BOSTON SCIENTIFIC CORP
Form 10-Q
November 06, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2012
OR

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

Commission File No. 1-11083
BOSTON SCIENTIFIC CORPORATION
(Exact name of registrant as specified in its charter)

DELAWARE	04-2695240
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

ONE BOSTON SCIENTIFIC PLACE, NATICK, MASSACHUSETTS 01760-1537
(Address of principal executive offices) (zip code)
(508) 650-8000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).Yes þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares outstanding as of October 31, 2012
Common Stock, $.01 par value	1,372,983,740

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PART I
FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
in millions, except per share data	2012	2011	2012	2011
Net sales	$1,735	$1,874	$5,428	$5,774
Cost of products sold	558	680	1,767	1,999
Gross profit	1,177	1,194	3,661	3,775
Operating expenses:				
Selling, general and administrative expenses	589	629	1,895	1,866
Research and development expenses	220	229	648	665
Royalty expense	29	36	125	140
Amortization expense	99	97	294	325
Goodwill impairment charges	748		4,350	697
Intangible asset impairment charges	13	9	142	21
Contingent consideration expense (benefit)	(20)	6	(9)	18
Restructuring charges	54	22	93	77
Litigation-related net charges	50		119	
Gain on divestiture	(11)	(8)	(11)	(768)
	1,771	1,020	7,646	3,041
Operating (loss) income	(594)	174	(3,985)	734
Other (expense) income:				
Interest expense	(65)	(62)	(197)	(210)
Other, net	(4)	(1)	23	18
(Loss) income before income taxes	(663)	111	(4,159)	542
Income tax (benefit) expense	1	(31)	(30)	208
Net (loss) income	$(664)	$142	$(4,129)	$334
Net (loss) income per common share — basic	$(0.48)	$0.09	$(2.91)	$0.22
Net (loss) income per common share — assuming dilution	$(0.48)	$0.09	$(2.91)	$0.22
Weighted-average shares outstanding				
Basic	1,392.5	1,514.4	1,420.3	1,523.1
Assuming dilution	1,392.5	1,524.0	1,420.3	1,532.0

See notes to the unaudited condensed consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2012	2011	2012	2011
Net (loss) income	$(664)	$142	$(4,129)	$334
Other comprehensive (loss) income:				
Foreign currency translation adjustment	2	(44)	9	2
Net change in unrealized gains and losses on derivative financial instruments, net of tax	(27)	35	17	(5)
Total other comprehensive (loss) income	(25)	(9)	26	(3)
Total comprehensive (loss) income	$(689)	$133	$(4,103)	$331

See notes to the unaudited condensed consolidated financial statements.

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BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

in millions, except share and per share data	As of September 30, 2012 (Unaudited)	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$352	$267
Trade accounts receivable, net	1,197	1,246
Inventories	911	931
Deferred income taxes	483	458
Prepaid expenses and other current assets	230	203
Total current assets	3,173	3,105
Property, plant and equipment, net	1,624	1,670
Goodwill	5,724	9,761
Other intangible assets, net	6,154	6,473
Other long-term assets	223	281
	$16,898	$21,290
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current debt obligations	$3	$4
Accounts payable	228	203
Accrued expenses	1,325	1,327
Other current liabilities	259	273
Total current liabilities	1,815	1,807
Long-term debt	4,252	4,257
Deferred income taxes	1,705	1,865
Other long-term liabilities	2,298	2,008
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $.01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, $.01 par value - authorized 2,000,000,000 shares and issued 1,541,569,188 shares as of September 30, 2012 and 1,531,006,390 shares as of December 31, 2011	15	15
Treasury stock, at cost - 168,697,617 shares as of September 30, 2012 and 81,950,716 shares as of December 31, 2011	(992)	(492)
Additional paid-in capital	16,427	16,349
Accumulated deficit	(8,510)	(4,381)
Accumulated other comprehensive loss, net of tax	(112)	(138)
Total stockholders' equity	6,828	11,353
	$16,898	$21,290

See notes to the unaudited condensed consolidated financial statements.

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

in millions	Nine Months Ended September 30, 2012	2011
Cash provided by operating activities	$891	$659
Investing activities:		
Purchases of property, plant and equipment, net of proceeds	(164)	(221)
Proceeds from sales of publicly traded and privately held equity securities and collections of notes receivable		2
Payments for acquisitions of businesses, net of cash acquired	(134)	(370)
Payments for investments in companies and acquisitions of certain technologies	(18)	(10)
Proceeds from business divestitures, net of costs	10	1,426
Cash (used for) provided by investing activities	(306)	827
Financing activities:		
Payments on long-term borrowings	(9)	(1,250)
Proceeds from borrowings on credit facilities, net of debt issuance costs	251	425
Payment of contingent consideration	(4)	
Payments on borrowings from credit facilities	(260)	(425)
Payments for acquisitions of treasury stock	(500)	(192)
Proceeds from issuances of shares of common stock	20	22
Cash used for financing activities	(502)	(1,420)
Effect of foreign exchange rates on cash	2	(3)
Net increase in cash and cash equivalents	85	63
Cash and cash equivalents at beginning of period	267	213
Cash and cash equivalents at end of period	$352	$276
Supplemental Information		
Non-cash operating activities:		
Stock-based compensation expense	$85	$96

See notes to the unaudited condensed consolidated financial statements.

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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A – BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in Item 8 of our 2011 Annual Report filed on Form 10-K.

We have reclassified certain prior year amounts to conform to the current year's presentation. See Note L – Segment Reporting for further details.

Subsequent Events

We evaluate events occurring after the date of our most recent accompanying unaudited condensed consolidated balance sheets for potential recognition or disclosure in our financial statements. We did not identify any material subsequent events requiring adjustment to our accompanying unaudited condensed consolidated financial statements (recognized subsequent events) for the three and nine month periods ended September 30, 2012. Those items requiring disclosure (unrecognized subsequent events) in the financial statements have been disclosed accordingly. Refer to Note J - Commitments and Contingencies and Note N - Subsequent Events for more information.

NOTE B – ACQUISITIONS

Over the past two years, we have completed several acquisitions as part of our priority growth initiatives, including in the areas of cardiac rhythm management, structural heart therapy, deep brain stimulation, peripheral vascular disease, endoscopic pulmonary intervention, and atrial fibrillation. Our unaudited condensed consolidated financial statements include the operating results for each acquired entity from its respective date of acquisition. We do not present pro forma financial information for these acquisitions given their results are not material to our consolidated financial statements. Transaction costs associated with these acquisitions were expensed as incurred and were not material for the three and nine months ended September 30, 2012 and 2011.

2012 Acquisitions

Cameron Health, Inc.

On June 8, 2012, we completed the acquisition of the remaining equity of Cameron Health, Inc. (Cameron). Cameron has developed the world's first and only commercially available subcutaneous implantable cardioverter defibrillator - the S-ICD® system. The S-ICD® system has received CE Mark approval and is currently sold in Europe, Middle East, and Africa (EMEA). In addition, in late September 2012, we received U.S. Food and Drug Administration (FDA) approval for the S-ICD® system, and commenced a limited commercial launch of this system in the United States during the fourth quarter of 2012. We accounted for this acquisition as a business combination and, in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification® (ASC) Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date.

