INTERNATIONAL BUSINESS MACHINES CORP
Form 8-K
January 17, 2002

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

FORM 8-K

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

Date of Report: January 17, 2002
(Date of earliest event reported)

INTERNATIONAL BUSINESS MACHINES CORPORATION
(Exact name of registrant as specified in its charter)

New York	1-2360	13-0871985
(State of Incorporation)	(Commission File Number)	(IRS employer Identification No.)

ARMONK, NEW YORK	10504
(Address of principal executive offices)	(Zip Code)

914-499-1900
(Registrant's telephone number)

Item 5. Other Events

The registrant's press release dated January 17, 2002, regarding its financial results for the periods ended December 31, 2001, including unaudited consolidated financial statements for the periods ended December 31, 2001, is Attachment I of this Form 8-K.

Attachment II of this Form 8-K is IBM's Chief Financial Officer John R. Joyce's fourth quarter earnings presentation to securities analysts on Thursday, January 17, 2002.

IBM's web site (www.ibm.com) contains a significant amount of information about IBM, including financial and other information for investors (www.ibm.com/investor/). IBM encourages investors to visit its various web sites from time to time, as information is updated and new information is posted.

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, hereunto duly authorized.

Date: January 17, 2002

By: /s/ Mark Loughridge

(Mark Loughridge)
Vice President and Controller

ATTACHMENT I

ARMONK, N.Y., January 17, 2002 . . . IBM today announced fourth-quarter 2001 diluted earnings per common share of $1.33, a 10 percent decrease compared with diluted earnings per common share of $1.48 in the fourth quarter of 2000. Fourth-quarter 2001 net income was $2.3 billion, a 13 percent decrease from $2.7 billion in the year-earlier period. IBM's fourth-quarter 2001 revenues totaled $22.8 billion, down 11 percent (8 percent at constant currency) compared with the fourth quarter of 2000.

Louis V. Gerstner, Jr., IBM chairman and chief executive officer, said: "This was a solid finish to a demanding year. We achieved strong profitability and we continued to gain market share in high-priority segments of our software, storage and server businesses. For example, our new 'Regatta' UNIX servers, which didn't begin shipping until late in the quarter, are sold out. On a full-year basis, our mainframe revenues grew for the first time since 1989. Our services business also had over $15 billion in new signings, although many of these signings also came very late in the quarter, reflecting the tough business environment. We also once again demonstrated exceptional management of our cost and expense structure, and we ended the year with very powerful free cash flow.

"We had our share of challenges, too, but these were largely expected: slow PC sales and ongoing weakness in our OEM business. Our overall revenue decline came principally from these two units, and we've taken a number of actions to improve our long-term competitiveness in these areas. As we have demonstrated time after time, our diverse business portfolio allows us to overcome weakness in certain areas and still deliver strong results.

"Business conditions remain difficult as we enter the new year, although we believe that our business will strengthen as we move through the year," Mr. Gerstner said. "Further, and most important, we have absolutely no doubt that customer buying patterns throughout the world are continuing to shift in IBM's favor. Customers increasingly are demanding fully integrated technology -- not the latest single-function offerings from the piece-part makers -- and that plays directly to IBM's strengths in e-business software, in powerful, secure servers, and in our unparalleled global services capabilities."

In the Americas, fourth-quarter revenues were $9.8 billion, a decrease of 9 percent (8 percent at constant currency) from the 2000 period. Revenues from Europe/Middle East/Africa were $6.9 billion, down 6 percent (6 percent at constant currency). Asia-Pacific revenues declined 10 percent (1 percent at constant currency) to $4.5 billion. OEM revenues decreased 34 percent (33 percent at constant currency) to $1.6 billion compared with the fourth quarter of 2000.

Revenues from Global Services, including maintenance, declined 1 percent (up 1 percent at constant currency) in the fourth quarter to $9.1 billion. Global Services revenues, excluding maintenance, declined 2 percent (up 1 percent at constant currency). New contract signings for Global Services in the fourth quarter were approximately $15 billion. IBM's total services backlog at year-end 2001 was $102 billion. Overall, the gross profit margin for Global Services improved 1.2 points year over year to 28.2 percent.

Hardware revenues decreased 24 percent (21 percent at constant currency) to $8.7 billion from the 2000 fourth quarter. Revenues from z900 mainframe servers were essentially flat, reflecting a difficult year-over-year comparison. Mainframe computing capacity grew 12 percent in the fourth quarter as measured in MIPS (millions of instructions per second). Revenues from IBM's UNIX-based pSeries declined, in large part because of a transition to IBM's new "Regatta" family of UNIX servers, which began shipping on December 14. Personal computer and microelectronics revenues decreased substantially over the prior year's quarter, principally due to price pressures in PCs and an ongoing downturn affecting the worldwide semiconductor and OEM markets. Revenues from IBM's high-end storage product line -- Shark -- grew in a declining market.

Software revenues increased 6 percent (8 percent at constant currency) to $3.8 billion compared to the prior year's fourth quarter. Overall, IBM's middleware software revenues grew 10 percent at constant currency. IBM's premier data management and WebSphere products grew 48 percent and 43 percent, respectively. Operating system revenues fell 2 percent. The company's total gross profit margin in software improved 1.8 points, to 85.2 percent.

Global Financing revenues decreased 5 percent (4 percent at constant currency) in the fourth quarter to $927 million. As expected, revenues from the Enterprise Investments/Other area, which includes products for specialized customer uses, declined 20 percent (18 percent at constant currency) compared to the fourth quarter of 2000 to $340 million. IBM has been consistently shifting development and distribution of products in this segment to third-party companies.

The company's total gross profit margin improved to 38.3 percent in the 2001 fourth quarter from 37.3 percent in the 2000 fourth quarter.

Despite absorbing workforce-balancing actions and writedowns of certain equity investments, IBM's total expenses improved 6 percent year over year to $5.4 billion. The improvement came from each of the company's two main expense categories: selling, general and administrative expenses as well as research and development expenses. IBM continued to reduce its expenses and improve operating efficiencies through the use of electronic procurement, sales, education and customer support systems. These systems -- known as e-procurement, IBM.com, e-learning and e-Care -- have resulted in substantial productivity improvements.

IBM's tax rate in the fourth quarter was 29.3 percent compared with 29.5 percent in the fourth quarter of 2000.

IBM spent approximately $1.0 billion on share repurchases in the fourth quarter. The average number of basic common shares outstanding in the quarter was 1.72 billion compared with 1.75 billion shares in the same period of 2000.

Full-year 2001 Results

Net income for the year ended December 31, 2001 was $7.7 billion, or $4.35

per diluted common share, compared with net income of $8.1 billion, or $4.44 per diluted common share, in 2000. Revenues in 2001 totaled $85.9 billion, a decline of 3 percent (up 1 percent at constant currency) compared with revenues of $88.4 billion in the year-earlier period.

In the Americas, full-year revenues were $37.4 billion, down 3 percent (2 percent at constant currency) from the 2000 period. Revenues from Europe/Middle East/Africa were $24.0 billion, a decrease of 1 percent (up 3 percent at constant currency). Asia-Pacific revenues fell 2 percent (up 8 percent at constant currency) to $17.2 billion. OEM revenues decreased 7 percent (6 percent at constant currency) to $7.2 billion.

Revenues from Global Services totaled $35.0 billion, an increase of 5 percent (10 percent at constant currency). Hardware revenues in 2001 were $33.4 billion, a decrease of 12 percent (8 percent at constant currency). Software revenues totaled $12.9 billion, an increase of 3 percent (7 percent at constant currency). Global Financing revenues totaled $3.4 billion, a decrease of 1 percent (up 1 percent at constant currency). Revenues from the Enterprise Investments/Other area declined 18 percent (14 percent at constant

currency) to $1.2 billion.

Common share repurchases totaled approximately $5.3 billion in 2001. The average number of basic shares outstanding was 1.73 billion in 2001 compared with 1.76 billion in 2000. There were 1.72 billion basic common shares outstanding at December 31, 2001.

IBM completed 2001 with $6.4 billion in cash, after major expenditures which included the share repurchases, capital investments of $5.6 billion and an 8 percent dividend increase.

The company's debt in support of operations, excluding global financing, increased $543 million from year-end 2000 to $1.6 billion, resulting in a debt-to-capitalization ratio of 7 percent at the end of 2001. Global financing debt declined $2.0 billion from year-end 2000 to a total of $25.5 billion, resulting in a debt-to-equity ratio of 6.8 to 1.

Forward-Looking and Cautionary Statements

Except for the historical information and discussions contained herein, statements contained in this release may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve a number of risks, uncertainties and other factors that could cause actual results to differ materially, as discussed in the company's filings with the Securities and Exchange Commission.

Financial Results Attached

INTERNATIONAL BUSINESS MACHINES CORPORATION
COMPARATIVE FINANCIAL RESULTS
(Dollars in millions except per share amounts)

	Three Months Ended December 31,			Twelve Months Ended December 31,		
			Percent			Percent

	2001	2000*	Change	2001	2000*	Change
REVENUE						
Global Services	$9,061	$9,186	-1.4%	$34,956	$33,152	5.4%
Gross margin	28.2%	27.0%		27.5%	26.7%	
Hardware	8,714	11,463	-24.0%	33,392	37,777	-11.6%
Gross margin	26.3%	30.4%		27.7%	28.4%	
Software	3,784	3,571	6.0%	12,939	12,598	2.7%
Gross margin	85.2%	83.4%		82.5%	81.9%	
Global Financing	927	971	-4.6%	3,426	3,465	-1.1%
Gross margin	55.4%	42.9%		50.6%	43.3%	
Enterprise Investments/ Other	340	425	-20.0%	1,153	1,404	-17.9%
Gross margin	45.8%	44.9%		45.0%	46.8%	
TOTAL REVENUE	22,826	25,616	-10.9%	85,866	88,396	-2.9%

GROSS PROFIT	8,745	9,553	-8.4%	31,782	32,054	-0.9%
Gross margin	38.3%	37.3%		37.0%	36.3%	
EXPENSE						
S,G&A	4,176	4,340	-3.8%	15,490	15,639	-1.0%
% of revenue	18.3%	16.9%		18.0%	17.7%	
R,D&E	1,263	1,449	-12.8%	5,006	5,151	-2.8%
% of revenue	5.5%	5.7%		5.8%	5.8%	
Other income	(48)	(125)	-62.4%	95	(617)	-115.4%
Interest expense	54	102	-47.3%	238	347	-31.4%
TOTAL EXPENSE	5,445	5,766	-5.6%	20,829	20,520	1.5%
% of revenue	23.9%	22.5%		24.3%	23.2%	
INCOME BEFORE INCOME TAXES	3,300	3,787	-12.9%	10,953	11,534	-5.0%
Pre-tax margin	14.5%	14.8%		12.8%	13.0%	
Provision for income taxes	967	1,117	-13.4%	3,230	3,441	-6.1%
Effective tax rate	29.3%	29.5%		29.5%	29.8%	
NET INCOME	$2,333	$2,670	-12.7%	$7,723	$8,093	-4.6%
Net margin	10.2%	10.4%		9.0%	9.2%	
Preferred stock dividends	0	5		10	20	

NET INCOME APPLICABLE TO COMMON STOCKHOLDERS	$2,333	$2,665	-12.5%	$7,713	$8,073	-4.5%
EARNINGS PER SHARE OF COMMON STOCK - ASSUMING DILUTION	$1.33	$1.48	-10.1%	$4.35	$4.44	-2.0%
EARNINGS PER SHARE OF COMMON STOCK - BASIC	$1.35	$1.52	-11.2%	$4.45	$4.58	-2.8%
AVERAGE NUMBER OF COMMON SHARES OUT-STANDING (M's)						
DILUTED	1,758.0	1,790.6		1,771.2	1,812.1	
BASIC	1,722.4	1,749.2		1,733.3	1,763.0	

* Reclassified to conform with 2001 presentation.

INTERNATIONAL BUSINESS MACHINES CORPORATION
CONSOLIDATED STATEMENT OF FINANCIAL POSITION

(Dollars in millions)	At December 31, 2001	At December 31, 2000	Percent Change
ASSETS			
Cash, cash equivalents, and marketable securities	$6,393	$3,722	71.8%
Receivables - net, inventories, and prepaid expenses	36,068	40,158	-10.2%
Plant, rental machines, and other property - net	16,504	16,714	-1.3%
Investments and other assets	29,348	27,755	5.7%
TOTAL ASSETS	$88,313	$88,349	-0.0%
LIABILITIES AND STOCKHOLDERS' EQUITY			
Short-term debt	$11,188	$10,205	9.6%
Long-term debt	15,963	18,371	-13.1%
Total debt	27,151	28,576	-5.0%

Accounts payable, taxes, and accruals	23,931	26,201	-8.7%
Other liabilities	13,617	12,948	5.2%
TOTAL LIABILITIES	64,699	67,725	-4.5%
STOCKHOLDERS' EQUITY	23,614	20,624	14.5%
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$88,313	$88,349	-0.0%

INTERNATIONAL BUSINESS MACHINES CORPORATION
SEGMENT DATA

	FOURTH QUARTER 2001				
(Dollars in millions)	Revenue External	Revenue Internal	Revenue Total	Pre-tax Income	Pre-tax Income Margin
SEGMENTS					
Global Services	$9,061	$724	$9,785	$1,413	14.4%
% change	-1.4%	22.7%	0.1%	8.4%	
Technology	1,879	530	2,409	(293)	-12.2%
% change	-30.2%	-36.5%	-31.7%	-200.7%	
Personal and Printing Systems	2,910	23	2,933	(17)	-0.6%

% change	-32.0%	-11.5%	-31.9%	-116.2%	
Enterprise Systems	4,074	163	4,237	719	17.0%
% change	-13.2%	-6.3%	-13.0%	-18.0%	
Software	3,784	295	4,079	1,167	28.6%
% change	6.0%	26.6%	7.2%	21.4%	
Global Financing	921	189	1,110	265	23.9%
% change	-5.5%	-24.1%	-9.3%	-8.0%	
Enterprise Investments	336	2	338	(74)	-21.9%
% change	-21.9%		-21.4%	14.9%	
TOTAL SEGMENTS	22,965	1,926	24,891	3,180	12.8%
% change	-11.1%	-8.6%	-10.9%	-14.9%	
Eliminations / Other	(139)	(1,926)	(2,065)	120	

TOTAL IBM	$22,826	$0	$22,826	$3,300	14.5%
% change	-10.9%		-10.9%	-12.9%	

FOURTH QUARTER 2000*

(Dollars in millions)	Revenue External	Revenue Internal	Total	Pre-tax Income	Pre-tax Income Margin
SEGMENTS					
Global Services	$9,186	$590	$9,776	$1,303	13.3%
Technology	2,693	835	3,528	291	8.2%
Personal and Printing Systems	4,278	26	4,304	105	2.4%
Enterprise Systems	4,694	174	4,868	877	18.0%
Software	3,571	233	3,804	961	25.3%
Global Financing	975	249	1,224	288	23.5%
Enterprise Investments	430	0	430	(87)	-20.2%
TOTAL SEGMENTS	25,827	2,107	27,934	3,738	13.4%
Eliminations / Other	(211)	(2,107)	(2,318)	49	
TOTAL IBM	$25,616	$0	$25,616	$3,787	14.8%

* Reclassified to conform with 2001 presentation.

