BAXTER INTERNATIONAL INC
Form 10-Q
May 09, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-4448

BAXTER INTERNATIONAL INC.

(Exact name of registrant as specified in its charter)

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

224-948-2000
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of shares of the registrant's Common Stock, par value $1.00 per share, outstanding as of April 30, 2018 was 535,485,895 shares.

BAXTER INTERNATIONAL INC.

FORM 10-Q

For the quarterly period ended March 31, 2018

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Item 1. Financial Statements
Baxter International Inc.

Condensed Consolidated Statements of Income (unaudited)

(in millions, except per share data)

	Three months ended March 31,	
	2018	2017
Net sales	$2,677	$2,475
Cost of sales	1,563	1,431
Gross margin	1,114	1,044
Marketing and administrative expenses	622	564
Research and development expenses	140	127
Claris settlement	(80)	—
Operating income	432	353
Net interest expense	12	14
Other (income) expense, net	(18)	11
Income from continuing operations before income taxes	438	328
Income tax expense	49	55
Income from continuing operations	389	273
Loss from discontinued operations, net of tax	—	(1)
Net income	$389	$272
Income from continuing operations per common share		
Basic	$0.72	$0.50
Diluted	$0.71	$0.50
Loss from discontinued operations per common share		
Basic	$—	$—
Diluted	$—	$(0.01)
Net income per common share		
Basic	$0.72	$0.50
Diluted	$0.71	$0.49
Weighted-average number of common shares outstanding		
Basic	539	541
Diluted	551	551
Cash dividends declared per common share	$0.160	$0.130

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

Baxter International Inc.

Condensed Consolidated Statements of Comprehensive Income (unaudited)

(in millions)

	Three months ended March 31,	
	2018	2017
Net income	$389	$272
Other comprehensive income (loss), net of tax:		
Currency translation adjustments, net of tax (benefit) expense of ($7) and $20 for the three months ended March 31, 2018 and 2017, respectively	81	122
Pension and other employee benefits, net of tax expense of $13 and $10 for the three months ended March 31, 2018 and 2017, respectively	52	21
Hedging activities, net of tax expense (benefit) of $1 and ($4) for the three months ended March 31, 2018 and 2017, respectively	(5)	(7)
Available-for-sale securities, net of tax expense of zero for the three months ended March 31, 2018 and 2017.	—	2
Total other comprehensive income (loss), net of tax	128	138
Comprehensive income	$517	$410

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

Baxter International Inc.

Condensed Consolidated Balance Sheets (unaudited)

(in millions, except shares)

		March 31, 2018	December 31, 2017
Current assets	Cash and equivalents	$2,947	$ 3,394
	Accounts and other current receivables, net	1,807	1,793
	Inventories	1,581	1,475
	Prepaid expenses and other	621	601
	Total current assets	6,956	7,263
Property, plant and equipment, net		4,614	4,588
Other assets	Goodwill	3,107	3,099
	Other intangible assets, net	1,507	1,374
	Other	706	787
	Total other assets	5,320	5,260
Total assets		$16,890	$ 17,111
Current liabilities	Current maturities of long-term debt and lease obligations	$3	$ 3
	Accounts payable and accrued liabilities	2,533	2,733
	Current income taxes payable	106	85
	Total current liabilities	2,642	2,821
Long-term debt and lease obligations		3,550	3,509
Other long-term liabilities		1,605	1,665
Equity	Common stock, $1 par value, authorized 2,000,000,000 shares, issued 683,494,944 shares in 2018 and 2017	683	683
	Common stock in treasury, at cost, 146,993,164 shares in 2018 and 142,017,600 shares in 2017	(8,354)	(7,981)
	Additional contributed capital	5,912	5,940
	Retained earnings	14,734	14,483
	Accumulated other comprehensive (loss) income	(3,876)	(4,001)
	Total Baxter shareholders’ equity	9,099	9,124
	Noncontrolling interests	(6)	(8)
	Total equity	9,093	9,116
Total liabilities and equity		$16,890	$ 17,111

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

Baxter International Inc.

Condensed Consolidated Statements of Cash Flows (unaudited)

(in millions)

		Three months ended March 31, 2018	2017
Cash flows from operations	Net income	$389	$272
	Adjustments to reconcile income from continuing operations to net cash from operating activities:		
	Loss from discontinued operations, net of tax	—	1
	Depreciation and amortization	192	194
	Deferred income taxes	(33)	9
	Stock compensation	20	18
	Net periodic pension benefit and OPEB costs	10	31
	Other	12	(1)
	Changes in balance sheet items		
	Accounts and other current receivables, net	76	78
	Inventories	(56)	(29)
	Accounts payable and accrued liabilities	(103)	(262)
	Business optimization items	(27)	(43)
	Other	(33)	(62)
	Cash flows from operations – continuing operations	447	206
	Cash flows from operations – discontinued operations	—	(17)
	Cash flows from operations	447	189
Cash flows from investing activities	Capital expenditures	(155)	(123)
	Acquisitions and investments, net of cash acquired	(219)	(6)
	Divestitures and other investing activities, net	—	12
	Cash flows from investing activities	(374)	(117)
Cash flows from financing activities	Cash dividends on common stock	(87)	(70)
	Proceeds from stock issued under employee benefit plans	82	111
	Purchases of treasury stock	(522)	(51)
	Other	(18)	(27)
	Cash flows from financing activities	(545)	(37)
Effect of foreign exchange rate changes on cash and equivalents		25	22
(Decrease) increase in cash and equivalents		(447)	57
Cash and equivalents at beginning of period		3,394	2,801
Cash and equivalents at end of period		$2,947	$2,858

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

Baxter International Inc.

Notes to Condensed Consolidated Financial Statements (unaudited)

1. BASIS OF PRESENTATION

The unaudited interim condensed consolidated financial statements of Baxter International Inc. and its subsidiaries (the company or Baxter) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles (GAAP) in the United States have been condensed or omitted. These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the company's Annual Report on Form 10-K for the year ended December 31, 2017 (2017 Annual Report).

