

ECOLAB INC  
Form 10-Q  
November 06, 2009

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

- 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)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**41-0231510**  
(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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of 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  No

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

|   |  |
|---|--|
| Large accelerated filer <input checked="" type="checkbox"/>                                     | Accelerated filer <input type="checkbox"/>         |
| Non-accelerated filer <input type="checkbox"/><br>(Do not check if a smaller reporting company) | Smaller reporting company <input type="checkbox"/> |

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of October 30, 2009.

237,554,525 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)                                    | Third Quarter Ended<br>September 30<br>(unaudited) |            |
|---|--|------------|
|   | 2009   | 2008       |
| Net sales   | \$ 1,546.4   | \$ 1,626.3 |
| Cost of sales (including special charges of \$1.3 in 2009)      | 763.9  | 834.3      |
| Selling, general and administrative expenses                    | 554.1  | 578.8      |
| Special gains and charges                                       | 5.4  | 11.8       |
| Operating income  | 223.0  | 201.4      |
| Interest expense, net   | 15.1   | 16.0       |
| Income before income taxes                                      | 207.9  | 185.4      |
| Provision for income taxes                                      | 62.7   | 59.5       |
| Net income including noncontrolling interest                    | 145.2  | 125.9      |
| Less: Net income (loss) attributable to noncontrolling interest | 0.2  | (0.3)      |
| Net income attributable to Ecolab                               | \$ 145.0   | \$ 126.2   |
| Net income attributable to Ecolab per common share              |  |            |
| Basic   | \$ 0.61  | \$ 0.51    |
| Diluted   | \$ 0.60  | \$ 0.50    |
| Dividends declared per common share                             | \$ 0.1400  | \$ 0.1300  |
| Weighted-average common shares outstanding                      |  |            |
| Basic   | 237.0  | 247.5      |
| Diluted   | 240.6  | 251.8      |

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



## ECOLAB INC.

## CONSOLIDATED STATEMENT OF INCOME

| (millions, except per share)                                    | Nine Months Ended<br>September 30<br>(unaudited) |            |
|---|--|------------|
|   | 2009   | 2008       |
| Net sales   | \$ 4,336.1                                       | \$ 4,654.2 |
| Cost of sales (including special charges of \$9.4 in 2009)      | 2,196.9  | 2,371.4    |
| Selling, general and administrative expenses                    | 1,596.8  | 1,715.8    |
| Special gains and charges                                       | 56.9   | (5.6)      |
| Operating income  | 485.5  | 572.6      |
| Interest expense, net   | 46.1   | 46.1       |
| Income before income taxes                                      | 439.4  | 526.5      |
| Provision for income taxes                                      | 137.0  | 158.5      |
| Net income including noncontrolling interest                    | 302.4  | 368.0      |
| Less: Net income (loss) attributable to noncontrolling interest | 0.9  | (0.1)      |
| Net income attributable to Ecolab                               | \$ 301.5   | \$ 368.1   |
| Net income attributable to Ecolab per common share              |  |            |
| Basic   | \$ 1.27  | \$ 1.49    |
| Diluted   | \$ 1.26  | \$ 1.46    |
| Dividends declared per common share                             | \$ 0.4200  | \$ 0.3900  |
| Weighted-average common shares outstanding                      |  |            |
| Basic   | 236.5  | 247.2      |
| Diluted   | 239.6  | 251.7      |

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

## ECOLAB INC.

## CONSOLIDATED BALANCE SHEET

| (millions)   | September 30<br>2009 | December 31<br>2008 |
|--|----------------------|---------------------|
|  | (unaudited)          |                     |
| <b>ASSETS</b>  |                      |                     |
| <b>Current assets</b>  |                      |                     |
| Cash and cash equivalents  | \$ 107.5             | \$ 66.7             |
| Accounts receivable (net of allowance of \$51.6 at September 30, 2009 and \$43.8 at December 31, 2008) | 1,013.0              | 971.0               |
| Inventories  | 474.8                | 467.2               |
| Deferred income taxes  | 93.8                 | 94.7                |
| Other current assets   | 126.9                | 91.5                |
| <b>Total current assets</b>  | <b>1,816.0</b>       | <b>1,691.1</b>      |
| Property, plant and equipment, net   | 1,149.1              | 1,135.2             |
| Goodwill   | 1,369.8              | 1,267.7             |
| Other intangible assets, net   | 312.2                | 326.7               |
| Other assets   | 341.7                | 336.2               |
| <b>Total assets</b>  | <b>\$ 4,988.8</b>    | <b>\$ 4,756.9</b>   |