INTERNATIONAL BUSINESS MACHINES CORPORATION
SEGMENT DATA

TWELVE MONTHS 2001

(Dollars in millions)	Revenue External	Revenue Internal	Total	Pre-tax Income	Pre-tax Income Margin
SEGMENTS					
Global Services	$34,956	$2,647	$37,603	$5,161	13.7%
% change	5.4%	8.5%	5.7%	14.3%	
Technology	7,970	2,325	10,295	(374)	-3.6%
% change	-6.4%	-22.7%	-10.7%	-155.1%	
Personal and Printing Systems	11,982	73	12,055	(153)	-1.3%

% change	-20.6%	4.3%	-20.5%	-251.5%	
Enterprise Systems	13,743	710	14,453	1,830	12.7%
% change	-3.2%	9.4%	-2.6%	-4.8%	
Software	12,939	981	13,920	3,168	22.8%
% change	2.7%	18.5%	3.7%	13.4%	
Global Financing	3,407	836	4,243	1,143	26.9%
% change	-2.7%	-11.4%	-4.5%	-2.8%	
Enterprise Investments	1,118	4	1,122	(317)	-28.3%
% change	-18.3%	33.3%	-18.2%	-6.7%	
TOTAL SEGMENTS	86,115	7,576	93,691	10,458	11.2%
% change	-2.6%	-4.6%	-2.8%	-4.0%	
Eliminations / Other	(249)	(7,576)	(7,825)	495	
TOTAL IBM	$85,866	$0	$85,866	$10,953	12.8%
% change	-2.9%		-2.9%	-5.0%	

TWELVE MONTHS 2000*

(Dollars in millions)	Revenue External	Revenue Internal	Revenue Total	Pre-tax Income	Pre-tax Income Margin
SEGMENTS					
Global Services	$33,152	$2,439	$35,591	$4,517	12.7%
Technology	8,519	3,007	11,526	679	5.9%
Personal and Printing Systems	15,098	70	15,168	101	0.7%
Enterprise Systems	14,194	649	14,843	1,922	12.9%
Software	12,598	828	13,426	2,793	20.8%
Global Financing	3,500	944	4,444	1,176	26.5%
Enterprise Investments	1,369	3	1,372	(297)	-21.6%
TOTAL SEGMENTS	88,430	7,940	96,370	10,891	11.3%
Eliminations / Other	(34)	(7,940)	(7,974)	643	
TOTAL IBM	$88,396	$0	$88,396	$11,534	13.0%

* Reclassified to conform with 2001 presentation.

ATTACHMENT II

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IBM 4Q 2001
EARNINGS PRESENTATION

JANUARY 2002

Thank you, Mandy. Good afternoon. This is Hervey Parke, Vice President of Investor Relations for IBM, thank you all for joining us. Let me quickly give you a few pieces of information.

At this time, the opening page of the presentation should have automatically loaded and you should be on Chart 1, the title page.

After the last chart in the presentation we will provide you an index to go back to specific slides during the Q&A. Or, you can jump to the index at any time by clicking on the index link located on the navigation bar on the left side of your screen.

For printing slides, there are two alternatives:

As in the previous quarter, there is a link on the index pages so you can download the entire set of charts for printing.

Or, there is a link on the navigation bar so you can download the charts at any time.

In about 45 minutes, you will also be able to link to the prepared remarks off that same navigation bar.

And finally, a replay of this webcast will be available on this website by this time tomorrow.

Now, please click on the NEXT button and move to Chart 2.

Certain comments made by John Joyce or myself during this call may be characterized as forward looking under the Private Securities Litigation Reform Act of 1995.

Those statements involve a number of factors that could cause actual results to differ materially.

Additional information concerning these factors is contained in the company's filing with the SEC. Copies are available from the SEC, from the IBM web site, or from us in Investor Relations.

Now, please click again on the NEXT button for Chart 3.

And at this time, let me turn the call over to John Joyce, IBM's Senior Vice President and Chief Financial Officer.

Thanks, Hervey. Good afternoon.

It has been a tough year, but our 4th-quarter results once again were strong relative to our competitors in the technology sector.

- Nearly $23 billion in revenues
- $2.3 billion in after-tax profit,
- And for the full year, $7.4 billion in Free Cash Flow. We ended the

year with $6.4 billion in cash.

And, we continued to gain share.

Year-to-year, our 4th-quarter revenue declined, reflecting a difficult economic environment, worldwide. But all of the decline at constant currency was due to two heavily distressed segments, PCs and OEM Technology.

As always, we benefited from the breadth of our portfolio.

Back in October, we were asked about our ability to grow earnings per share sequentially by nearly 50% from the 3rd quarter to the 4th quarter to achieve average Street expectations, despite the difficult economic environment.

We said it was achievable if we could get the same sales yield from our pipeline that we realized in the difficult 3rd quarter. I'm happy to report that we executed well and hit that EPS growth target.

Of course, as is so often the case, areas of strength offset areas of weakness. And in the 4th quarter --

- We did better than we expected in zSeries mainframes, our new Regatta server in pSeries, and in Software.

- We had weaker results than anticipated in our Technology Group and in our PC Division.

There's an important point to be made regarding this tradeoff, a very important point:

  - The weak revenue performance of the PCs and HDDs, both down about 35% year-to-year, has little bearing on our earnings per share.
  - Strong performance in zSeries and software is very helpful.
  - So you can see how our revenue performance in the quarter was less than expected, but EPS was on track.

I also want to address Global Services here. While the revenue grew just 1% at constant currency, the underlying dynamics point to good growth in 2002.

We were pleased with our 4th-quarter signings. Over $15 billion, which was up 54% from the 3rd quarter and 22% from last year's 4th quarter.

We had indicated in October that our pipeline was as big as we'd ever seen it. That's still the case, but our customers have been very careful about their decisions, given the economic environment. So while our signings have been big, customer decisions came late in the quarter, and this defers the start of that revenue until the 1st quarter.

Also in 2002, the annuity-like portions of Global Services - Outsourcing and Maintenance, should sustain us until the more transaction-based contracts return to their historical growth rates with the economy recovering.

So we feel very good about our Services business, our strategy, and our position in the marketplace. In a year of uncertain economic growth, Services should benefit early from recent Outsourcing signings, and then pick up further speed in the 2nd half with the more economically sensitive Consulting businesses.

The 4th quarter was a solid finish to a demanding year.

- Particularly in Software, and in Services signings, these two segments generated nearly 80% of our profit in the 4th quarter.
- We had sustained, strong customer demand for our zSeries mainframe and a fast start for our new pSeries Regatta.
- Our R&D efforts have produced products that are extending our competitive lead, and patents that will ensure that leadership remains.
- We continued to manage cost and expense with a proper balance between current results and future opportunity.
- And we generated strong cash flow in support of our business model.

Before I get into the details of the 4th quarter, let me hit some key points about how we see 2002.

We said last quarter, it is largely an economic call.

- Most analysts seem to feel that a slow recovery will start around midyear.

- And customers are still taking a careful look at all of their investments. But they continue to spend on applications and products that provide the fastest returns, and they're building cost-efficient infrastructures. We've got the solutions they're looking for.

But also, in this environment, we have been taking some pretty tough actions which will yield results in 2002.

- We've made excellent progress on our objective of reducing indirect expense by $2 billion by the end of 2002, cutting over a billion in 2001. And we're reinvesting these savings in direct expense that can drive future revenue and share gain.

- In addition, we've been focusing on our Technology Group and our PC Group which, between the two of them, lost over $500 million in 2001.

  We've rebalanced our resources in both of them, and in our PC Division, we continued to tighten our business model by

  contracting to outsource assembly and distribution of our desktop PC line.

  We should be able to improve our results in these units regardless of the economy.

With our cost-cutting actions, in combination with our strong business model, our share gains in key segments, and our strong balance sheet, we feel there are few companies as well positioned to address the coming year as IBM.

And at this early stage of the year, we feel that the consensus estimate for earnings per share in 2002 is reasonable.

Now let's get into the details of the 4th-quarter results. Click on the NEXT button for Chart 4.

Here's the quick financial overview of the 4th quarter:

- Revenue, at $22.8 billion was up 12% sequentially from the 3rd quarter.

  Year-to-year, it was down 8% at constant currency, and 11%, as reported, driven entirely by OEM and PCs.

  So with the weakening Yen, currency was about a two-and-a-half-point hit, about a point worse than the spot rates suggested three months ago.

  Let me just note here that based on current spot rates, the negative effect of currency on revenue for the 1st quarter would still be about 2 points.

- Pretax income was down 13%, compared to the 19% decline last quarter, and again principally due to the slowdown in our Technology OEM businesses.

- Our tax rate was 29.3%, down two tenths of a point from a year ago.

  Our full-year tax rate was at 29.5%, down 3 tenths of a point from 2000.

- Average diluted shares outstanding for the quarter were 1 billion, 758 million, down 1.8% from last year.

- And earnings per share were $1.33, down 15 cents or 10%.

  In these 4th-quarter results we've absorbed currency, workforce-rebalancing initiatives, and a minor equity write-down. These three factors contributed about 12 cents to our 15-cent year-to-year decline.

We've included our full-year results on these charts, and let me use this one to put our results in perspective:

The economy created a lot of turmoil in 2001.

- Corporate profits declined dramatically.
- Many of our competitors in the IT sector lost money.

But...

- At constant currency, IBM's revenue actually grew in 2001, and
- We generated $11 billion of pretax profit, with the vast majority of that coming from Services and Software.

Now, let's turn to Revenue in the 4th quarter, starting with a geographic perspective. Click the NEXT button for Chart 5.

Over 90% of our revenue comes from sales to end-user customers, which we break into three geographic areas.

On a year-to-year basis, at constant currency, they were down 6%.

- The Americas declined 8%, driven by the Industrial, Communications, and Distribution sectors.

- o Europe declined 6%, with almost no currency impact. The Financial Services sector was weak, notably in Germany, but the Automotive sector did well, due to Services.

- o Asia Pacific declined 1%, before 9 points of currency impact. Here again, the Communications sector was weak, but the Financial Services and Automotive sectors were strong, also due to Services.

- o Across all geographies, the Public Sector was strong, but the small and medium businesses were weak, since they were heavily impacted by the PC revenue decline.

Finally, our OEM business -- which had declined 22% from 2nd to 3rd quarter, started to show a little life by growing 7% from the 3rd to the 4th quarter. Still, on a year-to-year basis OEM revenue declined 34% in the 4th quarter.

In our Microelectronics business, our OEM customers made a little more progress in working off inventory in addition to generating some sequential revenue growth.

And in our hard disk drive business, industry demand remained weak, due to continued weakness in PC volumes.

Now, if you'll click on the Next button for Chart 6, I'll touch on Revenue by major line item.

Let me start with Global Services.

Revenue was $9.1 billion, growing 1% year-to-year at constant currency, and 4% sequentially from the 3rd quarter.

Our annuity-like Outsourcing and Maintenance businesses continued to do well, but we felt the economic pressure in Consulting and Systems Integration as did the rest of the industry.

Hardware revenue in the 4th quarter was $8.7 billion, a 21% decline at constant currency.

The new Regatta UNIX server got off to a fast start. Shark storage subsystems grew in a very weak market. And despite a very difficult comparison base, our zSeries mainframes grew revenue for the 5th quarter in a row.

However, as I mentioned -- our OEM businesses -- Microelectronics and hard disk drives continued to have significant year-to-year revenue declines, despite slight sequential-quarter growth. PCs declined significantly.

Software, at $3.8 billion, grew 8% at constant currency.

We had strong performance across all geographies, gaining more share on our competitors, particularly in Data Management and WebSphere.

Global Financing revenue at $927 million, declined 4% at constant currency.

Income-generating assets were down from last year, and financing originations were $5.3 billion in the quarter.

Now let's review gross profit margin, Chart 7.

Total gross profit margin for the 4th quarter was 38.3%, up a point from last year, and up 2 points from the 3rd quarter.

Gross margin improved in each revenue segment except hardware which declined by 4 points.

This decline in hardware was about the same as in the 3rd quarter, and for the same reason, low volumes in our technology group and pricing pressures in PCs and hard disk drives.

Global Services gross profit margin improved 1.2 points.

Maintenance improved, and Services was stable.

Software gross profit margin improved 1.8 points.

And our Global Financing gross profit margin improved 12 points, reflecting a downward trend in interest rates.

Now let's turn to Expense, Chart 8.

Total expense was $5.4 billion, down 6% from last year.

SG&A decreased 4%, and R&D decreased 13%, primarily driven by the integration of Lotus and Tivoli into our Software business.

We continued to cut discretionary expense like travel and consulting.

But also underneath this, is the billion-dollar reduction in infrastructure expenses we've made this year.

As we reduced these expenses, we continued to increase investments in key areas where we can leverage our leadership, like development and sales for Software, Services, Servers and Storage.

Let me add that our intellectual property income and licensing royalties were flat in the quarter, which included the sale of our optical transceiver business to JDS Uniphase. For the year, IP was down about $200 million.

And finally, we continue to invest in Information Technology to improve our own efficiency in procurement and customer support.

As you can see, we're watching expense carefully. But the strength of our business model is that we are not forced to eliminate important programs during a period of weak revenues.

Now before we move on, let me touch on some issues that have been raised for all companies in 2002 that are mainly noncash items, notably:

- Goodwill accounting changes
- Adjustments to pension accounting assumptions
- Equity investment write-downs, and
- Currency hedges.

For IBM, based on what we know now, it's reasonable to assume that the net effect of these items on year-to-year earnings will not be material.

Now let's move to Cash Flow, Chart 9.

Cash flow was strong in 2001.

We generated $7.4 billion of Free Cash Flow, slightly more that last year.

Our ongoing focus on working capital management continued to yield results.

This continued strong cash flow, even in a difficult economic environment, gave us the flexibility to make necessary, appropriate investments for the future of our business or for share repurchases.

$5.6 billion on gross capital expenditures, mainly for our Services and Financing businesses, as well as in selected hardware businesses, like Microelectronics.

$5.6 billion in research and development investments, that contributed to the ninth year in a row of our leading the world in generating new patents.

A billion dollars for acquisitions -- principally Informix.

$1 billion in dividends to our shareholders.

And $5.3 billion dollars in stock buyback.

This is real cash flow.

Now let's look at the Balance Sheet, Chart 10.

The balance sheet remains very healthy.

Cash on the balance sheet stands at $6.4 billion, $2.7 billion above last year's level.

Total debt decreased $1.4 billion.

94% of our debt is for our Global Financing business, which was leveraged at a comfortable 6.8 to 1.

The remaining $1.6 billion of Core Debt stands at a conservative 7% debt-to-capital.