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

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

New accounting standards

Recently adopted accounting pronouncements

As of January 1, 2018, the company adopted Accounting Standards Update (ASU) No. 2017-07, Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which amends ASC 715, Compensation – Retirement Benefits, to require employers that present a measure of operating income in their statements of earnings to include only the service cost component of net periodic postretirement benefit cost in operating expenses. The service cost component of net periodic postretirement benefit cost should be presented in the same operating expense line items as other employee compensation costs arising from services rendered during the period. The other components of net benefit cost, including interest costs, expected return on assets, amortization of prior service cost/credit and actuarial gains/losses, and settlement and curtailment effects, are to be included separately and outside of any subtotal of operating income. This guidance impacted the presentation of the company's consolidated statements of income with no significant impact on net income. The retrospective impact of adoption for the three months ended March 31, 2017 is shown in the following table.

	Three months ended March 31, 2017		
	As Previously Reported	Reclassification	As Reclassified

Cost of sales	$1,433	$ (2)	$ 1,431
Gross margin	1,042	2	1,044
Marketing and administrative expenses	570	(6)	564
Research and development expenses	128	(1)	127
Operating income	344	9	353
Other (income) expense, net	2	9	11

As of January 1, 2018, the company adopted ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory. ASU No. 2016-16 generally accelerates the recognition of income tax consequences for asset transfers between entities under common control. Entities are required to adopt using a modified retrospective approach with a cumulative adjustment to opening retained earnings in the year of adoption for previously unrecognized income tax expense. The company recorded a net negative retained earnings adjustment of approximately $66 million upon adoption of the standard on January 1, 2018 related to the unrecognized income tax effects of asset transfers that occurred prior to adoption.

As of January 1, 2018, the company adopted ASU No. 2016-01, Financial Instruments: Recognition and Measurement of Financial Assets and Liabilities. The new standard amends certain aspects of accounting and disclosure requirements of financial instruments, including the requirement that equity investments with readily determinable fair values be measured at fair value with changes in fair value recognized in the results of operations. The adoption of this standard did not have a material impact on the company’s condensed consolidated financial statements.

As of January 1, 2018, the company adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which amends the existing accounting standards for revenue recognition. ASU No. 2014-09 is based on principles that govern the recognition of revenue at an amount an entity expects to be entitled when products are transferred to customers. The company adopted the standard using the modified retrospective method. The primary impact of the new standard relates to the company’s contract manufacturing operations and software arrangements. Certain contract manufacturing arrangements require revenue recognition over-time in situations in which the company produces products that have no alternative use and the company has an enforceable right to payment for performance completed to date, inclusive of a reasonable profit margin. This results in an acceleration of revenue recognition for certain contractual arrangements as compared to recognition under prior accounting literature. The new guidance also impacts the company’s arrangements subject to previous software revenue recognition guidance, as the company is required to recognize as revenue a significant portion of the contract consideration upon delivery of the software compared to the previous practice of recognizing the contract consideration ratably over time for certain arrangements. The adjustment upon adoption increased the company’s opening balance of retained earnings by approximately $48 million, net of tax, on January 1, 2018. Refer to Note 2 for further information regarding the company’s revenues.

2. REVENUES

Revenue is recognized when obligations under the terms of a contract with a customer are satisfied; generally this occurs with the transfer of control of the company’s products or services. Revenue is measured as the amount of consideration the company expects to receive in exchange for transferring goods or providing services. A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in the contract. A contract’s transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Some of the company’s contracts have multiple performance obligations. For contracts with multiple performance obligations, the company allocates the contract’s transaction price to each performance obligation using its best estimate of the standalone selling price of each distinct good or service in the contract.

The majority of the company’s performance obligations are satisfied at a point in time. This includes sales of the company’s broad portfolio of essential healthcare products across its geographic segments including acute and chronic dialysis therapies; sterile IV solutions; infusion systems and devices; parenteral nutrition therapies; inhaled anesthetics; generic injectable pharmaceuticals; and surgical hemostat and sealant products. For a majority of these sales, the company’s performance obligation is satisfied upon delivery to the customer. Shipping and handling activities are considered to be fulfillment activities and are not considered to be a separate performance obligation.

To a lesser extent, in all the company’s segments, the company enters into other types of contracts including contract manufacturing arrangements, equipment leases, and certain subscription software and licensing arrangements. The company recognizes revenue for these arrangements over time or at a point in time depending on its evaluation of when the customer obtains control of the promised goods or service. Revenue is recognized over time when the company is creating or enhancing an asset that the customer controls as the asset is created or enhanced or the company’s performance does not create an asset with an alternative use and the company has an enforceable right to payment for performance completed.

On March 31, 2018, the company had $2.8 billion of transaction price allocated to remaining performance obligations related to executed contracts with an original duration of one year or more which are primarily included in the Americas segment. Some contracts in the United States included in this amount may contain index-dependent price increases, which are not known at this time. The company expects to recognize approximately 25% of this amount as revenue in 2018, 27% in 2019, and the remaining balance thereafter.

Significant Judgments

Revenues from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for reserves related to rebates, product returns, sales discounts and wholesaler chargebacks. These reserves are based on estimates of the amounts earned or to be claimed on the related sales. Management's estimates take into consideration historical experience, current contractual and statutory requirements, specific known market events and trends, industry data, and forecasted customer buying and payment patterns. Overall, these reserves reflect the company’s best estimates of the amount of consideration to which it is entitled based on the terms of the contract. The amount of variable consideration included in the net sales price is limited to the amount that is probable not to result in a significant reversal in the amount of the cumulative revenue recognized in a future period. Revenue recognized in the current period related to performance obligations satisfied in prior periods was not material.

The company’s contracts with customers sometimes include promises to transfer multiple products and services to a customer. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Judgment is also required to determine the stand-alone selling price for each distinct performance obligation and whether there is a discount to be allocated based on the relative stand-alone selling price of the various products and services.