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

(Continued)

## ECOLAB INC.

## CONSOLIDATED BALANCE SHEET (Continued)

| (millions, except per share)                    | September 30<br>2009 | (unaudited) | December 31<br>2008 |
|---|----------------------|-------------|---------------------|
| <b>LIABILITIES AND EQUITY</b>                   |                      |             |                     |
| <b>Current liabilities</b>                      |                      |             |                     |
| Short-term debt                                 | \$ 121.0             |             | \$ 338.9            |
| Accounts payable                                | 367.3                |             | 359.6               |
| Compensation and benefits                       | 271.8                |             | 261.1               |
| Income taxes                                    | 31.0                 |             | 46.3                |
| Other current liabilities                       | 501.8                |             | 436.0               |
| <b>Total current liabilities</b>                | <b>1,292.9</b>       |             | <b>1,441.9</b>      |
| Long-term debt                                  | 850.0                |             | 799.3               |
| Postretirement health care and pension benefits | 601.7                |             | 680.2               |
| Other liabilities                               | 274.2                |             | 256.5               |
| <b>Equity (a)</b>                               |                      |             |                     |
| Common stock                                    | 329.5                |             | 328.0               |
| Additional paid-in capital                      | 1,154.0              |             | 1,090.5             |
| Retained earnings                               | 2,819.2              |             | 2,617.0             |
| Accumulated other comprehensive loss            | (224.6)              |             | (359.1)             |
| Treasury stock                                  | (2,116.3)            |             | (2,104.8)           |
| <b>Total Ecolab shareholders' equity</b>        | <b>1,961.8</b>       |             | <b>1,571.6</b>      |
| Noncontrolling interest                         | 8.2                  |             | 7.4                 |
| <b>Total equity</b>                             | <b>1,970.0</b>       |             | <b>1,579.0</b>      |
| <b>Total liabilities and equity</b>             | <b>\$ 4,988.8</b>    |             | <b>\$ 4,756.9</b>   |

(a) Common stock, 400 million shares authorized, \$1.00 par value per share, 237.5 million shares outstanding at September 30, 2009, 236.2 million shares outstanding at December 31, 2008.

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



## ECOLAB INC.

## CONSOLIDATED STATEMENT OF CASH FLOWS

| (millions)  | Nine Months Ended<br>September 30<br>(unaudited) |          |
|---|--|----------|
|   | 2009   | 2008     |
| <b>OPERATING ACTIVITIES</b>   |  |          |
| Net income including noncontrolling interest  | \$ 302.4   | \$ 368.0 |
| Adjustments to reconcile net income including noncontrolling interest to cash provided by operating activities: |  |          |
| Depreciation and amortization   | 248.6  | 255.2    |
| Deferred income taxes   | 20.2   | 70.4     |
| Share-based compensation expense  | 22.9   | 22.4     |
| Excess tax benefits from share-based payment arrangements   | (5.9)  | (8.1)    |
| Pension and postretirement plan contributions   | (144.8)  | (94.1)   |
| Pension and postretirement plan expense   | 61.5   | 54.7     |
| Special charges-restructuring, net of cash paid   | 28.9   |          |
| Gain on sale of plant   |  | (24.5)   |
| Other, net  | 7.4  | (2.4)    |
| Changes in operating assets and liabilities:  |  |          |
| Accounts receivable   | 23.1   | (129.3)  |
| Inventories   | 21.7   | (48.5)   |
| Other assets  | (14.6)   | (0.1)    |
| Accounts payable  | (12.7)   | 40.9     |
| Other liabilities   | (27.2)   | (8.4)    |
| Cash provided by operating activities   | \$ 531.5   | \$ 496.2 |

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

(Continued)