Purchase Price Allocation

The components of the Cameron purchase price as of the acquisition date were as follows (in millions):

Cash, net of cash acquired	$134
Fair value of contingent consideration	259
Fair value of prior interests	79
Fair value of debt assumed	9
	$481

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Prior to the acquisition, we had an equity interest in Cameron and held $40 million of notes receivable. We re-measured our previously held investments to their estimated acquisition-date fair value of $79 million and recorded a gain of $39 million in other, net in the accompanying condensed consolidated statements of operations during the second quarter of 2012. We measured the fair values of the previously held investments based on the liquidation preferences and priority of the equity interests and debt, including accrued interest. In addition, we prepaid the assumed debt obligation of Cameron for approximately $9 million during the second quarter of 2012.

Total consideration includes an initial $150 million cash payment at closing of the transaction, with a potential payment of $150 million upon FDA approval of the S-ICD® system and up to an additional $1.05 billion of potential payments upon achievement of specified revenue-based milestones over a six-year period following FDA approval. Due to our receipt of FDA approval of Cameron's S-ICD® system, we expect to make the related $150 million milestone payment to the former shareholders of Cameron during the fourth quarter of 2012.

The following summarizes the purchase price allocation (in millions):

Goodwill	$314
Amortizable intangible assets	42
Indefinite-lived intangible assets	48
Other net assets	3
Deferred income taxes	74
	$481

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

	Amount Assigned (in millions)	Weighted Average Amortization Period (in years)	Range of Risk-Adjusted Discount Rates used in Purchase Price Allocation	
Amortizable intangible assets:				
Technology-related	$40	11	14.0	%
Customer relationships	2	5	14.0	%
Indefinite-lived intangible assets:				
Purchased research and development	48		14.0	%
	$90			

Our technology-related intangible assets consist of technical processes, intellectual property, and institutional understanding with respect to products and processes that we expect to leverage in future products or processes and carry forward from one product generation to the next. The technology-related intangible assets are being amortized on a straight-line basis over their assigned estimated useful lives.

Purchased research and development represents the estimated fair value of acquired in-process research and development projects which have not yet reached technological feasibility. These indefinite-lived intangible assets are tested for impairment on an annual basis, or more frequently if impairment indicators are present, in accordance with U.S. GAAP and our accounting policies described in our 2011 Annual Report filed on Form 10-K. Upon completion of the associated research and development efforts, we determine the useful life of the technology and begin amortizing the assets to reflect their use over their remaining lives. Upon receiving FDA approval for Cameron's S-ICD® system in September 2012, we reclassified approximately $47 million of in-process research and development (IPR&D) to technology-related amortizable intangible assets. The total estimated costs to complete the remaining IPR&D program associated with Cameron are immaterial.

We believe that the estimated intangible asset values represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the assets. We used the income approach, specifically the discounted

cash flow method and excess earnings method, to derive the fair value of the amortizable intangible assets and purchased research and development. These fair value measurements are based on significant unobservable inputs, including management estimates and assumptions and, accordingly, are classified as Level 3 within the fair value hierarchy prescribed by ASC Topic 820, Fair Value Measurements and Disclosures.

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We recorded the excess of the aggregate purchase price over the estimated fair values of the identifiable assets acquired as goodwill, which is non-deductible for tax purposes. Goodwill was established due primarily to revenue and cash flow projections associated with future technologies, as well as synergies expected to be gained from the integration of this business into our Cardiac Rhythm Management (CRM) business, and has been allocated to our reportable segments based on the relative expected benefit from the business combinations, as follows (in millions):

U.S.	$184
EMEA	97
Inter-Continental	27
Japan	6
	$314

2011 Acquisitions

Sadra Medical, Inc.

On January 4, 2011, we completed the acquisition of the remaining fully diluted equity of Sadra Medical, Inc. (Sadra). Prior to the acquisition, we held a 14 percent equity ownership in Sadra. Through our acquisition of Sadra, we are developing a fully repositionable and retrievable device for transcatheter aortic valve replacement (TAVR) to treat patients with severe aortic stenosis. The Lotus™ Valve System consists of a stent-mounted tissue valve prosthesis and catheter delivery system for guidance and placement of the valve. The low-profile delivery system and introducer sheath are designed to enable accurate positioning, repositioning and retrieval at any time prior to release of the aortic valve implant. The acquisition was intended to broaden and diversify our product portfolio by expanding into the structural heart market, and TAVR is one of the fastest growing medical device markets. We are integrating the operations of the Sadra business into our Interventional Cardiology business. Total consideration includes a net cash payment of $193 million at closing to acquire the remaining 86 percent of Sadra and potential payments up to $193 million through 2016 that are contingent upon the achievement of certain regulatory- and revenue-based milestones. During the second quarter of 2012, we recorded an impairment charge of $129 million ($110 million after-tax) to write-down the balance of intangible assets to their fair value related to our in-process research and development project associated with Sadra. Refer to Note D - Goodwill and Other Intangible Assets for further details regarding this charge.

Intelect Medical, Inc.

On January 5, 2011, we completed the acquisition of the remaining fully diluted equity of Intelect Medical, Inc. (Intelect). Prior to the acquisition, we held a 15 percent equity ownership in Intelect. Through our acquisition of Intelect, we are developing advanced visualization and programming technology for deep-brain stimulation (DBS). We have integrated the operations of the Intelect business into our Neuromodulation business. The acquisition was intended to leverage the core architecture of our Vercise™ DBS platform and advance our technology in the field of deep-brain stimulation. We paid $60 million at the closing of the transaction to acquire the remaining 85 percent of Intelect. There is no contingent consideration related to the Intelect acquisition.

ReVascular Therapeutics, Inc.

On February 15, 2011, we completed the acquisition of 100 percent of the fully diluted equity of ReVascular Therapeutics, Inc. (RVT). RVT has developed the TRUEPATH™ intraluminal chronic total occlusion crossing device enabling endovascular treatment in cases that typically cannot be treated with standard endovascular devices. This acquisition was intended to complement our portfolio of devices for lower extremity peripheral artery disease and we have integrated the operations of RVT into our Peripheral Interventions business. Total consideration includes a cash payment of $19 million at closing of the transaction and potential payments of up to $16 million through 2014 that are contingent upon the achievement of certain regulatory- and commercialization-based milestones and revenue.

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Atritech, Inc.

On March 3, 2011, we completed the acquisition of 100 percent of the fully diluted equity of Atritech, Inc. (Atritech). Atritech has developed a device designed to close the left atrial appendage of the heart. The WATCHMAN® Left Atrial Appendage Closure Technology, developed by Atritech, is the first device proven to offer an alternative to anticoagulant drugs for patients with atrial fibrillation and at high risk for stroke, and is approved for use in CE Mark countries. The acquisition was intended to broaden our portfolio of less-invasive devices for cardiovascular care by expanding into the areas of atrial fibrillation and structural heart therapy. We are integrating the operations of the Atritech business and are leveraging expertise from both our Electrophysiology and Interventional Cardiology divisions in the commercialization of the WATCHMAN® device. Total consideration includes a net cash payment of $98 million at closing of the transaction and potential payments up to $275 million through 2015 that are contingent upon achievement of certain regulatory-based milestones and revenue.

