BAXTER INTERNATIONAL INC
Form 10-Q/A
March 31, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the quarterly period ended September 30, 2004

¨ **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 of 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 x No ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

The number of shares of the registrant s Common Stock, par value $1.00 per share,

outstanding as of March 28, 2005 was 619,758,508 shares.

EXPLANATORY NOTE

Baxter International Inc. is filing this Form 10-Q/A Amendment No. 1 for the quarter ended September 30, 2004 to reflect the restatement of its consolidated financial statements for the quarters ended September 30, 2004 and 2003. The restatement arises from the controls surrounding the income tax accounts. Specifically, current income taxes payable balances were not reconciled to expected tax payments due, and the company did not adequately review the difference between the income tax basis and the financial reporting basis of assets and liabilities, and reconcile the difference to recorded deferred income tax assets and liabilities. Refer to Note 1A for a complete description and quantification of the restatement.

The information in this Form 10-Q/A Amendment No. 1 has not been updated from the original Form 10-Q except as required to reflect the effects of the restatement. This restatement includes changes to Part I, Items 1, 2 and 4. Items included in the original Form 10-Q that are not included herein are not amended and remain in effect as of the date of the original filing. Additionally, this Form 10-Q/A Amendment No. 1 does not purport to provide an update or a discussion of any other developments at the company subsequent to the original filing.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Baxter International Inc. and Subsidiaries

Condensed Consolidated Statements of Income (unaudited)

(in millions, except per share data)

	Three months ended September 30,		**Nine months ended September 30,**	
	2004	**2003**	**2004**	**2003**
Net sales	$2,320	$2,216	$6,908	$6,373
Cost and expenses				
Cost of goods sold	1,357	1,247	4,113	3,555
Marketing and administrative expenses	462	440	1,460	1,320
Research and development expenses	124	137	389	412
Restructuring charges			543	337
Net interest expense	20	25	66	71
Other expense, net	11	6	74	46
Total costs and expenses	1,974	1,855	6,645	5,741
Income from continuing operations before income taxes and cumulative effect of accounting changes	346	361	263	632
Income tax expense (benefit)	87	86	(14)	96
Income before cumulative effect of accounting changes	259	275	277	536
Discontinued operations	17	(5)	5	(17)
Income from continuing operations before cumulative effect of accounting changes	276	270	282	519
Cumulative effect of accounting changes, net of income tax benefit of $5		(17)		(17)
Net income	$ 276	$ 253	$ 282	$ 502
Earnings per basic common share				
Continuing operations	$ 0.42	$ 0.47	$ 0.45	$ 0.90
Discontinued operations	0.03	(0.01)	0.01	(0.02)
Cumulative effect of accounting changes		(0.03)		(0.03)
Net income	$ 0.45	$ 0.43	$ 0.46	$ 0.85
Earnings per diluted common share				
Continuing operations	$ 0.42	$ 0.46	$ 0.45	$ 0.89
Discontinued operations	0.03	(0.01)	0.01	(0.03)
Cumulative effect of accounting changes		(0.03)		(0.03)

Net income	$ 0.45	$ 0.42	$ 0.46	$ 0.83
Weighted average number of common shares outstanding				
Basic	615	589	613	595
Diluted	619	592	617	604

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

Baxter International Inc. and Subsidiaries

Condensed Consolidated Balance Sheets (unaudited)

(in millions, except shares)

	Restated	
	September 30, 2004	**December 31, 2003**
Current assets		
Cash and equivalents	$ 822	$ 925
Accounts and other current receivables	2,108	1,914
Inventories	2,106	2,104
Short-term deferred income taxes	405	140
Prepaid expenses and other	282	277
Total current assets	5,723	5,360
Property, plant and equipment		
At cost	7,840	7,791
Accumulated depreciation and amortization	(3,494)	(3,199)
Net property, plant and equipment	4,346	4,592
Other assets		
Goodwill	1,591	1,599
Other intangible assets	572	611
Other	1,535	1,545
Total other assets	3,698	3,755
Total assets	$13,767	$13,707
Current liabilities		
Short-term debt	$ 178	$ 153
Accounts payable and accrued liabilities	2,800	3,107
Income taxes payable	548	438
Total current liabilities	3,526	3,698
Long-term debt and lease obligations	4,411	4,421
Other long-term liabilities	2,036	2,206
Commitments and contingencies		
Stockholders equity		
Common stock, $1 par value, authorized 2,000,000,000 shares, 648,417,007 issued in 2004 and 648,574,109 in 2003	648	649
Common stock in treasury, at cost, 32,539,304 shares in 2004 and 37,273,424 shares in 2003	(1,613)	(1,863)

Additional contributed capital	3,643	3,786
Retained earnings	2,512	2,230
Accumulated other comprehensive loss	(1,396)	(1,420)
Total stockholders equity	3,794	3,382
Total liabilities and stockholders equity	$13,767	$13,707

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

Baxter International Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

(brackets denote cash outflows)

	Nine months ended September 30,	
	2004	2003
Cash flows from operations		
Income from continuing operations	$ 277	$ 536
Adjustments		
Depreciation and amortization	445	400
Deferred income taxes	(238)	(135)
Restructuring charges	543	337
Other	151	34
Changes in balance sheet items		
Accounts receivable	(155)	16
Inventories	(44)	(233)
Accounts payable and accrued liabilities	(270)	(171)
Restructuring payments	(136)	(38)
Other	(44)	(76)
Cash flows from continuing operations	529	670
Cash flows from discontinued operations	17	5
Cash flows from operations	546	675
Cash flows from investing activities		
Capital expenditures	(363)	(564)
Acquisitions (net of cash received) and investments in and advances to affiliates	(20)	(106)
Divestitures and other	31	
Cash flows from investing activities	(352)	(670)
Cash flows from financing activities		
Issuances of debt	519	654
Redemptions of financing obligations	(596)	(1,001)
Increase in debt with maturities of three months or less, net	64	335
Common stock cash dividends	(361)	(346)
Proceeds from stock issued under employee benefit plans	108	60
Issuance of stock		644
Purchases of treasury stock	(18)	(714)
Cash flows from financing activities	(284)	(368)
Effect of currency exchange rate changes on cash and equivalents	(13)	24
Decrease in cash and equivalents	(103)	(339)
Cash and equivalents at beginning of period	925	1,169

Cash and equivalents at end of period	$ 822	$ 830

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

Baxter International Inc. and Subsidiaries

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 Form 10-K/A for the year ended December 31, 2003.

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 (refer to Note 2 for certain special charges recorded during the second quarter of 2004). The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the full year.

Certain reclassifications have been made to conform the 2003 financial statements and notes to the 2004 presentation.

Stock compensation plans

The company has a number of stock-based employee compensation plans, including stock option, stock purchase and restricted stock plans. The company applies the recognition and measurement principles of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for these plans. In accordance with this intrinsic value method, no compensation expense is recognized for the company s fixed stock options that have an exercise price equal to or greater than the market price on the date of grant, and employee stock purchase subscriptions. The following table illustrates the effect on net income and earnings per share (EPS) if the company had applied the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, an Amendment of FASB Statement No. 123, to all stock-based employee compensation.

	Three months ended September 30,		**Nine months ended September 30,**	
(in millions, except per share data)	**2004**	**2003**	**2004**	**2003**
Net income, as reported	$ 276	$ 253	$ 282	$ 502
Add:				
Stock-based employee compensation expense included in reported net income, net of tax	1	1	13	1
Deduct:				
Total stock-based employee compensation expense determined under the fair value method, net of tax	(19)	(35)	(79)	(120)
Pro forma net income	$ 258	$ 219	$ 216	$ 383

Earnings per basic share				
As reported	$0.45	$0.43	$0.46	$0.85
Pro forma	$0.42	$0.38	$0.35	$0.65
Earnings per diluted share				
As reported	$0.45	$0.42	$0.46	$0.83
Pro forma	$0.42	$0.37	$0.35	$0.64

Changes in accounting principles

Financial Accounting Standards Board (FASB) Interpretation No. 46, Consolidation of Variable Interest Entities (FIN 46), was adopted July 1, 2003. Refer to the company s 2003 Form 10-K/A for further information. In December 2003 the FASB revised and reissued FIN 46 (FIN 46-R). The provisions of FIN 46-R were required to be adopted no later than March 31, 2004. Baxter adopted FIN 46-R on March 31, 2004, and adoption of the revised standard did not have a material impact on the company s consolidated financial statements.

1A. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

The company has restated its previously issued financial statements for 2001 through 2003 and the first three quarters of 2004 as a result of inadequate reconciliations, leading to classification errors in tax and other related balance sheet accounts. Specifically, the company restated previously issued financial information contained in its Form 10-K/A Amendment No. 1 for the years ended December 31, 2003, 2002 and 2001 by filing a Form 10-K/A Amendment No. 2 for the year ended December 31, 2003. The company s previously reported quarterly information in its Form 10-Q/A Amendment No. 1 for the quarter ended March 31, 2004 has been restated by filing a Form 10-Q/A Amendment No. 2 for the quarter ended March 31, 2004. The company s previously reported quarterly information in its Forms 10-Q for the quarters ended June 30, 2004 and September 30, 2004 has been restated by filing a Form 10-Q/A Amendment No. 1 for each of the quarters ended June 30, 2004 and September 30, 2004.