## ECOLAB INC.

## CONSOLIDATED STATEMENT OF CASH FLOWS (Continued)

| (millions)  | 2009        | Nine Months Ended<br>September 30<br>(unaudited) | 2008          |
|---|-------------|--|---------------|
| <b>INVESTING ACTIVITIES</b>   |             |  |               |
| Capital expenditures  | \$ (169.0)  |  | \$ (248.5)    |
| Capitalized software expenditures                                       | (29.7)      |  | (51.3)        |
| Property sold   | 3.2         |  | 35.7          |
| Businesses acquired and investments in affiliates, net of cash acquired | (7.1)       |  | (203.7)       |
| Sale of businesses  | 0.7         |  | 2.2           |
| Deposit into indemnification escrow                                     |             |  | (21.0)        |
| Cash used for investing activities                                      | (201.9)     |  | (486.6)       |
| <b>FINANCING ACTIVITIES</b>   |             |  |               |
| Net issuances (repayments) of commercial paper and notes payable        | (219.8)     |  | (229.3)       |
| Long-term debt borrowings   |             |  | 257.7         |
| Long-term debt repayments   | (5.0)       |  | (3.4)         |
| Reacquired shares   | (11.5)      |  | (20.9)        |
| Cash dividends on common stock  | (99.5)      |  | (96.3)        |
| Exercise of employee stock options                                      | 37.1        |  | 35.6          |
| Excess tax benefits from share-based payment arrangements               | 5.9         |  | 8.1           |
| Other, net  |             |  | (0.6)         |
| Cash used for financing activities                                      | (292.8)     |  | (49.1)        |
| Effect of exchange rate changes on cash                                 | 4.0         |  | 4.2           |
| <b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                 | <b>40.8</b> |  | <b>(35.3)</b> |
| Cash and cash equivalents, beginning of period                          | 66.7        |  | 137.4         |
| Cash and cash equivalents, end of period                                | \$ 107.5    |  | \$ 102.1      |

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, 2009 and 2008, reflect, in the opinion of management, all adjustments necessary for a fair presentation of the financial position, results of operations and cash flows of Ecolab Inc. ( 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, 2008 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, 2008.

With respect to the unaudited financial information of the company for the three and nine-month periods ended September 30, 2009 and 2008 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. Therefore, their separate report dated November 6, 2009 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.

2. Special Gains and Charges

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

| (millions)                          | Third Quarter Ended<br>September 30 |      | Nine Months Ended<br>September 30 |        |
|-------------------------------------|-------------------------------------|------|-----------------------------------|--------|
|                                     | 2009                                | 2008 | 2009                              | 2008   |
| Cost of sales                       |                                     |      |                                   |        |
| Restructuring charges               | \$ 1.3                              | \$   | \$ 9.4                            | \$     |
| Special gains and charges           |                                     |      |                                   |        |
| Restructuring charges               | 4.0                                 |      | 52.6                              |        |
| Business structure and optimization | 0.7                                 | 8.6  | 2.3                               | 14.3   |
| Gain on sale of plant               |                                     |      |                                   | (24.0) |
| Gain on sale of business            |                                     |      |                                   | (1.7)  |
| Other non-recurring items           | 0.7                                 | 3.2  | 2.0                               | 5.8    |
| Total                               | 5.4                                 | 11.8 | 56.9                              | (5.6)  |

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|                                 |    |     |    |      |    |      |    |       |
|---------------------------------|----|-----|----|------|----|------|----|-------|
| Total special gains and charges | \$ | 6.7 | \$ | 11.8 | \$ | 66.3 | \$ | (5.6) |
|---------------------------------|----|-----|----|------|----|------|----|-------|

ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

2. Special Gains and Charges (Continued)

In the first quarter of 2009, the company announced plans to undertake restructuring and other cost-saving actions during 2009 in order to streamline operations and improve efficiency and effectiveness. The restructuring plan includes a reduction of the company's global workforce by approximately 1,000 positions or 4% and the reduction of plant and distribution center locations during 2009. As a result of these actions, the company recorded restructuring charges of \$5.3 million (\$4.4 million after tax) or \$0.02 per diluted share and \$62.0 million (\$44.2 million after tax) or \$0.18 per diluted share, during the third quarter and nine months ended September 30, 2009, respectively.

