BAXTER INTERNATIONAL INC
Form 10-Q
November 05, 2007

Table of Contents

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, 2007

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

For the transition period from __________ to __________

Commission file number 1-4448

BAXTER INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

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

847-948-2000

(Registrant s telephone number, including area code)

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

Yes þ No o

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer 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

The number of shares of the registrant s Common Stock, par value $1.00 per share, outstanding as of October 30, 2007 was 634,072,529 shares.

BAXTER INTERNATIONAL INC.
FORM 10-Q
For the quarterly period ended September 30, 2007
TABLE OF CONTENTS

		Page Number
PART I.	FINANCIAL INFORMATION	
Item 1.	Financial Statements	
	Condensed Consolidated Statements of Income	2
	Condensed Consolidated Balance Sheets	3
	Condensed Consolidated Statements of Cash Flows	4
	Notes to Condensed Consolidated Financial Statements	5
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	20
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	32
Item 4.	Controls and Procedures	33
Review by Independent Registered Public Accounting Firm		34
Report of Independent Registered Public Accounting Firm		35
PART II.	OTHER INFORMATION	
Item 1.	Legal Proceedings	36
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	37
Item 6.	Exhibits	38
Signature		39

Letter Re Unaudited Interim Financial Information
Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a)
Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a)
Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350
Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

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

	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Net sales	$2,750	$2,557	$8,254	$7,615
Costs and expenses				
Cost of goods sold	1,374	1,342	4,220	4,193
Marketing and administrative expenses	663	562	1,867	1,670
Research and development expenses	203	149	539	433
Restructuring charges			70	
Net interest expense	6	5	10	33
Other expense, net	21	20	28	55
Total costs and expenses	2,267	2,078	6,734	6,384
Income before income taxes	483	479	1,520	1,231
Income tax expense	88	105	291	266
Net income	$ 395	$ 374	$1,229	$ 965
Earnings per common share				
Basic	$ 0.62	$ 0.58	$ 1.90	$ 1.49
Diluted	$ 0.61	$ 0.57	$ 1.87	$ 1.47
Weighted average number of common shares outstanding				
Basic	641	653	647	650
Diluted	651	661	657	656

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

Table of Contents

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

		September 30, 2007	December 31, 2006
Current assets	Cash and equivalents	$ 1,818	$ 2,485
	Accounts and other current receivables	1,976	1,838
	Inventories	2,320	2,066
	Other current assets	526	581
	Total current assets	6,640	6,970
Property, plant and equipment, net		4,216	4,229
Other assets	Goodwill	1,649	1,618
	Other intangible assets, net	457	480
	Other	1,185	1,389
	Total other assets	3,291	3,487
Total assets		$ 14,147	$ 14,686
Current liabilities	Short-term debt	$ 46	$ 57
	Current maturities of long-term debt and lease obligations	500	177
	Accounts payable and accrued liabilities	3,143	3,376
	Total current liabilities	3,689	3,610
Long-term debt and lease obligations		2,024	2,567
Other long-term liabilities		2,142	2,237
Commitments and contingencies			
Shareholders equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2007 and 2006	683	683
	Common stock in treasury, at cost, 49,669,849 shares in 2007 and 33,016,340 shares in 2006	(2,420)	(1,433)
	Additional contributed capital	5,251	5,177
	Retained earnings	4,039	3,271
	Accumulated other comprehensive loss	(1,261)	(1,426)
	Total shareholders equity	6,292	6,272

Total liabilities and shareholders equity	$ 14,147	$ 14,686

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

Table of Contents

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

		Nine months ended September 30, 2007	Nine months ended September 30, 2006
Cash flows from operating activities	Net income	$ 1,229	$ 965
	Adjustments		
	Depreciation and amortization	428	431
	Deferred income taxes	32	76
	Stock compensation	99	68
	Restructuring and infusion pump charges	70	76
	Average wholesale pricing litigation charge	56	
	In-process research and development charges	46	
	Other	53	29
	Changes in balance sheet items		
	Accounts and other current receivables	(114)	33
	Inventories	(261)	(108)
	Accounts payable and accrued liabilities	(85)	(159)
	Restructuring payments	(20)	(34)
	Other	21	44
	Cash flows from operating activities	1,554	1,421
Cash flows from investing activities	Capital expenditures	(424)	(336)
	Acquisitions of, and investments in, businesses and technologies	(83)	(3)
	Divestitures and other	490	140
	Cash flows from investing activities	(17)	(199)
Cash flows from financing activities	Issuances of debt	73	707
	Payments of obligations	(501)	(1,235)
	Cash dividends on common stock	(598)	(363)
	Proceeds from stock issued under employee benefit plans	500	195
	Other issuances of stock		1,249
	Purchases of treasury stock	(1,641)	(479)
	Cash flows from financing activities	(2,167)	74
Effect of currency exchange rate changes on cash and equivalents		(37)	(70)

