ECOLAB INC
Form 10-Q
October 30, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission File No. 1-9328

ECOLAB INC.

(Exact name of registrant as specified in its charter)

Delaware	**41-0231510**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

370 Wabasha Street N., St. Paul, Minnesota 55102

(Address of principal executive offices) (Zip Code)

1-800-232-6522

(Registrant s telephone number, including area code)

(Not Applicable)

(Former name, former address and former fiscal year,

if changed since last report)

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

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 Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of September 30, 2014.

300,116,468 shares of common stock, par value $1.00 per share.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

ECOLAB INC.

CONSOLIDATED STATEMENT OF INCOME

(millions, except per share amounts)	Third Quarter Ended September 30 2014		2013	
	(unaudited)			
Net sales	$	3,694.9	$	3,484.0
Cost of sales (including special charges of $0.8 in 2014 and $6.3 in 2013)		1,970.6		1,866.1
Selling, general and administrative expenses		1,145.9		1,114.1
Special (gains) and charges		7.0		27.8
Operating income		571.4		476.0
Interest expense, net		63.3		67.0
Income before income taxes		508.1		409.0
Provision for income taxes		138.7		101.8
Net income including noncontrolling interest		369.4		307.2
Less: Net income (loss) attributable to noncontrolling interest		4.5		(0.8)
Net income attributable to Ecolab	$	364.9	$	308.0
Earnings attributable to Ecolab per common share				
Basic	$	1.22	$	1.02
Diluted	$	1.19	$	1.00
Dividends declared per common share	$	0.2750	$	0.2300
Weighted-average common shares outstanding				
Basic		300.0		301.2
Diluted		305.7		307.2

The accompanying notes are an integral part of the consolidated financial information.

ECOLAB INC.

CONSOLIDATED STATEMENT OF INCOME

(millions, except per share amounts)	Nine Months Ended September 30 2014		2013	
	(unaudited)			
Net sales	$	10,599.7	$	9,693.9
Cost of sales (including special charges of $7.9 in 2014 and $23.5 in 2013)		5,699.2		5,216.0
Selling, general and administrative expenses		3,435.5		3,236.8
Special (gains) and charges		30.5		151.1
Operating income		1,434.5		1,090.0
Interest expense, net (including special charges of $2.5 in 2013)		194.6		194.7
Income before income taxes		1,239.9		895.3
Provision for income taxes		361.0		211.3
Net income including noncontrolling interest		878.9		684.0
Less: Net income attributable to noncontrolling interest (including special charges of $0.5 in 2013)		11.6		3.3
Net income attributable to Ecolab	$	867.3	$	680.7
Earnings attributable to Ecolab per common share				
Basic	$	2.89	$	2.27
Diluted	$	2.83	$	2.23
Dividends declared per common share	$	0.8250	$	0.6900
Weighted-average common shares outstanding				
Basic		300.1		299.4
Diluted		306.0		305.3

The accompanying notes are an integral part of the consolidated financial information.

ECOLAB INC.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(millions)	Third Quarter Ended September 30 2014	Third Quarter Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
		(unaudited)		
Net income including noncontrolling interest	$ 369.4	$ 307.2	$ 878.9	$ 684.0
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments				
Foreign currency translation	(41.5)	(126.2)	(86.3)	(276.9)
Gain (loss) on net investment hedge	7.4	(4.2)	5.6	(4.2)
	(34.1)	(130.4)	(80.7)	(281.1)
Derivatives and hedging instruments	5.0	1.6	0.9	9.1
Pension and postretirement benefits				
Amortization of net actuarial loss and prior service cost included in net periodic pension and postretirement costs	2.6	10.4	7.7	31.3
Subtotal	(26.5)	(118.4)	(72.1)	(240.7)
Total comprehensive income, including noncontrolling interest	342.9	188.8	806.8	443.3
Less: Comprehensive income (loss) attributable to noncontrolling interest	3.2		10.3	(11.0)
Comprehensive income attributable to Ecolab	$ 339.7	$ 188.8	$ 796.5	$ 454.3

The accompanying notes are an integral part of the consolidated financial information.

ECOLAB INC.

CONSOLIDATED BALANCE SHEET

(millions)	September 30 2014 (unaudited)	December 31 2013
ASSETS		
Current assets		
Cash and cash equivalents	$ 197.8	$ 339.2
Accounts receivable, net	2,694.4	2,568.0
Inventories	1,464.4	1,321.9
Deferred income taxes	166.1	163.0
Other current assets	349.1	306.3
Total current assets	4,871.8	4,698.4
Property, plant and equipment, net	2,978.5	2,882.0
Goodwill	6,849.1	6,862.9
Other intangible assets, net	4,583.1	4,785.3
Other assets	403.3	407.9
Total assets	$ 19,685.8	$ 19,636.5

The accompanying notes are an integral part of the consolidated financial information.

(Continued)

ECOLAB INC.

CONSOLIDATED BALANCE SHEET (continued)

(millions, except shares and per share amounts)	September 30 2014 (unaudited)	December 31 2013
LIABILITIES AND EQUITY		
Current liabilities		
Short-term debt	$ 1,922.8	$ 861.0
Accounts payable	1,047.3	1,021.9
Compensation and benefits	547.1	571.1
Income taxes	81.9	80.9
Other current liabilities	855.9	953.8
Total current liabilities	4,455.0	3,488.7
Long-term debt	4,874.0	6,043.5
Postretirement health care and pension benefits	785.0	795.6
Other liabilities	1,805.5	1,899.3
Total liabilities	11,919.5	12,227.1
Equity (a)		
Common stock	347.2	345.1
Additional paid-in capital	4,832.6	4,692.0
Retained earnings	5,318.7	4,699.0
Accumulated other comprehensive loss	(377.3)	(305.2)
Treasury stock	(2,423.3)	(2,086.6)
Total Ecolab shareholders equity	7,697.9	7,344.3
Noncontrolling interest	68.4	65.1
Total equity	7,766.3	7,409.4
Total liabilities and equity	$ 19,685.8	$ 19,636.5

(a) Common stock, 800 million shares authorized, $1.00 par value per share, 300.1 million shares outstanding at September 30, 2014, 301.1 million shares outstanding at December 31, 2013. Shares outstanding are net of treasury stock.

The accompanying notes are an integral part of the consolidated financial information.

ECOLAB INC.

CONSOLIDATED STATEMENT OF CASH FLOWS

(millions)	Nine Months Ended September 30 2014	2013
	(unaudited)	
OPERATING ACTIVITIES		
Net income including noncontrolling interest	$ 878.9	$ 684.0
Adjustments to reconcile net income including noncontrolling interest to cash provided by operating activities:		
Depreciation	417.4	381.3
Amortization	236.6	220.5
Deferred income taxes	(79.1)	(102.7)
Share-based compensation expense	55.1	53.6
Excess tax benefits from share-based payment arrangements	(41.7)	(26.2)
Pension and postretirement plan contributions	(61.0)	(62.0)
Pension and postretirement plan expense	65.4	106.9
Restructuring, net of cash paid	(22.4)	(20.5)
Venezuela currency devaluation		23.3
Gain on sale of business	(1.4)	
Other, net	8.4	12.9
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(163.5)	(70.3)
Inventories	(168.7)	(92.3)
Other assets	(51.7)	(109.5)
Accounts payable	29.5	(40.7)
Other liabilities	43.2	(29.1)
Cash provided by operating activities	$ 1,145.0	$ 929.2

The accompanying notes are an integral part of the consolidated financial information.

