BAXTER INTERNATIONAL INC
Form 10-Q
May 02, 2008

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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 March 31, 2008

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, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

The number of shares of the registrant s Common Stock, par value $1.00 per share, outstanding as of April 30, 2008 was 627,379,237 shares.

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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 March 31,	
	2008	2007
Net sales	$ 2,877	$ 2,675
Costs and expenses		
Cost of goods sold	1,497	1,409
Marketing and administrative expenses	640	583
Research and development expenses	190	159
Net interest expense	17	5
Other income, net	(1)	(10)
Total costs and expenses	2,343	2,146
Income before income taxes	534	529
Income tax expense	105	126
Net income	$ 429	$ 403
Earnings per common share		
Basic	$ 0.68	$ 0.62
Diluted	$ 0.67	$ 0.61
Weighted average number of common shares outstanding		
Basic	632	650
Diluted	644	659

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

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

		March 31, 2008	December 31, 2007
Current assets	Cash and equivalents	$ 1,736	$ 2,539
	Accounts and other current receivables	2,096	2,026
	Inventories	2,536	2,334
	Other current assets	645	656
	Total current assets	7,013	7,555
Property, plant and equipment, net		4,633	4,487
Other assets	Goodwill	1,768	1,690
	Other intangible assets, net	461	455
	Other	1,097	1,107
	Total other assets	3,326	3,252
Total assets		$ 14,972	$ 15,294
Current liabilities	Short-term debt	$ 44	$ 45
	Current maturities of long-term debt and lease obligations	97	380
	Accounts payable and accrued liabilities	3,095	3,387
	Total current liabilities	3,236	3,812
Long-term debt and lease obligations		2,731	2,664
Other long-term liabilities		2,008	1,902
Commitments and contingencies			
Shareholders equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2008 and 2007	683	683
	Common stock in treasury, at cost, 55,832,435 shares in 2008 and 49,857,061 shares in 2007	(2,930)	(2,503)
	Additional contributed capital	5,322	5,297
	Retained earnings	4,671	4,379
	Accumulated other comprehensive loss	(749)	(940)
	Total shareholders equity	6,997	6,916
Total liabilities and shareholders equity		$ 14,972	$ 15,294

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

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

		Three months ended March 31,	
		2008	2007
Cash flows from operating activities	Net income	$ 429	$ 403
	Adjustments		
	Depreciation and amortization	156	140
	Deferred income taxes	61	(13)
	Stock compensation	38	27
	Infusion pump charge	53	
	Other	9	4
	Changes in balance sheet items		
	Accounts and other current receivables	18	(98)
	Inventories	(105)	(128)
	Accounts payable and accrued liabilities	(341)	(158)
	Restructuring payments	(12)	(3)
	Other	56	41
	Cash flows from operating activities	362	215
Cash flows from investing activities	Capital expenditures	(157)	(93)
	Acquisitions of and investments in businesses and technologies	(61)	(31)
	Divestitures and other	29	447
	Cash flows from investing activities	(189)	323
Cash flows from financing activities	Issuances of debt	4	15
	Payments of obligations	(459)	(221)
	Cash dividends on common stock	(138)	(380)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	112	226
	Purchases of treasury stock	(545)	(270)
	Cash flows from financing activities	(1,026)	(630)

Effect of currency exchange rate changes on cash and equivalents	50	(9)
Decrease in cash and equivalents	(803)	(101)
Cash and equivalents at beginning of period	2,539	2,485
Cash and equivalents at end of period	$ 1,736	$2,384

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

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Baxter International Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) 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 2007 Annual Report to Shareholders (2007 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 new accounting standards

SFAS No. 159

On January 1, 2008, the company adopted Statement of Financial Accounting Standards (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 are 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. The new standard did not impact the company s consolidated financial statements as the company did not elect the fair value option for any instruments existing as of the adoption date. However, the company will evaluate the fair value measurement election with respect to financial instruments the company enters into in the future.

Issued but not yet effective accounting standards

SFAS No. 161

In March 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS No. 161). The standard expands the disclosure requirements of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and requires qualitative disclosures about the objectives and strategies for using derivatives, quantitative disclosures about the fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. The company is in the process of analyzing this new standard, which will be effective for the company in the first quarter of 2009.

