the cellular material and culture media used to grow the cells. Because it is produced in cell culture, the amount of Recombinate rAHF that can be produced is not limited by the availability of source plasma. Baxter has been committed to increasing the supply of recombinant

Factor VIII in the marketplace due to the tremendous need for Factor VIII by the world's hemophilia community. Over the past two years, Baxter has received licensing for two additional manufacturing suites at its recombinant manufacturing facility in Thousand Oaks, California, with a fourth suite projected to come on-line by 2004. Baxter also has a new multi-purpose recombinant manufacturing facility in Neuchâtel, Switzerland, that initially will produce the world's first recombinant Factor VIII prepared without the addition of any human or animal protein in the cell-culture process, purification or final therapeutic. In 2002, the company expects to complete the clinical trials for this next-generation Factor VIII and expects to file for regulatory approval in the United States and Europe. Baxter also is applying the technology to fields outside of hemophilia that include other blood disorders, immune and inflammatory diseases, and vaccines.

TAKING AIM AT CANCER

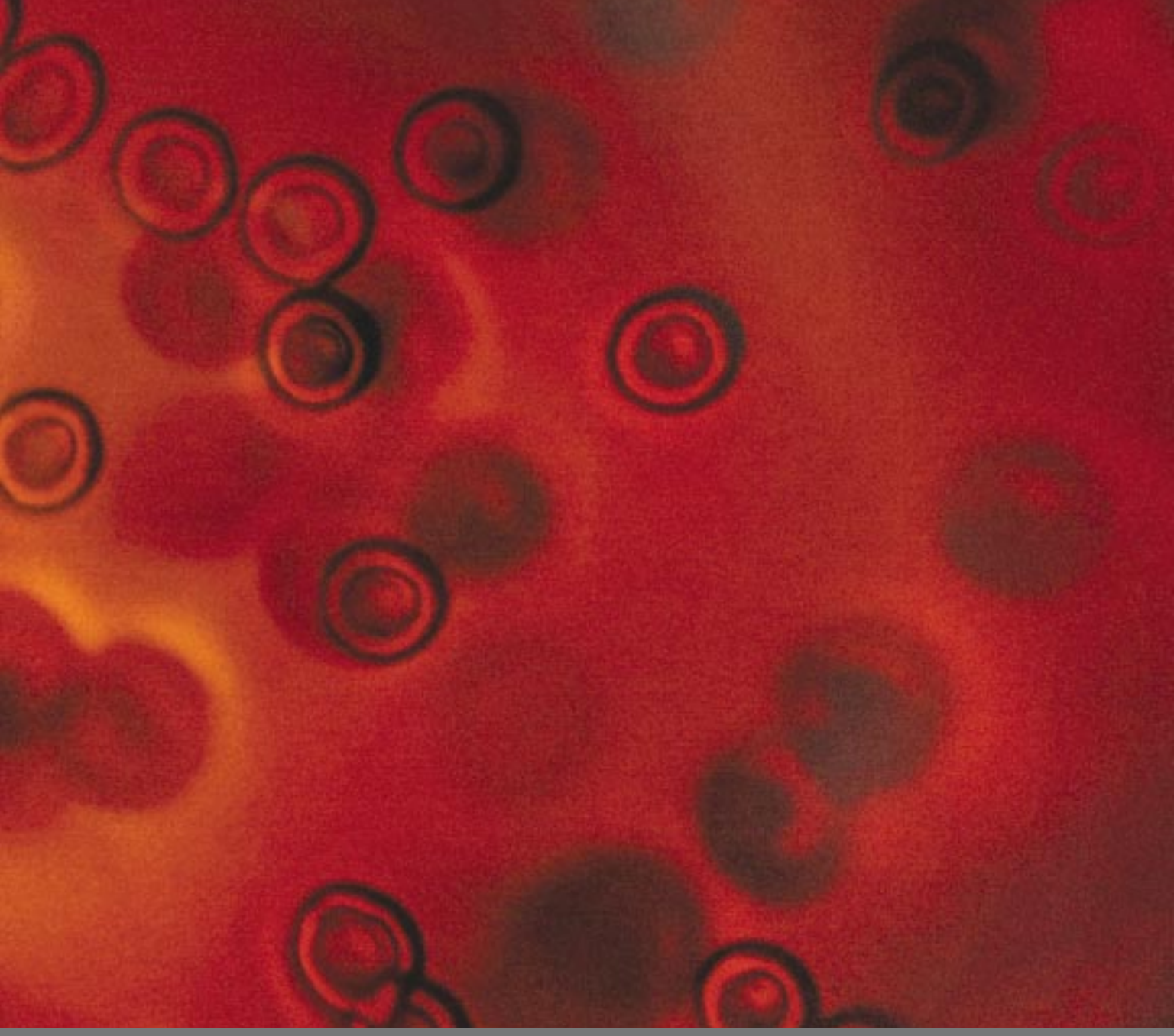
Cancer killed more than six million people last year, making it the world's second-leading cause of death after heart disease. As many as four million new cases of cancer are diagnosed each year, with the incidence of many cancers rising due to an aging population and higher incidence of disease, resulting in oncology being one of the fastest growing segments in health care. Baxter strengthened its presence in the global oncology market in 2001 when it acquired ASTA Medica Oncology, a German-based manufacturer of small-molecule cytotoxic (chemotherapy) drugs. The manufacture of cytotoxic agents requires a unique chemical-synthesis process that warrants special handling and safety measures, which provides a barrier to entry for many pharmaceutical manufacturers. Through the acquisition of ASTA, Baxter manufactures some of the most widely used chemotherapy drugs on the market, used to treat a broad range of cancers. These products are marketed in more than 100 countries, with

significant presence in Europe, North America and Latin America. Baxter also has a number of exciting new products in development, which include next-generation chemotherapeutic agents, other agents that reduce toxicities associated with chemotherapy, and additional small-molecule drugs for future cancer treatments. Advances in the treatment and prevention of cancers include increasing use of combinations of chemotherapeutic agents, enhancements in delivery systems and developments in biopharmaceuticals and vaccines, all of which leverage Baxter's core strengths. The ability to provide delivery systems, drugs and drug platforms in ways that can enhance the administration of cancer therapies is unique to Baxter, positioning the company for sustainable growth and success in the oncology market in the years ahead.



MAKING THE MOST OF LIFE'S MOST PRECIOUS RESOURCE

Of the three main blood components used in transfusions – platelets, plasma and red blood cells – red cells are, by far, the most in need. In the United States, for example, there are approximately 13.5 million red-cell transfusions a year compared to 1.75 million transfusions of platelets and between 3 and 4 million transfusions of plasma. Unlike platelets and plasma, however, red cells are collected primarily by manual whole-blood donations rather than an automated blood-component collection device. One reason is that the market has lacked a fast and easily portable, automated collection system for red cells. In 2001, Baxter submitted for approval to the U.S. Food and Drug Administration (FDA) its new ALYX automated blood-component collection system. By returning



saline and unneeded blood components to the donor, ALYX can collect two units of red cells from a donor versus one unit using current manual blood-collection processes. Collecting twice as many red cells from a single donor can help blood centers deliver the optimum supply of critically needed, high-quality blood components despite a shrinking donor base. In addition, ALYX's small size allows it to take up less space in the blood center and makes it ideal for use in mobile units — another benefit given that nearly two-thirds of all blood is collected outside of blood centers. Baxter expects to launch ALYX in 2002 in the United States following FDA clearance, and also expects to begin clinical trials in Europe.

This discussion and analysis presents the factors that had a material effect on Baxter International Inc.'s (Baxter or the company) results of operations and cash flows during the three years ended December 31, 2001, and the company's financial position at that date. The information below pertains to continuing operations only. As discussed in Note 2 to the consolidated financial statements, the cardiovascular business was distributed to shareholders on March 31, 2000, and the company's consolidated financial statements and related notes have been restated to reflect the financial position, results of operations and cash flows of the cardiovascular business as a discontinued operation.

The matters discussed in this Annual Report that are not historical facts include forward-looking statements that involve risks and uncertainties. Actual results could differ materially. Factors that could cause actual results to differ include but are not limited to currency exchange rates; interest rates; technological advances in the medical field; economic conditions; demand and market acceptance risks for new and existing products, technologies and health-care services; the impact of competitive products and pricing; manufacturing capacity; new plant start-ups; global regulatory, trade and tax policies; regulatory, legal or other developments relating to the company's A, AF and AX series dialyzers; continued price competition; product development risks, including technological difficulties; ability to enforce patents; actions of regulatory bodies and other government authorities; reimbursement policies of government agencies; commercialization factors; results of product testing; and other factors described elsewhere in this report or in the company's filings with the Securities and Exchange Commission.

Management's financial objectives for 2001 were outlined in last year's Annual Report and are summarized below, along with the company's results relative to those objectives.

Key Financial Objectives and Results

2001 Objectives	Results
Increase net sales in the low double digits.	Net sales increased 11 percent in 2001. Excluding fluctuations in currency exchange rates, net sales increased 15 percent.
Increase net earnings in the mid-teens.	Net earnings from continuing operations increased 16 percent in 2001, excluding the cumulative effect of a change in accounting principle, charges for in-process research and development (IPR&D) and acquisition-related costs, and the special charge in 2001 relating to the company's A, AF and AX series dialyzers.
Generate more than $500 million in operational cash flow, after investing more than $1 billion in capital expenditures and research and development.	The company generated operational cash flow of $503 million during 2001. The total of capital expenditures and research and development expenses (excluding IPR&D) was $1.2 billion.

Refer to the consolidated financial statements and accompanying notes for information regarding the company's financial position, result of operations and cash flows prepared in accordance with generally accepted accounting principles (GAAP).

Company and Industry Overview

Baxter is a global leader in providing critical therapies for life-threatening conditions and operates in three segments, which are described in Note 13. The company's products and services in bioscience, medication delivery and renal therapy are used by health-care providers and their patients in more than 100 countries. Baxter manufactures and markets products and services used to treat patients with hemophilia, immune deficiencies, infectious diseases, cancer, kidney disease, trauma and other disorders. The company generates close to 50 percent of its revenues outside the United States. While health-care cost containment continues to be a focus around the world, with the aging population and the availability of new and better medical treatments, demand for health-care products and services continues to be strong worldwide, particularly in developing markets. The company's strategies emphasize global expansion and technological innovation to advance medical care worldwide.

The company's primary markets are highly competitive and subject to substantial regulation. There has been consolidation in the company's customer base and by its competitors, which has resulted in pricing and market share pressures. The company has experienced increases in its labor and material costs, which are partly influenced by general inflationary trends. Competitive market conditions have minimized inflation's impact on the selling prices of the company's products and services. Management expects these trends to continue. The company will continue to manage these issues by capitalizing on its market-leading positions, developing innovative products and services, investing in human resources, upgrading and expanding facilities, leveraging its cost structure, making acquisitions, and entering into alliances and joint venture arrangements.

Results of Operations

Net Sales

years ended December 31 (in millions)	2001	2000	1999	Percent increase 2001	Percent increase 2000
Medication Delivery	$2,935	$2,719	$2,524	8%	8%
BioScience	2,786	2,353	2,176	18%	8%
Renal	1,942	1,824	1,680	6%	9%
Total net sales	$7,663	$6,896	$6,380	11%	8%

years ended December 31 (in millions)	2001	2000	1999	Percent increase 2001	Percent increase 2000
United States	$3,887	$3,194	$2,921	22%	9%
International	3,776	3,702	3,459	2%	7%
Total net sales	$7,663	$6,896	$6,380	11%	8%

Excluding fluctuations in currency exchange rates, which impacted sales growth unfavorably for all three segments, total net sales growth was 15 percent in 2001 and 12 percent in 2000. The company's sales growth was unfavorably impacted by fluctuations in currency exchange rates in 2001 principally due to the weakening of the Euro and Japanese Yen relative to the United States Dollar. In 2000, the weakening of the Euro relative to the United States Dollar was partially offset by the strengthening of the Japanese Yen.

Medication Delivery The Medication Delivery segment generated eight percent sales growth in both 2001 and 2000. Excluding the impact of fluctuations in currency exchange rates, sales growth was 11 percent in 2001 and 2000. Of the constant-currency sales growth, two points of growth in both 2001 and 2000 were generated by recent acquisitions, principally the October 2001 acquisition of a subsidiary of Degussa AG, ASTA Medica Onkologie GmbH & CoKG (ASTA), the August 2001 acquisition of Cook Pharmaceutical Solutions, formerly a unit of Cook Group Incorporated (Cook), the January 2000 acquisition of a domestic ambulatory and infusion pump business and the September 1999 acquisition of a nutrition and fluid therapy business in Europe. Refer to Note 3 for further information on the company's significant acquisitions. In 2001 and 2000, three points and four points of growth, respectively, were generated from the anesthesia business, with a portion of such growth driven by the segment's sales of Propofol, an intravenous drug used for the induction or maintenance of anesthesia in surgery, and as a sedative in monitored anesthesia care. Sales of the Colleague® electronic infusion pumps, and intravenous fluids and administration sets used with electronic infusion pumps, contributed two points of sales growth in both 2001 and 2000. The majority of the remaining sales growth in 2001 and 2000 was driven by sales of specialty products, particularly premixed drugs and nutrition products. Sales in the United States and Western Europe have been impacted by competitive pricing pressures and cost pressures from health-care providers. These factors are expected to continue to be more than offset by expansion of higher-margin specialty products outside the United States, as well as increased sales and a broadening of the portfolio of products and technologies for medication delivery as a result of internal development, new distribution and alliance agreements, and acquisitions.

BioScience Sales in the BioScience segment increased 18 percent and eight percent in 2001 and 2000, respectively. Excluding the impact of fluctuations in currency exchange rates, sales growth was 22 percent in 2001 and 14 percent in 2000, with growth particularly strong in the domestic market in 2001 and outside the United States in 2000. Of the constant-currency growth rates, nine points and three points of growth in 2001 and 2000, respectively, were due to increased sales of recombinant products, particularly Recombinate Antihemophilic Factor (rAHF) (Recombinate), with such growth principally a result of increased capacity, improved pricing, as well as continued strong demand for this product. Sales of plasma-derived products increased the segment's growth rates by approximately 11 points and six points in 2001 and 2000, respectively, due principally to strong sales of plasma Factor VIII in 2001, the February 2001 acquisition of Sera-Tec Biologicals, L.P. (Sera-Tec), and improved product supply and strong growth of Gammagard® S/D IGIV in 2000. The transfusion therapy business also generated solid sales growth during 2001 and 2000, principally due to an increase in sales of products that provide for leukoreduction, which is the removal of white blood cells from blood products used for transfusion. Partially offsetting these increases in 2001 were reduced sales of vaccines, which were principally due to the company not receiving a license for its tick-borne encephalitis product in Germany, and a nonrecurring sale of a vaccine in 2000. The June

2000 acquisition of North American Vaccine, Inc. (NAV) contributed three points to the segment's sales growth rate in 2000. The effects of regulatory, supply, competitive and other pressures on the BioScience segment are expected to continue to be more than offset by the effects of global expansion, technological advancement and innovation, increases in manufacturing capacity, and strategic alliances, joint ventures and acquisitions.

Renal The Renal segment generated sales growth of six percent and nine percent in 2001 and 2000, respectively. Excluding the impact of fluctuations in currency exchange rates, sales growth was 13 percent in 2001 and 11 percent in 2000. Strong growth was generated by the segment's Renal Therapy Services business, which operates dialysis clinics in partnership with local physicians in international markets, and the Renal Management Strategies business, which is a renal-disease management organization, with revenues from these businesses increasing $110 million in 2001 and $60 million in 2000. Sales related to the March 2000 acquisition of Althin Medical A.B. (Althin), a manufacturer of hemodialysis products, contributed four points to the segment's growth rate in 2000. The remaining sales growth in the Renal segment was driven principally by continued penetration of products for peritoneal dialysis. The penetration continues to be strongest in emerging markets such as Latin America and Asia, where many people with end-stage renal disease are currently under-treated. Sales in certain geographic markets continue to be affected by strong pricing pressures and the impact of market consolidation. These issues are expected to continue to be more than offset by increased penetration of peritoneal dialysis, growth in sales of hemodialysis products, product innovation, continued expansion into developing markets, and additional acquisitions and alliances. The October 2001 acquisition of the assets and rights to technology relating to a proprietary recombinant erythropoietin drug for the treatment of anemia is also expected to contribute to the segment's future sales growth.