Purchase Price Allocation

The components of the aggregate purchase price as of the acquisition date for acquisitions closed in the first nine months of 2011 are as follows (in millions):

Cash, net of cash acquired	$370
Fair value of contingent consideration	287
Prior investments	55
	$712

As of the respective acquisition dates, we recorded total contingent consideration liabilities of $287 million, representing the estimated fair value of the contingent consideration we expected to pay to the former shareholders of the acquired companies based upon the achievement of certain regulatory- and commercialization-related milestones and revenue. The fair value of the contingent consideration liabilities was estimated by discounting, to present value, contingent payments expected to be made. In certain circumstances, we utilized a probability-weighted approach to determine the fair value of contingent consideration related to the expected achievement of milestones. We used risk-adjusted discount rates ranging from two to 20 percent as of the acquisition date to derive the fair value of the expected obligations, which we believe are appropriate and representative of market participant assumptions.

Prior to our acquisition of the remaining equity ownership in Sadra and Intelect, we held equity interests in these companies of 14 percent and 15 percent, respectively, carried at an aggregate value of $11 million, and a note receivable carried at a value of $6 million. As a result of re-measuring these previously held investments to fair value, estimated at $55 million as of the respective acquisition dates, we recorded a gain of $38 million in other, net in the accompanying unaudited condensed consolidated statements of operations during the first quarter of 2011. We measured the fair values of the previously held investments based on a pro-rata allocation of the consideration paid for the controlling interests acquired less an estimated minority interest discount in certain circumstances after considering previous financing rounds and liquidation preferences of the equity interests.

We accounted for these acquisitions as business combinations and, in accordance with ASC Topic 805, Business Combinations, we have recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date. The following summarizes the aggregate purchase price allocation (in millions):

Goodwill	$266
Amortizable intangible assets	97
Indefinite-lived intangible assets	470
Deferred income taxes	(121)
	$712

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We allocated the aggregate purchase price to specific intangible asset categories as follows:

	Amount Assigned (in millions)	Weighted Average Amortization Period (in years)	Range of Risk-Adjusted Discount Rates used in Purchase Price Allocation
Amortizable intangible assets			
Technology-related	$97	7.4	22.6% - 25.0%
Indefinite-lived intangible assets			
Purchased research and development	470		23.6% - 30.0%
	$567		

Our technology-related intangible assets consist of technical processes, intellectual property, and institutional understanding with respect to products and processes that we expect to leverage in future products or processes and carry forward from one product generation to the next. The technology-related intangible assets are being amortized on a straight-line basis over their assigned estimated useful lives.

Purchased research and development represents the estimated fair value of acquired in-process research and development projects which have not yet reached technological feasibility. These indefinite-lived intangible assets are tested for impairment on an annual basis, or more frequently if impairment indicators are present, in accordance with U.S. GAAP and our accounting policies described in our 2011 Annual Report filed on Form 10-K, and amortization of the purchased research and development begins upon completion of the related projects. We estimate that the total cost to complete the IPR&D programs acquired in 2011 is approximately $250 million to $300 million, as of September 30, 2012, and we expect material net cash inflows from the products in development to commence in 2014-2018. See Note D - Goodwill and Other Intangible Assets, which contains additional details related to our asset impairment charges related to IPR&D projects.

We believe that the estimated intangible asset values represent the fair value at the date of each acquisition and did not exceed the amount a third party would pay for the assets. We used the income approach, specifically the discounted cash flow method and excess earnings method, to derive the fair value of the amortizable intangible assets and purchased research and development. These fair value measurements are based on significant unobservable inputs, including management estimates and assumptions and, accordingly, are classified as Level 3 within the fair value hierarchy prescribed by ASC Topic 820, Fair Value Measurements and Disclosures.
We recorded the excess of the aggregate purchase price over the estimated fair values of the identifiable assets acquired as goodwill, which is non-deductible for tax purposes. Goodwill was established due primarily to revenue and cash flow projections associated with future technologies, as well as synergies expected to be gained from the integration of these businesses into our existing operations, and has been allocated to our reportable segments based on the relative expected benefit from the business combinations, as follows (in millions):

U.S.	$161
EMEA	99
Inter-Continental	5
Japan	1
	$266

Contingent Consideration

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

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We recorded net benefits related to the changes in fair value of our contingent consideration liabilities of $20 million and $9 million in the third quarter and first nine months of 2012, respectively, and net expenses of $6 million and $18 million during the third quarter and first nine months of 2011, respectively. We did not make any payments in the third quarter of 2012 and made payments of $4 million during the first nine months of 2012. For the third quarter and first nine months of 2011 we did not make any payments related to prior-period acquisitions. As of September 30, 2012, the maximum amount of future contingent consideration (undiscounted) that we could be required to pay is approximately $1.927 billion.

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

Balance as of December 31, 2011	$(358)
Amounts recorded related to new acquisitions	(259)
Net fair value adjustments	9
Payments made	4
Balance as of September 30, 2012	$(604)

Increases or decreases in the fair value of our contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing and amount of revenue estimates or in the timing or likelihood of achieving regulatory-, revenue- or commercialization-based milestones. The recurring Level 3 fair value measurements of our contingent consideration liability include the following significant unobservable inputs:

Contingent Consideration Liability	Fair Value as of September 30, 2012	Valuation Technique	Unobservable Input	Range
R&D, Regulatory and Commercialization-based Milestones	$305 million	Probability Weighted Discounted Cash Flow	Discount Rate	0% - 2.4%
			Probability of Payment	13% - 100%
			Projected Year of Payment	2012 - 2017
Revenue-based Payments	$185 million	Discounted Cash Flow	Discount Rate	12% - 18%
			Probability of Payment	65% - 100%
			Projected Year of Payment	2012 - 2018
	$114 million	Monte Carlo	Revenue Volatility	15%
			Risk Free Rate	LIBOR Term Structure
			Projected Year of Payment	2013-2018

Contingent consideration liabilities are remeasured to fair value each reporting period using projected revenues, discount rates, probabilities of payment and projected payment dates. Projected contingent payment amounts related to R&D, regulatory- and commercialization-based milestones and certain revenue-based milestones are discounted back to the current period using a discounted cash flow model. Other revenue-based payments are valued using a monte carlo valuation model, which simulates future revenues during the earn out-period using management's best estimates. Projected revenues are based on our most recent internal operational budgets and long-range strategic plans. Increases in projected revenues and probabilities of payment may result in higher fair value measurements. Increases in discount rates and the time to payment may result in lower fair value measurements. Increases (decreases) in any of those inputs in isolation may result in a significantly lower (higher) fair value measurement.