(Decrease) increase in cash and equivalents	(667)	1,226
Cash and equivalents at beginning of period	2,485	841
Cash and equivalents at end of period	$ 1,818	$ 2,067

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

Table of Contents

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the company s 2006 Annual Report to Shareholders (2006 Annual Report).

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

Adoption of FIN No. 48

On January 1, 2007, the company adopted Financial Accounting Standards Board (FASB) Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement 109 (FIN No. 48). FIN No. 48 prescribes a two-step process for the financial statement measurement and recognition of a tax position taken or expected to be taken in a tax return. The first step involves the determination of whether it is more likely than not (greater than 50 percent likelihood) that a tax position will be sustained upon examination, based on the technical merits of the position. The second step requires that any tax position that meets the more-likely-than-not recognition threshold be measured and recognized in the financial statements at the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. FIN No. 48 also provides guidance on the accounting for related interest and penalties, financial statement classification and disclosure. The cumulative effect of applying FIN No. 48 is to be reported as an adjustment to the opening balance of retained earnings in the period of adoption.

The adoption of FIN No. 48 by the company on January 1, 2007 had no impact on the opening balance of retained earnings.

At January 1, 2007, the company s liability for uncertain tax positions totaled $405 million, including liabilities related to interest and penalties. The liabilities related to interest and penalties at January 1, 2007 were not material. At December 31, 2006, the entire balance was classified as a current liability. In applying FIN No. 48 s liability classification provisions, the company reclassified $200 million of the total liability to noncurrent liabilities on January 1, 2007. There was no material change in the liability for uncertain tax positions during the third quarter or first nine months of 2007.

None of the positions included in the liability for uncertain tax positions related to tax positions for which the ultimate deductibility is highly certain but for which there is uncertainty about the timing of such deductibility.

The company has historically classified interest and penalties associated with income taxes in the income tax expense line in the consolidated statement of income, and this treatment is unchanged under FIN No. 48. Interest and penalties recorded during the third quarter or first nine months of 2007 were not material.

Refer to the Annual Report included in the company s Form 10-K for the year ended December 31, 2006 for a description, by major tax jurisdiction, of tax years that remain subject to examination. Other than the settlement of a tax audit outside the United States during the second quarter, there were no material changes during the first nine months of 2007.

As of January 1, 2007, Baxter had ongoing audits in several jurisdictions, as well as bilateral Advance Pricing Agreement proceedings that the company voluntarily initiated between the U.S. government and the governments of Switzerland and Japan with respect to intellectual property, product, and service transfer pricing arrangements. Baxter expects to settle these proceedings within the next 12 months. In the opinion of management, the company has made adequate tax provisions for all years subject to examination. There is a reasonable possibility that the ultimate settlements will be more or less than the amounts reserved for these unrecognized tax benefits.

Table of Contents

Issued but not yet effective accounting standards

SFAS No. 157

In September 2006, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS No. 157), which clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 does not expand the use of fair value to any new circumstances, and must be applied on a prospective basis except in certain cases. The standard also requires expanded financial statement disclosures about fair value measurements, including disclosure of the methods used and the effect on earnings. The company is in the process of analyzing this new standard, which will be effective for the company on January 1, 2008.

SFAS No. 159

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115 (SFAS No. 159). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under SFAS No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option would be required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. At the adoption date, unrealized gains and losses on existing items for which the fair value option has been elected are reported as a cumulative adjustment to beginning retained earnings. The company is in the process of analyzing this new standard, which will be effective for the company on January 1, 2008.