Gross Margin and Expense Ratios

years ended December 31 (as a percent of sales)	2001	2000	1999
Gross margin	44.8%	44.4%	44.1%
Marketing and administrative expenses	19.2%	19.7%	20.5%

The improvement in the gross margin in both 2001 and 2000 was partly due to changes in the products and services mix, as well as fluctuations in currency exchange rates along with the effects of related hedging activities. The improved sales mix in 2001 was principally due to significantly higher sales of Recombinate in the BioScience segment. The improved sales mix in 2000 was principally due to significantly higher sales of Recombinate and vaccines in the BioScience segment.

The reduction in the expense ratios in both 2001 and 2000 was primarily due to the company's aggressive management of expenses and leveraging of recent acquisitions. Partially offsetting these cost reductions were the effects of the company's significant investments to continue to grow its businesses, including the costs to attract and retain a highly talented workforce.

The gross margin and expense ratios also benefited from the company's pension plan asset returns. In addition, various recently implemented strategic sourcing initiatives have resulted in significant efficiencies and cost savings to the company, which has contributed to improved gross margin and expense ratios, and has allowed management to redeploy valuable resources within the company. Management expects the gross margin to continue to increase in 2002 as a result of continued sales growth of higher-margin products. Management expects to reduce the expense ratio in 2002 as it continues to make strategic investments while leveraging and closely managing costs.

Research and Development

				Percent increase	
years ended December 31 (in millions)	2001	2000	1999	2001	2000
Research and development expenses	$427	$379	$332	13%	14%
as a percent of sales	6%	5%	5%		

Research and development (R&D) expenses above exclude IPR&D charges, which principally consisted of the $250 million charge relating to the acquisition of ASTA in 2001 and the $250 million IPR&D charge relating to the acquisition of NAV in 2000. Refer to Note 3 for a discussion of significant acquisitions, along with related IPR&D charges. R&D expenses increased in all three segments in both 2001 and 2000. The overall increase was primarily due to spending in the BioScience segment, principally relating to the development of a next-generation recombinant clotting factor for hemophilia, next-generation oxygen-therapeutics program, initiatives in the wound management and plasma-based products areas, and, in 2000, research and development expenses added as a result of the acquisition of NAV. The status of development, stage of completion, nature and timing of remaining efforts for completion, risks and uncertainties, and other key factors vary by R&D project. In many cases, substantial further R&D, preclinical testing and clinical trials will be required to determine the technical feasibility and commercial viability of

the projects. At December 31, 2001, the company had approximately 50 significant R&D projects in its pipeline, with the projects in various stages of development, from the development or preclinical stage through the final regulatory review stage. Management's growth strategy is to continue to make significant investments in R&D initiatives across the three segments.

Special Charge – A, AF and AX Series Dialyzers

As further discussed in Note 4, the company recorded a $189 million pretax charge ($156 million on an after-tax basis) related to the decision to initiate a global recall and permanently cease manufacturing its Renal segment's A, AF and AX series dialyzers. Testing led the company to conclude that a processing fluid used during the manufacturing of a limited number of dialyzers produced in the company's Ronneby, Sweden facility may have played a role in patient deaths reported in Croatia and other countries. Included in the charge are writedowns of two facilities and related equipment, and certain goodwill and other intangible assets due to impairment. The charge also includes employee-related and other cash costs. Management believes the established reserve for this exit program is adequate to complete the actions contemplated by the program. Total cash expenditures, which are estimated to be $50 million on an after-tax basis, will be funded with cash generated from the company's operations. The operating results relating to the A, AF and AX series dialyzers were not significant.

Goodwill Amortization

Goodwill amortization increased in 2001 principally due to the acquisitions of Sera-Tec in February 2001 and NAV in June 2000. Goodwill amortization increased in 2000 principally due to the acquisition of NAV. Goodwill amortization on a net-of-tax basis was $41 million, $28 million and $17 million in 2001, 2000 and 1999, respectively, or $0.07, $0.05 and $0.03 per diluted common share, respectively. In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," goodwill relating to acquisitions completed after June 30, 2001 is not being amortized. Effective January 1, 2002 all goodwill will no longer be amortized but will be subject to periodic impairment reviews. Management expects to significantly increase R&D spending in 2002, offsetting the reduced expense due to the elimination of goodwill amortization.

Other Income and Expense

Net interest expense declined in 2001 principally due to the May 2001 issuance of convertible debt, which bears a lower interest rate than the debt balances repaid with the proceeds from the issuance. Net interest expense declined in 2000 due principally to the impact of a greater mix of foreign currency denominated debt, which bears a lower average interest rate, and to lower average debt levels, partially offset by the impact of increased interest rates in the United States and Europe.

As further discussed in Note 10, other income in 2001 included a pretax gain of $105 million from the disposal of a non-strategic common stock investment. This gain was substantially offset by impairment charges for other assets and investments whose decline in value was deemed to be other than temporary. Other income in 2000 consisted principally of net gains relating to foreign currency hedging instruments, partially offset by losses relating to the early termination of debt. Other income and expense in 2001, 2000 and 1999 also included gains and losses on disposals of non-strategic investments and fluctuations in currency exchange rates.

Pretax Income

Refer to Note 13 for a summary of financial results by segment. Certain items are maintained at the company's corporate headquarters and are not allocated to the segments. They primarily include the majority of the hedging activities, certain foreign currency fluctuations, net interest expense, income and expense related to certain non-strategic investments, corporate headquarters costs, and certain nonrecurring gains and losses. The following is a summary of significant factors that impacted the segments' financial results.

Medication Delivery Growth in pretax income of 11 percent and one percent in 2001 and 2000, respectively, was primarily a result of solid sales growth, the close management of costs, and the leveraging of expenses in conjunction with recent acquisitions, partially offset by the unfavorable impact of fluctuations in currency exchange rates in both periods, increased pump service costs in 2000 and the termination of certain non-core distribution agreements in 2000.

BioScience The four percent and 23 percent growth in pretax income in 2001 and 2000, respectively, was primarily the result of an improved gross margin due to strong sales growth, a favorable product mix and manufacturing efficiencies, and the leveraging and close management of marketing and administrative expenses, partially offset by the unfavorable impact of fluctuations in currency exchange rates, significantly increased R&D expenditures, and, in 2001, the effect of the loss of a vaccine license. The impact of eased supply constraints and manufacturing capacity expansions for Recombinate also contributed to the growth in pretax income in 2000.

Renal Pretax income decreased five percent in 2001 and three percent in 2000. The decline in pretax income was principally due to unfavorable fluctuations in currency exchange rates, an unfavorable change in the sales mix of products and services, and higher R&D expenses, partially offset by the effect of closely managing administrative and other costs.

Income Taxes

The effective tax rate relating to continuing operations per the consolidated statements of income was 31 percent, 22 percent and 26 percent in 2001, 2000 and 1999, respectively. Excluding special charges for IPR&D and acquisition-related costs in 2001 and 2000, and the charge in 2001 relating to the company's A, AF and AX series dialyzers, the effective income tax rate relating to continuing operations was 26 percent in each of 2001, 2000 and 1999. Management does not expect a significant change in the effective tax rate in 2002.

Income from Continuing Operations Before Cumulative Effect of Accounting Changes

Income from continuing operations before cumulative effect of accounting changes per the consolidated statements of income was $664 million, $738 million and $779 million in 2001, 2000 and 1999, respectively. Excluding special charges for IPR&D and acquisition-related costs in 2001 and 2000, and the charge in 2001 relating to the company's A, AF and AX series dialyzers, income from continuing operations before cumulative effect of accounting changes was $1,063 million, $915 million and $779 million in 2001, 2000 and 1999, respectively, and the growth rate was 16 percent and 17 percent in 2001 and 2000, respectively.

Changes in Accounting Principles

As further discussed in Note 1, the company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and its amendments (SFAS No. 133) at the beginning of 2001. The new standard changed prior accounting rules and requires that all derivative instruments be carried on the balance sheet at fair value. In accordance with the transition provisions of SFAS No. 133, upon adoption the company recorded a cumulative effect after-tax reduction to earnings of $52 million and a cumulative effect after-tax increase to other comprehensive income of $8 million. At the beginning of 1999, the company recorded a $27 million after-tax charge for the cumulative effect of a change in accounting principle related to the adoption of AICPA Statement of Position 98-5, "Reporting on the Costs of Start-up Activities."

Critical Accounting Policies

The company's results of operations and financial position are determined based on the application of the company's accounting policies, as discussed in the notes to the consolidated financial statements. Certain of the company's accounting policies represent a selection among acceptable alternatives under GAAP. Management has not determined how reported amounts would differ based on the application of different accounting policies. Management has also not determined the likelihood that materially different amounts could be reported under different conditions or using different assumptions.

The recognition of revenue relating to sales of products and services rendered requires application of accounting policies for which GAAP provides various models, and for which management must use judgment to determine the most appropriate model to apply, given the particular facts and circumstances. In evaluating these transactions, management assesses all relevant GAAP and chooses the model that most accurately reflects the nature of the transactions.

The application of accounting policies requires the use of judgment and estimates. As it relates to the company, estimates and forecasts are required to determine allowances for bad debts, reserves for excess and obsolete inventory, litigation reserves and related insurance recoveries, deferred tax asset valuation reserves, employee benefit-related liabilities, product warranty liabilities, any impairments of assets, allocations of purchase prices related to acquisitions (including IPR&D), and anticipated transactions to be hedged.

These matters that are subject to judgments and estimation are inherently uncertain, and different amounts could be reported using different assumptions and estimates. Management uses its best estimates and judgments in determining the appropriate amount to reflect in the financial statements, using historical experience and all available information. The company also uses outside experts where appropriate. The company applies estimation methodologies consistently from year to year.

Liquidity and Capital Resources

Cash flows from continuing operations per the consolidated statements of cash flows decreased in 2001 and increased in 2000. In 2001, higher earnings (before non-cash items) were offset by higher net cash outflows relating to accounts receivable, inventories, litigation and other items. In 2000, the increase compared to the prior year was due to higher earnings (before non-cash items) and lower net cash outflows relating to accounts receivable, litigation and other items. As further discussed in Note 6, cash flows benefited from the sales of certain accounts receivable in each year.

Cash flows from discontinued operation decreased in 2001 and 2000 due to the spin-off of Edwards on March 31, 2000.

Cash flows from investing activities decreased in both 2001 and 2000. Capital expenditures (including additions to the pool of equipment placed with or leased to customers) increased 21 percent and three percent in 2001 and 2000, respectively, as the company increased its investments in various capital projects across the three segments. The growth in capital expenditures principally reflected increases in manufacturing capacity in the BioScience segment, as the company is in the process of increasing manufacturing capacity for vaccines, and plasma-based and recombinant products. Capital expenditures are made at a sufficient level to support the strategic and operating needs of the businesses. With the various growth opportunities in the businesses, management expects to further increase these activities and invest over $850 million in capital expenditures in 2002.

Net cash outflows relating to acquisitions increased in both 2001 and 2000. In 2001, net cash outflows relating to acquisitions included $455 million related to the acquisition of ASTA and $111 million related to the acquisition of Cook. Also included in the 2001 total was $40 million related to the Renal segment's acquisitions of dialysis centers in international markets, and $38 million related to the Renal segment's acquisition of the assets and rights to technology relating to a proprietary recombinant erythropoietin drug for the treatment of anemia. The remainder of the outflows relating to acquisitions in 2001 consisted of individually insignificant acquisitions. As further discussed in Note 3, the purchase price of Sera-Tec and a portion of the purchase price of Cook was paid with Baxter common stock.

In 2000, net cash outflows relating to acquisitions included $55 million related to the acquisition of Althin and $63 million related to the acquisition of NAV. A portion of the purchase price for both of these acquisitions was paid in company common stock. Approximately $131 million of the total outflows in 2000 related to several acquisitions and investments in the Medication Delivery segment, principally the acquisition of a domestic ambulatory and infusion pump business and a contingent purchase price payment associated with the 1998 acquisition of a domestic manufacturer of inhalants and drugs used for general and local anesthesia. Approximately $15 million related to the acquisition of dialysis centers in international markets, and the remainder of the outflows relating to acquisitions in 2000 consisted of individually insignificant acquisitions.

In 1999, net cash outflows relating to acquisitions included $36 million for a contingent purchase price payment pertaining to the 1997 acquisition of Immuno International AG, $22 million related to acquisitions of dialysis centers in international markets and $88 million related to the acquisition of a nutrition and fluid therapy business in Europe.

In 2001, the company generated $44 million of cash relating to the sale and leaseback of certain assets. The cash flows relating to divestitures and other asset dispositions in 2000 principally related to the spin-off of Edwards on March 31, 2000. In 1999, the company generated $30 million of cash relating to a prior year divestiture in the BioScience segment and $42 million of cash relating to the sale and leaseback of certain assets.

Cash flows from financing activities increased in both 2001 and 2000. As further discussed in Note 5, in order to balance its capital structure and reduce net interest expense, in May 2001 the company issued $800 million of callable convertible debentures. The proceeds of the debt were used to refinance certain of the company's short-term debt. The debentures allow the holders to require the company to repurchase the debt at the end of the first year and in the fifth, tenth and fifteenth years. The company also issued other debt during 2001 principally to fund its investing activities. In order to better match the currency denomination of its assets and liabilities, the company rebalanced certain of its debt during 2000, acquiring $878 million of its U.S. Dollar denominated debt securities and increasing its non-U.S. Dollar denominated debt. The company's net-debt-to-capital ratio was 35.9 percent and 40.1 percent at December 31, 2001 and 2000, respectively.

Common stock dividends increased in 2001 and decreased in 2000. Effective at the beginning of 2000, the company changed from a quarterly to an annual dividend payout schedule, resulting in lower cash dividends paid during 2000. Aside from this change, the dividends increased in both 2001 and 2000 due to a higher number of shares outstanding. In November 2001, the board of directors declared an annual dividend on the company's common stock of $0.582 per share. The dividend, which was payable on January 7, 2002 to stockholders of record as of December 14, 2001, is a continuation of the current annual rate. As further discussed in Note 8, cash flows in 1999 included $198 million in cash inflows relating to the Shared Investment Plan. Cash received for stock issued under employee benefit plans decreased in 2001 and increased in 2000. A portion of the increase in 2000 was due to required exercises of stock options by employees transferring to Edwards as a result of the March 31, 2000 spin-off of that business. Aside from these exercises in 2000 relating to Edwards, stock issued under employee benefit plans increased in 2001 principally due to a higher average stock option exercise price. In order to rebalance the company's capital structure following the acquisition of ASTA, the company issued 9.7 million common shares for $500 million in December 2001.

As authorized by the board of directors, the company repurchases its stock to optimize its capital structure depending upon its operational cash flows, net debt level and current market conditions. In November 1995, the company's board of directors authorized the repurchase of up to $500 million of common stock over a period of several years, all of which was repurchased by early 2000. In November 1999, the board of directors authorized the repurchase of another $500 million over a period of several years, all of which was repurchased by December 31, 2001. In July 2001, the board of directors authorized the repurchase of an additional $500 million from time to time, of which $76 million has been repurchased as of December 31, 2001. Stock repurchases totaled $288 million, $375 million and $184 million, in 2001, 2000 and 1999, respectively.

On February 27, 2001, Baxter's board of directors approved a two-for-one stock split of the company's common shares. This approval was subject to shareholder approval of an increase in the number of authorized shares of common stock, which was received on May 1, 2001. On May 30, 2001, shareholders of record on May 9, 2001 received one additional share of Baxter common stock for each share held on May 9, 2001. All share and per share data in this report has been adjusted and restated to reflect the split.