As a result of the restatement, stockholders equity as of both September 30, 2004 and December 31, 2003 increased approximately $108 million, with offsetting decreases of approximately $157 to net tax liabilities and $49 million to goodwill. The restatement did not impact the consolidated statements of income or cash flows for the quarters or year-to-date periods ended September 30, 2004 and 2003.

The following is a summary of the impact of the restatement on the previously filed consolidated balance sheets at September 30, 2004 and December 31, 2003.

Consolidated Balance Sheets at September 30, 2004 and December 31, 2003

	September 30, 2004		December 31, 2003	
(in millions, except shares)	**As originally reported**	**As restated**	**As previously reported (Amendment No. 1)**	**As restated**
Current assets				
Cash and equivalents	$ 822	$ 822	$ 925	$ 925
Accounts and other current receivables	2,108	2,108	1,914	1,914
Inventories	2,106	2,106	2,104	2,104
Short-term deferred income taxes	405	405	140	140
Prepaid expenses and other	282	282	277	277
Total current assets	5,723	5,723	5,360	5,360
Property, plant and equipment				
At cost	7,840	7,840	7,791	7,791
Accumulated depreciation and amortization	(3,494)	(3,494)	(3,199)	(3,199)
Net property, plant and equipment	4,346	4,346	4,592	4,592
Other assets				
Goodwill	1,640	1,591	1,648	1,599
Other intangible assets	572	572	611	611
Other	1,488	1,535	1,498	1,545
Total other assets	3,700	3,698	3,757	3,755
Total assets	$13,769	$13,767	$13,709	$13,707
Current liabilities				
Short-term debt	$ 178	$ 178	$ 153	$ 153
Accounts payable and accrued liabilities	2,800	2,800	3,107	3,107
Income taxes payable	648	548	538	438
Total current liabilities	3,626	3,526	3,798	3,698
Long-term debt and lease obligations	4,411	4,411	4,421	4,421
Other long-term liabilities	2,046	2,036	2,216	2,206

Commitments and contingencies				
Stockholders equity				
Common stock, $1 par value, authorized 2,000,000,000 shares, issued 648,417,007 shares in 2004 and 648,574,109 shares in 2003	648	648	649	649
Common stock in treasury, at cost, 32,539,304 shares in 2004 and 37,273,424 shares in 2003	(1,613)	(1,613)	(1,863)	(1,863)
Additional contributed capital	3,630	3,643	3,773	3,786
Retained earnings	2,427	2,512	2,145	2,230
Accumulated other comprehensive loss	(1,406)	(1,396)	(1,430)	(1,420)
Total stockholders equity	3,686	3,794	3,274	3,382
Total liabilities and stockholders equity	$13,769	$13,767	$13,709	$13,707

2. SUPPLEMENTAL FINANCIAL INFORMATION

Net interest expense

Net interest expense consisted of the following.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	**2004**	**2003**	**2004**	**2003**
Interest expense	$ 29	$33	$ 87	$ 94
Interest income	(9)	(7)	(21)	(21)
Net interest expense	$ 20	$26	$ 66	$ 73
Continuing operations	$ 20	$25	$ 66	$ 71
Discontinued operations	$	$ 1	$	$ 2

Other income and expense

Other income and expense typically includes amounts relating to fluctuations in currency exchange rates, minority interests, income and losses relating to equity method investments, divestiture gains and asset impairment charges. The increase in other expense for the three months ended September 30, 2004 principally related to foreign currency fluctuations. The increase in other expense for the nine months ended September 30, 2004 principally related to foreign currency fluctuations and lower equity method income. Equity method income was lower in 2004 because Baxter divested its equity method investment in Acambis, Inc. in late 2003.

In addition, asset impairment charges totaled $18 million and $13 million for the nine-month periods ended September 30, 2004 and 2003, respectively. The charges related to investments whose declines in value were deemed to be other than temporary, with the investments written down to estimated fair value, as determined by reference to quoted market values, where available (see below for more information regarding the second quarter 2004 special charge). Other expense for the year-to-date period ended September 30, 2004 also included a charge relating to the application of FASB Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45), to the company s guarantee of the Shared Investment Plan loans, as further discussed in Note 9. Included in other expense in the year-to-date period ended September 30, 2003 were $11 million in costs associated with the redemption of the company s convertible bonds.

Comprehensive income

Total comprehensive income was $352 million and $306 million for the three and nine months ended September 30, 2004, respectively, and $257 million and $539 million for the three and nine months ended September 30, 2003, respectively. The increase in comprehensive income during the quarter was principally related to favorable currency translation adjustments and higher net income. The decrease in comprehensive income during the year-to-date period was principally related to unfavorable currency translation adjustments and lower net income, partially offset by changes in the value of the company s net investment and foreign currency cash flow hedges.

Earnings per share

The numerator for both basic and diluted EPS is net earnings available to common shareholders. The denominator for basic EPS is the weighted-average number of common shares outstanding during the period. The dilutive effect of outstanding employee stock options, employee stock purchase subscriptions and the purchase contracts in the company s equity units is reflected in the denominator for diluted EPS by application of the treasury stock method under SFAS No. 128, Earnings per Share. Prior to the adoption of SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, on July 1, 2003, the dilutive effect of equity forward agreements was reflected in the denominator for diluted EPS by application of the reverse treasury stock method. Refer to the 2003 Form 10-K/A for additional information regarding the company s equity units (which did not have a dilutive effect in either 2004 or 2003), as well as the equity forward agreements (which were terminated during the third quarter of 2003). The following is a reconciliation of the shares (denominator) of the basic and diluted per-share computations.

	Three months ended September 30,		**Nine months ended September 30,**	
(in millions)	**2004**	**2003**	**2004**	**2003**

Basic shares	615	589	613	595
Effect of dilutive securities				
Employee stock options	3	1	3	1
Equity forward agreements				7
Employee stock purchase plans	1	2	1	1
Diluted shares	619	592	617	604

Inventories

Inventories consisted of the following.

(in millions)	September 30, 2004	December 31, 2003
Raw materials	$ 460	$ 568
Work in process	813	731
Finished products	833	805
Total inventories	$2,106	$2,104

Goodwill

Goodwill was $859 million (as restated), $568 million (as restated) and $164 million (as restated) for the Medication Delivery, BioScience and Renal segments, respectively, at September 30, 2004. Goodwill was $860 million (as restated), $571 million (as restated) and $168 million (as restated) for the Medication Delivery, BioScience and Renal segments, respectively, at December 31, 2003. The change in the goodwill balance for each segment principally related to fluctuations in currency exchange rates.

Other intangible assets

The following is a summary of the company s intangible assets subject to amortization at September 30, 2004 and December 31, 2003. Intangible assets with indefinite useful lives are not material to the company.

(in millions, except amortization period data)	Developed technology, including patents	Manufacturing, distribution and other contracts	Other	Total
September 30, 2004				
Gross intangible assets	$804	$46	$72	$922
Accumulated amortization	308	28	21	357
Net intangible assets	$496	$18	$51	$565
Weighted-average amortization period (in years)	15	8	20	15
December 31, 2003				
Gross intangible assets	$802	$39	$74	$915
Accumulated amortization	279	14	18	311
Net intangible assets	$523	$25	$56	$604
Weighted-average amortization period (in years)	15	9	20	15

The amortization expense for these intangible assets was $16 million and $11 million for the three months ended September 30, 2004 and 2003, respectively, and $48 million and $38 million for the nine months ended September 30, 2004 and 2003, respectively. At September 30, 2004, the anticipated annual amortization expense for these intangible assets is $67 million, $60 million, $56 million, $45 million, $41 million and $39 million in 2004, 2005, 2006, 2007, 2008 and 2009, respectively.

Product warranties

The following is a summary of activity in the product warranty liability.

	As of and for the three months ended September 30,	As of and for the nine months ended September 30,

(in millions)	2004	2003	2004	2003
Beginning of period	$52	$52	$ 53	$ 53
New warranties and adjustments to existing warranties	6	7	16	20
Payments in cash or in kind	(6)	(8)	(17)	(22)
End of period	$52	$51	$ 52	$ 51

Second quarter 2004 special charges

Financial results for the nine-month period ended September 30, 2004 include several special charges recorded during the second quarter, in addition to the restructuring charge discussed in Note 4. These special charges, as summarized below, reduced pre-tax income from continuing operations by $115 million, and reduced net income for the nine months ended September 30, 2004 by $20 million or $0.03 per diluted share. By line item, cost of goods sold increased $45 million, marketing and administrative expenses increased $55 million, other expense, net increased $15 million, and income tax expense decreased $95 million.

Accounts and other receivable reserves

The company established a reserve due to the uncertain collectibility of a loan from Cerus Corporation (Cerus). This reserve was determined based on Cerus current financial position. Also, based on the lengthening age of accounts receivables and more current market data in certain markets, the company increased the allowance for doubtful accounts. In addition, certain Shared Investment Plan participants defaulted on their loans, which were due and payable in May 2004, requiring the company to make payments to the bank under its guarantee arrangement. Refer to Note 9 for further information regarding the Shared Investment Plan. While the company has not forgiven any of these loans and is pursuing repayment of the defaulted amounts, a reserve was recorded for potential losses, representing the amount that the company paid to the bank under the loan guarantee as a result of the defaulted loans. These adjustments, which were recorded in marketing and administrative expenses, totaled $55 million.