(Continued)

ECOLAB INC.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

(millions)	Nine Months Ended September 30 2014	2013
	(unaudited)	
INVESTING ACTIVITIES		
Capital expenditures	$ (488.7)	$ (423.4)
Capitalized software expenditures	(31.9)	(25.7)
Property and other assets sold	8.6	9.6
Businesses acquired and investments in affiliates, net of cash acquired	(70.8)	(1,442.3)
Divestiture of businesses	9.2	(7.9)
Deposit into indemnification escrow		(10.6)
Release from indemnification escrow	8.7	13.0
Cash used for investing activities	(564.9)	(1,887.3)
FINANCING ACTIVITIES		
Net issuances (repayments) of commercial paper and notes payable	310.2	(90.6)
Long-term debt borrowings		900.1
Long-term debt repayments	(407.3)	(337.8)
Reacquired shares	(341.0)	(228.5)
Dividends paid	(258.9)	(143.6)
Exercise of employee stock options	51.5	77.7
Excess tax benefits from share-based payment arrangements	41.7	26.2
Acquisition related liabilities and contingent consideration	(101.5)	(9.8)
Acquisition of noncontrolling interest	(8.4)	
Other, net		0.6
Cash provided by (used for) financing activities	(713.7)	194.3
Effect of exchange rate changes on cash	(7.8)	0.4
Decrease in cash and cash equivalents	(141.4)	(763.4)
Cash and cash equivalents, beginning of period	339.2	1,157.8
Cash and cash equivalents, end of period	$ 197.8	$ 394.4

The accompanying notes are an integral part of the consolidated financial information.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Consolidated Financial Information

The unaudited consolidated financial information for the third quarter and nine months ended September 30, 2014 and 2013 reflect, in the opinion of management, all adjustments necessary for a fair presentation of the financial position, results of operations, comprehensive income and cash flows of Ecolab Inc. (Ecolab or the company) for the interim periods presented. The financial results for any interim period are not necessarily indicative of results for the full year. The consolidated balance sheet data as of December 31, 2013 was derived from the audited consolidated financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The unaudited consolidated financial information should be read in conjunction with the consolidated financial statements and notes thereto incorporated in the company s Annual Report on Form 10-K for the year ended December 31, 2013.

With respect to the unaudited financial information of the company for the third quarter and nine months ended September 30, 2014 and 2013 included in this Form 10-Q, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their separate report dated October 30, 2014 appearing herein states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933, as amended (the Act), for their report on the unaudited financial information because that report is not a report or a part of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

Effective in the first quarter of 2014, certain employee-related costs from the company s recently acquired businesses that were historically presented within cost of sales were revised and reclassified to selling, general and administrative expenses (SG&A) on the Consolidated Statement of Income. These immaterial revisions were made to conform with management s view of the respective costs within the global organizational model. Total costs reclassified were $16.7 million for the third quarter ended September 30, 2013, $60.3 million for the nine months ended September 30, 2013 and $78.9 million for the year ended December 31, 2013.

Results for 2013 have been revised to conform to the current year presentation. The reclassification had no impact on net earnings, financial position or cash flows.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Special (Gains) and Charges

Special (gains) and charges reported on the Consolidated Statement of Income include the following:

	Third Quarter Ended September 30		Nine Months Ended September 30	
(millions)	2014	2013	2014	2013
Cost of sales				
Restructuring charges	$ 0.4	$ 1.9	$ 7.5	$ 5.5
Recognition of inventory fair value step-up	0.4	4.4	0.4	18.0
Subtotal	0.8	6.3	7.9	23.5
Special (gains) and charges				
Restructuring charges	6.3	11.9	34.9	75.4
Champion acquisition and integration costs	4.1	10.7	15.8	42.5
Nalco merger and integration costs	2.0	5.3	4.8	13.5
Venezuela currency devaluation		(0.1)		23.3
Litigation activity, settlements, and other gains	(5.4)		(25.0)	(3.6)
Subtotal	7.0	27.8	30.5	151.1
Operating income subtotal	7.8	34.1	38.4	174.6
Interest expense, net				
Acquisition debt costs				2.5
Net income attributable to noncontrolling interest				
Venezuela currency devaluation				(0.5)
Total special (gains) and charges	$ 7.8	$ 34.1	$ 38.4	$ 176.6

For segment reporting purposes, special (gains) and charges are included in the Corporate segment, which is consistent with the company s internal management reporting.

Restructuring Charges

The company incurs net costs for restructuring activities associated with plans to enhance its efficiency and effectiveness and sharpen its competitiveness. These restructuring plans include net costs associated with significant actions involving employee-related severance charges, contract termination costs and asset write-downs and disposals. Employee termination costs are largely based on policies and severance plans, and include personnel reductions and related costs for severance, benefits and outplacement services. These charges are reflected in the quarter when the actions are probable and the amounts are estimable, which typically is when management approves the associated actions. Contract termination costs include charges to terminate leases prior to the end of their respective terms and other contract terminations. Asset write-downs and disposals include leasehold improvement write-downs, other asset write-downs associated with combining operations and disposal of assets.

Restructuring charges have been included as a component of both cost of sales and special (gains) and charges on the Consolidated Statement of Income. Amounts included within cost of sales include supply chain related severance and other asset write-downs associated with combining operations. Restructuring liabilities have been classified as a component of both other current and non-current liabilities on the Consolidated Balance Sheet.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Special (Gains) and Charges (continued)

Energy Restructuring Plan

On April 10, 2013, the company completed its acquisition of privately held Champion Technologies and its related company Corsicana Technologies (collectively Champion).

In April 2013, following the completion of the acquisition of Champion, the company commenced plans to undertake restructuring and other cost-saving actions to realize its acquisition-related cost synergies as well as streamline and strengthen Ecolab s position in the fast growing global energy market (the Energy Restructuring Plan). Actions associated with the acquisition to improve the effectiveness and efficiency of the business include a reduction of the combined business s current global workforce by approximately 500 positions. A number of these reductions are expected to be achieved through eliminating open positions and attrition. The company also anticipates leveraging and simplifying its global supply chain, including the reduction of plant and distribution center locations and product line optimization, as well as the reduction of other redundant facilities.

The company expects to incur pre-tax restructuring charges of approximately $80 million ($55 million after tax) under the Energy Restructuring Plan through substantial completion of the Plan in 2015. During 2013, the company incurred $27 million ($19 million after tax) of charges related to the Energy Restructuring Plan. Approximately $15 million ($10 million after tax) of charges are expected to occur in 2014.

The company anticipates that approximately $60 million of the $80 million of the pre-tax charges represent cash expenditures. The remaining pre-tax charges represent estimated asset write-downs and disposals. No decisions have been made for any asset disposals and estimates could vary depending on the actual actions taken.

The company recorded restructuring charges related to the Energy Restructuring Plan of $1.3 million ($0.7 million after tax) and $8.4 million ($6.7 million after tax) during the third quarter of 2014 and 2013, respectively. During the nine months ended September 30, 2014 and 2013, the company incurred charges of $8.9 million ($5.9 million after tax) and $20.6 million ($14.3 million after tax), respectively.

Restructuring charges and activity related to the Energy Restructuring Plan since inception of the underlying actions include the following:

	Energy Restructuring Plan	
	Employee Termination	**Asset**

(millions)	Costs	Disposals	Other	Total
2013 Activity:				
Recorded expense and accrual	$ 22.9	$ 3.6	$ 0.9	$ 27.4
Cash payments	(16.7)		(0.8)	(17.5)
Non-cash charges		(3.6)		(3.6)
Effect of foreign currency translation	0.6			0.6
Restructuring liability, December 31, 2013	6.8		0.1	6.9
2014 Activity:				
Recorded expense and accrual	7.5	0.5	0.9	8.9
Cash payments	(11.9)		(0.9)	(12.8)
Non-cash charges		(0.5)		(0.5)
Effect of foreign currency translation	0.3			0.3
Restructuring liability, September 30, 2014	$ 2.7	$	$ 0.1	$ 2.8

As shown in the previous table, cash payments under the Energy Restructuring Plan were $12.8 million during the first nine months of 2014 and $17.5 million during 2013. The majority of cash payments under this Plan are related to severance, with the current accrual expected to be paid over the next twelve months.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Special (Gains) and Charges (continued)

Combined Restructuring Plan

In February 2011, the company commenced a comprehensive plan to substantially improve the efficiency and effectiveness of its European business, as well as to undertake certain restructuring activities outside of Europe (the 2011 Restructuring Plan). Additionally, in January 2012, following the merger with Nalco Holding Company (Nalco), the company formally commenced plans to undertake restructuring actions related to the reduction of its global workforce and optimization of its supply chain and office facilities, including planned reductions of plant and distribution center locations (the Merger Restructuring Plan). During the first quarter of 2013, the company determined that because the objectives of the plans discussed above were aligned, the previously separate restructuring plans should be combined into one plan.