2. SUPPLEMENTAL FINANCIAL INFORMATION

Net pension and other postemployment benefits expense

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

(in millions)	Three months ended September 30, 2007	2006	Nine months ended September 30, 2007	2006
Pension benefits				
Service cost	$ 22	$ 23	$ 65	$ 68
Interest cost	47	44	139	131
Expected return on plan assets	(54)	(50)	(161)	(149)
Amortization of net loss, prior service cost and transition obligation	24	29	73	87
Net pension plan expense	$ 39	$ 46	$ 116	$ 137
OPEB				
Service cost	$ 1	$ 2	$ 4	$ 5
Interest cost	8	7	23	22
Amortization of net loss and prior service cost	1	1	3	4
Net OPEB plan expense	$ 10	$ 10	$ 30	$ 31

Net interest expense

(in millions)	Three months ended September 30, 2007	Three months ended September 30, 2006	Nine months ended September 30, 2007	Nine months ended September 30, 2006
Interest expense, net of capitalized interest	$ 30	$ 25	$ 90	$ 70
Interest income	(24)	(20)	(80)	(37)
Net interest expense	$ 6	$ 5	$ 10	$ 33

Table of Contents

Comprehensive income

Total comprehensive income was $429 million and $410 million for the three months ended September 30, 2007 and 2006, respectively, and $1,394 million and $1,003 million for the nine months ended September 30, 2007 and 2006, respectively. The increase in comprehensive income in both periods was principally due to higher net income and favorable movements in currency translation adjustments, partially offset, particularly in the third quarter, by unfavorable movements in the fair value of the company s net investment hedges.

Effective tax rate

The company s effective income tax rate was 18.2% and 21.9% in the third quarters of 2007 and 2006, respectively, and 19.1% and 21.6% in the nine-month periods ended September 30, 2007 and 2006, respectively. For a discussion of the effective tax rate anticipated for the full-year 2007, see the Income Taxes section of Management s Discussion and Analysis below.

The decrease in the third quarter was principally due to a $57 million reduction of the valuation allowance on net operating loss carryforwards in a foreign jurisdiction due to recent profitability improvements, a $12 million reduction in tax expense due to recently enacted legislation reducing corporate income tax rates in Germany, as well as an approximately $8 million net favorable tax impact of a charge related to the company s average wholesale pricing litigation (see Note 6 for further information regarding this charge) and in-process research and development (IPR&D) charges recorded in the quarter (see Acquisitions of, and investments in, businesses and technologies section below for further information regarding these charges). In addition, as a result of profitability in lower tax rate jurisdictions around the world that was higher than previous estimates, the company lowered its expected full-year tax rate on earnings excluding special items, which reduced income tax expense in the quarter by approximately $14 million related to earnings through the first half of 2007. Partially offsetting these items in the quarter was $84 million of U.S. income tax expense related to foreign earnings, which are no longer considered permanently reinvested outside of the United States because management now believes these earnings will be remitted to the United States in the foreseeable future.

In addition to the items noted above, the decrease in the year-to-date period was due to the extension of tax incentives and the favorable settlement of a tax audit in jurisdictions outside of the United States, as well as the impact of the second quarter 2007 restructuring charges. These benefits were partially offset by the tax impact of the gain on the divestiture of the Transfusion Therapies (TT) business and related charges. The effective tax rate for the nine months ended September 30, 2006 was impacted by costs associated with the COLLEAGUE and SYNDEO infusion pumps that have lower tax benefits. Refer to Note 3 for further information on the divestiture and Note 4 for further information on the restructuring charges recorded in 2007 and the infusion pump charges recorded in 2006.

Earnings per share

The numerator for both basic and diluted earnings per share (EPS) is net income. The denominator for basic EPS is the weighted-average number of common shares outstanding during the period. The dilutive effect of outstanding employee stock options, employee stock purchase subscriptions, the purchase contracts in the company s equity units (which were settled in February 2006), restricted stock units, performance share units and restricted stock is reflected in the denominator for diluted EPS principally using the treasury stock method.

Employee stock options to purchase 11 million and 28 million shares for the third quarters of 2007 and 2006, respectively, and 11 million and 42 million for the nine-month periods ended September 30, 2007 and 2006, respectively, were not included in the computation of diluted EPS because the assumed proceeds were greater than the average market price of the company s common stock, resulting in an anti-dilutive effect on diluted EPS.

