ECOLAB INC
Form 10-Q
August 07, 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 June 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 June 30, 2014.

299,630,068 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)	Second Quarter Ended June 30 2014		Second Quarter Ended June 30 2013	
	(unaudited)			
Net sales	$	3,568.2	$	3,337.8
Cost of sales (including special charges of $1.1 in 2014 and $15.2 in 2013)		1,909.4		1,810.2
Selling, general and administrative expenses		1,152.7		1,101.7
Special (gains) and charges		(6.1)		73.6
Operating income		512.2		352.3
Interest expense, net (including special charges of $0.3 in 2013)		66.2		66.2
Income before income taxes		446.0		286.1
Provision for income taxes		131.0		70.3
Net income including noncontrolling interest		315.0		215.8
Less: Net income attributable to noncontrolling interest		3.6		2.7
Net income attributable to Ecolab	$	311.4	$	213.1
Earnings attributable to Ecolab per common share				
Basic	$	1.04	$	0.71
Diluted	$	1.02	$	0.69
Dividends declared per common share	$	0.2750	$	0.2300
Weighted-average common shares outstanding				
Basic		299.6		301.5
Diluted		305.2		307.4

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

ECOLAB INC.

CONSOLIDATED STATEMENT OF INCOME

(millions, except per share amounts)	Six Months Ended June 30 2014 (unaudited)	2013
Net sales	$ 6,904.8	$ 6,209.9
Cost of sales (including special charges of $7.1 in 2014 and $17.2 in 2013)	3,728.6	3,349.9
Selling, general and administrative expenses	2,289.6	2,122.7
Special (gains) and charges	23.5	123.3
Operating income	863.1	614.0
Interest expense, net (including special charges of $2.5 in 2013)	131.3	127.7
Income before income taxes	731.8	486.3
Provision for income taxes	222.3	109.5
Net income including noncontrolling interest	509.5	376.8
Less: Net income attributable to noncontrolling interest (including special charges of $0.5 in 2013)	7.1	4.1
Net income attributable to Ecolab	$ 502.4	$ 372.7
Earnings attributable to Ecolab per common share		
Basic	$ 1.67	$ 1.25
Diluted	$ 1.64	$ 1.23
Dividends declared per common share	$ 0.5500	$ 0.4600
Weighted-average common shares outstanding		
Basic	300.1	298.5
Diluted	305.9	304.2

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

ECOLAB INC.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(millions)	Second Quarter Ended June 30 2014	Second Quarter Ended June 30 2013	Six Months Ended June 30 2014	Six Months Ended June 30 2013
	(unaudited)			
Net income including noncontrolling interest	$ 315.0	$ 215.8	$ 509.5	$ 376.8
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments				
Foreign currency translation	22.2	(89.1)	(44.8)	(150.7)
Gain (loss) on net investment hedge	1.9	2.2	(1.8)	
	24.1	(86.9)	(46.6)	(150.7)
Derivatives and hedging instruments	(4.1)	3.6	(4.1)	7.5
Pension and postretirement benefits				
Amortization of net actuarial loss and prior service cost included in net periodic pension and postretirement costs	2.5	10.5	5.1	20.9
Subtotal	22.5	(72.8)	(45.6)	(122.3)
Total comprehensive income, including noncontrolling interest	337.5	143.0	463.9	254.5
Less: Comprehensive income (loss) attributable to noncontrolling interest	3.6	(3.1)	7.1	(11.0)
Comprehensive income attributable to Ecolab	$ 333.9	$ 146.1	$ 456.8	$ 265.5

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

ECOLAB INC.