As I've said in previous quarters, this is not the environment to have growing inventories or accounts receivables.

Both are down year-to-year.

The management of our balance sheet and cash flow is taken very seriously and is a key focus. Our asset and debt levels demonstrate that we are executing well.

Now let me turn to a discussion of some of our individual businesses, starting with Global Services, Chart 11.

Global Services, at $9.1 billion, was up 1% at constant currency.

Signings were over $15 billion, up 22%. We had:

- 14 deals greater than $100 million,
- of which two were a billion dollars or more.
- We had over $600 million of web-hosting signings, up 45%, bringing our total web-hosting signings to $2.4 billion this year.

Our backlog now stands at $102 billion.

In revenue, Maintenance was up 2%, and Services was up 1%.

Services revenue growth slowed this quarter due to:

- A slowdown in Consulting and Systems Integration,
- Slower signings back in the middle of the year, and
- The timing of this quarter's signings.

  Several large contracts closed late in the quarter, resulting in lower current-period revenue yield.

  Customers wanted to sign the contracts to start realizing the benefits. But they are just being very careful in this environment.

An important note on signings: While a slowdown in signings in the middle of the year, particularly in short-term engagements, impacted our 4th-quarter revenue, the acceleration in signings in the 4th quarter will contribute to a pickup in 2002.

Now let me review the three major services segments.

First, Outsourcing and e-Sourcing, which is more than 40% of Global Services, grew 6% at constant currency.

- Our strong signings in the 4th quarter, and our strong pipeline of opportunity, demonstrate that customers recognize the need to improve their competitiveness, particularly in this economic environment. They want integrated IT solutions and fast cost savings.

- Outsourcing growth was again strongest in the Asia Pacific region, where our investment in services capabilities has really paid off.

- And Hosting became a billion dollar business for us in 2001.

Next, Integrated Technology Services, which includes product support services and maintenance, is a third of Global Services.

- IT Services, excluding maintenance, was up 4%.

- Services in support of server consolidation and business recovery continued to grow, but,

- Revenue growth has been moderating for services in support of non-IBM hardware deployment, as you would expect with the slowdowns in PCs, telecommunications, and networking equipment providers.

Finally, Business Innovation Services, which includes consulting and systems integration, is slightly less than a quarter of Global Services revenue.

This segment of Services, which is transaction-based, short-term contracts, has been most impacted by the economy.

And yet our B-I-S revenue declined only 6% year-to-year.

- The rate of slowdown varied across the geographies this quarter, but it was most predominant in the Americas.

  Customers were investing less in custom application development and e-business strategy consulting.

- Yet we did have successes. We continued to see year-to-year growth in key e-business areas:

  Supply chain and e-business integration grew significantly, while ERP was up moderately.

  Customers continued to spend on these deployments that yield significant cost savings.

We feel very good about IBM Global Services.

For the year:

- Services revenue grew 11% at constant currency.
- We gained share.
- Our profit margin increased.

We ended the year:

- with a $102 billion backlog
- a strong signings quarter
- solid gross profit margins.

- and a healthy pipeline going into 2002.

  In fact, we just signed a $1.2 billion CRM outsourcing agreement, and an alliance to deploy wireless services, with Nextel.

Looking forward:

- The 4th-quarter signings and converting the strong pipeline into contracts should have a positive impact on 2002 revenue growth.

- We've been through these dynamics before, a slowdown in signings and revenue, followed by a recovery, back with Y2K. But with our skills and capabilities, we will continue to gain share.

- And we expect good growth in 2002

Now, Click on the NEXT button for Chart 12, and I'll discuss eServers and Storage.

In this tough environment, customers continued to be very cautious with their IT spending. We did see continued server consolidation.

Our eServers and storage subsystems, we expect, gained roughly 4 points of market share last year.

zSeries mainframes had their fifth consecutive quarter of revenue growth, a momentum that began with the z900 announcement in October of 2000.

For the year, zSeries revenue grew more than 15%, the first full year of revenue growth since 1989, and a clear recognition of the unique advantages mainframes offer our customers.

Against a very tough comparison, MIPS again grew by double digits, driven by a 35% increase in new application workload, by server consolidation and leveraging Linux. 11% of the MIPS shipped were for Linux.

Later this year, we will bring mainframe functionality to the mid-market, offering our small and medium-sized customers the ability to run new workloads on a z-platform.

pSeries revenue was up more than 35% sequentially, but down nearly 20% when compared to last year's strong 4th quarter.

At the high end, the p690 Regatta, which only began to ship in December, did even better than we expected and was sold out in the quarter.

Entry and mid-range pSeries servers were down significantly year-to-year, yet we still expect to gain share in both of these segments. And, we will further strengthen our technology leadership in these segments by bringing Regatta's Power4 technology to these product lines later this year.

Revenue for the iSeries servers declined, but again we expect to have gained share in the $10 thousand to $1 million server category.

Similar to zSeries, the iSeries benefited from server consolidation and Linux this quarter.

For example, in Japan, a subsidiary of NTT replaced Sun and Oracle with an iSeries model 820, running Linux in a dynamic partition.

ABN AMRO and Caterpillar are two customers who have consolidated multiple servers on iSeries.

xSeries revenue also declined, reflecting the extremely competitive environment in the low-end server market.

In a repeat of the strategy we used in the UNIX market, we are investing in game-changing technologies in IBM's Intel-based servers by adding some of the advanced functions previously available only on high-end servers.

One example is technology developed for mainframes that proactively corrects software and hardware failures before they occur. By reducing repair and downtime, the total cost of ownership is cut by as much as 50% over a five-year period.

Our disk and tape Storage had a good quarter with growth in revenue, margin and profit.

Growth in disk storage was 2% year-to-year, driven by our high-end Shark which grew 6%, in a market declining at approximately 20%.

I have previously spoken with you about our focus on reducing cost and expense, and it is paying off in storage.

Gross margins for Storage increased both sequentially and year-to-year in this fiercely competitive environment.

When I talk with customers, they tell me they're looking for networked storage solutions to help reduce cost. And we're seeing over 65% of Sharks being ordered with network-enabled features.

A recent IDC report shows IBM moving into the number-two position in SAN deployment. This success was driven by our end-to-end focus that includes software, services, interoperability with the leading providers of SAN components, and the strongest lineup of storage hardware we've ever had.

Now click on the NEXT button for Personal and Printing Systems, Chart 13.

Revenue in this Group was down 31% year-to-year at constant currency, although up 4% sequentially from 3rd quarter.

We lost $17 million in this segment in the 4th quarter as we continued to focus on cost, expense and our go-to-market model.

Last quarter 44% of the PC Division's worldwide sales were direct, with 66% in the U.S.

We have a target of 50% worldwide for this division in the 1st quarter.

The improving direct model, continued cost improvements, and initiatives like our recently announced outsourcing agreement with Sanmina-SCI should improve our results.

Now if you'll move to Chart 14, we'll cover Technology.

Revenue for our OEM microelectronics division was down 36% year-to-year, reflecting the continued severe downturn in the semiconductor industry.

We had a modest sequential up-tick from the 3rd quarter, suggesting we've hit the bottom.

Our customers' inventory of IBM components, which had been about $250 million at the end of both the 2nd and 3rd quarters, was down 50 million by the end of the 4th.

Revenue from Hard Disk Drives was also down year-to-year, yet up sequentially from the 3rd quarter.

As we look into the 1st quarter, we expect to start shipping our three new drives in volume:

- our Discovery II server drive
- Cascade, the new mobile drive we announced in November, the industry's highest-capacity 2.5-inch mobile drive. And,
- Vancouver, the new desktop drive also announced in November, the industry's most power-efficient 7200-RPM desktop drive.

Now click on the NEXT button for Software, Chart 15.

Our software business, at $3.8 billion, was up 8% year-to-year at constant currency.

- Middleware, the majority of our software revenue at more than 80% of the total, grew 10%.

- Operating system revenues declined 2%.

This was another excellent quarter for our software business, in a difficult economy, with broad-based market share gains at the expense of our competitors.

Strong momentum in middleware drove our growth. On a full-year basis, middleware was 11 billion of our $13 billion software business.

Data management, our database, tools, business intelligence and content management business, grew 48% this quarter.

- DB2 database grew 13% in head-to-head growth against our competition,
- And database tools were up 62%.
- Informix also contributed to our growth, and the acquisition is exceeding our expectations. In the 4th quarter alone, 10,000 Informix customers recommitted to IBM, including Sears, Wal-Mart, MBNA and Motorola.

WebSphere, our e-infrastructure middleware, grew 43% this quarter.

- This was significantly faster than any of the competition.
- Giga estimated that, with our share gains in 2001, WebSphere is in a dead heat with BEA for the industry lead.
- We are winning market share through head-to-head benchmarks.
- 50,000 paying customers; 600,000 active developers; 9,000 applications; and 7,000 certified solution providers are driving this tremendous success.
- And our technology leadership will continue to advance with the acquisition of CrossWorlds that was successfully completed this month.

- Although 4th-quarter revenue was down year-to-year in our Tivoli and Lotus businesses, both units had strong growth sequentially. And we are seeing benefits of our restructuring, with improved profitability in both units.

The strong sequential growth in these units was driven by our regenerated product portfolio.

In Tivoli:

- Security software revenue doubled sequentially.

- And storage management software revenue grew 60% sequentially.

In Lotus, we are leveraging an 85-million-seat Notes base to fuel growth in next generation collaboration.

- Advanced collaboration software, including Sametime and Quickplace, nearly doubled sequentially.

- And in eLearning, IBM delivered distance learning solutions to twice the number of customers as the nearest competitor.

We also had success across platforms:

- Middleware software grew 5% year-to-year on UNIX and NT, while many of our competitors experienced flat or declining revenues.

- Server consolidations for total cost of ownership savings, and our tools business, continue to be growth drivers on host platforms. Middleware on host platforms grew 16% this quarter.

  We continue to aggressively go after the tools market, notably data base and Application Development tools.

Finally, our Strategic ISV Alliance strategy continued to expand, driving more than $1.5 billion of total IBM revenue in the 4th quarter, all at the expense of our competitors.

- We signed four new alliances this quarter, with an increased focus on emerging areas such as Life Sciences.

- We now have a total of 74 alliances signed to date.

We are taking tremendous momentum in our software business into 2002, driven by:

- Best-of-breed technology,

- Our ability to deliver integrated e-business solutions across platforms,

- Share gains, and

- A 10,000-person dedicated software sales force, 56,000 business partners, and a Strategic Alliance Program that IDC calls an industry-leading best practice.

Now, if you'll hit the NEXT button, let me summarize my remarks.

For nearly all of our competitors, 2001 was a difficult year.

For IBM, it was a good year.

Yes, the stock performed well. But what's most important are the reasons behind this performance.

What became more evident in 2001 was the financial strength and competitiveness of our business model, including these three key elements:

- First, with the irrational exuberance associated with the dot-com phenomenon behind us, customers are really starting to expect more of their IT vendors.

  They want real integrated business solutions. And it is important to recognize that, when the economy turns, customers are not going to return to that roll-your-own-IT era.

  Building integrated solutions is a unique core strength for IBM.

Many of our competitors are trying to find ways to emulate our capabilities, but it is not something that can be simply acquired. It takes years of investment to build this capability.

- Second, we've gained share in key business segments throughout 2001. We now offer better products and services because we exploit both our industry-leading technology and the knowledge that comes from our multi-platform integration experience.

- And the third point that's become more evident is that having a financial core of annuity-like revenue and profit streams gives us more than just

  stable results. Its associated real cash flow also enables us to continue investing in our growth businesses, further building our lead, while our more market-sensitive competitors must cut investments and overhaul their business models.

Each of these elements is going to serve us very well in 2002.

- The first half of this year, at a minimum, doesn't appear to have a much different economic look to it than what we've just come through.

  So our business model, with its large element of annuity-like profit, is going to retain its advantage.

- And last week, we announced that for the ninth year in a row, IBM was the top producer of patents, far exceeding any of our competitors.

  Using this intellectual property, combined with our ability to build integrated e-business solutions, we expect to gain more share in 2002.

- And most important of all, when the economy picks up, customers will reaccelerate their IT investments in the tough work of building resilient infrastructures and real e-business solutions.

  Our study of 33,000 companies showed that their CEOs and CIOs are going to want integration, not just pieceparts.

2002 is going to be another demanding year, and a tough one to forecast.

Strategists and security analysts are quite undecided about what to expect of earnings growth for the market as a whole, and for the technology sector in particular.

But I said in my opening remarks that we think the consensus for IBM's earnings per share is reasonable, despite the challenging environment. That view rests on three fundamentals:

- As we start the year, we've already got about half of our earnings under contract.

- And we expect that improving our cost structure in our technology group and our PC division can make significant contributions to growing earnings.

- Finally, we expect to gain share in key segments like Software, Services, Storage, and Servers, just as we did in 2001.

There's a notion out there that history will repeat itself, that high-beta stocks may come back when the economy turns. But there will be no telecoms or dot-coms with open checkbooks waiting for them, just traditional companies working hard to improve their competitiveness, our kind of customers.

So 2002 will be another good year to have:

- A strong business model
- Competitive products and services that can gain share, and
- A strong balance sheet and cash flow.

IBM's strategy, our focus and our value proposition are more relevant today than ever.

Now Hervey and I will take your questions.

Thanks, John.

Now, if you'll all go to the next chart, you'll find an index of all our slides that may be helpful during the Q&A.

Before I turn the call over to the operator to give you polling instructions, let me request that you refrain from multi-part questions, to give others some time. As always, we are on a tight schedule.

OK, Mandy -- let's get started.

-1-

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IBM 4Q 2001
EARNINGS PRESENTATION

JANUARY 2002

-2-

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Certain comments made in this presentation may be characterized as forward looking under the Private Securities Litigation Reform Act of 1995.

Those statements involve a number of factors that could cause actual results to differ materially.

Additional information concerning these factors is contained in the Company's filing with the SEC. Copies are available from the SEC, from the IBM web site, or from IBM Investor Relations.