Contract Balances

The timing of revenue recognition, billings and cash collections results in billed accounts receivable, unbilled receivables (contract assets), and customer advances and deposits (contract liabilities) on the condensed consolidated balance sheet. Net trade accounts receivable at March 31, 2018 and January 1, 2018 were $1.7 billion, respectively. Generally, for certain contract manufacturing and software arrangements, billing occurs subsequent to revenue recognition, resulting in contract assets. These assets are reported on the condensed consolidated balance sheet on an individual basis at the end of each reporting period. The contract asset balances at March 31, 2018 and January 1, 2018 were $68 million and $73 million, respectively. The contract assets as of March 31, 2018 are presented within accounts and other current receivables, net ($41 million) and other ($27 million) on the condensed consolidated balance sheet. The decrease from January 1, 2018 to March 31, 2018 was due primarily to net billings under the company's contract manufacturing programs. The company had no contract liabilities as of March 31, 2018 and January 1, 2018, respectively.

Practical Expedients

The company applies a practical expedient to expense costs as incurred for costs to obtain a contract with a customer when the amortization period would have been one year or less. These costs include the company's internal sales force compensation programs as the company has determined annual compensation is commensurate with annual sales activities. The company does not disclose the value of transaction price allocated to unsatisfied performance obligations for contracts with an original expected length of one year or less. The company has elected to use the practical expedient to not adjust the promised amount of consideration for the effects of a significant financing component if it is expected, at contract inception, that the period between when the company transfers a promised good or service to a customer, and when the customer pays for that good or service, will be one year or less. Additionally, all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific revenue-producing transaction and collected from a customer are excluded from revenue.

The company adopted ASC 606 using the modified retrospective method. The impact to net sales and cost of sales as a result of the adoption was insignificant for the three months ended March 31, 2018.

3. SEPARATION OF BAXALTA INCORPORATED

On July 1, 2015, Baxter completed the distribution of approximately 80.5% of the outstanding common stock of Baxalta Incorporated (Baxalta) to Baxter shareholders (the Distribution). Baxter and Baxalta entered into several agreements in connection with the July 1, 2015 separation, including a transition services agreement (TSA), separation and distribution agreement, manufacturing and supply agreements (MSA), tax matters agreement, an employee matters agreement, a long-term services agreement, and a shareholder's and registration rights agreement. Pursuant to the TSA, Baxter and Baxalta and their respective subsidiaries are providing to each other, on an interim, transitional basis, various services. Services being provided by Baxter include, among others, finance, information technology, human resources, quality supply chain and certain other administrative services. The services generally commenced on the Distribution date and are expected to terminate within 36 months of the Distribution date (July

2018). Billings by Baxter under the TSA are recorded as a reduction of the costs to provide the respective service in the applicable expense category, primarily in marketing and administrative expenses, in the condensed consolidated statements of income. In the first quarter of 2018 and 2017, the company recognized approximately $7 million and $20 million, respectively, as a reduction to marketing and administrative expenses related to the TSA.

Pursuant to the MSA, Baxalta or Baxter, as the case may be, manufactures, labels, and packages products for the other party. The terms of the agreements range in initial duration from five to 10 years. In the first quarters of 2018 and 2017, Baxter recognized approximately $6 million in sales to Baxalta. In addition, in the first quarter of 2018 and 2017, Baxter recognized $37 million and $48 million, respectively, in cost of sales related to purchases from Baxalta pursuant to the MSA. The cash flows associated with these agreements are included in cash flows from operations — continuing operations.

Cash outflows of $17 million were reported in cash flows from operations — discontinued operations for the three-month period ending March 31, 2017. These related to non-assignable tenders whereby Baxter was the seller of Baxalta products, transactions related to importation services Baxter provides in certain countries, in addition to trade payables settled post local separation on Baxalta’s behalf.

4. SUPPLEMENTAL FINANCIAL INFORMATION

Net interest expense

(in millions)	Three months ended March 31, 2018	2017
Interest expense, net of capitalized interest	$22	$ 20
Interest income	(10)	(6)
Net interest expense	$12	$ 14

Other (income) expense, net

(in millions)	Three months ended March 31, 2018	2017
Foreign exchange	$(15)	$ —
Pension	(12)	9
All other	9	2
Other (income) expense, net	$(18)	$ 11

Inventories

(in millions)	March 31, 2018	December 31, 2017
Raw materials	$361	$ 347
Work in process	166	116
Finished goods	1,054	1,012
Inventories	$1,581	$ 1,475

Property, plant and equipment, net

(in millions)	March 31, 2018	December 31, 2017

Property, plant and equipment, at cost	$10,390	$ 10,148
Accumulated depreciation	(5,776)	(5,560)
Property, plant and equipment, net	$4,614	$ 4,588

In the first quarter of 2018, the estimated useful life of the company's enterprise resource planning (ERP) software was extended from 2020 on a prospective basis based on the company's commitment to upgrade, enhance and support its existing systems through 2028. This change in estimate resulted in a reduction of depreciation expense of $6 million and increase in net income of $4 million, or $0.01 per diluted share, for the three months ended March 31, 2018.

5. EARNINGS PER SHARE

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

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

	Three months ended March 31,	
(in millions)	2018	2017
Basic shares	539	541
Effect of dilutive securities	12	10
Diluted shares	551	551

The effect of dilutive securities included unexercised stock options, unvested RSUs and contingently issuable shares related to granted PSUs. The computation of diluted EPS excluded 2 million and 3 million equity awards for the three months ended March 31, 2018 and 2017, respectively, because their inclusion would have had an anti-dilutive effect on diluted EPS. Refer to Note 10 for additional information regarding items impacting basic shares.