The combined restructuring plan (the Combined Plan) combines opportunities and initiatives from both plans and continues to follow the original format of the Merger Restructuring Plan by focusing on global actions related to optimization of the supply chain and office facilities, including reductions of the global workforce and plant and distribution center locations.

During 2013, the company incurred $64 million ($48 million after tax) of charges related to the Combined Plan. The company recorded restructuring charges related to the Combined Plan of $5.4 million ($3.3 million after tax) and $5.3 million ($2.1 million after tax), during the third quarter of 2014 and 2013, respectively. During the nine months ended September 30, 2014 and 2013, the company incurred charges of $33.4 million ($27.0 million after tax) and $60.5 million ($42.5 million after tax), respectively.

Through substantial completion of the Combined Plan at the end of 2015, the company expects to incur pretax charges of approximately $50 million ($40 million after tax) during the remainder of 2014 and 2015.

The company anticipates that substantially all of the remaining Combined Plan pre-tax charges will represent net cash expenditures.

Restructuring charges and activity related to the Combined Plan since inception of the underlying actions include the following:

	Combined Plan			
(millions)	**Employee Termination Costs**	**Asset Disposals**	**Other**	**Total**
2011 - 2013 Activity:				

Recorded net expense and accrual	$	248.2	$	(1.2)	$	30.7	$	277.7
Net cash payments		(182.2)		9.1		(19.1)		(192.2)
Non-cash net charges				(7.9)		(4.3)		(12.2)
Effect of foreign currency translation		(0.1)						(0.1)
Restructuring liability, December 31, 2013		65.9				7.3		73.2
2014 Activity:								
Recorded net expense and accrual		28.9		(1.1)		5.6		33.4
Net cash payments		(47.4)		2.6		(7.0)		(51.8)
Non-cash net charges				(1.5)				(1.5)
Effect of foreign currency translation		(0.7)						(0.7)
Restructuring liability, September 30, 2014	$	46.7	$		$	5.9	$	52.6

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Special (Gains) and Charges (continued)

As shown in the previous table, net cash payments under the Combined Plan were $51.8 million during the first nine months of 2014 and $192.2 million from 2011 through 2013. The majority of cash payments under this Plan are related to severance, with the current accrual expected to be paid over a period of a few months to several quarters.

Non-restructuring Special (Gains) and Charges

Champion acquisition and integration costs

As a result of the Champion acquisition completed in 2013, the company incurred charges of $4.1 million ($2.7 million after tax) and $15.1 million ($10.3 million after tax) during the third quarter of 2014 and 2013, respectively. During the nine months ended September 30, 2014 and 2013, the company incurred charges of $15.8 million ($10.2 million after tax) and $63.0 million ($44.9 million after tax), respectively.

Champion related costs have been included as a component of cost of sales, special (gains) and charges and net interest expense on the Consolidated Statement of Income. Amounts within cost of sales include the recognition of fair value step-up in Champion international inventory, which is maintained on a FIFO basis. Amounts included in special (gains) and charges include acquisition costs, advisory and legal fees and integration charges. Amounts included in net interest expense include the interest expense through the close date of the Champion transaction of the company s $500 million public debt issuance in December 2012 as well as amortizable fees to secure term loans and short-term debt, all of which were initiated to fund the Champion acquisition. Further information related to the acquisition of Champion is included in Note 3.

Nalco merger and integration costs

As a result of the Nalco merger completed in 2011, the company incurred net charges of $2.0 million ($2.0 million after tax) and $5.3 million ($3.5 million after tax) during the third quarter of 2014 and 2013, respectively. During the nine months ended September 30, 2014 and 2013, the company incurred charges of $4.8 million ($4.0 million after tax) and $13.5 million ($9.2 million after tax), respectively. Nalco related special charges for 2014 and 2013 have been included as a component of special (gains) and charges on the Consolidated Statement of Income, and include integration charges.

Venezuelan currency devaluation

Venezuela is a country with a highly inflationary economy under U.S. GAAP. As a result, the U.S. dollar is the functional currency for our subsidiaries in Venezuela. Any currency remeasurement adjustments for non-dollar denominated monetary assets and liabilities held by our subsidiaries and other transactional foreign exchange gains and losses are reflected in earnings.

On February 8, 2013, the Venezuelan government devalued its currency, the Bolivar Fuerte (bolivar) from 4.30 bolivars to 1 U.S. dollar to 6.30 bolivars to 1 U.S. dollar, resulting in a charge during 2013 of $22.7 million ($16.1 million after tax), due to the remeasurement of the local balance sheet. As a result of the ownership structure in place in Venezuela, the company also reflected a portion of the devaluation impact as a component of net income (loss) attributable to noncontrolling interest on the Consolidated Statement of Income.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. Special (Gains) and Charges (continued)

In 2013, the Venezuelan government created a new foreign exchange mechanism known as the Complementary System of Foreign Currency Acquirement (SICAD 1). It operates similar to an auction system and allows entities to exchange a limited number of bolivars for U.S. dollars at a bid rate established via weekly auctions under SICAD 1. As of August 31, 2014, the fiscal quarter end for the company s international operations, the SICAD 1 exchange rate closed at 11.5 bolivars to 1 U.S. dollar. The company does not use the SICAD 1 rate or expect to use the SICAD 1 currency exchange mechanism.

In January 2014, the Venezuelan government announced the replacement of the Commission for the Administration of Foreign Exchange (CADIVI) with a new foreign currency administration, the National Center for Foreign Commerce (CENCOEX). As of August 31, 2014, the company had $102 million of net monetary assets denominated in bolivars that were required to be remeasured to U.S. dollars. During the nine month period ended August 31, 2014, the company continued to obtain approvals and authorization to pay amounts at the CENCOEX fixed currency exchange rate of 6.30 bolivars to 1 U.S. dollar. As the company believes the fixed currency exchange rate of 6.30 bolivars to 1 U.S. dollar remains legally available to it and the company continues to transact at this rate, the company intends to continue to remeasure the net monetary assets of its Venezuela subsidiaries at this rate.

In March 2014, the Venezuelan government introduced an additional currency exchange auction mechanism (SICAD 2). At August 31, 2014, the SICAD 2 exchange rate closed at 49.97 bolivars to 1 U.S. dollar. The company does not use the SICAD 2 rate, but is evaluating whether it will use the SICAD 2 currency exchange mechanism in future periods.

Net sales within Venezuela are approximately 1% of the company s consolidated net sales. Assets held in Venezuela at August 31, 2014 represented less than 2% of the company s consolidated assets.

Other special (gains) and charges

The company recognized other special gains of $5.0 million ($3.1 million after tax) and $24.6 million ($19.5 million after tax) during the third quarter and the first nine months of 2014, respectively. The gain recognized in the third quarter of 2014 resulted from the consolidation of the Emirates National Chemicals Company LLC (Emochem) entity and removal of the corresponding equity method investment. The gains recognized during the first six months of 2014 related to a favorable licensing settlement and other settlement gains.

3. Acquisitions and Dispositions

Champion acquisition

On April 10, 2013, the company completed its acquisition of Champion, a global energy specialty products and services company delivering its offerings to the oil and gas industry. The total fair value of cash and stock consideration transferred to acquire all of Champion s stock was approximately $2.1 billion. Champion s sales for the business acquired by the company were approximately $1.3 billion in 2012. The business became part of the company s Global Energy reportable segment in the second quarter of 2013.