-3-

[LOGO] IBM

-4-

IBM 4Q 2001 RESULTS

($B)	4Q01	B/(W) Yr/Yr	FY01	B/(W) Yr/Yr
Revenue - as reported	22.8	(11%)	85.9	(3%)
@cc		(8%)		1%
GP%	38.3%	1.0 pts	37.0%	0.7 pts
E/R%	23.9%	(1.4 pts)	24.3%	(1.1 pts)
Pre-tax Income	3.3	(13%)	11.0	(5%)
Pre-tax Income Margin	14.5%	(0.3 pts)	12.8%	(0.2 pts)
Tax Rate%	29.3%	0.2 pts	29.5%	0.3 pts
Net Income	2.3	(13%)	7.7	(5%)
Net Income Margin	10.2%	(0.2 pts)	9.0%	(0.2 pts)
Average Shares - Diluted (M)	1758.0	1.8%	1771.2	2.3%
EPS - Diluted	$1.33	(10%)	$4.35	(2%)

-5-

IBM 4Q 2001 GEOGRAPHIC REVENUE

($B)	4Q01	B/(W) Yr/Yr Rptd	B/(W) Yr/Yr @CC	FY01	B/(W) Yr/Yr Rptd	B/(W) Yr/Yr @CC	% of Rev FY01
Americas	9.8	(9%)	(8%)	37.4	(3%)	(2%)	44%
Europe/ME/A	6.9	(6%)	(6%)	24.0	(1%)	3%	28%
Asia Pacific	4.5	(10%)	(1%)	17.2	(2%)	8%	20%
OEM	1.6	(34%)	(33%)	7.2	(7%)	(6%)	8%

IBM	22.8	(11%)	(8%)	85.9*	(3%)	1%	100%

* Rounding

-6-

IBM 4Q 2001 REVENUE

($B)	4Q01	B/(W) Yr/Yr Rptd	B/(W) Yr/Yr @CC	FY01	B/(W) Yr/Yr Rptd	B/(W) Yr/Yr @CC	% of Rev FY01
Global Services	9.1	(1%)	1%	35.0	5%	10%	41%
Hardware	8.7	(24%)	(21%)	33.4	(12%)	(8%)	39%
Software	3.8	6%	8%	12.9	3%	7%	15%
Global Financing	0.9	(5%)	(4%)	3.4	(1%)	1%	4%
Enterprise Inv. / Other	0.3	(20%)	(18%)	1.2	(18%)	(14%)	1%
IBM	22.8	(11%)	(8%)	85.9	(3%)	1%	100%

-7-

IBM 4Q 2001 GROSS PROFIT MARGIN

	4Q01	B/(W) Yr/Yr	FY01	B/(W) Yr/Yr
Global Services	28.2%	1.2 pts	27.5%	0.8 pts
Hardware	26.3%	(4.1 pts)	27.7%	(0.7 pts)
Software	85.2%	1.8 pts	82.5%	0.6 pts
Global Financing	55.4%	12.5 pts	50.6%	7.3 pts
Enterprise Inv./Other	45.8%	0.9 pts	45.0%	(1.8 pts)

IBM	38.3%	1.0 pts	37.0%	0.7 pts

-8-

IBM 4Q 2001 EXPENSE SUMMARY

($B)	4Q01	B/(W) Yr/Yr	FY01	B/(W) Yr/Yr
Operating Expenses				
SG&A	4.2	4%	15.5	1%
R&D	1.3	13%	5.0	3%
Net Interest / Other Income	--	NA	0.3	NA
Total Expense	5.4*	6%	20.8	(2%)
E/R%	23.9%	(1.4 pts)	24.3%	(1.1 pts)

*Rounding

-9-

IBM CASH FLOW

($B)	FY00	FY01
Net Income	8.1	7.7
Depreciation/Amortization	5.0	4.8
Working Capital / Other	(0.8)	0.4
Total Operating Sources	12.3	12.9
Capital Expenditures, Net	(4.6)	(5.1)
Other Operating Uses	(0.5)	(0.4)
Total Operating Uses	(5.0)	(5.5)

Free Cash Flow	7.3	7.4
Dividends	(0.9)	(1.0)
Acquisitions	(0.3)	(0.9)
Share Repurchase	(6.7)	(5.3)
Other	0.2	1.1
Global Financing, Net	(0.8)	0.7
Core Debt, Net	(0.9)	0.6
Net Cash Flow	(2.1)	2.7

-10-

IBM BALANCE SHEET

($B)	Dec 1999	Dec 2000	Dec 2001
Cash	5.8	3.7	6.4
Core Assets*	43.6	45.1	46.0
Global Fin. Assets*	38.1	39.6	35.9
Total Assets	87.5	88.3	88.3
Other Liabilities	38.6	39.1	37.5
Core Debt	1.6	1.1	1.6
Global Fin. Debt	26.8	27.5	25.5
Total Debt	28.4	28.6	27.2
Total Liabilities	67.0	67.7	64.7
Equity	20.5	20.6	23.6
Core Debt/Cap	9%	6%	7%
Global Fin. Leverage	5.5	6.6	6.8

*Excluding Cash

-11-

GLOBAL SERVICES

Revenue $9.1B, +1% @CC

Services	+1%		Signings	$ 15B
Maintenance	+2%		Backlog	$102B

- o Strong services business model
  - > Outsourcing and maintenance provide annuity stream
  - > Managing margins well
  - > Full year Services growth of 11%
  - > Healthy 4Q signings, backlog, and pipeline going into 2002

- o Outsourcing and eSourcing up 6%
  - > $1 Billion hostng business in 2001

- o Integrated Technology Services up 4%
  - > Server consolidations and Business Continuity Services up

- o Business Innovation Services declined 6%

-12-

eSERVERS AND STORAGE

Revenue $4.1B, -11% @CC

Gaining share despite opportunity declines

- o eServers:
  - > zSeries:
    - -- Revenue growth despite tough compare
    - -- Five quarters of growth
    - -- MIPS +12%
  - > pSeries:
    - -- Regatta sold out
    - -- Low-end and Midrange weakness
  - > iSeries:
    - -- New workload gaining momentum

- o Storage
  - > Total disk, Shark, and tape - yr/yr revenue growth
  - > Margin improvement in tough environment
  - > Strong profit growth

-13-

PERSONAL AND PRINTING SYSTEMS

Revenue $2.9B, -31% @CC
4Q01 revenue up 4% qtr/qtr

- o PC environment remains challenging

- o Cost & Expense challenges gaining traction

> Increasing PC Division direct channel participation
  - 4Q01 worldwide revenue was 44% direct
  - 4Q01 U.S. revenue was 66% direct
  - 1Q02 worldwide target is 50% direct

> Desktop manufacturing outsourcing

-14-

TECHNOLOGY
==========

Revenue $1.6B, -33% @CC

o OEM Microelectronics

> +3% qtr/qtr, consistent with industry

> Customer inventory down $50M

o OEM Storage

> Revenue down yr/yr but up sequentially
  - Gained unit share in mobile and desktop

> New drives in volume shipment 1Q02
  - Discovery II server
  - Cascade mobile
  - Vancouver desktop

-15-

SOFTWARE
========

Revenue $3.8B, +8% @CC

4Q01 Revenue Dynamics

[BAR GRAPH OMITTED]

[The following data was depicted as a bar graph in the printed material.]

			Middleware	
Operating Systems	-2% yr/yr	-------------->	UNIX/NT	+5% yr/yr
Middleware	+10% yr/yr	-------------->	Host	+16% yr/yr

---

o Strong momentum driven by middleware

o DB2 outperformed the industry with 13% revenue growth

o WebSphere leadership continued with 43% growth

- Three consecutive quarters of sequential improvement at Tivoli
- Lotus leadership continues in web collaboration and eLearning
- Leveraging 10,000 strong sales force; 56,000 business partners, and 74 ISV alliances

-16-

[LOGO] IBM

CURRENCY: YEAR-TO-YEAR COMPARISON

QUARTERLY AVERAGES PER US$

	3Q01	4Q01	1/16 Spot	@ 1/16 Spot 1Q02	@ 1/16 Spot 2Q02
Euro	1.12	1.12	1.14		
Yr/Yr	-2%	3%		-5%	1%
Pound	0.70	0.69	0.70		
Yr/Yr	-3%	-0%		-2%	1%
Yen	121	124	131		
Yr/Yr	-13%	-13%		-11%	-7%
Negative IBM Rev. Impact				3 pts	1 pt

Negative Yr/Yr growth signifies a translation hurt

D>(in millions) 2006 2005

(in millions)	2006	2005
Raw materials	$480	$435
Work in process	574	614
Finished products	952	876
Total inventories	$2,006	$1,925

Property, plant and equipment, net

(in millions)	March 31, 2006	December 31, 2005
Property, plant and equipment, at cost	$7,886	$7,878
Accumulated depreciation and amortization	(3,764)	(3,734)
Property, plant and equipment, net	$4,122	$4,144

Goodwill

Goodwill at March 31, 2006 totaled $862 million for the Medication Delivery segment, $567 million for the BioScience segment and $133 million for the Renal segment. Goodwill at December 31, 2005 totaled $855 million for the Medication Delivery segment, $564 million for the BioScience segment and $133 million for the Renal segment. The change in the goodwill balance from December 31, 2005 to March 31, 2006 for each segment related to foreign currency fluctuations.

Other intangible assets

The following is a summary of the company s intangible assets subject to amortization at March 31, 2006 and December 31, 2005.

(in millions, except amortization period data)	Developed technology, including patents	Manufacturing, distribution and other contracts	Other	Total
March 31, 2006				
Gross intangible assets	$791	$34	$84	$909
Accumulated amortization	380	16	32	428
Net intangible assets	$411	$18	$52	$481
Weighted-average amortization period (in years)	15	8	18	14
December 31, 2005				
Gross intangible assets	$784	$34	$82	$900
Accumulated amortization	368	15	30	413
Net intangible assets	$416	$19	$52	$487
Weighted-average amortization period (in years)	15	8	18	15

The amortization expense for these intangible assets was $14 million for both the first quarter of 2006 and the first quarter of 2005. At March 31, 2006, the anticipated annual amortization expense for these intangible assets is $53 million in 2006, $46 million in 2007, $43 million in 2008, $42 million in 2009, $39 million in 2010 and $35 million in 2011.

Securitization arrangements

The company s securitization arrangements resulted in net cash outflows of $33 million and $52 million during the first quarter of 2006 and 2005, respectively. A summary of the activity is as follows.

(in millions)	Three months ended March 31, 2006	2005
Sold receivables at beginning of period	$ 451	$ 594
Proceeds from sales of receivables	332	356

Cash collections (remitted to the owners of the receivables)	(365)	(408)
Effect of currency exchange rate changes	2	(3)
Sold receivables at end of period	$ 420	$ 539

8

Table of Contents

Stock issuances and repurchases

Stock Issuances

Refer to the 2005 Annual Report regarding the purchase contracts included in the company s equity units. The purchase contracts were settled in February 2006, and the company issued 35 million shares of common stock in exchange for $1.25 billion. Management is using these proceeds to pay down maturing debt, for stock repurchases, and for other general corporate purposes.

Stock Repurchases

As authorized by the board of directors, from time to time the company repurchases its stock on the open market depending upon the company s cash flows, net debt level and current market conditions. During the first quarter of 2006, the company repurchased approximately 4.5 million shares for $171 million under the board of directors October 2002 authorization. As of March 31, 2006, $72 million was available for repurchases under this authorization. In February 2006, the board of directors authorized the repurchase of an additional $1.5 billion of the company s common stock. There have been no repurchases under this program to date.

3. RESTRUCTURING AND OTHER SPECIAL CHARGES

2004 restructuring charge

In 2004 the company recorded a $543 million pre-tax restructuring charge principally associated with management s decision to implement actions to reduce the company s overall cost structure and to drive sustainable improvements in financial performance. The charge was primarily for severance and costs associated with the closing of facilities (including the closure of additional plasma collection centers) and the exiting of contracts. These actions included the elimination of over 4,000 positions, or 8% of the global workforce, as management reorganized and streamlined the company.

Included in the 2004 charge was $196 million relating to asset impairments, almost all of which was to write down property, plant and equipment. Also included in the 2004 charge was $347 million for cash costs, principally pertaining to severance and other employee-related costs. Refer to the 2005 Annual Report for additional information. Substantially all of the targeted positions have been eliminated through the first quarter of 2006.

The following table summarizes activity in the company s restructuring reserves.

(in millions)	Employee-related costs	Contractual and other costs	Total
Charge	$ 212	$ 135	$ 347
Utilization and adjustments in 2004 and 2005	(167)	(87)	(254)
Reserve at December 31, 2005	45	48	93
Utilization	(14)	(4)	(18)
Reserve at March 31, 2006	$ 31	$ 44	$ 75

Approximately $60 million of the remaining reserve is expected to be utilized during the remainder of 2006, with the rest of the cash outflows principally relating to certain long-term leases and remaining employee severance payments.

Table of Contents

Restructuring reserve utilization in the first quarter of 2006 totaled $19 million, with $18 million relating to the 2004 program (as detailed above) and $1 million relating to a program initiated in 2003, which is substantially complete.

Other special charges

The 2005 and 2006 charges discussed below were classified in cost of goods sold in the company s consolidated income statements. The actual costs relating to certain of the matters below may differ from management s estimates. It is possible that additional charges may be required in future periods, based on new information or changes in estimates.

COLLEAGUE Pump 2005 and 2006 Charges

The company has held shipments of COLLEAGUE infusion pumps since July 2005. Please refer to the company s 2005 Annual Report at pages 42-43 for a description of recalls designated by the U.S. Food and Drug Administration (FDA) as Class I, the FDA s highest priority, as well as a description of deaths and serious injuries that may have been associated with the product. Refer to Note 5 for a description of related COLLEAGUE litigation.

The company recorded a $77 million pre-tax charge in 2005 for remediation costs associated with correcting design issues related to its COLLEAGUE infusion pump. Included in the $77 million charge was $73 million for cash costs and $4 million relating to asset impairments. The $73 million reserve represented management s estimate of the cash expenditures for the materials, labor and freight costs expected to be incurred to remediate these design issues. During the first quarter of 2006, the company recorded an additional $18 million pre-tax expense, of which $7 million related to asset impairments and $11 million related to additional warranty and other commitments made to customers during the quarter. The company has utilized $8 million of the total reserve for cash costs through the first quarter of 2006. The company is in the process of working with the U.S. Food and Drug Administration and regulatory bodies in other countries to develop and execute the remediation plans.

6060 Infusion Pump 2005 Charge

The company recorded a $49 million pre-tax charge in 2005 for costs associated with withdrawing its 6060 multi-therapy infusion pump from the market. Included in the $49 million charge was $41 million for cash costs. The charge principally consisted of the estimated costs to provide customers with replacement pumps, with the remainder of the charge related to asset impairments, principally to write off customer lease receivables. The company has utilized $2 million of the reserve for cash costs through March 31, 2006. The majority of the remaining reserve is expected to be utilized by the end of 2006.

Hemodialysis Instruments 2005 Charge

The company recorded a $50 million pre-tax charge in 2005 associated with management s decision to discontinue the manufacture of hemodialysis (HD) instruments, including the company s Meridian instrument. Included in the $50 million charge was $23 million relating to asset impairments, principally to write down inventory, equipment and other assets used to manufacture HD machines. The remaining $27 million of the charge related to the estimated cash payments associated with providing customers with replacement instruments. The company has utilized $4 million of the reserve for cash costs through the first quarter of 2006. The remainder of the reserve is expected to be utilized in 2006 and 2007.

4. STOCK-BASED COMPENSATION PLANS

Summary

The company has a number of stock-based employee compensation plans, including stock option, stock purchase, restricted stock and restricted stock unit (to be settled in stock) (RSU) plans. Refer to the separate discussions below regarding the nature and terms of each of these plans.