Stock repurchases

In July 2012, the Board of Directors authorized the repurchase of up to $2.0 billion of the company's common stock. The Board of Directors increased this authority by an additional $1.5 billion in each of November 2016 and February 2018. During the first three months of 2018, the company repurchased 7.7 million shares pursuant to one or more Rule 10b5-1 plans for $522 million in cash. The company had $2.1 billion remaining available under the authorization (as amended and after giving effect to stock repurchases) as of March 31, 2018.

6. ACQUISITIONS AND OTHER ARRANGEMENTS

Claris Injectables Limited

On July 27, 2017, Baxter acquired 100 percent of Claris Injectables Limited (Claris), a wholly owned subsidiary of Claris Lifesciences Limited, for total cash consideration of approximately $629 million, net of cash acquired. Through the acquisition, Baxter added capabilities in production of essential generic injectable medicines, such as anesthesia and analgesics, renal, anti-infectives and critical care in a variety of presentations including bags, vials and ampoules. The following table summarizes the fair value of the assets acquired and liabilities assumed as of the acquisition date for the company's acquisition of Claris:

(in millions)	
Assets acquired and liabilities assumed	
Cash	$11
Accounts and other current receivables	16
Inventories	30
Prepaid expenses and other	16
Property, plant and equipment	132
Goodwill	291
Other intangible assets	280
Other	20
Accounts payable and accrued liabilities	(22)
Other long-term liabilities	(134)
Total assets acquired and liabilities assumed	$640

The results of operations of Claris have been included in the company's condensed consolidated statement of income since the date the business was acquired and were not material. Acquisition and integration costs associated with the Claris acquisition were $7 million in the three months ended March 31, 2018, and were primarily included within marketing and administrative expenses and cost of sales on the condensed consolidated statements of income.

Baxter allocated $280 million of the total consideration to acquired intangible assets. The acquired intangible assets include $140 million of developed technology with a weighted-average useful life of eight years and $140 million of in-process research and development (IPR&D) with an indefinite useful life. For the IPR&D, additional R&D will be required to assess technological feasibility.

The fair value of intangible assets was determined using the income approach. The income approach is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset would generate over its remaining useful life, discounted to present value. The discount rates used to measure the developed technology and IPR&D intangible assets were 12% and 13%, respectively. The company considers the fair value of each of the acquired intangible assets to be Level 3 assets due to the significant estimates and assumptions used by management in establishing the estimated fair values. Refer to Note 10 within the 2017 Annual Report for additional information regarding fair value measurements.

The goodwill, which is not deductible for tax purposes, includes the value of potential future technologies as well as the overall strategic benefits provided to Baxter in the injectables market, and is included primarily in the Americas segment.

In the first quarter of 2018, Baxter and Claris Lifesciences Limited settled certain claims related to the acquired operations and terminated a development agreement with Dorizoe Lifesciences Limited. As a result, Baxter received $73 million in February 2018 and was released from an accrued liability to Claris Lifesciences Limited of $7 million. The total of $80 million is reflected as a benefit in the 2018 condensed consolidated income statement.

RECOTHROM and PREVELEAK

On March 16, 2018, Baxter acquired two hemostat and sealant products from Mallinckrodt plc: RECOTHROM Thrombin topical (Recombinant), the first and only stand-alone recombinant thrombin, and PREVELEAK Surgical Sealant, which is used in vascular reconstruction. The company concluded that the acquired assets met the definition of a business and accounted for the transaction as a business combination using the acquisition method of accounting. The purchase price included an upfront payment of approximately $148 million, subject to customary post-closing adjustments, as well as new and assumed contingent payments in the future related to technology transfer milestones and net revenue royalty payments with an estimated fair value of $14 million as of the acquisition date. As of the acquisition date, the maximum aggregate amount payable for the technology transfer and net revenue royalties was $15 million and $143 million, respectively. The fair value of the potential contingent consideration payments were estimated by applying a probability-weighted expected payment model for technology transfer payments and a Monte Carlo simulation model for contingent royalty payments, which were then discounted to present value. The fair value measurements were based on Level 3 inputs.

The following table summarizes total consideration:

(in millions)	
Cash	$ 148
Contingent consideration	14
Total consideration	$ 162

The following table summarizes the fair value of the assets acquired as of the acquisition date.

(in millions)	
Assets acquired	
Accounts receivable	$ 2
Inventory	39
Goodwill	13
Other intangible assets	108
Total assets acquired	$ 162

The valuation of the assets acquired are preliminary and measurement period adjustments may be recorded in the future as the company finalizes its fair value estimates. The results of operations of the acquired business have been included in the company’s condensed consolidated statement of income since the date the business was acquired and were not material. Acquisition and integration costs associated with the acquisition were insignificant in the three months ended March 31, 2018.

Baxter allocated $108 million of the total consideration to the RECOTHROM and PREVELEAK developed product rights with a weighted-average useful life of 10 years. The fair value of the intangible assets was determined using the income approach. The income approach is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset will generate over its remaining useful life, discounted to present value at a rate to reflect the internal rate of return and uncertainty in the cash flow projections. The discount rates used to measure the RECOTHROM and PREVELEAK intangible assets were 14% and 15%, respectively. The company considers the fair value of the intangible assets to be Level 3 assets due to the significant estimates and assumptions used by management in establishing the estimated fair values. Refer to Note 10 within the

2017 annual report for additional information regarding fair value measurements.

The goodwill, which is deductible for tax purposes, includes the value of potential future technologies as well as the overall strategic benefits provided to Baxter's surgical portfolio of hemostats and sealants, and is included in the Americas segment.

Celerity Pharmaceuticals, LLC

In the first quarter of 2018, Baxter paid approximately $37 million and $35 million, respectively, to acquire the rights to Bivalirudin and Dexmedetomidine from Celerity Pharmaceuticals, LLC (Celerity). Baxter capitalized the purchase price of Bivalirudin as an intangible asset and is amortizing the asset over its estimated economic life of 12 years. The payment for Dexmedetomidine was based on tentative approval from the U.S. Food and Drug Administration (FDA) and will be amortized over its estimated economic life of 12 years. Refer to Note 5 within the 2017 Annual Report for additional information regarding the company's agreement with Celerity.

7. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

The following is a reconciliation of goodwill by business segment.

(in millions)	Americas	EMEA	APAC	Total
Balance as of December 31, 2017	$ 2,474	$ 392	$ 233	$3,099
Additions	13	—	—	13
Currency translation adjustments	(4)	(1)	—	(5)
Balance as of March 31, 2018	$ 2,483	$ 391	$ 233	$3,107

As of March 31, 2018, there were no accumulated goodwill impairment losses.

Other intangible assets, net

The following is a summary of the company’s other intangible assets.

(in millions)	Developed technology, including patents	Other amortized intangible assets	Indefinite-lived intangible assets	Total
March 31, 2018				
Gross other intangible assets	$ 2,177	$ 435	$ 172	$2,784
Accumulated amortization	(1,041)	(236)	—	(1,277)
Other intangible assets, net	$ 1,136	$ 199	$ 172	$1,507
December 31, 2017				
Gross other intangible assets	$ 2,002	$ 435	$ 172	$2,609
Accumulated amortization	(1,010)	(225)	—	(1,235)
Other intangible assets, net	$ 992	$ 210	$ 172	$1,374

Intangible asset amortization expense was $41 million and $38 million in the first quarters of 2018 and 2017, respectively.

8. INFUSION PUMP AND BUSINESS OPTIMIZATION CHARGES

Infusion Pump Charges

In 2017, the company recorded a charge of $22 million related to a second field corrective action with respect to the SIGMA Spectrum Infusion Pump, which is predominantly sold in the United States. Remediation primarily includes inspection and repair charges as well as a temporary replacement pump in a limited number of cases. The charge includes estimated cash costs associated with remediation efforts and $7 million of this charge had been utilized as of March 31, 2018.

Business Optimization Charges

Beginning in the second half of 2015, the company initiated actions to transform its cost structure and enhance operational efficiency. These efforts include restructuring the organization, optimizing the manufacturing footprint, R&D operations and supply chain network, employing disciplined cost management, and centralizing and streamlining certain support functions. Through March 31, 2018, the company has incurred cumulative pretax costs of $614 million related to these actions. The costs consisted primarily of employee termination, implementation costs and accelerated depreciation. The company expects to incur additional pretax costs of approximately $200 million and capital expenditures of $50 million through the completion of these initiatives. The costs will primarily include employee termination costs, implementation costs, and accelerated depreciation.

During the three months ended March 31, 2018 and 2017, the company recorded the following charges related to business optimization programs.

	Three months ended March 31,	
(in millions)	2018	2017
Restructuring charges, net	$12	$ 3
Costs to implement business optimization programs	25	21
Accelerated depreciation	1	5
Total business optimization charges	$38	$ 29

For segment reporting, business optimization charges are unallocated expenses.

During the three months ended March 31, 2018 and 2017, the company recorded the following restructuring charges.

	Three months ended March 31, 2018			
(in millions)	COGS	SG&A	R&D	Total
Employee termination costs	$1	$ 6	$ 3	$ 10

Asset impairments	1	1	—	2
Total restructuring charges	$ 2	$ 7	$ 3	$ 12

(in millions)	Three months ended March 31, 2017 COGS	SGA	R&D	Total
Employee termination costs	$ 10	$ 6	$ —	$ 16
Contract termination costs	—	1	—	1
Reserve adjustments	(7)	(5)	(2)	(14)
Total restructuring charges	$ 3	$ 2	$ (2)	$ 3

Costs to implement business optimization programs for the three months ended March 31, 2018 were $25 million and consisted primarily of external consulting and transition costs as well as employee salary and related costs. These costs were included within cost of sales and marketing and administrative expense.

Costs to implement business optimization programs for the three months ended March 31, 2017, were $21 million, and consisted primarily of external consulting and employee salary related costs. These costs were included within cost of sales and marketing and administrative expense.

For the three months ended March 31, 2018 and 2017, the company recognized accelerated depreciation, primarily associated with facilities to be closed, of $1 million and $5 million, respectively. The costs were recorded within cost of sales and marketing and administrative expense.

The following table summarizes activity in the reserves related to the company's business optimization initiatives.

(in millions)	
Reserves as of December 31, 2017	$112
Charges	10
Utilization	(27)
CTA	(13)
Reserves as of March 31, 2018	$82

Approximately 90% of the company's restructuring reserves as of March 31, 2018 relate to employee termination costs, with the remaining reserves attributable to contract termination costs. The reserves are expected to be substantially utilized by the end of 2018.

9. DEBT, FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS

Securitization arrangement

The following is a summary of the activity relating to the company's securitization arrangement in Japan.

	Three months ended March 31,	
(in millions)	2018	2017
Sold receivables at beginning of period	$71	$68
Proceeds from sales of receivables	62	62
Cash collections (remitted to the owners of the receivables)	(71)	(71)
Effect of currency exchange rate changes	2	2
Sold receivables at end of period	$64	$61

The impacts on the condensed consolidated statements of income relating to the sale of receivables were immaterial for each period. Refer to the 2017 Annual Report for further information regarding the company's securitization agreements.

Concentrations of credit risk

The company invests excess cash in certificates of deposit or money market funds and diversifies the concentration of cash among different financial institutions. With respect to financial instruments, where appropriate, the company has diversified its selection of counterparties, and has arranged collateralization and master-netting agreements to minimize the risk of loss.

The company continues to do business with foreign governments in certain countries including Greece, Spain, Portugal and Italy that have experienced a deterioration in credit and economic conditions. As of March 31, 2018, the company's net accounts receivable from the public sector in Greece, Spain, Portugal and Italy totaled $137 million.

Global economic conditions and liquidity issues in certain countries have resulted, and may continue to result, in delays in the collection of receivables and credit losses. Governmental actions and customer-specific factors may also require the company to re-evaluate the collectability of its receivables and the company could potentially incur additional credit losses. These conditions may also impact the stability of the Euro.