Refer to the 2006 Annual Report regarding the purchase contracts included in the company s equity units. The purchase contracts were settled in February 2006, and the company issued approximately 35 million shares of common stock in exchange for $1.25 billion. Using the treasury stock method, prior to the February 2006 settlement date, the purchase contracts had a dilutive effect when the average market price of Baxter stock exceeded $35.69.

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

Table of Contents

(in millions)	Three months ended September 30, 2007	2006	Nine months ended September 30, 2007	2006
Basic shares	641	653	647	650
Effect of dilutive securities				
Employee stock options	9	7	9	6
Performance share units, restricted stock units and other	1	1	1	
Diluted shares	651	661	657	656

Inventories

(in millions)	September 30, 2007	December 31, 2006
Raw materials	$ 650	$ 526
Work in process	667	676
Finished products	1,003	864
Total inventories	$ 2,320	$ 2,066

Property, plant and equipment, net

(in millions)	September 30, 2007	December 31, 2006
Property, plant and equipment, at cost	$ 8,430	$ 8,311
Accumulated depreciation and amortization	(4,214)	(4,082)
Property, plant and equipment, net (PP&E)	$ 4,216	$ 4,229

Goodwill

Goodwill at September 30, 2007 totaled $579 million for the BioScience segment, $921 million for the Medication Delivery segment and $149 million for the Renal segment. Goodwill at December 31, 2006 totaled $579 million for the BioScience segment, $898 million for the Medication Delivery segment and $141 million for the Renal segment. Approximately $12 million of goodwill in the BioScience segment was included in the book value of the TT business in determining the divestiture gain. Refer to Note 3 for further information. The remaining change in the goodwill balance from December 31, 2006 to September 30, 2007 for each segment principally related to foreign currency fluctuations.

Other intangible assets, net

The following is a summary of the company s intangible assets subject to amortization at September 30, 2007 and December 31, 2006.

(in millions, except amortization period data)	Developed technology, including patents	Other	Total
September 30, 2007			
Gross intangible assets	$ 834	$ 126	$ 960
Accumulated amortization	442	68	510
Net intangible assets	$ 392	$ 58	$ 450
Weighted-average amortization period (in years)	14	14	14
December 31, 2006			
Gross intangible assets	$ 827	$ 122	$ 949
Accumulated amortization	418	58	476
Net intangible assets	$ 409	$ 64	$ 473
Weighted-average amortization period (in years)	15	15	15

The amortization expense for these intangible assets was $14 million and $15 million for the three months ended September 30, 2007 and 2006, respectively, and $43 million and $42 million for the nine months ended September 30, 2007 and 2006, respectively.

The anticipated annual amortization expense for intangible assets recorded as of September 30, 2007 is $57 million in 2007, $51 million in 2008, $50 million in 2009, $48 million in 2010, $43 million in 2011 and $39 million in 2012.

Acquisitions of, and investments in, businesses and technologies

MAAS Medical, LLC

In June 2007, the company acquired certain assets of MAAS Medical, LLC, a company that specializes in infusion systems technology. This acquisition expands Baxter s R&D capabilities, as the talent and technology acquired will be incorporated into Baxter s R&D pipeline and applied in the development of infusion systems and related technologies within the Medication Delivery segment. The purchase price of $11 million was principally allocated to IPR&D, and expensed at the acquisition date. The IPR&D relates to products under development which had not achieved regulatory approval and had no alternative future use. Baxter may be required to make additional payments of up to $14 million based on the achievement of specified regulatory approvals of products as well as the retention of certain key employees. These contingent payments will be recorded if and when the contingencies are resolved, as the outcomes of the contingencies are not determinable beyond a reasonable doubt on the acquisition date.

HHD

In August 2007, the company entered into a collaboration with HHD, LLC (HHD) and DEKA Products Limited Partnership and DEKA Research and Development Corp. (collectively, DEKA) for the development of a next-generation home hemodialysis (HD) machine. This Renal business collaboration highlights Baxter s ongoing commitment to innovation in end-stage renal disease treatment, and reflects the company s strategic approach to expediting and enhancing product development through targeted partnerships. The arrangement will provide Baxter with the opportunity to offer two forms of at-home dialysis, peritoneal dialysis (PD) and home HD, with the goal of continuing to offer patients an improved quality of life, and greater flexibility and control as to when and where they receive treatment.