SFAS No. 160

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 (SFAS No. 160). The new standard changes the accounting and reporting of noncontrolling interests, which have historically been referred to as minority interests. SFAS No. 160 requires that noncontrolling interests be presented in the consolidated balance sheets within shareholders equity, but separate from the parent s equity, and that the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented in the consolidated statements of income. Any losses in excess of the noncontrolling interest s equity interest will continue to be allocated to the noncontrolling interest. Purchases or sales of equity interests that do not result in a change of control will be accounted for as equity transactions. Upon a loss of control, the interest sold, as well as any interest retained, will be measured at fair value, with any gain or loss recognized in earnings. In partial acquisitions, when control is obtained, the acquiring company will recognize at fair value, 100% of the assets and liabilities, including goodwill, as if the entire target company had been acquired. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008, with early adoption prohibited. The new standard will be applied prospectively, except for the presentation and

disclosure requirements, which will be applied retrospectively for all periods presented. The company is in the process of analyzing the standard, which will be adopted by the company at the beginning of 2009.

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SFAS No. 141-R

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations (SFAS No. 141-R). The new standard changes the accounting for business combinations in a number of significant respects. The key changes include the expansion of transactions that will qualify as business combinations, the capitalization of in-process research and development as an indefinite-lived asset, the recognition of certain acquired contingent assets and liabilities at fair value, the expensing of acquisition costs, the expensing of costs associated with restructuring the acquired company, the recognition of contingent consideration at fair value on the acquisition date, and the recognition of post-acquisition date changes in deferred tax asset valuation allowances and acquired income tax uncertainties as income tax expense or benefit. SFAS No. 141-R is effective for business combinations that close in years beginning on or after December 15, 2008, with early adoption prohibited. The company is in the process of analyzing this new standard, which will be adopted by the company at the beginning of 2009.

Partial adoption of SFAS No. 157

In September 2006, the FASB issued 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.

In February 2008, FASB Staff Position (FSP) FAS No. 157-2, Effective Date of FASB Statement No. 157 (FSP No. 157-2) was issued. FSP No. 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP No. 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The partial adoption of SFAS No. 157 on January 1, 2008 with respect to financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis did not have a material impact on the company s consolidated financial statements. See Note 5 for the fair value measurement disclosures for these assets and liabilities. The company is in the process of analyzing the potential impact of SFAS No. 157 relating to its planned January 1, 2009 adoption of the remainder of the standard.

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.

	Three months ended March 31,	
(in millions)	2008	2007
Pension benefits		
Service cost	$ 21	$ 21
Interest cost	51	46
Expected return on plan assets	(58)	(53)
Amortization of net loss, prior service cost and transition obligation	20	24
Net pension plan expense	$ 34	$ 38

OPEB		
Service cost	$ 1	$ 1
Interest cost	8	8
Amortization of net loss and prior service cost		1
Net OPEB plan expense	$ 9	$ 10

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Net interest expense

(in millions)	Three months ended March 31, 2008	2007
Interest expense, net of capitalized interest	$ 37	$ 29
Interest income	(20)	(24)
Net interest expense	$ 17	$ 5

Comprehensive income

Total comprehensive income was $620 million and $464 million for the three months ended March 31, 2008 and 2007, respectively. The increase in comprehensive income in 2008 was principally due to higher net income and favorable movements in currency translation adjustments, partially offset 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 19.7% and 23.8% in the first quarters of 2008 and 2007, respectively. The effective tax rate in the first quarter of 2007 was unusually high due to the tax impact of the gain on the divestiture of the Transfusion Therapies (TT) business and related charges recorded in that period. Refer to Note 3 for further information about the divestiture of the TT business.

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, performance share units, restricted stock units and restricted stock is reflected in the denominator for diluted EPS principally using the treasury stock method.

In the first quarters of 2008 and 2007, 8 million and 12 million employee stock options, 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.

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

(in millions)	Three months ended March 31, 2008	2007
Basic shares	632	650
Effect of employee stock options and other dilutive securities	12	9
Diluted shares	644	659

Inventories

(in millions)	March 31, 2008	December 31, 2007

Raw materials	$ 672	$ 624
Work in process	779	695
Finished products	1,085	1,015
Total inventories	$ 2,536	$ 2,334

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Property, plant and equipment, net

(in millions)	March 31, 2008	December 31, 2007
Property, plant and equipment, at cost	$ 9,182	$ 8,824
Accumulated depreciation and amortization	(4,549)	(4,337)
Property, plant and equipment, net	$ 4,633	$ 4,487

Goodwill

Goodwill at March 31, 2008 totaled $609 million for the BioScience segment, $993 million for the Medication Delivery segment and $166 million for the Renal segment. Goodwill at December 31, 2007 totaled $587 million for the BioScience segment, $948 million for the Medication Delivery segment and $155 million for the Renal segment. The increase in the goodwill balance is principally due to several small acquisitions in the Medication Delivery and BioScience segments, as well as foreign currency fluctuations.

Other intangible assets

The following is a summary of the company s intangible assets subject to amortization at March 31, 2008 and December 31, 2007.