Derivatives and hedging activities

The company operates on a global basis and is exposed to the risk that its earnings, cash flows and equity could be adversely impacted by fluctuations in foreign exchange and interest rates. The company's hedging policy attempts to manage these risks to an acceptable level based on the company's judgment of the appropriate trade-off between risk, opportunity and costs.

The company is primarily exposed to foreign exchange risk with respect to recognized assets and liabilities, forecasted transactions and net assets denominated in the Euro, British Pound, Chinese Yuan, Korean Won, Australian Dollar, Canadian Dollar, Japanese Yen, Colombian Peso, Brazilian Real, Mexican Peso and New Zealand Dollar. The company manages its foreign currency exposures on a consolidated basis, which allows the company to net exposures and take advantage of any natural offsets. In addition, the company uses derivative and nonderivative instruments to further reduce the net exposure to foreign exchange. Gains and losses on the hedging instruments offset losses and gains on the hedged transactions and reduce the earnings and equity volatility resulting from foreign exchange. Financial market and currency volatility may limit the company's ability to cost-effectively hedge these exposures.

The company is also exposed to the risk that its earnings and cash flows could be adversely impacted by fluctuations in interest rates. The company's policy is to manage interest costs using a mix of fixed- and floating-rate debt that the company believes is appropriate.

To manage this mix in a cost-efficient manner, the company periodically enters into interest rate swaps in which the company agrees to exchange, at specified intervals, the difference between fixed and floating interest amounts calculated by reference to an agreed-upon notional amount.

The company does not hold any instruments for trading purposes and none of the company's outstanding derivative instruments contain credit-risk-related contingent features.

All derivative instruments are recognized as either assets or liabilities at fair value in the condensed consolidated balance sheets and are classified as short-term or long-term based on the scheduled maturity of the instrument. Based upon the exposure being hedged, the company designates its hedging instruments as cash flow, fair value, or net investment hedges.

Cash Flow Hedges

The company may use options, including collars and purchased options, forwards and cross-currency swaps to hedge the foreign exchange risk to earnings relating to forecasted transactions and recognized assets and liabilities.

For each derivative instrument that is designated and effective as a cash flow hedge, the gain or loss on the derivative is accumulated in accumulated other comprehensive income (AOCI) and then recognized in earnings consistent with the underlying hedged item. Option premiums or net premiums paid are initially recorded as assets and reclassified to other comprehensive income (OCI) over the life of the option, and then recognized in earnings consistent with the underlying hedged item. Cash flow hedges are classified in net sales, cost of sales, net interest expense, and other (income) expense, net, and primarily relate to forecasted third-party sales denominated in foreign currencies, forecasted intercompany sales denominated in foreign currencies, and anticipated issuances of debt, respectively.

The notional amounts of foreign exchange contracts were $731 million and $660 million as of March 31, 2018 and December 31, 2017, respectively. There were no outstanding interest rate contracts designated as cash flow hedges as of March 31, 2018 and December 31, 2017. The maximum term over which the company has cash flow hedge contracts in place related to forecasted transactions as of March 31, 2018 is 15 months.

Fair Value Hedges

The company uses interest rate swaps to convert a portion of its fixed-rate debt into variable-rate debt. These instruments hedge the company's earnings from changes in the fair value of debt due to fluctuations in the designated benchmark interest rate. For each derivative instrument that is designated and effective as a fair value hedge, the gain or loss on the derivative is recognized immediately to earnings, and offsets the loss or gain on the underlying hedged item. Fair value hedges are classified in net interest expense, as they hedge the interest rate risk associated with certain of the company’s fixed-rate debt.

The total notional amount of interest rate contracts designated as fair value hedges was $200 million as of March 31, 2018 and December 31, 2017.

Net Investment Hedges

In May 2017, the company issued €600 million of senior notes due May 2025. The company has designated this debt as a hedge of a portion of its net investment in its European operations and, as a result, mark to spot rate adjustments of the outstanding debt balances have been and will be recorded as a component of AOCI. As of March 31, 2018, the company had an accumulated pre-tax unrealized translation loss in AOCI of $100 million related to the Euro-denominated senior notes.

Dedesignations

If it is determined that a derivative or nonderivative hedging instrument is no longer highly effective as a hedge, the company discontinues hedge accounting prospectively. If the company removes the cash flow hedge designation because the hedged forecasted transactions are no longer probable of occurring, any gains or losses are immediately reclassified from AOCI to earnings. Gains or losses relating to terminations of effective cash flow hedges in which the forecasted transactions are still probable of occurring are deferred and recognized consistent with the loss or income recognition of the underlying hedged items.

There were no hedge dedesignations in the first quarters of 2018 or 2017 resulting from changes in the company's assessment of the probability that the hedged forecasted transactions would occur.

If the company terminates a fair value hedge, an amount equal to the cumulative fair value adjustment to the hedged items at the date of termination is amortized to earnings over the remaining term of the hedged item. There were no fair value hedges terminated during the first quarters of 2018 and 2017.

If the company terminates a net investments hedge, any gain or loss recognized in AOCI is not reclassified to earnings until the company sells, liquidates, or deconsolidates the foreign investments that were being hedged.

Undesignated Derivative Instruments

The company uses forward contracts to hedge earnings from the effects of foreign exchange relating to certain of the company's intercompany and third-party receivables and payables denominated in a foreign currency. These derivative instruments are generally not formally designated as hedges, and the change in fair value, which substantially offsets the change in book value of the hedged items, is recorded directly to other (income) expense, net. The terms of these instruments generally do not exceed one month.

The total notional amount of undesignated derivative instruments was $845 million as of March 31, 2018 and $885 million as of December 31, 2017.

Gains and Losses on Hedging Activities

The following tables summarize the income statement locations and gains and losses on the company's derivative instruments for the three months ended March 31, 2018 and 2017.

