BAXTER INTERNATIONAL INC
Form 10-K
February 26, 2016
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2015

OR

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

Commission file number 1-4448

Baxter International Inc.

(Exact Name of Registrant as Specified in its Charter)

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

Registrant s telephone number, including area code 224.948.2000

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

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

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

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

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

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

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

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

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

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

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

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2015 (the last business day of the registrant s most recently completed second fiscal quarter), based on the per share closing sale price of $69.93 on that date and the assumption for the purpose of this computation only that all of the registrant s directors and executive officers are affiliates, was approximately $38 billion. There is no non-voting common equity held by non-affiliates of the registrant. The number of shares of the registrant s common stock, $1.00 par value, outstanding as of January 31, 2016 was 547,871,849.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive 2016 proxy statement for use in connection with its Annual Meeting of Stockholders to be held on May 3, 2016 are incorporated by reference into Part III of this report.

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PART I

Item 1. ***Business.***

Company Overview

Baxter International Inc., through its subsidiaries, provides a broad portfolio of essential renal and hospital products, including home, acute and in-center dialysis; sterile IV solutions; infusion systems and devices; parenteral nutrition; biosurgery products and anesthetics; and pharmacy automation, software and services. The company s global footprint and critical nature of its products and services play a key role in expanding access to healthcare in emerging and developed countries. These products are used by hospitals, kidney dialysis centers, nursing homes, rehabilitation centers, doctors offices and by patients at home under physician supervision. As of December 31, 2015, Baxter manufactures products in approximately 25 countries and sells them in approximately 120 countries.

Baxter International Inc. was incorporated under Delaware law in 1931. As used in this report, Baxter International means Baxter International Inc. and Baxter, the company or the Company means Baxter International and its consolidated subsidiaries (after giving effect to the separation and distribution of Baxalta Incorporated (Baxalta), as further described below), unless the context otherwise requires.

Separation of Baxalta

On July 1, 2015, Baxter completed the distribution of approximately 80.5% of the outstanding common stock of its biopharmaceuticals business, Baxalta, to Baxter stockholders. The distribution was made to Baxter s stockholders of record as of the close of business on June 17, 2015, who received one share of Baxalta common stock for each Baxter common share held as of such date. The distribution was intended to take the form of a tax-free distribution for federal income tax purposes in the United States. As a result of the distribution, Baxalta is now an independent public company whose shares trade on the New York Stock Exchange under the symbol BXLT.

The local separation of Baxalta s business in certain countries outside the United States did not occur prior to the distribution date due to regulatory requirements, the need to obtain consents from local governmental authorities and other business reasons. The International Commercial Operations Agreement (ICOA), entered into by Baxter and Baxalta in connection with the separation and distribution on June 30, 2015, provides for the conduct of the Baxalta business by Baxter in such countries until the local separation is completed. The ICOA also governs the process for the local separation of Baxalta s business following the distribution date.

On January 27, 2016, Baxter exchanged 37,573,040 of its retained Baxalta shares with the Chase Lincoln First Commercial Corporation, the sole lender under its $1.8 billion revolving credit facility, as described in Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Credit Facilities, Access to Capital and Credit Ratings Credit Facilities. This exchange was consummated in connection with the termination of such facility and the extinguishment of all outstanding indebtedness thereunder.

As a result of the separation, the consolidated statements of income, consolidated balance sheets, consolidated statements of cash flow, and related financial information reflect Baxalta s operations, assets and liabilities, and cash flows as discontinued operations for all periods presented.

Refer to Note 2 in Item 8 of this Annual Report on Form 10-K for additional information regarding the separation of Baxalta.

Business Segments and Products

After giving effect to the separation and distribution, the company now operates in two segments: Hospital Products and Renal.

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The Hospital Products business manufactures intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, inhalation anesthetics, and biosurgery products. The business also provides products and services related to pharmacy compounding, and drug formulation.

The Renal business provides products and services to treat end-stage renal disease, or irreversible kidney failure and acute kidney injuries. The Renal business offers a comprehensive portfolio to meet the needs of patients across the treatment continuum, including technologies and therapies for peritoneal dialysis (PD), in-center hemodialysis (HD), home HD (HHD), continuous renal replacement therapy (CRRT) and additional dialysis services.

For financial information about Baxter s segments and principal product categories, see Note 17 in Item 8 of this Annual Report on Form 10-K.

Sales and Distribution

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

International sales are made and products are distributed on a direct basis or through independent distributors or sales agents in more than 100 countries as of December 31, 2015.

International Operations

The majority of the company s revenues are generated outside of the United States and geographic expansion remains a core component of the company s strategy. Baxter s international presence includes operations in Europe (including Eastern and Central Europe), the Middle East, Africa, Asia-Pacific, Latin America and Canada. The company is subject to certain risks inherent in conducting business outside the United States. For more information on these risks, see the information under the captions Risks Related to Baxter s Business We are subject to risks associated with doing business globally and Changes in foreign currency exchange rates and interest rates could have a material adverse effect on our operating results and liquidity in Item 1A of this Annual Report on Form 10-K.

For financial information about foreign and domestic operations and geographic information, see Note 17 in Item 8 of this Annual Report on Form 10-K. For more information regarding foreign currency exchange risk, refer to the discussion under the caption entitled Financial Instrument Market Risk in Item 7 of this Annual Report on Form 10-K.

Contractual Arrangements

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

In keeping with the increased emphasis on cost-effectiveness in healthcare delivery, many hospitals and other customers of medical products in the United States have joined group purchasing organizations (GPOs), or formed integrated delivery networks (IDNs), to enhance purchasing power. GPOs and IDNs negotiate pricing

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arrangements with manufacturers and distributors, and the negotiated prices are made available to members. Baxter has purchasing agreements with several of the major GPOs in the United States. GPOs may have agreements with more than one supplier for certain products. Accordingly, in these cases, Baxter faces competition from other suppliers even where a customer is a member of a GPO under contract with Baxter. Purchasing power is similarly consolidated in many other countries. For example, public contracting authorities act as the purchasing entities for the hospitals and other customers of medical products in their region and many hospitals and other customers have joined joint procurement entities and buying consortia. The result is that demand for healthcare products is increasingly concentrated across the company s markets globally.

Raw Materials

Raw materials essential to Baxter s business are purchased from numerous suppliers worldwide in the ordinary course of business. Although most of these materials are generally available, Baxter at times may experience shortages of supply. In an effort to manage risk associated with raw materials supply, Baxter works closely with its suppliers to help ensure availability and continuity of supply while maintaining high quality and reliability. The company also seeks to develop new and alternative sources of supply where beneficial to its overall raw materials procurement strategy.

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

In connection with the separation and distribution, Baxter entered into a long-term manufacturing and supply agreement with Baxalta. Baxalta manufactures and supplies Baxter with ARTISS, TISSEEL, FLOSEAL and stand-alone thrombin under the manufacturing and supply agreement, on a cost-plus basis.

Competition and Healthcare Cost Containment

Baxter s Hospital Products and Renal businesses benefit from a number of competitive advantages, including the breadth and depth of their product offering, as well as strong relationships with customers, including hospitals and clinics, group purchasing organizations, physicians, and patients, many who self-administer the home-based therapies supplied by Baxter. Baxter as a whole benefits from efficiencies and cost advantages resulting from shared manufacturing facilities and the technological advantages of its products.

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

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

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similar issues outside of the United States. In Europe and Latin America, for example, the government provides healthcare at low cost to patients, and controls its expenditures by purchasing products through public tenders, collective purchasing, regulating prices, setting reference prices in public tenders or limiting reimbursement or patient access to certain products.

Intellectual Property

Patents and other proprietary rights are essential to Baxter s business. Baxter relies on patents, trademarks, copyrights, trade secrets, know-how and confidentiality agreements to develop, maintain and strengthen its competitive position. Baxter owns a number of patents and trademarks throughout the world and has entered into license arrangements relating to various third-party patents and technologies. Products manufactured by Baxter are sold primarily under its own trademarks and trade names. Some products distributed by the company are sold under the company s trade names, while others are sold under trade names owned by its suppliers or partners. Trade secret protection of unpatented confidential and proprietary information is also important to Baxter. The company maintains certain details about its processes, products and technology as trade secrets and generally requires employees, consultants, and business partners to enter into confidentiality agreements. These agreements may be breached and Baxter may not have adequate remedies for any breach. In addition, Baxter s trade secrets may otherwise become known or be independently discovered by competitors. To the extent that Baxter s employees, consultants, and business partners use intellectual property owned by others in their work for the company, disputes may arise as to the rights in related or resulting know-how and inventions.

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

Baxter operates in an industry susceptible to significant patent litigation. At any given time, the company is involved as either a plaintiff or defendant in a number of patent infringement and other intellectual property-related actions. Such litigation can result in significant royalty or other payments or result in injunctions that can prevent the sale of products. For more information on patent and other litigation, see Note 16 in Item 8 of this Annual Report on Form 10-K.

Research and Development

Baxter s investment in research and development (R&D), consistent with the company s portfolio optimization and capital allocation strategies, helps fuel its future growth and its ability to remain competitive in each of its business segments. Accordingly, Baxter continues to focus its investment on select R&D programs to enhance future growth through clinical differentiation. Expenditures for Baxter s R&D activities were $603 million in 2015, $610 million in 2014 and $582 million in 2013. These expenditures include costs associated with R&D activities performed at the company s R&D centers located around the world, which include facilities in Belgium, Sweden, Italy, Germany, China, Japan and the United States, as well as in-licensing, milestone and reimbursement payments made to partners for R&D work performed at non-Baxter locations.

For more information on the company s R&D activities, refer to the discussion under the caption entitled Strategic Objectives in Item 7 of this Annual Report on Form 10-K.

Quality Management

Baxter s continued success depends upon the quality of its products. Quality management plays an essential role in determining and meeting customer requirements, preventing defects, facilitating continuous improvement of the company s processes, products and services, and assuring the safety and efficacy of the company s products. Baxter has one quality system deployed globally that enables the design, development, manufacturing, packaging, sterilization, handling, distribution and labeling of the company s products to ensure they conform to

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customer requirements. In order to continually improve the effectiveness and efficiency of the quality system, various measurements, monitoring and analysis methods such as management reviews and internal, external and vendor audits are employed at local and central levels.

Each product that Baxter markets is required to meet specific quality standards, both in packaging and in product integrity and quality. If any of those is determined to be compromised at any time, Baxter endeavors to take corrective and preventive actions designed to ensure compliance with regulatory requirements and to meet customer expectations. For more information on corrective actions taken by Baxter, refer to the discussion under the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K.

Government Regulation

The operations of Baxter and many of the products manufactured or sold by the company are subject to extensive regulation by numerous government agencies, both within and outside the United States. The Food and Drug Administration (FDA) in the United States, the European Medicines Agency (EMA) in Europe, the China Food and Drug Administration (CFDA) in China and other government agencies inside and outside of the United States, administer requirements covering the testing, safety, effectiveness, manufacturing, labeling, promotion and advertising, distribution and post-market surveillance of Baxter s products. The company must obtain specific approval from FDA and non-U.S. regulatory authorities before it can market and sell most of its products in a particular country. Even after the company obtains regulatory approval to market a product, the product and the company s manufacturing processes and quality systems are subject to continued review by FDA and other regulatory authorities globally. State agencies in the United States also regulate the facilities, operations, employees, products and services of the company within their respective states. The company and its facilities are subject to periodic inspections and possible administrative and legal actions by FDA and other regulatory agencies inside and outside the United States. Such actions may include warning letters, product recalls or seizures, monetary sanctions, injunctions to halt manufacture and distribution of products, civil or criminal sanctions, refusal of a government to grant approvals or licenses, restrictions on operations or withdrawal of existing approvals and licenses. As situations require, the company takes steps to ensure safety and efficacy of its products, such as removing products found not to meet applicable requirements from the market and improving the effectiveness of quality systems. For more information on compliance actions taken by the company, refer to the discussion under the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K.

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

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

Employees

As of December 31, 2015, Baxter employed approximately 50,000 people.

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Available Information

Baxter makes available free of charge on its website at www.baxter.com its Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), as soon as reasonably practicable after electronically filing or furnishing such material to the Securities and Exchange Commission. In addition, Baxter s Corporate Governance Guidelines, Code of Conduct, and the charters for the committees of Baxter s Board of Directors are available on Baxter s website at www.baxter.com under About us Governance, Ethics & Compliance. All the foregoing materials will be made available to stockholders in print upon request by writing to: Corporate Secretary, Baxter International Inc., One Baxter Parkway, Deerfield, Illinois 60015. Information contained on Baxter s website shall not be deemed incorporated into, or to be a part of, this Annual Report on Form 10-K.

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

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

Risks Related to Baxter s Business

We may not achieve our long-term financial improvement goals.

In connection with the separation and distribution, we announced plans to enhance profitability and returns for our stockholders. These plans include the achievement of certain financial goals (including improved operating margin) in 2016 and beyond. While we are continuing to refine these goals, our plan contemplates significant margin expansion over our long-range plan, which covers the time period from 2015 through 2020. We have identified certain key strategies to help achieve these targets. These strategies include optimizing our core product portfolio globally, driving operational excellence through the rebasing of our cost structure and maximizing the value derived from the allocation of our capital.

As part of these strategies, we continue to evaluate the performance of all of our businesses and may sell or acquire a business or product line or exit a particular market. We are also evaluating our corporate and commercial infrastructure in the interest of streamlining costs while maintaining our commitment to quality and safety. Future divestitures may result in significant write-offs, including those related to goodwill and other intangible assets. Future acquisitions may fail to achieve the desired financial results (including return on investment) and synergies and may not provide the desired market access. The restructuring of our operations may not generate targeted savings or may cause unexpected disruptions to our business. As a result, we may not achieve our targeted financial results, which could have a material adverse effect on our business, financial condition or results of operations.

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

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

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

Our success depends upon the availability and quality of our products. The medical products industry is competitive and subject to complex market dynamics and varying demand levels. These levels vary in response to macro-economic conditions, regulatory requirements (including the availability of private or public reimbursement) and seasonality. Additionally the development of new or enhanced products involves a lengthy regulatory process and is capital intensive. As a result, our ability to match our production levels and capacity to market demand is imprecise and may result in a failure to meet market demand or satisfy customer requirements for our products or, alternatively, an oversupply of inventory. Failure to meet market demand may result in customers transitioning to available competitive products resulting in a loss of market share or customer confidence. In the event of an oversupply, we may be forced to lower our prices or record asset impairment charges or take other action which may adversely affect our business, financial condition and results of operations.

Additionally, quality management plays an essential role in determining and meeting customer requirements, preventing defects, improving the company s products and services and assuring the safety and efficacy of our products. Our future success depends on our ability to maintain and continuously improve our quality management program. While we have one quality system deployed globally that covers the lifecycle of our products, quality and safety issues may occur with respect to any of our products. A quality or safety issue may result in adverse inspection reports, warning letters, product recalls (either voluntary or required by the FDA or similar governmental authorities in other countries) or seizures, monetary sanctions, injunctions to halt manufacture and distribution of products, civil or criminal sanctions, costly litigation, refusal of a government to grant approvals and licenses, restrictions on operations or withdrawal of existing approvals and licenses. An inability to address a quality or safety issue in an effective and timely manner may also cause negative publicity, a loss of customer confidence in us or our current or future products, which may result in the loss of sales and difficulty in successfully launching new products. Additionally, Baxter has made and continues to make significant investments in assets, including inventory and property, plant and equipment, which relate to potential new products or modifications to existing products. Product quality or safety issues may restrict the company from being able to realize the expected returns from these investments, potentially resulting in asset impairments in the future.

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

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

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

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

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The manufacture, distribution, marketing and use of our products are subject to extensive regulation and scrutiny by FDA and other regulatory authorities globally. Any new product must undergo lengthy and rigorous testing and other extensive, costly and time-consuming procedures mandated by FDA and foreign regulatory authorities. Changes to current products may be subject to vigorous review, including additional 510(k) and other regulatory submissions, and approvals are not certain. Our facilities must be approved and licensed prior to production and remain subject to inspection from time to time thereafter. Failure to comply with the requirements of FDA or other regulatory authorities, including a failed inspection or a failure in our adverse event reporting system, could result in adverse inspection reports, warning letters, product recalls or seizures, monetary sanctions, injunctions to halt the manufacture and distribution of products, civil or criminal sanctions, refusal of a government to grant approvals or licenses, restrictions on operations or withdrawal of existing approvals and licenses. Any of these actions could cause a loss of customer confidence in us and our products, which could adversely affect our sales. The requirements of regulatory authorities, including interpretative guidance, are subject to change and compliance with additional or changing requirements or interpretative guidance may subject the company to further review, result in product launch delays or otherwise increase our costs. For information on current regulatory issues affecting us, please refer to the caption entitled Certain Regulatory Matters in Item 7 of this Annual Report on Form 10-K. In connection with these issues, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, that sales of other products may not be adversely affected, or that additional regulation will not be introduced that may adversely affect the company s operations and consolidated financial statements.

The sales, marketing and pricing of products and relationships that pharmaceutical and medical device companies have with healthcare providers are under increased scrutiny by federal, state and foreign government agencies. Compliance with the Anti-Kickback Statute, False Claims Act, Food, Drug and Cosmetic Act (including as these laws relate to off-label promotion of products) and other healthcare related laws, as well as competition, data and patient privacy and export and import laws, is under increased focus by the agencies charged with overseeing such activities, including FDA, OIG, DOJ and the Federal Trade Commission. The DOJ and the Securities and Exchange Commission have also increased their focus on the enforcement of the U.S. Foreign Corrupt Practices Act (FCPA), particularly as it relates to the conduct of pharmaceutical companies. The FCPA and similar anti-bribery laws generally prohibit companies and their employees, contractors or agents from making improper payments to government officials for the purpose of obtaining or retaining business. Healthcare professionals in many countries are employed by the government and consequently may be considered government officials. Foreign governments have also increased their scrutiny of pharmaceutical and medical device companies sales and marketing activities and relationships with healthcare providers and competitive practices generally. The laws and standards governing the promotion, sale and reimbursement of our products and those governing our relationships with healthcare providers and governments, including the Sunshine Act enacted under the Patient Protection and Affordable Care Act, can be complicated, are subject to frequent change and may be violated unknowingly. We have compliance programs in place, including policies, training and various forms of monitoring, designed to address these risks. Nonetheless, these programs and policies may not always protect us from conduct by individual employees that violate these laws. Violations or allegations of violations of these laws may result in large civil and criminal penalties, debarment from participating in government programs, diversion of management time, attention and resources and may otherwise have an adverse effect on our business, financial condition and results of operations. For more information related to the company s ongoing government investigations, please refer to Note 16 in Item 8 of this Annual Report on Form 10-K.

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

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If reimbursement or other payment for our current or future products is reduced or modified in the United States or abroad, including through the implementation of government-sponsored healthcare reform or other similar actions, cost containment measures, or changes to policies with respect to pricing, taxation or rebates, then our business could suffer.

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

Global efforts toward healthcare cost containment continue to exert pressure on product pricing. Governments around the world use various mechanisms to control healthcare expenditures such as price controls, the formation of public contracting authorities, product formularies (lists of recommended or approved products), and competitive tenders which require the submission of a bid to sell products. Sales of our products are dependent, in part, on the availability of reimbursement by government agencies and healthcare programs, as well as insurance companies and other private payors. In much of Europe, Latin America, Asia and Australia, for example, the government provides healthcare at low cost to patients, and controls its expenditures by purchasing products through public tenders, collective purchasing, regulating prices, setting reference prices in public tenders or limiting reimbursement or patient access to certain products. Additionally, austerity measures or other reforms by foreign governments may limit, reduce or eliminate payments for our products and adversely affect both pricing flexibility and demand for our products.

For example, in the United States the Patient Protection and Affordable Care Act (PPACA), which was signed into law in March 2010, includes several provisions which impact our businesses in the United States, including increased Medicaid rebates and an expansion of the 340B Drug Pricing Program which provides certain qualified entities, such as hospitals serving disadvantaged populations, with discounts on the purchase of drugs for outpatient use and an excise tax on the sale of certain drugs. We may also experience downward pricing pressure as the PPACA reduces Medicare and Medicaid payments to hospitals and other providers. While it is intended to expand health insurance coverage and increase access to medical care generally, the long-term impact of the PPACA on our business and the demand for our products is uncertain.

As a result of these and other measures, including future measures or reforms that cannot be predicted, reimbursement may not be available or sufficient to allow us to sell our products on a competitive basis. Legislation and regulations affecting reimbursement for our products may change at any time and in ways that may be adverse to us. We cannot predict the impact of these pressures and initiatives, or any negative effects of any additional regulations that may affect our business.

There is substantial competition in the product markets in which we operate.

Although no single company competes with us in all of our businesses, we face substantial competition in both of our segments from international and domestic healthcare and pharmaceutical companies and providers of all sizes. Competition is primarily focused on cost-effectiveness, price, service, product performance, and technological innovation.

Competition may increase further as additional companies begin to enter our markets or modify their existing products to compete directly with ours. If our competitors respond more quickly to new or emerging technologies and changes in customer requirements or we do not introduce new versions or upgrades to our product portfolio in response to those requirements, our products may be rendered obsolete or non-competitive. If our competitors develop more effective or affordable products, or achieve earlier patent protection or product commercialization than we do, our operations will likely be negatively affected. If we are forced to reduce our prices due to

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increased competition, our business could become less profitable. The company s sales could be adversely affected if any of its contracts with GPOs, IDNs or other customers are terminated due to increased competition or otherwise.

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

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

For more information on recent business development activities, see Note 5 in Item 8 of this Annual Report on Form 10-K.

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

The manufacture of our products requires the timely delivery of sufficient amounts of quality components and materials. We manufacture our products in approximately 50 manufacturing facilities around the world. We acquire our components and materials from many suppliers in various countries. We work closely with our suppliers to ensure the continuity of supply but we cannot guarantee these efforts will always be successful. Further, while efforts are made to diversify our sources of components and materials, in certain instances we acquire components and materials from a sole supplier. For most of our components and materials for which a sole supplier is used, we believe that alternative sources of supply exist and have made a strategic determination to use a sole supplier. In very limited instances, however, we do rely upon sole supplier relationships for which no alternatives have currently been identified. Although we do carry strategic inventory and maintain insurance to mitigate the potential risk related to any related supply disruption, there can be no assurance that such measures will be effective. Due to the regulatory environment in which we operate, we may be unable to quickly establish additional or replacement sources for some components or materials. A reduction or interruption in supply, and an inability to develop alternative sources for such supply, could adversely affect our ability to manufacture our products in a timely or cost-effective manner, and our ability to make product sales.

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

Several of our products are manufactured at a single manufacturing facility or stored at a single storage site. Loss or damage to a manufacturing facility or storage site due to a natural disaster or otherwise could adversely affect

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

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

Patent and other proprietary rights are essential to our business. Our success depends to a significant degree on our ability to obtain and enforce patents and licenses to patent rights, both in the United States and in other countries. We cannot guarantee that pending patent applications will result in issued patents, that patents issued or licensed will not be challenged or circumvented by competitors, that our patents will not be found to be invalid or that the intellectual property rights of others will not prevent the company from selling certain products or including key features in the company s products.