Inventories

Based upon second quarter 2004 restructuring decisions in the Bioscience segment, which will reduce inventory production in an effort to focus on more profitable sales in the plasma market, the company expects that future sales in this market will be less than previously expected. As a result, the company increased inventory reserves (a charge to cost of goods sold) by $28 million.

Hedges

As discussed in the 2003 Form 10-K/A, the company uses forwards to hedge the risk to earnings relating to anticipated intercompany sales denominated in foreign currencies (cash flow hedges). Based on a second quarter 2004 analysis, intercompany sales from the United States to Europe (denominated in Euros) are expected to be lower than originally projected. In particular, due to the strong European sales launch of ADVATE (Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method) rAHF-PFM, the company s advanced recombinant therapy (which is manufactured in Europe), the second quarter 2004 forecasts of intercompany sales of Recombinate Antihemophilic Factor (rAHF) from the United States into Europe had been reduced. Because it was probable that these originally forecasted sales would no longer occur, the related deferred hedge loss was recorded as a $17 million charge to cost of goods sold.

Pathogen Inactivation program assets

As a result of lower than expected sales from the company s Pathogen Inactivation programs, strategic decisions announced in the second quarter of 2004 by Cerus, along with an assessment of future market potential for these products, the company performed an impairment review of its fixed assets in this program and recorded a $15 million impairment charge, which was classified as other expense.

Income taxes

The income tax benefit relating to the above-mentioned charges totaled $40 million. In addition, as a result of the completion of tax audits in the second quarter of 2004, $55 million of reserves for matters previously under review were reversed into income in the quarter.

3. DISCONTINUED OPERATIONS

During the fourth quarter of 2002, the company recorded a $294 million pre-tax charge ($229 million on an after-tax basis) principally associated with management s decision to divest the majority of the services businesses included in the Renal segment. Refer to the 2003 Form 10-K/A for further information.

During 2003, the company sold RMS Lifeline, Inc. and RMS Disease Management, Inc. and the Medication Delivery segment s offsite pharmacy admixture products and services business, and closed or had under contract the majority of transactions in connection with the divestiture of the Renal Therapy Services centers. Management expects the divestiture plan to be completed during 2004.

Net revenues relating to the discontinued businesses were $2 million and $42 million for the three months ended September 30, 2004 and 2003, respectively, and $22 million and $142 million for the nine months ended September 30, 2004 and 2003, respectively. During 2004, discontinued operations generated income of $17 million and $5 million for the three- and nine-month periods ended September 30, respectively (net of tax benefits of $24 million and $28 million, respectively). The income was principally related to tax and other adjustments, as the company completes divestitures. During 2003, discontinued operations generated losses of $5 million and $17 million for the three- and nine-month periods ended September 30, respectively (net of tax benefits of $3 million and $6 million, respectively).

Included in the pre-tax charge was $269 million pertaining to asset impairments, principally relating to goodwill and property and equipment. Also included in the charge was $25 million for cash costs, principally relating to severance and other employee-related costs associated with the elimination of approximately 75 positions, as well as legal and contractual commitment costs. Approximately $2 million of the reserve for cash costs was utilized during 2004. The remaining reserve is insignificant and is expected to be substantially utilized in 2004.

4. RESTRUCTURING INITIATIVES

Second quarter 2004 restructuring charge

In January 2004, management announced plans (which were finalized during the second quarter of 2004) to implement restructuring initiatives (in addition to the actions initiated in 2003, as discussed below). Management undertook these actions in order to reduce the company s overall cost structure and to drive sustainable improvements in financial performance.

These actions include the elimination of over 4,000 positions, or 8% of the global workforce, as management reorganizes and streamlines the company. Approximately 50% of the positions being eliminated are in the United States. Approximately three quarters of the estimated savings impact general and administrative expenses, with the remainder primarily impacting cost of sales. The eliminations impact all three of the company s segments, along with the corporate headquarters and functions. Baxter is also further reducing plasma production and closing additional plasma collection centers. In addition, the company is exiting certain other facilities and activities. As a result, management recorded a restructuring charge in the second quarter of 2004 totaling $543 million ($394 million, or $0.64 per diluted share, on an after-tax basis), principally for severance and costs associated with the closing of facilities and the exiting of contracts.

Included in the 2004 pre-tax charge was $196 million relating to asset impairments, almost all of which was to write down property, plant and equipment (PP&E), based on market data for the assets. Also included in the 2004 pre-tax charge was $347 million for cash costs, principally pertaining to severance and other employee-related costs. Approximately one third of the targeted positions have been eliminated as of September 30, 2004.

Second quarter 2003 restructuring charge

During the second quarter of 2003, the company recorded a $337 million restructuring charge ($202 million, or $0.33 per diluted share, on an after-tax basis) principally associated with management s decision to close certain facilities and reduce headcount on a global basis. Management decided to take these actions in order to position the company more competitively and to enhance profitability. The company has closed 26 plasma collection centers across the United States, as well as a plasma fractionation facility located in Rochester, Michigan. In addition, the company has consolidated and integrated several facilities, including facilities in Maryland; Frankfurt, Germany; Issoire, France; and Mirandola, Italy. Management discontinued Baxter s recombinant hemoglobin protein program because it did not meet expected clinical milestones. Also included in the charge were costs related to other reductions in the company s workforce.

Included in the 2003 pre-tax charge was $128 million relating to asset impairments, principally to write down PP&E, and goodwill and other intangible assets. The impairment loss relating to the PP&E was based on market data for the assets. The impairment loss relating to goodwill and other intangible assets was based on management s assessment of the value of the related businesses. Also included in the 2003 pre-tax charge was $209 million for cash costs, principally pertaining to severance and other employee-related costs associated with the elimination of approximately 3,200 positions worldwide. Virtually all of the targeted positions have been eliminated as of September 30, 2004, and the program is substantially complete, except for remaining severance and other cash payments to be made in the future.

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Restructuring reserves

The following summarizes activity in the company s restructuring reserves for cash costs for the nine-month period ended September 30, 2004.

(in millions)	Employee-related costs	Contractual and other costs	Total
2003 Restructuring Charge			
Reserve at December 31, 2003	$ 97	$ 43	$140
Utilization	(25)	(12)	(37)
Reserve at March 31, 2004	$ 72	$ 31	$103
Utilization	(19)	(1)	(20)
Reserve at June 30, 2004	$ 53	$ 30	$ 83
Utilization	(23)	(3)	(26)
Reserve at September 30, 2004	$ 30	$ 27	$ 57
2004 Restructuring Charge			
Charge	$212	$135	$347
Utilization	(4)		(4)
Reserve at June 30, 2004	$208	$135	$343
Utilization	(29)	(18)	(47)
Reserve at September 30, 2004	$179	$117	$296

With respect to the 2003 restructuring charge, the majority of the severance and other costs are expected to be paid in 2004. With respect to the 2004 restructuring charge, approximately $50 million is expected to be paid during the remainder of 2004, approximately $150 million in 2005, and the remainder in 2006.

5. SECURITIZATIONS

Where economical, the company has entered into agreements with various financial institutions in which undivided interest in certain pools of receivables are sold. Refer to the 2003 Form 10-K/A for further information regarding these arrangements. There have been no material changes in the company s accounting policies with respect to its securitization arrangements. The key assumptions used in measuring the fair values of the retained interests are substantially unchanged from those disclosed in the 2003 Form 10-K/A.

Baxter s securitization arrangements resulted in net cash outflows of $84 million and $274 million for the three and nine months ended September 30, 2004, respectively, and generated net cash inflows of $10 million and net cash outflows of $44 million for the three and nine

months ended September 30, 2003, respectively.

A summary of the activity for these securitization arrangements is as follows.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	**2004**	**2003**	**2004**	**2003**
Sold receivables at beginning of period	$ 547	$ 644	$ 742	$ 721
Proceeds from sales of receivables	307	458	1,000	1,334
Cash collections (remitted to the owners of the receivables)	(391)	(448)	(1,274)	(1,378)
Effect of currency exchange rate changes	(1)	7	(6)	(16)
Sold receivables at end of period	$ 462	$ 661	$ 462	$ 661

6. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Net pension and other postretirement benefits cost

The following is a summary of net expense relating to the company s pension and other postretirement benefit plans.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	**2004**	**2003**	**2004**	**2003**
Pension benefits				
Service cost	$ 19	$ 18	$ 59	$ 51
Interest cost	38	38	114	104
Expected return on assets	(47)	(48)	(141)	(134)
Amortization of net loss, prior service cost and transition obligation	16	6	47	18
Net periodic pension benefit cost	$ 26	$ 14	$ 79	$ 39
Other benefits				
Service cost	$ 3	$ 2	$ 7	$ 6
Interest cost	7	7	22	21
Amortization of net loss and prior service cost	2	2	7	4
Net periodic other benefit cost	$ 12	$ 11	$ 36	$ 31

Medicare Prescription Drug, Improvement and Modernization Act

In December 2003, the Medicare Prescription Drug, Improvement and Modernization Act (the Act) was signed into law. The Act introduces a prescription drug benefit under Medicare (Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare (Part D). Detailed final regulations necessary to implement the Act have not yet been issued. The effects of the Act are not recognized in the company s net expense and benefit obligation as management is not yet able to determine whether the company s benefits are actuarially equivalent to Medicare (Part D). However, based on preliminary analyses, management has determined that any impact of the Act on the company s consolidated financial statements will not be material.