(in millions)	Developed technology, including patents	Other	Total
March 31, 2008			
Gross other intangible assets	$ 874	$138	$1,012
Accumulated amortization	(481)	(77)	(558)
Other intangible assets, net	$ 393	$ 61	$ 454
December 31, 2007			
Gross other intangible assets	$ 848	$130	$ 978
Accumulated amortization	(458)	(72)	(530)
Other intangible assets, net	$ 390	$ 58	$ 448

The amortization expense for these intangible assets was $13 million and $15 million for the three months ended March 31, 2008 and 2007, respectively. The anticipated annual amortization expense for intangible assets recorded as of March 31, 2008 is $54 million in 2008, $52 million in 2009, $51 million in 2010, $44 million in 2011, $41 million in 2012 and $37 million in 2013.

Securitization arrangements

The company s securitization arrangements resulted in net cash outflows of $16 million and $27 million for the three months ended March 31, 2008 and 2007, respectively. A summary of the activity is as follows.

(in millions)	Three months ended March 31, 2008	2007
Sold receivables at beginning of period	$ 129	$ 348
Proceeds from sales of receivables	104	356
Cash collections (remitted to the owners of the receivables)	(120)	(383)
Effect of currency exchange rate changes	16	(1)
Sold receivables at end of period	$ 129	$ 320

3. SALE OF TRANSFUSION THERAPIES BUSINESS

On February 28, 2007, the company divested substantially all of the assets and liabilities of its TT business to an affiliate of TPG Capital, L.P., which established the new company as Fenwal Inc. (Fenwal), for $540 million. Prior to the divestiture, the TT business was part of the BioScience business. Refer to the 2007 Annual Report for further information.

Under transition agreements, the company is providing manufacturing and support services to Fenwal for a period of time after divestiture, which varies based on the product or service provided and other factors, but generally approximates two years. Due to the company s actual and 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 arose subsequent to the divestiture date that changed the initial expectation of significant continuing cash flows. Revenues associated with the manufacturing, distribution and other transition services provided by the company, which were $44 million and $9 million in the first quarters of 2008 and 2007, respectively, are reported at the corporate headquarters level and not allocated to a segment. Included in these revenues in the first quarter of 2008 was $8 million of deferred revenue related to the manufacturing, distribution and other transition agreements. As of March 31, 2008, deferred revenue that will be recognized in the future as the services under these arrangements are performed totaled $21 million.

In the first quarter of 2007, the company recorded a pre-tax gain on the sale of the TT business of $58 million. In the first quarter of 2008, the company recorded an income adjustment to the gain of $16 million as a result of the finalization of the net assets transferred in the divestiture.

In connection with the TT divestiture, in the first quarter of 2007, the company recorded a $35 million pre-tax charge principally associated with severance and other employee-related costs. Reserve utilization through the end of the first quarter of 2008 was $6 million. The reserve is expected to be substantially utilized by the end of 2009, and the company believes that the reserves are adequate. However, adjustments may be recorded in the future as the transition is completed.

The gain on the sale of the TT business and the related charges and adjustments in 2008 and 2007 were recorded in other income, net on the consolidated statements of income.

4. RESTRUCTURING AND OTHER SPECIAL CHARGES

Restructuring charges

The following is a summary of restructuring charges recorded in 2007 and 2004. Refer to the 2007 Annual Report for additional information about these charges.

2007

In 2007, the company recorded a restructuring charge of $70 million principally associated with the consolidation of certain commercial and manufacturing operations outside of the United States. Based on a review of current and future capacity needs, the company decided to integrate several facilities to reduce the company s cost structure and optimize operations, principally in the Medication Delivery segment.

Included in the charge was $17 million related to asset impairments, principally to write down property, plant and equipment (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.

2004

In 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.

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Restructuring reserves

The following table summarizes cash activity in the company s 2007 and 2004 restructuring charges.

(in millions)	Employee-related costs	Contractual and other costs	Total
2004 Charge	$ 212	$ 135	$ 347
Utilization and adjustments in 2004, 2005 and 2006	(198)	(94)	(292)
Reserve at December 31, 2006	14	41	55
2007 Charge	46	7	53
Utilization	(15)	(12)	(27)
Reserve at December 31, 2007	45	36	81
Utilization	(6)	(6)	(12)
Reserve at March 31, 2008	$ 39	$ 30	$ 69

Restructuring reserve utilization in the first quarter of 2008 totaled $12 million, with $3 million relating to the 2007 program and $9 million relating to the 2004 program. The 2007 and 2004 reserves are expected to be utilized by the end of 2009, with the majority of the payments to be made in 2008. The company believes that the reserves are adequate. However, adjustments may be recorded in the future as the programs are completed.