CONSOLIDATED BALANCE SHEET

(millions)	**June 30 2014**	**December 31 2013**
	(unaudited)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 187.0	$ 339.2
Accounts receivable, net	2,637.3	2,568.0
Inventories	1,414.3	1,321.9
Deferred income taxes	167.3	163.0
Other current assets	366.2	306.3
Total current assets	4,772.1	4,698.4
Property, plant and equipment, net	2,938.9	2,882.0
Goodwill	6,862.9	6,862.9
Other intangible assets, net	4,635.9	4,785.3
Other assets	404.0	407.9
Total assets	$ 19,613.8	$ 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)	June 30 2014 (unaudited)	December 31 2013
LIABILITIES AND EQUITY		
Current liabilities		
Short-term debt	$ 1,589.7	$ 861.0
Accounts payable	1,004.5	1,021.9
Compensation and benefits	492.8	571.1
Income taxes	43.4	80.9
Other current liabilities	836.5	953.8
Total current liabilities	3,966.9	3,488.7
Long-term debt	5,539.1	6,043.5
Postretirement health care and pension benefits	797.4	795.6
Other liabilities	1,850.3	1,899.3
Total liabilities	12,153.7	12,227.1
Equity (a)		
Common stock	346.7	345.1
Additional paid-in capital	4,791.4	4,692.0
Retained earnings	5,036.3	4,699.0
Accumulated other comprehensive loss	(350.8)	(305.2)
Treasury stock	(2,420.7)	(2,086.6)
Total Ecolab shareholders equity	7,402.9	7,344.3
Noncontrolling interest	57.2	65.1
Total equity	7,460.1	7,409.4
Total liabilities and equity	$ 19,613.8	$ 19,636.5

(a) Common stock, 800 million shares authorized, $1.00 par value per share, 299.6 million shares outstanding at June 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)	Six Months Ended June 30 2014	2013
	(unaudited)	
OPERATING ACTIVITIES		
Net income including noncontrolling interest	$ 509.5	$ 376.8
Adjustments to reconcile net income including noncontrolling interest to cash provided by operating activities:		
Depreciation	276.1	250.4
Amortization	159.3	139.5
Deferred income taxes	(50.6)	(79.3)
Share-based compensation expense	42.7	39.7
Excess tax benefits from share-based payment arrangements	(30.9)	(17.9)
Pension and postretirement plan contributions	(45.0)	(37.0)
Pension and postretirement plan expense	43.5	71.3
Restructuring, net of cash paid	(9.3)	(6.4)
Venezuela currency devaluation		23.4
Gain on sale of business	(1.6)	
Other, net	8.7	7.5
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	(79.4)	5.0
Inventories	(107.2)	(72.6)
Other assets	(34.8)	(87.7)
Accounts payable	(20.0)	(58.5)
Other liabilities	(129.1)	(161.2)
Cash provided by operating activities	$ 531.9	$ 393.0

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

(Continued)

ECOLAB INC.

CONSOLIDATED STATEMENT OF CASH FLOWS (continued)

(millions)	Six Months Ended June 30 2014	2013
	(unaudited)	
INVESTING ACTIVITIES		
Capital expenditures	$ (321.7)	$ (265.1)
Capitalized software expenditures	(15.5)	(16.2)
Property and other assets sold	5.3	2.3
Businesses acquired and investments in affiliates, net of cash acquired	(34.4)	(1,452.1)
Divestiture of businesses	5.6	
Deposit into indemnification escrow		(10.6)
Release from indemnification escrow	1.4	13.0
Cash used for investing activities	(359.3)	(1,728.7)
FINANCING ACTIVITIES		
Net issuances (repayments) of commercial paper and notes payable	477.6	67.6
Long-term debt borrowings		900.1
Long-term debt repayments	(256.5)	(236.0)
Reacquired shares	(336.6)	(175.7)
Dividends paid	(172.3)	(72.4)
Exercise of employee stock options	30.9	56.2
Excess tax benefits from share-based payment arrangements	30.9	17.9
Acquisition related liabilities and contingent consideration	(86.6)	
Acquisition of noncontrolling interest	(7.3)	
Other, net		0.1
Cash provided by (used for) financing activities	(319.9)	557.8
Effect of exchange rate changes on cash	(4.9)	(4.7)
Decrease in cash and cash equivalents	(152.2)	(782.6)
Cash and cash equivalents, beginning of period	339.2	1,157.8
Cash and cash equivalents, end of period	$ 187.0	$ 375.2