Management assesses the company's liquidity in terms of its overall ability to mobilize cash to support ongoing business levels and to fund its growth. Management uses an internal performance measure called operational cash flow that evaluates each operating business and geographic region on all aspects of cash flow under its direct control. Operational cash flow, as defined, reflects all litigation payments and related insurance recoveries except for those payments and recoveries relating to mammary implants, which the company never manufactured or sold. The company expects to generate in excess of $500 million in operational cash flow in 2002.

The following table reconciles cash flows from continuing operations, as determined by GAAP, to operational cash flow, which is not a measure defined by GAAP.

Brackets denote cash outflows years ended December 31 (in millions)	**2001**	2000	1999
Cash flows from continuing operations per the company's consolidated statements of cash flows	$1,149	$1,233	$977
Capital expenditures	(787)	(648)	(631)
Net interest, after tax	54	51	52
Other	87	(48)	190
Operational cash flow from continuing operations	$ 503	$ 588	$588

Refer to Note 5 for further discussion of the company's long-term debt, credit facilities, financial guarantees, and lease and other commitments. As of December 31, 2001, the company can issue up to $550 million in aggregate principal amount of additional senior unsecured debt securities under effective registration statements filed with the Securities and Exchange Commission. The company's debt ratings on senior debt are A3 by Moody's, A by Standard & Poor's and A by Fitch. The company's debt ratings on short-term debt are P2 by Moody's, A1 by Standard & Poor's and F1 by Fitch. The company intends to fund its short-term and long-term obligations as they mature through cash flows from operations, by issuing additional debt, by entering into other financing arrangements or by issuing common stock. The company believes it has lines of credit adequate to support ongoing operational requirements. Beyond that, the company believes it has sufficient financial flexibility to attract long-term capital on acceptable terms as may be needed to support its growth objectives. The company's ability to generate cash flows from operations, issue additional debt, enter into other financing arrangements, or raise additional long-term capital on acceptable terms could be adversely affected in the event there is a material decline in the demand for the company's products, deterioration in the company's key financial ratios or credit ratings, or other significantly unfavorable change in conditions. With respect to the company's credit arrangements and debt outstanding at December 31, 2001, while a deterioration in the company's credit rating could unfavorably impact the financing costs associated with the credit arrangements, such a downgrade would not affect the company's ability to draw on the credit arrangements, and would not result in an acceleration of the scheduled maturities of the company's outstanding debt.

The company periodically enters into off-balance sheet financing arrangements where economical and consistent with the company's business strategy. At December 31, 2001 the company has entered or is committed to enter into operating lease agreements, two of which are with special purpose entities, relating to facilities and equipment used in the operations of the company and its affiliates. The majority of these arrangements were entered into during 2001. Under each lease, the company has the right to renegotiate renewal terms, exercise a purchase option with respect to the leased property or arrange for the sale of the leased property. In the event the leased property is sold on behalf of the lessor and the sales proceeds are less than the lessor's investment in the property, the company is responsible for the shortfall, up to an aggregate maximum recourse amount under all of the leases of $159 million. At December 31, 2001, management believes the fair values of the leased properties are equal to or in excess of the lessors' investments in the leased properties. Refer to Note 5 for further information regarding these leases. As further discussed in Note 6, the company has also entered into certain arrangements whereby it securitizes, on a continuous basis, an undivided interest in certain pools of trade accounts receivable (including lease receivables). The portfolio of receivables sold totaled $683 million at December 31, 2001.

The company and Nexell Therapeutics Inc. (Nexell) entered into agreements whereby Baxter issued put rights in connection with a $63 million private placement by Nexell of preferred stock. Baxter owns a minority equity interest in Nexell and has other business relationships with Nexell. The put rights, which are included in current liabilities at estimated fair value in the amount of $57 million at December 31, 2001, were issued in conjunction with Nexell's repayment of amounts owed to Baxter. Refer to Note 5 for further discussion of these agreements as well as the company's other commitments.

Euro Conversion

On January 1, 1999, certain member countries of the European Union established fixed conversion rates between their existing currencies and the new common currency, the Euro. The transition period for the introduction of the Euro ended January 1, 2002. Issues that faced the company as a result of the introduction of the Euro included converting information technology systems, reassessing currency risk, negotiating and amending certain agreements and contracts, processing tax and accounting records and reassessing pricing and competition. While the company will continue to evaluate the impact of the Euro, management does not currently expect the conversion to the Euro to have a material impact on the company's financial position, cash flows or results of operations.

Financial Instrument Market Risk

The company operates on a global basis and is exposed to the risk that its earnings, cash flows and stockholders' equity could be adversely impacted by fluctuations in currency exchange rates, interest rates and the market price of the company's common stock. The company's hedging policy attempts to manage these risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity and costs. Refer to Note 6 for further information regarding the company's financial instruments and hedging strategies.

Currency Risk

The company is primarily exposed to currency exchange-rate risk with respect to firm commitments, forecasted transactions and net assets denominated in Japanese Yen, Euro, British Pound and Swiss Franc. 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 utilizes derivative and nonderivative financial instruments to further reduce the net exposure to currency fluctuations. Gains and losses on the hedging instruments are intended to offset losses and gains on the hedged transactions with the goal of reducing the earnings and stockholders' equity volatility resulting from fluctuations in currency exchange rates.

The company principally uses option and forward contracts to hedge the risk to earnings associated with fluctuations in currency exchange rates relating to the company's firm commitments and forecasted transactions expected to be denominated in foreign currencies. The company enters into foreign currency forward and cross-currency swap agreements to hedge certain receivables, payables and debt denominated in foreign currencies. The company also periodically hedges certain of its net investments in international affiliates using a combination of debt denominated in foreign currencies and cross-currency swap agreements. Certain other firm commitments and forecasted transactions are also periodically hedged with option and forward contracts.

In adopting SFAS No. 133, management reassessed its hedging strategies, and, in some cases, increased the company's use of derivative instruments or changed the type of derivative instruments used to manage currency exchange-rate risk, in part because the new accounting standard allows for increased opportunities and different approaches for managing the volatility in earnings and stockholders' equity resulting from fluctuations in currency exchange rates.

As part of its risk-management program, the company performs sensitivity analyses to assess potential changes in the fair value of its derivative instruments relating to hypothetical movements in currency exchange rates. A sensitivity analysis of changes in the fair value of foreign exchange option and forward contracts outstanding at December 31, 2001 indicated that, if the U.S. Dollar uniformly fluctuated unfavorably by 10 percent against all currencies, the fair value of those contracts, while still positive, would decrease by $157 million. A similar analysis performed with respect to option and forward contracts outstanding at December 31, 2000 indicated that the fair value of such contracts would decrease by $20 million. The amount for 2001 is greater than that for 2000 principally due to a significant increase in the notional amounts of the option and forward contracts outstanding at December 31, 2001 as compared to the prior year. With respect to the company's cross-currency swap agreements, if the U.S. Dollar uniformly weakened by 10 percent, the fair value of the contracts would decrease by $72 million and $83 million as of December 31, 2001 and 2000, respectively. These sensitivity analyses disregard the possibility that currency exchange rates can move in opposite directions and that gains from one currency may or may not be offset by losses from another currency. The analyses also disregard the offsetting change in value of the underlying hedged transactions and balances.

Interest Rate Risk

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 management believes is appropriate. To manage this mix in a cost efficient manner, the company periodically enters into interest rate swaps, in which the company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional amount. The company also uses forward-starting interest rate swaps to hedge the risk to earnings associated with fluctuations in interest rates relating to anticipated issuances of debt.

As part of its risk-management program, the company performs sensitivity analyses to assess potential gains and losses in earnings relating to hypothetical movements in interest rates. A 31 basis-point increase in interest rates (approximately 10 percent of the company's weighted-average interest rate during 2001) affecting the company's financial instruments, including debt obligations and related derivatives, and investments, would have an immaterial effect on the company's 2001 and 2000 earnings and on the fair value of the company's fixed-rate financial instruments as of the end of such fiscal years.

As discussed in Note 6, the fair values of the company's long-term litigation liabilities and related insurance receivables were computed by discounting the expected cash flows based on currently available information. A 10 percent movement in the assumed discount rate would have an immaterial effect on the fair values of those assets and liabilities.

Other Risks

As further discussed in Note 6, in order to partially offset the potentially dilutive effect of employee stock options, the company periodically enters into forward agreements with independent third parties related to the company's common stock. In accordance with GAAP, these contracts are not carried on the balance sheet at fair value, but are recorded upon maturity, or at an earlier termination date, and are classified within stockholders' equity. If the company's stock price were to decline 10 percent, the positive fair value of these contracts of $167 million would be reduced to a positive fair value of $2 million. Performing a similar analysis as of December 31, 2000 with respect to the portfolio outstanding at that date, a 10 percent decline in the company's stock price would reduce the positive fair value of the forward agreements of $171 million to $108 million.

With respect to the company's investments in affiliates, management believes any reasonably possible near-term losses in earnings, cash flows and fair values would not be material to the company's consolidated financial position.

Legal Proceedings

See Note 12 for a discussion of the company's legal contingencies and related insurance coverage. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established reserves. While such a future charge could have a material adverse effect on the company's net income or cash flows in the period in which it is recorded or paid, based on the advice of counsel, management believes that any outcome of these actions, individually or in the aggregate, will not have a material adverse effect on the company's consolidated financial position.

Based on the company's assessment of the costs associated with its environmental responsibilities, including recurring administrative costs, capital expenditures and other compliance costs, such costs have not had, and in management's opinion, will not have in the foreseeable future, a material effect on the company's financial position, results of operations, cash flows or competitive position.

New Accounting and Disclosure Standards

SFAS No. 141, "Business Combinations" and SFAS No. 142, "Goodwill and Other Intangible Assets" were issued in July 2001. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method of accounting. With the adoption of SFAS No. 142 in its entirety on January 1, 2002, all of the company's goodwill will no longer be amortized, but will be subject to periodic impairment reviews, beginning on the date of adoption. Goodwill amortization on an after-tax basis was approximately $41 million in 2001. In accordance with the transition provisions of SFAS No. 142, goodwill associated with acquisitions completed after June 30, 2001 is not being amortized. In performing the periodic impairment reviews, potential impairment is to be identified by comparing the fair value of a reporting unit with its carrying amount, and if the fair value is less than the carrying amount, an impairment loss is recorded as the excess of the carrying amount of the goodwill over its implied value. While the company is still in the process of analyzing SFAS No. 142, it is management's preliminary assessment that a goodwill impairment charge will not be recorded as of the date of adoption.

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," was issued in August 2001. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and establishes a single accounting model for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," and certain provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The company will adopt the standard at the beginning of 2002, and does not expect that the new standard will have a material impact on the company's consolidated financial statements.

Management's Responsibilities for Financial Reporting

The accompanying financial statements and other financial data have been prepared by management, which is responsible for their integrity and objectivity. The statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include amounts that are based upon management's best estimates and judgments.

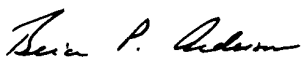
Management is responsible for establishing and maintaining a system of internal controls over financial reporting and safeguarding assets against unauthorized acquisition, use or disposition. This system is designed to provide reasonable assurance as to the integrity and reliability of financial reporting and safeguarding of assets. The concept of reasonable assurance is based on the recognition that there are inherent limitations in all systems of internal controls, and that the cost of such systems should not exceed the benefits to be derived from them.

Management believes that the foundation of an appropriate system of internal controls is a strong ethical company culture and climate. The Corporate Responsibility Office, which reports to the Public Policy Committee of the board of directors, is responsible for developing and communicating appropriate business practices, policies and initiatives; maintaining independent channels of communication for providing guidance and reporting potential business practice violations; and monitoring compliance with the company's business practices, including annual compliance certifications by senior managers worldwide. Additionally, a professional staff of corporate auditors reviews the design and function of the system of internal controls and the accounting policies and procedures supporting this system and compliance with them. The results of these reviews are reported at least annually to the Public Policy and/or Audit Committees of the board of directors.

PricewaterhouseCoopers LLP performs audits, in accordance with auditing standards generally accepted in the United States of America, which include a review of the system of internal controls and result in assurance that the financial statements are, in all material respects, fairly presented.

The board of directors, through its Audit Committee comprised solely of non-employee directors, is responsible for overseeing the integrity and reliability of the company's accounting and financial reporting practices and the effectiveness of its system of internal controls. PricewaterhouseCoopers LLP and the corporate auditors meet regularly with, and have access to, this committee, with and without management present, to discuss the results of the audit work.

Harry M. Jansen Kraemer, Jr.
Chairman and
Chief Executive Officer



Brian P. Anderson
Senior Vice President and
Chief Financial Officer

Report of Independent Accountants

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, cash flows and stockholders' equity and comprehensive income present fairly, in all material respects, the financial position of Baxter International Inc. (the company) and its subsidiaries at December 31, 2001 and 2000, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2001, the company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities."

PricewaterhouseCoopers LLP
Chicago, Illinois
February 14, 2002

as of December 31 (in millions, except share information)		2001	2000
Current Assets	Cash and equivalents	$ 582	$ 579
	Accounts receivable	1,493	1,387
	Notes and other current receivables	129	155
	Inventories	1,341	1,159
	Short-term deferred income taxes	82	159
	Prepaid expenses	350	212
	Total current assets	3,977	3,651
Property, Plant and Equipment, Net		3,306	2,807
Other Assets	Goodwill and other intangible assets	1,698	1,239
	Insurance receivables	93	160
	Other	1,269	876
	Total other assets	3,060	2,275
	Total assets	$10,343	$8,733
Current Liabilities	Short-term debt	$ 149	$ 576
	Current maturities of long-term debt and lease obligations	52	58
	Accounts payable and accrued liabilities	2,432	1,990
	Income taxes payable	661	748
	Total current liabilities	3,294	3,372
Long-Term Debt and Lease Obligations		2,486	1,726
Long-Term Deferred Income Taxes		218	160
Long-Term Litigation Liabilities		140	184
Other Long-Term Liabilities		448	632
Commitments and Contingencies			
Stockholders' Equity	Common stock, $1 par value, authorized 1,000,000,000 shares in 2001 and 700,000,000 in 2000, issued 608,817,449 shares in 2001 and 596,266,502 shares in 2000	609	298
	Common stock in treasury, at cost, 9,924,459 shares in 2001 and 9,906,124 shares in 2000	(328)	(349)
	Additional contributed capital	2,815	2,506
	Retained earnings	1,093	853
	Accumulated other comprehensive loss	(432)	(649)
	Total stockholders' equity	3,757	2,659
	Total liabilities and stockholders' equity	$10,343	$8,733

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

years ended December 31 (in millions, except per share data)		2001	2000	1999
Operations	**Net sales**	$7,663	$6,896	$6,380
	Costs and expenses			
	Cost of goods sold	4,227	3,833	3,568
	Marketing and administrative expenses	1,469	1,356	1,311
	Research and development expenses	427	379	332
	In-process research and development and acquisition-related costs	280	286	—
	Special charge – A, AF and AX series dialyzers	189	—	—
	Goodwill amortization	47	31	19
	Interest expense, net	69	85	87
	Other (income) expense	(9)	(20)	11
	Total costs and expenses	6,699	5,950	5,328
	Income from continuing operations before income taxes and cumulative effect of accounting change	964	946	1,052
	Income tax expense	300	208	273
	Income from continuing operations before cumulative effect of accounting change	664	738	779
	Discontinued operation	—	2	45
	Income before cumulative effect of accounting change	664	740	824
	Cumulative effect of accounting change, net of income tax benefit of $32 in 2001 and $7 in 1999	(52)	—	(27)
	Net income	$ 612	$ 740	$ 797
Per Share Data	**Earnings per basic common share**			
	Continuing operations	$ 1.13	$ 1.26	$ 1.34
	Discontinued operation	—	—	0.08
	Cumulative effect of accounting change	(0.09)	—	(0.05)
	Net income	$ 1.04	$ 1.26	$ 1.37
	Earnings per diluted common share			
	Continuing operations	$ 1.09	$ 1.24	$ 1.32
	Discontinued operation	—	—	0.08
	Cumulative effect of accounting change	(0.09)	—	(0.05)
	Net income	$ 1.00	$ 1.24	$ 1.35
	Weighted average number of common shares outstanding			
	Basic	590	585	579
	Diluted	609	597	590