The company adopted SFAS No. 123-R effective January 1, 2006 using the modified prospective method. Under this transition method, stock compensation expense recognized in the first quarter of 2006 includes the following:

(a) Compensation expense for all stock-based compensation awards granted before January 1, 2006, but not yet vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123) and

(b) Compensation expense for all stock-based compensation awards granted on or after January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123-R.

Prior to January 1, 2006, the company measured stock compensation expense using the intrinsic value method of accounting in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations (APB No. 25). Thus, expense was generally not recognized for the company s employee stock option and purchase plans, but expense was recognized relating to the company s restricted stock and RSU grants and certain modifications to stock options. Results for prior periods have not been restated.

Impact of adoption of SFAS No. 123-R in Q1 2006

Stock compensation expense measured in accordance with SFAS No. 123-R totaled approximately $18 million ($12 million on a net-of-tax basis, or $0.02 per basic and diluted share) in the first quarter of 2006. The adoption of SFAS No. 123-R resulted in increased expense of approximately $15 million ($10 million on a net-of-tax basis, or $0.02 per basic and diluted share) as compared to the stock compensation expense that would have been recorded pursuant to APB No. 25 (relating to RSU and restricted stock plans only). In the first quarter of 2005, approximately $1 million of pre-tax expense was recorded under APB No. 25 (relating to RSU and restricted stock plans only).

Stock compensation expense is recorded at the corporate headquarters level and is not allocated to the segments. Approximately three-quarters of stock compensation expense is classified in marketing and administrative expenses, with the remainder classified in cost of goods sold and research and development expenses. Costs capitalized in the consolidated balance sheet in the first quarter of 2006 were not significant.

Pro forma impact in Q1 2005 had the company applied the fair value provisions of SFAS No. 123

The following table shows net income and EPS had the company applied the fair value method of accounting for stock compensation in accordance with SFAS No. 123 during the first quarter of 2005 (in millions, except per share data).

	Q1 2005 (SFAS No. 123 Pro Forma)
Net income, as reported	$ 226
Add:	
Stock compensation expense included in reported net income, net of tax	
Deduct:	
Total stock compensation expense determined under the fair value method, net of tax	12
Pro forma net income	$ 214
Basic EPS	
As reported	$0.37
Pro forma	$0.35
Diluted EPS	
As reported	$0.36
Pro forma	$0.34

Impact of SFAS No. 123-R in Q1 2006 compared to the pro forma impact of SFAS No. 123 in Q1 2005

As noted above, the adoption of SFAS No. 123-R in the first quarter of 2006 impacted net income by $0.02 per diluted share. Had the company applied the fair value method of accounting for stock compensation pursuant to SFAS No. 123 during the first quarter of 2005, net income for that period would also have been impacted by $0.02 per diluted share.

Methods of estimating fair value

Under both SFAS No. 123-R and under the fair value method of accounting under SFAS No. 123 (i.e., SFAS No. 123 Pro Forma), the fair value of restricted stock and RSUs is determined based on the number of shares granted and the quoted price of the company s common stock on the date of grant. The fair value of stock options is determined using the Black-Scholes model.

Significant assumptions used to estimate fair value

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

	Q1 2006 (SFAS No. 123-R)	Q1 2005 (SFAS No. 123 Pro Forma)
Expected volatility	27.6%	37.0%
Expected life (in years)	5.5	5.5
Risk-free interest rate	4.7%	4.2%
Dividend yield	1.5%	1.7%
Fair value per stock option	$11	$12

Under SFAS No 123-R, the company s expected volatility assumption is based on an equal weighting of the historical volatility of Baxter s stock and the implied volatility from traded options on Baxter s stock. Under SFAS No. 123 Pro Forma, the company s expected volatility assumption was based on the historical volatility of Baxter s stock. The expected life assumption is primarily based on historical exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The

dividend yield reflects historical experience as well as future expectations over the expected term of the option.
Stock compensation expense recognized in the first quarter of 2006 is based on awards expected to vest, and therefore has been reduced by estimated forfeitures. SFAS No. 123-R requires forfeitures to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates. Under SFAS No. 123 Pro Forma, the company accounted for forfeitures as they occurred. The cumulative effect of estimating future forfeitures in determining expense, rather than recording forfeitures when they occur, was immaterial.

Types of stock compensation plans

In anticipation of the adoption of SFAS No. 123-R, the company did not modify the terms of previously granted options. As part of an overall, periodic reevaluation of the company s stock compensation programs, the company did make changes to its equity compensation program relating to key employees beginning in the first quarter of 2005, reducing the overall number of options granted and utilizing a mix of stock options and RSUs. As noted below, the company modified its employee stock purchase plans during 2005.

Shares issued as a result of stock option exercises, restricted stock and RSU grants, and employee stock purchase plan purchases are generally issued out of treasury stock. As of March 31, 2006, approximately 22 million authorized shares are available for future awards under the company s stock-based compensation plans.

The following is a summary of each of the company s stock compensation plans.

Stock Option Plans

Stock options are granted to employees and non-employee directors with exercise prices at least equal to 100% of the market value on the date of grant. Generally, employee stock options vest 100% in three years from the grant date and have a contractual term of 10 years. Stock options granted to non-employee directors generally vest 100% one year from the grant date and have a contractual term of 10 years. Expense is recognized on a straight-line basis over the vesting period.

Stock option activity for the first quarter of 2006 is as follows.

(options and aggregate intrinsic values in thousands)	Options	Weighted-average exercise price	Weighted-average remaining contractual term (in years)	Aggregate intrinsic value
Outstanding at January 1, 2006	65,986	$37.32		
Granted	9,365	38.35		
Exercised	(1,400)	27.94		
Forfeited	(1,803)	36.10		
Outstanding at March 31, 2006	72,148	$37.67	6.3	$ 293,428
Vested or expected to vest as of March 31, 2006	70,241	$37.66	6.2	$ 291,675
Exercisable at March 31, 2006	45,539	$39.56	3.0	$ 176,672

Table of Contents

The aggregate intrinsic value in the table above represents the difference between the exercise price and the company s closing stock price on the last trading day of the period. The total intrinsic value of options exercised during the first quarter of 2006 was $15 million.

As of March 31, 2006, $178 million of pre-tax unrecognized compensation cost related to stock options is expected to be recognized as expense over a weighted-average period of 1.9 years.

Restricted Stock and RSU Plans

The company grants restricted stock and RSUs to key employees, and grants restricted stock to non-employee directors. Grants of RSUs were first made in 2005, and principally vest in one-third increments over a three-year period. The total grant-date fair value, adjusted for estimated forfeitures, is recognized as expense on a straight-line basis over the vesting period.

The following table summarizes nonvested restricted stock and RSU activity for the first quarter of 2006.

(shares and share units in thousands)	Shares or share units	Weighted-average grant-date fair value
Nonvested restricted stock and RSUs at January 1, 2006	870	$34.98
Granted	697	38.34
Vested	(213)	34.85
Forfeited	(98)	35.50
Nonvested restricted stock and RSUs at March 31, 2006	1,256	$36.83

As of March 31, 2006, $41 million of pre-tax unrecognized compensation cost related to restricted stock and RSUs is expected to be recognized as expense over a weighted-average period of 2.3 years.

Employee Stock Purchase Plans

Nearly all employees are eligible to participate in the company s employee stock purchase plans. For subscriptions that began prior to April 1, 2005, the employee purchase price was the lower of 85% of the closing market price on the date of subscription or 85% of the closing market price on the purchase dates, as defined by the plans. For subscriptions that began on or after April 1, 2005, the employee purchase price is 95% of the closing market price on the purchase date, as defined by the plans. The change to the employee stock purchase plan in 2005 was made as part of an overall reassessment of employee benefits and in contemplation of the new stock compensation accounting rules.

Under SFAS No. 123-R, no compensation expense is recognized for subscriptions that began on or after April 1, 2005. The first quarter 2006 and expected future expense relating to subscriptions that began prior to April 1, 2005 is immaterial. During the first quarter of 2006 and 2005, the company issued approximately 175,000 and 500,000 shares, respectively, under these plans. The number of shares under subscription at March 31, 2006 totaled approximately 560,000.

Other

Realized Income Tax Benefits and the Impact on the Statement of Cash Flows

SFAS No. 123-R changes the presentation of realized excess tax benefits associated with exercised stock options in the statement of cash flows. Prior to the adoption of SFAS No. 123-R, such realized tax benefits were required to be presented as an inflow within the operating section of the statement. Under SFAS No. 123-R, such realized tax benefits are presented as an inflow within the financing section of the statement. Due primarily to the company s U.S. net operating loss position, no income tax benefits were realized from stock option exercises during the first quarters of 2006 and 2005.

Special Vesting Provisions

The company s stock options and RSUs provide that if the grantee retires and meets certain age and years of service thresholds, the options or RSUs continue to vest for a period of time after retirement as if the grantee continued to be an employee. In these cases, for awards granted prior to the adoption of SFAS No. 123-R, expense will be recognized for such awards over the service period, and any unrecognized costs will be accelerated into expense when the employee retires. For awards granted on or after January 1, 2006, expense will be recognized over the period from the grant date to the date the employee would no longer be required to perform services to vest in the award. The difference between the two accounting methods was not material for the quarters ended March 31, 2006 or 2005.

5. LEGAL PROCEEDINGS

Baxter is involved in product liability, patent, shareholder, commercial, and other legal proceedings that arise in the normal course of the company s business. The company records a liability when a loss is considered probable and the amount can be reasonably estimated. If the reasonable estimate of a probable loss is a range, and no amount within the range is a better estimate, the minimum amount in the range is accrued. If a loss is not probable or a probable loss cannot be reasonably estimated, no liability is recorded.

Baxter has established reserves for certain of the matters discussed below. Management is not able to estimate the amount or range of any loss for certain of the company s legal contingencies for which there is no reserve or additional loss for matters already reserved. While the liability of the company in connection with the claims cannot be estimated with any certainty and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company s results of operations for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company s consolidated financial position. While the company believes that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

In addition to the matters described below, the company remains subject to other additional potential administrative and legal actions. With respect to regulatory matters in particular, these actions include product recalls, additional product seizures, injunctions to halt manufacture and distribution, restrictions on the company s operations, civil sanctions, including monetary sanctions, and criminal sanctions. Any of these actions could have an adverse effect on the company s business and subject the company to additional regulatory actions and costly litigation. With respect to patents, the company may be exposed to significant litigation concerning patents and products, challenges to the coverage and validity of the company s patents on products or processes and allegations that the company s products infringe patents held by competitors or other third parties. A loss in any of these types of cases could result in a loss of patent protection or the ability to market products, which could lead to a significant loss of sales, or otherwise materially affect future results of operations.

Table of Contents

Product Liability

Mammary Implant Litigation

The company is currently a defendant in various courts in a number of lawsuits seeking damages for injuries of various types allegedly caused by silicone mammary implants previously manufactured by the Heyer-Schulte division of American Hospital Supply Corporation (AHSC). AHSC, which was acquired by Baxter in 1985, divested its Heyer-Schulte division in 1984. The majority of the claims and lawsuits against the company have been resolved. After concluding a class action settlement with a large group of U.S. claimants, the company will continue to participate in the resolution of class member claims, for which reserves have been established, until 2010. In addition, as of March 31, 2006, Baxter remains a defendant or co-defendant in approximately 30 lawsuits relating to mammary implants brought by claimants who have opted out of the class settlement. The company has also established reserves for these lawsuits. Baxter believes that a substantial portion of its liability and defense costs for mammary implant litigation may be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer insolvency.

Plasma-Based Therapies Litigation

Baxter currently is a defendant in a number of lawsuits and subject to additional claims brought by individuals who have hemophilia and their families, all seeking damages for injuries allegedly caused by anti-hemophilic factor concentrates VIII or IX derived from human blood plasma (factor concentrates) processed by the company from the late 1970s to the mid-1980s. The typical case or claim alleges that the individual was infected with the HIV virus by factor concentrates that contained the HIV virus. None of these cases involves factor concentrates currently processed by the company.

After concluding a class action settlement with a group of U.S. claimants for which all eligible claims have been paid, Baxter remained as a defendant in approximately 90 lawsuits and subject to approximately 128 additional claims. Among the lawsuits, the company and other manufacturers have been named as defendants in approximately 70 lawsuits pending or expected to be transferred to the U.S.D.C. for the Northern District of Illinois on behalf of claimants, who are primarily non-U.S. residents, seeking unspecified damages for HIV or Hepatitis C infections from their use of plasma-based factor concentrates. In March 2005, the District Court denied plaintiff s motion to certify purported classes. Thereafter, plaintiffs have filed additional lawsuits on behalf of individual claimants outside of the United States. In December 2005, the District Court granted defendants motion to return U.K. claimants to their home jurisdiction. That matter is on appeal.

In addition, Immuno International AG (Immuno), acquired by the company in 1996, has unsettled claims and lawsuits for damages for injuries allegedly caused by its plasma-based therapies. The typical claim alleges that the individual with hemophilia was infected with HIV or Hepatitis C by factor concentrates. Immuno s successor, an indirect Austrian subsidiary of Baxter International Inc., is a participant in a foundation that would make payments to Italian applicants who are HIV positive. Additionally, Immuno has received notice of a number of claims arising from its vaccines and other biologically derived therapies.

The company believes that a substantial portion of the liability and defense costs related to its plasma-based therapies litigation may be covered by insurance, subject to self-insurance retentions, exclusions, conditions, coverage gaps, policy limits and insurer insolvency and that in regard to the Immuno liability, costs will be additionally covered by an approximately $16 million holdback of the purchase price, established at the time of the acquisition, to cover potential claims of this nature.

Althane Dialyzers Litigation

Baxter was named as a defendant in a number of civil cases seeking unspecified damages for alleged injury or death from exposure to Baxter s Althane series of dialyzers, which were withdrawn from the market in 2001. All of these suits have been resolved. Currently, the Spanish Ministry of Health has raised a claim, although a suit has not been filed, and the U.S. government is investigating Baxter s withdrawal of the dialyzers from the market. In December 2002, Baxter received a subpoena to provide documents to the U.S. Department of Justice and is cooperating fully with the investigation.

Vaccines Litigation

As of March 31, 2006, the company has been named as a defendant, along with others, in approximately 134 lawsuits filed in various state and U.S. federal courts, seeking damages, injunctive relief and medical monitoring for claimants alleged to have contracted autism or attention deficit disorders as a result of exposure to vaccines for childhood diseases containing the preservative, thimerosal. These vaccines were formerly manufactured and sold by North American Vaccine, Inc., which was acquired by Baxter in June 2000, as well as by other companies.

Patent Litigation

ADVATE Litigation

In April 2003, A. Nattermann & Cie GmbH and Aventis Behring L.L.C. filed a patent infringement lawsuit in the U.S.D.C. for the District of Delaware naming Baxter Healthcare Corporation as the defendant. In November 2003, the lawsuit was dismissed without prejudice. The complaint, which sought injunctive relief, alleged that Baxter s planned manufacture and sale of ADVATE would infringe U.S. Patent No. 5,565,427. A reexamination of the patent has been proceeding in the U.S. Patent and Trademark Office since October 2003. During these proceedings certain of the original claims were amended or rejected, and new claims have been added. The Patent Office has recently issued a Notice of Intent to issue the patent, and a reexamination certificate is expected to be issued in the near term.