The patent position of a healthcare company is often uncertain and involves complex legal and factual questions. Significant litigation concerning patents and products is pervasive in our industry. Patent claims include challenges to the coverage and validity of our patents on products or processes as well as allegations that our products infringe patents held by competitors or other third parties. A loss in any of these types of cases could result in a loss of patent protection or the ability to market products, which could lead to a significant loss of sales, or otherwise materially affect future results of operations. We also rely on trademarks, copyrights, trade secrets and know-how to develop, maintain and strengthen our competitive positions. Third parties may know, discover or independently develop equivalent proprietary information or techniques, or they may gain access to our trade secrets or disclose our trade secrets to the public.

Although our employees, consultants, parties to collaboration agreements and other business partners are generally subject to confidentiality or similar agreements to protect our confidential and proprietary information, these agreements may be breached, and we may not have adequate remedies for any breach. To the extent that our employees, consultants, parties to collaboration agreements and other business partners use intellectual property owned by others in their work for us, disputes may arise as to the rights in related or resulting know-how and inventions.

Furthermore, our intellectual property, other proprietary technology and other sensitive company data is potentially vulnerable to loss, damage or misappropriation from system malfunction, computer viruses, unauthorized access to our data or misappropriation or misuse thereof by those with permitted access and other events. While we have invested to protect our intellectual property and other data, and continue to work diligently in this area, there can be no assurance that our precautionary measures will prevent breakdowns, breaches, cyber incidents or other events. Such events could have a material adverse effect on our reputation, business, financial condition or results of operations.

Misappropriation or other loss of our intellectual property from any of the foregoing would have an adverse effect on our competitive position and may cause us to incur substantial litigation costs.

We are subject to risks associated with doing business globally.

Our operations are subject to risks inherent in conducting business globally and under the laws, regulations and customs of various jurisdictions and geographies. These risks include changes in exchange controls and other governmental actions, loss of business in government and public tenders that are held annually in many cases, increasingly complex labor environments, availability of raw materials, changes in taxation, export control restrictions, changes in or violations of U.S. or local laws, including the FCPA and the United Kingdom Bribery

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Act, dependence on a few government entities as customers, pricing restrictions, economic and political instability (including instability as it relates to the Euro and currencies in certain emerging market countries), disputes between countries, diminished or insufficient protection of intellectual property, and disruption or destruction of operations in a significant geographic region regardless of cause, including war, terrorism, riot, civil insurrection or social unrest. Failure to comply with, or material changes to, the laws and regulations that affect our global operations could have an adverse effect on our business, financial condition or results of operations.

Changes in foreign currency exchange rates and interest rates could have a material adverse effect on our operating results and liquidity.

We generate the majority of our revenue and profit outside the United States. As a result, our financial results may be adversely affected by fluctuations in foreign currency exchange rates. We cannot predict with any certainty changes in foreign currency exchange rates or our ability to mitigate these risks. We may experience additional volatility as a result of inflationary pressures and other macroeconomic factors in certain emerging market countries. We are also exposed to changes in interest rates, and our ability to access the money markets and capital markets could be impeded if adverse liquidity market conditions occur. A discussion of the financial impact of foreign exchange rate and interest rate fluctuations, and the ways and extent to which we attempt to mitigate such impact is contained under the caption Financial Instrument Market Risk in Item 7 of this Annual Report on Form 10-K.

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

Tax policy reform continues to be a topic of discussion in the United States. A significant change to the tax system in the United States, including changes to the taxation of international income, could have an adverse effect upon our results of operations. Because we operate in multiple income tax jurisdictions both inside and outside the United States, we are subject to tax audits in various jurisdictions. Tax authorities may disagree with certain positions we have taken and assess additional taxes. We regularly assess the likely outcomes of these audits in order to determine the appropriateness of our tax provision. However, we may not accurately predict the outcome of these audits, and as a result the actual outcome of these audits may have an adverse impact on our financial results. For more information on ongoing audits, see Note 15 in Item 8 of this Annual Report on Form 10-K.

We are increasingly dependent on information technology systems and subject to privacy and security laws, and our systems and infrastructure face certain risks, including from cyber security breaches and data leakage.

We increasingly rely upon technology systems and infrastructure. Our technology systems are potentially vulnerable to breakdown or other interruption by fire, power loss, system malfunction, unauthorized access and other events. Likewise, data privacy breaches by employees and others with both permitted and unauthorized access to our systems may pose a risk that sensitive data (including protected health information (PHI)) may be exposed to unauthorized persons or to the public, or may be permanently lost. The increasing use and evolution of technology, including cloud-based computing, creates additional opportunities for the unintentional dissemination of information, intentional destruction of confidential information stored in our systems or in non-encrypted portable media or storage devices. We could also experience a business interruption, information theft of confidential information, or reputational damage from industrial espionage attacks, malware or other cyber incidents, which may compromise our system infrastructure or lead to data leakage, either internally or at our third-party providers or other business partners. Additionally, we must comply with numerous federal and state laws and regulations governing the collection, dissemination, access, use, security and PHI, including The Health Insurance Portability and Accountability Act of 1996 and its implementing privacy and security regulations. While we have invested heavily in the protection of data and information technology and in related training, there

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can be no assurance that our efforts will prevent significant breakdowns, breaches in our systems or other cyber incidents or ensure compliance with all applicable security and privacy laws, regulations and standards, including with respect to third-party service providers that utilize sensitive personal information, including PHI, on our behalf. Any such breakdown, breach, incident or failure to comply could have a material adverse effect upon our reputation, business, operations or financial condition. In addition, significant implementation issues may arise as we continue to consolidate and outsource certain computer operations and application support activities.

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

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

We are subject to a number of pending lawsuits.

We are a defendant in a number of pending lawsuits. In addition, we may be named as a defendant in future patent, product liability or other lawsuits. These current and future matters may result in a loss of patent protection, reduced revenue, significant liabilities and diversion of our management s time, attention and resources. Given the uncertain nature of litigation generally, we are not able in all cases to estimate the amount or range of loss that could result from an unfavorable outcome in these current matters. In view of these uncertainties, the outcome of these matters may result in charges in excess of any established reserves, and, to the extent available, liability insurance. We also continue to be self-insured with respect to product liability claims. The absence of third-party insurance coverage for current or future claims increases our potential exposure to unanticipated claims and adverse decisions. Protracted litigation, including any adverse outcomes, may have an adverse impact on the business, operations or financial condition of the company. Even claims without merit could subject us to adverse publicity and require us to incur significant legal fees. See Note 16 in Item 8 of this Annual Report on Form 10-K for more information regarding current lawsuits.

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

The company s ability to generate cash flows from operations could be affected if there is a material decline in the demand for the company s products, in the solvency of its customers or suppliers, or deterioration in the company s key financial ratios or credit ratings. Current or worsening economic conditions may adversely affect the ability of our customers (including governments) to pay for our products and services, and the amount spent on healthcare generally. This could result in a decrease in the demand for our products and services, declining cash flows, longer sales cycles, slower adoption of new technologies and increased price competition. These conditions may also adversely affect certain of our suppliers, which could cause a disruption in our ability to produce our products. We continue to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, which have experienced deterioration in credit and economic conditions. As of December 31, 2015, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $211 million. While global economic conditions have not significantly impacted the company s ability to collect receivables, liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses. These conditions may also impact the stability of the Euro or Yuan. For more information on accounts receivable and credit matters with respect to certain of these countries, refer to the discussion under the caption entitled Credit Facilities, Access to Capital and Credit Ratings in Item 7 of this Annual Report on Form 10-K.

We may incur operational difficulties or be exposed to claims and liabilities as a result of the separation and distribution.

On July 1, 2015, we distributed approximately 80.5% of the outstanding shares of Baxalta common stock to Baxter stockholders in connection with the separation of our biopharmaceuticals business. After giving effect to the

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distribution we retained approximately 19.5% of the outstanding Baxalta shares (the Retained Shares). In connection with the distribution, we entered into a separation and distribution agreement and various other agreements (including a transition services agreement, a tax matters agreement, a long term services agreement, a manufacturing and supply agreement, an employee matters agreement, a trademark license agreement, a Galaxy license agreement, an international commercial operations agreement, a shareholders and registration rights agreement and certain other commercial agreements). These agreements govern the separation and distribution and the relationship between the two companies going forward, including with respect to potential tax-related losses associated with the separation and distribution and certain dispositions of the Retained Shares. They also provide for the performance of services by each company for the benefit of the other for a period of time (including under the manufacturing and supply agreement pursuant to which Baxalta manufactures and sells certain products and materials to us).

In connection with Baxalta s entry into a merger agreement with Shire plc (Shire) on January 11, 2016, we entered into a letter agreement with Shire and Baxalta (the Letter Agreement). The Letter Agreement, as further described below, addresses certain matters related to the tax matters agreement and provides us with enhanced transaction support with respect to certain debt-for-equity and/or equity-for-equity exchanges involving the Retained Shares (the Retained Shares Transactions). See *There could be significant liability if the separation and distribution or any Later Distribution is determined to be a taxable transaction. Baxalta has indemnified us for certain potential liabilities that may arise, and such indemnification obligation is guaranteed by Shire with respect to the proposed combination of Baxalta and Shire, but Baxalta and Shire may be unable to satisfy their indemnification obligations to us in the future* for a more detailed discussion of the Letter Agreement.

The separation and distribution agreement provides for indemnification obligations designed to make Baxalta financially responsible for many liabilities that may exist relating to its business activities, whether incurred prior to or after the distribution, including any pending or future litigation. It is possible that a court would disregard the allocation agreed to between us and Baxalta and require us to assume responsibility for obligations allocated to Baxalta. Third parties could also seek to hold us responsible for any of these liabilities or obligations, and the indemnity rights we have under the separation and distribution agreement may not be sufficient to fully cover all of these liabilities and obligations. Even if we are successful in obtaining indemnification, we may have to bear costs temporarily. In addition, our indemnity obligations to Baxalta may be significant. These risks could negatively affect our business, financial condition or results of operations.

The separation of Baxalta continues to involve a number of risks, including, among other things, the indemnification risks described above and the potential that management s and our employees attention will be significantly diverted by the provision of transitional services. Certain of the agreements described above provide for the performance of services by each company for the benefit of the other for a period of time. If Baxalta is unable to satisfy its obligations under these agreements, including its indemnification obligations, we could incur losses. These arrangements could also lead to disputes over rights to certain shared property and rights and over the allocation of costs and revenues for products and operations. Our inability to effectively manage the separation activities and related events could adversely affect our business, financial condition or results of operations.

We may not achieve some or all of the expected benefits of the separation and distribution, and such events may adversely affect our business.

We may not be able to achieve the full strategic and financial benefits expected to result from the separation and distribution, or such benefits may be delayed or not occur at all. Although the separation of Baxalta is expected to provide a number of benefits, including, among others, enabling management to better focus on our medical products business, providing the ability to more effectively commercialize new and existing product offerings, drive innovation across our Hospital Products and Renal businesses and allocate necessary resources to the areas presenting the highest growth potential and providing flexibility to pursue growth and investment strategies that could result in revenue acceleration, improved profitability and enhanced returns, if we fail to achieve some or all

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of the expected benefits of the separation, or if such benefits are delayed, our business, financial condition and results of operations could be adversely affected and the value of our stock could be adversely impacted. See Risks Associated with Our Business *We may not achieve our long-term financial improvement goals* for additional information on risks associated with our post-separation strategies.

We may not be able to capture the full benefits from our retained stake in Baxalta.

As of January 31, 2016, we owned approximately 94.3 million Baxalta shares after giving effect to a Retained Shares Transaction, as described above. As with any investment in a publicly traded company, this investment is subject to risks and uncertainties relating to Baxalta s business, some of which are disclosed in Baxalta s filings with the SEC (including with respect to the proposed combination of Baxalta and Shire) and risks and uncertainties relating to fluctuations in public equity markets generally.

In addition, under the shareholders and registration rights agreement, we committed to vote all of the Retained Shares in proportion to the votes cast by Baxalta s other stockholders. Although we have entered into the Letter Agreement, such commitment could adversely impact our ability to exert influence (that we may otherwise have) over Baxalta to act in a manner that we may believe best for protecting or enhancing the value of our investment.

Additionally, any disposition of the Retained Shares by us in the public market, or the perception that such dispositions could occur, could adversely affect prevailing market prices for Baxalta shares and thereby adversely affect the value of the Retained Shares disposed of by us in any Retained Shares Transaction or adversely affect the terms and conditions of such disposition.

There could be significant liability if the separation and distribution or subsequent distribution of Retained Shares is determined to be a taxable transaction. Baxalta has indemnified us for certain potential liabilities that may arise, and such indemnification obligation is guaranteed by Shire with respect to the proposed combination of Baxalta and Shire, but Baxalta and Shire may be unable to satisfy their indemnification obligations to us in the future.

The separation and distribution, the Retained Shares Transactions and certain other uses of the Retained Shares, including a contribution to our U.S. qualified pension plan or dividend to our stockholders (collectively, the Baxter Transactions), are intended to qualify for tax-free treatment to Baxter and its stockholders under the Internal Revenue Code of 1986, as amended (the Code). Completion of the separation and distribution was conditioned upon, among other things, the receipt of a private letter ruling from the IRS regarding certain issues relating to the tax-free treatment of the Baxter Transactions. Although the IRS private letter ruling is generally binding on the IRS, the continuing validity of such ruling is subject to the accuracy of factual representations and assumptions made in the ruling. Completion of the distribution was also conditioned upon Baxter s receipt of a tax opinion from KPMG LLP regarding certain aspects of the Baxalta spin-off not covered by the IRS private letter ruling. The opinion was based upon various factual representations and assumptions, as well as certain undertakings made by Baxter and Baxalta. If any of the factual representations or assumptions in the IRS private letter ruling or tax opinion is untrue or incomplete in any material respect, if any undertaking is not complied with, or if the facts upon which the IRS private letter ruling or tax opinion are based are materially different from the actual facts relating to the Baxter Transactions, the opinion or IRS private letter ruling may not be valid. Moreover, opinions of a tax advisor are not binding on the IRS. As a result, the conclusions expressed in the opinion of a tax advisor could be successfully challenged by the IRS.

If the Baxter Transactions are determined to be taxable, Baxter and its stockholders could incur significant tax liabilities. Pursuant to the tax matters agreement, Baxalta agreed to indemnify us for certain tax-related losses incurred if Baxalta s actions cause the separation and distribution and certain related transactions to fail to qualify for tax-free status under the applicable provisions of the Code.

In connection with the proposed Baxalta Shire merger, we entered into the Letter Agreement with Shire and Baxalta (as described above). Under the Letter Agreement, from and after the closing of the merger, Baxalta

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agreed to indemnify, and Shire agreed to guarantee such indemnity to, Baxter and each of its affiliates and each of their respective officers, directors and employees against certain tax-related losses attributable to or resulting from (in whole or in part) the merger as further described in the Letter Agreement. If the Baxter Transactions are determined to be taxable as a result (in whole or in part) of the merger (for example, if the merger is deemed to be part of a plan (or series of related transactions) that includes the Baxter Transactions), Baxter and its stockholders could incur significant tax liabilities. Although Baxalta and Shire may be required to indemnify Baxter under the tax matters agreement and the Letter Agreement for any such tax liabilities incurred by Baxter, there can be no assurance that the indemnity from Baxalta or the guarantee thereof by Shire will be sufficient to protect us against all or a part of the amount of such liabilities, or that either Baxalta or Shire will be able to fully satisfy their respective obligations.

Even if we ultimately succeed in recovering from Baxalta or Shire any amounts for which we are held liable, we may be temporarily required to bear these costs ourselves, which could negatively affect our business, results of operations and financial condition.

Item 1B. ***Unresolved Staff Comments.***

None.

Item 2. ***Properties.***

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

Baxter owns or has long-term leases on all of its manufacturing facilities. The company s principal manufacturing facilities by segment are listed below:

Business	Location	Owned/Leased
Hospital Products		
	Lessines, Belgium	Owned
	Shanghai, China	Owned
	Cartago, Costa Rica	Owned
	Haina, Dominican Republic	Leased
	Halle, Germany	Owned
	Guayama, Puerto Rico	Owned
	Jayuya, Puerto Rico	Leased
	Aibonito, Puerto Rico	Leased
	Sabinanigo, Spain	Owned
	San Vittore, Switzerland	Owned
	Thetford, United Kingdom	Owned
	Round Lake, Illinois	Owned
	Bloomington, Indiana	Owned/Leased[(1)]
	Brooklyn Park, Minnesota	Leased
	Cleveland, Mississippi	Leased
	Medina, New York	Leased
	Hayward, California	Leased
Renal		
	Guangzhou, China	Owned
	Shanghai, China	Owned
	Prerov, Czech Republic	Leased
	Meyzieu, France	Owned
	Hechingen, Germany	Leased
	Joka, Germany	Owned

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Business	Location	Owned/Leased
Renal	Rostock, Germany	Leased
	Medolla, Italy	Owned
	Sondalo, Italy	Owned
	Miyazaki, Japan	Owned
	Tijuana, Mexico	Owned
	Lund, Sweden	Leased
	Opelika, Alabama	Owned
Shared (Hospital Products and Renal)		
	Toongabbie, Australia	Owned
	Sao Paulo, Brazil	Owned
	Alliston, Canada	Owned
	Suzhou, China	Owned
	Cali, Colombia	Owned
	Castlebar, Ireland	Owned
	Swinford, Ireland	Owned
	Grosotta, Italy	Owned
	Lublin, Poland	Leased/Owned
	Marsa, Malta	Owned
	Cuernavaca, Mexico	Owned
	PESA, Mexico	Owned
	Woodlands, Singapore	Owned/Leased
	Liverpool, United Kingdom	Owned
	Mountain Home, Arkansas	Owned/Leased
	Englewood, Colorado	Leased
	North Cove, North Carolina	Owned

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

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

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

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

Incorporated by reference to Note 16 in Item 8 of this Annual Report on Form 10-K.

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

Not Applicable.

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Executive Officers of the Registrant

As of February 26, 2016, the following serve as Baxter s executive officers:

Mr. José E. Almeida, age 53, is Chairman and Chief Executive Officer, having served in that capacity since January 2016. Between October 2015 and January 2016, Mr. Almeida served as an executive officer of the company. Previously, he served as an operating executive to the Carlye Group L.P. from May 2015 until October 2015. Previously, he served as the Chairman, President and Chief Executive Officer of Covidien plc (Covidien) from March 2012 to January 2015, prior to Medtronic Inc. s acquisition of Covidien, and President and Chief Executive Officer of Covidien from July 2011 to March 2012. Mr. Almeida served in other executive roles with Covidien (formerly Tyco Healthcare) between April 2004 and June 2011.

Brik V. Eyre, age 52, is Corporate Vice President and President, Hospital Products. Mr. Eyre joined the company in 2008 as general manager for BioPharma Solutions, our manufacturing and contract services business. He later served as general manager for our U.S. medication delivery business and most recently he was Corporate Vice President and President, Renal. Prior to joining Baxter, he held a variety of senior management positions at Cardinal Health, Inc., including president of Cardinal s PreSource Products and Services business.

Robert Felicelli, age 57, is Corporate Vice President, Quality. Mr. Felicelli joined the company in 2009 and has held several positions of increasing responsibility. He previously served as Vice President, Quality, in BioPharma Solutions, Baxter s global manufacturing and contract services business. Prior to that, he served as Vice President of Lifecycle Management in Renal.

Timothy P. Lawrence, age 53, is Corporate Vice President, Operations. Most recently he served as Vice President of manufacturing and supply chain. Mr. Lawrence joined the company in 2001 as the Director of Operations at one of our former BioScience manufacturing facilities. In 2003, he was named plant manager for one of our manufacturing facilities and in 2006 assumed the role of Vice President of Manufacturing, Renal. In 2008, Mr. Lawrence was appointed Vice President of Manufacturing for our Medication Delivery business. Mr. Lawrence currently serves as President of the Baxter International Foundation.

Jeanne K. Mason, *Ph.D.,* age 60, is Corporate Vice President, Human Resources. Prior to joining Baxter in May 2006, Dr. Mason was with General Electric from 1988, holding various leadership positions, the most recent of which was with GE Insurance Solutions where she was responsible for global human resource functions.

James K. Saccaro, age 43, is Corporate Vice President and Chief Financial Officer and has served in that capacity since June 2015. Mr. Saccaro was Senior Vice President and Chief Financial Officer at Hill-Rom Corporation from December 2013 to July 2014 prior to rejoining Baxter in July 2014 as Special Advisor to the Chief Executive Officer. Prior to that, Mr. Saccaro served as Corporate Vice President and Treasurer of Baxter from 2011 to 2013. He originally joined the company in 2002 as manager of strategy for the company s former BioScience business, and from there moved onto positions of increasing responsibility, including Vice President of Financial Planning and Vice President of Finance for the company s operations in Europe, Middle East and Africa. Prior to Baxter, he held strategy and business development positions at Clear Channel Communications and the Walt Disney Company.

Jill M. Schaaf, age 52, is Corporate Vice President and President, Renal. Most recently Ms. Schaaf was global franchise head for our chronic renal franchise. She joined the company in 2001 and has held several positions including Vice President of Home Therapies, Marketing, Vice President of Home Hemodialysis and general manager of the U.S. Renal business. Prior to joining Baxter, she served in a variety of global and U.S. marketing roles at Searle Medical Products.

Marcus Schabacker, M.D., Ph.D., age 52, is Corporate Vice President and Chief Scientific Officer. Dr. Schabacker joined the company in 2011. Prior to his current role, Dr. Schabacker served as Vice President, R&D, Medical Products. Dr. Schabacker held the position of Senior Vice President and Chief Scientific Officer at ConvaTec, Inc. before joining the company. His previous roles include Corporate Vice President R&D at B. Braun Medical and Senior Medical Officer at Mafikeng General Hospital, South Africa.

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David P. Scharf, age 48, is Corporate Vice President and General Counsel, having served in this capacity since August 2009. Mr. Scharf has also served as Corporate Secretary from September 2013. Mr. Scharf joined Baxter in July 2005 and served in advancing leadership roles within the legal department. Prior to joining Baxter, Mr. Scharf was with Guidant Corporation from 2002, in roles of increasing responsibility.

Paul Vibert, age 56, is Corporate Vice President and President, International. Mr. Vibert joined the company in January 2008 as Vice President of Business Development for Asia Pacific. He also served as regional general manager for China and Hong Kong for two years before moving to Ferring Pharmaceuticals, as Senior Vice President, Asia Pacific, from May 2011 to May 2013. He returned to Baxter in May 2013 as President of Western Europe, and assumed his current role in January 2015. Prior to joining Baxter in 2008, Vibert spent 19 years with Abbott Laboratories, where he held various leadership positions.

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

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PART II

Item 5. ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.***

On July 25, 2012, the company announced that its Board of Directors authorized the company to repurchase up to $2.0 billion of its common stock on the open market or in private transactions. The company did not repurchase any shares during 2015. The remaining authorization under this program totaled approximately $0.5 billion at December 31, 2015. This program does not have an expiration date.

Additional information required by this item is incorporated by reference to Note 18 in Item 8 of this Annual Report on Form 10-K.

