

BAXTER INTERNATIONAL INC

Form 10-Q

May 06, 2015

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2015**

.. **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)**

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Delaware  
(State or other jurisdiction of

36-0781620  
(I.R.S. Employer

incorporation or organization)

Identification No.)

One Baxter Parkway, Deerfield, Illinois  
(Address of principal executive offices)

60015  
(Zip Code)

224-948-2000

(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  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares of the registrant's Common Stock, par value \$1.00 per share, outstanding as of April 30, 2015 was 544,254,211 shares.

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BAXTER INTERNATIONAL INC.

FORM 10-Q

For the quarterly period ended March 31, 2015

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

Baxter International Inc.

Condensed Consolidated Statements of Income (unaudited)

(in millions, except per share data)

	Three months ended March 31,	
	2015	2014
Net sales	\$ 3,764	\$ 3,848
Cost of sales	1,963	1,957
Gross margin	1,801	1,891
Marketing and administrative expenses	1,015	910
Research and development expenses	300	309
Net interest expense	30	43
Other income, net	(74)	(24)
Income from continuing operations before income taxes	530	653
Income tax expense	110	146
Income from continuing operations	420	507
Income from discontinued operations, net of tax	10	49
Net income	\$ 430	\$ 556
Income from continuing operations per common share		
Basic	\$ 0.77	\$ 0.93
Diluted	\$ 0.76	\$ 0.92
Income from discontinued operations per common share		
Basic	\$ 0.02	\$ 0.09
Diluted	\$ 0.02	\$ 0.09
Net income per common share		
Basic	\$ 0.79	\$ 1.02
Diluted	\$ 0.78	\$ 1.01
Weighted-average number of common shares outstanding		
Basic	543	542
Diluted	548	548

Cash dividends declared per common share	\$ 0.52	\$ 0.49
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The accompanying notes are an integral part of these condensed consolidated financial statements.

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## Baxter International Inc.

## Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three months ended March 31,	
	2015	2014
Net income	\$ 430	\$556
Other comprehensive (loss) income, net of tax:		
Currency translation adjustments, net of tax (benefit) expense of (\$109) and \$4 for the three months ended March 31, 2015 and 2014, respectively	(1,138)	6
Pension and other employee benefits, net of tax expense of \$31 and \$9 for the three months ended March 31, 2015 and 2014, respectively	68	23
Hedging activities, net of tax (benefit) of (\$7) and (\$6) for the three months ended March 31, 2015 and 2014, respectively	(10)	(10)
Other, net of tax expense of \$9 and \$3 for the three months ended March 31, 2015 and 2014, respectively	21	11
Total other comprehensive (loss) income, net of tax	(1,059)	30
Comprehensive (loss) income	\$ (629)	\$586

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

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## Baxter International Inc.

## Condensed Consolidated Balance Sheets (unaudited)

(in millions, except shares)

		March 31, 2015	December 31, 2014
Current assets	Cash and equivalents	\$ 2,530	\$ 2,925
	Accounts and other current receivables, net	2,599	2,803
	Inventories	3,501	3,559
	Prepaid expenses and other	1,104	1,064
	Total current assets	9,734	10,351
Property, plant and equipment, net		8,492	8,698
Other assets	Goodwill	3,694	3,874
	Other intangible assets, net	2,068	2,079
	Other	873	915
	Total other assets	6,635	6,868
Total assets		\$24,861	\$25,917
Current liabilities	Short-term debt	\$ 2,151	\$ 913
	Current maturities of long-term debt and lease obligations	174	786
	Accounts payable and accrued liabilities	3,749	4,343
	Total current liabilities	6,074	6,042
Long-term debt and lease obligations		7,680	7,606
Other long-term liabilities		3,819	4,113
Commitments and contingencies			
Equity	Common stock, \$1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2015 and 2014	683	683
	Common stock in treasury, at cost, 139,644,913 shares in 2015 and 141,116,857 shares in 2014	(7,890)	(7,993)
	Additional contributed capital	5,822	5,853
	Retained earnings	13,352	13,227
	Accumulated other comprehensive loss	(4,709)	(3,650)
	Total Baxter shareholders' equity	7,258	8,120
	Noncontrolling interests	30	36
	Total equity	7,288	8,156
Total liabilities and equity		\$24,861	\$25,917

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

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## Baxter International Inc.

## Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

		Three months ended March 31,	
		2015	2014
Cash flows from operations	Net income	\$ 430	\$ 556
	Adjustments		
	Depreciation and amortization	247	236
	Deferred income taxes	46	(17)
	Stock compensation	39	31
	Net periodic pension benefit and OPEB costs	82	71
	Other	(100)	1
	Changes in balance sheet items		
	Accounts and other current receivables, net	12	233
	Inventories	(207)	(233)
	Accounts payable and accrued liabilities	(383)	(278)
	Business optimization and infusion pump payments	(23)	(45)
	Other	(47)	4
	Cash flows from operations	96	559
Cash flows from investing activities	Capital expenditures	(521)	(421)
	Acquisitions and investments, net of cash acquired	(235)	(59)
	Divestitures and other investing activities	(14)	96
	Cash flows from investing activities	(770)	(384)
Cash flows from financing activities	Issuances of debt	900	32
	Payments of obligations	(618)	(510)
	Increase in debt with original maturities of three months or less, net	361	
	Cash dividends on common stock	(282)	(266)
	Proceeds and realized excess tax benefits from stock issued under employee benefit plans	48	138
	Purchases of treasury stock		(250)
	Other	(25)	4
	Cash flows from financing activities	384	(852)
Effect of foreign exchange rate changes on cash and equivalents		(105)	(7)
Decrease in cash and equivalents		(395)	(684)



Cash and equivalents at beginning of period	2,925	2,733
Cash and equivalents at end of period	\$2,530	\$2,049

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

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## Baxter International Inc.

## Notes to Condensed Consolidated Financial Statements (unaudited)

**1. BASIS OF PRESENTATION**

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States have been condensed or omitted. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the company's Annual Report on Form 10-K for the year ended December 31, 2014 (2014 Annual Report).

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

Certain reclassifications have been made to conform the prior period condensed consolidated financial statements to the current period presentation.

Prior to 2015, the company's biosurgery products and services were reported in the BioScience segment. As a result of the planned spin-off of the biopharmaceuticals business, the company realigned its biosurgery products and services to the Medical Products segment. Effective January 1, 2015, the company changed its segment presentation to reflect this new structure, and recast all prior periods presented to conform to the new presentation.

**Vaccines discontinued operations**

In July 2014, the company entered into an agreement with Pfizer Inc. to sell its commercial vaccines business and committed to a plan to divest the remainder of its Vaccines franchise, which includes certain R&D programs. In December 2014, the company completed the divestiture of the commercial vaccines business. In the first quarter of 2015, the company recorded an after-tax gain of \$9 million as a result of a purchase price adjustment. In December 2014, the company also entered into a separate agreement for the sale of the remainder of the Vaccines franchise. As a result of the divestitures, the operations and cash flows of the Vaccines franchise will be eliminated from the ongoing operations of the company.

Following is a summary of the operating results of the Vaccines franchise, which have been reflected as discontinued operations for the three months ended March 31, 2015 and 2014.

(in millions)	Three months ended	
	March 31,	
	2015	2014
Net sales	\$ 1	\$103
Income before income taxes	11	56
Income tax expense	1	7

Net income	\$10	\$ 49
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**Planned spin-off of biopharmaceuticals business**

In March 2014, Baxter announced plans to create two separate, independent global healthcare companies – one focused on developing and marketing innovative biopharmaceuticals and the other on life-saving medical products. The transaction is intended to take the form of a tax-free distribution in the United States to Baxter shareholders of more than 80% of the publicly traded stock in the new biopharmaceuticals company. The transaction is expected to be completed by mid-year 2015, subject to market, regulatory and certain other conditions, including final approval by the Baxter Board of Directors, receipt of a favorable opinion and/or rulings in the United States with respect to the tax-free nature of the transaction, and the effectiveness of a Form 10 registration statement that has been filed with the SEC. Upon separation, the historical results of the biopharmaceuticals business will be presented as discontinued operations.

**Table of Contents****New accounting standards**

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which amends the existing accounting standards for revenue recognition. ASU 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers. ASU No. 2014-09 will be effective for the company beginning on January 1, 2017. Early adoption is not permitted. The new revenue standard may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of adoption. In April 2015, the FASB issued an exposure draft that would delay the effective date of the standard by one year and allow early adoption as of the original effective date. The company is currently evaluating the impact of adopting the new revenue standard on its consolidated financial statements.

**2. SUPPLEMENTAL FINANCIAL INFORMATION****Net interest expense**

(in millions)	Three months ended March 31,	
	2015	2014
Interest expense, net of capitalized interest	\$35	\$48
Interest income	(5)	(5)
Net interest expense	\$30	\$43

**Inventories**

(in millions)	March 31,	December 31,
	2015	2014
Raw materials	\$ 859	\$ 910
Work in process	1,107	1,126
Finished goods	1,535	1,523
Inventories	\$3,501	\$3,559

**Property, plant and equipment, net**

(in millions)	March 31,	December 31,
	2015	2014
Property, plant and equipment, at cost	\$14,366	\$14,808
Accumulated depreciation	(5,874)	(6,110)
Property, plant and equipment (PP&E), net	\$ 8,492	\$ 8,698

**3. EARNINGS PER SHARE**

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

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

(in millions)

Three months ended  
March 31,  
2015