Sevoflurane Litigation

In September 2005, the U.S.D.C. for the Northern District of Illinois ruled that a patent owned by Abbott Laboratories and the Central Glass Company, U.S. Patent No. 5,990,176, was not infringed by Baxter s generic version of sevoflurane. Abbott and Central Glass have appealed and Baxter has filed a cross-appeal on the validity of the patent. Related actions are pending in various jurisdictions in the United States and abroad. Abbott and Central Glass filed another patent infringement action on two related patents against Baxter in the U.S.D.C. for the Northern District of Illinois. Baxter has filed a motion asserting that judgment of non-infringement should be entered based on the September 2005 decision. In May 2005, Abbott and Central Glass filed suit in the Tokyo District Court on a counterpart Japanese patent. In June 2005, Baxter filed suit in the High Court of Justice in London, England seeking revocation of the U.K. part of the related European patent and a declaration of non-infringement. Trial in this action is expected to commence in late 2006. Parallel opposition proceedings in the European and Japanese Patent Offices seeking to revoke versions of the patent are also pending.

GAMMAGARD Liquid Litigation

In June 2005, Talecris Biotherapeutics, Inc. filed a patent infringement lawsuit in the U.S.D.C. for the District of Delaware naming Baxter Healthcare Corporation as the defendant. The complaint, which seeks injunctive relief, alleges that Baxter s planned manufacture and sale of GAMMAGARD liquid would infringe U.S. Patent No. 6,686,191. The case is presently pending before the District Court and is in its early stages. Trial is scheduled to commence in July 2007. Related actions are pending in various jurisdictions abroad. Baxter has filed a declaratory judgment action in the High Court of Justice in London, England seeking to invalidate the U.K. part of the related European patent and to receive a judgment of non-infringement. Baxter has also filed a corresponding action in Belgium. A parallel opposition proceeding in the European Patent Office is also pending.

Table of Contents

Alyx Component Collection System Litigation

In December 2005, Haemonetics Corporation filed a lawsuit in the U.S.D.C. for the District of Massachusetts naming Baxter Healthcare Corporation as a defendant. The complaint, which seeks injunctive relief, alleges that Baxter s Alyx Component Collection System infringes U.S. Patent No. 6,705,983. The case is in a preliminary stage.

In addition, Haemonetics filed a demand for arbitration in December 2005 against Baxter Healthcare Corporation, Baxter Healthcare S.A. and Baxter International Inc. with the American Arbitration Association in Boston, Massachusetts. The demand alleges that the Baxter parties breached their obligations under the parties technology development agreement related to pathogen inactivation.

Securities Laws

In August 2002, six purported class action lawsuits were filed in the U.S.D.C. for the Northern District of Illinois naming Baxter and its then Chief Executive Officer and then Chief Financial Officer as defendants. These lawsuits, which were consolidated, alleged that the defendants violated the federal securities laws by making misleading statements regarding the company s financial guidance that allegedly caused Baxter common stock to trade at inflated levels. The Court of Appeals for the Seventh Circuit reversed a trial court order granting Baxter s motion to dismiss the complaint and the U.S. Supreme Court declined to grant certiorari in March 2005. In February 2006, the trial court denied Baxter s motion for judgment on the pleadings. In October 2004, a purported class action was filed in the same court against Baxter and its current Chief Executive Officer and Chief Financial Officer and their predecessors for alleged violations of the Employee Retirement Income Security Act of 1974, as amended. Plaintiff alleges that these defendants, along with the Administrative and Investment Committees of the company s 401(k) plans, breached their fiduciary duties to the plan participants by offering Baxter common stock as an investment option in each of the plans during the period of January 2001 to October 2004. Plaintiff alleges that Baxter common stock traded at artificially inflated prices during this period and seeks unspecified damages and declaratory and equitable relief. In March 2006, the trial court certified a class of plan participants who elected to acquire Baxter common stock through the plans between January 2001 and the present, and denied defendants motion to dismiss.

In July 2004, a series of four purported class action lawsuits, now consolidated, were filed in the U.S.D.C. for the Northern District of Illinois, in connection with the company s restatement of its consolidated financial statements, previously announced in July 2004, naming Baxter and its current Chief Executive Officer and Chief Financial Officer and their predecessors as defendants. The lawsuits allege that the defendants violated the federal securities laws by making false and misleading statements regarding the company s financial results, which allegedly caused Baxter common stock to trade at inflated levels during the period between April 2001 and July 2004. As of December 2005, the District Court had dismissed the last of the remaining actions. The matter is on appeal. In August and September 2004, three plaintiffs raised similar allegations based on breach of fiduciary duty in separate derivative actions filed against members of the company s management and directors and consolidated in the Circuit Court of Cook County Illinois. The Circuit Court dismissed those claims in December 2005 on defendants motion, and the time for the plaintiffs to appeal has expired. One of the plaintiffs thereafter sent to the company s board of directors a letter demanding that the company take action to recover sums paid to certain directors and employees, which demand the board of directors has taken under advisement.

Other

On October 12, 2005 the United States filed a complaint in the U.S.D.C. for the Northern District of Illinois to effect the seizure of COLLEAGUE pumps that were on hold in Northern Illinois (customer-owned pumps were not affected), which the company has answered. Additional third party claims may be filed in connection with the COLLEAGUE matter.

Table of Contents

The company is a defendant, along with others, in approximately 50 lawsuits brought in various state and U.S. federal courts, which allege that Baxter and other defendants reported artificially inflated average wholesale prices for Medicare and Medicaid eligible drugs. These cases have been brought by private parties on behalf of various purported classes of purchasers of Medicare and Medicaid eligible drugs, as well as by state attorneys general. A number of these cases were consolidated in the U.S.D.C. for the District of Massachusetts for pretrial case management under Multi District Litigation rules. The lawsuits against Baxter include eleven lawsuits brought by state attorneys general, which seek unspecified damages, injunctive relief, civil penalties, disgorgement, forfeiture and restitution. Various state and federal agencies are conducting civil investigations into the marketing and pricing practices of Baxter and others with respect to Medicare and Medicaid reimbursement. These investigations may result in additional cases being filed by various state attorneys general.

Baxter has been named a potentially responsible party (PRP) for environmental clean-up at a number of sites. Under the U.S. Superfund statute and many state laws, generators of hazardous waste sent to a disposal or recycling site are liable for clean-up of the site if contaminants from that property later leak into the environment. The laws generally provide that a PRP may be held jointly and severally liable for the costs of investigating and remediating the site.

6. SEGMENT INFORMATION

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

The **Medication Delivery** business is a manufacturer of intravenous (IV) solutions and administration sets, pre-mixed drugs and drug reconstitution systems, pre-filled vials and syringes for injectable drugs, electronic infusion pumps, and other products used to deliver fluids and drugs to patients. The business also provides IV nutrition solutions, containers and compounding systems and services, general anesthetic agents and critical care drugs, contract manufacturing services, and drug packaging and formulation technologies.

The **BioScience** business manufactures plasma-based and recombinant proteins used to treat hemophilia, and other biopharmaceutical products, including plasma-based therapies to treat immune disorders, alpha 1 antitrypsin deficiency and other chronic blood-related conditions; biosurgery products for hemostasis, wound-sealing and tissue regeneration; and vaccines. The business also manufactures manual and automated blood and blood-component separation and collection systems.

The **Renal** business manufactures products for peritoneal dialysis (PD), a home therapy for people with end-stage renal disease, or irreversible kidney failure. These products include a range of PD solutions and related supplies to help patients safely perform fluid exchanges, as well as automated PD cyclers that perform solution exchanges for patients overnight while they sleep. The business also distributes products (hemodialysis instruments and disposables, including dialyzers) for hemodialysis, a form of dialysis generally conducted several times a week in a hospital or clinic.

Management uses more than one measurement and multiple views of data to measure segment performance and to allocate resources to the segments. However, the dominant measurements are consistent with the company s consolidated financial statements and, accordingly, are reported on the same basis herein. Management evaluates the performance of its segments and allocates resources to them primarily based on pre-tax income along with cash flows and overall economic returns.

Table of Contents

Intersegment sales are generally accounted for at amounts comparable to sales to unaffiliated customers, and are eliminated in consolidation.

Certain items are maintained at the corporate level (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 restructuring and certain asset impairments), deferred income taxes, certain foreign currency fluctuations, certain employee benefit costs, stock compensation expense, the majority of the foreign currency and interest rate hedging activities, and certain litigation liabilities and related insurance receivables. With respect to depreciation and amortization and expenditures for long-lived assets, the difference between the segment totals and the consolidated totals principally relate to assets maintained at Corporate.

Financial information for the company s segments for the quarters ended March 31 is as follows.

	Three months ended March 31,	
(in millions)	2006	2005
Net sales		
Medication Delivery	$ 916	$ 978
BioScience	1,000	902
Renal	493	503
Total	$2,409	$2,383
Pre-tax income from continuing operations		
Medication Delivery	$ 121	$ 157
BioScience	290	204
Renal	90	97
Total pre-tax income from segments	$ 501	$ 458

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 March 31,	
(in millions)	2006	2005
Total pre-tax income from segments	$ 501	$ 458
Unallocated amounts		
Interest expense, net	(18)	(31)
Certain foreign currency fluctuations and hedging activities	(10)	(24)
Stock compensation expense	(18)	(1)
Other corporate items	(101)	(104)
Income from continuing operations before income taxes	$ 354	$ 298

20

Table of Contents

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

Refer to the 2005 Annual Report for management s discussion and analysis of the financial condition and results of operations of the company for the year ended December 31, 2005. The following is management s discussion and analysis of the financial condition and results of operations of the company for the first quarter of 2006.

RESULTS OF CONTINUING OPERATIONS

ADOPTION OF SFAS NO. 123-R

The company adopted Statement of Financial Accounting Standards (SFAS) No. 123, Share-Based Payment (SFAS No. 123-R) on January 1, 2006. This new standard requires companies to expense the fair value of employee stock options and similar awards. The company adopted SFAS No. 123-R using the modified prospective transition method. Therefore, stock compensation expense measured in accordance with SFAS No. 123-R was recorded during the first quarter of 2006, but the prior year consolidated statement of income was not restated. The adoption of SFAS No. 123-R resulted in incremental expense in the first quarter of 2006 of $15 million ($10 million on a net-of-tax basis, or $0.02 per diluted share). Refer to Note 4 for further information.

NET SALES

	Three months ended March 31,		Percent
(in millions)	2006	2005	change
Medication Delivery	$ 916	$ 978	(6%)
BioScience	1,000	902	11%
Renal	493	503	(2%)
Total net sales	$2,409	$2,383	1%

	Three months ended March 31,		Percent
(in millions)	2006	2005	change
International	$1,350	$1,339	1%
United States	1,059	1,044	1%
Total net sales	$2,409	$2,383	1%

Foreign currency fluctuations reduced sales growth by 3 percentage points during the first quarter of 2006. The impact was principally due to the stronger U.S. Dollar relative to the Euro and the Japanese Yen during the quarter.

Certain reclassifications have been made to the prior year sales by product line data within the BioScience and Renal segments to conform to the current year presentation. Specifically, for BioScience, sales of Tisseel, which were previously reported in Plasma Proteins, are now reported in BioSurgery. Sales of plasma to third parties and contract manufacturing revenues, which also were previously reported in Plasma Proteins, are now reported in Other. Sales of FloSeal and CoSeal, which were previously reported in Other, are now reported in BioSurgery. For Renal, sales of pharmaceutical and certain other products,

Table of Contents

which were previously reported in Other, are now reported in PD Therapy. There were no sales reclassifications between segments.

Medication Delivery

Net sales for the Medication Delivery segment declined 6% during the first quarter of 2006 (including a reduction of 2 percentage points relating to the unfavorable impact of foreign currency fluctuations).

The following is a summary of sales by significant product line.

(in millions)	Three months ended March 31, 2006	2005	Percent change
IV Therapies	$ 304	$ 296	3%
Drug Delivery	195	204	(4%)
Infusion Systems	195	230	(15%)
Anesthesia	212	231	(8%)
Other	10	17	(41%)
Total net sales	$ 916	$ 978	(6%)

IV Therapies

This product line principally consists of intravenous (IV) solutions and nutritional products. Growth for the quarter was principally driven by strong global sales of nutritional products as well as strong U.S. sales of IV solutions.

Drug Delivery

This product line primarily consists of pre-mixed drugs and contract manufacturing services, principally for pharmaceutical and biotechnology customers. Sales growth in this product line for the first quarter of 2006 was unfavorably impacted by $9 million of sales in the prior year quarter under an order from the U.S. Government related to its biodefense program. Sales levels in 2006 were also unfavorably impacted by pricing pressures from generic competition related to the expiration of the patent for Rocephin, a frozen pre-mixed antibiotic. Partially offsetting these items were increased contract manufacturing services revenues and increased sales of certain generic and branded pre-mixed drugs and small parenterals in the United States.

Infusion Systems

Sales of electronic infusion pumps declined in 2006 principally due to the company s ceasing in July 2005 to ship new COLLEAGUE infusion pumps due to certain pump design issues. Refer to the 2005 Annual Report and Note 3 in this report for additional information. As a result of the decision to stop shipping new COLLEAGUE infusion pumps, there were no sales of the pumps during the second half of 2005 or during the first quarter of 2006. The company s sales of COLLEAGUE pumps totaled approximately $40 million in the first quarter of 2005. Refer to the COLLEAGUE Matter section below for additional information. However, the segment s sales of disposable tubing sets used with Baxter pumps (including COLLEAGUE pumps) increased during the first quarter of 2006.

Table of Contents

Anesthesia

The primary reason for the decrease in sales in this product line during the first quarter of 2006 was the decline in both sales volume and pricing of generic propofol due to additional competition. Partially offsetting this sales decline were strong sales of SUPRANE (Desflurane, USP), an inhaled anesthetic agent, and increased sales of multi-source generic products in the United States, which were driven by the continued launch of a new vial product, ceftriaxone, as well as sevoflurane.

Other

This category primarily includes other hospital-distributed products in international markets. The decline in sales during 2006 was largely due to the continued exit of certain lower-margin distribution businesses outside the United States.

BioScience

Sales in the BioScience segment increased 11% during the first quarter of 2006 (net of a 4 percentage point decline relating to the unfavorable impact of foreign currency fluctuations).

The following is a summary of sales by significant product line.