NOTE C – DIVESTITURES

In January 2011, we closed the sale of our Neurovascular business to Stryker Corporation for a purchase price of $1.500 billion in cash. We received $1.450 billion at closing, including an upfront payment of $1.426 billion, and $24 million which was placed into escrow and released throughout 2011 upon the completion of local closings in certain foreign jurisdictions. During the third quarter of 2012, we received an additional $10 million of consideration, which we recorded as a gain in our accompanying unaudited condensed consolidated statements of operations. We will

receive an additional $40 million contingent upon the transfer or separation of certain manufacturing facilities, which we expect will occur during 2013. Due to our continuing involvement in the operations of the Neurovascular business, the divestiture does not meet the criteria for presentation as a discontinued operation. We recorded a pre-tax gain of $760 million ($530 million after-tax) during the first quarter of 2011 associated with the closing of the transaction.

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Revenue generated by the Neurovascular business was $32 million in the third quarter of 2012, $91 million in the first nine months of 2012, $34 million in the third quarter of 2011, and $111 million in the first nine months of 2011. We continue to generate net sales pursuant to our supply and distribution agreements with Stryker; however, these net sales are at significantly lower levels and at reduced gross profit margins as compared to periods prior to the divestiture.

NOTE D – GOODWILL AND OTHER INTANGIBLE ASSETS

The gross carrying amount of goodwill and other intangible assets and the related accumulated amortization for intangible assets subject to amortization and accumulated write-offs of goodwill as of September 30, 2012 and December 31, 2011 is as follows:

	As of September 30, 2012		December 31, 2011	
(in millions)	Gross Carrying Amount	Accumulated Amortization/ Write-offs	Gross Carrying Amount	Accumulated Amortization/ Write-offs
Amortizable intangible assets				
Technology - core	$6,745	$(1,906)	$6,786	$(1,722)
Technology - developed	1,126	(1,019)	1,037	(1,012)
Patents	561	(348)	539	(331)
Other intangible assets	808	(415)	808	(376)
	$9,240	$(3,688)	$9,170	$(3,441)
Unamortizable intangible assets				
Goodwill	$15,201	$(9,477)	$14,888	$(5,127)
Technology - core	242		242	
	$15,443	$(9,477)	$15,130	$(5,127)

In addition, we had $360 million and $502 million of purchased research and development intangible assets as of September 30, 2012 and December 31, 2011, respectively.

The following is a rollforward of our goodwill balance by reportable segment:

(in millions)	United States	EMEA	Japan	Inter-Continental	Total
Balance as of December 31, 2011	$4,667	$4,004	$554	$ 536	$9,761
Purchase price adjustments	(1)	(2)	(1)	3	(1)
Goodwill acquired	184	97	6	27	314
Goodwill written off	(748)	(3,602)			(4,350)
Balance as of September 30, 2012	$4,102	$497	$559	$ 566	$5,724

The 2012 purchase price adjustments relate primarily to adjustments in taxes payable and deferred income taxes, including changes in the liability for unrecognized tax benefits.

Goodwill Impairment Charges

2012 Charges

We test our April 1 goodwill balances during the second quarter of each year for impairment, or more frequently if indicators are present or changes in circumstances suggest that impairment may exist. In the second quarter of 2012, we performed our annual goodwill impairment test for all of our reporting units and concluded that the goodwill within our EMEA reporting unit was impaired and recorded a $3.602 billion ($3.579 billion after-tax) charge in the second quarter of 2012. We finalized the second step of the EMEA goodwill impairment test during the third quarter of 2012, in accordance with ASC Topic 350, Intangibles -Goodwill and Other, and there were no adjustments to the charge upon finalization.

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In the third quarter of 2012, we performed an interim goodwill impairment test and recorded a non-cash $748 million (pre- and after-tax) estimated charge associated with our U.S. Cardiac Rhythm Management (U.S. CRM) reporting unit, primarily driven by the reduction in the estimated size of the U.S. CRM market, related adjustments to our business and other competitive factors, which led to lower projected U.S. CRM results compared to prior forecasts. We would recognize any necessary adjustment to this estimate in the fourth quarter of 2012, as we finalize the second step of the goodwill impairment test, in accordance with ASC Topic 350. As previously disclosed in our 2011 Annual Report filed on Form 10-K, our EMEA, U.S. Cardiovascular, U.S. Neuromodulation, and U.S. CRM reporting units had material amounts of goodwill that were at higher risk of potential failure of the first step of the impairment test. In our goodwill impairment tests we used the income approach, specifically the discounted cash flow (DCF) method, to derive the fair value of our EMEA and U.S. CRM reporting units, as described in our accounting policies in our 2011 Annual Report filed on Form 10-K. We updated all aspects of the DCF models associated with the EMEA and U.S. CRM businesses, including the amount and timing of future expected cash flows, terminal value growth rates and the appropriate market-participant risk-adjusted weighted average costs of capital (WACC) to apply.

EMEA

As a result of revised estimates developed during our annual strategic planning process and analysis performed in conjunction with our annual goodwill impairment test in the second quarter, we concluded that the revenue growth rates projected for the EMEA reporting unit will be slightly lower than our previous estimates primarily driven by macro-economic factors and our performance in the European market. We updated short-term operating projections based on our most recent strategic plan for EMEA prepared by management. We reduced the EMEA long-term growth rates and terminal value growth rate projections and increased the discount rate within our 15-year DCF model for EMEA by approximately 100 basis points due to increased risk associated with our projections in this market primarily as a result of on-going economic uncertainty in Europe. While we do expect revenue growth in our EMEA business, our expectations for future growth and profitability are lower than our previous estimates and reflect declines in average selling prices and volume pressures due to austerity measures. The declines expected in the EMEA market did not impact our assumptions related to other reporting units.

The aggregate amount of goodwill that remains associated with our EMEA reporting unit is $497 million as of September 30, 2012. In addition, the remaining book value of our other EMEA intangible assets allocated to our EMEA reporting unit is approximately $1.498 billion as of September 30, 2012. In accordance with ASC Topic 350, we tested our EMEA amortizable intangible assets as of April 1, 2012 for impairment on an undiscounted cash flow basis, and determined that these assets were not impaired. We also tested our indefinite-lived intangible assets associated with EMEA as of April 1, 2012 and recorded an impairment charge related to the in-process research and development associated with our acquisition of Sadra Medical, Inc. See Intangible Asset Impairment Charges below for a further discussion of this impairment.

U.S. CRM

The reduction of the estimated size of the U.S. CRM market, related adjustments to our business and other competitive factors during the third quarter of 2012 warranted an interim goodwill impairment test for our U.S. CRM reporting unit. The declines expected in the U.S. CRM market did not impact our assumptions related to other reporting units. The U.S. CRM market is dynamic, highly competitive and difficult to forecast; in the third quarter of 2012, we lowered our projections for the U.S. CRM market size and our future revenue levels within this market, primarily to reflect recent changes in expectations of average selling prices and unit growth, adjustments to our business and other competitive factors. The increased pricing pressure and lower unit volumes are primarily due to physician alignment with hospitals, efforts to reduce health care costs, focus on appropriate device usage, replacement volumes and competition, and have been more impactful to the U.S. CRM business than previously estimated. In addition, we recently aligned certain elements of our business and shifted investments to focus on areas expected to provide the highest future growth and financial return. As a result of these factors, we reduced the compound annual revenue growth rate of our 15 year DCF model for the U.S. CRM reporting unit by approximately 250 basis points. We continue to analyze business trends using all available information and our U.S. CRM goodwill remains sensitive to changes in expectations of future growth of this market and our performance.