HHD owns certain intellectual property and licensing rights that will be used in developing the next-generation home HD machine. In addition, pursuant to an R&D and license agreement between HHD and DEKA, DEKA will perform R&D activities for HHD in exchange for compensation for the R&D services and licensing rights, plus royalties on any commercial sales of the developed product.

In connection with this collaboration, the company purchased an option for $25 million to acquire the assets of HHD, and will reimburse HHD for the R&D services performed by DEKA, as well as other of HHD s costs associated with developing the home HD machine. Pursuant to the option agreement with HHD, the company can exercise the option at any time between the effective date of the agreement and the earlier of U.S. Food and Drug Administration approval of the product or January 31, 2011. The exercise price is fixed, varying only based on the timing of exercise, with the exercise price decreasing over the exercise period, from $45 million to $19 million. Upon exercise, the company would make an additional payment of up to $4 million based on a contractual relationship between HHD and a third party. Because the company is the primary beneficiary of the risks and rewards of HHD s activities, the company is consolidating the financial results of HHD from the date of the option purchase.

HHD s assets and technology have not yet received regulatory approval and no alternative future use has been identified. In conjunction with the execution of the option agreement with HHD and the related payment of $25 million, the company recognized a net IPR&D charge of $25 million during the third quarter of 2007.

Halozyme Therapeutics, Inc.

In February 2007, the company entered into an arrangement to expand the company s existing arrangements with Halozyme Therapeutics, Inc. (Halozyme) to include the use of HYLENEX recombinant (hyaluronidase human injection) with the company s proprietary and non-proprietary small molecule drugs. Under the terms of the arrangement, the company made an initial payment of $10 million for license and other rights, which was capitalized as an intangible asset, and made a $20 million investment in the common stock of Halozyme. The company assumes the development, manufacturing, clinical, regulatory, and sales and marketing costs associated with the products included in the arrangement. This arrangement will provide the Medication Delivery segment with a new route of administration for injected drugs and fluids, and a potential pipeline of proprietary drug applications through the kitting and co-formulating of HYLENEX with generic molecules.

Table of Contents

In September 2007, the company entered into an arrangement with Halozyme to apply Halozyme s Enhanze technology to the development of a subcutaneous route of administration for Baxter s liquid formulation of IVIG (intravenous immunoglobulin). Under this arrangement, the company made an initial payment of $10 million, which was expensed as IPR&D as the licensed technology had not received regulatory approval and had no alternative future use. The goal of this BioScience segment collaboration is to enable the company to provide patients with immunodeficiency disorders access to enhanced administration of IVIG therapy.

With respect to both of these arrangements, the company may be required to make additional payments of up to $62 million based on the successful completion of specified regulatory and sales milestones, as well as royalty payments on future sales of the related products. Based on the company s projections, any contingent payments made in the future will be more than offset over time by the estimated net future cash flows related to the rights acquired for those payments.

Securitization arrangements

The company s securitization arrangements resulted in net cash outflows of $23 million and $71 million for the three months ended September 30, 2007 and 2006, respectively, and $31 million and $105 million for the nine months ended September 30, 2007 and 2006, respectively. A summary of the activity is as follows.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	2007	2006	2007	2006
Sold receivables at beginning of period	$337	$429	$348	$451
Proceeds from sales of receivables	402	358	1,172	1,039
Cash collections (remitted to the owners of the receivables)	(425)	(429)	(1,203)	(1,144)
Effect of currency exchange rate changes	13	(1)	10	11
Sold receivables at end of period	$327	$357	$327	$357

3. SALE OF TRANSFUSION THERAPIES BUSINESS

On February 28, 2007, the company completed the disposition of substantially all of the assets and liabilities of its TT business to an affiliate of TPG Capital, L.P. (TPG), which has established the new company as Fenwal Inc. (Fenwal), for $540 million. This purchase price is subject to customary adjustments based upon the finalization of the net assets transferred. Under the terms of the sale agreement, TPG acquired the net assets of the TT business, including its product portfolio of manual and automated blood-collection products and storage equipment, as well as five manufacturing facilities located in Haina, Dominican Republic; La Chatre, France; Maricao and San German, Puerto Rico; and Nabeul, Tunisia. The decision to sell the TT net assets was based on the results of strategic and financial reviews of the company s business portfolio, and will allow the company to increase its focus and investment on businesses with more long-term strategic value to the company.