(in millions)	Three months ended March 31, 2006	2005	Percent change
Recombinants	$ 374	$ 344	9%
Plasma Proteins	192	170	13%
Antibody Therapy	183	89	106%
BioSurgery	69	66	5%
Transfusion Therapies	124	133	(7%)
Other	58	100	(42%)
Total net sales	$ 1,000	$ 902	11%

Recombinants

The primary driver of sales growth in the BioScience segment during the first quarter of 2006 was increased sales volume of recombinant Factor VIII products. Factor VIII products are used in the treatment of hemophilia A, which is a bleeding disorder caused by a deficiency in blood clotting Factor VIII. Sales growth was fueled by the continuing adoption by customers of the advanced recombinant therapy, ADVATE (Antihemophilic Factor (Recombinant), Plasma/Albumin-Free Method) rAHF-PFM. Sales of ADVATE totaled approximately $170 million in the first quarter of 2006, as compared to approximately $120 million in the first quarter of 2005.

Plasma Proteins

The Plasma Proteins product line includes plasma-derived hemophilia, albumin and certain other specialty therapeutics, including FEIBA, an anti-inhibitor coagulant complex, and ARALAST (alpha1-proteinase inhibitor (human)) for the treatment of hereditary emphysema. The primary driver of the increase in sales in the Plasma Proteins product line in the first quarter of 2006 was increased volume due to the 2005 plasma procurement agreement with the American Red Cross (ARC). Effective at the beginning of the third quarter of 2005, the company and the ARC terminated their contract manufacturing agreement (which is reported in the Other product line) and replaced it with a plasma procurement

Table of Contents

agreement. In addition, pricing improved across the plasma-based products portfolio in the first quarter of 2006 as compared to the prior year quarter.

Antibody Therapy

Higher sales of IVIG (intravenous immunoglobulin), which is used in the treatment of immune deficiencies, fueled sales growth during the first quarter of 2006, with pricing in the United States continuing to improve, and with customers converting to the liquid formulation of the product. The company launched its liquid formulation of IVIG in the United States in September 2005. Because it does not need to be reconstituted prior to infusion, the liquid formulation offers added convenience for clinicians and patients. Sales volume in this product line also increased in 2006 as a result of the new procurement agreement with the ARC in mid-2005 (as discussed above). In addition, sales of WinRho SDF [Rho(D) Immune Globulin Intravenous (Human)], which is a product used to treat a critical bleeding disorder, contributed to the product line s sales growth in the first quarter of 2006. The company acquired the U.S. marketing and distribution rights relating to this product at the end of the first quarter of 2005. The company launched the liquid formulation of WinRho during the first quarter of 2006.

BioSurgery

This product line includes plasma-based and non-plasma-based products for hemostasis, wound-sealing and tissue regeneration. Growth in the first quarter of 2006 was principally driven by increased sales of FloSeal and CoSeal.

Transfusion Therapies

The transfusion therapies product line includes products and systems for use in the collection and preparation of blood and blood components. Sales volume and pricing continued to be unfavorably impacted in the first quarter of 2006 by consolidation by customers in the plasma industry.

Other

Other BioScience products primarily consist of vaccines and sales of plasma to third parties. Sales in 2005 included the above-mentioned ARC contract manufacturing revenues. The decline in sales in this product line was principally due to the termination of the contract manufacturing agreement with the ARC in mid-2005, as well as a decline in sales of plasma to third parties as a result of management s decision to exit certain lower-margin contracts. Partially offsetting these declines were increased sales of certain vaccines, particularly FSME Immun (for the prevention of tick-borne encephalitis). Sales of vaccines fluctuate from period to period based on the timing of government tenders.

Renal

Sales in the Renal segment decreased 2% during the first quarter of 2006 (including a decline of 3 percentage points relating to the unfavorable impact of foreign currency fluctuations).

The following is a summary of sales by significant product line.

	Three months ended March 31,		Percent
(in millions)	2006	2005	change
PD Therapy	$ 388	$ 377	3%
HD Therapy	105	126	(17%)
Total net sales	$ 493	$ 503	(2%)

24

Table of Contents

PD Therapy

Peritoneal dialysis, or PD Therapy, is a dialysis treatment method for end-stage renal disease. PD Therapy, which is used primarily at home, uses the peritoneal membrane, or abdominal lining, as a natural filter to remove waste from the bloodstream. Excluding the unfavorable impact of foreign currency fluctuations, the sales growth during the first quarter of 2006 was primarily driven by an increased number of patients in all major markets, especially in Latin America and Asia, as well as improved pricing. Increased penetration of PD Therapy products continues to be strong in emerging markets, where many people with end-stage renal disease are currently under-treated.

HD Therapy

Hemodialysis, or HD Therapy, is another form of end-stage renal disease dialysis therapy, which is generally performed in a hospital or outpatient center. HD Therapy works by removing wastes and fluid from the blood by using a machine and a filter, also known as a dialyzer. The sales decline during the first quarter of 2006 was principally due to the divestiture of the Renal Therapy Services (RTS) business in Taiwan at the end of the first quarter of 2005. Revenues relating to this business totaled approximately $20 million during the first quarter of 2005. In addition, sales declined due to the decision in 2005 to discontinue the manufacture of HD instruments. Refer to the 2005 Annual Report for further information.

GROSS MARGIN AND EXPENSE RATIOS

	Three months ended March 31,		
	2006	2005	Change
Gross margin	43.7%	40.7%	3.0 pts.
Marketing and administrative expenses	21.8%	20.3%	1.5 pts.

Gross Margin

The improvement in gross margin in the first quarter of 2006 was principally driven by an improved mix of sales, with increased sales of higher-margin recombinant products, largely the result of the continued adoption by customers of ADVATE, and improved pricing for IVIG and certain other products. These improvements were partially offset by the impact of generic competition and an $18 million COLLEAGUE pump-related expense, principally associated with additional warranty and other commitments made to customers during the quarter.

Marketing and Administrative Expenses

Approximately one-third of the increase in the marketing and administrative expense ratio during the first quarter of 2006 resulted from the adoption of SFAS No. 123-R on January 1, 2006. The remainder of the increase in the ratio was principally due to increased spending in the BioScience segment relating to new marketing programs and product launches. Partially offsetting these increases were cost savings relating to the company s restructuring initiatives.

Table of Contents

RESEARCH AND DEVELOPMENT

(in millions)	Three months ended March 31, 2006	2005	Percent change
Research and development (R&D) expenses	$138	$133	4%
As a percent of sales	5.7%	5.6%	

R&D expenses increased during the first quarter of 2006, with increased spending on R&D projects across all three segments. Refer to the 2005 Annual Report for a discussion of the company s R&D pipeline.

RESTRUCTURING PROGRAM

During 2004, the company recorded a $543 million restructuring charge principally associated with management s decision to implement actions to reduce the company s overall cost structure and to drive sustainable improvements in financial performance. The charge was primarily for severance and costs associated with the closing of facilities (including the closure of additional plasma collection centers) and the exiting of contracts. These actions included the elimination of over 4,000 positions, or 8% of the global workforce, as management reorganized and streamlined the company.

Refer to Note 3 for further information, including reserve utilization and headcount eliminations through March 31, 2006. The cash expenditures are being funded with cash generated from operations. Management s original estimates of the benefits of the program are unchanged.

NET INTEREST EXPENSE

Net interest expense decreased $13 million, or 42%, during the first quarter of 2006, principally due to a lower average debt level. Refer to the 2005 Annual Report for a discussion of debt retirements during the fourth quarter of 2005. Also, as discussed below, during the first quarter of 2006, certain maturing debt was paid down using a portion of the $1.25 billion cash proceeds received upon settlement of the equity units purchase contracts in February 2006.

OTHER EXPENSE, NET

Other expense, net was $16 million during the first quarter of 2006 and $24 million in the first quarter of 2005. Other income and expense in both periods principally included amounts relating to foreign exchange, minority interests and equity method investments, with the decline in expense in 2006 primarily relating to foreign exchange.

PRE-TAX INCOME

Refer to Note 6 for a summary of financial results by segment. Certain items are maintained at the company s corporate level and are not allocated to the segments. These items primarily include net interest expense, certain foreign currency fluctuations, the majority of the foreign currency and interest rate hedging activities, stock compensation expense, income and expense related to certain non-strategic investments, corporate headquarters costs, certain employee benefit plan costs, certain nonrecurring gains and losses and certain special charges (such as restructuring and certain asset impairments). The following is a summary of significant factors impacting the segments financial results.

Table of Contents

Medication Delivery

Pre-tax income decreased 23% during the first quarter of 2006. The primary driver of the decline was the company s continuing to hold shipments of new COLLEAGUE pumps (which began in July 2005), as well as the above-mentioned $18 million expense in the first quarter of 2006, which was principally associated with additional warranty and other commitments made to customers during the quarter. In addition, the lower pre-tax earnings were a result of generic competition for certain products, the impact of the significant order in the first quarter of 2005 by the U.S. government related to its biodefense program, and higher R&D spending. Partially offsetting these items were the continued benefits from restructuring initiatives.

BioScience

Pre-tax income increased 42% during the first quarter of 2006. The primary driver of the increase was the strong sales of higher-margin recombinant products, which was fueled by the continued adoption of ADVATE. Also contributing to the increased pre-tax earnings was improved pricing in certain product lines, such as IVIG, as well as restructuring-related benefits. Partially offsetting this growth was the impact of higher spending on new marketing programs and product launches, as well as increased R&D spending.

Renal

Pre-tax income decreased 7% during the first quarter of 2006. The decrease was principally due to higher R&D spending and lower sales of HD Therapy products.

Other

As mentioned above, certain income and expense amounts are not allocated to the segments. These amounts are detailed in the table in Note 6 and include net interest expense, certain foreign currency fluctuations and hedging activities, stock compensation expense and other corporate items. Refer to the discussion above regarding the change in net interest expense and stock compensation expense from the first quarter of 2005 to the first quarter of 2006. The expense associated with foreign currency fluctuations and hedging activities declined from 2005 to 2006 principally due to reduced expenses related to the company s cash flow hedges. There was no significant change in the total of other corporate items from 2005 to 2006.

INCOME TAXES

The effective income tax rate was 20.3% in the first quarter of 2006 and 24.8% in the first quarter of 2005. The company s effective income tax rate has declined over the last year principally due to ongoing improvements to the company s geographic product sourcing.

INCOME AND EARNINGS PER DILUTED SHARE FROM CONTINUING OPERATIONS

Income from continuing operations of $282 million, or $0.43 per diluted share, for the first quarter of 2006 increased 26% from the $224 million, or $0.36 per diluted share, reported in the prior year quarter. The significant factors and events contributing to the growth are discussed above.

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 as

Table of Contents

of December 31, 2005 is included in Note 1 to the company s consolidated financial statements in the 2005 Annual Report. 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 of Financial Condition and Results of Operations section in the 2005 Annual Report.

The company adopted SFAS No. 123-R effective January 1, 2006. The following is a summary of the critical judgments and estimates made by management in applying these new accounting rules. Refer to Note 4 for further information regarding this new accounting standard.

STOCK-BASED COMPENSATION PLANS

Under SFAS No. 123-R, stock compensation cost is estimated at the grant date based on the fair value of the award, and the cost is recognized as expense ratably over the vesting period. Determining the appropriate fair value model to use requires judgment. Determining the assumptions that enter into the model is highly subjective and also requires judgment, including long-term projections regarding stock price volatility, employee exercise, post-vesting termination, and pre-vesting forfeiture behaviors, interest rates and dividend yields. Management used the guidance outlined in Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB No. 107) relating to SFAS No. 123-R in selecting a model and developing assumptions.

The company has historically used the Black-Scholes model for estimating the fair value of stock options in providing the pro forma fair value method disclosures pursuant to SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). After a review of alternatives, the company decided to continue to use this model for estimating the fair value of stock options as it meets the fair value measurement objective of SFAS No. 123-R.

Under SFAS No 123-R, the company s expected volatility assumption is based on an equal weighting of the historical volatility of Baxter s stock and the implied volatility from traded options on Baxter s stock. Management arrived at this expected volatility assumption based on a consideration and weighting of the factors outlined in SAB No. 107. The expected life assumption is primarily based on historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant. The dividend yield reflects historical experience as well as future expectations over the expected term of the option. The forfeiture rate used to calculate compensation expense is primarily based on historical pre-vesting employee forfeiture patterns. In finalizing its assumptions, management also reviewed comparable companies assumptions, as available in published surveys and in publicly available financial filings.

The use of different assumptions would result in different amounts of stock compensation expense. Holding all other variables constant, the indicated change in each of the assumptions below increases or decreases the fair value of an option (and hence, expense), as follows:

Assumption	Change to Assumption	Impact on Fair Value of Option
Expected volatility	Higher	Higher
Expected life	Higher	Higher
Risk-free interest rate	Higher	Higher
Dividend yield	Higher	Lower

Table of Contents

The pre-vesting forfeitures assumption is ultimately adjusted to the actual forfeiture rate. Therefore, changes in the forfeitures assumption would not impact the total amount of expense ultimately recognized over the vesting period. Different forfeitures assumptions would only impact the timing of expense recognition over the vesting period. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances.
The fair value of an option is particularly impacted by the expected volatility and expected life assumptions. In order to understand the impact of changes in these assumptions on the fair value of an option, management performed sensitivity analyses. Holding all other variables constant, if the expected volatility assumption used in valuing the stock options granted in the first quarter 2006 was increased by 100 basis points, the fair value of a stock option relating to one share of common stock would increase by approximately 2%, from $11.33 to $11.61. Holding all other variables constant (including the expected volatility assumption), if the expected term assumption used in valuing the stock options granted in the first quarter of 2006 was increased by one year, the fair value of a stock option relating to one share of common stock would increase by approximately 8%, from $11.33 to $12.24.
Management is not able to estimate the probability of actual results differing from expected results, but believes the company s assumptions are appropriate, based upon the requirements of SFAS No. 123-R, the guidance included in SAB No. 107, and the company s historical and expected future experience.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

Cash flows from operating activities

Cash flows from operating activities increased during the first quarter of 2006. The increase in cash flows in 2006 was primarily due to higher earnings (before non-cash items), improved working capital management, lower payments related to restructuring programs, and lower contributions to the company s pension plans, partially offset by the impact of cash inflows in the first quarter of 2005 relating to the settlements of certain mirror cross-currency swaps.

Accounts Receivable

Cash flows relating to accounts receivable decreased slightly during 2006. Days sales outstanding declined from 59.2 days at March 31, 2005 to 54.8 days at March 31, 2006, partially due to continued improvement in the collection of international receivables. Proceeds from the factoring of receivables increased, while net cash outflows relating to the company s securitization arrangements totaled $33 million during the first quarter of 2006 (as detailed in Note 2).

Inventories

The following is a summary of inventories at March 31, 2006 and December 31, 2005, as well as inventory turns for the first quarter of 2006 and 2005, by segment.

29

	Inventories		Annualized inventory turns for the three months ended March 31,	
(in millions, except inventory turn data)	March 31, 2006	December 31, 2005	2006	2005
BioScience	$1,110	$ 1,102	1.73	1.54
Medication Delivery	694	624	3.19	3.91
Renal	202	199	4.86	3.89
Total	$2,006	$ 1,925	2.55	2.57

Inventory turns in the first quarter of 2006 were relatively flat as compared to the prior year, as improved performances in the BioScience and Renal segments were offset by a decline in turns in the Medication Delivery segment. The lower inventory turns in the Medication Delivery segment were partially due to the above-mentioned sales hold on COLLEAGUE pumps, as well as to support the launch of sevoflurane.