7. LEGAL PROCEEDINGS, COMMITMENTS AND CONTINGENCIES

Refer to Part II Item 1. Legal Proceedings below.

8. SEGMENT INFORMATION

The company operates in three segments, each of which are strategic businesses that are managed separately because each business develops, manufactures and sells distinct products and services. The segments and a description of their businesses are as follows:

Medication Delivery, which provides a range of intravenous solutions and specialty products that are used in combination for fluid replenishment, general anesthesia, nutrition therapy, pain management, and antibiotic therapy; **BioScience**, which develops biopharmaceuticals, biosurgery products, vaccines and blood collection, processing and storage products and technologies for transfusion therapies; and **Renal**, which develops products and provides services to treat end-stage kidney disease.

Certain items are maintained at corporate headquarters (Corporate) and are not allocated to the segments. They primarily include most of the company s debt and cash and equivalents and related net interest expense, corporate headquarters costs, certain non-strategic investments and related income and expense, certain nonrecurring gains and losses, certain special charges (such as in-process research and development and restructuring), deferred income taxes, certain foreign currency fluctuations, certain employee benefit costs, the majority of foreign currency and interest rate hedging activities, and certain litigation liabilities and related insurance receivables.

Financial information for the company s segments for the quarter and year-to-date period ended September 30 is as follows.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	**2004**	**2003**	**2004**	**2003**
Net sales				
Medication Delivery	$ 986	$ 945	$2,918	$2,730
BioScience	849	820	2,552	2,333
Renal	485	451	1,438	1,310
Total	$2,320	$2,216	$6,908	$6,373
Pre-tax income from continuing operations				
Medication Delivery	$ 191	$ 184	$ 524	$ 480
BioScience	181	161	440	460
Renal	87	81	259	226
Other	(113)	(65)	(960)	(534)
Total	$ 346	$ 361	$ 263	$ 632

The following is a reconciliation of segment pre-tax income to income from continuing operations before income taxes per the consolidated income statements.

	Three months ended September 30,		Nine months ended September 30,	
(in millions)	**2004**	**2003**	**2004**	**2003**
Total pre-tax income from segments	$459	$426	$1,223	$1,166
Unallocated amounts				
Interest expense, net	(20)	(25)	(66)	(71)
Restructuring charge			(543)	(337)
Certain currency exchange rate fluctuations and hedging activities	(21)	(16)	(91)	(49)
Other corporate items	(72)	(24)	(260)	(77)
Income from continuing operations before income taxes and cumulative effect of accounting changes	$346	$361	$ 263	$ 632

9. SHARED INVESTMENT PLAN

As discussed in the 2003 Form 10-K/A, in order to align management and shareholder interests, in 1999 the company sold 6.1 million shares of the company s stock to 142 of Baxter s senior managers for $198 million in cash. The participants used five-year full-recourse personal bank loans to purchase the stock at the May 3, 1999 closing price (adjusted for the company s stock split) of $31.81. Baxter guaranteed repayment to the banks in the event a participant in the plan defaulted on his or her obligations, which were due on May 6, 2004. The plan also included certain risk-sharing provisions, which terminated on May 6, 2004. The company was entitled to 50% of any gain relating to stock sold on or before May 3, 2002. For stock sold after May 3, 2002 and through May 6, 2004, the company shared 50% in any loss incurred by the participants relating to a stock price decline.

In May 2003, management announced that, in order to continue to align management and shareholder interests and to balance both the short- and long-term needs of Baxter, the board of directors authorized the company to provide a new three-year guarantee at the May 6, 2004 loan due date for the non-executive officer employees who remain in the plan, should they elect to extend their loans. As noted above, as of May 6, 2004, the 50% risk-sharing provision included in the original plan terminated. The amount under the company s loan guarantee at September 30, 2004 relating to the 70 eligible employees who have extended their loans was $95 million. In accordance with FIN 45 (which was effective for guarantees issued or modified after December 31, 2002), the company has recorded a $5 million liability for the fair value of these guarantees. As with the guarantee issued in 1999, the company may take actions relating to participants and their assets to obtain full reimbursement for any amounts the company pays to the banks pursuant to the loan guarantee.

With respect to the participants who were either not eligible or did not elect to extend their loans on the May 6, 2004 due date, the majority paid their principal and interest obligations in full. However, seven participants did not pay their principal and interest obligations in full on the due date. While the company has not forgiven any of these loans, a reserve of $10 million, which represented the amount that the company paid to the banks under the loan guarantee, was recorded during the second quarter of 2004 for potential losses (as discussed in Note 2 above).

The company collected monies during the third quarter from certain of the participants, and the reserve balance totaled $8 million at September 30, 2004. The company is pursuing repayment of the remaining defaulted loan balance in order to obtain full reimbursement for amounts the

company paid to the bank pursuant to the loan guarantee.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

As discussed in Note 1A to the consolidated financial statements, the company has restated its previously issued financial statements for 2001 through 2003 and the first three quarters of 2004 as a result of inadequate reconciliations, leading to classification errors in tax and other related balance sheet accounts. Refer to Note 1A for further information, including the impact of the restatement for each of the restated periods included in this filing. As a result of the restatement, stockholders equity as of both September 30, 2004 and December 31, 2003 increased approximately $108 million, with offsetting decreases of approximately $157 to net tax liabilities and $49 million to goodwill. The restatement does not impact the consolidated statements of income or cash flows for the quarters or year-to-date periods ended September 30, 2004 and 2003.

Refer to the company s Form 10-K/A Amendment No. 2 for the year ended December 31, 2003 (which reflects the above-mentioned restatement) for management s discussion and analysis of financial condition and results of operations of the company for the year ended December 31, 2003. The following is management s discussion and analysis of the financial condition and results of operations of the company for the quarter and year-to-date period ended September 30, 2004. The information in this discussion and analysis reflects the restatement, but is not otherwise updated.

RESULTS OF CONTINUING OPERATIONS

NET SALES

	Three months ended September 30,			Nine months ended September 30,		
			Percent			Percent
(in millions)	2004	2003	increase	2004	2003	increase
International	$ 1,218	$ 1,149	6%	$ 3,693	$ 3,353	10%
United States	1,102	1,067	3%	3,215	3,020	6%
Total net sales	$ 2,320	$ 2,216	5%	$ 6,908	$ 6,373	8%

Currency exchange rate fluctuations benefited sales growth by 3 points and 4 points during the three and nine months ended September 30, 2004, respectively, principally because the United States Dollar weakened since the prior year periods relative to the Euro. These fluctuations impacted sales growth for all three segments. Refer to Note 8 for a summary of net sales by segment.

Medication Delivery

The Medication Delivery segment generated 4% and 7% sales growth for the three- and nine-month periods ended September 30, 2004, respectively (including 2 and 3 percentage points relating to the favorable impact of foreign currency fluctuations for the quarter and year-to-date period, respectively).

Increased sales of certain generic and branded pre-mixed drugs, as well as increased contract services revenues, contributed 1 point and 2 points of sales growth for the quarter and year-to-date period, respectively. Sales of intravenous therapies, which principally include intravenous solutions and nutritional products, were flat for the quarter and contributed 2 points to the segment s growth rate for the year-to-date period. Sales of anesthesia and critical care products were flat for the quarter and contributed 1 point to the segment s growth rate for the nine-month period, with pricing stable for both periods, and volume impacted by domestic wholesaler inventory reduction actions. Sales of electronic infusion pumps and related tubing sets contributed 3 points and 2 points to the growth rate for the quarter and year-to-date periods, respectively, with device sales the primary contributors. Increased device volume in the United States during the quarter, and in the United States and Canada during the year-to-date period, was partially offset by reduced pricing. The growth in volume in the United States in 2004 was partially due to the timing of group purchasing organization (GPO) contract awards, as certain customers delayed capital purchases in the prior year in anticipation of a new contract award. The reduced pricing, which is expected to impact growth for the remainder of 2004, is primarily due to the renegotiated long-term contracts with certain GPOs, principally Premier Purchasing Partners L. P. (Premier). The most significant renegotiated Premier contract became effective in February 2004. Management believes that over time, the impact of reduced pricing will be substantially offset by increased sales volumes and product mix upgrades.

BioScience

Sales in the BioScience segment increased 4% and 9% for the three- and nine-month periods ended September 30, 2004, respectively (including 4 and 5 percentage points due to the favorable impact of foreign currency fluctuations for the quarter and year-to-date period, respectively).