Performance Graph

The following graph compares the change in Baxter s cumulative total shareholder return (including reinvested dividends) on Baxter s common stock with the Standard & Poor s 500 Composite Index and the Standard & Poor s 500 Health Care Index over the past five years. Performance through June 30, 2015 has been adjusted for the Baxalta separation which occurred on July 1, 2015.

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

See Note 1 of Item 8 for additional details regarding basis of presentation.

as of or for the years ended December 31		**2015[2,1]**	2014[3,1]	2013[4,1]	2012[5,1]	2011[6,1]
Operating Results	Net sales	**$ 9,968**	10,719	9,413	8,626	8,421
(in millions)	Income from continuing operations	**$ 393**	457	315	663	434
	Income from discontinued operations, net of tax	**$ 575**	2,040	1,697	1,663	1,790
	Net income[7]	**$ 968**	2,497	2,012	2,326	2,224
Balance Sheet	Capital expenditures, continuing operations	**$ 911**	925	706	622	629
Information	Total assets	**$ 20,975**	26,138	25,224	20,390	19,073
(in millions)	Long-term debt and lease obligations	**$ 3,935**	7,331	8,126	5,580	4,749
Common Stock Information	Weighted-average number of common shares outstanding					
	Basic	**545**	542	543	551	569
	Diluted	**549**	547	549	556	573
	Income from continuing operations per common share					
	Basic	**$ 0.72**	0.84	0.58	1.20	0.76
	Diluted	**$ 0.72**	0.83	0.57	1.19	0.76
	Income from discontinued operations per common share					
	Basic	**$ 1.06**	3.77	3.12	3.02	3.15
	Diluted	**$ 1.04**	3.73	3.09	2.99	3.12
	Net income per common share					
	Basic	**$ 1.78**	4.61	3.70	4.22	3.91
	Diluted	**$ 1.76**	4.56	3.66	4.18	3.88
	Cash dividends declared per common share	**$ 1.270**	2.050	1.920	1.570	1.265

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

[2] Income from continuing operations included charges totaling $127 million for business optimization, $73 million related to the integration of Gambro AB (Gambro), $111 million related to the Baxalta separation and $130 million related to Baxter s July 2015 tender offer for certain outstanding indebtedness. Also included were benefits of $28 million primarily related to adjustments to the COLLEAGUE and SIGMA SPECTRUM infusion pump reserves, $52 million related to a litigation settlement in which Baxter was the beneficiary and $20 million relating to the reversal of contingent consideration milestone liabilities.

[3] Income from continuing operations included charges totaling $68 million for SIGMA Spectrum Infusion Pump product remediation efforts, $144 million related to the integration of Gambro, $11 million related to the Baxalta separation and $3 million to account for an additional year of the Branded Prescription Drug Fee in accordance with final regulations issued by the Internal Revenue Service. Also included were benefits of $13 million for business optimization and $1 million related to third-party recoveries and reversals of prior reserves.

[4] Income from continuing operations included charges totaling $148 million for business optimization, $17 million primarily related to remediation efforts associated with modifications to the SIGMA Spectrum Infusion Pump in conjunction with re-filing for 510(k) clearance, $255 million related to the acquisition and integration of Gambro and losses from the derivative instruments used to hedge the anticipated foreign currency cash outflows and $25 million related to an upfront payment associated with one of the company s collaboration arrangements. Also included were benefits of $3 million related to tax and legal reserves associated with VAT matters in Turkey.

[5] Income from continuing operations included charges totaling $106 million for business optimization, $15 million primarily related to business development, and $170 million primarily related to pension settlement charges and other pension-related items. Also included were benefits of $23 million primarily related to an adjustment to the COLLEAGUE infusion pump reserve when the company substantially completed its recall activities in the United States and $91 million for gains related to a decrease in the estimated fair value of acquisition-related contingent payment liabilities.

[6] Income from continuing operations included charges totaling $156 million for business optimization, $36 million related to litigation and certain historical rebate and discount adjustments and $103 million primarily related to the write-down of Greek government bonds and a contribution to the Baxter International Foundation.

[7] Excludes net income attributable to noncontrolling interests of $32 million in 2011.

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

The following commentary should be read in conjunction with the consolidated financial statements and accompanying notes.

EXECUTIVE OVERVIEW

Description of the Company and Business Segments

Baxter International Inc., through its subsidiaries, provides a broad portfolio of essential renal and hospital products, including home, acute and in-center dialysis; sterile IV solutions; infusion systems and devices; parenteral nutrition; biosurgery products and anesthetics; and pharmacy automation, software and services. The company s global footprint and the critical nature of its products and services play a key role in expanding access to healthcare in emerging and developed countries. These products are used by hospitals, kidney dialysis centers, nursing homes, rehabilitation centers, doctors offices and by patients at home under physician supervision.

Separation of Baxalta Incorporated

On July 1, 2015, Baxter completed the distribution of approximately 80.5% of the outstanding common stock of its biopharmaceuticals business, Baxalta Incorporated (Baxalta), to Baxter stockholders (the Distribution). As a result of the separation, the operating results of Baxalta have been reflected as discontinued operations for the years ended December 31, 2015, 2014 and 2013. Refer to Note 2 in Item 8 for additional information regarding the separation of Baxalta. Unless otherwise stated, financial results herein reflect continuing operations.

Change in Segments

As a result of the separation of Baxalta, Baxter has further realigned its organizational structure under two reportable segments, Renal and Hospital Products. Refer to Note 14 in Item 8 for additional information regarding the company s segments.

The segments and a description of their products and services are as follows:

The **Renal** business provides products and services to treat end-stage renal disease, or irreversible kidney failure, and acute kidney therapies. The Renal business offers a comprehensive portfolio to meet the needs of patients across the treatment continuum, including technologies and therapies for peritoneal dialysis (PD), in-center hemodialysis (HD), home HD, continuous renal replacement therapy (CRRT) and additional dialysis services.

The **Hospital Products** business manufactures intravenous (IV) solutions and administration sets, premixed drugs and drug-reconstitution systems, pre-filled vials and syringes for injectable drugs, IV nutrition products, infusion pumps, inhalation anesthetics, and biosurgery products. The business also provides products and services related to pharmacy compounding, drug formulation and packaging technologies.

Baxter has approximately 50,000 employees and conducts business in over 100 countries. The company generates approximately 60% of its revenues outside the United States, and maintains approximately 50 manufacturing facilities and over 100 distribution facilities in the United States, Europe, Asia-Pacific, Latin America and Canada.

Financial Results

Baxter s global net sales totaled $10 billion in 2015, a decrease of 7% over 2014, including an unfavorable foreign currency impact of eight percentage points. International sales totaled $6 billion in 2015, a decrease of 11% compared to 2014, including an unfavorable foreign currency impact of thirteen percentage points. Sales in the United States totaled $4 billion in 2015, in line with 2014 sales.

Baxter s income from continuing operations for 2015 totaled $393 million, or $0.72 per diluted share, compared to $457 million, or $0.83 per diluted share, in the prior year. Income from continuing operations in 2015 included special items which resulted in a net reduction to income from continuing operations by $362 million, or $0.66

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per diluted share. Income from continuing operations in 2014 included special items which resulted in a net reduction to income from continuing operations by $245 million, or $0.45 per diluted share. The company s special items are discussed further in the Results of Operations section below.

Baxter s financial results included research and development (R&D) expenses totaling $603 million in 2015, which reflects the company s focus to balance increased investments to support a new product pipeline with efforts to optimize overall R&D spending through continuous evaluation of the portfolio.

The company s financial position remains strong, with operating cash flows from continuing operations totaling $1.1 billion in 2015. The company has continued to execute on its disciplined capital allocation framework, which is designed to optimize stockholder value creation through reinvestment in the businesses, dividends and opportunistic share repurchases, as well as acquisitions and other business development initiatives as discussed in Strategic Objectives below.

Capital investments totaled $911 million in 2015 as the company continues to invest across its businesses to support future growth, including additional investments in support of new and existing product capacity expansions. The company s investments in capital expenditures in 2015 were focused on projects that improve production efficiency and enhance manufacturing capabilities to support its strategy of geographic expansion with select investments in growing markets.

The company also continued to return value to its stockholders in the form of dividends. During 2015, the company paid cash dividends to its shareholders totaling $910 million. Additionally, on July 1, 2015 Baxter completed the distribution of approximately 80.5% of the outstanding common stock of its biopharmaceuticals business, Baxalta, to Baxter stockholders. The distribution positioned both Baxter and Baxalta with improved focus and an ability to innovate and operate more effectively.

Strategic Objectives

Baxter continues to focus on several key objectives to successfully execute its long-term strategy to achieve sustainable growth and deliver enhanced stockholder value. Baxter s diversified and broad portfolio of medical products that treat life-threatening acute or chronic conditions and its global presence are core components of the company s strategy to achieve these objectives. After giving effect to the separation and distribution and Mr. Almeida s appointment as Chief Executive Officer and Chairman effective as of January 1, 2016, the company is now focused on three distinct strategic factors: optimizing its core portfolio globally; operational excellence focused on streamlining the cost structure and enhancing operational efficiency; and following a disciplined and balanced approach to capital allocation.

Optimizing the Core Portfolio Globally

Baxter is in the process of evaluating and categorizing its product portfolio and the markets in which it operates to identify and invest in opportunities in which it has greatest potential to enhance returns. These opportunities include product areas across mature and emerging markets.

Additionally, as part of its portfolio review, Baxter seeks to optimize its position in product areas where the company has a stable, profitable business model, identify and alter investments in products that have reached the end of their life cycles or with respect to which market positions have evolved unfavorably. In the course of doing so, Baxter expects to reallocate capital to more promising opportunities, as described above.

As part of this strategy, Baxter will focus its investments to drive innovation where it has compelling opportunities to serve patients and healthcare professionals while advancing the business and will accelerate the pace in bringing these advances to market. Baxter is in the midst of launching more than 50 products over the next five years in such areas as chronic and acute renal care; smart pump technology; hospital pharmaceuticals and nutritionals; surgical sealants, and more. These comprise a mix of entirely new offerings, marked improvements on existing technologies, and the expansion of current products into new geographies.

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Operational Excellence

As part of its pursuit of improved margin performance, Baxter is working to rebase its cost structure, consistent with its emergence as a stand-alone medical products company after the Baxalta separation and distribution. It is also critically assessing optimal support levels in light of the company s ongoing portfolio optimization efforts.

The company intends to actively manage its cost structure to help ensure it is committing resources to where they will have the greatest value. Such high value activities include supporting innovation, building out the portfolio, expanding patient access and accelerating growth for the company s stockholders.

Baxter is undergoing a comprehensive review of all aspects of its operations and has already begun to implement changes in line with its business goals.

Maintaining Disciplined and Balanced Capital Allocation

Baxter s capital allocation strategies include the following:

- reinvest in the business, by funding opportunities that are positioned to deliver sustainable growth, support the company s innovation efforts and improve margin performance;
- return capital to stockholders through stock dividends, to meaningfully increase with earnings growth;
- opportunistic share repurchases, which may involve utilization of the Retained Shares; and
- identify and pursue accretive M&A opportunities that generate returns above targeted thresholds.

Responsible Corporate Citizen

The company strives for continued growth and profitability, while furthering its focus on acting as a responsible corporate citizen. At Baxter, sustainability means creating lasting social, environmental and economic value by addressing the needs of the company s wide-ranging stakeholder base. Baxter s comprehensive sustainability program is focused on areas where the company is uniquely positioned to make a positive impact. Priorities include providing employees a safe, healthy and inclusive workplace, fostering a culture that drives integrity, strengthening access to healthcare, enhancing math and science education, and driving environmental performance across the product life cycle including development, manufacturing and transport. Baxter and the Baxter International Foundation provide financial support and product donations in support of critical needs, from assisting underserved communities to providing emergency relief for countries experiencing natural disasters.

Throughout 2015 the company continued to implement a range of water conservation strategies and facility-based energy saving initiatives. In the area of product stewardship and life cycle management, Baxter is pursuing efforts such as sustainable design and reduced packaging. Baxter is also responding to the challenges of climate change through innovative greenhouse gas emissions-reduction programs, such as shifting to less carbon-intensive energy sources in manufacturing and transport. Additionally, the company developed new long-term goals to drive continued environmental stewardship while creating healthier, more sustainable communities where Baxter employees work and live.

Risk Factors

The company s ability to sustain long-term growth and successfully execute the strategies discussed above depends in part on the company s ability to manage within an increasingly competitive and regulated environment and to address the other risk factors described in Item 1A of this Annual Report on Form 10-K.

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RESULTS OF OPERATIONS

Special Items

The following table provides a summary of the company s special items and the related impact by line item on the company s results of continuing operations for 2015, 2014, and 2013.

years ended December 31 (in millions)	2015	2014	2013
Gross Margin			
Intangible asset amortization expense	**$ (158)**	$ (168)	$ (113)
Business optimization items[1]	**(38)**	11	(47)
Product-related items[2]	**28**	(64)	(17)
Gambro acquisition and integration items[3]			(63)
Total Special Items	**$ (168)**	$ (221)	$ (240)
Impact on Gross Margin Ratio	**(1.7 pts)**	(2.1 pts)	(2.6 pts)
Marketing and Administrative Expenses			
Reserve items and adjustments[5]	**$**	$	$ 32
Branded Prescription Drug Fee[6]		3	
Business optimization items[1]	**79**	(4)	78
Product-related items[2]		4	
Gambro acquisition and integration items[3]	**73**	119	115
Separation-related costs[7]	**110**	11	
Total Special Items	**$ 262**	$ 133	$ 225
Impact on Marketing and Administrative Expense Ratio	**2.6 pts**	1.2 pts	2.4 pts
Research and Development Expenses			
Business development items[4]	**$**	$	$ 25
Business optimization items[1]	**13**	2	23
Separation-related costs[7]	**1**		
Total Special Items	**$ 14**	$ 2	$ 48
Other Expense (Income), Net			
Gambro acquisition and integration items[3]	**$**	$ 25	$ 77
Business optimization items[1]	**(3)**		
Reserve items and adjustments[5]	**(52)**	1	(35)
Loss on debt extinguishment[8]	**130**		
Business development items[4]	**(20)**		
Total Special Items	**$ 55**	$ 26	$ 42
Income Tax Expense			
Impact of special items	**$ (137)**	$ (137)	$ (45)
Total Special Items	**$ (137)**	$ (137)	$ (45)
Impact on Effective Tax Rate	**(10.4 pts)**	(12.8 pts)	(0.5 pts)

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Intangible asset amortization expense is identified as a special item to facilitate an evaluation of current and past operating performance, particularly in terms of cash returns, and is similar to how management internally assesses performance. Additional special items are identified above because they are highly variable, difficult to predict, and of a size that may substantially impact the company s reported operations for a period. Management believes that providing the separate impact of the above items on the company s results in accordance with generally accepted accounting principles (GAAP) in the United States may provide a more complete understanding of the company s operations and can facilitate a fuller analysis of the company s results of operations, particularly in evaluating performance from one period to another.

[1] In 2015, 2014 and 2013, the company s results were impacted by costs associated with the company s execution of certain strategies to optimize its organization and global cost structure on a global basis. These actions included streamlining the company s international operations, rationalizing its manufacturing facilities, reducing its general and administrative infrastructure, re-aligning certain R&D activities and cancelling certain R&D programs. The company recorded net business optimization charges (benefits) of $127 million, $(13) million, and $148 million in 2015, 2014, and 2013, respectively. This included the net benefit from adjustments made in 2014 and 2013 for reserves that are no longer probable of being utilized. Refer to Note 7 in Item 8 for further information regarding these charges and related reserves.

[2] The company s 2015 results included a net benefit of $28 million primarily related to adjustments to the COLLEAGUE and SIGMA SPECTRUM infusion pump reserves. The company s results in 2014 included charges, net of reversals, of $68 million primarily related to product remediation efforts for the SIGMA SPECTRUM infusion pump. In 2013, the company s results included total charges of $17 million, primarily related to remediation efforts associated with modifications to the SIGMA Spectrum Infusion Pump in conjunction with re-filing for 510(k) clearance. Refer to Note 7 in Item 8 for further information regarding these charges and related reserves.

[3] The company s results in 2015 and 2014 included total charges of $73 million and $144 million, respectively, primarily related to the integration of Gambro AB (Gambro). In 2013, the company s results included total charges of $255 million primarily related to the acquisition and integration of Gambro and losses from the derivative instruments used to hedge the anticipated foreign currency cash outflows for the planned acquisition of Gambro. Refer to Note 5 in Item 8 for further information regarding the acquisition of Gambro.

[4] The company s results in 2015 included a benefit of $20 million relating to the reversal of contingent consideration milestone liabilities. The company s results in 2013 included total charges of $25 million related to upfront payment associated with the one of company s collaboration arrangements. Refer to Note 5 in Item 8 for further information regarding the company s acquisitions and other arrangements.

[5] The company s results in 2015 included income of $52 million related to a litigation settlement in which Baxter was the beneficiary. The company s results in 2014 included income of $1 million related to third-party recoveries and reversals of prior litigation reserves. The company s results in 2013 included income, net of expense, of $3 million related to tax and legal reserves associated with tax and VAT matters in Turkey.

[6] The company s results in 2014 included a charge of $3 million to account for an additional year of the Branded Prescription Drug Fee in accordance with final regulations issued in the third quarter of 2014 by the Internal Revenue Service.

[7] The company s results in 2015 and 2014 included costs related to the Baxalta separation of $111 million and $11 million, respectively.

[8] The company s 2015 results included a loss of $130 million related to its July 2015 tender offer, for certain of its outstanding indebtedness. See Note 8 in Item 8 for additional information.

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Net Sales

years ended December 31 (in millions)	2015	2014	2013	Percent change At actual currency rates 2015	At actual currency rates 2014	At constant currency rates 2015	At constant currency rates 2014
Renal	**$ 3,789**	$ 4,172	$ 3,089	**(9)%**	35%	**1%**	38%
Hospital Products	**6,179**	6,547	6,324	**(6)%**	4%	**1%**	4%
Total net sales	**$ 9,968**	$ 10,719	$ 9,413	**(7)%**	14%	**1%**	15%

years ended December 31 (in millions)	2015	2014	2013	Percent change At actual currency rates 2015	At actual currency rates 2014	At constant currency rates 2015	At constant currency rates 2014
United States	**$ 4,001**	$ 3,999	$ 3,584	**0%**	12%	**0%**	12%
International	**5,967**	6,720	5,829	**(11)%**	15%	**2%**	18%
Total net sales	**$ 9,968**	$ 10,719	$ 9,413	**(7)%**	14%	**1%**	15%

Net sales for the year ended December 31, 2015 declined seven percent at actual currency rates but increased one percent on a constant currency basis. Net sales for the year ended December 31, 2014 included $1.6 billion in Gambro sales compared to $513 million in 2013, from the September 6, 2013 acquisition date. Refer to Note 5 in Item 8 for further information regarding the Gambro acquisition.

Foreign currency unfavorably impacted net sales by eight percentage points during the year ended December 31, 2015 compared to the prior year principally due to the strengthening of the U.S. Dollar relative to the Euro, Australian Dollar, Columbian Peso, and certain other currencies. Foreign currency unfavorably impacted net sales by one percentage point during the year ended December 31, 2014 principally due to the strengthening of the U.S. Dollar relative to the Euro, Swedish Krona and certain other currencies.

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

Franchise Net Sales Reporting

Effective January 1, 2015, Baxter modified its commercial franchise structure for reporting net sales. Prior period net sales have been recast to reflect the new commercial franchise structure.

As a result of the segment realignment, the Renal segment is presented as a separate commercial franchise and includes sales of the company s peritoneal dialysis (PD), hemodialysis (HD) and continuous renal replacement therapies (CRRT).

The Hospital Products segment includes four commercial franchises: Fluid Systems, Integrated Pharmacy Solutions, Surgical Care and Other.

Fluid Systems includes sales of the company s intravenous (IV) therapies, infusion pumps and administration sets.

Integrated Pharmacy Solutions includes sales of the company s premixed and oncology drug platforms, nutrition products and pharmacy compounding services.

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Surgical Care includes sales of the company s inhaled anesthesia products as well as biological products and medical devices used in surgical procedures for hemostasis, tissue sealing and adhesion prevention.

Other includes sales primarily from the company s pharmaceutical partnering business.

The following is a summary of net sales by commercial franchise.

				Percent change			
				At actual currency rates		At constant currency rates	
years ended December 31 (in millions)	**2015**	2014	2013	**2015**	2014	**2015**	2014
Total Renal net sales	**$ 3,789**	$ 4,172	$ 3,089	**(9)%**	35%	**1%**	38%
Fluid Systems	**$ 2,106**	$ 2,129	$ 2,142	**(1)%**	(1%)	**6%**	(11)%
Integrated Pharmacy Solutions	**2,297**	2,535	2,364	**(9)%**	7%	**(2)%**	19%
Surgical Care	**1,323**	1,373	1,307	**(4)%**	5%	**3%**	6%
Other	**453**	510	511	**(11)%**	%	**(5)%**	(2)%
Total Hospital Products net sales	**$ 6,179**	$ 6,547	$ 6,324	**(6)%**	4%	**1%**	4%

Net sales in the Renal segment decreased 9% in 2015 from 2014 but increased 35% in 2014 compared to 2013. Foreign currencies had an unfavorable foreign currency impact of ten percentage points in 2015 and three percentage points in 2014. Net sales in the Hospital Products segment declined 6% in 2015 but increased 4% in 2014. Foreign currencies had an unfavorable impact of seven percentage points in 2015. Excluding the impact of foreign currency, the principal drivers impacting net sales were the following:

In the Renal segment, sales increased 1% on a constant currency basis in 2015, driven by continued growth in the number of PD patients globally, which contributed approximately three percentage points, and strong demand in the acute business. These factors were partially offset by lower sales in the chronic in-center HD business, resulting from the decision to forgo certain lower margin sales opportunities, increased austerity measures in Western Europe, and competitive pressures for dialyzers. Sales growth in 2014 was impacted by a full year of Gambro revenues of $1.6 billion compared to $513 million from the September 6, 2013 acquisition date through December 31, 2013. Sales in 2014 also benefited from growth in the number of PD patients in the United States and emerging markets, which contributed approximately four percentage points, partially offset by the divestiture of Baxter s legacy CRRT business in the first quarter of 2014.

In the Fluid Systems franchise, sales increased 6% in 2015 on a constant currency basis driven by increased sales of infusion system products, which contributed approximately four percentage points, including the relaunch of the SIGMA Spectrum infusion pump in the United States, Puerto Rico, and Canada during 2015. Additionally, sales growth in 2015 was impacted by favorable pricing and demand in the United States for the company s IV therapies, which contributed approximately one percentage point. Sales growth in 2014 was driven by price improvements and strong United States demand for the company s IV solutions which was offset by a decline in SIGMA Spectrum Infusion Pump sales due to suspension of sales to new accounts commencing with the receipt of an FDA Warning Letter in April 2013.