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

years ended December 31 (in millions) (brackets denote cash outflows)		2001	2000	1999
Cash Flows from Operations	Income from continuing operations before cumulative effect of accounting change	$ 664	$ 738	$ 779
	Adjustments			
	Depreciation and amortization	441	405	372
	Deferred income taxes	116	(170)	92
	Loss (gain) on asset dispositions and impairments	(20)	6	13
	In-process research and development and acquisition-related costs	280	286	—
	Special charge – A, AF and AX series dialyzers	189	—	—
	Other	5	26	20
	Changes in balance sheet items			
	Accounts receivable	(138)	54	(103)
	Inventories	(178)	(114)	17
	Accounts payable and accrued liabilities	(76)	60	30
	Net litigation payable and other	(134)	(58)	(243)
	Cash flows from continuing operations	1,149	1,233	977
	Cash flows from discontinued operation	—	(19)	106
	Cash flows from operations	1,149	1,214	1,083
Cash Flows from Investing Activities	Capital expenditures	(669)	(547)	(529)
	Additions to the pool of equipment placed with or leased to customers	(118)	(101)	(102)
	Acquisitions (net of cash received) and investments in affiliates	(840)	(345)	(179)
	Divestitures and other asset dispositions	35	(60)	75
	Cash flows from investing activities	(1,592)	(1,053)	(735)
Cash Flows from Financing Activities	Issuances of debt obligations	2,108	1,180	764
	Redemption of debt obligations	(946)	(1,953)	(481)
	Increase (decrease) in debt with maturities of three months or less, net	(756)	879	(552)
	Common stock cash dividends	(341)	(84)	(338)
	Stock issued under Shared Investment Plan	—	—	198
	Stock issued under employee benefit plans	192	233	148
	Other issuance of stock	500	—	—
	Purchases of treasury stock	(288)	(375)	(184)
	Cash flows from financing activities	469	(120)	(445)
Effect of Foreign Exchange Rate Changes on Cash and Equivalents		(23)	(68)	(6)
Increase (Decrease) in Cash and Equivalents		3	(27)	(103)
Cash and Equivalents at Beginning of Year		579	606	709
Cash and Equivalents at End of Year		$ 582	$ 579	$ 606
Supplemental information				
Interest paid, net of portion capitalized		$ 109	$ 110	$ 150
Income taxes paid		$ 243	$ 279	$ 197

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

as of or for the years ended December 31 (in millions)		2001	2000	1999
Common Stock	Beginning of year	$ 298	$ 294	$ 291
	Common stock issued	13	4	—
	Two-for-one stock split	298	—	—
	Stock issued under Shared Investment Plan	—	—	3
	End of year	609	298	294
Common Stock in Treasury	Beginning of year	(349)	(269)	(210)
	Common stock issued	63	39	—
	Purchases of common stock	(288)	(375)	(184)
	Common stock issued under employee benefit plans	246	256	125
	End of year	(328)	(349)	(269)
Additional Contributed Capital	Beginning of year	2,506	2,282	2,064
	Common stock issued	661	247	—
	Two-for-one stock split	(298)	—	—
	Stock issued under Shared Investment Plan	—	—	195
	Common stock issued under employee benefit plans	(54)	(23)	23
	End of year	2,815	2,506	2,282
Retained Earnings	Beginning of year	853	1,415	990
	Net income	612	740	797
	Elimination of reporting lag for international operations	(23)	—	(34)
	Common stock cash dividends	(349)	(341)	(338)
	Distribution of Edwards Lifesciences Corporation common stock to stockholders	—	(961)	—
	End of year	1,093	853	1,415
Accumulated Other Comprehensive Loss	Beginning of year	(649)	(374)	(296)
	Other comprehensive income (loss)	217	(275)	(78)
	End of year	(432)	(649)	(374)
	Total stockholders' equity	$3,757	$2,659	$3,348
Comprehensive Income	Net income	$ 612	$ 740	$ 797
	Cumulative effect of accounting change, net of tax expense of $5 in 2001	8	—	—
	Currency translation adjustments, net of tax expense of $58 in 2001, $82 in 2000 and $87 in 1999	155	(297)	(80)
	Unrealized net gain on hedging activities, net of tax expense of $45 in 2001	74	—	—
	Unrealized net gain (loss) on marketable equity securities, net of tax expense (benefit) of $(14) in 2001, $15 in 2000 and $1 in 1999	(20)	22	2
	Other comprehensive income (loss)	217	(275)	(78)
	Elimination of reporting lag for international operations, net of tax benefit of $8 in 2001 and $22 in 1999	(23)	—	(34)
	Total comprehensive income	$ 806	$ 465	$ 685

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

Note 1 / Summary of Significant Accounting Policies

The Company and Financial Statement Presentation

Baxter International Inc. (Baxter or the company) is a global medical products and services company that provides critical therapies for people with life-threatening conditions. The company's products and services are described in Note 13. The preparation of the financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Basis of Consolidation

The accompanying consolidated financial statements include the accounts of Baxter and its majority-owned subsidiaries. Historically, certain operations outside the United States were included in the consolidated financial statements on the basis of fiscal years ending November 30. In conjunction with the implementation of new financial systems, this one-month lag was eliminated as of the beginning of fiscal 1999 for certain countries and as of the beginning of fiscal 2001 for the remaining countries. The December 2000 and 1998 net losses for these entities of $23 million and $34 million, respectively, were recorded directly to retained earnings.

Foreign Currency Translation

The results of operations for non-U.S. subsidiaries, other than those located in highly inflationary countries, are translated into U.S. Dollars using the average exchange rates during the year, while assets and liabilities are translated using period-end rates. Resulting translation adjustments are recorded as currency translation adjustments (CTA) within other comprehensive income (OCI). Where foreign affiliates operate in highly inflationary economies, non-monetary amounts are remeasured at historical exchange rates while monetary assets and liabilities are remeasured at the current rate with the related adjustments reflected in the consolidated statements of income.

Revenue Recognition

The company's policy is to recognize revenues from product sales and services when earned, as defined by GAAP, and in accordance with SEC Staff Accounting Bulletin No. 101 (SAB 101). Specifically, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred (or services have been rendered), the price is fixed or determinable, and collectibility is reasonably assured. For product sales, revenue is not recognized until title and risk of loss have transferred to the customer. The company enters into certain arrangements in which it commits to provide multiple elements to its customers. Revenue is deferred unless the criteria outlined in SAB 101 for separate recognition of the individual elements are met. If the criteria are met, total revenue for the arrangement is allocated among the elements based on the fair value of the individual elements, with the fair values determined based on objective evidence (generally based on sales of the individual element to other third parties). Provisions for discounts, rebates to customers, and returns are provided for at the time the related sales are recorded, and are reflected as a reduction of sales.

Warranty Expense

The company provides for the estimated costs that may be incurred under its warranty programs at the time revenue is recognized.

Research and Development

Research and development costs are expensed when incurred.

Inventories

as of December 31 (in millions)	2001	2000
Raw materials	$ 353	$ 261
Work in process	244	174
Finished products	744	724
Total inventories	$1,341	$1,159

Inventories are stated at the lower of cost (first-in, first-out method) or market value. Market value for raw materials is based on replacement costs and, for other inventory classifications, on net realizable value. Reserves for excess and obsolete inventory were $125 million and $110 million at December 31, 2001 and 2000, respectively.

Property, Plant and Equipment

as of December 31 (in millions)	2001	2000
Land	$ 115	$ 113
Buildings and leasehold improvements	1,111	967
Machinery and equipment	3,214	2,822
Equipment with customers	538	484
Construction in progress	754	592
Total property, plant and equipment, at cost	5,732	4,978
Accumulated depreciation and amortization	(2,426)	(2,171)
Property, plant and equipment, net	$3,306	$2,807

Depreciation and amortization are calculated on the straight-line method over the estimated useful lives of the related assets, which range from 20 to 50 years for buildings and improvements and from three to 15 years for machinery and equipment. Leasehold improvements are amortized over the life of the related facility lease or the asset, whichever is shorter. Straight-line and accelerated methods of depreciation are used for income tax purposes. Accumulated amortization for assets under capital lease was $17 million and $11 million at December 31, 2001 and 2000, respectively. Depreciation expense was $334 million, $308 million and $290 million in 2001, 2000 and 1999, respectively. Repairs and maintenance expense was $142 million, $105 million and $97 million in 2001, 2000 and 1999, respectively.

Acquisitions

Acquisitions are accounted for under the purchase method. The company applied the provisions of Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations," in accounting

for acquisitions completed after June 30, 2001. Pursuant to SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill related to acquisitions completed after June 30, 2001 is not being amortized. See further discussion of these new standards below. Results of operations of acquired companies are included in the company's results of operations as of the respective acquisition dates. The purchase price of each acquisition is allocated to the net assets acquired based on estimates of their fair values at the date of the acquisition. The excess of the purchase price over the fair values of the tangible assets and identifiable intangible assets acquired and liabilities assumed is allocated to goodwill. The allocation of purchase price in certain cases may be subject to revision based on the final determination of fair values. A portion of the purchase price for certain acquisitions is allocated to in-process research and development (IPR&D) which, under GAAP, is immediately expensed.

IPR&D

Amounts allocated to IPR&D are determined on the basis of independent valuations using the income approach, which measures the value of an asset by the present value of its future economic benefits. Estimated cash flows are discounted to their present values at rates of return that reflect the risks associated with the particular projects. The status of development, stage of completion, assumptions, nature and timing of remaining efforts for completion, risks and uncertainties, and other key factors may vary by individual project. The valuations incorporate the stage of completion for each individual project. Projected revenue and cost assumptions are determined considering the company's historical experience and industry trends and averages. No value is assigned to any IPR&D project unless it is probable of being further developed.

Goodwill and Other Intangible Assets

as of December 31 (in millions)	2001	2000
Goodwill	$1,598	$1,094
Accumulated amortization	(185)	(138)
Net goodwill	1,413	956
Other intangible assets	809	701
Accumulated amortization	(524)	(418)
Net other intangible assets	285	283
Goodwill and other intangible assets	$1,698	$1,239

Intangible assets are amortized on a straight-line basis. Goodwill is amortized over estimated useful lives ranging from 15 to 40 years, and other intangible assets, consisting of purchased patents, trademarks and other identified rights, are amortized over their estimated useful lives, generally ranging from three to 25 years. Pursuant to SFAS No. 142, and as further discussed below, effective at the beginning of 2002 goodwill will no longer be amortized but will be subject to periodic impairment reviews.

Prior to the adoption of SFAS No. 142, the company's policy has been to review the carrying amounts of goodwill and other long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Such events or circumstances might include a significant decline in market share, a significant decline in profits, rapid changes in technology, significant litigation or other items. In evaluating the recoverability of these assets, management's policy has been to compare the carrying amounts of such assets with the estimated undiscounted future operating cash flows. In the event impairment exists, an impairment charge would be determined by comparing the carrying amounts of the asset to the applicable estimated future cash flows, discounted at a risk-adjusted interest rate. In addition, the remaining amortization period for the impaired asset would be reassessed and revised if necessary. Refer to Note 4 regarding an asset impairment charge recorded in 2001 relating to the decision to cease manufacturing the Renal segment's A, AF and AX series dialyzers.

Earnings Per Share (EPS)

The numerator for both basic and diluted EPS is net earnings available to common shareholders. The denominator for basic EPS is the weighted-average number of common shares outstanding during the period. The following is a reconciliation of the shares (denominator) of the basic and diluted per-share computations.

years ended December 31 (in million of shares)	2001	2000	1999
Basic	590	585	579
Effect of dilutive securities			
Employee stock options	18	11	9
Employee stock purchase plans and equity forward agreements	1	1	2
Diluted	609	597	590

Refer to Note 8 for further information regarding the company's stock compensation plans.

Comprehensive Income

Comprehensive income encompasses all changes in stockholders' equity other than those arising from stockholders, and generally consists of net income, currency translation adjustments, unrealized gains and losses on certain hedging activities and unrealized gains and losses on unrestricted available-for-sale marketable equity securities. The components of accumulated other comprehensive income (loss) were as follows.

as of December 31 (in millions)	2001	2000
Currency translation adjustments	$(519)	$(674)
Hedging activities	82	—
Marketable equity securities	5	25
Total accumulated other comprehensive loss	$(432)	$(649)

Derivatives and Hedging Activities

All derivatives are recognized on the consolidated balance sheet at fair value. When the company enters into a derivative contract, it designates and documents the derivative as (1) a hedge of a forecasted transaction, including a hedge of a foreign currency denominated transaction (a cash flow hedge); (2) a hedge of the fair value of a recognized asset or liability (a fair value hedge); (3) a hedge of a net investment in a foreign operation; or (4) an instrument that is not formally designated as a hedge. The company also uses and designates certain nonderivative financial instruments as hedges of net investments in foreign operations. In certain circumstances, while a derivative may be used to economically hedge a transaction, asset or liability, the company may not formally designate it as a fair value, cash flow or net investment hedge. The company does not hold any instruments for trading purposes.

Changes in the fair value of a derivative that is highly effective and is designated and qualifies as a cash flow hedge are recorded in OCI, with such changes in fair value reclassified to earnings when the hedged transaction affects earnings. Such hedges are principally classified in cost of sales, and they primarily relate to intercompany sales denominated in foreign currencies. Changes in the fair value of a derivative that is highly effective and is designated and qualifies as a fair value hedge, along with changes in the fair value of the hedged asset or liability, which are attributable to the hedged risk, are recorded directly to net interest expense, as they hedge the interest rate risk associated with certain of the company's fixed-rate debt. Changes in the fair value of a derivative or nonderivative instrument that is highly effective and is designated and qualifies as a hedge of a net investment in a foreign operation are recorded in the CTA account within OCI, with any hedge ineffectiveness recorded in net interest expense. Changes in the fair value of undesignated instruments are reported directly to other income or expense or net interest expense, depending on the classification of the hedged item. Instruments that are indexed to and potentially settled in the company's common stock are accounted for in accordance with Emerging Issues Task Force Nos. 00-7 and 00-19.

If it is determined that a derivative or nonderivative hedging instrument ceases to be highly effective as a hedge, the company discontinues hedge accounting prospectively. Gains or losses relating to terminations of effective cash flow hedges are deferred and recognized consistent with the income or loss recognition of the underlying hedged items. If the company removes the designation for cash flow hedges because the hedged forecasted transactions are no longer probable of occurring, any gains or losses relating to such dedesignated hedges are reclassified from accumulated OCI to earnings, and are principally classified in cost of sales.

Derivatives are classified in other assets or other liabilities, as applicable, and are generally classified as short-term or long-term based on the scheduled maturity of the instrument. Derivatives are generally classified in the consolidated statement of cash flows in the same category as the cash flows of the hedged items.

Cash and Equivalents

Cash and equivalents include cash, certificates of deposit and marketable securities with an original maturity of three months or less.

Shipping and Handling Costs

Shipping and handling costs are classified in either cost of goods sold or marketing and administrative expenses based on their nature. Approximately $218 million, $200 million and $200 million of shipping and handling costs were classified in marketing and administrative expenses in 2001, 2000 and 1999, respectively.

Income Taxes

Deferred taxes are recognized for the future tax effects of temporary differences between the financial and income tax reporting based upon enacted tax laws and rates. Deferred tax assets are reduced by a valuation allowance unless it is more likely than not that such assets will be realized.

Stock Compensation Plans

The company applies Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock compensation plans.

Reclassifications

Certain reclassifications have been made to conform the 2000 and 1999 financial statements and notes to the 2001 presentation.