Under transition agreements, the company is providing manufacturing and a variety of support services to Fenwal for a period of time after divestiture, which vary based on the products or services provided and other factors, but generally approximate two years. Due to the company s expected significant continuing cash flows associated with this business, the company continued to include the results of operations of TT in the company s results of continuing operations through the February 28, 2007 sale date. No facts or circumstances have arisen in the second or third quarter of 2007 that change the expectation of significant continuing cash flows. TT s sales, which were reported in the BioScience segment, were $79 million in 2007 through the February 28 sale date and $121 million and $371 million in the third quarter and first nine months of 2006, respectively. Revenues associated with the manufacturing, distribution and other transition services provided by the company to Fenwal post-divestiture, which were $44 million in the third quarter of 2007 and $100 million in the year-to-date period, are reported at the corporate headquarters level and not allocated to a segment.

The major classes of the assets and liabilities classified as held for sale as of the February 28, 2007 sale date and that were included in the company s consolidated financial statements as of December 31, 2006 were as follows.

(in millions)	February 28, 2007	December 31, 2006
Current assets	$ 149	$208
Noncurrent assets	$ 224	$206
Total assets	$ 373	$414
Total liabilities	$ 58	$ 64

The company recorded a pre-tax gain on the sale of the TT business of $58 million ($30 million, or $0.05 per diluted share, on an after-tax basis) during the first quarter of 2007. Cash proceeds were $473 million, representing the purchase price of $540 million net of certain items, principally international receivables that have been retained by the company post-divestiture. The gain on the sale was recorded net of transaction-related expenses and other costs of $36 million, and a $12 million allocation of a portion of BioScience segment goodwill. In addition, $52 million of the cash proceeds were allocated to the manufacturing, distribution and other transition agreements because these arrangements provide for below-market consideration for those services. Approximately $7 million and $17 million of deferred revenue related to these arrangements was recognized during the third quarter of 2007 and in the year-to-date period, respectively, as the services were performed.

In connection with the TT divestiture, the company recorded a $35 million pre-tax charge ($24 million, or $0.04 per diluted share, on an after-tax basis) principally associated with severance and other employee-related costs. Reserve utilization in the third quarter of 2007 was $5 million. The reserve is expected to be utilized by the end of 2008, and the company believes that the reserves are adequate. However, adjustments may be recorded in the future as the program is completed.

The gain on the sale of the TT business and the related charges were recorded in other income and expense, net on the consolidated statement of income. These amounts were reported at the corporate headquarters level and were not allocated to a segment.

4. RESTRUCTURING AND OTHER SPECIAL CHARGES

2007 restructuring charges

During the second quarter of 2007, the company recorded pre-tax restructuring charges of $70 million principally associated with the consolidation of certain commercial and manufacturing operations outside of the United States. Based upon a review of current and future capacity needs, the company decided to integrate several facilities in order to reduce the company s cost structure and optimize the company s operations, principally within the Medication Delivery segment.

Included in the charge was $17 million related to asset impairments, principally to write down PP&E based on market data for the assets. Also included in the charge was $53 million for cash costs, principally pertaining to severance and other employee-related costs associated with the elimination of approximately 550 positions, or approximately 1% of the company s total workforce. Reserve utilization through September 30, 2007 was not significant. The reserve for severance and other costs is expected to be utilized by the end of 2009, with the majority of the payments to be made in 2007 and 2008. The company believes that the reserves are adequate. However, adjustments may be recorded in the future as the programs are completed.

2004 restructuring charge

During 2004, the company recorded a $543 million pre-tax restructuring charge principally associated with management s decision to implement actions to reduce the company s overall cost structure and to drive sustainable improvements in financial performance. Included in the 2004 charge was $196 million relating to asset impairments, almost all of which was to write down PP&E. Also included in the 2004 charge was $347 million for cash costs, principally pertaining to severance and other employee-related costs. Refer to the 2006 Annual Report for additional information.

The following table summarizes cash activity in the company s 2004 restructuring reserve.

Table of Contents

(in millions)	Employee-related costs	Contractual and other costs	Total