In the Integrated Pharmacy Solutions franchise, sales declined 2% in 2015 on a constant currency basis driven by decreased sales of cyclophosphamide, a generic oncology drug, following a competitor entering the U.S. market in November 2014 which contributed approximately six percentage points. Annual U.S. sales for cyclophosphamide during 2014 were approximately $450 million compared to approximately $270 million in 2015. Excluding the negative impact of foreign exchange and sales of U.S. cyclophosphamide sales in the Integrated Pharmacy Solutions franchise increased 7% driven by a two percentage point increase in revenues from pharmacy compounding services, increased demand for

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the company s nutritional therapies, and pharmacy injectable products, including approximately $40 million in sales of Protopam, which contributed two percentage points. The company expects additional competition in 2016 in the U.S. for cyclophosphamide which is anticipated to substantially impact pricing and demand for Baxter s product, resulting in expected sales of $180 million in 2016. Additionally, given the purchasing pattern associated with Protopam, these sales may not recur in 2016. Sales growth in 2014 was driven by increased sales and favorable pricing of cyclophosphamide in the United States and higher pharmacy compounding revenues as well as strong U.S. demand for nutritional therapies.

In the Surgical Care franchise, sales increased 3% in 2015 on a constant currency basis driven by strong global demand for the company s portfolio of anesthetics products, which contributed three percentage points, offset partially by lower sales of select non-core biosurgery products. Sales growth in 2014 was driven by increased international sales of anesthetics products and surgical sealants TISSEL and FLOSEAL.

In the Other franchise, sales were down 5% in 2015 on a constant currency basis compared to 2014 driven by one of the company s pharmaceutical partners electing to self-manufacture products previously contract manufactured by Baxter, which contributed five percentage point to the decline. This loss was partially offset by sales related to the company s manufacturing and supply agreement with Baxalta. Sales in 2014 declined 2% on a constant currency basis.

Gross Margin and Expense Ratios

				Change	
years ended December 31 (as a percent of net sales)	**2015**	2014	2013	**2015**	2014
Gross margin	**41.6%**	42.7%	44.2%	**(1.1 pts)**	(1.5 pts)
Marketing and administrative expenses	**31.0%**	30.9%	32.8%	**0.1 pts**	(1.9 pts)

Gross Margin

The special items previously identified in the above had an unfavorable impact of 1.7, 2.1 and 2.6 percentage points on the gross margin percentage in 2015, 2014, and 2013, respectively. Refer to the Special Items above for additional detail.

In addition to the impact of the special items, the gross margin percentage in 2015 was unfavorably impacted by decreased sales of cyclophosphamide within the Hospital Products segment, partially offset by improved product mix in the Renal segment.

In addition to the impact of the special items, the 2014 gross margin percentage was unfavorably impacted as a result of the integration of the lower margin Gambro business. Other unfavorable impacts include foreign currency, expedited freight for PD solutions, and manufacturing inefficiencies resulting from lower production volumes as the company continues to make investments to enhance its operations, quality systems and processes.

Marketing and Administrative Expenses

The special items identified above had an unfavorable impact of 2.6, 1.2 and 2.4 percentage points on the marketing and administrative expenses ratio in 2015, 2014, and 2013, respectively. Refer to the Special Items caption above for additional detail.

Excluding the impact of the special items, the marketing and administrative expense ratio in 2015 was impacted by the benefits from the company s business optimization actions as the company resets its cost structure, reduced its discretionary spending, and benefited from certain costs charged to Baxalta under the transition services agreement. This was partially offset by bad debt expense in emerging markets.

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Excluding the impact of the special items, the marketing and administrative expenses ratio in 2014 was unfavorably impacted as a result of inclusion of Gambro s operations and incremental freight and logistical expenses to support the strong demand for IV and PD solutions. These unfavorable impacts in 2014 were more than offset by savings from the company s continued focus on controlling discretionary spending, lower pension expense and benefits from the company s business optimization initiatives.

Pension Plan Expense

Fluctuations in pension plan expense impacted the company s gross margin and expense ratios. Pension plan expense increased $8 million in 2015 primarily due to a decrease in the discount rate. Pension plan expense decreased $88 million from 2013 to 2014 driven by a decrease in the amortization of actuarial losses. The company currently expects pension expense to decrease in 2016 compared to 2015 by approximately $100 million due to the expected contribution of at least $600 million of Baxalta equity to the U.S. qualified plan, the impact from the change in approach for calculating the service and interest components of the net periodic benefit cost, and an increase in the discount rate. This is offset partially by changes to the mortality assumptions and a reduction in the expected rate of return on plan assets primarily for the U.S. plans.

Business Optimization Items

The company has implemented certain business optimization initiatives in an effort to streamline its operations, rationalize its manufacturing facilities, enhance its general and administrative infrastructure, and re-align certain R&D activities. The company estimates that business optimization activities from 2012 through 2014 have resulted in cumulative savings of approximately $0.27 per diluted share as of December 31, 2015. The company expects additional savings of approximately $0.01 per diluted share as the programs are fully implemented through 2016. The savings from these actions will impact cost of sales, marketing and administrative expenses, and R&D expenses. In 2015, the company recorded charges of $130 million and expects savings of approximately $0.16 per diluted share as the programs are fully implemented through 2017. Refer to Note 7 in Item 8 for additional information regarding the company s business optimization initiatives.

Research and Development

				Percent change	
years ended December 31 (in millions)	**2015**	2014	2013	**2015**	2014
Research and development expenses	**$603**	$610	$582	**(1%)**	5%
as a percent of net sales	**6.0%**	5.7%	6.2%	**0.3 pts**	(0.5 pts)

The special items identified above had an unfavorable impact of $14 million, $2 million and $48 million in 2015, 2014 and 2013, respectively.

R&D expenses in 2015 declined as the company worked to balance increased investments with efforts to optimize its overall R&D expenditures. The increase in R&D expenses in 2014 was driven by contributions from the acquisition of Gambro and additional investments in renal therapies.

Net Interest Expense

Net interest expense was $126 million, $145 million, and $128 million in 2015, 2014, and 2013, respectively. The decrease in 2015 was principally driven by the debt tender offer completed in July 2015 and the maturity of $600 million of 4.625% senior unsecured notes in March 2015, partially offset by higher interest on the company s short term revolving credit facility, lower capitalized interest, and lower income from interest rate hedging activities. The increase in 2014 was driven by an increase in debt from the issuance of $3.5 billion of senior unsecured notes in June 2013, which was partially offset by the maturity of $350 million of 4.0% senior

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unsecured notes in March 2014, and the company s interest rate swap hedging activities. Refer to Note 3 in Item 8 for a summary of the components of net interest expense for 2015, 2014 and 2013.

Other (Income) Expense, Net

Other (income) expense, net was income of $105 million in 2015, expense of $21 million in 2014 and income of $7 million in 2013. Current year results were driven primarily by $52 million of income related to a favorable litigation settlement, $38 million income from the sale of available-for-sale securities, and $113 million of income related to foreign currency fluctuations principally relating to intercompany receivables, payables and monetary assets denominated in a foreign currency, partially offset by a $130 million loss on extinguishment of debt related to the July 2015 debt tender offer.

Segment EBITDA

The company uses income from continuing operations before net interest expense, income tax expense, depreciation and amortization expense (Segment EBITDA), on a segment basis to make resource allocation decisions and assess the ongoing performance of the company s business segments. Refer to Note 17 in Item 8 for additional details regarding the company s segments. The following is a summary of significant factors impacting the segments financial results.

Renal

Segment EBITDA was $566 million, $666 million, and $670 million in 2015, 2014, and 2013, respectively. EBITDA declined in 2015 due to unfavorable foreign currency, the impairment of certain intangible assets, investments in certain quality programs and manufacturing capabilities, partially offset by efficiencies related to the integration of the Gambro business. EBITDA in 2014 was impacted by a $1.1 billion increase in sales from Gambro as 2014 included 12 months of sales compared to four months in 2013. EBITDA in 2014 was also impacted by unfavorable foreign currency, the integration of the lower margin Gambro business, and incremental freight and logistical expenses.

Hospital Products

Segment EBITDA was $2.0 billion, $2.2 billion, $2.2 billion in 2015, 2014, and 2013. EBITDA in 2015 was impacted primarily by unfavorable foreign currency and decreased sales of the high margin cyclophosphamide product. This was offset by a reduction in costs incurred in 2014 related to manufacturing inefficiencies and quality costs EBITDA in 2014 benefited from an increase in net sales. This was partially offset by foreign currency and increased costs related to manufacturing inefficiencies and quality initiatives.

Corporate and other

Certain income and expense amounts are not allocated to a segment. These amounts are detailed in the table in Note 17 in Item 8 and primarily include net interest expense, foreign exchange fluctuations (principally relating to intercompany receivables, payables and loans denominated in foreign currency) and the majority of the foreign currency hedging activities, corporate headquarters costs, international global support, stock compensation expense, non-strategic investments and related income and expense, certain employee benefit plan costs as well as certain nonrecurring gains, losses, and other charges (such as business optimization and asset impairments).

Income Taxes

Effective Income Tax Rate

The effective income tax rate for continuing operations was 8.2% in 2015, 6.7% in 2014, and 16.0% in 2013. The company anticipates that the effective income tax rate for continuing operations, calculated in accordance with GAAP, will be approximately 19.5% in 2016, excluding any impact from additional audit developments or other special items.

The company s effective tax rate differs from the U.S. federal statutory rate each year due to certain operations that are subject to tax incentives, state and local taxes and foreign taxes that are different than the U.S. federal

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statutory rate. The average foreign effective tax rate on international pre-tax income for continuing operations was 27.5%, 24.1% and 26.1% for the years ended December 31, 2015, 2014 and 2013, respectively. The company s average foreign effective tax rate was lower than the U.S. federal statutory rate as a result of the impact of tax incentives in Puerto Rico, Switzerland and certain other tax jurisdictions outside of the United States, as well as foreign earnings in tax jurisdictions with lower statutory rates than the United States. Adversely impacting the foreign rate were foreign loss making operations that did not receive tax benefits due to the losses resulting in, or contributing to, the need for a valuation allowance. In addition, as discussed further below, the company s effective income tax rate can be impacted in each year by discrete factors or events. Refer to Note 15 in Item 8 for further information regarding the company s income taxes.

Factors adversely impacting the company s effective tax rate in 2015 included charges related to contingent tax matters primarily related to transfer pricing and the separation of Baxalta as well as the need to record valuation allowances for some loss making entities. Partially offsetting the foregoing adverse factors was a benefit from reaching a settlement of the Puerto Rico excise tax matter as well as the U.S. R&D credit resulting from the retroactive reinstatement in December 2015 of the Protecting Americans from Tax Hikes Act of 2015.

Factors impacting the company s effective tax rate in 2014 included the favorable settlement of a portion of the company s contingent tax matter related to operations in Turkey as well as a favorable shift of earnings from high to low tax jurisdictions compared to the prior period. Additionally, the effective tax rate was unfavorably impacted by increases in valuation allowances due to the tax benefit from losses that the company does not believe that it is more likely than not to realize and interest expense related to the company s unrecognized tax benefits.

Factors impacting the company s effective tax rate in 2013 were gains of $53 million and $38 million for the reduction of certain contingent payment liabilities related to the prior acquisitions of Prism and ApaTech, respectively, for which there were no tax charges. Also impacting the effective tax rate was a cost of sales reduction of $37 million for an adjustment to the COLLEAGUE infusion pump reserves when the company substantially completed the recall in the United States in 2012, for which there was no tax charge. These items were offset by a change in the earnings mix from lower tax to higher tax rate jurisdictions compared to the prior year period as well as charges for contingent tax matters principally related to the company s operations in Turkey.

As described in Note 15 in Item 8, management intends to reinvest past earnings in several jurisdictions outside of the United States indefinitely. The company will continue to evaluate its global financial structure and U.S. cash needs as part of its completed separation into two independent, global healthcare companies.

Income from Continuing Operations and Earnings per Diluted Share

Income from continuing operations was $393 million in 2015, $457 million in 2014, and $315 million in 2013. Income from continuing operations per diluted share was $0.72 in 2015, $0.83 in 2014, and $0.57 in 2013. The significant factors and events causing the net changes from 2014 to 2015 and from 2013 to 2014 are discussed above. Additionally, income from continuing operations per diluted share was positively impacted by the repurchase of eight million shares in 2014 and 13 million shares in 2013. Refer to Note 12 in Item 8 for further information regarding the company s stock repurchases.

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Income from Discontinued Operations

The following table is a summary of the operating results of Baxalta, which have been reflected as discontinued operations for the years ended December 31, 2015, 2014 and 2013.

Years ended December 31 (in millions)	**2015**	2014	2013
Net sales	**$ 2,895**	$ 6,523	$ 5,847
Total income from discontinued operations before income taxes	**752**	2,562	2,175
Income tax expense	**177**	522	478
Total income from discontinued operations	**$ 575**	$ 2,040	$ 1,697

Refer to Note 2 in Item 8 for additional information regarding the separation of Baxalta. Unless otherwise stated, financial results herein reflect continuing operations.

LIQUIDITY AND CAPITAL RESOURCES

The company s cash flows reflect both continuing and discontinued operations.

Cash Flows from Operations Continuing Operations

Operating cash flows from continuing operations totaled $1.1 billion in 2015, $1.2 billion in 2014, and $1.3 billion in 2013. Cash flows declined in 2015 as compared to 2014 and increased in 2014 as compared to 2013 due to the factors discussed below. The cash flows from continuing operations in 2015 was impacted by a $52 million legal settlement received in the second quarter as well as $114 million of payments related to the July 2015 debt tender offer.

Accounts Receivable

Cash flows relating to accounts receivable increased in 2015 and decreased in 2014 as the days sales outstanding increased in 2015 and decreased in 2014. Days sales outstanding were 56.2 days, 54.2 days, and 61.1 days for 2015, 2014, and 2013, respectively. Days sales outstanding increased in 2015 driven by slower collections in the United States. Days sales outstanding in 2014 included an unfavorable impact from the acquisition of Gambro which generally has longer days sales outstanding but was offset by an improvement in collection periods in both the U.S. and certain international markets as well as the favorable impact of foreign currency.

Inventories

Cash outflows for inventories declined in 2015 and increased in 2014. The following is a summary of inventories at December 31, 2015 and 2014, as well as inventory turns by segment for 2015, 2014 and 2013. Inventory turns for the year are calculated as the annualized fourth quarter cost of sales divided by the year-end inventory balance.

	Inventories		Inventory turns		
(in millions, except inventory turn data)	**2015**	2014	**2015**	2014	2013
Renal	**$ 605**	$ 618	**3.7**	3.6	4.4
Hospital Products	**955**	959	**3.6**	3.7	3.6
Other	**44**		**n/a**	n/a	n/a
Total company	**$ 1,604**	$ 1,577	**3.6**	3.7	3.9

Segment inventory levels remained consistent from 2014 to 2015. The decrease in inventory turns in 2014 compared to 2013 was driven by higher cost of sales in 2013 compared to 2014 associated with Gambro purchase accounting adjustments and business optimization charges.

Other

The changes in accounts payable and accrued liabilities were an inflow of $236 million in 2015, a $37 million outflow in 2014, and an inflow of $175 million in 2013. The changes were primarily driven by the timing of payments to suppliers as well as timing of tax payments.

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Payments related to the execution of the infusion pump recalls and the company s business optimization initiatives were $112 million in 2015, $124 million in 2014, and $94 million in 2013. Refer to Note 7 in Item 8 for further information regarding the infusion pump recall and the business optimization initiatives.

Net cash outflows in other balance sheet items were $318 million, $17 million, and $26 million in 2015, 2014, and 2013, respectively. The changes during 2015 and 2014 were primarily driven by prepaid expenses and hedging activity. Additionally, cash contributions to the company s pension plans totaled $157 million, $74 million, and $67 million in 2015, 2014, and 2013, respectively.

Cash Flows from Investing Activities Continuing Operations

Capital Expenditures

Capital expenditures relating to continuing operations totaled $911 million in 2015, $925 million in 2014, and $706 million in 2013. The company s capital expenditures in 2015 and 2014 were driven by additional investments in projects to support production of PD and IV solutions as well as expansion plans to meet the growing global demand for dialyzers. The company continues to invest in projects that enhance its cost structure and manufacturing capabilities, supports the company s strategy of geographic expansion with select investments in growing markets and support an ongoing strategic focus on R&D.

Acquisitions and Investments

Net cash outflows related to acquisitions and investments were $34 million in 2015, $95 million in 2014, and $3.7 billion in 2013. The cash outflows in 2015 were driven by the acquisition of the rights to cefazolin injection in GALAXY Container (2g/100mL). The cash outflows in 2014 were driven by the acquisitions of IC Net International Ltd and certain investments. The cash outflows in 2013 included $3.6 billion for the acquisition of Gambro (net of cash acquired of $88 million). Also included was an upfront payment of $25 million associated with the company s collaboration arrangement with JW Holdings Corporation.

Refer to Note 5 in Item 8 for further information about these acquisitions and other arrangements.

Divestitures and Other Investing Activities

Net cash inflows relating to divestitures and other investing activities were $84 million in 2015, $99 million in 2014, and $31 million in 2013. Cash inflows in 2015 were driven by the sale of certain investments and other assets. Cash inflows in 2014 primarily related to proceeds from the divestiture of Baxter s legacy CRRT business and the sale of certain investments. Cash inflows in 2013 primarily related to various sales of certain investments and other assets.

Cash Flows from Financing Activities

Debt Issuances, Net of Payments of Obligations

Net cash inflows related to debt and other financing obligations totaled $2.5 billion in 2015 driven by approximately $6.9 billion in issuances of debt primarily related to the Baxalta senior notes and borrowings under the company s revolving credit facilities. The company purchased an aggregate of approximately $2.7 billion in principal amount of its notes through two debt tender offers that closed in July 2015. Additionally, the company repaid $600 million of 4.625% senior unsecured notes that matured in March 2015 as well as the borrowings under the company s Euro-denominated revolving credit facility. The company issued and redeemed commercial paper throughout the year, and had $300 million outstanding as of December 31, 2015.

Net cash outflows related to debt and other financing obligations totaled $113 million in 2014 driven by approximately $1 billion in repayments, which included $500 million of floating rate senior unsecured notes that matured in December 2014 as well as $350 million of 4.0% senior unsecured notes that matured in March 2014. The company issued and redeemed commercial paper throughout the year, and had $875 million outstanding as of December 31, 2014.

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In June 2013, the company issued $3.5 billion of senior unsecured notes with various maturities. Approximately $3.0 billion of the net proceeds of these debt issuances was used to finance the acquisition of Gambro in 2013 and the remainder was used for general corporate purposes, including the repayment of commercial paper. This issuance was partially offset by the repayment of $300 million of 1.8% senior unsecured notes that matured in March 2013 and payment of assumed Gambro debt of $221 million after completion of the acquisition in September 2013.

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

Other Financing Activities

In connection with the separation, Baxter transferred $2.1 billion of cash to Baxalta.

Cash dividend payments totaled $0.9 billion in 2015, $1.1 billion in 2014, and $1.0 billion in 2013. The decrease in cash dividend payments in 2015 was primarily due to the fourth quarter dividend declining to $0.115 per share, compared to $0.52 per share for quarterly dividends beginning after May 2014.

Proceeds and realized excess tax benefits from stock issued under employee benefit plans totaled $200 million, $369 million, and $508 million in 2015, 2014, and 2013, respectively. Total realized excess tax benefits, which were $7 million in 2015, $24 million in 2014, and $34 million in 2013, are presented in the consolidated statements of cash flows as an inflow in the financing section and an outflow in the operating section. Approximately $9 million in 2014 and $13 million in 2013 of realized excess tax benefits are recognized within operating cash flows from discontinued operations.

As authorized by the Board of Directors, the company repurchases its stock depending on the company s cash flows, net debt level and market conditions. The company did not repurchase any stock during 2015. The company repurchased 8 million shares for $550 million in 2014 and 13 million shares for $913 million in 2013. In July 2012, the Board of Directors authorized the repurchase of up to $2.0 billion of the company s common stock and $0.5 billion remained available as of December 31, 2015.

Credit Facilities, Access to Capital and Credit Ratings

Credit Facilities

Effective July 1, 2015, the company terminated its $1.5 billion U.S. dollar-denominated revolving credit facility and 300 million Euro-denominated revolving credit facility, which were set to mature in December 2015, in connection with the separation and distribution. In connection with such terminations, the company entered into credit agreements providing for a senior U.S. dollar-denominated revolving credit facility in an aggregate principal amount of up to $1.5 billion maturing in 2020, as well as a Euro-denominated senior revolving credit facility in an aggregate principal amount of up to 200 million maturing in 2020. The company may, at its option, seek to increase the aggregate commitment under the new U.S. facility by up to an additional $750 million. The new facilities enable the company to borrow funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net leverage ratio and maximum interest coverage ratio.

Additionally, as of December 31, 2015, the company had a third revolving credit facility, with a maximum capacity of $1.8 billion, which was scheduled to mature on the earlier of March 28, 2016 and the date on which commitments under the facility have been reduced to zero or terminated in whole pursuant to the terms thereof. On January 27, 2016, Baxter exchanged approximately 37.6 million shares of Baxalta common stock for the $1.45 billion aggregate principal amount outstanding under this revolving credit facility. This exchange extinguished all outstanding indebtedness under the facility. In connection with the exchange of Baxalta common stock, Baxter will recognize approximately $1.2 billion of realized gains in the first quarter of 2016.

As of December 31, 2015, prior to giving effect to the termination of the company s $1.8 billion revolving credit facility, the company s U.S. dollar-denominated revolving credit facilities and Euro-denominated senior revolving credit facility had a maximum capacity of $3.3 billion and approximately $220 million, respectively.

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As of December 31, 2015, the company was in compliance with the financial covenants in these agreements. During 2015, the company borrowed $1.5 billion which is outstanding as of December 31, 2015, under its $1.8 billion U.S. dollar-denominated revolving credit facility at a weighted average interest rate of 1.41%. The non-performance of any financial institution supporting either of its remaining credit facilities (after giving effect to the termination of the company s $1.8 billion revolving credit facility) would reduce the maximum capacity of such facilities by each institution s respective commitment thereunder.

The company also maintains other credit arrangements, as described in Note 8 in Item 8.

Access to Capital

The company intends to fund short-term and long-term obligations as they mature through cash on hand, future cash flows from operations or by issuing additional debt. The company had $2.2 billion of cash and equivalents as of December 31, 2015, with adequate cash available to meet operating requirements in each jurisdiction in which the company operates. The company invests its excess cash in certificates of deposit and money market funds, and diversifies the concentration of cash among different financial institutions.

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

Baxter held an investment in Baxalta common stock with a fair value of approximately $5.1 billion as of December 31, 2015 (prior to giving effect to the exchange described above in Credit Facilities). This ownership interest provides the rights to dividends declared on Baxalta s common stock, including a $0.07 per share cash dividend paid on January 4, 2016. As discussed above in Credit Facilities, on January 27, 2016, Baxter exchanged 37,573,040 shares of Baxalta common stock for all of the indebtedness outstanding under its prior $1.8 billion revolving credit facility. After giving effect to this exchange, Baxter has 94,329,679 remaining Baxalta shares. Baxter currently intends to use such shares (or proceeds therefrom) to repurchase or retire additional indebtedness and make contributions to the company s U.S. qualified pension plan. The company may also conduct stock for stock exchanges and make stock distributions. On January 11, 2016, Baxter entered into a letter agreement with Baxalta and Shire plc (Shire) in connection with Shire s planned acquisition of Baxalta. The letter agreement, among other things, addresses certain aspects of the tax matters agreement and modifies certain aspects of the shareholder s and registration rights agreement, each entered into in connection with the separation and distribution. In accordance with the terms of the shareholder s and registration rights agreement (as amended by the letter agreement), Baxter may cause Baxalta to register the shares of Baxalta common stock held by Baxter under the U.S. Securities Act of 1933, as amended, in accordance with the terms thereof, and provide certain support in connection with the planned dispositions of such shares. Baxter caused Baxalta to register the public offering of the 37,573,040 Baxalta shares that Baxter exchanged as described above in accordance with the terms of the related agreements. In 2016, the company will look to further deploy the remaining Baxalta equity through a combination of additional debt for equity and equity for equity exchanges as well as make a contribution of at least $600 million of equity to its U.S. qualified pension plan subject to final regulatory approval.