The primary driver of the segment s growth rate for the quarter and year-to-date period was increased sales of recombinant Factor VIII products, contributing 6 points and 7 points of growth in the three- and nine-month periods, respectively. Growth in sales of recombinant products in both the quarter and year-to-date period was principally fueled by the launch of the advanced recombinant therapy, ADVATE (Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method (rAHF-PFM)), which received regulatory approval in the United States in July 2003 and in Europe in March 2004. Partially offsetting the growth in sales volume relating to the ADVATE launch in the year-to-date period was the impact of reductions in wholesaler inventory levels of recombinant products in the United States, which management expects will continue for the remainder of the year. Management expects an increased sales contribution from ADVATE during the remainder of 2004 as the launch of this new product continues.

Sales of plasma-based products (excluding anti-body therapies) increased slightly during the quarter and contributed 2 points to the segment s growth rate in the year-to-date period. The increase in the quarter was due solely to foreign currency fluctuations. The growth in the year-to-date period was primarily due to increased sales volume of FEIBA, an anti-inhibitor coagulant complex, along with increased pricing of this product, partially offset by reduced pricing in other product lines. Increased sales of FEIBA were partially offset by the impact of competitive pressures across certain product lines, as well as a continuing shift in the market from plasma-based to recombinant hemophilia products. As discussed further below, as a result of these competitive pressures, the company closed 26 plasma collection centers and a plasma fractionation plant during 2003, and is reducing plasma production and closing additional centers during 2004, to improve the profitability of the business.

Higher sales of anti-body therapies, including IVIG (intravenous immunoglobulin) for immune deficiencies, contributed 1 point and 2 points to the growth rate for the quarter and year-to-date period, respectively, principally due to improved pricing in the United States and, in the year-to-date period, higher product availability due to cycle time reduction initiatives.

Partially offsetting the growth in these product lines was the impact of lower sales of transfusion therapies products and vaccines in both the quarter and year-to-date period. The lower sales of vaccines principally related to smallpox and Neis-Vac-C (for the prevention of meningitis C) vaccines. Sales of vaccines are impacted by the timing of government tenders, and there were no significant tenders filled during the first nine months of 2004. Management expects that the segment s growth for the remainder of the year will continue to be impacted by lower sales of plasma and transfusion therapies products due to consolidation in the plasma industry.

Renal

Sales from continuing operations in the Renal segment increased 8% and 10% for the three- and nine-month periods ended September 30, 2004, respectively (including 4 and 6 percentage points, respectively, due to the favorable impact of foreign currency fluctuations). Increased sales of products for peritoneal dialysis contributed 5 points and 7 points to the segment s growth rate for the quarter and year-to-date periods, respectively. In addition to the favorable impact of foreign currency fluctuations, the sales growth in both periods was primarily driven by an increased number of peritoneal dialysis patients, principally in Europe, Japan and Asia. Changes in the pricing of the segment s peritoneal dialysis products were not a significant factor. Increased penetration of products for peritoneal dialysis continues to be strongest in emerging markets, where many people with end-stage renal disease are currently under-treated. The remaining 3 points of growth for both the quarter and the nine-month period ended September 30, 2004, respectively, was primarily related to increased sales of hemodialysis hardware and related products.

GROSS MARGIN AND EXPENSE RATIOS

The following table shows key ratios of certain income statement items as a percent of sales.

	Three months ended September 30,			Nine months ended September 30,		
	2004	**2003**	**Change**	**2004**	**2003**	**Change**
Gross margin	41.5%	43.7%	(2.2 pts)	40.5%	44.2%	(3.7 pts)
Marketing and administrative expenses	19.9%	19.9%	pts	21.1%	20.7%	0.4 pts

The decline in gross margin in both the quarter and year-to-date period was impacted by changes in product mix. In the BioScience segment, the gross margin declined in the year-to-date period principally because increased margins in certain product lines, such as recombinants, were offset by lower sales of other high-margin products. In the Medication Delivery segment, the above-mentioned pricing pressures associated with the renegotiated contracts with Premier contributed to Baxter s margin decline in both the quarter and year-to-date period. In the Renal segment, the margin declined in both the quarter and nine-month period due to an unfavorable mix of sales of peritoneal and hemodialysis products. In addition, while 2004 sales benefited from the effect of foreign currency fluctuations, principally relating to the strengthened Euro, the gross margin was unfavorably impacted by the company s foreign currency hedging activities, especially in the year-to-date period ended September 30, 2004. Increased inventory reserves and foreign currency hedge adjustments totaling $45 million (included in the second quarter 2004 special charges, which are discussed in Note 2) accounted for almost 1 point of the decline during the year-to-date period. In addition, costs associated with the company s employee pension and other postretirement benefit plans have increased since the prior year periods (as further discussed

below). These factors, which unfavorably impacted the company s gross margin, were partially offset by cost savings relating to the company s 2003 and 2004 restructuring programs (as further discussed below).

Marketing and administrative expenses as a percent of sales were flat for the quarter and increased during the year-to-date period. Increased receivable reserves totaling $55 million (discussed in Note 2) increased the expense ratio by approximately 1 point in the year-to-date period. Expenses also increased because of foreign currency fluctuations, employee pension and other postretirement benefit plan costs, and the impact of reduced costs in the prior year due to a change in the employee vacation policy. Offsetting these increases were the benefits of the company s restructuring programs. See further discussion below regarding the restructuring initiatives.

Expenses associated with the company s pension and other postretirement benefit plans increased $13 million and $45 million during the third quarter and first nine months of 2004, respectively, as detailed in Note 6, principally due to a reduction in the discount rate and the amortization of unrecognized losses. Refer to the 2003 Form 10-K/A for further information. Expenses associated with Baxter s pension and other postretirement benefit plans are expected to further increase in 2005, by approximately $40 million, primarily due to changes in pension assumptions. The 2005 assumptions for the domestic plans, which represent over three-quarters of the company s total pension assets and obligation, will be reduced from 6.00% to 5.75% (discount rate) and from 10% to 8.5% (expected return on assets). The discount rate assumption change is due to reductions in market interest rates used to determine the appropriate pension discount rate. The change in the expected return on assets assumption is a result of anticipated changes in the company s pension trust asset allocation.

RESEARCH AND DEVELOPMENT

	Three months ended September 30,			Nine months ended September 30,		
(in millions)	**2004**	**2003**	**Percent decrease**	**2004**	**2003**	**Percent decrease**
Research and development (R&D)	$ 124	$ 137	(9)%	$ 389	$ 412	(6)%
As a percent of sales	5.3%	6.2%		5.6%	6.5%	

R&D expenses declined in both the third quarter and first nine months of 2004, with increased spending on certain projects across the three segments more than offset by the cost savings generated by the restructuring initiatives and the termination of certain programs (such as the recombinant hemoglobin protein project, which was terminated in the second quarter of 2003). Management expects a similar decline in R&D spending during the fourth quarter of 2004.

RESTRUCTURING INITIATIVES

Second quarter 2004 restructuring charge

In January 2004, management announced plans (which were finalized during the second quarter of 2004) to implement restructuring initiatives (in addition to the actions initiated in 2003, as discussed below). Management undertook these actions in order to reduce the company s overall cost structure and to drive sustainable improvements in financial performance.

These actions include the elimination of over 4,000 positions, or 8% of the global workforce, as management reorganizes and streamlines the company. Approximately 50% of the positions being eliminated are in the United States. Approximately three quarters of the estimated savings impact general and administrative expenses, with the remainder primarily impacting cost of sales. The eliminations impact all three of the company s segments, along with the corporate headquarters and functions. Baxter is also further reducing plasma production and closing additional plasma collection centers. In addition, the company is exiting certain other facilities and activities. As a result, management recorded a restructuring charge in the second quarter of 2004 totaling $543 million ($394 million, or $0.64 per diluted share, on an after-tax basis), principally for severance and costs associated with the closing of facilities and the exiting of contracts. Refer to Note 4 for additional information.

During the three- and nine-month period ended September 30, 2004, $47 million and $51 million, respectively, of the reserve for cash costs was utilized. Approximately $50 million is expected to be paid during the remainder of 2004, approximately $150 million in 2005, and the remainder in 2006. The cash expenditures are being funded with cash generated from operations. Approximately one third of the targeted positions have been eliminated as of September 30, 2004, and management expects that approximately half of the targeted positions will be eliminated by the end of the year. The program is proceeding on plan.

Management estimates that these additional initiatives will yield savings of approximately $0.05 per diluted share in the second half of 2004, and anticipates that the initiatives will yield savings of approximately $0.20 to $0.25 per diluted share in 2005, an incremental $0.15 to $0.20 per diluted share as compared to 2004. Once fully implemented in 2006, management anticipates total annual savings will be approximately $0.30 to $0.35 per diluted share.

Second quarter 2003 restructuring charge

During the second quarter of 2003, the company recorded a $337 million restructuring charge ($202 million, or $0.33 per diluted share, on an after-tax basis) principally associated with management s decision to close certain facilities and reduce headcount on a global basis. Management decided to take these actions in order to position the company more competitively and to enhance the company s profitability. Refer to Note 4 for additional information.

During the three- and nine-month period ended September 30, 2004, $26 million and $83 million, respectively, of the reserve for cash costs was utilized. Virtually all of the targeted positions have been eliminated as of September 30, 2004, and the program is substantially complete. The majority of the severance and other costs are expected to be paid by the end of 2004. The cash expenditures are being funded with cash generated from operations.