Other

Other cash outflows decreased in the first quarter of 2006 as compared to the prior year quarter. Contributing to the decrease in cash outflows were reduced payments related to the company s restructuring program, with payments declining $24 million, from $43 million in the first quarter of 2005 to $19 million in the first quarter of 2006. Contributions to the company s pension plans also declined, with a contribution to a non-U.S. plan of $31 million during the first quarter of 2006, as compared to a contribution to the U.S. and Puerto Rico plans of $100 million during the prior year quarter. Partially offsetting these and other declines was the impact of a $58 million cash inflow related to the settlement of certain mirror cross-currency swaps during the first quarter of 2005. There were no settlements of cross-currency swaps during the first quarter of 2006. Refer to the 2005 Annual Report for further information regarding these swaps.

Cash flows from investing activities

Capital Expenditures

Capital expenditures increased $11 million during the first quarter of 2006, from $65 million in 2005 to $76 million in 2006. The company is investing in various multi-year capital projects across its three segments, including ongoing projects to upgrade facilities or increase manufacturing capacity for drug delivery, plasma-based (including antibody therapy) and other products. Two of the significant projects include the expansion of the company s manufacturing facility in Bloomington, Indiana and the upgrade of the company s plasma fractionation facility in Los Angeles, California.

Divestitures and Other

Net cash inflows relating to divestitures and other activities totaled $11 million during the first quarter of 2006 and $49 million during the first quarter of 2005. The 2006 total principally related to cash collections on retained interests associated with securitization arrangements. The 2005 total principally related to the collection of a loan from Cerus Corporation, a company in which Baxter owns approximately 1% of the common stock, and cash proceeds relating to the divestiture of the Renal segment s RTS business in Taiwan.

Cash flows from financing activities

Debt Issuances, Net of Payments of Obligations

Net cash outflows relating to debt and other financing obligations totaled $928 million during the first quarter of 2006. Using the cash proceeds from the settlement of the equity units purchase contracts (further discussed below), the company paid down maturing debt during the quarter. In the first quarter of 2005, a net cash inflow of $28 million was generated from debt issuances, net of payments of obligations. Included in the net total for 2005 was $312 million in cash outflows associated with the settlement of certain of the company s cross-currency swap agreements. Refer to further discussion below.

30

Table of Contents

Other Financing Activities
Cash dividend payments, which totaled $363 million in the first quarter of 2006, increased from the prior year quarter due to a higher number of common shares outstanding, and were funded with cash generated from operations. Cash received for stock issued under employee stock plans decreased by $9 million, from $53 million in the first quarter of 2005 to $44 million in the first quarter of 2006, primarily due to a lower cash receipts relating to employee stock purchase plans.

In February 2006 the company issued 35 million shares of common stock for $1.25 billion in conjunction with the settlement of the purchase contracts included in the company s equity units. Management is using these proceeds to pay down maturing debt, for stock repurchases, and for other general corporate purposes. Refer to the 2005 Annual Report for further information regarding the equity units.

Stock repurchases totaled $171 million in the first quarter of 2006. There were no stock repurchases during the first quarter of 2005. As authorized by the board of directors, from time to time the company repurchases its stock on the open market depending upon the company s cash flows, net debt level and current market conditions. The repurchases during the first quarter of 2006 were made pursuant to the board of directors October 2002 $500 million authorization. At March 31, 2006, $72 million remained available under this authorization. In February 2006, the board of directors authorized the repurchase of an additional $1.5 billion of the company s common stock. No shares have been repurchased under this authorization.

CREDIT FACILITIES, ACCESS TO CAPITAL, AND COMMITMENTS

Refer to the 2005 Annual Report for further discussion of the company s credit facilities, access to capital, and commitments and contingencies.

Credit facilities

The company had $881 million of cash and equivalents at March 31, 2006. The company also maintains three primary revolving credit facilities, which totaled $2 billion at March 31, 2006. One of the facilities totals $640 million and matures in October 2007, another facility totals $800 million and matures in September 2009, and the third facility, which is denominated in Euros, totals $610 million and matures in January 2008. The facilities enable the company to borrow funds in U.S. Dollars, Euros or Swiss Francs on an unsecured basis at variable interest rates. 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 quarterly minimum interest coverage ratio. At March 31, 2006, the company was in compliance with the financial covenants in these agreements. At March 31, 2006, there was $244 million in borrowings under the $610 million Euro-denominated credit facility. The borrowings bear interest at a variable rate and are repayable at any time, in whole or in part, through the maturity date of the revolving facility. There were no other borrowings outstanding under the company s primary credit facilities at March 31, 2006.

Access to capital

Management intends to fund short-term and long-term obligations as they mature through cash on hand, future cash flows from operations, or by issuing additional debt or common stock. As of March 31, 2006, the company has $399 million of shelf registration statement capacity available for the issuance of debt, common stock or other securities.

Table of Contents

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 if 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 the company has sufficient financial flexibility in the future to issue debt, enter into other financing arrangements, and attract long-term capital on acceptable terms to support the company s growth objectives.

LEGAL CONTINGENCIES

Refer to Note 5 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 liabilities. While the liability of the company in connection with the claims cannot be estimated with any certainty, and although the resolution in any reporting period of one or more of these matters could have a significant impact on the company s results of operations for that period, the outcome of these legal proceedings is not expected to have a material adverse effect on the company s consolidated financial position. While the company believes that it has valid defenses in these matters, litigation is inherently uncertain, excessive verdicts do occur, and the company may in the future incur material judgments or enter into material settlements of claims.

COLLEAGUE MATTER

The company has held shipments of COLLEAGUE infusion pumps since July 2005. Please see the company s 2005 Annual Report at pages 42-43 for a description of recalls designated by the U.S. Food and Drug Administration (FDA) as Class I, the FDA s highest priority, as well as a description of deaths and serious injuries that may have been associated with the product. In October 2005, the FDA seized approximately 6,000 Baxter-owned COLLEAGUE pumps, as well as 850 SYNDEO PCA syringe pumps, which were on hold at two facilities in Northern Illinois. The seizure did not affect customer-owned pumps. Litigation relating to the seizure is described in Note 5.

Although the company is working to resolve these infusion pump issues with the FDA and in the related seizure litigation, the company nevertheless remains subject to administrative and legal actions. These actions include product recalls, additional product seizures, injunctions to halt manufacture and distribution, restrictions on the company s operations, civil sanctions, including monetary sanctions, and criminal sanctions. Any of these actions could have an adverse effect on the company s business and subject the company to additional regulatory actions and costly litigation. While, as further described in Note 3, the company has provided COLLEAGUE customers with additional warranty and other commitments, there can be no assurance that sales of disposables used with COLLEAGUE pumps or any other products may not be adversely affected as the company works to resolve these issues. The company continues to work with the FDA with respect to its observations and investigations of these issues and remains committed to enhancing quality systems and processes across the company. Please see Item 1A. Risk Factors in the company s Form 10-K for the year ended December 31, 2005 for additional discussion of COLLEAGUE matters.

NEW ACCOUNTING STANDARDS

During the first quarter of 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments an amendment of FASB Statements No. 133 and 140 (SFAS No. 155) and

Table of Contents

SFAS No. 156, Accounting for Servicing of Financial Instruments an amendment of FASB Statement No. 140 (SFAS No. 156). SFAS No. 155 requires that interests in securitized financial assets be evaluated to determine whether they contain embedded derivatives, and permits the accounting for any such hybrid financial instruments as single financial instruments at fair value with changes in fair value recognized directly in earnings. SFAS No. 156 specifies that servicing assets or liabilities recognized upon the sale of financial assets must be initially measured at fair value, and subsequently either measured at fair value or amortized in proportion to and over the period of estimated net servicing income or loss. The company plans to adopt both standards on January 1, 2007. Management is in the process of analyzing the new standards.

FORWARD-LOOKING INFORMATION

This quarterly report includes forward-looking statements, including accounting estimates, expectations with respect to restructuring activities, statements with respect to infusion pumps and other regulatory matters, sales and pricing forecasts, litigation outcomes, future costs relating to HD instruments, developments with respect to credit and credit ratings, including the adequacy of credit facilities, estimates of liabilities, statements regarding future capital expenditures, the expected net-to-debt capital ratio, the sufficiency of the company s financial flexibility, and the expected impact of the implementation of SFAS No. 123-R, and all other statements that do not relate to historical facts. The statements are based on assumptions about many important factors, including assumptions concerning:

- future actions of regulatory bodies and other government authorities, including the FDA and foreign counterparts, that could delay, limit or suspend product development, manufacturing or sale or result in seizures, injunctions and monetary sanctions, including with respect to the company s infusion pumps;
- product quality or patient safety issues, leading to product recalls, withdrawals, launch delays, litigation, or declining sales;
- product development risks, including satisfactory clinical performance, the ability to manufacture at appropriate scale, and the general unpredictability associated with the product development cycle;
- demand for and market acceptance risks for new and existing products, such as ADVATE, and other technologies;
- the impact of geographic and product mix on the company s sales;
- 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;
- the availability of acceptable raw materials and component supply;
- global regulatory, trade and tax policies;
- 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;
- the company s ability to realize in a timely manner the anticipated benefits of restructuring initiatives;

foreign currency fluctuations;

change in credit agency ratings; and

Table of Contents

other factors identified elsewhere in this report and other filings with the Securities and Exchange Commission, including those factors described under the caption Item 1A. Risk Factors in the company s Form 10-K for the year ended December 31, 2005, all of which are available are on the company s website.

Actual results may differ materially from those projected in the forward-looking statements. The company does not undertake to update its forward-looking statements.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Currency risk

Refer to the caption Financial Instrument Market Risk in the company s 2005 Annual Report. As part of its risk-management program, the company performs sensitivity analyses to assess potential changes in the fair value of its foreign exchange instruments relating to hypothetical and reasonably possible near-term movements in foreign exchange rates.

A sensitivity analysis of changes in the fair value of foreign exchange forward and option contracts outstanding at March 31, 2006, while not predictive in nature, indicated that if the U.S. Dollar uniformly fluctuated unfavorably by 10% against all currencies, on a net-of-tax basis, the net liability balance of $11 million with respect to those contracts would increase by $65 million.

With respect to the company s cross-currency swap agreements (including the outstanding mirror swaps), if the U.S. Dollar uniformly weakened by 10%, on a net-of-tax basis, the net liability balance of $410 million with respect to those contracts outstanding at March 31, 2006 would increase by $85 million. Any increase or decrease in the fair value of cross-currency swap agreements designated as hedges of the net assets of foreign operations relating to changes in spot currency exchange rates is offset by the change in the value of the hedged net assets relating to changes in spot currency exchange rates. With respect to the portion of the cross-currency swap portfolio that is no longer designated as a net investment hedge, but is fixed via the mirror swaps, as the fair value of this fixed portion of the portfolio decreases, the fair value of the mirror swaps increases by an approximately offsetting amount, and vice versa.

The sensitivity analysis model recalculates the fair value of the foreign currency forward, option and cross-currency swap contracts outstanding at March 31, 2006 by replacing the actual exchange rates at March 31, 2006 with exchange rates that are 10% unfavorable to the actual exchange rates for each applicable currency. All other factors are held constant. These sensitivity analyses disregard the possibility that currency exchange rates can move in opposite directions and that gains from one currency may or may not be offset by losses from another currency. The analyses also disregard the offsetting change in value of the underlying hedged transactions and balances.

Interest Rate and Other Risks

Refer to the caption Financial Instrument Market Risk in the company s 2005 Annual Report. There were no significant changes during the first quarter of 2006.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Baxter carried out an evaluation, under the supervision and with the participation of its Disclosure Committee and management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Baxter s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of March 31, 2006. Baxter s disclosure controls and procedures are designed to ensure that information required to be disclosed by Baxter 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 communicated to management, including the Chief Executive Officer, Chief Financial Officer and its Board of Directors 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 are effective as of March 31, 2006.

Changes in Internal Control over Financial Reporting

There has been no change in Baxter s internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2006 that has materially affected, or is reasonably likely to materially affect, Baxter s internal control over financial reporting.

Table of Contents

Review by Independent Registered Public Accounting Firm

Reviews of the interim condensed consolidated financial information included in this Quarterly Report on Form 10-Q for the three months ended March 31, 2006 and 2005 have been performed by PricewaterhouseCoopers LLP, the company s independent registered public accounting firm. Its 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.

37

Table of Contents

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Baxter International Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Baxter International Inc. and its subsidiaries as of March 31, 2006, and the related condensed consolidated statements of income and of cash flows for each of the three-month periods ended March 31, 2006 and 2005. 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, 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.

As discussed in Note 1 to the condensed consolidated financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123-R, Share Based Payment.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2005, and the related consolidated statements of income, cash flows and shareholders equity and comprehensive income for the year then ended, management s assessment of the effectiveness of the Company s internal control over financial reporting as of December 31, 2005 and the effectiveness of the Company s internal control over financial reporting as of December 31, 2005; and in our report dated March 1, 2006, we expressed unqualified opinions thereon. The consolidated financial statements and management s assessment of the effectiveness of internal control over financial reporting referred to above are not presented herein. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
PricewaterhouseCoopers LLP
Chicago, Illinois
May 2, 2006

Table of Contents

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information in Part I, Item 1, Note 5 is incorporated herein by reference.

Table of Contents

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
The following table includes information about the company s common stock repurchases during the first quarter of 2006.

Issuer Purchases of Equity Securities

Period	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (1)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Programs (1) (2)
January 1, 2006 through January 31, 2006				
February 1, 2006 through February 28, 2006	502,800	$ 38.23	502,800	
March 1, 2006 through March 31, 2006	3,957,795	38.34	3,957,795	
Total	4,460,595	$ 38.33	4,460,595	$1.572 billion

(1) In November 2002 the company announced that its board of directors authorized the company to repurchase up to $500 million of its common stock on the open market, of which $428 million (approximately 9.6 million shares) has been repurchased to date. During the first quarter of 2006, the company repurchased $171 million, or approximately 4.5 million shares, under this program. The program does not have an expiration date.

(2) In February 2006, the company announced that its board of directors authorized the company to repurchase up to $1.5 billion of its common stock on the open market. There have been no repurchases under this program to date. The program does not have an expiration date.

The total dollar value of shares that may be repurchased under the two programs at March 31, 2006 is as follows:

October 2002 authorization	$72 million
February 2006 authorization	1,500 million
Total	$1,572 million

Table of Contents

Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index hereto.

41

Table of Contents

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: May 3, 2006	By:	/s/ John J. Greisch
		John J. Greisch Corporate Vice President and Chief Financial Officer (duly authorized officer and chief financial officer)

Table of Contents

EXHIBITS FILED WITH OR FURNISHED TO THE SECURITIES AND EXCHANGE COMMISSION

Number	Description of Exhibit
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. Section 1350
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350