The restructuring charges and subsequent reductions to the related liability accounts include the following:

| (millions)                                  | Employee<br>Termination<br>Costs | Asset<br>Disposals | Other  | Total   |
|---|----------------------------------|--------------------|--------|---------|
| Recorded expense and accrual                | \$ 31.2                          | \$ 0.6             | \$ 0.9 | \$ 32.7 |
| Cash payments                               | (8.0)                            |                    |        | (8.0)   |
| Non-cash charges                            |                                  | (0.6)              | (0.9)  | (1.5)   |
| Restructuring liability, March 31, 2009     | 23.2                             |                    |        | 23.2    |
| Recorded expense and accrual                | 24.0                             |                    |        | 24.0    |
| Cash payments                               | (14.8)                           |                    |        | (14.8)  |
| Effect of foreign currency translation      | 1.2                              |                    |        | 1.2     |
| Restructuring liability, June 30, 2009      | 33.6                             |                    |        | 33.6    |
| Recorded expense and accrual                | 3.4                              | 1.2                | 0.7    | 5.3     |
| Cash payments                               | (10.3)                           |                    |        | (10.3)  |
| Non-cash charges                            |                                  | (1.2)              | (0.5)  | (1.7)   |
| Effect of foreign currency translation      | 0.3                              |                    |        | 0.3     |
| Restructuring liability, September 30, 2009 | \$ 27.0                          | \$                 | \$ 0.2 | \$ 27.2 |

Restructuring charges on the Consolidated Statement of Income have been included both as a component of cost of sales and as a component of special gains and charges. Amounts included as a component of cost of sales include asset write-downs and manufacturing related severance. Restructuring liabilities have been classified as a component of other current liabilities on the Consolidated Balance Sheet.

Employee termination costs include personnel reductions and related costs for severance, benefits and outplacement services. Asset disposals include inventory and intangible asset write-downs related to the discontinuance of product lines which are not consistent with the company's long-term strategies. Other charges include one-time curtailment and settlement charges related to the company's International pension plans and U.S. postretirement health care benefits plan.

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The restructuring plan is expected to be finalized and actions completed during the current year. The company anticipates additional restructuring expenses during the remainder of 2009, which are expected to result in total pretax charges of approximately \$70 million (\$50 million after tax) for the full year 2009. The company anticipates that approximately \$65 million of the total restructuring charges represent cash expenditures, of which \$33 million has been paid as of September 30, 2009 and the majority of the remainder is expected to be paid within the next twelve months.

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

ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Selected Balance Sheet Information

| (millions)                                | September 30<br>2009 | December 31<br>2008 |
|---|----------------------|---------------------|
| <b>Inventories</b>                        |                      |                     |
| Finished goods                            | \$ 280.6             | \$ 263.8            |
| Raw materials and parts                   | 220.2                | 232.8               |
| Inventories at FIFO cost                  | 500.8                | 496.6               |
| Excess of FIFO cost over LIFO cost        | (26.0)               | (29.4)              |
| <b>Total</b>                              | <b>\$ 474.8</b>      | <b>\$ 467.2</b>     |
| <b>Property, plant and equipment, net</b> |                      |                     |
| Land                                      | \$ 28.1              | \$ 26.5             |
| Buildings and leaseholds                  | 353.6                | 330.6               |
| Machinery and equipment                   | 724.6                | 673.5               |
| Merchandising equipment                   | 1,430.0              | 1,333.3             |
| Capitalized software                      | 204.7                | 162.9               |
| Construction in progress                  | 113.9                | 125.5               |
|   | 2,854.9              | 2,652.3             |
| Accumulated depreciation                  | (1,705.8)            | (1,517.1)           |
| <b>Total</b>                              | <b>\$ 1,149.1</b>    | <b>\$ 1,135.2</b>   |
| <b>Other intangible assets, gross</b>     |                      |                     |
| Customer relationships                    | \$ 291.9             | \$ 266.9            |
| Intellectual property                     | 81.6                 | 78.3                |
| Trademarks                                | 115.0                | 111.9               |
| Other intangibles                         | 54.2                 | 54.0                |
|   | 542.7                | 511.1               |
| <b>Accumulated amortization</b>           |                      |                     |
| Customer relationships                    | (151.1)              | (120.3)             |
| Intellectual property                     | (28.1)               | (22.8)              |
| Trademarks                                | (37.1)               | (31.1)              |
| Other intangibles                         | (14.2)               | (10.2)              |
| <b>Other intangible assets, net</b>       | <b>\$ 312.2</b>      | <b>\$ 326.7</b>     |
| <b>Other assets</b>                       |                      |                     |
| Deferred income taxes                     | \$ 162.2             | \$ 157.9            |
| Pension                                   | 15.0                 | 12.1                |
| Other                                     | 164.5                | 166.2               |
| <b>Total</b>                              | <b>\$ 341.7</b>      | <b>\$ 336.2</b>     |