Management expects that the actions initiated in 2003 will generate incremental annual savings of approximately $0.15 to $0.20 per diluted share when fully implemented. Management estimates that the cost savings in the three- and nine-month periods ended September 30, 2004 were approximately $0.04 and $0.12 per diluted share, respectively, and expects that the full year 2004 savings will total approximately $0.15 per diluted share. As mentioned above, these benefits are offset by increased employee benefit costs.

NET INTEREST EXPENSE

Net interest expense decreased $5 million for both the quarter and year-to-date period ended September 30, 2004, principally due to a lower average net debt level, partially offset by lower capitalized interest, as the company completed certain projects and placed assets into service.

OTHER EXPENSE, NET

Other income and expense typically includes amounts relating to fluctuations in currency exchange rates, minority interests, income and losses relating to equity method investments, divestiture gains and asset impairment charges. The increase in other expense for the three months ended September 30, 2004 principally related to foreign currency fluctuations. The increase in other expense for the nine months ended September 30, 2004 principally related to foreign currency fluctuations and lower equity method income. Equity method income was lower in 2004 because Baxter divested its equity method investment in Acambis, Inc. in late 2003. Refer to Note 2 for further information.

PRE-TAX INCOME

Refer to Note 8 to the condensed consolidated financial statements for a summary of financial results by segment. Certain items are maintained at the company s corporate headquarters and are not allocated to the segments. They primarily include certain foreign currency fluctuations, the majority of the foreign currency and interest rate hedging activities, net interest expense, income and expense related to certain non-strategic investments, corporate headquarters costs, certain employee benefit costs, certain nonrecurring gains and losses and certain special charges (such as in-process research and development and restructuring). The following is a summary of significant factors impacting the segments financial results.

Medication Delivery

Pre-tax income increased 4% and 9% for the three and nine months ended September 30, 2004, respectively. The growth in pre-tax income was primarily the result of sales growth (especially in the year-to-date period), the close management of costs, the benefits of the restructuring initiatives, and changes in currency exchange rates (as noted above, foreign currency hedging activities for all segments are recorded at corporate, and are not included in segment results). As noted above, these factors were partially offset by the impact of reduced pricing in the renegotiated long-term contracts with GPOs, principally Premier. Earnings growth is expected to continue to be impacted by the reduced pricing in these contracts during the remainder of 2004.

BioScience

Pre-tax income increased 12% and decreased 4% for the three and nine months ended September 30, 2004, respectively. The increase in pre-tax income for the quarter was primarily due to lower R&D spending as a result of the recent prioritization initiatives (including the termination of the recombinant hemoglobin protein project in 2003), the close management of costs, the benefits of the recent restructuring initiatives, and changes in currency exchange rates. While many of these factors also impacted the year-to-date period, pre-tax income for the nine months ended September 30, 2004 declined primarily due to increased inventory reserves and an asset impairment charge (recorded as special charges in the second quarter of 2004, as discussed in Note 2) and lower sales of certain high-margin products. In addition, both prior year periods, particularly the year-to-date period, include income from the company s investment in Acambis, Inc. As noted above, this investment was divested in late 2003.

Renal

Pre-tax income increased 7% and 15% for the three and nine months ended September 30, 2004, respectively. The increase in pre-tax income was primarily due to solid sales growth, particularly in the year-to-date period, changes in currency exchange rates, the close management of costs, and the benefits of the recent restructuring initiatives, partially offset by an unfavorable change in mix, particularly during the quarter.

INCOME TAXES

As discussed in Note 2, as a result of the completion of tax audits in the second quarter of 2004, $55 million of reserves for matters previously under review were reversed into income during the second quarter of 2004. In addition, the effective tax rates for both the three- and nine-month periods of both 2004 and 2003 were impacted by the restructuring charges and the special charges discussed in Notes 4 and 2, respectively, which were tax-effected at different (generally higher) rates, depending on the particular tax jurisdictions. There were no other significant changes to the company s effective income tax rate.

In October 2004, the American Jobs Creation Act of 2004 (the Act) was enacted. The Act includes numerous provisions, including the creation of a temporary incentive for U.S. multinationals to repatriate accumulated income earned abroad. The temporary tax deduction is subject to a number of limitations. Management is analyzing the provisions of the Act and has not yet determined the effects on the company s plans or its consolidated financial statements.

INCOME AND EARNINGS PER DILUTED SHARE FROM CONTINUING OPERATIONS

Income from continuing operations before the cumulative effect of accounting changes was $259 million and $275 million for the three months ended September 30, 2004 and 2003, respectively, and $277 million and $536 million for the nine months ended September 30, 2004 and 2003, respectively. Income from continuing operations per diluted share was $0.42 and $0.46 in the three months ended September 30, 2004 and 2003, respectively, and $0.45 and $0.89 for the nine months ended September 30, 2004 and 2003, respectively. The significant factors and events causing the declines from 2003 to 2004 are discussed above.

DISCONTINUED OPERATIONS

During 2004, discontinued operations generated income of $17 million and $5 million for the three- and nine-month periods ended September 30, respectively (net of tax benefits of $24 million and $28 million, respectively). The income was principally related to tax and other adjustments, as the company completes divestitures. During 2003, discontinued operations generated losses of $5 million and $17 million for the three- and nine-month periods ended September 30, respectively (net of tax benefits of $3 million and $6 million, respectively). Refer to Note 3 for further discussion of the discontinued operations. Management expects the divestiture plan will be completed by the end of 2004.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in accordance with generally accepted accounting principles (GAAP) requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. A summary of the company s significant accounting policies is included in Note 1 to the company s consolidated financial statements for the year ended December 31, 2003, which are included in the 2003 Form 10-K/A. Certain of the company s accounting policies are considered critical, as these policies are the most important to the depiction of the company s financial statements and require significant, difficult or complex judgments by management, often employing the use of estimates about the effects of matters that are inherently uncertain. Such policies are summarized in the Management s Discussion and Analysis section of the 2003 Form 10-K/A. There have been no significant changes in the application of the critical accounting policies since December 31, 2003.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

Cash flows from continuing operations

The company reported cash flows from continuing operations of $529 million for the nine months ended September 30, 2004, a decrease of $141 million from the prior year. The decrease in cash flows was principally due to increased payments related to the restructuring programs, higher contributions to the pension trusts, and reduced accounts receivables securitization cash flows, partially offset by improved inventory management.

Accounts Receivable

The decrease in cash flows relating to accounts receivable was primarily due to $87 million in reduced cash flows from the company s securitization and factoring activities, with $230 million in reduced cash flows from securitization arrangements, partially offset by $143 million of increased cash flows relating to factoring activities. In addition, days sales outstanding increased from 62.4 days at September 30, 2003 to 63.9 days at September 30, 2004.

Inventories

The following is a summary of inventories at September 30, 2004 and December 31, 2003, as well as inventory turns for the first nine months of 2004 and 2003, by segment.

	Inventories		Inventory Turns Nine months ended September 30,	
(in millions, except inventory turn data)	**September 30, 2004**	**December 31, 2003**	**2004**	**2003**
BioScience	$1,271	$1,378	1.51	1.39
Medication Delivery	620	528	3.70	3.64
Renal	215	198	4.13	3.95
Total	$2,106	$2,104	2.48	2.31

Inventory balances were relatively flat from December 31, 2003 to September 30, 2004. The reduction in BioScience inventories principally related to the planned reduction in plasma inventories. Inventory turns are impacted by seasonality and the timing of facility shutdowns for planned maintenance in certain of the company s businesses, and are generally highest in the fourth quarter of the year, and lower earlier in the year, for these businesses. Inventory turns increased in total and for all of the businesses as management continues to focus on working capital efficiency.

Liabilities, Including Restructuring Payments and Contributions to the Pension Trusts

As noted above, the most significant reasons for the decline in cash flows from continuing operations during the nine-month period were increased payments associated with restructuring programs and increased contributions to the company s pension trusts. Restructuring payments increased $98 million, from $38 million to $136 million. Contributions to Baxter s pension trusts increased $84 million, from $11 million to $95 million.

Cash flows from discontinued operations

Cash flows relating to discontinued operations increased $12 million during the first nine months of 2004, from $5 million in 2003 to $17 million in 2004, with the increased cash flows primarily relating to divestiture proceeds. As discussed in Note 3 and above, the company has divested the majority of the discontinued operations and plans to complete the divestiture plan in 2004.

Cash flows from investing activities

Capital Expenditures

Capital expenditures decreased for the nine months ended September 30, 2004 by $201 million, from $564 million in 2003 to $363 million in 2004. As discussed in the 2003 Form 10-K/A, management is reducing its level of investments in capital expenditures in 2004 as certain significant long-term projects are completed and as management more aggressively manages capital spending. Management currently anticipates that the company s capital expenditures will not exceed $650 million in 2004. Construction in progress decreased 9% from December 31, 2003 to September 30, 2004, as major projects were completed and the company placed assets into service.