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 second quarter and six months ended June 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 second quarter and six months ended June 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 August 7, 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 $18.4 million for the second quarter ended June 30, 2013, $43.6 million for the six months ended June 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

2. Special (Gains) and Charges

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

(millions)	Second Quarter Ended June 30 2014	Second Quarter Ended June 30 2013	Six Months Ended June 30 2014	Six Months Ended June 30 2013
Cost of sales				
Restructuring charges	$ 1.1	$ 1.6	$ 7.1	$ 3.6
Recognition of Champion inventory fair value step-up		13.6		13.6
Subtotal	1.1	15.2	7.1	17.2
Special (gains) and charges				
Restructuring charges	6.0	45.0	28.6	63.5
Champion acquisition and integration costs	5.2	24.0	11.7	31.8
Nalco merger and integration costs	1.5	4.4	2.8	8.2
Venezuela currency devaluation				23.4
Litigation related charges, settlements and other	(18.8)	0.2	(19.6)	(3.6)
Subtotal	(6.1)	73.6	23.5	123.3
Operating income subtotal	(5.0)	88.8	30.6	140.5
Interest expense, net				
Acquisition debt costs		0.3		2.5
Net income attributable to noncontrolling interest				
Venezuela currency devaluation				(0.5)
Total special (gains) and charges	$ (5.0)	$ 89.1	$ 30.6	$ 142.5

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

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 the completion of the Plan in 2015. Approximately $30 million ($20 million after tax) of those charges are expected to occur in 2014. During 2013, the company incurred $27 million ($19 million after tax) of charges related to the Energy Restructuring Plan.

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.

As a result of restructuring activities under the Energy Restructuring Plan, the company recorded restructuring charges of $2.7 million ($2.2 million after tax) and $12.2 million ($7.6 million after tax) during the second quarter of 2014 and 2013, respectively. During the six months ended June 30, 2014 and 2013, the company incurred charges of $7.6 million ($5.2 million after tax) and $12.2 million ($7.6 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

(millions)	Termination Costs	Asset 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	6.3	0.1	1.2	7.6
Cash payments	(9.2)		(1.0)	(10.2)
Non-cash charges		(0.1)		(0.1)
Effect of foreign currency translation	(0.2)			(0.2)
Restructuring liability, June 30, 2014	$ 3.7	$	$ 0.3	$ 4.0

As shown in the previous table, cash payments under the Energy Restructuring Plan were $10.2 million during the first six 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

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 plant and distribution center locations and the global workforce. Through substantial completion of the Combined Plan at the end of 2014, the company expects to incur pre-tax charges of approximately $50 million ($40 million after tax) during 2014. During 2013, the company incurred $64 million ($48 million after tax) of charges related to the Combined Plan.

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

As a result of restructuring activities under the Combined Plan, the company recorded restructuring charges of $4.3 million ($3.9 million after tax) and $34.4 million ($26.1 million after tax), during the second quarter of 2014 and 2013, respectively. During the six months ended June 30, 2014 and 2013, the company incurred charges of $28.0 million ($23.7 million after tax) and $55.2 million ($40.4 million after tax), respectively.

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 expense and accrual	$ 248.2	$ (1.2)	$ 30.7	$ 277.7
Net cash payments	(182.2)	9.1	(19.1)	(192.2)
Non-cash 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		25.1		(1.3)		4.2		28.0
Net cash payments		(30.5)				(4.2)		(34.7)
Non-cash net charges				1.3				1.3
Effect of foreign currency translation		0.2						0.2
Restructuring liability, June 30, 2014	$	60.7	$		$	7.3	$	68.0

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Special (Gains) and Charges (continued)