(in millions)	Gain (loss) recognized in OCI 2018	Gain (loss) recognized in OCI 2017	Location of gain (loss) in income statement	Gain (loss) reclassified from AOCI into income 2018	Gain (loss) reclassified from AOCI into income 2017
Cash flow hedges					
Foreign exchange contracts	$ (9)	$ (8)	Cost of sales	$ (4)	$ 2
Net investment hedge	(21)	—	Other (income) expense, net	—	—
Total	$ (30)	$ (8)		$ (4)	$ 2

Gain (loss) recognized in income

(in millions)	Location of gain (loss) in income statement	2018	2017
Fair value hedges			
Interest rate contracts	Net interest expense	$ (4)	$ (1)
Undesignated derivative instruments			
Foreign exchange contracts	Other (income) expense, net	$ (17)	$ —

For the company’s fair value hedges, equal and offsetting gains of $4 million and $1 million were recognized in net interest expense in the first quarter of 2018 and 2017, respectively. Ineffectiveness related to the company’s cash flow and fair value hedges for all periods presented were not material.

As of March 31, 2018, $13 million of deferred, net after-tax losses on derivative instruments included in AOCI are expected to be recognized in earnings during the next 12 months, coinciding with when the hedged items are expected to impact earnings.

Fair Values of Derivative Instruments

The following table summarizes the classification and fair values of derivative instruments reported in the condensed consolidated balance sheet as of March 31, 2018.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Foreign exchange contracts	Prepaid expenses and other	$ 11	Accounts payable and accrued liabilities	$ 2
Total derivative instruments designated as hedges		$ 11		$ 2
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$ —	Accounts payable and accrued liabilities	$ 2
Total derivative instruments		$ 11		$ 4

The following table summarizes the classification and fair values of derivative instruments reported in the condensed consolidated balance sheet as of December 31, 2017.

	Derivatives in asset positions		Derivatives in liability positions	
(in millions)	Balance sheet location	Fair value	Balance sheet location	Fair value
Derivative instruments designated as hedges				
Interest rate contracts	Other long-term assets	$ 4	Other long-term liabilities	$ —
Foreign exchange contracts	Prepaid expenses and other	14	Accounts payable and accrued liabilities	3
Total derivative instruments designated as hedges		$ 18		$ 3
Undesignated derivative instruments				
Foreign exchange contracts	Prepaid expenses and other	$ 1	Accounts payable and	$ 1

		accrued liabilities
Total derivative instruments	$ 19	$ 4

While the company’s derivatives are all subject to master netting arrangements, the company presents its assets and liabilities related to derivative instruments on a gross basis within the condensed consolidated balance sheets. Additionally, the company is not required to post collateral for any of its outstanding derivatives.

The following table provides information on the company’s derivative positions as if they were presented on a net basis, allowing for the right of offset by counterparty.

	March 31, 2018		December 31, 2017	
(in millions)	Asset	Liability	Asset	Liability
Gross amounts recognized in the consolidated balance sheet	$11	$ 4	$19	$ 4
Gross amount subject to offset in master netting arrangements not offset in the consolidated balance sheet	(4)	(4)	(4)	(4)
Total	$7	$ —	$15	$ —

Fair value measurements

The following tables summarize the bases used to measure financial assets and liabilities that are carried at fair value on a recurring basis in the condensed consolidated balance sheets.

(in millions)	Balance as of March 31, 2018	Basis of fair value measurement: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 11	$ —	$ 11	$ —
Marketable equity securities	7	7	—	—
Total assets	$ 18	$ 7	$ 11	$ —
Liabilities				
Foreign currency hedges	$ 4	$ —	$ 4	$ —
Contingent payments related to acquisitions	23	—	—	23
Total liabilities	$ 27	$ —	$ 4	$ 23

(in millions)	Balance as of December 31, 2017	Basis of fair value measurement: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Assets				
Foreign currency hedges	$ 15	$ —	$ 15	$ —
Interest rate hedges	4	—	4	—
Marketable equity securities	8	8	—	—
Total assets	$ 27	$ 8	$ 19	$ —
Liabilities				
Foreign currency hedges	$ 4	$ —	$ 4	$ —
Contingent payments related to acquisitions	9	—	—	9
Total liabilities	$ 13	$ —	$ 4	$ 9

As of March 31, 2018, cash and equivalents of $2.9 billion included money market funds of approximately $0.7 billion, and as of December 31, 2017, cash and equivalents of $3.4 billion included money market funds of approximately $0.7 billion. Money market funds are considered Level 2 in the fair value hierarchy.

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

Contingent payments related to acquisitions consist of milestone payments and sales-based payments, and are valued using discounted cash flow techniques. The fair value of milestone payments reflects management's expectations of probability of payment, and increases as the probability of payment increases or expectation of timing of payments is accelerated. The fair value of sales-based payments is based upon probability-weighted future revenue estimates, and increases as revenue estimates increase, probability weighting of higher revenue scenarios increase or expectation of timing of payment is accelerated. The change in the fair value of contingent payments related to Baxter's acquisitions, which use significant unobservable inputs (Level 3) in the fair value measurement, were primarily driven by new contingent liabilities recognized as a result of the RECOTHROM and PREVELEAK acquisitions of approximately $14 million in the first quarter of 2018.

Equity investments not measured at fair value and excluded from the above table are comprised of other equity investments without readily determinable fair values of $41 million at March 31, 2018 and $43 million at December 31, 2017. These amounts are included in Other assets.

The following table provides information relating to the company's investments in marketable equity securities.

(in millions)	Amortized cost	Unrealized gains	Unrealized losses	Fair value
March 31, 2018	$ 8	$ —	$ 1	$ 7
December 31, 2017	$ 8	$ —	$ —	$ 8

In the first quarter of 2017, the company recorded an other-than-temporary impairment charge related to a marketable equity security of $4 million within other (income) expense, net.