Changes in Accounting Principles

Effective at the beginning of 2001, the company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," and its amendments (SFAS No. 133). In accordance with the transition provisions of SFAS No. 133, upon adoption the company recorded a cumulative effect after-tax reduction to earnings of $52 million and a cumulative effect after-tax increase to OCI of $8 million. Effective at the beginning of 1999, the company adopted AICPA Statement of Position 98-5, "Reporting on the Costs of Start-up Activities," and, upon adoption, recorded a cumulative effect after-tax reduction to earnings of $27 million.

Recently Issued Accounting Pronouncements

SFAS No. 141 and SFAS No. 142 were issued in July 2001. SFAS No. 141 requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method of accounting. The amortization provisions of SFAS No. 142, including nonamortization of goodwill, apply to goodwill and intangible assets acquired after June 30, 2001. With the adoption of SFAS No. 142 in its entirety on

January 1, 2002, all of the company's goodwill will no longer be amortized, but will be subject to periodic impairment reviews, beginning on the date of adoption. In performing the review, potential impairment is to be identified by comparing the fair value of a reporting unit with its carrying amount, and if the fair value is less than the carrying amount, an impairment loss is recorded as the excess of the carrying amount of the goodwill over its implied value. The implied fair value is determined by allocating the fair value of the entire unit to all of its assets and liabilities, with any excess of fair value over the amount allocated representing the implied fair value of that unit's goodwill. Goodwill amortization on an after-tax basis was $41 million in 2001. While the company is still in the process of analyzing SFAS No. 142, it is management's preliminary assessment that a goodwill impairment charge will not be recorded as of the date of adoption.

SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," was issued in August 2001. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and establishes a single accounting model for the impairment or disposal of long-lived assets. SFAS No. 144 supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," and certain provisions of APB Opinion No. 30, "Reporting the Results of Operations – Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." The company will adopt the standard at the beginning of 2002, and does not expect that the new standard will have a material impact on the company's consolidated financial statements.

Note 2 / Discontinued Operation

On March 31, 2000, Baxter stockholders of record on March 29, 2000 received all of the outstanding stock of Edwards Lifesciences Corporation (Edwards), the company's cardiovascular business, in a tax-free spin-off. The company's consolidated financial statements and related notes have been adjusted and restated to reflect the financial position, results of operations and cash flows of Edwards as a discontinued operation. Through the issuance of new third-party debt, $502 million of Baxter's debt was indirectly assumed by Edwards upon spin-off. The distribution of Edwards stock totaled $961 million, and was charged directly to retained earnings.

In 2000 and 1999, the company recorded income from the discontinued operation of $14 million and $64 million, respectively, which was net of income tax expense of $5 million and $19 million, respectively. In addition, in 2000 and 1999 the company recorded $12 million (including tax of $6 million) and $19 million, respectively, of net costs directly associated with effecting the business distribution. The impact of these costs on diluted earnings per share was $.02 in 2000 and $.03 in 1999. Net sales of the discontinued operation were $906 million in 1999 and $252 million for the three-month period ended March 31, 2000.

The cardiovascular business in Japan was not transferred to Edwards at the time of distribution due to Japanese regulatory requirements and business culture considerations. The business is operated pursuant to a contractual joint venture under which a Japanese subsidiary of Baxter retains ownership of the business assets, but a subsidiary of Edwards holds a 90 percent profit interest. Edwards has an option to purchase the Japanese assets, which option may be exercised during the period of June 2002 through March 2005. The exercise price of the option is approximately 26.4 billion Japanese Yen, of which Edwards would obtain approximately 23.2 billion Japanese Yen upon termination of the joint venture for the return of its fair value in the joint venture at inception. Included in current liabilities at December 31, 2001 was $181 million relating to this contractual joint venture, which was established in connection with the accounting for the spin-off of Edwards.

Note 3 / Acquisitions

Significant Acquisitions

The following is a summary of the company's significant acquisitions during the three years ended December 31, 2001, along with the allocation of the purchase price to intangible assets.

(in millions)	Acquisition date	Purchase price	Intangible assets		
			IPR&D	Goodwill	Other
ASTA	October 2001	$455	$250	$120	$53
Cook	August 2001	220	—	137	10
Sera-Tec	February 2001	127	—	152	—
NAV	June 2000	328	250	245	10

As discussed in Note 1, goodwill associated with acquisitions completed after June 30, 2001 is not being amortized, and amortization of all goodwill will cease effective January 1, 2002.

The company acquired a subsidiary of Degussa AG, ASTA Medica Onkologie GmbH & CoKG (ASTA), which develops, produces and markets oncology products worldwide. This acquisition will provide the company with a stronger presence in the oncology market as well as a significant drug development pipeline. In addition to the intangible assets above, $22 million of accounts receivable, $25 million of inventories, $42 million of property, plant and equipment, and $4 million of other assets were acquired, and $61 million of liabilities were assumed. The results of operations and assets and liabilities, including goodwill, of ASTA are included in the Medication Delivery segment. A substantial portion of the goodwill is expected to be

deductible for tax purposes. The other intangible assets consist of developed technology and are being amortized on a straight-line basis over an estimated useful life of 15 years.

The acquisition of Cook Pharmaceutical Solutions, formerly a unit of Cook Group Incorporated (Cook), which provides contract filling of syringes and vials, supports the company's strategic initiative to become a full-line provider of drug delivery solutions. The purchase price was paid in approximately 2.1 million shares of Baxter common stock and $111 million in cash. In addition to the intangible assets noted above, $69 million of property, plant and equipment, and $4 million of other assets were acquired. The results of operations and assets and liabilities, including goodwill, of Cook are included in the Medication Delivery segment. The goodwill is expected to be fully deductible for tax purposes. The other intangible assets consist of customer relationships and are being amortized on a straight-line basis over an estimated useful life of ten years.

Sera-Tec Biologicals, L.P. (Sera-Tec) owned and operated 80 plasma centers in 28 states, and a central testing laboratory, and is included in the company's BioScience segment. The purchase price of Sera-Tec was paid in approximately 2.8 million shares of Baxter common stock. Goodwill has been amortized on a straight-line basis over 40 years.

North American Vaccine, Inc. (NAV) was engaged in the research, development, production and sales of vaccines for the prevention of human infectious diseases, and is included in the BioScience segment. The purchase price of NAV was principally paid in approximately 3.8 million shares of Baxter common stock, and goodwill has been amortized on a straight-line basis over 40 years.

The $280 million charge for IPR&D and acquisition-related costs recorded in 2001 consisted principally of the $250 million IPR&D charge relating to ASTA, an $18 million IPR&D charge relating to an acquisition in the Renal segment, and acquisition-related costs associated with several acquisitions in the three segments. The $286 million charge for IPR&D and acquisition-related costs recorded in 2000 consisted principally of the $250 million IPR&D charge relating to NAV, a total of $15 million in IPR&D charges pertaining to three other acquisitions, as well as $21 million of acquisition costs related to an acquisition in the Medication Delivery segment.

IPR&D

The IPR&D charge associated with the acquisition of ASTA pertains to oncology therapeutics projects. Material net cash inflows were forecasted in the valuation to commence between 2004 and 2009. Discount rates used in the valuations of the projects, which included tubulin inhibitor, mafosfamide, glufosfamide and other oncology-related projects, ranged from 20 percent to 30 percent. Assumed additional research and development (R&D) expenditures prior to the dates of product introductions totaled over $100 million. The percentage completion rate for significant projects ranged in the valuation from approximately 40 percent to 90 percent, with the weighted-average completion rate approximately 50 percent. Subsequent to the October 2001 acquisition date, the projects have been proceeding in accordance with the original projections. Approximately $3 million of R&D costs were expensed in 2001 subsequent to the acquisition date relating to these projects.

The IPR&D charge associated with the acquisition of NAV pertains to vaccines projects. Material net cash inflows were forecasted in the valuation to commence between 2002 and 2005. A discount rate of 20 percent was used for all projects, which include Streptococcal B, Pneumococcal, Meningococcal B/C/Y and other vaccines. Assumed additional R&D expenditures prior to the dates of product introductions totaled approximately $85 million. The percentage completion rate for significant projects ranged in the valuation from 65 percent to over 90 percent, with the weighted-average completion rate approximately 70 percent. Subsequent to the June 2000 acquisition date, the projects have been proceeding in accordance with the original projections. Approximately $14 million and $8 million of R&D costs were expensed in 2001 and 2000, subsequent to the acquisition date, respectively, relating to these projects.

With respect to ASTA and NAV IPR&D, the products currently under development are at various stages of development, and substantial further research and development, preclinical testing and clinical trials will be required to determine their technical feasibility and commercial viability. There can be no assurance such efforts will be successful. Delays in the development, introduction or marketing of the products under development could result either in such products being marketed at a time when their cost and performance characteristics would not be competitive in the marketplace or in a shortening of their commercial lives. If the products are not completed on time, the expected return on the company's investments could be significantly and unfavorably impacted.

Pro Forma Information

The following unaudited pro forma information presents a summary of the company's consolidated results of operations as if significant acquisitions during 2001 and 2000 had taken place as of the beginning of the current and preceding fiscal year, giving effect to purchase accounting adjustments. No adjustments were made for the charges for IPR&D and acquisition-related costs.

years ended December 31 (in millions, except per share data)	2001	2000
Net sales	$7,865	$7,367
Income from continuing operations before cumulative effect of accounting change	$ 663	$ 703
Net income	$ 611	$ 705
Net income per diluted common share	$ 1.00	$ 1.16

These pro forma results of operations have been presented for comparative purposes only and do not purport to be indicative of the results of operations which actually would have resulted had the acquisitions occurred on the date indicated, or which may result in the future. The pro forma earnings above relating to acquisitions completed after June 30, 2001 do not include amortization of goodwill.

Acquisition Reserves

Based on plans formulated at acquisition date, as part of the allocation of purchase price, reserves have been established for certain acquisitions. The reserves were established principally for employee-related costs associated with headcount reductions at the acquired companies, and contract termination and other costs related primarily to the exiting of activities and termination of distribution, lease and other contracts of the acquired companies that existed prior to the acquisition date that either continued with no economic benefit or required payment of a cancellation penalty. Actions executed to date and anticipated in the future with respect to these acquisitions are substantially consistent with the original plans. Management believes remaining reserves, which are not material, are adequate to complete the actions contemplated by the plans.

Note 4 / Special Charge – A, AF and AX Series Dialyzers

Following reports in October 2001 of patient deaths in Croatia, Baxter initiated a global recall of its A, AF and AX series Renal segment dialyzers. A panel of dialysis experts was established to investigate the circumstances surrounding reports of deaths in Croatia and other countries. In addition, the company has been conducting its own investigations into these reports and has been fully cooperating with the United States Food and Drug Administration and other health authorities around the world. Testing has led the company to conclude that a processing fluid used during the manufacturing of a limited number of dialyzers produced in the company's Ronneby, Sweden facility may have played a role in the deaths. Baxter has decided to permanently cease manufacturing the A, AF and AX series dialyzers. The fluid is not used in the manufacturing process for other dialyzers that Baxter manufactures or distributes. The company has ceased production of the discontinued dialyzers and is in the process of closing its Ronneby facility. The Miami Lakes, Florida facility, that provided materials used in the discontinued dialyzers, has also been closed. Refer to Note 12 for a discussion of legal proceedings relating to this matter.

The company recorded a pretax charge in the fourth quarter of 2001 of $189 million ($156 million on an after-tax basis) to cover the costs of discontinuing this product line and other related costs. The noncash costs principally include $21 million to write off inventory, $15 million to write down property, plant and equipment, and $80 million to write down goodwill and other intangible assets due to impairment. The cash costs include $12 million for severance costs resulting from the elimination of approximately 360 positions, the majority of which were located in the manufacturing facilities. Substantially all of these positions have been eliminated as of December 31, 2001. The cash costs also include $61 million for other related expenses, including costs associated with the recall, litigation and a long-term lease. Approximately $13 million of the cash costs have been paid as of December 31, 2001. The revenues and profits relating to these products were not material to the consolidated financial statements.

Note 5 / Long-Term Debt and Commitments

as of December 31 (in millions)	Effective interest rate	2001	2000
Commercial paper	4.3%	$ 230	$ 800
Short-term notes	0.4%	273	513
8.125% notes due 2001	7.0%	—	40
7.625% notes due 2002	7.5%	47	46
Variable rate loan due 2004	3.9%	209	—
5.75% notes due 2006	4.9%	594	—
7.125% notes due 2007	7.1%	55	55
7.25% notes due 2008	7.3%	29	29
9.5% notes due 2008	9.4%	76	75
1.25% convertible debentures due 2021	1.4%	800	—
6.625% debentures due 2028	6.5%	152	147
Other		73	79
Total debt and lease obligations		2,538	1,784
Current portion		(52)	(58)
Long-term portion		$2,486	$1,726

In order to balance its capital structure and reduce net interest expense, in May 2001 the company issued $800 million of convertible debentures. The debentures bear an initial 1.25 percent coupon, mature in 20 years, are callable on or after June 5, 2006 at a price equal to 100 percent of the principal amount plus accrued interest up to the redemption date, allow the holders to require the company to repurchase the debt at the end of the first year and in the fifth, tenth and fifteenth years, at a price equal to 100 percent of the principal amount plus accrued interest up to the repurchase date, and are convertible into Baxter common stock at a conversion price of $65.18 per share if the closing price of Baxter common stock exceeds $71.70 for a specified period of time. The initial interest rate will be reset on specified future dates, subject to a maximum of 2.9 percent. The proceeds from the convertible debt issuance were used to refinance certain of the company's short-term debt. The company also issued other debt during 2001, principally to fund its investing activities.

In order to better match the currency denomination of its assets and liabilities, the company rebalanced certain of its debt during 2000. The company acquired approximately $878 million of its U.S. Dollar denominated debt securities during 2000 and increased its Japanese Yen and Euro denominated debt. The net costs associated with the early termination of the U.S. Dollar denominated debt were recorded in other expense as they were not material.

The company leases certain facilities and equipment under capital and operating leases expiring at various dates. The leases generally provide for the company to pay taxes, maintenance, insurance and certain other operating costs of the leased property. Most of the operating leases contain renewal options. Rent expense under operating leases was $108 million, $99 million and $91 million in 2001, 2000 and 1999, respectively.

Future Minimum Lease Payments and Debt Maturities

as of and for the years ended December 31 (in millions)	Operating leases	Aggregate debt maturities and capital leases
2002	$ 83	$ 52
2003	64	1,338 [1]
2004	46	212
2005	38	2
2006	30	589
Thereafter	78	355
Total obligations and commitments	$339	2,548
Amounts representing interest, discounts, premiums and deferred financing costs		(10)
Total long-term debt and present value of lease obligations		$2,538

[1] Includes approximately $1,303 million of commercial paper, short-term notes and convertible debt supported by long-term credit facilities with funding expiration dates in 2003.

The company maintains two revolving credit facilities, which total $1.5 billion, and have funding expiration dates through November 2003. The facilities enable the company to borrow funds in U.S. Dollars, Euros or Swiss Francs on an unsecured basis at variable interest rates and contain various covenants, including a maximum debt-to-capital ratio and a minimum interest coverage ratio. There were no borrowings outstanding under these facilities at December 31, 2001 or 2000. Baxter also maintains or guarantees other short-term credit arrangements, which totaled $337 million at December 31, 2001. Approximately $146 million and $61 million of borrowings were outstanding under these facilities at December 31, 2001 and 2000, respectively.

Commercial paper, short-term notes and convertible debt, together totaling $1.3 billion at both December 31, 2001 and 2000, have been classified with long-term debt as they are supported by long-term credit facilities, which management intends to continue to refinance.