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Based on the remaining book value of our U.S. CRM reporting unit following the estimated goodwill impairment charge recorded during the third quarter of 2012, the carrying value of our U.S. CRM reporting unit continues to exceed its fair value, due primarily to the value of amortizable intangible assets allocated to this reporting unit. The remaining book value of the amortizable intangible assets allocated to the U.S. CRM reporting unit was approximately $3.347 billion as of September 30, 2012. In accordance with ASC Topic 350, we tested the amortizable intangible assets as of September 30, 2012, in conjunction with the interim goodwill impairment test of our U.S. CRM reporting unit. We performed the impairment analysis of the amortizable intangible assets on an undiscounted cash flow basis, and concluded that these assets were not impaired. However, following the recent declines in our CRM projections, the recoverability of our CRM-related amortizable intangibles ($4.684 billion globally) are sensitive to future cash flow assumptions and CRM business performance. The $4.684 billion of CRM-related amortizable intangibles are at higher risk of potential failure of the first step of the amortizable intangible recoverability test in future reporting periods. An impairment of a material portion of our CRM-related amortizable intangibles carrying value would occur if the second step of the amortizable intangible test is required in a future reporting period.

We continue to identify three reporting units with goodwill that is at higher risk of potential failure of the first step of the goodwill impairment test in future reporting periods. These reporting units include our U.S. CRM reporting unit, which holds $216 million of remaining allocated goodwill; our U.S. Cardiovascular reporting unit, which holds $2.352 billion of allocated goodwill; and our U.S. Neuromodulation reporting unit, which holds $1.266 billion of allocated goodwill, each as of September 30, 2012. As of September 30, 2012, the level of excess fair value over carrying value for these reporting units identified as being at higher risk (with the exception of the U.S. CRM reporting unit, whose carrying value continues to exceed its fair value) was approximately 10 to 13 percent. During the third quarter of 2012, the level of excess fair value over carrying value of our U.S. Cardiovascular reporting unit declined as a result of our performance, declines in our market share due to competitive launches, and continued average selling price declines in the U.S. drug-eluting stent (DES) market as a result of continued competitive pressures and declines in procedural volumes.

On a quarterly basis, we monitor the key drivers of fair value for these reporting units to detect events or other changes that would warrant an interim impairment test of our goodwill and intangible assets. The key variables that drive the cash flows of our reporting units and amortizable intangibles are estimated revenue growth rates and levels of profitability. Terminal value growth rate assumptions, as well as the WACC rate applied are additional key variables for reporting unit cash flows. These assumptions are subject to uncertainty, including our ability to grow revenue and improve profitability levels. Relatively small declines in the future performance and cash flows of a reporting unit or asset group or small changes in other key assumptions, including increases to the carrying values, may result in the recognition of significant asset impairment charges. For example, keeping all other variables constant, a 100 basis point decrease in the long term revenue and terminal growth rates would require that we perform the second step of the goodwill impairment test for the U.S. Neuromodulation reporting unit. A 200 basis point decrease in the long term revenue and terminal growth rates would require that we perform the second step of the goodwill impairment test for the U.S. Cardiovascular reporting unit. Increases in the WACC applied of 50 and 130 basis points would require that we perform the second step of the goodwill impairment test for the U.S. Neuromodulation and U.S. Cardiovascular reporting units, respectively. Given that the carrying value of the U.S. CRM reporting unit continues to exceed its fair value, any negative changes in the key variables or values associated with this reporting unit would likely require that we perform the second step of the goodwill impairment test in a future reporting period. The estimates used for our future cash flows and discount rates represent management's best estimates, which we believe to be reasonable, but future declines in business performance may impair the recoverability of our goodwill and intangible asset balances.

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

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

market and/or regulatory conditions that may cause significant launch delays or product recalls;
- decreases in our profitability due to an inability to successfully implement and achieve timely and sustainable cost improvement measures consistent with our expectations, increases in our market-participant tax rate, and/or changes in tax laws;
- negative developments in intellectual property litigation that may impact our ability to market certain products or increase our costs to sell certain products;
- the level of success of on-going and future research and development efforts, including those related to recent acquisitions,

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and increases in the research and development costs necessary to obtain regulatory approvals and launch new products;

- the level of success in managing the growth of acquired companies, achieving sustained profitability consistent with our expectations, establishing government and third-party payer reimbursement, and increases in the costs and time necessary to integrate acquired businesses into our operations successfully;
- changes in our reporting units or in the structure of our business as a result of future reorganizations or divestitures of assets or businesses;
- increases in our market-participant risk-adjusted WACC; and
- declines in revenue as a result of loss of key members of our sales force and other key personnel.

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

2011 Charge

Based on market information that became available to us toward the end of the first quarter of 2011, we concluded that there was a reduction in the estimated size of the U.S. ICD market, which led to lower projected U.S. CRM results compared to prior forecasts and created an indication of potential impairment of the goodwill balance attributable to our U.S. CRM business unit. Therefore, we performed an interim impairment test in accordance with U.S. GAAP and our accounting policies and recorded a non-deductible goodwill impairment charge of $697 million, on both a pre-tax and after-tax basis, associated with this business unit during the first quarter of 2011. For further information, refer to Note D - Goodwill and Other Intangible Assets to our consolidated financial statements included in Item 8 of our 2011 Annual Report filed on Form 10-K.

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

(in millions)	United States	EMEA	Japan	Inter-Continental	Total
Accumulated write-offs as of December 31, 2011	$(5,127)				$(5,127)
Goodwill written off	(748)	$(3,602)			(4,350)
Accumulated write-offs as of September 30, 2012	$(5,875)	$(3,602)			$(9,477)

Intangible Asset Impairment Charges

On a quarterly basis, we monitor for events or other potential indicators of impairment that would warrant an interim impairment test of our intangible assets. See Goodwill Impairment Charges above for discussion of future events that could have a negative impact on the recoverability of our amortizable intangible assets.

2012 Charges

During the third quarter of 2012, we performed our annual impairment test of all in-process research and development projects, and our indefinite lived core technology assets. Based on the results of our annual test, we recorded total impairment charges of $13 million ($10 million after-tax) to write-down the balances of certain in-process projects to their fair value. These charges were primarily due to increased expectations in the cost to bring an in-process project to market in a certain geographic region and lower future revenue expectations associated with an in-process project.

In-process research and development fair value is measured using projected revenues, projected expenses, discount rates, and probability of expected launch. The nonrecurring Level 3 fair value measurements of the impairment analysis performed in the third quarter of 2012 included the following significant unobservable inputs:

Intangible Asset	Fair Value as of September 30, 2012	Valuation Technique	Unobservable Input	Range
In-Process R&D	$26 million	Income Approach - Excess Earnings Method	Discount Rate	20-25%

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During the third quarter of 2012, in conjunction with the interim goodwill impairment test of our U.S. CRM reporting unit, we performed an impairment analysis of the amortizable intangible assets allocated to our U.S. CRM reporting unit as of September 30, 2012 on an undiscounted cash flow basis, and concluded that these assets were not impaired. However, following the recent declines in our CRM projections, the recoverability of our CRM-related amortizable intangibles ($4.684 billion globally) are sensitive to future cash flow assumptions and CRM business performance. The $4.684 billion of CRM-related amortizable intangibles are at higher risk of potential failure of the first step of the amortizable intangible recoverability test in future reporting periods. An impairment of a material portion of our CRM-related amortizable intangibles carrying value would occur if the second step of the amortizable intangible test is required in a future reporting period. See Goodwill Impairment Charges above for discussion of future events that could have a negative impact on the levels of excess fair value over carrying value of our reporting units and/or amortizable intangible assets.