Book Values and Fair Values of Financial Instruments

In addition to the financial instruments that the company is required to recognize at fair value in the condensed consolidated balance sheets, the company has certain financial instruments that are recognized at historical cost or some basis other than fair value. For these financial instruments, the following table provides the values recognized in the condensed consolidated balance sheets and the approximate fair values as of March 31, 2018 and December 31, 2017.

	Book values		Approximate fair values	
(in millions)	2018	2017	2018	2017
Liabilities				
Current maturities of long-term debt and lease obligations	$3	$3	$3	$3
Long-term debt and lease obligations	3,550	3,509	3,564	3,595

The following tables summarize the bases used to measure the approximate fair value of the financial instruments as of March 31, 2018 and December 31, 2017.

		Basis of fair value measurement		
(in millions)	Balance as of March 31, 2018	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Liabilities				

Current maturities of long-term debt and lease obligations	$ 3	$ —	$ 3	$ —
Long-term debt and lease obligations	3,564	—	3,564	—
Total liabilities	$ 3,567	$ —	$ 3,567	$ —

		Basis of fair value measurement		
(in millions)	Balance as of December 31, 2017	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Liabilities				
Current maturities of long-term debt and lease obligations	$ 3	$ —	$ 3	$ —
Long-term debt and lease obligations	3,595	—	3,595	—
Total liabilities	$ 3,598	$ —	$ 3,598	$ —

The estimated fair values of current and long-term debt were computed by multiplying price by the notional amount of the respective debt instrument. Price is calculated using the stated terms of the respective debt instrument and yield curves commensurate with the company's credit risk. The carrying values of the other financial instruments approximate their fair values due to the short-term maturities of most of these assets and liabilities.

10. STOCK COMPENSATION

Stock compensation expense totaled $20 million and $18 million in the first quarter of 2018 and 2017, respectively. Approximately 80% of stock compensation expense is classified in marketing and administrative expenses with the remainder classified in cost of sales and R&D expenses. The Tax Cuts and Jobs Act of 2017 (2017 Tax Act) made several changes to the $1 million deduction limitation on top executives' compensation including removing the exemption on performance based pay. Baxter is using the "cash first" approach to determine the deductible portion of executive compensation whereby the impact of cash compensation takes priority over stock-based compensation. Accordingly, the tax benefits recognized in respect of the equity compensation accruals for the top executives' compensation is expected to be insignificant.

The company awarded stock compensation grants which consisted of 3.8 million stock options, 0.5 million RSUs and 0.3 million PSUs during the first quarter of 2018.

Stock Options

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

	Three months ended March 31,	
	2018	2017
Expected volatility	18 %	19 %
Expected life (in years)	5.5	5.5
Risk-free interest rate	2.6 %	2.1 %
Dividend yield	1.0 %	1.0 %
Fair value per stock option	$ 13	$ 10

The total intrinsic value of stock options exercised was $66 million and $50 million during the first quarters of 2018 and 2017, respectively.

As of March 31, 2018, the unrecognized compensation cost related to all unvested stock options of $93 million is expected to be recognized as expense over a weighted-average period of 2.1 years.

Restricted Stock Units

As of March 31, 2018, the unrecognized compensation cost related to all unvested RSUs of $86 million is expected to be recognized as expense over a weighted-average period of 2.1 years.

Performance Share Units

As of March 31, 2018, the unrecognized compensation cost related to all unvested and awarded PSUs of $47 million is expected to be recognized as expense over a weighted-average period of 1.8 years.

11. RETIREMENT AND OTHER BENEFIT PROGRAMS

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

(in millions)	Three months ended March 31, 2018	2017
Pension benefits		
Service cost	$22	$22
Interest cost	46	45
Expected return on plan assets	(78)	(72)
Amortization of net losses and other deferred amounts	24	40
Net periodic pension benefit cost	$14	$35
OPEB		
Service cost	$—	$—
Interest cost	2	2
Amortization of net loss and prior service credit	(6)	(6)
Net periodic OPEB cost	$(4)	$(4)

U.S Pension Plan Amendments

In January 2018, the company announced changes to its U.S. pension plans. The company spun off the assets and liabilities of the qualified plan attributable to current employees into a new plan and will freeze the pay and service amounts used to calculate pension benefits for active participants in the U.S. pension plans as of December 31, 2022. The assets and liabilities attributable to retired and former company employees remained with the original qualified plan. Years of additional service earned and eligible compensation received after December 31, 2022 will not be included in the determination of the benefits payable to participants. These changes resulted in a $57 million decline in the projected benefit obligation (PBO) with an offsetting adjustment against AOCI upon the effective date of the changes.

12. ACCUMULATED OTHER COMPREHENSIVE INCOME

Comprehensive income includes all changes in shareholders' equity that do not arise from transactions with shareholders, and consists of net income, CTA, pension and other employee benefits, unrealized gains and losses on cash flow hedges and unrealized gains and losses on available-for-sale equity securities. As a result of recent changes in accounting guidance related to available-for-sale equity securities, the unrealized gains and losses associated with these assets are no longer recognized in AOCI beginning January 1, 2018. The following table is a net-of-tax summary of the changes in AOCI by component for the three months ended March 31, 2018 and 2017.

(in millions)	CTA	Pension and	Hedging	Available-	Total

		other employee benefits	activities	for-sale securities	
Gains (losses)					
Balance as of December 31, 2017	$(3,013)	$ (981)	$ (10)	$ 3	$(4,001)
Adoption of new accounting standard	—	—	—	(3)	(3)
Other comprehensive income before reclassifications	81	37	(8)	—	110
Amounts reclassified from AOCI (a)	—	15	3	—	18
Net other comprehensive income (loss)	81	52	(5)	—	128
Balance as of March 31, 2018	$(2,932)	$ (929)	$ (15)	$ —	$(3,876)

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(in millions)	CTA	Pension and other employee benefits	Hedging activities	Available-for-sale-securities	Total
Gains (losses)					