The company incurred certain acquisition related costs associated with the transaction that were expensed as incurred and are reflected in the Consolidated Statement of Income. Amounts included in cost of sales relate to recognition of fair value step-up in Champion international inventory, which is maintained on a FIFO basis. Amounts included in special (gains) and charges include acquisition costs, advisory and legal fees and integration charges. Amounts included in net interest expense include the interest expense through the close date of the Champion transaction of the company s $500 million public debt issuance in December 2012 as well as amortizable fees to secure term loans and short-term debt, all of which were initiated to fund the Champion acquisition.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

The Champion acquisition has been accounted for using the acquisition method of accounting, which requires, among other things, that most assets acquired and liabilities assumed be recognized at fair value as of the acquisition date.

The following table summarizes the value of Champion assets acquired and liabilities assumed as of December 31, 2013. During 2013, adjustments of $37.1 million were made to the preliminary purchase price allocation of the assets and liabilities assumed with a corresponding adjustment to goodwill.

Also summarized in the table, during the first quarter of 2014, net adjustments of $16.9 million were made to the value of Champion assets acquired and liabilities assumed. As the adjustments were not significant, they have been recorded in 2014 and are not reflected in the 2013 Consolidated Balance Sheet. Purchase price allocations were finalized during the first quarter of 2014.

(millions)	Allocation at December 31, 2013	Purchase Price Adjustments	Final Allocation at March 31, 2014
Current assets	$ 592.3	$ (4.5)	$ 587.8
Property, plant and equipment	357.8	(2.5)	355.3
Other assets	16.2	0.1	16.3
Identifiable intangible assets			
Customer relationships	840.0		840.0
Trademarks	120.0		120.0
Other technology	36.5		36.5
Total assets acquired	1,962.8	(6.9)	1,955.9
Current liabilities	409.5	3.6	413.1
Long-term debt	70.8		70.8
Net deferred tax liability	427.4	9.3	436.7
Noncontrolling interest and other liabilities	30.5	(2.9)	27.6
Total liabilities and noncontrolling interests assumed	938.2	10.0	948.2
Goodwill	1,030.1	16.9	1,047.0
Total aggregate purchase price	2,054.7		2,054.7
Future consideration payable to sellers	(86.4)	86.4	
Total consideration transferred	$ 1,968.3	$ 86.4	$ 2,054.7

The adjustments to the purchase price allocation during the first quarter of 2014 primarily related to estimated contingent liabilities, updated property, plant and equipment values and deferred taxes.

In accordance with the acquisition agreement, except under limited circumstances, the company was required to pay an additional amount in cash, up to $100 million in the aggregate, equal to 50% of the incremental tax on the merger consideration as a result of increases in applicable gains and investment taxes after December 31, 2012. In January 2014, in accordance with the above discussion, an additional payment of $86.4 million was made to the acquired entity s former stockholders.

The customer relationships, trademarks and other technology are being amortized over weighted average lives of 14, 12 and 7 years, respectively.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

The results of Champion s operations have been included in the company s consolidated financial statements since the close of the acquisition in April 2013. Due to the rapid pace at which the business has been integrated with the company s Global Energy segment, including all customer selling activity, discrete financial data specific to the legacy Champion business is no longer available post acquisition.

Based on applicable accounting and reporting guidance, the Champion acquisition is not material to the company s consolidated financial statements; therefore, pro forma financial information has not been presented.

Other acquisition activity

2014 Activity

During the first nine months of 2014, the company completed six business combination transactions. In addition, one transaction was completed subsequent to the end of the third quarter.

In December 2013, subsequent to the company s year end for international operations, the company completed the acquisition of AkzoNobel s Purate business, which specializes in global antimicrobial water treatment. Pre-acquisition annual sales of the business were approximately $23 million. The acquired business became part of the company s Global Industrial reportable segment during the first quarter of 2014.

In March 2014, the company acquired AK Kraus & Hiller Schädlingsbekämpfung, one of Germany s leading commercial pest elimination service providers. Pre-acquisition annual sales of the business were approximately $4 million. The business became part of the company s Other reportable segment during the second quarter of 2014.

In March 2014, the company purchased the remaining interest in a joint venture held in South Africa. The transaction is not significant to the company s operations.

In June 2014, the company purchased the remaining interest in a joint venture in Indonesia. The transaction is not significant to the company s operations.

In July 2014, the company obtained control of a joint venture in the United Arab Emirates through an amendment in the related shareholder agreements. This amendment resulted in the company consolidating the entity and removing the related equity method investment. The transaction is not significant to the company s operations. As discussed in Note 2, the company recognized a gain of $5.0 million during the third quarter of 2014 as a result of this transaction.

In July 2014, the company acquired the chemical division of AKJ Industries, a leading provider of chemical solutions in the coal industry. Pre-acquisition annual sales of the business were approximately $21 million. The business became part of the company s Industrial reportable segment during the third quarter of 2014.

In September 2014, subsequent to the company s third quarter end for international operations, the company acquired certain assets in Turkey. The transaction is not significant to the company s operations.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

2013 Activity

During the first nine months of 2013, in addition to the Champion acquisition, the company completed two business combination transactions.

In January 2013, the company completed the acquisition of Mexico-based Quimiproductos S.A. de C.V. (Quimiproductos), a wholly-owned subsidiary of Fomento Economico Mexicano, S.A.B. de C.V. (commonly known as FEMSA). Quimiproductos produces and supplies cleaning, sanitizing and water treatment goods and services to breweries and beverage companies located in Mexico and Central and South America. Pre-acquisition annual sales of the business were approximately $43 million. Approximately $8 million of the purchase price was placed in an escrow account for indemnification purposes related to general representations and warranties. During the third quarter of 2014 the escrow balance was paid to the seller. The business became part of the company s Global Industrial reportable segment during the first quarter of 2013.

In April 2013, the company completed the acquisition of Russia-based OOO Master Chemicals (Master Chemicals). Master Chemicals sells oil field chemicals to oil and gas producers located throughout Russia and parts of the Ukraine. Pre-acquisition annual sales of the business were approximately $29 million. Approximately $3 million of the purchase price was placed in an escrow account for indemnification purposes related to general representations and warranties. The business became part of the company s Global Energy reportable segment during the second quarter of 2013.

Other acquisition summary

Other acquisitions during the first nine months of 2014 and all of 2013 were not material to the company s consolidated financial statements; therefore, pro forma financial information has not been presented. The aggregate purchase price of acquisitions has been reduced for any cash or cash equivalents acquired with the acquisitions. Based upon purchase price allocations, the components of the aggregate purchase prices of other completed acquisitions during the third quarter and first nine months of 2014 and 2013 are shown in the following table.

	Third Quarter Ended September 30		Nine Months Ended September 30	
(millions)	**2014**	**2013**	**2014**	**2013**
Net tangible assets acquired, including impact of joint venture consolidation activity	$ (18.8)	$	$ 4.1	$ (2.3)
Identifiable intangible assets				
Customer relationships	27.7		30.6	58.8
Trademarks	2.6		3.4	1.4
Other technology	1.2		4.1	1.0

Non-compete			0.1	
Total intangible assets	31.5		38.2	61.2
Goodwill	16.8		28.1	41.2
Total aggregate purchase price	29.5		70.4	100.1
Acquisition related liabilities and contingent consideration	15.0		15.1	9.8
Liability for indemnification, net	8.0		8.7	2.4
Net cash paid for acquisitions, including contingent consideration	$ 52.5	$	$ 94.2	$ 112.3

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

The contingent consideration activity primarily relates to payments on legacy Nalco acquisitions. During the first quarter of 2013, the remaining $13 million escrow balance related to the O.R. Solutions Inc. acquisition was paid to the seller. As previously discussed, during the first quarter of 2013, approximately $8 million of the Quimiproductos purchase price was placed in an escrow account and was subsequently paid to the seller in the third quarter of 2014. During the third quarter of 2013, approximately $3 million of the Master Chemicals purchase price was placed in an escrow account.