The company periodically enters into off-balance sheet financing arrangements where economical and consistent with the company's business strategy. At December 31, 2001 the company has entered or is committed to enter into operating lease agreements, two of which are with special purpose entities, relating to facilities and equipment used in the operations of the company and its affiliates. The majority of these arrangements were entered into during 2001. The maximum amount committed by the lessors at December 31, 2001 under these transactions was approximately $188 million. Of this total, the amount funded was $98 million at December 31, 2001. The leases generally have an initial term of five years, with renewal options. Rent obligations will commence for certain of the leases at future dates, between January 2002 and December 2003. The minimum lease payments, which are included in the table above, are determined based on the expected funded amounts and will fluctuate based on actual interest rates. The company expects to receive $39 million of minimum lease payments from a sublease executed with a third party in which the company holds a minority equity interest. These sublease receipts, which are included in the table above, are currently estimated to be $3 million in 2003, $13 million in 2004, $12 million in 2005 and $11 million in 2006. With respect to its leases, the company has the right to renegotiate renewal terms, exercise a purchase option with respect to the leased property or arrange for the sale of the leased property. Under each lease, in the event the property is sold on behalf of the lessor and the sales proceeds are less than the lessor's investment in the property, the company is responsible for the shortfall, up to an aggregate maximum recourse amount under all of the leases of $159 million. The potential recourse amounts are not included in the minimum lease payments above as management believes the fair values of the properties equal or exceed the lessors' investments in the leased properties at December 31, 2001. The company is required to maintain compliance with covenants under certain of the leases, including a minimum interest coverage ratio. The company was in compliance with all covenants at December 31, 2001.

The company and Nexell Therapeutics Inc. (Nexell), an affiliate, have entered into an agreement whereby Baxter agreed to issue put rights in connection with a $63 million private placement by Nexell of preferred stock. The put rights and related agreement are recorded in current liabilities at estimated fair value, and totaled $57 million at December 31, 2001. The put rights were issued in conjunction with Nexell's repayment of amounts owed to the company. The preferred stock is convertible at the option of the holders into common stock of Nexell at $11 per share at any time until November 2006. The put rights provide the holders of the preferred stock with the ability to cause Baxter to purchase the preferred stock from November 2002 until November 2004. The purchase price to be paid by Baxter would reflect a per annum compounded return to the holders of the preferred stock of 5.91 percent, with a downward adjustment relating to dividends paid by Nexell on the preferred stock. The company and Nexell entered into a separate related agreement whereby the conversion price of the preferred stock will be adjusted downward in accordance with the

terms of the agreement in the event that the put rights are exercised by the holders. The fair value of the put rights was initially recorded in conjunction with the adoption of SFAS No. 133, as part of the cumulative effect of an accounting change. Subsequent changes in the fair value of the put rights and related agreement are recorded directly to other income or expense.

As further discussed in Note 8, the company has guaranteed repayment of the outstanding Shared Investment Plan participant loans, in the amount of $191 million at December 31, 2001.

In the normal course of business, Baxter enters into certain joint development and commercialization arrangements with third parties, often affiliates of the company. The arrangements are varied but generally provide that Baxter will receive certain rights to manufacture, market or distribute a specified technology or product under development by the third party. At December 31, 2001, future funding commitments under these arrangements totaled approximately $100 million, and the majority of them were contingent upon the third parties' achievement of contractually specified milestones.

Note 6 / Financial Instruments and Risk Management

Receivables

In the normal course of business, the company provides credit to customers in the health-care industry, performs credit evaluations of these customers and maintains reserves for potential credit losses which, when realized, have been within the range of management's allowance for doubtful accounts. The allowance for doubtful accounts was $57 million and $43 million at December 31, 2001 and 2000, respectively. As part of a financing program, the company had commitments to extend credit, the majority of which was to an affiliate, of $68 million, of which $30 million was drawn and outstanding at December 31, 2001.

The company has entered into agreements with financial institutions whereby it securitizes, on a continuous basis, an undivided interest in certain pools of trade accounts receivable (including lease receivables). Pursuant to the majority of these agreements, the company irrevocably sells the eligible accounts receivable to bankruptcy-remote third parties formed for the purpose of buying and selling these receivables, which then sell participating interests in the receivables to financial institutions. These transactions are accounted for as sales of accounts receivable. Under the terms of the arrangements, the company continues to service the receivables and retains a subordinated residual interest in the receivables. No servicing asset or liability has been recorded as the company's compensation for servicing the assets is just adequate to cover the cost of its servicing responsibilities. The carrying value of the residual interest is considered to approximate fair value. The net gains or losses recognized upon sale of the receivables, which are included in other income or expense, and the fees and costs associated with the securitization arrangements, which are included in net interest expense, are not material to the consolidated financial statements. Certain of the costs of the securitization arrangements vary with the company's credit rating. One of the arrangements requires that the company post cash collateral in the event of a specified change in credit rating. The potential cash collateral, which was not required as of December 31, 2001, totals less than $20 million. In 2001, 2000 and 1999 the company generated net operating cash inflows of $118 million, $195 million and $65 million, respectively, relating to such sales. In 2001, proceeds from new sales totaled $2.3 billion and cash collections totaled $2.2 billion. In 2000, proceeds from new sales totaled $1.5 billion and cash collections totaled $1.3 billion. The portfolio of accounts receivable that the company services, adjusted for changes in currency exchange rates from the original date of sale, totaled $683 million and $590 million at December 31, 2001 and 2000, respectively.

Other Concentrations of Risk

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

Foreign Currency and Interest Rate Risk Management

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

The company is primarily exposed to currency exchange-rate risk with respect to firm commitments, forecasted transactions and net assets denominated in Japanese Yen, Euro, British Pound and Swiss Franc. 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 utilizes derivative and nonderivative financial instruments to further reduce the net exposure to currency fluctuations. Gains and losses on the hedging instruments are intended to offset losses and gains on the hedged transactions with the goal of reducing the earnings and stockholders' equity volatility resulting from fluctuations in currency exchange rates.

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 management 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.

In adopting SFAS No. 133, management reassessed its hedging strategies, and, in some cases, increased the company's use of derivative instruments or changed the type of derivative instruments used to manage currency exchange-rate and interest-rate risk, in part because the new accounting standard allows for increased opportunities and different approaches for reducing earnings and stockholders' equity volatility resulting from fluctuations in currency exchange rates and interest rates.

Cash Flow Hedges

The company uses option and forward contracts to hedge the risk to earnings associated with fluctuations in currency exchange rates relating to the company's firm commitments and forecasted transactions expected to be denominated in foreign currencies. The company uses forward-starting interest rate swaps to hedge the risk to earnings associated with fluctuations in interest rates relating to anticipated issuances of debt. Certain other firm commitments and forecasted transactions are also periodically hedged with option and forward contracts.

The following table summarizes activity (net-of-tax) in 2001 in accumulated other comprehensive income (loss) (AOCI) related to the company's cash flow hedges.

year ended December 31 (in millions)	2001
AOCI balance at beginning of year	$ —
Cumulative effect of accounting change	8
Net gain in fair value of derivatives	126
Net gain reclassified to earnings	(52)
AOCI balance at December 31, 2001	$ 82

The net amounts recorded during 2001 relating to hedge ineffectiveness and the component of the derivative instruments' gain or loss excluded from the assessment of hedge effectiveness were immaterial to the consolidated financial statements. During 2001, certain foreign currency hedges were discontinued principally due to a change in the company's anticipated net exposures. This was partially as a result of recent business acquisitions, whereby the company gained natural offsets to previously existing currency exposures. The net-of-tax gain reclassified to earnings relating to these discontinued hedges, which is included in the table above, was $21 million. As of December 31, 2001, $43 million of deferred net after-tax gains on derivative instruments accumulated in AOCI (at their fair values as of December 31, 2001) are expected to be reclassified to earnings during the next twelve months, coinciding with when the hedged items, which principally include intercompany sales and interest payments on third-party debt, are expected to impact earnings. The maximum term over which the company has hedged exposures to the variability of cash flows, excluding interest payments on third-party debt, is four years.

Fair Value Hedges

The company uses interest rate swaps to convert a portion of its fixed-rate debt into variable-rate debt. These instruments serve to hedge the fair value of the company's debt. No portion of the change in fair value of the company's fair value hedges was ineffective or excluded from the assessment of hedge effectiveness during 2001.

Hedges of Net Investments in Foreign Operations

The company periodically uses cross-currency interest rate swaps and foreign currency denominated debt to hedge its stockholders' equity balance from the effects of fluctuations in currency exchange rates. The company measures effectiveness on the swaps based upon changes in spot foreign exchange rates. Approximately $95 million of net after-tax gains related to the derivative and nonderivative instruments were included in the company's CTA account for the year ended December 31, 2001.

Other Hedges

The company uses forward contracts and cross-currency swap agreements to hedge earnings from the effects of fluctuations in currency exchange rates relating to certain of the company's intercompany and third-party receivables, payables and debt denominated in a foreign currency. These derivative instruments are not formally designated as hedges, and the change in fair value of the instruments, which substantially offsets the change in book value of the hedged items, is recorded directly to earnings.

Other Risk Management Activities

In order to partially offset the potentially dilutive effect of employee stock options, the company periodically enters into forward agreements with independent third parties related to the company's common stock. The forward agreements require the company to purchase its common stock from the counterparties on specified future dates and at specified prices. The company can, at its option, require settlement of the agreements with shares of its common stock or, in some cases, cash, in lieu of physical settlement. The company may, at its option, terminate and settle these agreements early at any time before maturity. In accordance with GAAP, these agreements are not recorded on the balance sheet, but are recorded upon maturity or at an earlier termination date, and are classified within stockholders' equity. The agreements include certain Baxter stock price thresholds, below which the

agreements will automatically terminate. These thresholds are significantly below Baxter's stock price at both the various contract inception dates and as of December 31, 2001. If the thresholds were met in the future, the number of shares that could potentially be issued by the company under all of the agreements is subject to contractual maximums, and the maximum at December 31, 2001 is 184 million shares. At December 31, 2001, agreements related to 31 million shares mature in 2002 at exercise prices ranging from $33 to $55 per share, with a weighted-average exercise price of $49 per share. At December 31, 2000, forward agreements related to 12 million shares were outstanding. Put options for three million shares of common stock and call options for two million shares of common stock were outstanding at December 31, 2000, and matured in 2001. During 2001, certain of these agreements were terminated in conjunction with the company's repurchase of its common stock.

Book Values and Fair Values of Financial Instruments

	Book values		Approximate fair values	
as of December 31 (in millions)	**2001**	2000	**2001**	2000
Assets				
Long-term insurance receivables	$ 93	$ 160	$ 87	$ 145
Investments in affiliates	173	195	208	312
Foreign currency hedges	181	69	181	55
Equity forward agreements	—	—	167	171
Liabilities				
Short-term debt	149	576	149	576
Current maturities of long-term debt and lease obligations	52	58	52	58
Short-term borrowings classified as long term	1,303	1,313	1,303	1,313
Other long-term debt and lease obligations [1]	1,183	413	968	429
Foreign currency hedges	19	4	19	4
Nexell put rights liability	57	—	57	—
Long-term litigation liabilities	140	184	131	170

[1] Includes interest rate hedges with book values and fair values of $14 million in 2001 and net investment hedges with book values and fair values of $55 million and $69 million, respectively, in 2000.

The company's investments in affiliates are classified as available-for-sale. The fair values of certain of these investments are not readily determinable as the securities are not traded in a market. For those investments, fair value is assumed to approximate carrying value. With respect to the company's unrestricted available-for-sale marketable securities, the total net unrealized gain at December 31, 2001 consists of gross unrealized gains of $9 million net of gross unrealized losses of $1 million, and the total at December 31, 2000 consists of gross unrealized gains of $50 million net of gross unrealized losses of $9 million.

Although the company's litigation remains unresolved by final orders or settlement agreements in some cases, 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. The approximate fair values of other assets and liabilities are based on quoted market prices, where available.

The carrying values of other financial instruments approximate their fair values due to the short-term maturities of these assets and liabilities.

Note 7 / Accounts Payable and Accrued Liabilities

as of December 31 (in millions)	**2001**	2000
Accounts payable, principally trade	$ 708	$ 659
Employee compensation and withholdings	233	238
Litigation	110	177
Pension and other deferred benefits	49	17
Property, payroll and other taxes	99	77
Common stock dividends payable	349	341
Nexell put rights	57	—
Edwards joint venture liability	181	—
Other	646	481
Accounts payable and accrued liabilities	$2,432	$1,990

Refer to Note 2 for further information regarding the Edwards joint venture liability.

Note 8 / Common and Preferred Stock

Stock Split

On February 27, 2001, Baxter's board of directors approved a two-for-one stock split of the company's common shares. This approval was subject to shareholder approval of an increase in the number of authorized shares of common stock, which was received on May 1, 2001. On May 30, 2001, shareholders of record on May 9, 2001 received one additional share of Baxter common stock for each share held on May 9, 2001. All share and per share data, and option and per option data, in the consolidated financial statements and notes have been adjusted and restated to reflect the stock split.

Stock Compensation Plans

Baxter has several stock-based compensation plans, which are described below.

Fixed Stock Option Plans

Stock options have been granted at various dates. All grants have a 10-year initial term and have an exercise price at least equal to 100 percent of market value on the date of grant. Vesting terms vary, with the majority of outstanding options vesting 100 percent in three years.

Stock Options Outstanding

The following is a summary of stock options outstanding at December 31, 2001.

(option shares in thousands)

	Options outstanding			Options exercisable	
Range of exercise prices	Outstanding	Weighted-average remaining contractual life (years)	Weighted-average exercise price	Exercisable	Weighted-average exercise price
$10-24	10,476	4.4	$20.11	10,476	$20.11
25-29	9,851	7.3	27.39	4,953	28.04
30-39	8,558	7.2	32.29	575	35.18
40-44	13,246	8.8	41.27	3,880	41.34
45-47	16,175	9.2	45.42	—	—
48-50	7,400	9.9	49.47	—	—
$10-50	65,706	7.9	$36.59	19,884	$26.66

As of December 31, 2000 and 1999, there were 14,651,000 and 17,510,000 options exercisable, respectively, at weighted-average exercise prices of $20.33 and $20.53, respectively.

Stock Option Activity

(option shares in thousands)	Shares	Weighted-average exercise price
Options outstanding at December 31, 1998	32,746	$23.19
Granted	10,026	33.36
Exercised	(3,915)	19.59
Forfeited	(1,239)	28.37
Options outstanding at December 31, 1999	37,618	26.10
Granted	19,040	37.66
Exercised	(5,706)	19.73
Forfeited	(3,842)	28.91
Equitable adjustment	1,892	—
Options outstanding at December 31, 2000	49,002	30.11
Granted	23,862	46.54
Exercised	(5,225)	21.65
Forfeited	(1,933)	35.56
Options outstanding at December 31, 2001	65,706	$36.59

Included in the tables above are certain premium-priced options. During 1998, 941,000 premium-priced stock options were granted with a weighted-average exercise price of $37 and a weighted-average fair value of approximately $6 per option. During 1996, five million premium-stock options were granted with an exercise price of $24 and a weighted-average fair value of approximately $6 per option. All of such options granted in 1998 and 2.2 million of such options granted in 1996 are outstanding at December 31, 2001.

Employee Stock Purchase Plans

The company has employee stock purchase plans whereby it is authorized to issue up to a total of 20 million shares of common stock to its employees, nearly all of whom are eligible to participate. As of December 31, 2001, 11 million of the total authorized shares have been issued. The purchase price is the lower of 85 percent of the closing market price on the date of subscription or 85 percent of the closing market price on the purchase dates, as defined by the plans. The total subscription amount for each participant cannot exceed 25 percent of current annual pay. Under the plans, the company sold 1,423,806, 2,774,044 and 1,555,236 shares to employees in 2001, 2000 and 1999, respectively.

Equitable Adjustments

Outstanding options and employee stock subscriptions were modified as a result of the spin-off of Edwards in March 2000. Equitable adjustments were made to the number of shares and exercise price for each option and employee stock subscription outstanding. Employees of Edwards were required to exercise any vested options within 90 days from the date of spin-off, which occurred on March 31, 2000. All unvested options were canceled 90 days after the date of spin-off.