During the second quarter of 2012, as a result of revised estimates developed in conjunction with our annual strategic planning process and annual goodwill impairment test, we performed an interim impairment test of our in-process research and development projects associated with our acquisition of Sadra Medical, Inc. Based on our impairment analysis, we revised our expectations of the required effort, time and cost involved in completing the in-process projects and bringing the related products to market. As a result of these changes, we recorded an impairment charge of $129 million ($110 million after-tax) to write-down the balance of these intangible assets to their fair value during the second quarter of 2012.

The nonrecurring Level 3 fair value measurements of the impairment analysis performed in the second quarter of 2012 included the following significant unobservable inputs:

Intangible Asset	Fair Value as of June 30, 2012	Valuation Technique	Unobservable Input	Range
In-Process R&D	$184 million	Income Approach - Excess Earnings Method	Discount Rate	20%

2011 Charges

During the third quarter of 2011, we recorded a $9 million intangible asset impairment charge attributable to lower projected cash flows associated with certain technologies. During the second quarter of 2011, we recorded a $12 million intangible asset impairment charge associated with changes in the timing and amount of the expected cash flows related to certain acquired in-process research and development projects.

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

NOTE E – FAIR VALUE MEASUREMENTS

Derivative Instruments and Hedging Activities

We develop, manufacture and sell medical devices globally and our earnings and cash flows are exposed to market risk from changes in foreign currency exchange rates and interest rates. We address these risks through a risk management program that includes the use of derivative financial instruments, and operate the program pursuant to documented corporate risk management policies. We recognize all derivative financial instruments in our consolidated financial statements at fair value in accordance with ASC Topic 815, Derivatives and Hedging (Topic 815). In accordance with Topic 815, for those derivative instruments that are designated and qualify as hedging instruments, the hedging instrument must be designated, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation. The accounting for changes in the fair value (i.e. gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. Our derivative instruments do not subject our earnings or

cash flows to material risk, as gains and losses on these derivatives generally offset losses and gains on the item being hedged. We do not enter into derivative transactions for speculative purposes and we do not have any non-derivative instruments that are designated as hedging instruments pursuant to Topic 815.

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Currency Hedging

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

Designated Foreign Currency Hedges

All of our designated currency hedge contracts outstanding as of September 30, 2012 and December 31, 2011 were cash flow hedges under Topic 815 intended to protect the U.S. dollar value of our forecasted foreign currency denominated transactions. We record the effective portion of any change in the fair value of foreign currency cash flow hedges in other comprehensive income (OCI) until the related third-party transaction occurs. Once the related third-party transaction occurs, we reclassify the effective portion of any related gain or loss on the foreign currency cash flow hedge to earnings. In the event the hedged forecasted transaction does not occur, or it becomes no longer probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time. We had currency derivative instruments designated as cash flow hedges outstanding in the contract amount of $2.293 billion as of September 30, 2012 and $2.088 billion as of December 31, 2011.

We recognized net losses of $3 million in earnings on our cash flow hedges during the third quarter of 2012 and $29 million during the first nine months of 2012, as compared to net losses of $28 million during the third quarter of 2011 and $74 million during the first nine months of 2011. All currency cash flow hedges outstanding as of September 30, 2012 mature within 36 months. As of September 30, 2012, $34 million of net losses, net of tax, were recorded in accumulated other comprehensive income (AOCI) to recognize the effective portion of the fair value of any currency derivative instruments that are, or previously were, designated as foreign currency cash flow hedges, as compared to net losses of $52 million as of December 31, 2011. As of September 30, 2012, $31 million of net losses, net of tax, may be reclassified to earnings within the next twelve months.

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

Non-designated Foreign Currency Contracts

We use currency forward contracts as a part of our strategy to manage exposure related to foreign currency denominated monetary assets and liabilities. These currency forward contracts are not designated as cash flow, fair value or net investment hedges under Topic 815; are marked-to-market with changes in fair value recorded to earnings; and are entered into for periods consistent with currency transaction exposures, generally less than one year. We had currency derivative instruments not designated as hedges under Topic 815 outstanding in the contract amount of $1.808 billion as of September 30, 2012 and $2.209 billion as of December 31, 2011.

Interest Rate Hedging

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

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

probable that it will occur, we reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time. We had no interest rate derivative contracts outstanding as of September 30, 2012 or December 31, 2011.

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In prior years, we terminated certain interest rate derivative contracts, including fixed-to-floating interest rate contracts, designated as fair value hedges, and floating-to-fixed treasury locks, designated as cash flow hedges. We are amortizing the gains and losses on these derivative instruments upon termination into earnings as a reduction of interest expense over the remaining term of the hedged debt, in accordance with Topic 815. The carrying amount of certain of our senior notes included unamortized gains of $66 million as of September 30, 2012 and $73 million as of December 31, 2011, and unamortized losses of $3 million as of September 30, 2012 and $4 million as of December 31, 2011, related to the fixed-to-floating interest rate contracts. In addition, we had pre-tax net gains within AOCI related to terminated floating-to-fixed treasury locks of $6 million as of September 30, 2012 and $7 million as of December 31, 2011. We recorded $3 million during the third quarter of 2012 and $8 million during the first nine months of 2012 as a reduction to interest expense, resulting from the amortization of previously terminated interest rate derivative contracts. As of September 30, 2012, $10 million of pre-tax net gains may be reclassified to earnings within the next twelve months as a reduction to interest expense from amortization of our previously terminated interest rate derivative contracts.

Counterparty Credit Risk

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

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

Fair Value of Derivative Instruments

The following presents the effect of our derivative instruments designated as cash flow hedges under Topic 815 on our accompanying unaudited condensed consolidated statements of operations during the third quarter and first nine months of 2012 and 2011 (in millions):

	Amount of Pre-tax Gain (Loss) Recognized in OCI (Effective Portion)	Amount of Pre-tax Loss Reclassified from AOCI into Earnings (Effective Portion)	Location in Statement of Operations
Three Months Ended September 30, 2012			
Currency hedge contracts	$(44)	$(3)	Cost of products sold
	$(44)	$(3)	
Three Months Ended September 30, 2011			
Currency hedge contracts	$29	$(28)	Cost of products sold
	$29	$(28)	
Nine Months Ended September 30, 2012			
Currency hedge contracts	$2	$(29)	Cost of products sold
	$2	$(29)	
Nine Months Ended September 30, 2011			
Currency hedge contracts	$(77)	$(74)	Cost of products sold
	$(77)	$(74)	