The weighted average useful lives of identifiable intangible assets acquired during the first nine months of 2014 and 2013, as shown in the previous table, were 10 and 12 years, respectively.

Dispositions

2014 Activity

In April 2014, the company sold an immaterial business in Italy that was part of the company s Institutional reportable segment.

There were no other business disposals during the first nine months of 2014.

2013 Activity

In August 2013, the company sold substantially all the capital equipment design and build business of its Mobotec air emissions control business. The Mobotec equipment design and build business had 2012 sales of approximately $27 million, which were within the company s Global Industrial reportable segment. An insignificant loss related to the sale was recorded in special (gains) and charges during the third quarter of 2013. The company retained Mobotec s chemical business.

There were no other business disposals during the first nine months of 2013.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Balance Sheet Information

(millions)	September 30 2014 (unaudited)	December 31 2013
Accounts receivable, net		
Accounts receivable	$ 2,779.6	$ 2,648.9
Allowance for doubtful accounts	(85.2)	(80.9)
Total	$ 2,694.4	$ 2,568.0
Inventories		
Finished goods	$ 1,020.0	$ 953.3
Raw materials and parts	457.7	391.0
Inventories at FIFO cost	1,477.7	1,344.3
Excess of FIFO cost over LIFO cost	(13.3)	(22.4)
Total	$ 1,464.4	$ 1,321.9
Property, plant and equipment, net		
Land	$ 193.0	$ 191.4
Buildings and improvements	698.1	666.0
Leasehold improvements	86.7	87.9
Machinery and equipment	1,750.1	1,677.5
Merchandising and customer equipment	1,942.5	1,802.8
Capitalized software	456.7	435.4
Construction in progress	398.2	291.6
	5,525.3	5,152.6
Accumulated depreciation	(2,546.8)	(2,270.6)
Total	$ 2,978.5	$ 2,882.0
Other intangible assets, net		
Cost of intangible assets not subject to amortization		
Trade names	$ 1,230.0	$ 1,230.0
Cost of intangible assets subject to amortization		
Customer relationships	$ 3,459.8	$ 3,455.6
Trademarks	311.7	308.1
Patents	432.7	425.6
Other technology	214.1	210.2
	$ 4,418.3	$ 4,399.5
Accumulated amortization		
Customer relationships	$ (759.4)	$ (594.9)
Trademarks	(86.5)	(70.4)
Patents	(117.7)	(95.7)
Other technology	(101.6)	(83.2)
Other intangible assets, net	$ 4,583.1	$ 4,785.3
Other assets		
Deferred income taxes	$ 48.2	$ 54.5
Deferred financing costs	25.0	31.7

Pension		88.7		90.2
Other		241.4		231.5
Total	$	403.3	$	407.9

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Balance Sheet Information (continued)

(millions)		September 30 2014		December 31 2013
		(unaudited)		
Other current liabilities				
Discounts and rebates	$	261.0	$	263.2
Dividends payable		82.5		82.8
Interest payable		65.3		19.6
Taxes payable, other than income		121.7		115.3
Derivative liabilities		19.9		14.2
Restructuring		46.6		68.3
Future consideration payable to Champion sellers				86.4
Other		258.9		304.0
Total	$	855.9	$	953.8
Other liabilities				
Deferred income taxes	$	1,583.1	$	1,661.3
Income taxes payable - non-current		86.5		90.2
Restructuring		8.8		12.9
Other		127.1		134.9
Total	$	1,805.5	$	1,899.3
Accumulated other comprehensive loss				
Unrealized loss on derivative financial instruments, net of tax	$	(5.7)	$	(6.6)
Unrecognized pension and postretirement benefit expense, net of tax		(224.2)		(235.0)
Cumulative translation, net of tax		(147.4)		(63.6)
Total	$	(377.3)	$	(305.2)

5. Debt and Interest

The following table provides the components of the company s short-term debt obligations as of September 30, 2014 and December 31, 2013.

(millions)		September 30 2014		December 31 2013
		(unaudited)		
Short-term debt				
Commercial paper	$	630.2	$	304.8
Notes payable		36.8		50.9
Long-term debt, current maturities		1,255.8		505.3
Total	$	1,922.8	$	861.0

As of September 30, 2014, the company had in place a $1.5 billion multi-year credit facility, which expires in September 2016. The credit facility has been established with a diverse syndicate of banks and supports the company s $1.5 billion U.S. commercial paper program and the company s $200 million European commercial paper program. Combined borrowing under these two commercial paper programs may not exceed $1.5 billion. The company s U.S. commercial paper program, as shown in the previous table, had $630 million and $305 million outstanding as of September 30, 2014 and December 31, 2013, respectively.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Debt and Interest (continued)

The following table provides the components of the company s long-term debt obligations, including current maturities, as of September 30, 2014 and December 31, 2013.

(millions)	Maturity by year	September 30 2014	December 31 2013
		(unaudited)	
Long-term debt			
Description / 2014 Principal Amount			
Three year 2011 senior notes ($500 million)	2014	$ 500.0	$ 499.9
Seven year 2008 senior notes ($250 million)	2015	249.9	249.7
Three year 2012 senior notes ($500 million)	2015	499.9	499.9
Series B private placement senior euro notes (175 million euro)	2016	229.9	237.8
Five year 2011 senior notes ($1.25 billion)	2016	1,248.9	1,248.6
Term loan ($400 million)	2016	400.0	800.0
Five year 2012 senior notes ($500 million)	2017	495.5	499.7
Series A private placement senior notes ($250 million)	2018	250.0	250.0
Ten year 2011 senior notes ($1.25 billion)	2021	1,249.4	1,249.3
Series B private placement senior notes ($250 million)	2023	250.0	250.0
Thirty year 2011 senior notes ($750 million)	2041	743.0	742.8
Capital lease obligations		10.2	12.7
Other		3.1	8.4
Total debt		6,129.8	6,548.8
Long-term debt, current maturities		(1,255.8)	(505.3)
Total long-term debt		$ 4,874.0	$ 6,043.5

In February 2014, April 2014 and September 2014, the company repaid $100 million, $150 million and $150 million, respectively, of the term loan borrowings.

The company is in compliance with its debt covenants as of September 30, 2014.

Interest expense and interest income recognized during the third quarter and first nine months 2014 and 2013 were as follows:

(millions)	Third Quarter Ended September 30 2014	Third Quarter Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
Interest expense	$ 66.1	$ 69.2	$ 202.0	$ 203.0

Interest income		(2.8)		(2.2)		(7.4)		(8.3)
Interest expense, net	$	63.3	$	67.0	$	194.6	$	194.7

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Goodwill and Other Intangible Assets

Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired. The company s reporting units are its operating segments.

During the second quarter of 2014, the company completed its annual test for goodwill impairment. The company used a step zero qualitative test to assess all ten of its reporting units given substantial levels of headroom and other strong qualitative indicators. Qualitative testing evaluated factors including, but not limited to, economic, market and industry conditions, cost factors and the overall financial performance of the reporting units. Based on the step zero testing performed, no adjustment to the carrying value of goodwill was necessary.

If circumstances change significantly, the company would also test a reporting unit s goodwill for impairment during interim periods between its annual tests. Based on the current performance of the company s operating units, updating the impairment testing during the third quarter of 2014 was not deemed necessary. There has been no impairment of goodwill since the adoption of Financial Accounting Standards Board (FASB) guidance for goodwill and other intangibles on January 1, 2002.

The merger with Nalco and the acquisition of Champion resulted in the addition of $4.5 billion and $1.0 billion of goodwill, respectively. Subsequent performance of the reporting units holding the additional goodwill relative to projections used for the purchase price allocation of goodwill could result in an impairment if there is either underperformance by the reporting unit or if the carrying value of the reporting unit were to fluctuate significantly due to reasons that did not proportionately change fair value.