Restricted Stock and Performance-Share Plans

The management long-term incentive plan has historically included both stock options and restricted stock. Effective in 2001, the restricted stock component of the long-term incentive plan was eliminated and the plan consists solely of fixed stock options, the terms and conditions of which are similar to the company's other stock option plans. The number of stock options granted pursuant to the revised plan is based on the participant's stock option target, the participant's individual performance, as well as the performance of Baxter common stock relative to a comparator index. The company also has other incentive compensation plans whereby grants of restricted stock and performance shares are made to key employees. Effective in 2001, the restricted stock component of the non-employee director compensation plan was eliminated and the plan now consists solely of stock options. During 2001, 2000 and 1999, 12,000, 499,000 and 1,085,000 shares, respectively, of restricted stock and performance shares were granted at weighted-average grant-date fair values of $49.39, $32.88 and $32.00 per share, respectively. At December 31, 2001, 76,000 shares of stock were subject to restrictions, the majority of which lapse in 2002. The majority of the restricted stock granted in 2000 was forfeited pursuant to the long-term incentive plan transition discussed above.

Stock Compensation Expense

The compensation expense recognized in continuing operations for performance-based, restricted and other stock plans was $5 million, $23 million and $26 million in 2001, 2000 and 1999, respectively. As discussed above, the company terminated certain of these plans in 2001. No compensation cost has been recognized for fixed stock option plans and stock purchase plans. Had compensation cost for all of the company's stock-based compensation plans been determined based on the fair value at the grant dates consistent with the method of SFAS No. 123, "Accounting for Stock-Based Compensation," the company's income and related EPS would have been reduced to the pro forma amounts indicated below.

years ended December 31 (in millions, except per share data)	2001	2000	1999
Pro forma net income	$448	$ 681	$ 746
Pro forma basic EPS	$ .76	$1.16	$1.29
Pro forma diluted EPS	$ .74	$1.14	$1.26

Pro forma compensation expense for stock options and employee-stock subscriptions was calculated using the Black-Scholes model. The pro forma expense for stock option grants was calculated with the following weighted-average assumptions for grants in 2001, 2000 and 1999, respectively: dividend yield of 1%, 1.25% and 1.5%; expected life of six years for all periods; expected volatility of 36%, 31% and 29%; and risk-free interest rates of 4.9%, 6.1% and 5.4%. The weighted-average fair value of options granted during the year were $18.21, $13.75 and $11.30 in 2001, 2000 and 1999, respectively.

The pro forma expense for employee stock purchase subscriptions was estimated with the following weighted-average assumptions for 2001, 2000 and 1999, respectively: dividend yield of 1%, 1.4% and 1.5%; expected term of one year for all periods; expected volatility of 43% in 2001 and 33% in 2000 and 1999, and risk-free interest rates of 4.1%, 6.2% and 5.4%. The weighted-average fair value of those purchase rights granted in 2001, 2000 and 1999 was $18.56, $11.49 and $10.04, respectively.

Shared Investment Plan

In order to further align management and shareholder interests, in 1999 the company sold approximately 6.1 million shares of the company's common stock to 142 of Baxter's senior managers for $198 million in cash. The participants used five-year full-recourse market-rate personal bank loans to purchase the stock at the May 3, 1999 closing price (adjusted for the stock split) of $31.81. The plan includes certain risk-sharing provisions whereby, after May 3, 2002, the company shares 50 percent in any loss incurred by the participants. Any such loss reimbursements would represent taxable income to the participants. As further discussed in Note 5, Baxter has guaranteed repayment to the banks in the event of default by a participant in the plan.

Stock Repurchase Programs

As authorized by the board of directors, the company repurchases it stock to optimize its capital structure depending upon its operational cash flows, net debt level and current market conditions. In November 1995, the company's board of directors authorized the repurchase of up to $500 million of common stock over a period of several years, all of which was repurchased by early 2000. In November 1999, the board of directors authorized the repurchase of another $500 million over a period of several years, all of which was repurchased by December 31, 2001. In July 2001, the board of directors authorized the repurchase of an additional $500 million from time to time, of which $76 million has been repurchased as of December 31, 2001.

Issuance of Stock

In order to rebalance the company's capital structure following the acquisition of ASTA in October 2001, the company issued 9.7 million common shares for $500 million in December 2001.

Other

The board of directors is authorized to issue 100 million shares of no par value preferred stock in series with varying terms as it determines. In March 1999, common stockholders received a dividend of one preferred stock purchase right (collectively, the Rights) for each share of common stock. As a result of the two-for-one split of the company's common stock in May 2001, each outstanding share of common stock is now accompanied by one-half of one Right. The Rights may become exercisable at a specified time after (1) a person or group acquires 15 percent or more of the company's common stock or (2) a tender or exchange offer for 15 percent or more of the company's common stock is made. Once exercisable, the holder of each Right is entitled to purchase, upon payment of the exercise price, shares of the company's common stock having a market value equal to two times the exercise price of the Rights. The Rights have a current exercise price of $275. The Rights expire on March 23, 2009, unless earlier redeemed by the company under certain circumstances at a price of $0.01 per Right.

Note 9 / Retirement and Other Benefit Programs

The company sponsors several qualified and nonqualified pension plans for its employees. The company also sponsors certain unfunded contributory health-care and life insurance benefits for substantially all domestic retired employees.

Reconciliation of Plans' Benefit Obligations, Assets and Funded Status

as of and for the years ended December 31 (in millions)	Pension benefits 2001	Pension benefits 2000	Other benefits 2001	Other benefits 2000
Benefit Obligations				
Beginning of year	$1,555	$1,344	$ 219	$ 175
Service cost	40	41	3	3
Interest cost	115	113	16	14
Participant contributions	3	2	3	3
Actuarial loss	55	147	74	35
Acquisitions (divestitures), net	—	(10)	—	—
Curtailments and settlements	—	(10)	—	—
Benefit payments	(79)	(78)	(11)	(11)
Currency exchange-rate changes and other	3	6	—	—
End of year	1,692	1,555	304	219
Fair Value of Plan Assets				
Beginning of year	1,807	1,724	—	—
Actual return on plan assets	(351)	173	—	—
Employer contributions	147	19	8	8
Participant contributions	3	2	3	3
Acquisitions (divestitures), net	—	(8)	—	—
Curtailments and settlements	—	(11)	—	—
Benefit payments	(79)	(78)	(11)	(11)
Currency exchange-rate changes and other	3	(14)	—	—
End of year	1,530	1,807	—	—
Funded Status				
Funded status at December 31	(162)	252	(304)	(219)
Unrecognized transition obligation	2	4	—	—
Unrecognized net (gains) losses	338	(252)	26	(56)
Net amount recognized	$ 178	$ 4	$(278)	$(275)
Prepaid benefit cost	$ 320	$ 143	$ —	$ —
Accrued benefit liability	(142)	(139)	(278)	(275)
Net amount recognized	$ 178	$ 4	$(278)	$(275)

Assets held by the trusts of the plans consist primarily of equity securities. The accumulated benefit obligation is in excess of plan assets for certain of the company's pension plans. The projected benefit obligation, accumulated benefit obligation and fair value of plan assets for these plans was $262 million, $230 million and $83 million, respectively, at December 31, 2001, and $159 million, $142 million and $17 million, respectively, at December 31, 2000.

Net Periodic Benefit (Income) Cost

years ended December 31 (in millions)	2001	2000	1999
Pension Benefits			
Service cost	$ 40	$ 41	$ 48
Interest cost	115	113	102
Expected return on plan assets	(177)	(158)	(133)
Amortization of prior service cost	—	—	1
Amortization of net (gain) loss	(5)	(1)	—
Amortization of transition obligation	3	5	6
Net periodic pension benefit (income) cost	$ (24)	$ —	$ 24
Other Benefits			
Service cost	$ 3	$ 3	$ 3
Interest cost	16	14	12
Recognized actuarial gain	(4)	(7)	(7)
Net periodic other benefit cost	$ 15	$ 10	$ 8

The net periodic benefit cost amounts principally pertain to continuing operations.

Assumptions Used in Determining Benefit Obligations

	Pension benefits 2001	Pension benefits 2000	Other benefits 2001	Other benefits 2000
Discount rate				
U.S. and Puerto Rico plans	7.5%	7.8%	7.5%	7.8%
International plans (average)	5.7%	5.8%	n/a	n/a
Expected return on plan assets				
U.S. and Puerto Rico plans	11.0%	11.0%	n/a	n/a
International plans (average)	7.8%	8.1%	n/a	n/a
Rate of compensation increase				
U.S. and Puerto Rico plans	4.5%	4.5%	n/a	n/a
International plans (average)	3.6%	4.0%	n/a	n/a
Annual rate of increase in the per-capita cost	n/a	n/a	11.4%	7.5%
Rate decreased to	n/a	n/a	5.0%	5.5%
by the year ended	n/a	n/a	2007	2003

Effect of a One-Percent Change in Assumed Health-Care Cost Trend Rate

(in millions)	One percent increase 2001	One percent increase 2000	One percent decrease 2001	One percent decrease 2000
Effect on total of service and interest cost components	$ 2	$ 3	$ 3	$ 2
Effect on postretirement benefit obligation	$23	$29	$23	$24

With respect to the employees of Edwards, the company froze benefits at the date of spin-off under the U.S. defined benefit pension plan and under plans that provide retirees with health-care and life insurance benefits. The pension liabilities related to such employees' service prior to the spin-off date remain with Baxter. Included in net costs associated with effecting the business distribution in 1999 was a $5 million gain (net of tax of $4 million) relating to these benefit plan curtailments.

Most U.S. employees are eligible to participate in a qualified defined contribution plan. Company matching contributions relating to continuing operations were $18 million, $15 million and $14 million in 2001, 2000 and 1999, respectively.

Note 10 / Interest and Other (Income) Expense

Interest Expense, Net

years ended December 31 (in millions)	2001	2000	1999
Interest expense, net			
Interest costs	$130	$146	$165
Interest costs capitalized	(22)	(15)	(13)
Interest expense	108	131	152
Interest income	(39)	(39)	(35)
Total interest expense, net	$ 69	$ 92	$117
Allocated to continuing operations	$ 69	$ 85	$ 87
Allocated to discontinued operation	$ —	$ 7	$ 30

The allocation of interest to continuing and discontinued operations was based on relative net assets of these operations.

Other (Income) Expense

years ended December 31 (in millions)	2001	2000	1999
Equity in losses of affiliates and minority interests	$18	$ 9	$ 5
Asset dispositions and impairments, net	(20)	6	13
Foreign currency	(12)	(57)	(8)
Loss on early extinguishments of debt	—	15	—
Other	5	7	1
Total other (income) expense	$ (9)	$(20)	$11

Included in asset dispositions and impairments, net in 2001 was a gain of $105 million from the disposal of a non-strategic common stock investment by contribution to the company's pension trust. The cost basis used in the determination of the gain was specific identification. Substantially offsetting this gain in 2001 were charges for asset impairments, which primarily consisted of charges for investments whose decline in value was deemed to be other than temporary, with the investments written down to the market value as of the date the determination was made by management. As of December 31, 2001, the company does not hold any investments with significant unrealized losses. Included in foreign currency income in 2000 were gains of $66 million associated with the termination of cross-currency swap agreements. The contracts were terminated in conjunction with the company's rebalancing of its debt portfolio and in anticipation of the adoption of SFAS No. 133.

Note 11 / Income Taxes

Income Before Income Tax Expense by Category

years ended December 31 (in millions)	2001	2000	1999
U.S.	$321	$353	$ 330
International	643	593	722
Income from continuing operations before income taxes and cumulative effect of accounting change	$964	$946	$1,052

Income Tax Expense

years ended December 31 (in millions)	2001	2000	1999
Current			
U.S.			
Federal	$ (19)	$142	$ (13)
State and local	76	47	38
International	127	189	156
Current income tax expense	184	378	181
Deferred			
U.S.			
Federal	72	(98)	69
State and local	(18)	(21)	14
International	62	(51)	9
Deferred income tax expense (benefit)	116	(170)	92
Income tax expense	$300	$208	$273

The income tax for continuing operations was calculated as if Baxter were a stand-alone entity (without income from the discontinued operation).

Deferred Tax Assets and Liabilities

years ended December 31 (in millions)	2001	2000	1999
Deferred tax assets			
Accrued expenses	$257	$374	$389
Accrued postretirement benefits	101	102	102
Alternative minimum tax credit	139	146	162
Tax credits and net operating losses	102	92	100
Valuation allowances	(58)	(50)	(43)
Total deferred tax assets	541	664	710
Deferred tax liabilities			
Asset basis differences	456	410	471
Subsidiaries' unremitted earnings	38	85	160
Other	57	38	35
Total deferred tax liabilities	551	533	666
Net deferred tax asset (liability)	$ (10)	$131	$ 44

Income Tax Expense Rate Reconciliation

years ended December 31 (in millions)	2001	2000	1999
Income tax expense at statutory rate	$337	$331	$368
Tax-exempt operations	(157)	(147)	(134)
State and local taxes	31	9	23
Foreign tax expense	42	31	18
Rate difference on acquired R&D	62	—	—
Other factors	(15)	(16)	(2)
Income tax expense	$300	$208	$273

The company has received a tax-exemption grant from Puerto Rico, which provides that its manufacturing operations will be partially exempt from local taxes until the year 2013. Appropriate taxes have been provided for these operations assuming repatriation of all available earnings. In addition, the company has other manufacturing operations outside the United States, which benefit from reductions in local tax rates under tax incentives that will continue at least until 2004.

U.S. federal income taxes, net of available foreign tax credits, on unremitted earnings deemed permanently reinvested would be $569 million as of December 31, 2001.

In connection with the spin-off of its cardiovascular business, Baxter obtained a ruling from the Internal Revenue Service to the effect that the distribution should qualify as a tax-free spin-off in the United States. In many countries throughout the world, Baxter has not sought similar rulings from the local tax authorities and has taken the position that the spin-off was a tax-free event to Baxter. In the event that one or more countries' taxing authorities successfully challenge this position, Baxter would be liable for any resulting liability. Baxter believes that it has established adequate reserves to cover the expected tax liabilities. There can be no assurance, however, that Baxter will not incur losses in excess of such reserves.

U.S. federal income tax returns filed by Baxter International Inc. through December 31, 1994, have been examined and closed by the Internal Revenue Service. The company has ongoing audits in U.S. and international jurisdictions, including Belgium, Canada, France, Japan and Singapore. In the opinion of management, the company has made adequate provisions for tax expenses for all years subject to examination.

Note 12 / Legal Proceedings and Contingencies

Baxter International Inc. and certain of its subsidiaries are named as defendants in a number of lawsuits, claims and proceedings, including product liability claims involving products now or formerly manufactured or sold by the company or by companies that were acquired by the company. These cases and claims raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case and claim, the jurisdiction in which each suit is brought, and differences in applicable law. Accordingly, in many cases, the company is not able to estimate the amount of its liabilities with respect to such matters. Upon resolution of any pending legal matters, Baxter may incur charges in excess of presently established reserves. While such a future charge could have a material adverse impact on the company's net income and net cash flows in the period in which it is recorded or paid, management believes that no such charge would have a material adverse effect on Baxter's consolidated financial position. Following is a summary of certain legal matters pending against the company. For a more extensive description of such matters and other lawsuits, claims and proceedings against the company, see Part I, Item 3 of Baxter's Form 10-K for the year ended December 31, 2001.

Mammary Implant Litigation

The company, together with certain of its subsidiaries, is a defendant in various courts in a number of lawsuits brought by individuals, all seeking damages for injuries of various types allegedly caused by silicone mammary implants formerly manufactured by the Heyer-Schulte division (Heyer-Schulte) of American Hospital Supply Corporation (AHSC). AHSC, which was acquired by the company in 1985, divested its Heyer-Schulte division in 1984.

Settlement of a class action on behalf of all women with silicone mammary implants was approved by the U.S. District Court (U.S.D.C.) for the Northern District of Alabama in December 1995. The monetary provisions of the settlement provide compensation for all present and future plaintiffs and claimants through a series of specific funds and a disease-compensation program involving certain specified medical conditions. In addition to the class action, there are a number of individual suits currently pending against the company, primarily consisting of plaintiffs who have opted-out of the class action.