Acquisitions and Investments In and Advances to Affiliates

Net cash outflows relating to acquisitions and investments in and advances to affiliates decreased by $86 million during the first nine months of 2004, from $106 million in 2003 to $20 million in 2004. The current period included outflows relating to the 2003 acquisition of certain assets of Alpha Therapeutic Corporation, which are included in the BioScience segment. The 2003 outflows included the funding of a $50 million loan to Cerus Corporation, a minority investment holding (which is included in the BioScience segment), a $24 million additional purchase price payment relating to the December 2002 acquisition of ESI Lederle (which is included in the Medication Delivery segment), an $11 million common stock investment in Acambis, Inc., which was divested later in 2003, and an $11 million payment for an icodextrin manufacturing facility in England (which is included in the Renal segment).

Divestitures and Other

Net cash flows relating to divestitures and other totaled $31 million in the first nine months of 2004, and principally related to the sale of a building and the return of collateral.

Cash flows from financing activities

Debt Issuances, Net of Redemptions and Other Payments of Financing Obligations

Debt issuances, net of redemptions and other payments of financing obligations, were relatively flat for the first nine months of 2004 as compared to the prior year period. Included in the year-to-date outflows was a $40 million payment to exit one of the company s cross-currency swap agreements.

Other Financing Activities

Common stock cash dividends increased in 2004 by $15 million due to a higher level of common shares outstanding. Cash received for stock issued under employee benefit plans increased by $48 million principally due to a higher level of stock option exercises and purchases under the company s employee stock purchase plans. There were no common stock issuances in 2004. In September 2003, the company issued 22 million shares of common stock and received net proceeds of $644 million. The net proceeds were used to settle equity forward agreements, to fund the company s acquisition of certain assets of Alpha Therapeutic Corporation, and for other general corporate purposes. Stock repurchases decreased from 2003 to 2004. In the first nine months of 2004 the company paid $18 million to repurchase stock from Shared Investment Plan participants. Refer to Note 9 for further information regarding the Shared Investment Plan. In the first nine months of 2003 the company purchased 15 million shares of common stock for $714 million from counterparty financial institutions in conjunction with the settlement of equity forward agreements. Refer to the 2003 Form 10-K/A for further information.

CREDIT FACILITIES, ACCESS TO CAPITAL, AND COMMITMENTS AND CONTINGENCIES

Refer to the 2003 Form 10-K/A for further discussion of the company s credit facilities, access to capital, and commitments and contingencies.

Credit facilities

The company had $822 million of cash and equivalents at September 30, 2004. The company also maintains two revolving credit facilities, which totaled $1.44 billion at September 30, 2004. One of the facilities totals $640 million and matures in October 2007, and the other facility totals $800 million and matures in September 2009. The facilities enable the company to borrow funds on an unsecured basis at variable interest rates. The company has never drawn on these facilities. Management believes these credit facilities are adequate to support ongoing operational requirements. The credit facilities contain certain covenants, including a maximum net-debt-to-capital ratio and a minimum interest coverage ratio. At September 30, 2004, as in prior periods, the company was in compliance with all financial covenants. The company s net-debt-to-capital ratio, as defined below, of 38.3% (as restated) at September 30, 2004 was well below the credit facilities net-debt-to-capital covenant. Similarly, the company s actual interest coverage ratio of 7.8 to 1 in the third quarter of 2004 was well in excess of the minimum interest coverage ratio covenant. The net-debt-to-capital ratio, which is calculated in accordance with the company s primary credit agreements, and is not a measure defined by GAAP, is calculated as net debt (short-term and long-term debt and lease obligations, less cash and equivalents) divided by capital (the total of net debt and stockholders equity). The net-debt-to-capital ratio at September 30, 2004 and the corresponding covenant in the company s credit agreements give 70% equity credit to the company s equity units. Refer to the 2003 Form 10-K/A for a description of the equity units, which were issued in December 2002. The minimum interest coverage ratio is a four-quarter rolling calculation of the total of income from continuing operations before income taxes plus interest expense (before interest income), divided by interest expense (before interest income). Baxter also maintains certain other credit arrangements.

Access to capital

The company intends to fund its short-term and long-term obligations as they mature through cash on hand, future cash flows from operations, by issuing additional debt, or by issuing common stock. As of September 30, 2004, the company can issue up to $399 million of securities, including debt, common stock and other securities, under an effective registration statement filed with the Securities and Exchange Commission.

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

Credit ratings

The company s credit ratings at September 30, 2004 were Baa1 by Moody s, A- by Standard & Poor s and BBB+ by Fitch on senior debt, and P2 by Moody s, A2 by Standard & Poor s and F2 by Fitch on short-term debt. The outlooks were negative by Moody s and Standard & Poor s and stable by Fitch. The company s credit ratings and outlooks have been downgraded during 2004. Refer to the 2003 Form 10-K/A for a summary of the company s ratings and outlooks at December 31, 2003.

The rating agency downgrades in 2004 and any future downgrades of Baxter s credit ratings unfavorably impact the financing costs associated with the company s credit arrangements and future debt issuances. Management believes that the actual and anticipated impact of the recent downgrades and changes in outlook is not material. Management believes that the impact of reasonably possible future changes in credit ratings or outlook would also not be material.

Any future credit rating downgrades or changes in outlook would not affect the company s ability to draw on its credit facilities, and would not result in an acceleration of the scheduled maturities of any of the company s outstanding debt.

Certain specified rating agency downgrades, if they occur in the future, would require the company to post additional collateral pursuant to certain of its arrangements. These arrangements principally pertain to the company s foreign currency and interest rate derivatives, which Baxter uses for hedging purposes. For risk-management purposes, certain of the company s counterparty financial institutions require that collateral be posted under specified circumstances. The terms of the arrangements vary, but generally, the level of collateral postings is dependent upon the mark-to-market liability (if any) with the financial institution and the company s credit ratings. It is not possible to know with certainty what each of these variables will be in the future. However, if Baxter s credit rating on its senior unsecured debt declined to Baa2 or BBB (i.e., a one-rating or two-rating downgrade, depending upon the rating agency), the amount of collateral that would currently be required (holding the mark-to-market liability balance of outstanding derivative instruments constant) would total less than $100 million.

Net investment hedges

As discussed in the company s 2003 Form 10-K/A, the company has historically used cross-currency swaps to hedge the net assets of certain of its foreign operations. These swaps have served as effective hedges for accounting purposes and have reduced volatility in the company s stockholders equity balance and net-debt-to-capital ratio (as any increase or decrease in the fair value of the swaps relating to changes in spot currency exchange rates is offset by the change in value of the hedged net assets of the foreign operations relating to changes in spot currency exchange rates). Because the United States Dollar has weakened relative to the hedged currency, the hedged net assets have increased in value over time, while the cross-currency swaps have decreased in value over time. At September 30, 2004, the company had a liability in its consolidated balance sheet of $956 million relating to these cross-currency swap agreements (before consideration of deferred tax benefits).

Management has reevaluated its net investment hedge strategy and has decided to reduce the use of these instruments as a risk-management tool as the current portfolio matures. At this time, management does not intend to extend the current maturity dates of the instruments. Management

intends to settle the swaps that mature in 2005 as they mature, from cash flow from operations. Management anticipates that the remaining swaps will be settled as they mature, or possibly sooner, depending on the level of the company s future cash flows.

In addition, in order to reduce financial risk and uncertainty through the maturity (or cash settlement) dates of the cross-currency swaps, the company is executing offsetting or mirror cross-currency swaps relating to approximately 50% of the existing portfolio. These mirror swaps will effectively fix the net amount that the company will ultimately pay to settle the cross-currency swap agreements subject to this strategy. The mirror swaps will be settled when the offsetting existing swaps are settled. Of the pre-tax liability of $956 million at September 30, 2004 relating to the cross-currency swaps, the company has fixed $296 million by entering into mirror swaps as of October 31, 2004. The maturity by year of the $956 million cross-currency swaps portfolio, as well as the portion that is fixed via October 2004 executions of mirror swaps, is as follows:

Maturity Date	Swaps Liability As of September 30, 2004	Portion Fixed by Mirror Swaps As of October 31, 2004
2005	$338 million	$296 million
2007	44 million	
2008	232 million	
2009	342 million	
Total	$956 million	$296 million

For the mirrored swaps, the company will no longer realize the favorable interest rate differential between the two currencies, and this will result in increased net interest expense in the future. The amount of increased net interest expense will vary based on floating interest rates and the timing of the company s settlements. Based on interest rates at September 30, 2004, the increase in net interest expense is estimated to be approximately $15 million on an annual basis.

Legal contingencies

See Part II Item 1. Legal Proceedings for a discussion of the company s legal contingencies. Upon resolution of any of these uncertainties, the company may incur charges in excess of presently established reserves. While such a future charge could have a material adverse impact on the company s net income or cash flows in the period in which it is recorded or paid, based on the advise of counsel, management believes that any outcome of these actions, individually or in the aggregate, will not have a material adverse effect on the company s consolidated financial position.