The changes in the carrying amount of goodwill for each of the company s reportable segments during the nine months ended September 30, 2014 were as follows:

(millions)	Global Industrial	Global Institutional	Global Energy	Other	Total
Goodwill as of December 31, 2013	$ 2,729.5	$ 706.6	$ 3,306.2	$ 120.6	$ 6,862.9
Current year business acquisitions(a)	14.4		9.2	4.6	28.2
Prior year business acquisitions	(0.1)		16.9		16.8
Business disposals		(0.4)			(0.4)
Reclassifications(b)	(28.9)	5.0	23.9		
Effect of foreign currency translation	(22.9)	(6.0)	(28.4)	(1.1)	(58.4)
Goodwill as of September 30, 2014	$ 2,692.0	$ 705.2	$ 3,327.8	$ 124.1	$ 6,849.1

(a) For 2014, none of the goodwill related to businesses acquired is expected to be tax deductible.

(b) The reclassifications line represents immaterial transfers related to certain changes to the company s reportable segments during the first quarter of 2014. See Note 14 for additional information.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Goodwill and Other Intangible Assets (continued)

Other Intangible Assets

As part of the Nalco merger, the company added the Nalco trade name as an indefinite life intangible asset. During the second quarter of 2014, using the qualitative assessment method, the company completed its annual test for indefinite life intangible asset impairment. Based on this testing, no adjustment to the $1.2 billion carrying value of this asset was necessary. Additionally, based on the current performance of the company s operating units, updating the impairment testing during the third quarter of 2014 was not deemed necessary. There has been no impairment of the Nalco trade name intangible asset since it was acquired.

The company s other intangible assets subject to amortization primarily include customer relationships, trademarks, patents and other technology. Other intangible assets are amortized on a straight-line basis over their estimated economic lives. Total amortization expense related to other intangible assets during the third quarter ended September 30, 2014 and 2013 was $75.2 million and $79.0 million, respectively. Total amortization expense related to other intangible assets during the first nine months of 2014 and 2013 was $230.0 million and $214.1 million, respectively.

As of September 30, 2014, future estimated expense related to amortizable other identifiable intangible assets is expected to be:

(millions)		
2014 (Remainder: three-month period)	$	77
2015		306
2016		301
2017		298
2018		285
2019		277

7. Fair Value Measurements

The company s financial instruments include cash and cash equivalents, investments held in rabbi trusts, accounts receivable, accounts payable, contingent consideration obligations, commercial paper, notes payable, foreign currency forward contracts, interest rate swap contracts and long-term debt.

Fair value is defined as the exit price, or the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants as of the measurement date. A hierarchy has been established for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring the most observable inputs be used when available. The hierarchy is broken down into three levels:

Level 1 - Inputs are quoted prices in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2 - Inputs include observable inputs other than quoted prices in active markets.

Level 3 - Inputs are unobservable inputs for which there is little or no market data available.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Fair Value Measurements (continued)

The carrying amount and the estimated fair value for assets and liabilities measured on a recurring basis were:

		2014		
	Carrying	Fair Value Measurements		
September 30 (millions)	**Amount**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Investments held in rabbi trusts	$ 2.7	$ 2.7	$	$
Foreign currency forward contracts	19.2		19.2	
Interest rate swap contracts	0.5		0.5	
Contingent consideration	0.4		0.4	
Liabilities:				
Foreign currency forward contracts	15.5		15.5	
Interest rate swap contracts	4.4		4.4	
Contingent consideration	2.0			2.0

		2013		
	Carrying	Fair Value Measurements		
December 31 (millions)	**Amount**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Investments held in rabbi trusts	$ 4.3	$ 4.3	$	$
Foreign currency forward contracts	20.2		20.2	
Liabilities:				
Foreign currency forward contracts	14.2		14.2	
Contingent consideration	16.4			16.4
Future consideration payable to Champion sellers	86.4			86.4

Investments held in rabbi trusts are classified within level 1 because they are valued using quoted prices in active markets. The carrying value of foreign currency forward contracts is at fair value, which is determined based on foreign currency exchange rates as of the balance sheet date, and is classified within level 2. The carrying value of interest rate swap contracts is at fair value, which is determined based on current interest rates and forward LIBOR rates as of the balance sheet date, and is classified within level 2. Prior to its repayment in January 2014, the future consideration payable to Champion sellers was valued using level 3 inputs.

Contingent consideration is recognized and measured at fair value at the acquisition date. Contingent consideration is classified within level 3 as the underlying fair value is measured based on the probability-weighted present value of the consideration expected to be transferred. The consideration expected to be transferred is based on the company s expectations of various financial measures. The ultimate settlement of contingent consideration could deviate from current estimates based on the actual results of these financial measures. Changes in the fair value of contingent consideration for the nine months ended September 30, 2014 were as follows:

(millions)		
Contingent consideration, December 31, 2013	$	16.4
Amount recognized at transaction date		(0.4)
Loss (gain) recognized in earnings		(0.2)
Settlements		(14.2)
Foreign currency translation		
Contingent consideration, September 30, 2014	$	1.6

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Fair Value Measurements (continued)

The carrying values of accounts receivable, accounts payable, cash and cash equivalents, commercial paper and notes payable approximate fair value because of their short maturities, and as such are classified within level 1.

The fair value of long-term debt is based on quoted market prices for the same or similar debt instruments. The carrying amount and the estimated fair value of long-term debt, including current maturities, held by the company were:

	September 30, 2014		December 31, 2013	
(millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Long-term debt (including current maturities)	$ 6,129.8	$ 6,471.3	$ 6,548.8	$ 6,766.0

8. Derivatives and Hedging Transactions

The company uses foreign currency forward contracts, interest rate swaps and foreign currency debt to manage risks associated with foreign currency exchange rates, interest rates and net investments in foreign operations. The company does not hold derivative financial instruments of a speculative nature or for trading purposes. The company records all derivatives as assets and liabilities on the balance sheet at fair value. Changes in fair value are recognized immediately in earnings unless the derivative qualifies and is designated as a hedge. The company evaluates hedge effectiveness at inception and on an ongoing basis. If a derivative is no longer expected to be effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is recorded in earnings.

The company is exposed to credit risk in the event of nonperformance of counterparties for foreign currency forward exchange contracts and interest rate swap agreements. The company monitors its exposure to credit risk by using credit approvals and credit limits and by selecting major international banks and financial institutions as counterparties. The company does not anticipate nonperformance by any of these counterparties, and therefore, recording a valuation allowance against the company s derivative balance is not considered necessary.

Cash Flow Hedges

The company utilizes foreign currency forward contracts to hedge the effect of foreign currency exchange rate fluctuations on forecasted foreign currency transactions, including: inventory purchases and intercompany royalty and management fee payments. These forward contracts are designated as cash flow hedges. The effective portions of the changes in fair value of these contracts are recorded in accumulated other comprehensive income (AOCI) until the hedged items affect earnings, at which time the gain or loss is reclassified into the same line item in the Consolidated Statement of Income as the underlying exposure being hedged. All hedged transactions are forecasted to occur within the next twelve months.

The company occasionally enters into forward starting interest rate swap contracts to manage interest rate exposure. In September 2014, the company entered into a series of U.S. dollar denominated forward starting swap agreements to hedge against changes in interest rates that could impact a future debt issuance. The interest rate swap agreements were designated and effective as cash flow hedges of the expected interest payments related to the anticipated future debt issuance. The underlying gain recognized in the third quarter of 2014 was recorded in AOCI.

Also in September 2014, subsequent to the company s third quarter end for international operations, the company entered into a series of euro denominated forward starting swap agreements to hedge against changes in interest rates that could impact a future debt issuance.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

In 2011, the company entered into and subsequently closed a series of forward starting swap agreements in connection with the issuance of its private placement debt during the fourth quarter of 2011. In 2006, the company entered into and subsequently closed two forward starting swap contracts related to the issuance of its senior euro notes. The amounts recorded in AOCI for both the 2011 and 2006 transactions are recognized as part of interest expense over the remaining life of the notes as the forecasted interest transactions occur.

The company did not have any forward starting interest rate swap agreements outstanding at December 31, 2013.