Other charges

The charges discussed below were classified in cost of goods sold in the company s consolidated income statements, and were reflected in the Medication Delivery segment. The actual costs relating to certain of these matters may differ from the company s estimates. It is possible that additional charges may be required in future periods, based on new information or changes in estimates.

While the company continues to work to resolve the issues associated with COLLEAGUE infusion pumps and its heparin products described below, there can be no assurance that additional costs or civil and criminal penalties will not be incurred, that additional regulatory actions with respect to the company will not occur, that the company will not face civil claims for damages from purchasers or users, that substantial additional charges or significant asset impairments may not be required, or that sales of any other product may not be adversely affected.

COLLEAGUE Infusion Pumps

The company began to hold shipments of COLLEAGUE infusion pumps in July 2005, and continues to hold shipments of new pumps in the United States. Please refer to the company s 2007 Annual Report for further information.

The company recorded charges of $171 million ($157 million for cash costs and $14 million for asset impairments) in 2006 and 2005 related to issues associated with its COLLEAGUE infusion pumps. The reserve for cash costs represented an estimate of the cash expenditures for the materials, labor and freight costs expected to be incurred to remediate the design issues, customer accommodations, and warranty and other commitments made to customers. In 2007, the company increased its reserve for cash costs by $14 million as estimates were refined based on the company s experience executing the remediation plan.

As a result of delays in the remediation plan, principally due to additional software modifications and validation and testing required to remediate the pumps, and other changes in the estimated costs to execute the remediation plan, the company recorded an additional $53 million charge associated with the COLLEAGUE pumps during the first quarter of 2008. The charge consisted of $39 million for cash costs and $14 million principally relating to asset impairments. The reserve for cash costs principally relates to customer accommodations, including extended warranties, and other

costs associated with the delay in the recommercialization timeline.
The following table summarizes cash activity in the company s COLLEAGUE infusion pump reserves through March 31, 2008.

(in millions)	
Charges in 2005 and 2006	$157
Utilization and adjustments in 2005 through 2007	(87)
Reserve at December 31, 2007	70
Charge	39
Utilization	(12)
Reserve at March 31, 2008	$ 97

The majority of the remaining infusion pump reserves are expected to be utilized in 2008 and 2009.

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Heparin

During the first quarter of 2008, the company recorded a charge of $19 million related to the company s recall of its heparin sodium injection products in the United States. During the first quarter of 2008, the company identified an increasing level of severe allergic-type and hypotensive adverse reactions occurring in patients using its heparin sodium injection products in the United States, and initiated a field corrective action with respect to these products. Included in the charge were $14 million of asset impairments, primarily heparin inventory that will not be sold, and $5 million of cash costs related to the recall. The reserve for cash costs is expected to be utilized by the end of 2008. The company s sales of these heparin products totaled approximately $30 million in 2007.

5. FAIR VALUE MEASUREMENTS

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

		Basis of Fair Value Measurement		
(in millions)	Balance at March 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Foreign currency hedges	$ 22	$	$ 22	$
Interest rate hedges	32		32	
Equity securities	14	14		
Total assets	$ 68	$14	$ 54	$
Liabilities				
Foreign currency hedges	$ 127	$	$ 127	$
Net investment hedges	455		455	
Total liabilities	$ 582	$	$ 582	$

For assets that are measured using quoted prices in active markets, the fair value is the published market price per unit multiplied by the number of units held, without consideration of transaction costs. The majority of the derivatives entered into by the company are valued using internal valuation techniques as no quoted market prices exist for such instruments. The principal techniques used to value these instruments are discounted cash flow and Black-Scholes models. The key inputs, which are observable, depend on the type of derivative, and include contractual terms, interest rate yield curves, foreign exchange rates and volatility.

6. COMMON STOCK

Stock-based compensation plans

Stock compensation expense totaled $38 million ($26 million on a net-of-tax basis, or $0.04 per diluted share) and $27 million ($18 million on a net-of-tax basis, or $0.03 per diluted share) for the three months ended March 31, 2008 and 2007, respectively. Approximately three-quarters of stock compensation expense is classified in marketing and administrative expenses, with the remainder classified in cost of goods sold and research and development expenses. In March 2008, the company made its annual stock compensation grants, which consisted of approximately 7 million stock options and 0.7 million performance share units (PSUs).

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Stock options

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

	Three months ended March 31,	
	2008	2007
Expected volatility	23.8%	23.5%
Expected life (in years)	4.5	4.5
Risk-free interest rate	2.4%	4.5%
Dividend yield	1.5%	1.2%
Fair value per stock option	$12	$13

The total intrinsic valu