As shown in the previous table, net cash payments under the Combined Plan were $34.7 million during the first six 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 $5.2 million ($3.4 million after tax) and $37.9 million ($27.6 million after tax) during the second quarter of 2014 and 2013, respectively. During the six months ended June 30, 2014 and 2013, the company incurred charges of $11.7 million ($7.5 million after tax) and $47.9 million ($34.7 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 charges of $1.5 million ($1.1 million after tax) and $4.4 million ($3.0 million after tax) during the second quarter of 2014 and 2013, respectively. During the six months ended June 30, 2014 and 2013, the company incurred charges of $2.8 million ($2.0 million after tax) and $8.2 million ($5.7 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 May 31, 2014, the fiscal quarter end for the company s international operations, the SICAD 1 exchange rate closed at 10 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 May 31, 2014, the company had $86 million of net monetary assets denominated in bolivars that were required to be remeasured to U.S. dollars. During the six month period ended May 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 May 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 May 31, 2014 represented less than 2% of the company s consolidated assets.

Other special (gains) and charges

The company recognized gains of $18.8 million ($15.9 million after tax) and $19.6 million ($16.4 million after tax) in the second quarter and the first six months of 2014, respectively, 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.

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.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

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.

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 is being fully integrated with the company s Global Energy segment, including all customer selling activity, discrete financial data specific to the legacy Champion business is not necessarily available post acquisition.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

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 six months of 2014, the company completed three business combination transactions. In addition, three transactions were completed subsequent to the end of the second 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, subsequent to the company s second quarter end for international operations, 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 Emirates National Chemicals Company LLC 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.

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 will become part of the company s Industrial reportable segment during the third quarter of 2014.

2013 Activity

During the first six 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. The business became part of the company s Global Industrial reportable segment during the first quarter of 2013.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Acquisitions and Dispositions (continued)

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 six months of 2014 and all of 2013 were not material to the company s consolidated financial statements; therefore, pro forma financial information is not 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 completed acquisitions during the second quarter and first six months of 2014 and 2013 are shown in the following table.

(millions)	Second Quarter Ended June 30 2014	Second Quarter Ended June 30 2013	Six Months Ended June 30 2014	Six Months Ended June 30 2013
Net tangible assets acquired	$ 10.5	$ 1.9	$ 22.2	$ (2.3)
Identifiable intangible assets				
Customer relationships	1.0	11.6	2.9	58.8
Trademarks		1.3	0.8	1.4
Other technology		1.0	2.9	1.0
Non-compete	0.1		0.1	
Total intangible assets	1.1	13.9	6.7	61.2
Goodwill	4.4	7.9	11.3	41.2
Total aggregate purchase price	16.0	23.7	40.2	100.1
Acquisition related liabilities and contingent consideration	(1.1)		0.1	9.8
Liability for indemnification, net	0.3	(2.6)	1.4	2.4
Net cash paid for acquisitions, including contingent consideration	$ 15.2	$ 21.1	$ 41.7	$ 112.3

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, and as previously discussed, approximately $8 million of the Quimiproductos purchase price was placed in an escrow account. As part of the Master Chemicals transaction, during the second quarter of 2013, approximately $3 million of the purchase price was placed in an escrow account. The contingent consideration activity primarily relates to payments on legacy Nalco acquisitions.

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

Dispositions

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

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

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Balance Sheet Information

(millions)		June 30 2014 (unaudited)		December 31 2013
Accounts receivable, net				
Accounts receivable	$	2,721.6	$	2,648.9
Allowance for doubtful accounts		(84.3)		(80.9)
Total	$	2,637.3	$	2,568.0
Inventories				
Finished goods	$	994.4	$	953.3
Raw materials and parts		438.9		391.0
Inventories at FIFO cost		1,433.3		1,344.3
Excess of FIFO cost over LIFO cost		(19.0)		(22.4)
Total	$	1,414.3	$	1,321.9
Property, plant and equipment, net				
Land	$	194.2	$	191.4
Buildings and improvements		689.6		666.0
Leasehold improvements		87.8		87.9
Machinery and equipment		1,722.5		1,677.5
Merchandising and customer equipment		1,901.3		1,802.8
Capitalized software		448.3		435.4
Construction in progress		363.6		291.6
		5,407.3		5,152.6
Accumulated depreciation		(2,468.4)		(2,270.6)
Total	$	2,938.9	$	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	$	3,451.2	$	3,455.6
Trademarks		309.5		308.1
Patents		430.3		425.6
Other technology		213.3		210.2
	$	4,404.3	$	4,399.5
Accumulated amortization				
Customer relationships	$	(711.2)	$	(594.9)
Trademarks		(81.3)		(70.4)
Patents		(110.3)		(95.7)
Other technology		(95.6)		(83.2)
Other intangible assets, net	$	4,635.9	$	4,785.3
Other assets				
Deferred income taxes	$	52.5	$	54.5
Deferred financing costs		27.2		31.7
Pension		90.0		90.2
Other		234.3		231.5