The impact on AOCI and earnings from derivative contracts that qualified as cash flow hedges was as follows:

		Third Quarter Ended September 30		Nine Months Ended September 30	
(millions)	**Location**	**2014**	**2013**	**2014**	**2013**
Unrealized gain (loss) recognized into AOCI (effective portion)					
Foreign currency forward contracts	AOCI (equity)	$ 5.5	$ 1.4	$ 2.8	$ 8.0
Interest rate swap contract	AOCI (equity)	0.5		0.5	
		$ 6.0	$ 1.4	$ 3.3	$ 8.0
Gain (loss) reclassified from AOCI into income (effective portion)					
Foreign currency forward contracts	Cost of sales	$ 0.9	$ 0.1	$ 3.4	$ (1.6)
	SG&A		0.4	1.0	0.6
		0.9	0.5	4.4	(1.0)
Interest rate swap	Interest expense, net	(1.0)	(1.0)	(3.0)	(3.0)
		$ (0.1)	$ (0.5)	$ 1.4	$ (4.0)

Gains and losses recognized in income related to the ineffective portion of the company s cash flow hedges were insignificant during the first nine months of 2014 and 2013.

Fair Value Hedges

The company manages interest expense using a mix of fixed and floating rate debt. To help manage exposure to interest rate movements and to reduce borrowing costs, the company may enter into interest rate swaps under 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 principal amount. The mark-to-market of these fair value hedges is recorded as gains or losses in interest expense and is offset by the gain or loss of the underlying debt instrument, which also is recorded in interest expense. These fair value hedges are highly effective and thus, there is no impact on earnings due to hedge ineffectiveness.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

In May 2014, the company entered into an interest rate swap agreement that converted its $500 million 1.45% debt from a fixed rate to a floating or variable interest rate. The interest rate swap was designated as a fair value hedge.

The impact on earnings from derivative contracts that qualified as fair value hedges was as follows:

(millions)	Location	Third Quarter Ended September 30 2014	Third Quarter Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
Gain (loss) on derivative recognized in income					
Interest rate swap	Interest expense, net	$ (3.4)	$	$ (4.4)	$
Gain (loss) on hedged item recognized in income					
Interest rate swap	Interest expense, net	$ 3.4	$	$ 4.4	$

Net Investment Hedges

The company designates its outstanding euro 175 million ($230 million as of September 30, 2014) senior notes and related accrued interest as a hedge of existing foreign currency exposures related to net investments the company has in certain euro functional subsidiaries.

Prior to maturing in December 2013, the Ecolab Series A euro denominated senior notes were also designated as a hedge of existing foreign currency exposures.

In the third quarter of 2012, the company entered into a forward contract with a notional amount of euro 100 million to hedge an additional portion of the company s net investment in euro functional subsidiaries. The forward contract was closed during the second quarter of 2013. In the third quarter of 2014, the company entered into forward contracts with a total notional value of euro 75 million to hedge an additional portion of its net investment in euro functional subsidiaries. Also, in September 2014, subsequent to the company s international quarter end, the company entered into a forward contract with a notional amount of euro 495 million to hedge future foreign currency exposures.

The revaluation gains and losses on the euronotes and of the forward contracts, which are designated and effective as hedges of the company s net investments, have been included as a component of the cumulative translation adjustment account.

Total revaluation gains and losses related to the euronotes and forward contracts charged to shareholders equity were as follows:

	Third Quarter Ended September 30		Nine Months Ended September 30	
(millions)	**2014**	**2013**	**2014**	**2013**
Revaluation gains (losses), net of tax	$ 7.4	$ (4.2)	$ 5.6	$ (4.2)

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

Derivatives Not Designated as Hedging Instruments

The company also uses foreign currency forward contracts to offset its exposure to the change in value of certain foreign currency denominated assets and liabilities held at foreign subsidiaries, primarily receivables and payables, which are remeasured at the end of each period. Although the contracts are effective economic hedges, they are not designated as accounting hedges. Therefore, changes in the value of these derivatives are recognized immediately in earnings, thereby offsetting the current earnings effect of the related foreign currency denominated assets and liabilities.

The impact on earnings from derivative contracts that are not designated as hedging instruments was as follows:

(millions)	Location	Third Quarter Ended September 30 2014	Third Quarter Ended September 30 2013	Nine Months Ended September 30 2014	Nine Months Ended September 30 2013
Gain (loss) recognized in income					
Foreign currency forward contracts	SG&A	$ (0.6)	$ 8.9	$ 6.2	$ 4.4
	Interest expense, net	(2.7)	(0.6)	(8.1)	(3.2)
		$ (3.3)	$ 8.3	$ (1.9)	$ 1.2

The amounts recognized in SG&A above offset the earnings impact of the related foreign currency denominated assets and liabilities. The amounts recognized in interest expense above represent the component of the hedging gains (losses) attributable to the difference between the spot and forward rates of the hedges as a result of interest rate differentials.

Derivative Summary

The following table summarizes the fair value of the company s outstanding derivatives. The amounts represent gross values of derivative assets and liabilities and are included in other current assets and other current liabilities on the Consolidated Balance Sheet.

(millions)	Asset Derivatives September 30 2014	Asset Derivatives December 31 2013	Liability Derivatives September 30 2014	Liability Derivatives December 31 2013

Derivatives designated as hedging instruments								
Foreign currency forward contracts	$	5.2	$	4.4	$	3.2	$	1.1
Interest rate swap contracts		0.5				4.4		
Derivatives not designated as hedging instruments								
Foreign currency forward contracts		14.0		15.8		12.3		13.1
Total	$	19.7	$	20.2	$	19.9	$	14.2

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

The company s derivative transactions are subject to master netting arrangements that allow the company to net settle contracts with the same counterparties. These arrangements generally do not call for collateral. Had the company elected to offset amounts in its Consolidated Balance Sheet, it would have a net liability of $0.2 million and a net asset of $6.0 million as of September 30, 2014 and December 31, 2013, respectively.

The company had foreign currency forward exchange contracts with notional values that totaled approximately $2.0 billion at both September 30, 2014 and December 31, 2013, interest rate swap agreements with notional values of $725 million at September 30, 2014, and net investment hedges, excluding the euro denominated debt, with notional values of $75 million at September 30, 2014.

9. Other Comprehensive Income Information

Comprehensive income (loss) includes net income, foreign currency translation adjustments, unrecognized gains and losses on securities, defined benefit pension and postretirement plan adjustments, gains and losses on derivative instruments designated and effective as cash flow hedges and non-derivative instruments designated and effective as foreign currency net investment hedges that are charged or credited to the accumulated other comprehensive loss account in shareholders equity.

The following table provides other comprehensive income information related to the company s derivatives and hedging instruments and pension and postretirement benefits.

	Third Quarter Ended September 30		Nine Months Ended September 30	
(millions)	**2014**	**2013**	**2014**	**2013**
Derivative & Hedging Instruments				
Unrealized gains (losses) on derivative & hedging instruments				
Amount recognized into AOCI	$ 6.0	$ 1.4	$ 3.3	$ 8.0
(Gains) losses reclassified from AOCI into income				
Cost of sales	(0.9)	(0.1)	(3.4)	1.6
SG&A		(0.4)	(1.0)	(0.6)
Interest expense, net	1.0	1.0	3.0	3.0
	0.1	0.5	(1.4)	4.0
Translation & other insignificant activity	(0.4)	0.2	(0.1)	
Tax impact	(0.7)	(0.5)	(0.9)	(2.9)
Net of tax	$ 5.0	$ 1.6	$ 0.9	$ 9.1

Pension & Postretirement Benefits								
Amounts reclassified from AOCI into income								
Actuarial losses	$	5.7	$	18.6	$	17.2	$	55.8
Prior service costs		(1.6)		(1.9)		(5.0)		(5.6)
		4.1		16.7		12.2		50.2
Tax impact		(1.5)		(6.3)		(4.5)		(18.9)
Net of tax	$	2.6	$	10.4	$	7.7	$	31.3

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Other Comprehensive Income Information (continued)

The derivative losses reclassified from AOCI into income, net of tax, were $0.1 million and $0.4 million in third quarter of 2014 and 2013, respectively. The derivative gain reclassified from AOCI into income during the first nine months of 2014, net of tax, was $1.0 million. The derivative loss reclassified from AOCI into income during the first nine months of 2013, net of tax, was $2.9 million.