The company continues to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, which have experienced deterioration in credit and economic conditions. As of December 31, 2015, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $211 million.

While these economic conditions have not significantly impacted the company s ability to collect receivables, global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses.

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Credit Ratings

The company s credit ratings at December 31, 2015 were as follows:

	Standard & Poor s	Fitch	Moody s
Ratings			
Senior debt	A-	BBB+	Baa2
Short-term debt	A2	F2	P2
Outlook	Negative	Stable	Stable

In May 2015, Moody s downgraded Baxter s senior debt from A3 to Baa2. Fitch also downgraded Baxter s senior debt from A to BBB+ as well as Baxter s short-term debt from F1 to F2. The downgrades reflect the impact of the Baxalta separation as detailed in Note 2 in Item 8.

If Baxter s credit ratings or outlooks were to be further downgraded, the company s financing costs related to its credit arrangements and any future debt issuances could be unfavorably impacted. However, any future credit rating downgrade or change in outlook would not affect the company s ability to draw on its credit facilities, and would not result in an acceleration of the scheduled maturities of any of the company s outstanding debt, unless, with respect to certain debt instruments, preceded by a change in control of the company.

Contractual Obligations

As of December 31, 2015, the company had contractual obligations, excluding accounts payable and accrued liabilities (other than the current portion of unrecognized tax benefits), payable or maturing in the following periods.

(in millions)	Total	Less than one year	One to three years	Three to five years	More than five years
Short-term debt	$ 1,775	$ 1,775	$	$	$
Long-term debt and capital lease obligations, including current maturities	4,767	810	1,778	1,097	1,082
Interest on short- and long-term debt and capital lease obligations[1]	989	116	157	81	635
Operating leases	714	149	231	158	176
Other long-term liabilities[2]	739		144	61	534
Purchase obligations[3]	686	334	289	59	4
Unrecognized tax benefits[4]	97	97			
Contractual obligations[5]	$ 9,767	$ 3,281	$2,599	$ 1,456	$2,431

[1] Interest payments on debt and capital lease obligations are calculated for future periods using interest rates in effect at the end of 2015. Projected interest payments include the related effects of interest rate swap agreements. Certain of these projected interest payments may differ in the future based on changes in floating interest rates, foreign currency fluctuations or other factors or events. The projected interest payments only pertain to obligations and agreements outstanding at December 31, 2015. Refer to Note 8 and Note 9 in Item 8 for further discussion regarding the company s debt instruments and related interest rate agreements outstanding at December 31, 2015.

[2] The primary components of other long-term liabilities in the company s consolidated balance sheet are liabilities relating to pension and other postemployment benefit plans, litigation, foreign currency hedges, and certain income tax-related liabilities. The company projected the timing of the future cash payments based on contractual maturity dates (where applicable) and estimates of the timing of payments (for liabilities with no contractual maturity dates). The actual timing of payments could differ from the estimates.

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The company contributed $157 million, $74 million, and $67 million to its defined benefit pension plans in 2015, 2014, and 2013, respectively. Most of the company s plans are funded. The timing of funding in the future is uncertain and is dependent on future movements in interest rates and investment returns, changes in laws and regulations, and other variables. Therefore, the table above excludes pension plan cash outflows. The pension plan balance included in other long-term liabilities (and excluded from the table above) totaled $1.7 billion at December 31, 2015.

[3] Includes the company s significant contractual unconditional purchase obligations. For cancelable agreements, any penalty due upon cancellation is included. These commitments do not exceed the company s projected requirements and are in the normal course of business. Examples include firm commitments for raw material purchases, utility agreements and service contracts.

[4] Due to the uncertainty related to the timing of the reversal of uncertain tax positions, the long-term liability relating to uncertain tax positions of $112 million at December 31, 2015 has been excluded from the table above.

[5] Excludes contingent liabilities. These amounts have been excluded from the contractual obligations above due to uncertainty regarding the timing and amount of future payments. Refer to Notes 10 and 11 in Item 8 for additional information regarding these commitments.

Off-Balance Sheet Arrangements

Baxter periodically enters into off-balance sheet arrangements. Certain contingencies arise in the normal course of business, and are not recorded in the consolidated balance sheet in accordance with GAAP (such as contingent joint development and commercialization arrangement payments). Also, upon resolution of uncertainties, the company may incur charges in excess of presently established liabilities for certain matters (such as contractual indemnifications). For a discussion of the company s significant off-balance sheet arrangements, refer to Note 10 in Item 8 for information regarding receivable securitizations, Note 11 in Item 8 regarding joint development and commercialization arrangements and indemnifications, and Note 16 in Item 8 regarding legal contingencies.

FINANCIAL INSTRUMENT MARKET RISK

The company operates on a global basis and is exposed to the risk that its earnings, cash flows and equity could be adversely impacted by fluctuations in foreign exchange and interest rates. The company s hedging policy attempts to manage these risks to an acceptable level based on the company s judgment of the appropriate trade-off between risk, opportunity and costs. Refer to Note 9 and Note 10 in Item 8 for further information regarding the company s financial instruments and hedging strategies.

Currency Risk

The company is primarily exposed to foreign exchange risk with respect to revenues generated outside of the United States denominated in the Euro, British Pound, Chinese Yuan, Korean Won, Australian Dollar, Canadian Dollar, Japanese Yen, Columbian Peso, Brazilian Real, Swedish Krona, and Mexican Peso. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative financial instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and stockholders equity volatility relating to foreign exchange. Financial market and currency volatility may limit the company s ability to cost-effectively hedge these exposures.

The company may use options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions denominated in foreign currencies and recognized assets and liabilities. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions at December 31, 2015 is 12 months. The company also enters into derivative instruments to hedge certain intercompany and third-party receivables and payables and debt denominated in foreign currencies.

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Currency restrictions enacted in Venezuela require Baxter to obtain approval from the Venezuelan government to exchange Venezuelan Bolivars for U.S. Dollars and require such exchange to be made at the official exchange rate established by the government. Since January 1, 2010, Venezuela has been designated as a highly inflationary economy under GAAP and as a result, the functional currency of the company s subsidiary in Venezuela is the U.S. Dollar. The devaluation of the Venezuelan Bolivar and designation of Venezuela as highly inflationary did not have a material impact on the financial results of the company. As of December 31, 2015, the company s subsidiary in Venezuela had net assets of $43 million denominated in the Venezuelan Bolivar. In 2015, net sales in Venezuela represented less than 1% of Baxter s total net sales.

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

A sensitivity analysis of changes in the fair value of foreign exchange option and forward contracts outstanding at December 31, 2015, while not predictive in nature, indicated that if the U.S. Dollar uniformly weakened by 10% against all currencies, on a net-of-tax basis, the net asset balance of $5 million with respect to those contracts would decrease by $17 million, resulting in a net liability position. A similar analysis performed with respect to option and forward contracts outstanding at December 31, 2014 indicated that, on a net-of-tax basis, the net asset balance of $12 million would decrease by $72 million.

The sensitivity analysis model recalculates the fair value of the foreign exchange option and forward contracts outstanding at December 31, 2015 by replacing the actual exchange rates at December 31, 2015 with exchange rates that are 10% weaker compared to the actual exchange rates for each applicable currency. All other factors are held constant. These sensitivity analyses disregard the possibility that currency exchange rates can move in opposite directions and that gains from one currency may or may not be offset by losses from another currency. The analyses also disregard the offsetting change in value of the underlying hedged transactions and balances.

Interest Rate and Other Risks

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

As part of its risk management program, the company performs sensitivity analyses to assess potential gains and losses in earnings relating to hypothetical movements in interest rates. A 29 basis-point increase in interest rates (approximately 10% of the company s weighted-average interest rate during 2015) affecting the company s financial instruments, including debt obligations and related derivatives, would have an immaterial effect on the company s 2015, 2014 and 2013 earnings and on the fair value of the company s fixed-rate debt as of the end of each fiscal year.

As discussed in Note 10 in Item 8, the fair values of the company s long-term litigation liabilities were computed by discounting the expected cash flows based on currently available information. A 10% movement in the assumed discount rate would have an immaterial effect on the fair values of those liabilities.

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

CHANGES IN ACCOUNTING STANDARDS

Refer to Note 1 in Item 8 for information on changes in accounting standards.

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CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with GAAP requires the company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of the company s significant accounting policies is included in Note 1 in Item 8. Certain of the company s accounting policies are considered critical because these policies are the most important to the depiction of the company s financial statements and require significant, difficult or complex judgments by the company, often requiring the use of estimates about the effects of matters that are inherently uncertain. Actual results that differ from the company s estimates could have an unfavorable effect on the company s results of operations and financial position. There have been no significant changes in the company s application of its critical accounting policies during 2015. The company s critical accounting policies have been reviewed with the Audit Committee of the Board of Directors. The following is a summary of accounting policies that the company considers critical to the consolidated financial statements.

Revenue Recognition and Related Provisions and Allowances

The company s policy is to recognize revenues from product sales and services when earned. 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 collectability is reasonably assured. For product sales, revenue is not recognized until title and risk of loss have transferred to the customer. The shipping terms for the majority of the company s revenue arrangements are FOB destination. The company sometimes enters into arrangements in which it commits to delivering multiple products or services to its customers. In these cases, total arrangement consideration is allocated to the deliverables based on their relative selling prices. Then the allocated consideration is recognized as revenue in accordance with the principles described above. Selling prices are determined by applying a selling price hierarchy. Selling prices are determined using vendor specific objective evidence (VSOE), if it exists. Otherwise, selling prices are determined using third party evidence (TPE). If neither VSOE nor TPE is available, the company uses its best estimate of selling prices.

Provisions for rebates, chargebacks to wholesalers and distributors, returns, and discounts (collectively, sales deductions) are provided for at the time the related sales are recorded, and are reflected as a reduction of sales. The sales deductions are based primarily on estimates of the amounts earned or that will be claimed on such sales.

The company periodically and systematically evaluates the collectability of accounts receivable and determines the appropriate reserve for doubtful accounts. In determining the amount of the reserve, the company considers historical credit losses, the past-due status of receivables, payment history and other customer-specific information, and any other relevant factors or considerations.

The company also provides for the estimated costs that may be incurred under its warranty programs when the cost is both probable and reasonably estimable, which is at the time the related revenue is recognized. The cost is determined based on actual company experience for the same or similar products as well as other relevant information. Estimates of future costs under the company s warranty programs could change based on developments in the future. The company is not able to estimate the probability or amount of any future developments that could impact the reserves, but believes presently established reserves are adequate.

Pension and Other Postemployment Benefit (OPEB) Plans

The company provides pension and other postemployment benefits to certain of its employees. These employee benefit expenses are reported in the same line items in the consolidated income statement as the applicable employee s compensation expense. The valuation of the funded status and net periodic benefit cost for the plans is calculated using actuarial assumptions. These assumptions are reviewed annually, and revised if appropriate. The significant assumptions include the following:

- interest rates used to discount pension and OPEB plan liabilities;
- the long-term rate of return on pension plan assets;

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rates of increases in employee compensation (used in estimating liabilities);

anticipated future healthcare trend rates (used in estimating the OPEB plan liability); and

other assumptions involving demographic factors such as retirement, mortality and turnover (used in estimating liabilities).

Selecting assumptions involves an analysis of both short-term and long-term historical trends and known economic and market conditions at the time of the valuation (also called the measurement date). The use of different assumptions would result in different measures of the funded status and net cost. Actual results in the future could differ from expected results. The company is not able to estimate the probability of actual results differing from expected results, but believes its assumptions are appropriate.

The company s key assumptions are listed in Note 13 in Item 8. The most critical assumptions relate to the plans covering U.S. and Puerto Rico employees, because these plans are the most significant to the company s consolidated financial statements.

Discount Rate Assumption

Effective for the December 31, 2015 measurement date, the company utilized discount rates of 4.36% and 4.12% to measure its benefit obligations for the U.S. and Puerto Rico pension plans and OPEB plan, respectively. The company used a broad population of approximately 200 Aa-rated corporate bonds as of December 31, 2015 to determine the discount rate assumption. All bonds were denominated in U.S. Dollars, with a minimum amount outstanding of $50 million. This population of bonds was narrowed from a broader universe of approximately 700 Moody s Aa rated, non-callable (or callable with make-whole provisions) bonds by eliminating the top 10th percentile and bottom 40th percentile to adjust for any pricing anomalies and to represent the bonds Baxter would most likely select if it were to actually annuitize its pension and OPEB plan liabilities. This portfolio of bonds was used to generate a yield curve and associated spot rate curve to discount the projected benefit payments for the U.S. and Puerto Rico plans. The discount rate is the single level rate that produces the same result as the spot rate curve.

For plans in Canada, Japan, the United Kingdom and the Eurozone, the company uses a method essentially the same as that described for the U.S. and Puerto Rico plans. For the company s other international plans, the discount rate is generally determined by reviewing country- and region-specific government and corporate bond interest rates.

To understand the impact of changes in discount rates on pension and OPEB plan cost, the company performs a sensitivity analysis. Holding all other assumptions constant, for each 50 basis point (i.e., one-half of one percent) increase in the discount rate, global pre-tax pension and OPEB plan cost would decrease by approximately $42 million, and for each 50 basis point decrease in the discount rate, global pre-tax pension and OPEB plan cost would increase by approximately $50 million.

Effective January 1, 2016, the company will change its approach used to calculate the service and interest components of net periodic benefit cost. Previously, the company calculated the service and interest components utilizing a single weighted-average discount rate derived from the yield curve used to measure the benefit obligation. The company has elected an alternative approach that utilizes a full yield curve approach in the estimation of these components by applying the specific spot rates along the yield curve used in the determination of the benefit obligation to their underlying projected cash flows. The company believes this approach provides a more precise measurement of service and interest costs by improving the correlation between projected benefit cash flows and their corresponding spot rates. The company will account for this change prospectively as a change in estimate. As a result of this change, in 2016 the company estimates that the service cost and interest cost for these plans will be reduced by approximately $40 million in 2016 compared to the previous method.

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Return on Plan Assets Assumption

In measuring the net periodic cost for 2015, the company used a long-term expected rate of return of 7.25% for the pension plans covering U.S. and Puerto Rico employees. This assumption will decrease to 7.00% in 2016. This assumption is not applicable to the company s OPEB plan because it is not funded.

The company establishes the long-term asset return assumption based on a review of historical compound average asset returns, both company-specific and relating to the broad market (based on the company s asset allocation), as well as an analysis of current market and economic information and future expectations. The current asset return assumption is supported by historical market experience for both the company s actual and targeted asset allocation. In calculating net pension cost, the expected return on assets is applied to a calculated value of plan assets, which recognizes changes in the fair value of plan assets in a systematic manner over five years. The difference between this expected return and the actual return on plan assets is a component of the total net unrecognized gain or loss and is subject to amortization in the future.

To understand the impact of changes in the expected asset return assumption on net cost, the company performs a sensitivity analysis. Holding all other assumptions constant, for each 50 basis point increase (decrease) in the asset return assumption, global pre-tax pension plan cost would decrease (increase) by approximately $18 million.

Other Assumptions

For the U.S. and Puerto Rico plans, beginning with the December 31, 2014 measurement date, the company used the RP 2014 combined mortality table adjusted to reflect Baxter specific past experience with improvements projected using the generational BB-2D projection scale adjusted to a long term improvement of 0.8% in 2027. At the December 31, 2015 measurement date, the company refined its Baxter specific past experience adjustment which will result in approximately $15 million of incremental expense in 2016. For all other pension plans, the company utilized country- and region-specific mortality tables to calculate the plans benefit obligations. The company periodically analyzes and updates its assumptions concerning demographic factors such as retirement, mortality and turnover, considering historical experience as well as anticipated future trends.

The assumptions relating to employee compensation increases and future healthcare costs are based on historical experience, market trends, and anticipated future company actions. Refer to Note 13 in Item 8 for information regarding the sensitivity of the OPEB plan obligation and the total of the service and interest cost components of OPEB plan cost to potential changes in future healthcare trend rates.

Legal Contingencies

The company is involved in product liability, patent, commercial, regulatory and other legal proceedings that arise in the normal course of business. Refer to Note 16 f in Item 8 or further information. The company records a liability when a loss is considered probable and the amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded. The company has established reserves for certain of its legal matters. The company is not able to estimate the amount or range of any loss for certain of the legal contingencies for which there is no reserve or additional loss for matters already reserved. At December 31, 2015, total legal liabilities were $29 million.

The company s loss estimates are generally developed in consultation with outside counsel and are based on analyses of potential outcomes. With respect to the recording of any insurance recoveries, after completing the assessment and accounting for the company s legal contingencies, the company separately and independently analyzes its insurance coverage and records any insurance recoveries that are probable of occurring at the gross amount that is expected to be collected. In performing the assessment, the company reviews available information, including historical company-specific and market collection experience for similar claims, current facts and circumstances pertaining to the particular insurance claim, the financial viability of the applicable insurance company or companies, and other relevant information.

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

Deferred Tax Asset Valuation Allowances and Reserves for Uncertain Tax Positions

The company maintains valuation allowances unless it is more likely than not that all or a portion of the deferred tax asset will be realized. Changes in valuation allowances are included in the company s tax provision in the period of change. In determining whether a valuation allowance is warranted, the company evaluates factors such as prior earnings history, expected future earnings, carryback and carryforward periods, and tax strategies that could potentially enhance the likelihood of realization of a deferred tax asset. The realizability assessments made at a given balance sheet date are subject to change in the future, particularly if earnings of a subsidiary are significantly higher or lower than expected, or if the company takes operational or tax planning actions that could impact the future taxable earnings of a subsidiary.

In the normal course of business, the company is audited by federal, state and foreign tax authorities, and is periodically challenged regarding the amount of taxes due. These challenges relate to the timing and amount of deductions and the allocation of income among various tax jurisdictions. The company believes its tax positions comply with applicable tax law and the company intends to defend its positions. In evaluating the exposure associated with various tax filing positions, the company records reserves for uncertain tax positions in accordance with GAAP, based on the technical support for the positions, the company s past audit experience with similar situations, and potential interest and penalties related to the matters. The company s results of operations and effective tax rate in a given period could be impacted if, upon final resolution with taxing authorities, the company prevailed in positions for which reserves have been established, or was required to pay amounts in excess of established reserves.

Valuation of Intangible Assets, Including IPR&D

The company acquires intangible assets and records them at fair value. Valuations are generally completed for business acquisitions using a discounted cash flow analysis, incorporating the stage of completion and consideration of market participant assumptions. The most significant estimates and assumptions inherent in a discounted cash flow analysis include the amount and timing of projected future cash flows, the discount rate used to measure the risks inherent in the future cash flows, the assessment of the asset s life cycle, and the competitive and other trends impacting the asset, including consideration of technical, legal, regulatory, economic and other factors. Each of these factors and assumptions can significantly affect the value of the intangible asset.

Acquired in-process R&D (IPR&D) is the value assigned to acquired technology or products under development which have not received regulatory approval and have no alternative future use.

Acquired IPR&D included in a business combination is capitalized as an indefinite-lived intangible asset. Development costs incurred after the acquisition are expensed as incurred. Upon receipt of regulatory approval of the related technology or product, the indefinite-lived intangible asset is then accounted for as a finite-lived intangible asset and amortized on a straight-line basis over its estimated useful life. If the R&D project is abandoned, the indefinite-lived asset is charged to expense.

R&D acquired in transactions that are not business combinations is expensed immediately. For such transactions, payments made to third parties on or after regulatory approval are capitalized and amortized over the remaining useful life of the related asset, and are classified as intangible assets.

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Due to the inherent uncertainty associated with R&D projects, there is no assurance that actual results will not differ materially from the underlying assumptions used to prepare discounted cash flow analyses, nor that the R&D project will result in a successful commercial product.

Impairment of Assets

Goodwill and other indefinite-lived intangible assets are subject to impairment reviews annually, and whenever indicators of impairment exist. The company assesses goodwill for impairment based on its reporting units, which are the same as its operating segments, Renal and Hospital Products. As of December 31, 2015, the date of the company s annual impairment review, the fair value of the company s reporting units were in excess of their carrying values. The company performs a qualitative assessment of other indefinite-lived intangible assets, including IPR&D, at least annually. If the intangible asset is determined to be more likely than not impaired as a result of the assessment, the company completes a quantitative impairment test. Intangible assets with definite lives and other long-lived assets (such as fixed assets) are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Refer to Note 1 in Item 8 for further information. The company s impairment reviews are based on an estimated future cash flow approach that requires significant judgment with respect to future volume, revenue and expense growth rates, changes in working capital use, foreign currency exchange rates, the selection of an appropriate discount rate, asset groupings, and other assumptions and estimates. The estimates and assumptions used are consistent with the company s business plans and when applicable, market participant s views of the company and similar companies. The use of alternative estimates and assumptions could increase or decrease the estimated fair values of the assets, and potentially result in different impacts to the company s results of operations. Actual results may differ from the company s estimates.

Stock-Based Compensation Plans

Stock-based compensation cost is estimated at the grant date based on the fair value of the award, and the cost is recognized as expense ratably over the substantive vesting period. Determining the appropriate fair value model to use requires judgment. Determining the assumptions that enter into the model is highly subjective and also requires judgment. The company s stock compensation costs primarily relate to awards of stock options, restricted stock units (RSUs), and performance share units (PSUs). The company uses the Black-Scholes model for estimating the fair value of stock options, and significant assumptions include long-term projections regarding stock price volatility, employee exercise, post-vesting termination and pre-vesting forfeiture behaviors, interest rates and dividend yields. The company s expected volatility assumption is based on a weighted-average of the historical volatility of Baxter s stock and the implied volatility from traded options on Baxter s stock, with historical volatility more heavily weighted. The expected life assumption is primarily based on the vesting terms of the stock option, historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield reflects historical experience as well as future expectations over the expected life of the option.

The fair value of RSUs is equal to the quoted price of the company s common stock on the date of grant.

Current outstanding PSUs are based either on return on invested capital (ROIC) or are based upon Baxter stock performance relative to the company s peer group. The vesting condition for such PSUs based on return on invested capital (ROIC) have annual performance targets set at the beginning of the year for each tranche of the award during the three-year service period. The holder of the ROIC PSUs is entitled to receive a number of shares of common stock equal to a percentage, ranging from 0% to 200%, of the ROIC PSUs granted, depending on the actual results compared to the annual performance targets. Compensation cost for the ROIC PSUs is measured based on the fair value of the awards on the date that the specific vesting terms for each tranche of the award are established. The fair value of the awards is determined based on the quoted price of the company s stock on the grant date for each tranche of the award. The compensation cost for ROIC PSUs is adjusted at each reporting date to reflect the estimated probability of achieving the vesting condition. The probability of achieving

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the ROIC vesting condition has not materially changed during the year ended December 31, 2015. The vesting condition for PSUs based on Baxter stock performance relative to the company s peer group is fair valued using a Monte Carlo model. A Monte Carlo model uses stock price volatility and other variables to estimate the probability of satisfying the market conditions and the resulting fair value of the award. Refer to Note 12 in Item 8 for additional information.