Total	$	404.0	$	407.9

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

4. Balance Sheet Information (continued)

(millions)	June 30 2014	December 31 2013
	(unaudited)	
Other current liabilities		
Discounts and rebates	$ 279.5	$ 263.2
Dividends payable	82.4	82.8
Interest payable	25.3	19.6
Taxes payable, other than income	108.1	115.3
Derivative liabilities	15.3	14.2
Restructuring	62.5	68.3
Future consideration payable to Champion sellers		86.4
Other	263.4	304.0
Total	$ 836.5	$ 953.8
Other liabilities		
Deferred income taxes	$ 1,620.8	$ 1,661.3
Income taxes payable - non-current	92.3	90.2
Restructuring	9.5	12.9
Other	127.7	134.9
Total	$ 1,850.3	$ 1,899.3
Accumulated other comprehensive loss		
Unrealized loss on derivative financial instruments, net of tax	$ (10.7)	$ (6.6)
Unrecognized pension and postretirement benefit expense, net of tax	(230.4)	(235.0)
Cumulative translation, net of tax	(109.7)	(63.6)
Total	$ (350.8)	$ (305.2)

5. Debt and Interest

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

(millions)	June 30 2014	December 31 2013
	(unaudited)	
Short-term debt		
Commercial paper	$ 792.9	$ 304.8
Notes payable	41.9	50.9
Long-term debt, current maturities	754.9	505.3
Total	$ 1,589.7	$ 861.0

As of June 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 $793 million and $305 million outstanding as of June 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 June 30, 2014 and December 31, 2013.

(millions)	Maturity by year		June 30 2014 (unaudited)		December 31 2013
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		249.8		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		238.6		237.8
Five year 2011 senior notes ($1.25 billion)	2016		1,248.8		1,248.6
Term loan ($550 million)	2016		550.0		800.0
Five year 2012 senior notes ($500 million)	2017		498.7		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		742.9		742.8
Capital lease obligations			12.5		12.7
Other			3.4		8.4
Total debt			6,294.0		6,548.8
Long-term debt, current maturities			(754.9)		(505.3)
Total long-term debt		$	5,539.1	$	6,043.5

In February 2014, the company repaid $100 million of term loan borrowings. In April 2014, it repaid an additional $150 million of term loan borrowings.

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

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

	Second Quarter Ended June 30				Six Months Ended June 30			
(millions)		2014		2013		2014		2013
Interest expense	$	68.6	$	68.8	$	135.9	$	133.8

Interest income		(2.4)		(2.6)		(4.6)		(6.1)
Interest expense, net	$	66.2	$	66.2	$	131.3	$	127.7

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. 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 six months ended June 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)	7.0			4.4	11.4
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	(10.9)	(2.9)	(13.5)	(0.5)	(27.8)
Goodwill as of June 30, 2014	$ 2,696.6	$ 708.3	$ 3,333.5	$ 124.5	$ 6,862.9

(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. 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. 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 second quarter ended June 30, 2014 and 2013 was $76.7 million and $74.6 million, respectively. Total amortization expense related to other intangible assets during the first six months of 2014 and 2013 was $154.8 million and $135.1 million, respectively. The increase from 2013 to 2014 is primarily due to amortizable intangible assets acquired as part of the Champion transaction.