The pension and postretirement net actuarial loss and prior service cost reclassified from AOCI into income, net of tax, were $2.6 million and $10.4 million in third quarter of 2014 and 2013, respectively. During the first nine months of 2014 and 2013 the pension and postretirement net actuarial loss and prior service cost reclassified from AOCI into income, net of tax, were $7.7 million and $31.3 million, respectively.

See Note 8 for additional information related to the company s derivatives and hedging transactions. See Note 13 for additional information related to the company s recognition of net actuarial losses and amortization of prior service benefits.

10. Shareholders Equity

Champion acquisition

On April 10, 2013, the company issued 6,596,444 shares of common stock for the stock consideration portion of the Champion acquisition. Of the total shares issued, the company deposited 1,258,115 shares, or approximately $100 million of the total consideration, into an escrow fund to satisfy adjustments to the consideration and indemnification obligations of the acquired company s stockholders. Further information related to the acquisition of Champion is included in Note 3.

Share repurchases

In May 2011, the company s Board of Directors authorized the repurchase of up to 15 million shares of common stock, including shares to be repurchased under Rule 10b5-1. This repurchase authorization was completed in May 2014. In August 2011, the Finance Committee of the company s Board of Directors, via delegation by the company s Board of Directors, authorized the repurchase of an additional 10 million common shares which was contingent upon completion of the merger with Nalco.

In accordance with its share repurchase program through open market or private purchases, the company reacquired 3,096,464 shares of its common stock during 2013. The number of shares repurchased in 2013 includes 1,258,115 shares the company repurchased from the Champion escrow account, with the cash paid to the beneficial shareholders deposited back into escrow. During 2013 the company also reacquired 346,941 shares withheld for taxes related to the exercise of stock options and the vesting of stock awards and units.

During the first nine months of 2014, the company reacquired 3,201,021 shares of its common stock, of which 2,827,334 related to share repurchases through open market or private purchases and reacquired 373,687 shares withheld for taxes related to the exercise of stock options and the vesting of stock awards and units.

As of September 30, 2014, 9,886,298 shares remained to be repurchased under the company s repurchase authorization. The company intends to repurchase all shares under its authorization, for which no expiration date has been established, in open market or privately negotiated transactions, subject to market conditions.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. Earnings Attributable to Ecolab Per Common Share

The computations of the basic and diluted earnings attributable to Ecolab per share amounts were as follows:

	Third Quarter Ended September 30		Nine Months Ended September 30	
(millions, except per share amounts)	**2014**	**2013**	**2014**	**2013**
Net income attributable to Ecolab	$ 364.9	$ 308.0	$ 867.3	$ 680.7
Weighted-average common shares outstanding				
Basic	300.0	301.2	300.1	299.4
Effect of dilutive stock options, units and awards	5.7	6.0	5.9	5.9
Diluted	305.7	307.2	306.0	305.3
Earnings attributable to Ecolab per common share				
Basic	$ 1.22	$ 1.02	$ 2.89	$ 2.27
Diluted	$ 1.19	$ 1.00	$ 2.83	$ 2.23
Anti-dilutive securities excluded from computation of earnings per share			1.5	

12. Income Taxes

The company s tax rate was 27.3% and 24.9% for the third quarter of 2014 and 2013, respectively, and 29.1% and 23.6% for the first nine months of 2014 and 2013, respectively. The changes in the company s tax rate for the third quarter and nine month periods were primarily driven by the tax rate impact of special gains and charges and discrete tax items, with lesser impacts from the expiration of the U.S. R&D credit and favorable geographic income mix.

The company recognized discrete tax net benefits of $1.9 million during the third quarter of 2014 and discrete tax net expense of $16.3 million during the first nine months of 2014.

Third quarter 2014 discrete tax net benefits were driven primarily by recognizing adjustments from filing the company s 2013 U.S. federal income tax return, offset partially by the net impact of foreign audit settlements and adjustments.

Discrete tax net expense for the first nine months of 2014 was also impacted by an update to non-current tax liabilities for global tax audits, an adjustment related to the re-characterization of intercompany payments between the company s U.S. and foreign affiliates, a rate differential on certain prior year shared costs and the remeasurement of certain deferred tax assets and liabilities resulting from a change in the state tax rate for certain entities following the merger of Champion operations, which collectively more than offset the net change of valuation allowances based on the realizability of foreign deferred tax assets and benefits from other foreign country audit settlements.

The company recognized discrete tax net benefits of $12.5 million during the third quarter of 2013 and $40.1 million during the first nine months of 2013.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Income Taxes (continued)

Third quarter 2013 discrete tax net benefits were driven primarily by recognizing adjustments from filing the company s 2012 U.S. federal tax return and the recognition of settlements related to prior year income tax audits, partially offset by the remeasurement of certain deferred tax assets.

Discrete tax net benefits for the first nine months of 2013 were also impacted by the release of a valuation allowance related to the realizability of foreign deferred tax assets, law changes within a foreign jurisdiction, recognition of settlements related to our 2009 through 2010 U.S. income tax returns, the remeasurement of certain deferred tax assets and liabilities and the retroactive extension during first quarter 2013 of the U.S. R&D credit, all of which were partially offset by foreign audit adjustments.

13. Pension and Postretirement Plans

The company has a non-contributory qualified defined benefit pension plan covering the majority of its U.S. employees. The company also has U.S. non-contributory non-qualified defined benefit plans, which provide for benefits to employees in excess of limits permitted under its U.S. pension plans. On January 1, 2014, certain legacy Champion employees became eligible to participate in the U.S. qualified and non-qualified pension plans. Various international subsidiaries also have defined benefit pension plans. The company provides postretirement health care benefits to certain U.S. employees and retirees.

The components of net periodic pension and postretirement health care benefit costs for the third quarter ended September 30 are as follows:

	U.S. Pension		International Pension		U.S. Postretirement Health Care	
(millions)	2014	2013	2014	2013	2014	2013
Service cost	$ 16.6	$ 17.2	$ 8.5	$ 9.0	$ 1.1	$ 1.5
Interest cost on benefit obligation	22.5	21.2	12.2	11.7	2.7	2.7
Expected return on plan assets	(32.1)	(32.5)	(13.4)	(11.6)	(0.2)	(0.3)
Recognition of net actuarial (gain) loss	5.9	15.6	1.9	2.8	(2.1)	0.2
Amortization of prior service cost (benefit)	(1.7)	(1.7)	0.2	(0.1)	(0.1)	(0.1)
Settlements/curtailments						
	$ 11.2	$ 19.8	$ 9.4	$ 11.8	$ 1.4	$ 4.0

The components of net periodic pension and postretirement health care benefit costs for the nine months ended September 30 are as follows:

(millions)	U.S. Pension 2014	U.S. Pension 2013	International Pension 2014	International Pension 2013	U.S. Postretirement Health Care 2014	U.S. Postretirement Health Care 2013
Service cost	$ 49.8	$ 51.5	$ 25.1	$ 27.0	$ 3.2	$ 4.5
Interest cost on benefit obligation	67.5	63.6	37.5	35.2	8.1	8.1
Expected return on plan assets	(96.3)	(97.6)	(41.0)	(34.9)	(0.8)	(0.8)
Recognition of net actuarial (gain) loss	17.7	46.8	5.6	8.5	(6.1)	0.5
Amortization of prior service cost (benefit)	(5.2)	(5.2)	0.4	(0.1)	(0.2)	(0.3)
Settlements/curtailments			0.1	0.1		
	$ 33.5	$ 59.1	$ 27.7	$ 35.8	$ 4.2	$ 12.0