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

Derivatives Not Designated as Hedging Instruments	Location in Statement of Operations	Amount of Gain (Loss) Recognized in Earnings (in millions) Three Months Ended September 30,		Amount of Gain Recognized in Earnings (in millions) Nine Months Ended September 30,	
		2012	2011	2012	2011
Currency hedge contracts	Other, net	$(14)	$8		$2
		$(14)	$8		$2

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

in millions	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Gain (loss) on currency hedge contracts	$(14)	$8		$2
Gain (loss) on foreign currency transaction exposures	11	(12)	(13)	(11)
Net foreign currency gain (loss)	$(3)	$(4)	$(13)	$(9)

Topic 815 requires all derivative instruments to be recognized at their fair values as either assets or liabilities on the balance sheet. We determine the fair value of our derivative instruments using the framework prescribed by ASC Topic 820, Fair Value Measurements and Disclosures (Topic 820), by considering the estimated amount we would receive or pay to transfer these instruments at the reporting date and by taking into account current interest rates, foreign currency exchange rates, the creditworthiness of the counterparty for assets, and our creditworthiness for liabilities. In certain instances, we may utilize financial models to measure fair value. Generally, we use inputs that include quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; other observable inputs for the asset or liability; and inputs derived principally from, or corroborated by, observable market data by correlation or other means. As of September 30, 2012, we have classified all of our derivative assets and liabilities within Level 2 of the fair value hierarchy prescribed by Topic 820, as discussed below, because these observable inputs are available for substantially the full term of our derivative instruments.

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The following are the balances of our derivative assets and liabilities as of September 30, 2012 and December 31, 2011:

(in millions)	Location in Balance Sheet (1)	As of September 30, 2012	December 31, 2011
Derivative Assets:			
Designated Hedging Instruments			
Currency hedge contracts	Prepaid and other current assets	$18	$31
Currency hedge contracts	Other long-term assets	19	20
		37	51
Non-Designated Hedging Instruments			
Currency hedge contracts	Prepaid and other current assets	14	36
Total Derivative Assets		$51	$87
Derivative Liabilities:			
Designated Hedging Instruments			
Currency hedge contracts	Other current liabilities	$55	$69
Currency hedge contracts	Other long-term liabilities	25	49
		80	118
Non-Designated Hedging Instruments			
Currency hedge contracts	Other current liabilities	21	13
Total Derivative Liabilities		$101	$131

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

Other Fair Value Measurements

Recurring Fair Value Measurements

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

- Level 1 – Inputs to the valuation methodology are quoted market prices for identical assets or liabilities.
- Level 2 – Inputs to the valuation methodology are other observable inputs, including quoted market prices for similar assets or liabilities and market-corroborated inputs.
- Level 3 – Inputs to the valuation methodology are unobservable inputs based on management’s best estimate of inputs market participants would use in pricing the asset or liability at the measurement date, including assumptions about risk.

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Assets and liabilities measured at fair value on a recurring basis consist of the following as of September 30, 2012 and December 31, 2011:

	As of September 30, 2012				As of December 31, 2011			
(in millions)	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets								
Money market and government funds	$64			$64	$78			$78
Currency hedge contracts		$51		51		$87		87
	$64	$51		$115	$78	$87		$165
Liabilities								
Currency hedge contracts		$101		$101		$131		$131
Accrued contingent consideration			$604	604			$358	358
		$101	$604	$705		$131	$358	$489

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

In addition to $64 million invested in money market and government funds as of September 30, 2012, we had $147 million in short-term time deposits and $141 million in interest bearing and non-interest bearing bank accounts. In addition to $78 million invested in money market and government funds as of December 31, 2011, we had $88 million of cash invested in short-term time deposits, and $101 million in interest bearing and non-interest bearing bank accounts.

Changes in the fair value of assets and liabilities measured on a recurring basis using significant unobservable inputs (Level 3) during the first nine months of 2012 related solely to our contingent consideration liabilities. Refer to Note B - Acquisitions for a discussion of the fair value measurements related to our contingent consideration liabilities.

Non-Recurring Fair Value Measurements

We have certain assets and liabilities that are measured at fair value on a non-recurring basis in periods subsequent to initial recognition. The fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. The aggregate carrying amount of our cost method investments was $13 million as of September 30, 2012 and $16 million as of December 31, 2011.

During the three and nine months ended September 30, 2012, we recorded $761 million and $4.492 billion of losses, respectively, to adjust our goodwill and certain other intangible asset balances to their fair value. Refer to Note D - Goodwill and Other Intangible Assets, for further detailed information related to these charges and significant unobservable inputs.

The fair value of our outstanding debt obligations was $4.861 billion as of September 30, 2012 and $4.649 billion as of December 31, 2011, which was determined by using primarily quoted market prices for our publicly registered senior notes, classified as Level 1 within the fair value hierarchy. Refer to Note F – Borrowings and Credit Arrangements for a discussion of our debt obligations.

NOTE F – BORROWINGS AND CREDIT ARRANGEMENTS

We had total debt of $4.255 billion as of September 30, 2012 and $4.261 billion as of December 31, 2011. The debt maturity schedule for the significant components of our debt obligations as of September 30, 2012 is as follows:

(in millions)	2012	2013	2014	2015	2016	Thereafter	Total
Senior notes			$600	$1,250	$600	$1,750	$4,200
			$600	$1,250	$600	$1,750	$4,200

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

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Revolving Credit Facility

In April 2012, we financed a new $2.000 billion revolving credit facility which will mature in April 2017 and replaced the previous credit facility. Eurodollar and multicurrency loans under the new revolving credit facility bear interest at LIBOR plus an interest margin of between 0.875 percent and 1.475 percent (1.275 percent as of September 30, 2012), based on our corporate credit ratings and consolidated leverage ratio. In addition, we are required to pay a facility fee of between 0.125 percent and 0.275 percent (0.225 percent as of September 30, 2012) based on our corporate credit ratings, consolidated leverage ratio, and the total amount of revolving credit commitments, generally irrespective of usage, under the credit agreement. There were no amounts borrowed under our revolving credit facility as of September 30, 2012 or under our previous credit facility as of December 31, 2011.

Our revolving credit facility agreement in place as of September 30, 2012 requires that we maintain certain financial covenants, as follows:

	Covenant Requirement	Actual as of September 30, 2012
Maximum leverage ratio (1)	3.5 times	2.4 times
Minimum interest coverage ratio (2)	3.0 times	6.6 times

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

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

The credit agreement in place as of September 30, 2012, provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, through the credit agreement maturity, of up to $500 million in restructuring charges and restructuring-related expenses related to current or future restructuring plans. As of September 30, 2012, we had $410 million of the restructuring charge exclusion remaining. Any non-cash charges, as defined by the agreement, are excluded from the calculation of consolidated EBITDA. In addition, any cash litigation payments, as defined by the agreement, are excluded from the calculation of consolidated EBITDA and any new debt issued to fund any tax deficiency payments is excluded from consolidated total debt, as defined in the agreement, provided that the sum of any excluded cash litigation payments and any new debt issued to fund any tax deficiency payments shall not exceed $2.300 billion in the aggregate. As of September 30, 2012, we had $2.279 billion of the combined legal and debt exclusion remaining. As of and through September 30, 2012, we were in compliance with the required covenants.