CERTAIN REGULATORY MATTERS

In July 2014, the company received a Warning Letter from FDA primarily relating to processes implemented to ensure the absence of particulate matter or leaks associated with products manufactured at the company s Aibonito, Puerto Rico, plant. In October 2015, FDA lifted the Warning Letter.

In January 2014, the company received a Warning Letter from FDA primarily directed to quality systems for the company s Round Lake, Illinois, facility, particularly in that facility s capacity as a specification developer for certain of the company s medical devices. The company received a separate Warning letter in December 2013 that included observations related to the company s ambulatory infuser business in Irvine, California, which previously had been subject to agency action.

In June 2013, the company received a Warning Letter from FDA regarding operations and processes at its North Cove, North Carolina and Jayuya, Puerto Rico facilities and in November 2015 attended a Regulatory Meeting with FDA concerning the Jayuya facility. The Warning Letter addresses observations related to Current Good Manufacturing Practice (CGMP) violations at the two facilities.

In June 2010, the company received a Warning Letter from FDA in connection with an inspection of its McGaw Park, Illinois facility, which previously supported the Renal franchise. The company s Round Lake facility now provides the related capacity for the Renal franchise. The Warning Letter pertains to the processes by which the company analyzes and addresses product complaints through corrective and preventative action, and reports relevant information to FDA.

On October 9, 2014, the company had a Regulatory Meeting with FDA to discuss the Warning Letters described above. At the meeting, the company agreed to work closely with FDA to provide regular updates on its progress to meet all requirements and resolve all matters identified in the Warning Letters described above.

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

FORWARD-LOOKING INFORMATION

This annual report includes forward-looking statements. Use of the words may, will, would, could, should, believes, estimates, projec potential, expects, plans, seeks, intends, evaluates, pursues, anticipates, continues, designs, impacts, affects, forecasts, objective, designed, priorities, goal, or the negative of those words or other similar expressions is intended to identify forward-looking statements that represent our current judgment about possible future events. These forward-looking statements may include statements with respect to accounting estimates and assumptions, litigation-related matters including outcomes, future regulatory filings and the company s R&D pipeline, strategic objectives, credit exposure to foreign governments, potential developments with respect to credit ratings, investment of foreign earnings, estimates of liabilities including those related to uncertain tax positions, contingent payments, future pension plan contributions, costs, discount rates and rates of return, the company s exposure to financial market volatility and foreign currency and interest rate risks, the impact of the recent separation of the biopharmaceuticals and medical products businesses, the impact of competition, future sales growth, business development activities, business optimization initiatives, cost saving initiatives, future capital and R&D expenditures, future debt issuances, manufacturing expansion, the sufficiency of the company s facilities and financial flexibility, the adequacy of credit facilities, tax provisions and reserves, the effective tax rate and all other statements that do not relate to historical facts.

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These forward-looking statements are based on certain assumptions and analyses made in light of the company s experience and perception of historical trends, current conditions, and expected future developments as well as other factors that the company believes are appropriate in the circumstances. While these statements represent the company s current judgment on what the future may hold, and the company believes these judgments are reasonable, these statements are not guarantees of any events or financial results. Whether actual future results and developments will conform to expectations and predictions is subject to a number of risks and uncertainties, including the following factors, many of which are beyond our control:

failure to achieve our long-term financial improvement goals;

demand for and market acceptance risks for and competitive pressures related to new and existing products;

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

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

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

failures with respect to the company s compliance programs;

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

the impact of U.S. healthcare reform and other similar actions undertaken by foreign governments with respect to pricing, reimbursement, taxation and rebate policies;

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

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

global regulatory, trade and tax policies;

the company s ability to identify business development and growth opportunities and to successfully execute on business development strategies;

the company s ability to finance and develop new products or enhancements internally, on commercially acceptable terms or at all;

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

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

inability to create additional production capacity in a timely manner or the occurrence of other manufacturing or supply difficulties;

the company s ability to achieve the intended results associated with the recent separation of its biopharmaceuticals and medical products businesses or targeted margin improvements;

the company s ability to dispose of the Retained Shares in a tax-efficient manner;

the impact of any future tax liability with respect to the separation and distribution, including with respect to disposition of the Retained Shares;

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any failure by Baxalta or Shire to satisfy its obligation under the separation agreements, including the tax matters agreement, or the Letter Agreement;

the ability to protect or enforce the company s owned or in-licensed patent or other proprietary rights (including trademarks, copyrights, trade secrets and know-how) or patents of third parties preventing or restricting the company s manufacture, sale or use of affected products or technology;

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

fluctuations in foreign exchange and interest rates;

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

actions by tax authorities in connection with ongoing tax audits;

breaches or failures of the company s information technology systems;

loss of key employees or inability to identify and recruit new employees;

the outcome of pending or future litigation;

the adequacy of the company s cash flows from operations to meet its ongoing cash obligations and fund its investment program; and

other factors identified elsewhere in this Annual Report on Form 10-K including those factors described in Item 1A and other filings with the Securities and Exchange Commission, all of which are available on the company s website.

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

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

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

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

CONSOLIDATED BALANCE SHEETS

as of December 31 (in millions, except share information)		2015	2014
Current assets	Cash and equivalents	**$ 2,213**	$ 2,925
	Accounts and other current receivables, net	**1,731**	1,884
	Inventories	**1,604**	1,577
	Prepaid expenses and other	**855**	478
	Investment in Baxalta common stock	**5,148**	
	Current assets held for disposition	**245**	3,298
	Total current assets	**11,796**	10,162
Property, plant and equipment, net		**4,386**	4,434
Other assets	Goodwill	**2,687**	2,927
	Other intangible assets, net	**1,349**	1,620
	Other	**757**	930
	Non-current assets held for disposition		6,065
	Total other assets	**4,793**	11,542
	Total assets	**$ 20,975**	$ 26,138
Current liabilities	Short-term debt	**$ 1,775**	$ 913
	Current maturities of long-term debt and lease obligations	**810**	785
	Accounts payable and accrued liabilities	**2,666**	2,677
	Current income taxes payable	**453**	336
	Current liabilities held for disposition	**46**	1,326
	Total current liabilities	**5,750**	6,037
Long-term debt and lease obligations		**3,935**	7,331
Other long-term liabilities		**2,425**	2,937
Non-current liabilities held for disposition			1,677
Equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2015 and 2014	**683**	683
	Common stock in treasury, at cost, 135,839,938 shares in 2015 and 141,116,857 shares in 2014	**(7,646)**	(7,993)
	Additional contributed capital	**5,902**	5,853
	Retained earnings	**9,683**	13,227
	Accumulated other comprehensive income (loss)	**224**	(3,650)
	Total Baxter shareholders equity	**8,846**	8,120
	Noncontrolling interests	**19**	36
	Total equity	**8,865**	8,156
	Total liabilities and equity	**$ 20,975**	$ 26,138

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

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CONSOLIDATED STATEMENTS OF INCOME

years ended December 31 (in millions, except per share data)	**2015**	2014	2013
Net sales	**$ 9,968**	$ 10,719	$ 9,413
Cost of sales	**5,822**	6,138	5,251
Gross margin	**4,146**	4,581	4,162
Marketing and administrative expenses	**3,094**	3,315	3,084
Research and development expenses	**603**	610	582
Operating income	**449**	656	496
Net interest expense	**126**	145	128
Other (income) expense, net	**(105)**	21	(7)
Income from continuing operations before income taxes	**428**	490	375
Income tax expense	**35**	33	60
Income from continuing operations	**393**	457	315
Income from discontinued operations, net of tax	**575**	2,040	1,697
Net income	**$ 968**	**$ 2,497**	**$ 2,012**
Income from continuing operations per common share			
Basic	**$ 0.72**	$ 0.84	$ 0.58
Diluted	**$ 0.72**	$ 0.83	$ 0.57
Income from discontinued operations per common share			
Basic	**$ 1.06**	$ 3.77	$ 3.12
Diluted	**$ 1.04**	$ 3.73	$ 3.09
Net income per common share			
Basic	**$ 1.78**	$ 4.61	$ 3.70
Diluted	**$ 1.76**	$ 4.56	$ 3.66
Weighted-average number of common shares outstanding			
Basic	**545**	542	543
Diluted	**549**	547	549

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

years ended December 31 (in millions)	**2015**	2014	2013
Net income	**$ 968**	$ 2,497	$ 2,012
Other comprehensive (loss) income, net of tax:			
Currency translation adjustments, net of tax (benefit) expense of ($107) in 2015, ($132) in 2014 and $41 in 2013	**(1,094)**	(1,332)	236
Pension and other employee benefits, net of tax expense (benefit) of $104 in 2015, ($193) in 2014 and $309 in 2013	**165**	(400)	592
Hedging activities, net of tax expense of $9 in 2015, $14 in 2014 and $7 in 2013	**15**	24	15
Available-for-sale securities, net of tax expense (benefit) of $6 in 2015, ($2) in 2014 and ($3) in 2013	**4,438**	34	(9)
Total other comprehensive income (loss), net of tax	**3,524**	(1,674)	834
Comprehensive income	**$ 4,492**	$ 823	$ 2,846

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

years ended December 31 (in millions) (brackets denote cash outflows)		2015	2014	2013
Cash flows from operations	Net income	**$ 968**	$ 2,497	$ 2,012
	Adjustments to reconcile income from continuing operations to net cash from operating activities:			
	Income from discontinued operations, net of tax	**(575)**	(2,040)	(1,697)
	Depreciation and amortization	**759**	792	635
	Deferred income taxes	**(50)**	(117)	(185)
	Stock compensation	**126**	126	122
	Realized excess tax benefits from stock issued under employee benefit plans	**(7)**	(15)	(21)
	Business optimization charges	**130**	(6)	149
	Net periodic pension benefit and OPEB costs	**227**	219	308
	Infusion pump and other product-related charges	**(28)**	93	17
	Other, net	**(105)**	19	(73)
	Changes in balance sheet items			
	Accounts and other current receivables, net	**(4)**	(93)	16
	Inventories	**(118)**	(143)	(49)
	Accounts payable and accrued liabilities	**236**	(37)	175
	Business optimization and infusion pump payments	**(112)**	(124)	(94)
	Other, net	**(318)**	(17)	(26)
	Cash flows from operations continuing operations	**1,129**	1,154	1,289
	Cash flows from operations discontinued operations	**518**	2,061	1,909
	Cash flows from operations	**1,647**	3,215	3,198
Cash flows from investing activities	Capital expenditures	**(911)**	(925)	(706)
	Acquisitions and investments, net of cash acquired	**(34)**	(95)	(3,673)
	Divestitures and other investing activities	**84**	99	31
	Cash flows from investing activities continuing operations	**(861)**	(921)	(4,348)
	Cash flows from investing activities discontinued operations	**(946)**	(621)	(1,014)
	Cash flows from investing activities	**(1,807)**	(1,542)	(5,362)
Cash flows from financing activities	Issuances of debt	**6,868**	41	3,636
	Payments of obligations	**(3,776)**	(1,029)	(540)
	(Decrease) increase in debt with original maturities of three months or less, net	**(575)**	875	
	Transfer of cash and equivalents to Baxalta	**(2,122)**		
	Cash dividends on common stock	**(910)**	(1,095)	(1,023)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	**200**	369	508
	Purchases of treasury stock		(550)	(913)
	Other	**(42)**	(13)	(23)
	Cash flows from financing activities	**(357)**	(1,402)	1,645
Effect of foreign exchange rate changes on cash and equivalents		**(195)**	(79)	(18)

(Decrease) increase in cash and equivalents	**(712)**	192	(537)
Cash and equivalents at beginning of year	**2,925**	2,733	3,270
Cash and equivalents at end of year	**$ 2,213**	$ 2,925	$ 2,733
Other supplemental information			
Interest paid, net of portion capitalized	**$ 178**	$ 208	$ 200
Income taxes paid	**$ 466**	$ 726	$ 648

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

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CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

as of and for the years ended December 31 (in millions)	2015 Shares	2015 Amount	2014 Shares	2014 Amount	2013 Shares	2013 Amount
Common stock						
Balance, beginning and end of year	**683**	**$ 683**	683	$ 683	683	$ 683
Common stock in treasury						
Beginning of year	**141**	**(7,993)**	140	(7,914)	137	(7,592)
Purchases of common stock			8	(550)	13	(913)
Stock issued under employee benefit plans and other	**(5)**	**347**	(7)	471	(10)	591
End of year	**136**	**(7,646)**	141	(7,993)	140	(7,914)
Additional contributed capital						
Beginning of year		**5,853**		5,818		5,769
Stock issued under employee benefit plans and other		**49**		35		45
Exercise of SIGMA purchase option						4
End of year		**5,902**		5,853		5,818
Retained earnings						
Beginning of year		**13,227**		11,852		10,888
Net income		**968**		2,497		2,012
Dividends declared on common stock		**(695)**		(1,116)		(1,048)
Stock issued under employee benefit plans		**(90)**		(6)		
Distribution of Baxalta		**(3,727)**				
End of year		**9,683**		13,227		11,852
Accumulated other comprehensive income (loss)						
Beginning of year		**(3,650)**		(1,976)		(2,810)
Other comprehensive income (loss)		**3,524**		(1,674)		834
Distribution of Baxalta		**350**				
End of year		**224**		(3,650)		(1,976)
Total Baxter shareholders equity		**8,846**		$ 8,120		$ 8,463
Noncontrolling interests						
Beginning of year		**36**		$ 23		$ 40
Change in noncontrolling interests		**(17)**		13		(17)
End of year		**19**		$ 36		$ 23
Total equity		**$ 8,865**		$ 8,156		$ 8,486

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Baxter International Inc., through its subsidiaries, provides a broad portfolio of essential renal and hospital products, including home, acute and in-center dialysis; sterile IV solutions; infusion systems and devices; parenteral nutrition; biosurgery products and anesthetics; and pharmacy automation, software and services. The company s global footprint and the critical nature of its products and services play a key role in expanding access to healthcare in emerging and developed countries. These products are used by hospitals, kidney dialysis centers, nursing homes, rehabilitation centers, doctors offices and by patients at home under physician supervision. The company operates in two segments, Renal and Hospital Products, which are described in Note 17.

Use of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles (GAAP) requires the company to make estimates and assumptions that affect reported amounts and related disclosures. Actual results could differ from those estimates.

Basis of Presentation

The consolidated financial statements include the accounts of Baxter and its majority-owned subsidiaries that Baxter controls, after elimination of intercompany transactions. Certain reclassifications have been made to conform prior period consolidated financial statements to the current period presentation.

On July 1, 2015, Baxter completed the distribution of approximately 80.5% of the outstanding common stock of its biopharmaceuticals business, Baxalta Incorporated (Baxalta), to Baxter stockholders (the Distribution). The Distribution was made to Baxter s stockholders of record as of the close of business on June 17, 2015, who received one share of Baxalta common stock for each Baxter common share held as of such date. As a result of the Distribution, Baxalta is now an independent public company whose shares trade on the New York Stock Exchange under the symbol BXLT. Baxter is accounting for its investment in Baxalta common stock as an available-for-sale equity security with a fair value of approximately $5.1 billion as of December 31, 2015 (prior to giving effect to the disposition of 37,573,040 Baxalta shares of common stock on January 27, 2016 in a related debt for equity exchange).

As a result of the separation, the consolidated statements of income, consolidated balance sheets, consolidated statements of cash flow, and related financial information reflect Baxalta s operations, assets and liabilities, and cash flows as discontinued operations for all periods presented. Refer to Note 2 for additional information regarding the separation of Baxalta.

As a result of the separation of Baxalta, Baxter realigned its organizational structure under two reportable segments, Renal and Hospital Products. Refer to Note 17 for additional information regarding the company s segments.

On September 6, 2013, Baxter acquired Indap Holding AB, the holding company for Gambro AB (Gambro), a privately held dialysis product company based in Lund, Sweden, for cash consideration of $3.7 billion. Beginning September 6, 2013, Baxter s financial statements include the assets, liabilities, and operating results of Gambro. Refer to Note 5 for additional information about the Gambro acquisition.

Revenue Recognition

The company recognizes revenues from product sales and services when earned. Specifically, revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred (or services have been

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rendered), the price is fixed or determinable, and collectability is reasonably assured. For product sales, revenue is not recognized until title and risk of loss have transferred to the customer. The shipping terms for the majority of the company s revenue arrangements are FOB destination. The recognition of revenue is delayed if there are significant post-delivery obligations, such as training, installation or other services. Provisions for discounts, rebates to customers, chargebacks to wholesalers and returns are provided for at the time the related sales are recorded, and are reflected as a reduction to gross sales to arrive at net sales.

The company sometimes enters into arrangements in which it commits to delivering multiple products or services to its customers. In these cases, total arrangement consideration is allocated to the deliverables based on their relative selling prices. Then the allocated consideration is recognized as revenue in accordance with the principles described above. Selling prices are determined by applying a selling price hierarchy and by using vendor specific objective evidence (VSOE), if it exists. Otherwise, selling prices are determined using third party evidence (TPE). If neither VSOE nor TPE is available, the company uses its best estimate of selling prices.

Accounts Receivable and Allowance for Doubtful Accounts

In the normal course of business, the company provides credit to its customers, performs credit evaluations of these customers and maintains reserves for potential credit losses. In determining the amount of the allowance for doubtful accounts, the company considers, among other items, historical credit losses, the past-due status of receivables, payment histories and other customer-specific information. Receivables are written off when the company determines they are uncollectible. The allowance for doubtful accounts was $110 million at December 31, 2015 and $119 million at December 31, 2014.

Product Warranties

The company provides for the estimated costs relating to product warranties at the time the related revenue is recognized. The cost is determined based on actual company experience for the same or similar products, as well as other relevant information. Product warranty liabilities are adjusted based on changes in estimates.

Cash and Equivalents

Cash and equivalents include cash, certificates of deposit and money market funds with an original maturity of three months or less.

Inventories

as of December 31 (in millions)	**2015**	2014
Raw materials	**$ 374**	$ 372
Work in process	**142**	148
Finished goods	**1,088**	1,057
Inventories	**$ 1,604**	$ 1,577

Inventories are stated at the lower of cost (first-in, first-out method) or market value. Market value for raw materials is based on replacement costs, and market value for work in process and finished goods is based on net realizable value. The company reviews inventories on hand at least quarterly and records provisions for estimated excess, slow-moving and obsolete inventory, as well as inventory with a carrying value in excess of net realizable value.

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Property, Plant and Equipment, Net

as of December 31 (in millions)	2015	2014
Land	**$ 116**	$ 119
Buildings and leasehold improvements	**1,389**	1,378
Machinery and equipment	**5,414**	5,377
Equipment with customers	**1,238**	1,351
Construction in progress	**833**	729
Total property, plant and equipment, at cost	**8,990**	8,954
Accumulated depreciation	**(4,604)**	(4,520)
Property, plant and equipment (PP&E), net	**$ 4,386**	$ 4,434

Depreciation expense is calculated using the straight-line method over the estimated useful lives of the related assets, which range from 20 to 50 years for buildings and improvements and from three to 15 years for machinery and equipment. Leasehold improvements are amortized over the life of the related facility lease (including any renewal periods, if appropriate) or the asset, whichever is shorter. Baxter capitalizes certain computer software and software development costs incurred in connection with developing or obtaining software for internal use as part of machinery and equipment. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software, and are included in depreciation expense. Straight-line and accelerated methods of depreciation are used for income tax purposes. Depreciation expense was $597 million in 2015, $613 million in 2014 and $502 million in 2013.

Acquisitions

Results of operations of acquired companies are included in the company s results of operations as of the respective acquisition dates. The purchase price of each acquisition is allocated to the net assets acquired based on estimates of their fair values at the date of the acquisition. Any purchase price in excess of these net assets is recorded as goodwill. The allocation of purchase price in certain cases may be subject to revision based on the final determination of fair values during the measurement period, which may be up to one year from the acquisition date.

Contingent consideration is recognized at the estimated fair value on the acquisition date. Subsequent changes to the fair value of contingent payments are recognized in earnings as a component of other income (expense), net. Contingent payments related to acquisitions may consist of development, regulatory and commercial milestone payments, in addition to sales-based payments, and are valued using discounted cash flow techniques. The fair value of development, regulatory and commercial milestone payments reflects management s expectations of probability of payment, and increases or decreases as the probability of payment or expectation of timing of payments changes. The fair value of sales-based payments is based upon probability-weighted future revenue estimates and increases or decreases as revenue estimates or expectation of timing of payments changes.

Research and Development

Research and development (R&D) costs, including R&D acquired in transactions that are not business combinations, are expensed as incurred. Pre-regulatory approval contingent milestone obligations to counterparties in collaborative arrangements are expensed when the milestone is achieved. Payments made to counterparties on or after regulatory approval are capitalized and amortized over the remaining useful life of the related product. Amounts capitalized for such payments are included in other intangible assets, net of accumulated amortization.

Acquired in-process R&D (IPR&D) is the value assigned to technology or products under development acquired in a business combination which have not received regulatory approval and have no alternative future use.

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Acquired IPR&D is capitalized as an indefinite-lived intangible asset. Development costs incurred after the acquisition are expensed as incurred. Upon receipt of regulatory approval of the related technology or product, the indefinite-lived intangible asset is accounted for as a finite-lived intangible asset and amortized on a straight-line basis over the estimated economic life of the related technology or product, subject to annual impairment reviews as discussed below. If the R&D project is abandoned, the indefinite-lived asset is charged to expense.

Collaborative Arrangements

The company enters into collaborative arrangements in the normal course of business. These collaborative arrangements take a number of forms and structures, and are designed to enhance and expedite long-term sales and profitability growth. These arrangements may provide that Baxter obtain commercialization rights to a product under development, and require Baxter to make upfront payments, contingent milestone payments, profit-sharing, and/or royalty payments. Baxter may be responsible for ongoing costs associated with the arrangements, including R&D cost reimbursements to the counterparty. See above regarding the accounting treatment of payments during the development stage. Any royalty and profit-sharing payments during the commercialization phase are expensed as cost of sales when they become due and payable.

Business Optimization Charges

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

Goodwill

Goodwill is not amortized, but is subject to an impairment review annually and whenever indicators of impairment exist. Goodwill would be impaired if the carrying amount of a reporting unit exceeded the fair value of that reporting unit, calculated as the present value of estimated cash flows discounted using a risk-free market rate adjusted for a market participant s view of similar companies and perceived risks in the cash flows. The implied fair value of goodwill is then determined by subtracting the fair value of all identifiable net assets other than goodwill from the fair value of the reporting unit, with an impairment charge recorded for the excess, if any, of carrying amount of goodwill over the implied fair value.