FORWARD-LOOKING INFORMATION

The matters discussed in this report that are not historical facts include forward-looking statements. These statements are based on the company s current expectations and involve numerous risks and uncertainties. Some of these risks and uncertainties are factors that affect all international businesses, while some are specific to the company and the healthcare arenas in which it operates. Many factors could affect the company s actual results, causing results to differ, and possibly differ materially, from those expressed in any such forward-looking statements. These factors include, but are not limited to:

the company s ability to realize in a timely manner the anticipated benefits of restructuring initiatives;

the effect of economic conditions;

the impact of geographic and/or product mix on the company s sales;

actions of regulatory bodies and other government authorities, including the FDA and foreign counterparts that could delay, limit or suspend product sales and distribution;

product quality and/or patient safety concerns, leading to product recalls, withdrawals, launch delays or declining sales;

product development risks;

interest rates;

technological advances in the medical field;

demand for and market acceptance risks for new and existing products, such as ADVATE (Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method) rAHF-PFM, and other technologies;

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

inventory reductions or fluctuations in buying patterns by wholesalers or distributors;

foreign currency exchange rates;

the availability of acceptable raw materials and component supply;

global regulatory, trade and tax policies;

regulatory, legal or other developments relating to the company s A, AF and AX series dialyzers;

the ability to obtain adequate insurance coverage at reasonable cost;

the ability to enforce patents;

patents of third parties preventing or restricting the company s manufacture, sale or use of affected products or technology;

reimbursement policies of government agencies and private payers;

internal and external factors that could impact commercialization;

results of product testing; and

other factors described elsewhere in this report or in the company s other filings with the Securities and Exchange Commission.

Additionally, as discussed in Part II Item 1. Legal Proceedings, upon the resolution of certain legal matters, the company may incur charges in excess of presently established reserves. Any such charge could have a material adverse effect on the company s results of operations or cash flows in the period in which it is recorded.

Currency fluctuations are also a significant variable for global companies, especially fluctuations in local currencies where hedging opportunities are not economic or not available. If the United States Dollar strengthens significantly against foreign currencies, the company s ability to realize projected growth rates in its sales and net earnings outside the United States, as reported in United States Dollars, could be negatively impacted.

Management believes that its expectations with respect to forward-looking statements are based upon reasonable assumptions within the bounds of its knowledge of the company s business and operations, but there can be no assurance that the actual results or performance of the company will conform to any future results or performance expressed or implied by such forward-looking statements. The company does not undertake any obligation to update any forward-looking statements as a result of new information, future events, changed assumptions or otherwise, and all forward-looking statements speak only as of the time when made.

Item 4. Controls and Procedures

Controls and Procedures. The company carried out an evaluation, under the supervision and with the participation of the company s Disclosure Committee and the company s management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the company s disclosure controls and procedures (as such term is defined in Rules 13a-15(d) or 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the quarterly period covered by this report. The company s disclosure controls and procedures are designed to ensure that information required to be disclosed by the company in the reports it files or submits under the Exchange Act is recorded, processed, summarized and reported on a timely basis and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the company s disclosure controls and procedures were not effective as of September 30, 2004 for the reasons described below.

The company has restated its previously issued financial results for the years 2001 through 2003, and the first three quarters of 2004. This restatement was primarily the result of a material weakness that existed as it relates to the controls surrounding the income tax accounts. Specifically, current income taxes payable were not reconciled to expected tax payments due, and the company did not adequately review the difference between the income tax basis and financial reporting basis of assets and liabilities and reconcile the difference to recorded deferred income tax assets and liabilities. Refer to Note 1A to the consolidated financial statements for further information regarding this restatement. To address this material weakness, subsequent to December 31, 2004, the company s management has taken the following actions:

1. Performed an extensive study and reconciliation of the income tax accounts.

2. During that study, the company identified adjustments to the income tax accounts that relate to prior periods.

3. Assessed the materiality of these adjustments with the Chief Executive Officer and the Chief Financial Officer and the Audit Committee and concluded that the historical consolidated financial statements indicated above should be restated.

As a result of these actions, management believes that the financial statements included in this report fairly present in all material respects the company s financial condition, results of operations and cash flows for the periods presented. In addition, the more enhanced reconciliation procedures performed to address this issue subsequent to the 2004 year-end will continue to be performed in the future to ensure this matter is remediated.

In addition, as previously disclosed in the company s filings with the Securities and Exchange Commission, in August 2004 the company restated its previously issued financial results for the years 2001 through 2003, and for the first quarter of 2004. This restatement was primarily the result of the inappropriate application of accounting principles for revenue recognition and inadequate provisions for bad debts in Brazil during this period. Senior management became aware of these issues in 2004 through the reporting procedures established under Baxter s Global Business Practice Standards. Upon becoming aware of the issues in Brazil, senior management, with the assistance of the company s internal audit team, conducted a preliminary investigation. This preliminary investigation was followed by a more comprehensive investigation by the Audit Committee of Baxter s Board of Directors, with the assistance of independent legal counsel and forensic and other accountants. Refer to the company s Form 10-K/A Amendment No. 2 for the year ended December 31, 2003 for further information regarding this restatement.

The investigations described above identified the following, which collectively constitute a material weakness in the company s internal control over financial reporting:

- an ineffective control environment maintained by senior management in Brazil, including intentional overrides by senior management in Brazil of internal controls;
- inadequate revenue recognition controls in Brazil;
- inadequate controls in Brazil to ensure adherence to generally accepted accounting principles for loss contingencies, including bad debts; and
- ineffective financial review by management responsible for the Intercontinental region, which includes Latin America.

During the third and fourth quarters of 2004, the company took several actions that it believes has remediated this material weakness. These actions include:

- Terminated four members of senior management in the company s Brazilian operations and replaced the Vice President, Finance responsible for the Intercontinental region;
- Completed monthly detailed internal audits of the Brazilian operations, beginning in July 2004, with an emphasis on the areas that gave rise to the inaccurate financial reporting;
- Completed additional training for finance, accounting and sales personnel in Brazil on appropriate accounting for revenue recognition;
- Completed additional training for finance and accounting personnel in Brazil on accounting and reporting policies, including those relating to accounting in accordance with Statement of Financial Accounting Standards No. 5 Accounting for Contingencies and SEC Staff Accounting Bulletin No. 99 Materiality;
- Completed enhanced training for employees in Brazil regarding Baxter s Global Business Practice Standards, including obligations to maintain accurate books and records and to report wrongdoing promptly;
- Implemented enhanced financial review procedures at the Intercontinental region level, including quarterly financial reviews for each significant country;
- Hired a director of internal control for the Intercontinental region;
- Implemented improved procedures for reporting legal contingencies and establishing appropriate legal reserves, and provided training on these procedures;

Engaged a prominent independent public accounting firm (other than PricewaterhouseCoopers LLP) to perform a comprehensive review of internal control over financial reporting in Brazil;

Implemented new controls in Brazil relating to the recording of revenues and loss contingencies, including new revenue recognition procedures with enhanced documentation requirements, monitoring of inventory levels at distributors and specific tracking of equipment installation; and

Implemented new procedures in Brazil for determining bad debt reserve requirements.

The changes to internal control over financial reporting described above were implemented subsequent to June 30, 2004. Other than the actions mentioned above, there has been no change in the company s internal control over financial reporting that occurred during the quarter ended September 30, 2004 that has materially affected, or is reasonably likely to materially affect, the company s internal control over financial reporting.

Review by Independent Registered Public Accounting Firm

Reviews of the interim condensed consolidated financial information included in this Quarterly Report on Form 10-Q/A Amendment No. 1 for the three and nine months ended September 30, 2004 and 2003 have been performed by PricewaterhouseCoopers LLP, the company s independent registered public accounting firm. Their report on the interim condensed consolidated financial information follows. This report is not considered a report within the meaning of Sections 7 and 11 of the Securities Act of 1933 and therefore, the independent accountants liability under Section 11 does not extend to it.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Baxter International Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Baxter International Inc. and its subsidiaries as of September 30, 2004, and the related condensed consolidated statements of income for each of the three-month and nine-month periods ended September 30, 2004 and 2003 and the condensed consolidated statements of cash flows for the nine-month periods ended September 30, 2004 and 2003. These interim financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying condensed consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2003 and the related consolidated statements of income, cash flows and stockholders equity and comprehensive income for the year then ended (not presented herein), and in our report dated February 20, 2004, except for Note 1A which is as of August 9, 2004 and Note 1B which is as of March 14, 2005, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2003, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

As described in Note 1A, the Company has restated its previously issued consolidated financial statements.

/s/ PricewaterhouseCoopersLLP

PricewaterhouseCoopers LLP

Chicago, Illinois

November 4, 2004, except for Note 1A which is as of March 28, 2005

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

BAXTER INTERNATIONAL INC.
(Registrant)

Date: March 31, 2005

By: /s/ JOHN J. GREISCH

John J. Greisch
Corporate Vice President and

Chief Financial Officer

EXHIBIT INDEX

Number	Description of Exhibit
10.39*	Separation Agreement with Brian Anderson dated August 2, 2004, filed as exhibit 10.39 to the company s quarterly report for the quarter ended September 30, 2004.
10.40*	Form of Stock Option Plan Terms and Conditions, filed as exhibit 10.40 to the company s quarterly report on Form 10-Q for the quarter ended September 30, 2004.
15	Letter Re Unaudited Interim Financial Information.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. 1350

* Incorporated herein by reference.