Baxter believes that a substantial portion of its liability and defense costs for mammary implant litigation will be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer solvency.

Plasma-Based Therapies Litigation

Baxter is a defendant in a number of claims and lawsuits brought by individuals who have hemophilia, all seeking damages for injuries allegedly caused by antihemophilic factor concentrates VIII or IX derived from human blood plasma (factor concentrates) processed by the company from the late 1970s to the mid-1980s. The typical case or claim alleges that the individual was infected with the HIV virus by factor concentrates, which contained the HIV virus. None of these cases involves factor concentrates currently processed by the company.

In addition, Immuno International AG (Immuno), a company acquired by Baxter in 1997, has unsettled claims for damages for injuries allegedly caused by its plasma-based therapies. A portion of the liability and defense costs related to these claims will be covered by insurance, subject to exclusions, conditions, policy limits and other factors. Pursuant to the stock purchase agreement between the company and Immuno, as revised in April 1999 in consideration for payment by the company of 29 million Swiss Francs to Immuno as additional purchase price, 26 million Swiss Francs of the purchase price is being withheld to cover these contingent liabilities.

Baxter is also a defendant in a number of claims and lawsuits, including one certified class action in the U.S.D.C. for the Central District of California, brought by individuals who infused the company's Gammagard® IVIG (intravenous immunoglobulin), all of whom are seeking damages for Hepatitis C infections allegedly caused by infusing Gammagard® IVIG. In September 2000, the U.S. D.C. for the Central District of California approved a settlement of the class action that would provide financial compensation for U.S. individuals who used Gammagard® IVIG between January 1993 and February 1994.

Baxter believes that a substantial portion of the liability and defense costs related to its plasma-based therapies litigation will be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer solvency.

Other

As of December 31, 2001, Baxter and certain of its subsidiaries were named as defendants in two civil lawsuits in the United States seeking damages on behalf of persons who allegedly died or were injured as a result of exposure to Baxter's A, AF and AX series dialyzers. Other lawsuits and claims may be filed in the United States and elsewhere.

As of December 31, 2001, Baxter and certain of its subsidiaries were named as defendants, along with others, in lawsuits pending in U.S. federal courts on behalf of various classes of purchasers of Medicare and Medicaid eligible drugs alleged to have been injured as a result of pricing practices for such drugs, which are alleged to be artificially inflated. In addition, the Attorney General of Nevada filed a civil suit in January 2002 against a subsidiary of Baxter alleging that prices for Medicare and Medicaid eligible drugs were artificially inflated in violation of various state laws. Various state and federal agencies are conducting civil investigations into the marketing and pricing practices of Baxter and others with respect to Medicare and Medicaid reimbursement.

Allegiance Corporation (Allegiance) was spun off from the company in a tax-free distribution to shareholders on September 30, 1996. As of September 30, 1996, Allegiance assumed the defense of litigation involving claims related to its businesses, including certain claims of alleged personal injuries as a result of exposure to natural rubber latex gloves. Although Allegiance has not been named in most of this litigation, it will be defending and indemnifying Baxter pursuant to certain contractual obligations for all expenses and potential liabilities associated with claims pertaining to latex gloves.

In addition to the cases discussed above, Baxter is a defendant in a number of other claims, investigations and lawsuits, including certain environmental proceedings. Based on the advice of counsel, management does not believe that, individually or in the aggregate, these other claims, investigations and lawsuits will have a material adverse effect on the company's results of operations, cash flows or consolidated financial position.

Note 13 / Segment Information

Baxter operates in three segments, each of which is a strategic business that is managed separately because each business develops, manufactures and sells distinct products and services. The segments are as follows: **Medication Delivery,** medication delivery products and therapies, including intravenous infusion pumps and solutions, anesthesia-delivery devices and pharmaceutical agents, and oncology therapies; **BioScience,** biopharmaceutical and blood-collection, separation and storage products and technologies; and **Renal,** products and services to treat end-stage kidney disease. As discussed in Note 2, the company spun off Edwards on March 31, 2000. Financial information for Edwards, which is substantially the same as the former CardioVascular segment, is reflected in the consolidated financial statements as a discontinued operation.

Management utilizes more than one measurement and multiple views of data to measure segment performance and to allocate resources to the segments. However, the dominant measurements are consistent with the company's consolidated financial statements and, accordingly, are reported on the same basis herein. Management evaluates the performance of its segments and allocates resources to them primarily based on pretax income along with cash flows and overall economic returns. Intersegment sales are generally accounted for at amounts comparable to sales to unaffiliated customers, and are eliminated in consolidation. The accounting policies of the segments are substantially the same as those described in the summary of significant accounting policies, as discussed in Note 1.

Certain items are maintained at the company's corporate headquarters (Corporate) and are not allocated to the segments. They primarily include most of the company's debt and cash and equivalents and related net interest expense, corporate headquarters costs, certain non-strategic investments and nonrecurring gains and losses, deferred income taxes, certain foreign currency fluctuations, hedging activities, and certain litigation liabilities and related insurance receivables. With respect to depreciation and amortization, and expenditures for long-lived assets, the difference between the segment totals and the consolidated totals principally related to assets maintained at Corporate.

Segment Information

as of and for the years ended December 31 (in millions)	Medication Delivery	BioScience	Renal	Other	Total
2001					
Net sales	$2,935	$2,786	$1,942	$ —	$7,663
Depreciation and amortization	159	148	105	29	441
Pretax income	471	552	294	(353)	964
Assets	3,076	3,559	1,701	2,007	10,343
Expenditures for long-lived assets	221	282	129	155	787
2000					
Net sales	$2,719	$2,353	$1,824	$ —	$6,896
Depreciation and amortization	147	125	96	37	405
Pretax income	426	533	310	(323)	946
Assets	2,453	2,935	1,591	1,754	8,733
Expenditures for long-lived assets	185	248	126	89	648
1999					
Net sales	$2,524	$2,176	$1,680	$ —	$6,380
Depreciation and amortization	145	114	81	32	372
Pretax income	424	435	318	(125)	1,052
Assets	2,447	2,632	1,342	3,223	9,644
Expenditures for long-lived assets	175	235	125	96	631

Pretax Income Reconciliation

years ended December 31 (in millions)	2001	2000	1999
Total pretax income from segments	$1,317	$1,269	$1,177
Unallocated amounts			
In-process research and development expense and acquisition-related costs	(280)	(286)	—
Special charge – A, AF and AX series dialyzers	(189)	—	—
Interest expense, net	(69)	(85)	(87)
Certain currency exchange-rate fluctuations and hedging activities	113	15	25
Asset dispositions and impairments, net	36	—	—
Other Corporate items	36	33	(63)
Consolidated income from continuing operations before income taxes and cumulative effect of accounting change	$ 964	$ 946	$1,052

Assets Reconciliation

as of December 31 (in millions)	2001	2000	1999
Total segment assets	$ 8,336	$6,979	$6,421
Unallocated assets			
Cash and equivalents	582	579	606
Deferred income taxes	227	308	417
Insurance receivables	165	277	417
Net assets of discontinued operation	—	—	1,231
Property and equipment, net	255	217	204
Other Corporate assets	778	373	348
Consolidated total assets	$10,343	$8,733	$9,644

Geographic Information

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

as of and for the years ended December 31 (in millions)	2001	2000	1999
Net sales			
United States	$3,887	$3,194	$2,921
Japan	427	485	482
Other countries	3,349	3,217	2,977
Consolidated net sales	$7,663	$6,896	$6,380
Long-lived assets			
United States	$1,769	$1,543	$1,361
Austria	344	294	344
Other countries	1,193	970	945
Consolidated long-lived assets	$3,306	$2,807	$2,650

Note 14 / Quarterly Financial Results and Market for the Company's Stock (Unaudited)

years ended December 31 (in millions, except per share data)	First quarter	Second quarter	Third quarter	Fourth quarter	Total year
2001					
Net sales	$1,757	$1,870	$1,900	$2,136	$7,663
Gross profit	771	826	855	984	3,436
Income (loss) from continuing operations [1]	214	253	272	(75)	664
Net income (loss) [1]	162	253	272	(75)	612
Per common share					
Income from continuing operations [1]					
Basic	.36	.43	.46	(.13)	1.13
Diluted	.35	.42	.45	(.13)	1.09
Net income [1]					
Basic	.27	.43	.46	(.13)	1.04
Diluted	.27	.42	.45	(.13)	1.00
Dividends declared	—	—	—	.582	.582
Market price					
High	47.60	54.00	55.05	55.50	55.50
Low	40.75	43.95	47.50	45.95	40.75
2000					
Net sales	$1,583	$1,694	$1,687	$1,932	$6,896
Gross profit	687	747	762	867	3,063
Income from continuing operations [2]	191	46	231	270	738
Net income [2]	191	48	231	270	740
Per common share					
Income from continuing operations [2]					
Basic	.33	.08	.39	.46	1.26
Diluted	.32	.08	.38	.45	1.24
Net income [2]					
Basic	.33	.08	.39	.46	1.26
Diluted	.32	.08	.38	.45	1.24
Dividends declared	—	—	—	.582	.582
Market price					
High	33.78	36.00	42.38	44.31	44.31
Low	25.91	28.22	34.75	37.88	25.91

[1] The second quarter of 2001 includes a pretax gain of $105 million from the disposal of a non-strategic investment, which was substantially offset by impairment charges for other assets and investments whose decline in value was deemed to be other than temporary. The fourth quarter of 2001 includes a $280 million pretax charge for in-process research and development and acquisition-related costs and a $189 million pretax special charge for the company's A, AF and AX series dialyzers.

[2] The second quarter of 2000 includes a $286 million pretax charge for in-process research and development and acquisition-related costs.

Baxter common stock is listed on the New York, Chicago, Pacific, London and SWX Swiss stock exchanges. The New York Stock Exchange is the principal market on which the company's common stock is traded. At January 31, 2002, there were approximately 60,400 holders of record of the company's common stock.

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Senior Vice President and
President – BioScience

[1] Also an executive officer of Baxter Healthcare Corporation

[2] Also an executive officer of Baxter World Trade Corporation

As of February 26, 2002

Corporate Headquarters

Baxter International Inc.
One Baxter Parkway
Deerfield, IL 60015-4633
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Internet: www.baxter.com

Stock Exchange Listings

Ticker Symbols: BAX and BXL
Baxter International Inc. common stock is listed on the New York, Chicago, Pacific, London and SWX Swiss stock exchanges. The New York Stock Exchange is the principal market on which the company's common stock is traded.

Annual Meeting

The 2002 Annual Meeting of Stockholders will be held on Tuesday, May 7, at 10:30 a.m. at the Drury Lane Theatre in Oakbrook Terrace, Illinois.

Stock Transfer Agent

Correspondence concerning Baxter International Inc. stock holdings, lost or missing certificates or dividend checks, duplicate mailings or changes of address should be directed to:

Equiserve
P.O. Box 2500
Jersey City, NJ 07303-2500
Telephone: (800) 446-2617
(201) 324-0498
Internet: www.equiserve.com

Correspondence concerning Baxter International Inc. Contingent Payment Rights related to the acquisition of Somatogen, Inc. should be directed to:

U.S. Bank Trust National Association
Telephone: (800) 934-6802
(651) 244-8677

Dividend Reinvestment

The company offers an automatic dividend-reinvestment program to all holders of Baxter International Inc. common stock. A detailed brochure is available upon request from:

Equiserve
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Information Resources

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Stockholders may elect to view future proxy materials and annual reports on-line via the Internet instead of receiving them by mail. To sign up for this service, please go to www.econsent.com/bax. When the next proxy materials and annual reports are available, you will be sent an e-mail message with a proxy control number and a link to the website where you can cast your vote on-line. Once you provide your consent to receive electronic delivery of proxy materials via the Internet, your consent will remain in effect until you revoke it.

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Investor Relations

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

Baxter Investor Relations
Telephone: (847) 948-4551

Customer Inquiries / General Information

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

Annual Report or Form 10-K

A copy of the company's Form 10-K for the year ended December 31, 2001, may be obtained without charge by writing to Baxter International Inc., Investor Relations, One Baxter Parkway, DF2-2E, Deerfield, IL 60015. A copy of the company's Form 10-K and other filings with the U.S. Securities and Exchange Commission may be obtained from the Securities and Exchange Commission's website at www.sec.gov.

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as of or for the years ended December 31	2001[1]	2000[2,3]	1999	1998[4]	1997[5]
Operating Results (in millions)					
Net sales	$ 7,663	6,896	6,380	5,706	5,259
Income from continuing operations before cumulative effect of accounting change	$ 664	738	779	275	371
Depreciation and amortization	$ 441	405	372	344	318
Research and development expenses[6]	$ 427	379	332	323	339
Balance Sheet and Cash Flow Information (in millions)					
Capital expenditures	$ 787	648	631	556	454
Total assets	$10,343	8,733	9,644	9,873	8,511
Long-term debt and lease obligations	$ 2,486	1,726	2,601	3,096	2,635
Cash flows from continuing operations	$ 1,149	1,233	977	837	472
Cash flows from discontinued operation	$ —	(19)	106	102	86
Cash flows from investing activities	$(1,592)	(1,053)	(735)	(872)	(1,083)
Cash flows from financing activities	$ 469	(120)	(445)	173	265
Common Stock Information[7]					
Average number of common shares outstanding (in millions)[8]	590	585	579	567	555
Income from continuing operations per common share					
Basic	$ 1.13	1.26	1.34	0.49	0.67
Diluted	$ 1.09	1.24	1.32	0.48	0.66
Cash dividends declared per common share	$ 0.582	0.582	0.582	0.582	0.569
Year-end market price per common share[9]	$ 53.63	44.16	31.41	32.16	25.22
Other Information					
Net-debt-to-capital ratio	35.9%	40.1%	40.2%	48.4%	46.9%
"Operational cash flow" from continuing operations (in millions)[10]	$ 503	588	588	379	153
Total shareholder return[11]	22.8%	48.1%	(0.5%)	30.1%	25.9%
Common stockholders of record at year-end	60,662	59,100	61,200	61,000	62,900

[1] Income from continuing operations includes charges for in-process research and development and acquisition-related costs and the company's A, AF and AX series dialyzers of $280 million and $189 million, respectively.
[2] Income from continuing operations includes a charge for in-process research and development and acquisition-related costs of $286 million.
[3] Certain balance sheet and other data are affected by the spin-off of Edwards Lifesciences Corporation in 2000.
[4] Income from continuing operations includes charges for in-process research and development, net litigation, and exit and other reorganization costs of $116 million, $178 million and $122 million, respectively.
[5] Income from continuing operations includes a charge for in-process research and development of $220 million.
[6] Excludes charges for in-process research and development, as noted above.
[7] All share and per share data have been restated for the company's two-for-one stock split.
[8] Excludes common stock equivalents.
[9] Market prices are adjusted for the company's stock dividend and stock split.
[10] The company's internal "operational cash flow" measurement is defined on page 33 and is not a measure defined by generally accepted accounting principles.
[11] Represents the total of appreciation in market price plus cash dividends declared on common shares plus the effect of any stock dividends for the year.

OUR VISION	To be the global leader in providing critical therapies for individuals with life-threatening conditions.
OUR GOALS	• Best Team – Building the best global team in health care. • Best Partner – Creating sustainable win-win relationships with patients and customers. • Best Investment – Consistently delivering significant shareholder return. • Best Citizen – Improving lives in local and global communities.
OUR SHARED VALUES	• Respect • Responsiveness • Results
OVERALL RESULT	Baxter will be recognized as one of the most admired companies in the world.

Baxter

Baxter International Inc.
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Deerfield Illinois 60015

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Cover Photo: In Neuchâtel, Switzerland, Baxter is gearing up to produce the first totally protein-free-manufactured recombinant Factor VIII for the treatment of hemophilia. Recombinant protein production, in which therapeutic proteins are produced in cell culture rather than from source plasma, is one of Baxter's core competencies. This next-generation Factor VIII is one of a number of new products in Baxter's pipeline.