Intangible Assets Not Subject to Amortization

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

Other Long-Lived Assets

The company reviews the carrying amounts of long-lived assets, other than goodwill and intangible assets not subject to amortization, for potential impairment when events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. In evaluating recoverability, the company groups assets and liabilities at the lowest level such that the identifiable cash flows relating to the group are largely independent of the cash flows of other assets and liabilities. The company then compares the carrying amounts of the assets or asset groups with the related estimated undiscounted future cash flows. In the event impairment exists, an impairment charge is recorded as the amount by which the carrying amount of the asset or asset group exceeds the fair value.

Shipping and Handling Costs

Shipping costs, which are costs incurred to physically move product from Baxter s premises to the customer s premises, are classified as marketing and administrative expenses. Handling costs, which are costs incurred to

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store, move and prepare products for shipment, are classified as cost of sales. Approximately $272 million in 2015, $319 million in 2014 and $273 million in 2013 of shipping costs were classified in marketing and administrative expenses.

Income Taxes

Deferred taxes are recognized for the future tax effects of temporary differences between financial and income tax reporting based on enacted tax laws and rates. The company maintains valuation allowances unless it is more likely than not that the deferred tax asset will be realized. With respect to uncertain tax positions, the company determines whether the position is more likely than not to be sustained upon examination, based on the technical merits of the position. Any tax position that meets the more likely than not recognition threshold is measured and recognized in the consolidated financial statements at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. The liability relating to uncertain tax positions is classified as current in the consolidated balance sheets to the extent the company anticipates making a payment within one year. Interest and penalties associated with income taxes are classified in the income tax expense line in the consolidated statements of income.

Foreign Currency Translation

Currency translation adjustments (CTA) related to foreign operations are included in other comprehensive income (OCI). For foreign operations in highly inflationary economies, translation gains and losses are included in other expense (income), net, and were not material in 2015, 2014 and 2013.

Derivatives and Hedging Activities

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

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

For each derivative instrument that is designated and effective as a fair value hedge, the gain or loss on the derivative is recognized into earnings, offsetting the loss or gain on the underlying hedged item. Fair value hedges are classified in net interest expense, as they hedge the interest rate risk associated with certain of the company s fixed-rate debt.

For derivative instruments that are not designated as hedges, the change in fair value is recorded directly to other expense (income), net.

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

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Derivatives, including those that are not designated as a hedge, are principally classified in the operating section of the consolidated statements of cash flows in the same category as the related consolidated balance sheet account.

Refer to Note 9 for further information regarding the company s derivative and hedging activities.

New Accounting Standards

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes, which requires net deferred tax assets and liabilities to be classified as non-current on the Consolidated Balance Sheets. Prior to adoption of the new standard, net deferred tax assets and liabilities were presented separately as current and non-current on the Consolidated Balance Sheets. ASU No. 2015-17 is effective for financial statements issued for annual periods beginning after December 15, 2016 and early adoption is permitted. The company elected to retrospectively adopt this accounting standard as of December 31, 2015. As a result of the adoption, $354 million and $531 million net deferred tax assets are presented as non-current as of December 31, 2015 and 2014, respectively, and $195 million and $168 million net deferred tax liabilities are presented as non-current as of December 31, 2015 and 2014, respectively. There was no effect to Baxter shareholders equity or to the consolidated statements of net income as a result of this adoption.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles Goodwill and Other Internal-Use Software (Subtopic 350-40): Customer s Accounting for Fees Paid in a Cloud Computing Arrangement, which provides guidance to customers about how to account for cloud computing arrangements when such arrangements include software licenses. ASU No. 2015-05 will be effective for the company beginning on January 1, 2016. The standard may be applied retrospectively or prospectively. The company does not expect a material impact from the adoption of this standard.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which amends the existing accounting standards for revenue recognition. ASU No. 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers. In August 2015, the FASB approved a one-year deferral of the original effective date of January 1, 2017; therefore, ASU No. 2014-09 will be effective for the company beginning on January 1, 2018. Early adoption is permitted as of the original effective date. The standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. The company is currently evaluating the impact of adopting the standard on its consolidated financial statements.

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NOTE 2

SEPARATION OF BAXALTA INCORPORATED

The table following is a summary of the assets and liabilities distributed as part of the separation on July 1, 2015.

(in millions)	
Assets	
Cash and equivalents	$ 2,122
Accounts and other current receivables, net	600
Inventories	2,018
Other current assets	336
Property, plant and equipment, net	4,581
Goodwill	1,026
Other intangible assets, net	614
Other long-term assets	511
Total assets	$ 11,808
Liabilities	
Accounts payable and accrued liabilities	$ 1,166
Long-term debt and lease obligations	5,253
Other long-term liabilities	1,292
Total liabilities	$ 7,711
Net assets distributed	$ 4,097

In addition, approximately $350 million of accumulated other comprehensive losses, net of tax were distributed to Baxalta. Baxter also retained an investment in Baxalta with a cost basis of $719 million and fair value of $5.1 billion as of December 31, 2015.

The following table is a summary of the operating results of Baxalta, which have been reflected as discontinued operations for the years ended December 31, 2015, 2014 and 2013.

Years ended December 31 (in millions)	**2015**	2014	2013
Major classes of line items constituting income from discontinued operations before income taxes			
Net sales	**$ 2,895**	$ 6,523	$ 5,847
Cost of sales	**(1,214)**	(2,475)	(2,413)
Marketing and administrative expenses	**(547)**	(769)	(597)
Research and development expenses	**(389)**	(822)	(664)
Other income and expense items	**7**	105	2
Total income from discontinued operations before income taxes	**752**	2,562	2,175
Income tax expense	**177**	522	478

Total income from discontinued operations	**$ 575**	$ 2,040	$ 1,697

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The assets and liabilities of Baxalta have been classified as held for disposition as of December 31, 2015 and 2014. These amounts consist of the following carrying amounts in each major class.

As of December 31 (in millions)	2015	2014
Carrying amounts of major classes of assets included as part of discontinued operations		
Accounts and other current receivables, net	**$ 228**	$ 919
Inventories	**8**	1,982
Property, plant, and equipment, net	**2**	4,264
Goodwill		947
Other intangible assets, net		460
Other	**7**	791
Total assets of the disposal group	**$ 245**	$ 9,363
Carrying amounts of major classes of liabilities included as part of discontinued operations		
Accounts payable and accrued liabilities	**$ 46**	$ 1,325
Other long-term liabilities		1,402
Other		276
Total liabilities of the disposal group	**$ 46**	$ 3,003

For a portion of Baxalta s operations, the legal transfer of Baxalta s assets and liabilities did not occur with the separation of Baxalta on July 1, 2015 due to the time required to transfer marketing authorizations and other regulatory requirements in certain countries. Under the terms of the International Commercial Operations Agreement (ICOA), Baxalta is subject to the risks and entitled to the benefits generated by these operations and assets until legal transfer; therefore, the net economic benefit and any cash collected by these entities are transferred to Baxalta. As of December 31, 2015 Baxter has recorded a liability of $190 million for its obligation to transfer these net assets to Baxalta and net cash outflow of $19 million has been included within the consolidated statement of cash flows as a cash flow from operations discontinued operations. On February 1, 2016, the legal transfer of approximately $85 million of net assets as of December 31, 2015 was distributed to Baxalta. It is expected that the majority of the remaining operations will be transferred to Baxalta during 2016.

Baxter and Baxalta entered into several additional agreements in connection with the separation, including a transition services agreement (TSA), separation and distribution agreement, manufacturing and supply agreements (MSA), tax matters agreement, an employee matters agreement, a long-term services agreement, and a shareholder s and registration rights agreement.

Pursuant to the TSA, Baxter and Baxalta and their respective subsidiaries are providing to each other, on an interim, transitional basis, various services. Services being provided by Baxter include, among others, finance, information technology, human resources, quality supply chain, and certain other administrative services. The services generally commenced on the Distribution date and are expected to terminate within 24 months (or 36 months in the case of certain information technology services) of the Distribution date. Billings by Baxter under the TSA are recorded as a reduction of the costs to provide the respective service in the applicable expense category, primarily in marketing and administrative expenses, in the consolidated statements of income. In 2015, the company recognized approximately $75 million as a reduction to marketing and administrative expenses related to the TSA.

Pursuant to the MSA, Baxalta or Baxter, as the case may be, manufactures, labels, and packages products for the other party. The terms of the agreements range in initial duration from five to 10 years. In 2015, Baxter recognized approximately $37 million in sales to Baxalta. In addition, Baxter recognized approximately $100 million in cost of sales related to purchases from Baxalta pursuant to the MSA. The cash flows associated with these agreements are included in cash flows from operations continuing operations.

In December 2015, Baxter sold to Baxalta certain assets for approximately $28 million with no resulting impact to net income.

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NOTE 3

SUPPLEMENTAL FINANCIAL INFORMATION

Prepaid Expenses and Other

as of December 31 (in millions)	**2015**	2014
Prepaid valuation added taxes	**$ 118**	$ 71
Prepaid income taxes	**302**	27
Other	**435**	380
Prepaid expenses and other	**$ 855**	$ 478

Other Long-Term Assets

as of December 31 (in millions)	**2015**	2014
Deferred income taxes	**$ 354**	$ 531
Other long-term receivables	**176**	84
All other	**227**	315
Other long-term assets	**$ 757**	$ 930

Accounts Payable and Accrued Liabilities

as of December 31 (in millions)	**2015**	2014
Accounts payable, principally trade	**$ 716**	$ 677
Common stock dividends payable	**137**	363
Employee compensation and withholdings	**481**	485
Property, payroll and certain other taxes	**166**	184
Infusion pump reserves	**52**	145
Business optimization reserves	**98**	89
Accrued rebates	**192**	174
Separation-related reserves	**190**	
All other	**634**	560
Accounts payable and accrued liabilities	**$ 2,666**	$ 2,677

Other Long-Term Liabilities

as of December 31 (in millions)	**2015**	2014
Pension and other employee benefits	**$ 2,041**	$ 2,198
Deferred tax liabilities	**195**	168
Litigation reserves	**24**	32
Business optimization reserves	**18**	38

Contingent payment liabilities	**20**	51
All other	**127**	450
Other long-term liabilities	**$ 2,425**	$ 2,937

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Net Interest Expense

years ended December 31 (in millions)	**2015**	2014	2013
Interest costs	**$ 197**	$ 237	$ 225
Interest costs capitalized	**(51)**	(70)	(70)
Interest expense	**146**	167	155
Interest income	**(20)**	(22)	(27)
Net interest expense	**$ 126**	$ 145	$ 128

Other (Income) Expense, net

years ended December 31 (in millions)	**2015**	2014	2013
Foreign exchange	**$ (113)**	$ (8)	$ 26
Loss on debt extinguishment	**130**		
Gain on litigation settlement	**(52)**		
Gain on sale of investments and other assets	**(38)**	(20)	(16)
All other	**(32)**	49	(17)
Other (income) expense, net	**$ (105)**	$ 21	$ (7)

NOTE 4

EARNINGS PER SHARE

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

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

years ended December 31 (in millions)	**2015**	2014	2013
Basic shares	**545**	542	543
Effect of dilutive securities	**4**	5	6
Diluted shares	**549**	547	549

The effect of dilutive securities included unexercised stock options, unvested RSUs and contingently issuable shares related to granted PSUs. The computation of diluted EPS excluded 18 million, 9 million, and 5 million equity awards in 2015, 2014 and 2013, respectively, because their inclusion would have had an anti-dilutive effect on diluted EPS. Refer to Note 12 for additional information regarding items impacting basic shares.

NOTE 5

ACQUISITIONS AND OTHER ARRANGEMENTS

Gambro AB Acquisition

On September 6, 2013, Baxter acquired 100 percent of the voting equity interests in Indap Holding AB, the holding company for Gambro, a privately held dialysis product company based in Lund, Sweden. Gambro is a global medical technology company focused on developing, manufacturing and supplying dialysis products and therapies for patients with acute or chronic kidney disease. The transaction provided Baxter with a broad and complementary dialysis product portfolio, while further advancing the company s geographic footprint in the dialysis business. In addition, the company augmented its pipeline with Gambro s next-generation monitors, dialyzers, devices and dialysis solutions.

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The total cash consideration for the acquisition, as reduced by assumed debt of $221 million, was $3.7 billion. The following table summarizes the final fair value of the consideration transferred and the amounts recognized for assets acquired and liabilities assumed as of the acquisition date.

(in millions)	
Consideration transferred	
Cash	$ 3,700
Fair value of consideration transferred	$ 3,700
Assets acquired and liabilities assumed	
Cash	$ 88
Accounts receivable	488
Inventories	368
Prepaid expenses and other	54
Property, plant, and equipment	740
Other intangible assets	1,290
Other assets	11
Current-maturities of long-term debt and lease obligations	(2)
Accounts payable and accrued liabilities	(345)
Long-term debt and lease obligations	(261)
Other long-term liabilities (including pension obligations of $209)	(341)
Total identifiable net assets	2,090
Goodwill	1,610
Total assets acquired and liabilities assumed	$ 3,700

The results of operations, assets and liabilities of Gambro are included in the Renal segment. Goodwill recorded as part of the acquisition included expected synergies, as well as an expanded dialysis product portfolio and global footprint for the company s Renal business. The goodwill is not deductible for tax purposes. Other intangible assets included developed technology of $916 million, trademarks of $206 million, and indefinite-lived IPR&D of $168 million. Other intangible assets, excluding IPR&D, are being amortized on a straight-line basis over a weighted-average estimated useful life of approximately 15 years. The acquired IPR&D related to next generation monitors, dialyzers, fluids, and other technologies used in both chronic and acute therapies. The projects ranged in levels of completion and were expected to be completed over a five year period. The value of the IPR&D was calculated using cash flow projections adjusted for the inherent technical, regulatory, commercial and obsolescence risk in such activities, discounted at a rate of 12%. As of the acquisition date, additional research and development costs totaling approximately $85 million were projected to be required in order for the projects to obtain regulatory approval. Certain projects were completed during 2014 and 2015.

Long-term debt and lease obligations included $221 million of Gambro s pre-existing Euro-denominated debt assumed by Baxter on the date of closing, which was subsequently paid off in September 2013. The debt settlement has been classified as a financing activity in the consolidated statements of cash flows.

The company incurred acquisition-related costs of $101 million during 2013, which were recorded in marketing and administrative expenses.

Actual and pro forma impact of acquisition

The following table presents information for Gambro that has been included in Baxter s consolidated statements of income from the acquisition date through December 31, 2013.

For the year ended December 31, (in millions)	2013

Net sales	$ 513
Net loss	$ (45)

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The net loss included the impact of fair value adjustments to acquisition-date inventory that was sold in 2013 (approximately $62 million on a pre-tax basis).

The following table presents supplemental pro forma information for the year ended December 31, 2013 as if the acquisition of Gambro had occurred on January 1, 2012.

For the year ended December 31, (in millions, except per share information)	2013
Net sales	$10,149
Income from continuing operations	441
Basic EPS from continuing operations	$ 0.82
Diluted EPS from continuing operations	$ 0.80

The unaudited pro forma consolidated results were prepared using the acquisition method of accounting and are based on the historical information of Baxter and Gambro. The unaudited pro forma consolidated results are not necessarily indicative of what the consolidated results of operations would have been had the acquisition been completed on January 1, 2012. In addition, the unaudited pro forma consolidated results are not projections of future results of operations of the combined company nor do they reflect the expected realization of any cost savings or synergies associated with the acquisition.

The unaudited pro forma consolidated results reflect primarily the following pro forma pre-tax adjustments:

- Conversion of Gambro s historical results of operations from International Financial Reporting Standards (IFRS) to GAAP.
- Elimination of Gambro s historical intangible asset amortization expense and property, plant and equipment depreciation expense.
- Addition of amortization expense related to the fair value of identifiable intangible assets acquired.
- Addition of depreciation expense related to the fair value of property, plant and equipment acquired.
- Elimination of a $62 million charge related to the fair value adjustment of acquisition-date inventory from the year ended December 31, 2013.
- Elimination of Gambro s historical interest expense and addition of interest expense associated with debt that was issued in 2013 to partially finance the acquisition.
- Elimination of $244 million of acquisition, integration and currency-related charges from the year ended December 31, 2013 and addition of these costs to the year ended December 31, 2012. These costs were directly attributable to the acquisition and non-recurring in nature and included acquisition and integration related charges incurred by Baxter, in addition to post-acquisition restructuring costs and losses from foreign currency hedging activity related to the acquisition.

Other Arrangements

JW Holdings Corporation

In July 2013, Baxter entered into a collaboration agreement with JW Holdings Corporation (JW Holdings) for parenteral nutritional products containing a novel formulation of omega 3 lipids. Baxter has exclusive rights to co-develop and distribute the products globally, with the exception of Korea. In 2013, Baxter recognized an R&D charge of $25 million related to an upfront payment. Upon entering into the agreement,

Baxter had the potential to make future payments of up to $11 million relating to the achievement of regulatory milestones, in addition to future royalty payments.

Celerity Pharmaceuticals, LLC

In September 2013, Baxter entered into an agreement with Celerity Pharmaceutical, LLC (Celerity), a company of Water Street Healthcare Partners III, LLP, to develop certain acute care generic injectable premix and

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oncolytic molecules through regulatory approval. Baxter transferred its rights in these molecules to Celerity and Celerity assumed ownership and responsibility for development of the molecules. Baxter is obligated to purchase the individual product rights from Celerity if the products obtain regulatory approval. In 2015, Baxter paid approximately $14 million to acquire the rights to cefazolin injection in GALAXY Container (2 g/100 mL). Baxter capitalized the purchase price as an intangible asset and is amortizing the asset over the estimated economic life of 12 years. As of December 31, 2015, Baxter had the potential to make future payments of up to $280 million upon Celerity s achievement of specified regulatory approvals.

NOTE 6

GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

The following table is a summary of the activity in goodwill by segment.

(in millions)	Renal	Hospital Products	Total
December 31, 2013	$ 500	$ 2,790	$ 3,290
Additions			
Currency translation and other adjustments	(55)	(308)	(363)
December 31, 2014	$ 445	$ 2,482	$ 2,927
Additions			
Currency translation and other adjustments	(37)	(203)	(240)
December 31, 2015	**$ 408**	**$ 2,279**	**$ 2,687**

As a result of the separation of Baxalta in July 2015, the goodwill associated with Baxter s former BioScience segment has been eliminated. The remaining goodwill was allocated from the former Medical Products segment to the Renal and Hospital Products segments using the relative fair value approach.

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As of December 31, 2015, there were no reductions in goodwill relating to impairment losses.

Other Intangible Assets, Net

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

(in millions)	Developed technology, including patents	Other amortized intangible assets	Indefinite-lived intangible assets	Total
December 31, 2015				
Gross other intangible assets	$1,742	$ 393	$ 86	$2,221
Accumulated amortization	(729)	(143)		(872)
Other intangible assets, net	$1,013	$ 250	$ 86	$1,349
December 31, 2014				
Gross other intangible assets	$1,838	$ 414	$ 123	$2,375
Accumulated amortization	(636)	(119)		(755)
Other intangible assets, net	$1,202	$ 295	$ 123	$1,620

Intangible asset amortization expense was $158 million in 2015, $169 million in 2014 and $113 million in 2013. The anticipated annual amortization expense for definite-lived intangible assets recorded as of December 31, 2015 is $155 million in 2016, $142 million in 2017, $138 million in 2018, $129 million in 2019 and $125 million in 2020.

In 2015, the company recorded impairments of approximately $10 million related to acquired IPR&D and $13 million related to developed technology.

NOTE 7

INFUSION PUMP AND BUSINESS OPTIMIZATION CHARGES

Infusion Pump Charges

The company is undertaking a field corrective action with respect to the SIGMA Spectrum Infusion Pump, which is predominantly sold in the United States. The United States Food and Drug Administration (FDA) categorized the action as a Class 1 recall during the second quarter of 2014. Remediation is expected to include software-related corrections and a replacement pump in a limited number of cases. In 2014, the company recorded a charge of $93 million related primarily to cash costs associated with remediation efforts and utilized $4 million in 2014. During 2015, the company refined its expectations relating to the costs associated with the remediation effort and recorded partial reversals of the cash and non-cash reserves totaling $26 million and $10 million, respectively. Additionally the company utilized $13 million of the cash reserves during 2015. The total remaining reserve as of December 31, 2015 was $40 million. The company expects to complete remediation by the end of 2016.

From 2005 through 2013, the company recorded total charges and adjustments of $888 million related to the COLLEAGUE and SYNDEO infusion pumps, including $725 million of cash costs and $163 million principally related to asset impairments.

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During 2014, the company refined its expectations and recorded an adjustment of $25 million in cost of sales to reduce the COLLEAGUE infusion pump reserves based on the progress of remediation activities in Canada. The following table summarizes cash activity and reserve adjustments related to the company s COLLEAGUE and SYNDEO infusion pump reserves through December 31, 2015.

(in millions)	
Charges and adjustments in 2005 through 2013	$ 725
Utilization in 2005 through 2013	(642)
Reserves at December 31, 2013	83
Reserve adjustments	(25)
Utilization	(36)
Reserves at December 31, 2014	22
Reserve adjustments	**(7)**
Utilization	**(8)**
Reserves at December 31, 2015	**$ 7**

Business Optimization Charges

The company has recorded charges primarily related to costs associated with optimizing the company s overall cost structure on a global basis, as the company streamlined its international operations, rationalized its manufacturing facilities, enhanced its general and administrative infrastructure and realigned certain R&D activities.

The company s total charges in 2015, 2014, and 2013 were as follows:

years ended December 31 (in millions)	**2015**	2014	2013
Cash expenses	**$120**	$ 44	$ 132
Non-cash expenses	**42**	4	49
Reserve adjustments	**(32)**	(54)	(20)
Business optimization expenses in continuing operations	**$130**	$ (6)	$ 161

The business optimization charges are recorded as follows in the consolidated statements of income:

2015: $38 million in cost of sales, $79 million in marketing and administrative expenses, and $13 million in R&D expenses (with an additional ($7 million) recorded in discontinued operations).

2014: ($10 million) in cost of sales, $1 million in marketing and administrative expenses, and $3 million in R&D expenses (with an additional $33 million recorded in discontinued operations).

2013: $47 million in cost of sales, $92 million in marketing and administrative expenses, and $22 million in R&D expenses (with an additional $133 million recorded in discontinued operations).

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

(in millions)	
Reserve at December 31, 2012	$ 195
2013 charges	132
Reserve adjustments	(20)
Utilization in 2013	(67)
CTA	4
Reserve at December 31, 2013	244
2014 charges	44
Reserve adjustments	(54)
Utilization in 2014	(88)
CTA	(19)
Reserve at December 31, 2014	**127**
2015 charges	**120**
Reserve adjustments	**(32)**
Utilization in 2015	**(89)**
CTA	**(10)**
Reserve at December 31, 2015	**$ 116**

The reserves are expected to be substantially utilized by the end of 2016. The company believes the remaining reserves to be adequate; however, additional adjustments may be recorded in the future as the programs are completed.