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

Senior Notes

We had senior notes outstanding in the amount of $4.200 billion as of September 30, 2012 and December 31, 2011.

Other Arrangements

We also maintain a $350 million credit and security facility secured by our U.S. trade receivables. Effective June 29, 2012, we extended the maturity of this facility to June 2013, subject to further extension. There were no amounts borrowed under this facility as of September 30, 2012 or December 31, 2011.

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In addition, we have accounts receivable factoring programs in certain European countries that we account for as sales under ASC Topic 860, Transfers and Servicing (Topic 860). These agreements provide for the sale of accounts receivable to third parties, without recourse, of up to approximately 230 million Euro (approximately $298 million as of September 30, 2012). We have no significant retained interests in the transferred receivables, other than collection and administrative responsibilities and, once sold, the accounts receivable are no longer available to satisfy creditors in the event of bankruptcy. We de-recognized $201 million of receivables as of September 30, 2012 at an average interest rate of 2.5 percent, and $390 million as of December 31, 2011 at an average interest rate of 3.3 percent. The European sovereign debt crisis has impacted our ability to sell accounts receivable under our factoring programs within southern Europe. Certain of our factoring agents have suspended their factoring programs to reduce their exposure levels to government owned or supported debt. The European economic environment may further impact our future ability to transfer receivables, and may negatively impact the costs or credit limits of our existing factoring programs, which may negatively impact our cash flow and results of operations. Within Italy, Spain, Greece and Portugal the number of days our receivables are outstanding is greater than our historical levels in those countries. We believe we have adequate allowances for doubtful accounts related to our Italy, Spain, Greece and Portugal accounts receivable; however, we continue to monitor the European economic environment for any collectibility issues related to our outstanding receivables. In addition, we are currently pursuing alternative factoring arrangements to mitigate our risk of further reductions in cash flow in this region. During the second and third quarters of 2012, we received cash payments of $60 million and $28 million, respectively, related to a government-funded settlement of outstanding receivables in Spain. In addition, during 2011, the Greek government converted a significant portion of our outstanding receivables into bonds, which we monetized during the first half of 2011. These developments have reduced our credit exposure in these countries.

In addition, we have uncommitted credit facilities with a commercial Japanese bank that provide for accounts receivable discounting and factoring of up to 21.000 billion Japanese yen (translated to approximately $270 million as of September 30, 2012). Under these facilities, we de-recognized $191 million of Japanese trade receivables as of September 30, 2012 at an average interest rate of 1.6 percent and $188 million of Japanese trade receivables as of December 31, 2011 at an average interest rate of 1.7 percent. De-recognized accounts and notes receivable are excluded from trade accounts receivable, net in the accompanying unaudited condensed consolidated balance sheets.

NOTE G – RESTRUCTURING-RELATED ACTIVITIES

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

2011 Restructuring plan

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

We estimate that the 2011 Restructuring plan will result in total pre-tax charges of approximately $155 million to $210 million, and that approximately $150 million to $200 million of these charges will result in future cash outlays, of which we had made payments of $72 million as of September 30, 2012. As of September 30, 2012, we had recorded related costs of $133 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

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

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$125 million to $150 million
Other (1)	$20 million to $40 million
Restructuring-related expenses:	
Other (2)	$10 million to $20 million
	$155 million to $210 million

(1) Includes primarily consulting fees and costs associated with contractual cancellations.

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

2010 Restructuring plan

On February 6, 2010, our Board of Directors approved, and we committed to, a series of management changes and restructuring initiatives (the 2010 Restructuring plan) designed to focus our business, drive innovation, accelerate profitable revenue growth and increase both accountability and shareholder value. Key activities under the plan include the integration of our Cardiovascular and CRM businesses, as well as the restructuring of certain other businesses and corporate functions; the re-alignment of our international structure to reduce our administrative costs and invest in expansion opportunities including significant investments in emerging markets; and the re-prioritization and diversification of our product portfolio. Activities under the 2010 Restructuring plan were initiated in the first quarter of 2010 and are expected to be substantially complete by the end of 2012.

We estimate that the 2010 Restructuring plan will result in total pre-tax charges of approximately $165 million to $185 million, and that approximately $150 million to $160 million of these charges will result in cash outlays, of which we had made payments of $144 million as of September 30, 2012. As of September 30, 2012, we had recorded related costs of $160 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through other lines within our consolidated statements of operations.

The following provides a summary of our expected total costs associated with the 2010 Restructuring plan by major type of cost:

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$95 million to $100 million
Fixed asset write-offs	$10 million to $15 million
Other (1)	$50 million to $55 million
Restructuring-related expenses:	
Other (2)	$10 million to $15 million
	$165 million to $185 million

(1) Includes primarily consulting fees and costs associated with contractual cancellations.

(2) Comprised of other costs directly related to the 2010 Restructuring plan, including accelerated depreciation and infrastructure-related costs.

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Plant Network Optimization program

In January 2009, our Board of Directors approved, and we committed to, a plant network optimization initiative (the Plant Network Optimization program), which is intended to simplify our manufacturing plant structure by transferring certain production lines among facilities and by closing certain other facilities. The program is a complement to the restructuring initiatives approved by our Board of Directors in 2007 (the 2007 Restructuring plan), and is intended to improve overall gross profit margins. Activities under the Plant Network Optimization program were initiated in the first quarter of 2009 and are expected to be substantially complete by the end of 2012.

We estimate that the execution of the Plant Network Optimization program will result in total pre-tax charges of approximately $130 million to $145 million, and that approximately $110 million to $120 million of these charges will result in cash outlays, of which we had made payments of $99 million as of September 30, 2012. As of September 30, 2012, we had recorded related costs of $131 million since the inception of the plan, and are recording a portion of these expenses as restructuring charges and the remaining portion through cost of products sold within our consolidated statements of operations.

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

Type of cost	Total estimated amount expected to be incurred
Restructuring charges:	
Termination benefits	$35 million to $40 million
Restructuring-related expenses:	
Accelerated depreciation	$20 million to $25 million
Transfer costs (1)	$75 million to $80 million
	$130 million to $145 million

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

In the aggregate, we recorded restructuring charges pursuant to our restructuring plans of $54 million in the third quarter of 2012, $22 million in the third quarter of 2011, $93 million in the first nine months of 2012, and $77 million in the first nine months of 2011. In addition, we recorded expenses within other lines of our accompanying unaudited condensed consolidated statements of operations related to our restructuring initiatives of $4 million in the third quarter of 2012, $7 million in the third quarter of 2011, $15 million in the first nine months of 2012, and $32 million in the first nine months of 2011.

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

Three Months Ended September 30, 2012

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
Restructuring charges	$44				$10	$54
Restructuring-related expenses:						
Cost of products sold			$1			1
Selling, general and administrative expenses					3	3
			1		3	4
	$44		$1		$13	$58

(in millions)	Termination Benefits	Accelerated Depreciation	Transfer Costs	Fixed Asset Write-offs	Other	Total
2011 Restructuring plan	$43				$13	$56
2010 Restructuring plan	2					2
Plant Network Optimization program	(1)		$1			
	$44		$1		$13	$58