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

(millions)

2014 (Remainder: six-month period)	$	150
2015		302
2016		297
2017		295
2018		288
2019		275

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	
June 30 (millions)	**Amount**	**Level 1**	**Level 2**	**Level 3**
Assets:				
Investments held in rabbi trusts	$ 2.7	$ 2.7	$	$
Foreign currency forward contracts	9.3		9.3	
Liabilities:				
Foreign currency forward contracts	14.3		14.3	
Interest rate swap contracts	1.0		1.0	
Contingent consideration obligations	15.5			15.5

			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 obligations	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 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 obligations are recognized and measured at fair value at the acquisition date. Contingent consideration liabilities are classified within level 3 because 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 payment 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 obligations for the six months ended June 30, 2014 were as follows:

(millions)		
Contingent consideration, December 31, 2013	$	16.4
Liabilities recognized at acquisition date		
Loss (gain) recognized in earnings		0.4
Settlements		(1.2)
Foreign currency translation		(0.1)
Contingent consideration, June 30, 2014	$	15.5

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:

	June 30, 2014		December 31, 2013	
(millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Long-term debt (including current maturities)	$ 6,294.0	$ 6,675.4	$ 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.

In anticipation of debt issuances, the company occasionally enters into interest rate swap contracts to manage interest rate exposures. In 2011, the company entered into and subsequently closed six forward starting swap agreements in connection with the issuance of its private placement debt during the fourth quarter of 2011. The interest rate swap agreements were designated and effective as cash flow hedges of the expected interest payments related to the anticipated debt issuance. 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 June 30, 2014 or December 31, 2013.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

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

		Second Quarter Ended June 30		Six Months Ended June 30	
(millions)	**Location**	**2014**	**2013**	**2014**	**2013**
Unrealized gain (loss) recognized into AOCI (effective portion)					
Foreign currency forward contracts	AOCI (equity)	$ (2.9)	$ 3.0	$ (2.7)	$ 6.6
Gain (loss) reclassified from AOCI into income (effective portion)					
Foreign currency forward contracts	Cost of sales	$ 2.7	$ (1.4)	$ 2.5	$ (1.7)
	SG&A	0.4	0.2	1.0	0.2
		3.1	(1.2)	3.5	(1.5)
Interest rate swap	Interest expense, net	(1.0)	(1.0)	(2.0)	(2.0)
		$ 2.1	$ (2.2)	$ 1.5	$ (3.5)

Gains and losses recognized in income related to the ineffective portion of the company s cash flow hedges were insignificant during the first six 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 these agreements, 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.

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.

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ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Derivatives and Hedging Transactions (continued)

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

		Second Quarter Ended June 30		Six Months Ended June 30	
(millions)	**Location**	**2014**	**2013**	**2014**	**2013**
Gain (loss) on derivative recognized in income					
Interest rate swap	Interest expense, net	$ (1.0)	$	$ (1.0)	$
Gain (loss) on hedged item recognized in income					
Interest rate swap	Interest expense, net	$ 1.0	$	$ 1.0	$

Net Investment Hedge

The company designates its outstanding euro 175 million ($239 million as of June 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. Subsequent to the company s 2014 second quarter end for international operations, it 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.

The revaluation gains and losses on the euronotes and of the forward contract, through the date of its closing, 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 contract charged to shareholders equity were as follows:

(millions)	Second Quarter Ended June 30 2014	Second Quarter Ended June 30 2013	Six Months Ended June 30 2014	Six Months Ended June 30 2013
Revaluation gains (losses), net of tax	$ 1.9	$ 2.2	$ (1.8)	$

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:

		Second Quarter Ended June 30		Six Months Ended June 30	
(millions)	**Location**	**2014**	**2013**	**2014**	**2013**
Gain (loss) recognized in income					
Foreign currency forward contracts	SG&A	$ 3.7	$ 1.8	$ 6.8	$ (4.5)
	Interest expense, net	(3.0)	(1.4)	(5.4)	(2.6)
		$ 0.7	$ 0.4	$ 1.4	$ (7.1)

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.

Asset Derivatives		Liability Derivatives	
June 30	**December 31**	**June 30**	**December 31**