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NOTE 8

DEBT, CREDIT FACILITIES AND LEASE COMMITMENTS

Debt Outstanding

At December 31, 2015 and 2014, the company had the following debt outstanding:

as of December 31 (in millions)	**2015**	2014
Line of credit	**$1,450**	$
Commercial paper	**300**	875
Other short-term debt	**25**	38
Short-term debt	**$1,775**	$ 913

as of December 31 (in millions)	Effective interest rate in 2015[1]	**2015[2]**	2014[2]
Variable-rate loan due 2015	0.7%		171
4.625% notes due 2015	5.8%		604
5.9% notes due 2016	6.0%	**302**	614
0.95% notes due 2016	1.1%	**500**	500
1.85% notes due 2017	2.0%	**500**	500
Variable-rate loan due 2017	1.1%		120
5.375% notes due 2018	5.5%	**502**	500
1.85% notes due 2018	2.0%	**750**	750
4.5% notes due 2019	4.6%	**531**	535
4.25% notes due 2020	4.4%	**299**	299
Variable-rate loan due 2020	0.7%	**281**	
2.40% notes due 2022	2.6%	**212**	723
3.2% notes due 2023	3.6%	**147**	1,275
6.625% debentures due 2028	6.2%	**101**	132
6.25% notes due 2037	6.4%	**266**	499
3.65% notes due 2042	4.0%	**6**	298
4.5% notes due 2043	4.6%	**257**	500
Other		**91**	96
Total debt and capital lease obligations		**4,745**	8,116
Current portion		**(810)**	(785)
Long-term portion		**$3,935**	$ 7,331

[1] Excludes the effect of any related interest rate swaps.
[2] Book values include any discounts, premiums and adjustments related to hedging instruments.

Significant Debt Issuances

In June 2015, the company s then wholly-owned subsidiary Baxalta issued senior notes with a total aggregate principal amount of $5.0 billion. Approximately $4.0 billion of the related net proceeds were distributed to Baxter in connection with the separation. After the separation, Baxter has no obligations as it relates to the Baxalta senior notes or any other Baxalta indebtedness. Refer to the debt tender offer section below in connection with this debt issuance. In June 2013, the company issued $500 million of floating rate senior notes maturing in December 2014, $500 million of senior notes bearing a coupon rate of 0.95% and maturing in June 2016, $750 million of senior notes bearing a coupon rate of 1.85% and maturing in June 2018, $1.25 billion of senior notes bearing a coupon rate of 3.2% and maturing in June 2023, and $500 million of senior notes bearing a coupon rate of 4.5% and maturing in June 2043. Approximately $3.0 billion of the net proceeds from the June 2013 debt issuances were used to finance the acquisition of Gambro in 2013 and the remainder was used for general corporate purposes, including the repayment of commercial paper.

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Debt Tender Offer

On July 6, 2015 and July 21, 2015 the company purchased an aggregate of approximately $2.7 billion in principal amount of its 5.900% Notes due September 2016, 6.625% Debentures due February 2028, 6.250% Notes due December 2037, 3.650% Notes due August 2042, 4.500% Notes due June 2043, 3.200% Notes due June 2023, and 2.400% Notes due August 2022 pursuant to a debt tender offer. Baxter paid approximately $2.9 billion, including accrued and unpaid interest and tender premium, to purchase such notes. As a result of the debt tender offers the company recognized a loss on extinguishment of debt in the third quarter of 2015 of $130 million, which is included in other expense (income), net within the Consolidated Statements of Income.

Credit Facilities

As of December 31, 2015, the company has drawn $1.45 billion under its $1.8 billion U.S. dollar-denominated revolving credit facility at a weighted average interest rate of 1.41%. This facility was entered into in 2014, and in the fourth quarter of 2015, the company extended the scheduled maturity date to March 2016. On January 27, 2016, Baxter exchanged shares of Baxalta common stock for the $1.45 billion aggregate principal amount outstanding under its revolving credit facility. This exchange extinguished the indebtedness under the facility. There were no material prepayment penalties or breakage costs or fees associated with the termination of the facility. In connection with the exchange of Baxalta common stock, Baxter will recognize approximately $1.2 billion of realized gains in the first quarter of 2016.

Effective July 1, 2015, the company terminated its $1.5 billion U.S. dollar-denominated revolving credit facility and 300 million Euro denominated revolving credit facility and entered into credit agreements providing for a senior U.S. dollar-denominated revolving credit facility in an aggregate principal amount of up to $1.5 billion maturing in 2020, as well as a Euro-denominated senior revolving credit facility in an aggregate principal amount of up to 200 million maturing in 2020. As of December 31, 2014 there were no borrowings outstanding under any of the company s revolving credit facilities. The facilities enable the company to borrow funds on an unsecured basis at variable interest rates, and contain various covenants, including a maximum net leverage ratio and maximum interest coverage ratio.

The company also maintains other credit arrangements, which totaled $307 million at December 31, 2015 and $329 million at December 31, 2014. Borrowings outstanding under these facilities totaled $25 million at December 31, 2015 and $38 million at December 31, 2014.

At December 31, 2015, the company was in compliance with the financial covenants in these agreements. The non-performance of any financial institution supporting any of the credit facilities would reduce the maximum capacity of these facilities by each institution s respective commitment.

Commercial Paper

During 2015, the company issued and redeemed commercial paper, and there was $300 million outstanding at December 31, 2015 with a weighted-average interest rate of 0.6%. There was a balance of $875 million outstanding at December 31, 2014 with a weighted-average interest rate of 0.456%.

Leases

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. For the years ending December 31, 2015, 2014, and 2013 operating lease rent expense was $184 million, $203 million, and $174 million, respectively.

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Future Minimum Lease Payments and Debt Maturities

as of and for the years ended December 31 (in millions)	Operating leases	Debt maturities and capital leases
2016	$149	$ 810
2017	125	520
2018	106	1,258
2019	86	508
2020	72	589
Thereafter	176	1,082
Total obligations and commitments	714	4,767
Interest on capital leases, discounts and premiums, and adjustments relating to hedging instruments		(22)
Total debt and lease obligations	$714	$4,745

NOTE 9

DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITY

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 equity could be adversely impacted by fluctuations in foreign exchange and interest rates. The company s hedging policy attempts to manage these risks to an acceptable level based on the company s judgment of the appropriate trade-off between risk, opportunity and costs.

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

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

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

Cash Flow Hedges

The company may use options, including collars and purchased options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions and recognized assets and liabilities. The company periodically uses forward-starting interest rate swaps and treasury rate locks to hedge the

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risk to earnings associated with movements in interest rates relating to anticipated issuances of debt. Certain other firm commitments and forecasted transactions are also periodically hedged. Cash flow hedges primarily related to forecasted intercompany sales denominated in foreign currencies, and anticipated issuances of debt.

The notional amounts of foreign exchange contracts were $378 million and $917 million as of December 31, 2015 and 2014, respectively. The company did not have any interest rate contracts designated as cash flow hedges outstanding at December 31, 2015 and 2014. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions at December 31, 2015 is 12 months.

Fair Value Hedges

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

The total notional amount of interest rate contracts designated as fair value hedges was $1.3 billion and $2.9 billion as of December 31, 2015 and 2014, respectively.

Dedesignations

If it is determined that a derivative or nonderivative hedging instrument is no longer highly effective as a hedge, the company discontinues hedge accounting prospectively. If the company removes the cash flow hedge designation because the hedged forecasted transactions are no longer probable of occurring, any gains or losses are immediately reclassified from AOCI to earnings. Gains or losses relating to terminations of effective cash flow hedges in which the forecasted transactions are still probable of occurring are deferred and recognized consistent with the loss or income recognition of the underlying hedged items.

There were no hedge dedesignations in 2015 or 2014 resulting from changes in the company s assessment of the probability that the hedged forecasted transactions would occur. In 2013, the company had $1 billion of interest rate contracts designated as cash flow hedges that matured or were terminated, resulting in a net gain of $5 million that was deferred in AOCI. In the second quarter of 2013, the company determined that certain forecasted transactions associated with these contracts were no longer probable of occurring and therefore dedesignated the hedge relationship, which, together with ineffectiveness, resulted in the immediate reclassification of a net gain of $11 million from AOCI to net interest expense. The remaining deferred net loss of $6 million from the matured or terminated interest rate contracts is being amortized to net interest expense against the related accrued interest payments.

If the company terminates a fair value hedge, an amount equal to the cumulative fair value adjustment to the hedged items at the date of termination is amortized to earnings over the remaining term of the hedged item. In 2015, the company terminated $1.65 billion of interest rate contracts in connection with the July debt tender offers, which resulted in a $33 million reduction to the debt extinguishment loss. There were no fair value hedges terminated during 2014 or 2013.

Undesignated Derivative Instruments

The company uses forward contracts to hedge earnings from the effects of foreign exchange relating to certain of the company s intercompany and third-party receivables and payables denominated in a foreign currency. These derivative instruments are generally not formally designated as hedges and the terms of these instruments generally do not exceed one month.

The total notional amount of undesignated derivative instruments was $580 million as of December 31, 2015 and $434 million as of December 31, 2014.

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Gains and Losses on Derivative Instruments

The following table summarizes the gains and losses on the company s derivative instruments for the years ended December 31, 2015, 2014, and 2013.

(in millions)	Gain (loss) recognized in OCI **2015**	2014	2013	Location of gain (loss) in income statement	Gain (loss) reclassified from AOCI into income **2015**	2014	2013
Cash flow hedges							
Interest rate contracts	**$**	$	$ 26	Net interest expense	**$**	$ (1)	$ 10
Foreign exchange contracts	**(1)**	1	1	Net sales		1	(1)
Foreign exchange contracts	**4**	51	36	Cost of sales	**47**	13	32
Total	**$ 3**	$ 52	$ 63		**$ 47**	$ 13	$ 41

(in millions)	Location of gain (loss) in income statement	Gain (loss) recognized in income **2015**	2014	2013
Fair value hedges				
Interest rate contracts	Net interest expense	**$ (43)**	$ 68	$ (46)
Undesignated derivative instruments				
Foreign exchange contracts	Other expense (income), net	**$ (13)**	$ 49	$ 11

For the company s fair value hedges, equal and offsetting gains of $43 million, losses of $68 million, and gains of $46 million were recognized in net interest expense in 2015, 2014, and 2013, respectively, as adjustments to the underlying hedged items, fixed-rate debt. Ineffectiveness related to the company s cash flow and fair value hedges for the year ended December 31, 2015 was not material.

The following table summarizes net-of-tax activity in AOCI, a component of shareholders equity, related to the company s cash flow hedges.

as of and for the years ended December 31 (in millions)	**2015**	2014	2013
Accumulated other comprehensive income (loss) balance at beginning of year	**$ 34**	$ 10	$ (5)
Gain in fair value of derivatives during the year	**4**	32	41
Amount reclassified to earnings during the year	**(31)**	(8)	(26)
Accumulated other comprehensive income balance at end of year	**$ 7**	$ 34	$ 10

As of December 31, 2015, $1 million of deferred, net after-tax gains on derivative instruments included in AOCI are expected to be recognized in earnings during the next 12 months, coinciding with when the hedged items are expected to impact earnings.

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Fair Values of Derivative Instruments

The following table summarizes the classification and fair value amounts of derivative instruments reported in the consolidated balance sheet as of December 31, 2015.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$
Interest rate contracts	Other long-term assets	46	Other long-term liabilities	
Foreign exchange contracts	Prepaid expenses and other	9	Accounts payable and accrued liabilities	1
Total derivative instruments designated as hedges		$ 55		$ 1
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$ 1	Accounts payable and accrued liabilities	$ 1
Total derivative instruments		$ 56		$ 2

The following table summarizes the classification and fair value amounts of derivative instruments reported in the consolidated balance sheet as of December 31, 2014.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$
Interest rate contracts	Other long-term assets	89	Other long-term liabilities	
Foreign exchange contracts	Prepaid expenses and other	51	Accounts payable and accrued liabilities	
Total derivative instruments designated as hedges		$ 140		$
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$	Accounts payable and accrued liabilities	$23
Total derivative instruments		$ 140		$23

While the company s derivatives are all subject to master netting arrangements, the company presents its assets and liabilities related to derivative instruments on a gross basis within the consolidated balance sheets. Additionally, the company is not required to post collateral for any of its outstanding derivatives. The following table provides information on the company s derivative positions as if they were presented on a net basis, allowing for the right of offset by counterparty.

(in millions)	December 31, 2015 Asset	December 31, 2015 Liability	December 31, 2014 Asset	December 31, 2014 Liability
Gross amounts recognized in the consolidated balance sheet	$56	$ 2	$140	$23
Gross amount subject to offset in master netting arrangements not offset in the consolidated balance sheet	(2)	(2)	(22)	(22)
Total	$54	$	$118	$ 1

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NOTE 10

FINANCIAL INSTRUMENTS AND RELATED FAIR VALUE MEASUREMENTS

Receivable Securitizations

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

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

as of and for the years ended December 31 (in millions)	**2015**	2014	2013
Sold receivables at beginning of year	**$ 104**	$ 114	$ 157
Proceeds from sales of receivables	**361**	464	506
Cash collections (remitted to the owners of the receivables)	**(384)**	(459)	(519)
Effect of currency exchange rate changes		(15)	(30)
Sold receivables at end of year	**$ 81**	$ 104	$ 114

The net losses relating to the sales of receivables were immaterial for each year.

Concentrations of Credit Risk

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

The company continues to do business with foreign governments in certain countries, including Greece, Spain, Portugal and Italy, which have experienced deterioration in credit and economic conditions. As of December 31, 2015 and 2014, the company s net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $211 million and $275 million, respectively.

Global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses. Global economic conditions, governmental actions and customer-specific factors may require the company to re-evaluate the collectability of its receivables and the company could potentially incur additional credit losses. These conditions may also impact the stability of the Euro.

Fair Value Measurements

The fair value hierarchy under the accounting standard for fair value measurements consists of the following three levels:

Level 1 Quoted prices in active markets that the company has the ability to access for identical assets or liabilities;

Level 2 Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market; and

Level 3 Valuations using significant inputs that are unobservable in the market and include the use of judgment by the company s management about the assumptions market participants would use in pricing the asset or liability.

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

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2015	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 10	$	$ 10	$
Interest rate hedges	46		46	
Available-for-sale securities	5,162	14	5,148	
Total assets	$5,218	$14	$5,204	$
Liabilities				
Foreign currency hedges	$ 2	$	$ 2	$
Contingent payments related to acquisitions	20			20
Total liabilities	$ 22	$	$ 2	$20

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 51	$	$ 51	$
Interest rate hedges	89		89	
Available-for-sale securities	35	35		
Total assets	$175	$35	$140	$
Liabilities				
Foreign currency hedges	$ 23	$	$ 23	$
Interest rate hedges				
Contingent payments related to acquisitions	45			45
Total liabilities	$ 68	$	$ 23	$45

As of December 31, 2015, cash and equivalents of $2.2 billion included money market funds of approximately $500 million, which would be considered Level 2 in the fair value hierarchy.

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The investment in Baxalta common stock of $5.1 billion is categorized as a Level 2 security as these shares were unregistered as of December 31, 2015. The value of this investment is based on Baxalta s common stock price as of December 31, 2015, which represents an identical equity instrument registered under the Securities Act of 1933, as amended. The majority of the derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments.

The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs are considered observable and vary depending on the type of derivative, and include contractual terms, interest rate yield curves, foreign exchange rates and volatility.

Contingent payments related to acquisitions consist of commercial milestone payments and sales-based payments, and are valued using discounted cash flow techniques. The fair value of commercial milestone payments reflects management s expectations of probability of payment, and increases as the probability of payment increases or expectation of timing of payments is accelerated. The fair value of sales-based payments is

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based upon probability-weighted future revenue estimates, and increases as revenue estimates increase, probability weighting of higher revenue scenarios increase or expectation of timing of payment is accelerated.

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

(in millions)	Contingent payments
Fair value as of December 31, 2013	$49
Additions	
Payments	(3)
Net gains recognized in earnings	(1)
CTA	
Fair value as of December 31, 2014	**45**
Additions	
Payments	**(3)**
Net gains recognized in earnings	**(22)**
CTA	
Fair value as of December 31, 2015	**$ 20**

The company recognized net gains of approximately $22 million in 2015 related to changes in estimates with respect to the probability of achieving certain sales milestones. The gain was reported in other expense (income), net. The company made minor sales-based payments in 2015 and 2014.

The following table provides information relating to the company s investments in available-for-sale equity securities.

(in millions)	Amortized cost	Unrealized gains	Unrealized losses	Fair value
December 31, 2015	$732	$4,430	$	$5,162
December 31, 2014	$ 20	$ 15	$	$ 35

As discussed further in Note 7, the company recorded asset impairment charges related to its COLLEAGUE and SYNDEO infusion pumps and business optimization initiatives in 2015, 2014, and 2013. As these assets had no alternative use and no salvage value, the fair values, measured using significant unobservable inputs (Level 3), were assessed to be zero.

Book Values and Fair Values of Financial Instruments

In addition to the financial instruments that the company is required to recognize at fair value in the consolidated balance sheets, the company has certain financial instruments that are recognized at historical cost or some basis other than fair value. For these financial instruments, the following table provides the values recognized in the consolidated balance sheets and the approximate fair values.

as of December 31 (in millions)	Book values		Approximate fair values	
	2015	2014	**2015**	2014
Assets				
Investments	**$ 21**	$ 23	**$ 21**	$ 21

Liabilities				
Short-term debt	**1,775**	913	**1,775**	913
Current maturities of long-term debt and lease obligations	**810**	785	**818**	790
Long-term debt and lease obligations	**3,935**	7,331	**4,089**	7,917

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The following table summarizes the bases used to measure the approximate fair value of the financial instruments as of December 31, 2015 and 2014.

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2015	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Investments	$ 21	$	$ 2	$19
Total assets	$ 21	$	$ 2	$19
Liabilities				
Short-term debt	$1,775	$	$1,775	$
Current maturities of long-term debt and lease obligations	818		818	
Long-term debt and lease obligations	4,089		4,089	
Total liabilities	$6,682	$	$6,682	$

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2014	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Investments	$ 21	$	$ 8	$13
Total assets	$ 21	$	$ 8	$13
Liabilities				
Short-term debt	$ 913	$	$ 913	$
Current maturities of long-term debt and lease obligations	790		790	
Long-term debt and lease obligations	7,917		7,917	
Total liabilities	$9,620	$	$9,620	$

Investments in 2015 and 2014 include certain cost method investments and held-to-maturity debt securities.

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

value measurement.

The estimated fair values of current and long-term debt were computed by multiplying price by the notional amount of the respective debt instrument. Price is calculated using the stated terms of the respective debt instrument and yield curves commensurate with the company s credit risk. The carrying values of the other financial instruments approximate their fair values due to the short-term maturities of most of these assets and liabilities.

In 2015 and 2014, the company recorded income of $38 million and $20 million, respectively, in other expense (income), net related to equity method investments, which primarily represented gains from the sale of certain investments as well as distributions from funds that sold portfolio companies. The company did not record any gains or loss within other expense (income), net related to equity method investments in 2013.

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NOTE 11

COMMITMENTS AND CONTINGENCIES

Collaborative and Other Arrangements

Refer to Note 5 for information regarding the company s unfunded contingent payments associated with collaborative and other arrangements.

Indemnifications

During the normal course of business, Baxter makes indemnities, commitments and guarantees pursuant to which the company may be required to make payments related to specific transactions. Indemnifications include: (i) intellectual property indemnities to customers in connection with the use, sales or license of products and services; (ii) indemnities to customers in connection with losses incurred while performing services on their premises; (iii) indemnities to vendors and service providers pertaining to claims based on negligence or willful misconduct; (iv) indemnities involving the representations and warranties in certain contracts; (v) contractual indemnities related to the separation and distribution as set forth in certain of the agreements entered into in connection with such transactions (including the separation and distribution agreement and the tax matters agreement); and (vi) contractual indemnities for its directors and certain of its executive officers for services provided to or at the request of Baxter. In addition, under Baxter s Amended and Restated Certificate of Incorporation, and consistent with Delaware General Corporation Law, the company has agreed to indemnify its directors and officers for certain losses and expenses upon the occurrence of certain prescribed events. The majority of these indemnities, commitments and guarantees do not provide for any limitation on the maximum potential for future payments that the company could be obligated to make. To help address some of these risks, the company maintains various insurance coverages. Based on historical experience and evaluation of the agreements, the company does not believe that any significant payments related to its indemnities will occur, and therefore the company has not recorded any associated liabilities.

Legal Contingencies

Refer to Note 16 for a discussion of the company s legal contingencies.

NOTE 12

SHAREHOLDERS EQUITY

Stock-Based Compensation

The company s stock-based compensation generally includes stock options, restricted stock units (RSUs), performance share units (PSUs) and purchases under the company s employee stock purchase plan. Shares issued relating to the company s stock-based plans are generally issued out of treasury stock.

The Baxter International Inc. 2015 Incentive Plan provided for 35 million additional shares of common stock available for issuance with respect to awards for participants. As of December 31, 2015, approximately 54 million authorized shares are available for future awards under the company s stock-based compensation plans.

Stock Compensation Expense

Stock compensation expense, presented on a continuing operations basis, recognized in the consolidated statements of income was $126 million, $126 million and $122 million in 2015, 2014 and 2013, respectively. The related tax benefit recognized was $38 million in 2015, $41 million in 2014 and $36 million in 2013.

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Stock compensation expense is recorded at the corporate level and is not allocated to the segments. Approximately 70% of stock compensation expense is classified in marketing and administrative expenses, with the remainder classified in cost of sales and R&D expenses. Costs capitalized in the consolidated balance sheets at December 31, 2015 and 2014 were not material.

Stock compensation expense is based on awards expected to vest, and therefore has been reduced by estimated forfeitures.

In connection with the separation of Baxalta, the company adjusted its outstanding equity awards on July 1, 2015, in accordance with the terms of the employee matters agreement (equitable adjustment). For purposes of the vesting of these equity awards, continued employment or service with Baxter or with Baxalta is treated as continued employment for purposes of both Baxter s and Baxalta s equity awards. The adjustments are summarized as follows:

Stock options, RSUs, and PSUs granted prior to January 1, 2015 were generally converted into the same number of Baxter stock options (with an adjusted exercise price), RSUs, and PSUs as well as an equal number of Baxalta stock options, RSUs, and PSUs. The underlying performance conditions for the PSUs are consistent with Baxter s original performance targets and future measurement periods and future performance targets will be established to reflect each company s standalone business. The vesting terms of each amended grant remained unchanged.

Stock options and RSUs granted after January 1, 2015 were generally converted into: (i) for continuing Baxter employees, Baxter stock options (with an adjusted exercise price) and RSUs and (ii) for continuing Baxalta employees, Baxalta stock options and RSUs.

No incremental fair value was awarded as a result of the above adjustments.

Stock Options

Stock options are granted to employees and non-employee directors with exercise prices equal to 100% of the market value on the date of grant. Stock options granted to employees generally vest in one-third increments over a three-year period. Stock options granted to non-employee directors generally cliff-vest one year from the grant date. Stock options typically have a contractual term of 10 years. The grant-date fair value, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the substantive vesting period.

The fair value of stock options is determined using the Black-Scholes model. The weighted-average assumptions used in estimating the fair value of stock options granted during each year, along with the weighted-average grant-date fair values, were as follows:

years ended December 31	**2015**	2014	2013
Expected volatility	**20%**	24%	25%
Expected life (in years)	**5.5**	&nbs	