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Selected Balance Sheet Information (Continued)

| (millions)  | September 30<br>2009 |                | December 31<br>2008 |                |
|---|----------------------|----------------|---------------------|----------------|
| <b>Other current liabilities</b>                                    |                      |                |                     |                |
| Discounts and rebates   | \$                   | 208.9          | \$                  | 211.5          |
| Dividends payable   |                      | 33.2           |                     | 33.1           |
| Interest payable  |                      | 18.0           |                     | 8.4            |
| Restructuring liability   |                      | 27.2           |                     |                |
| Taxes payable, other than income                                    |                      | 57.5           |                     | 44.4           |
| Foreign exchange contracts  |                      | 10.0           |                     | 7.6            |
| Other   |                      | 147.0          |                     | 131.0          |
| <b>Total</b>  | <b>\$</b>            | <b>501.8</b>   | <b>\$</b>           | <b>436.0</b>   |
| <b>Other liabilities</b>  |                      |                |                     |                |
| Deferred income taxes   | \$                   | 80.2           | \$                  | 74.2           |
| Income taxes payable - non-current                                  |                      | 76.5           |                     | 65.4           |
| Other   |                      | 117.5          |                     | 116.9          |
| <b>Total</b>  | <b>\$</b>            | <b>274.2</b>   | <b>\$</b>           | <b>256.5</b>   |
| <b>Accumulated other comprehensive income</b>                       |                      |                |                     |                |
| Unrealized gain (loss) on financial instruments, net of tax         | \$                   | (2.8)          | \$                  | 8.0            |
| Unrecognized pension and postretirement benefit expense, net of tax |                      | (359.3)        |                     | (364.7)        |
| Cumulative translation  |                      | 137.5          |                     | (2.4)          |
| <b>Total</b>  | <b>\$</b>            | <b>(224.6)</b> | <b>\$</b>           | <b>(359.1)</b> |

4. Interest

| (millions)                   | Third Quarter Ended<br>September 30 |             |           | Nine Months Ended<br>September 30 |           |             |           |             |
|------------------------------|-------------------------------------|-------------|-----------|-----------------------------------|-----------|-------------|-----------|-------------|
|                              | 2009                                | 2008        | 2008      | 2009                              | 2008      | 2008        |           |             |
| Interest expense             | \$                                  | 16.4        | \$        | 17.9                              | \$        | 51.1        | \$        | 53.0        |
| Interest income              |                                     | (1.3)       |           | (1.9)                             |           | (5.0)       |           | (6.9)       |
| <b>Interest expense, net</b> | <b>\$</b>                           | <b>15.1</b> | <b>\$</b> | <b>16.0</b>                       | <b>\$</b> | <b>46.1</b> | <b>\$</b> | <b>46.1</b> |



## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. **Financial Instruments and Hedging Transactions**

The carrying amount and the estimated fair value of financial instruments held by the company were:

| (millions)                                    | September 30, 2009 |            | December 31, 2008 |            |
|---|--------------------|------------|-------------------|------------|
|   | Carrying Amount    | Fair Value | Carrying Amount   | Fair Value |
| <b><u>Assets</u></b>                          |                    |            |                   |            |
| Cash and cash equivalents                     | \$ 107.5           | \$ 107.5   | \$ 66.7           | \$ 66.7    |
| Accounts receivable, net                      | 1,013.0            | 1,013.0    | 971.0             | 971.0      |
| Foreign exchange contracts                    | 6.1                | 6.1        | 22.0              | 22.0       |
| <b><u>Liabilities</u></b>                     |                    |            |                   |            |
| Foreign exchange contracts                    | 10.0               | 10.0       | 7.6               | 7.6        |
| Notes payable                                 | 15.8               | 15.8       | 17.8              | 17.8       |
| Commercial paper                              | 98.5               | 98.5       | 316.0             | 316.0      |
| Long-term debt (including current maturities) | 856.7              | 877.1      | 804.4             | 713.8      |

The carrying amounts of cash equivalents, accounts receivable, notes payable and commercial paper approximate fair value because of their short maturities. The carrying amount of foreign exchange contracts is at fair value, which is determined based on foreign currency exchange rates as of the balance sheet date (level 2 - significant other observable inputs). The fair value of long-term debt is based on quoted market prices for the same or similar debt instruments. The company has concluded that it does not have any amounts of financial assets and liabilities measured using the company's own assumptions of fair market value (level 3 - unobservable inputs).

**Derivative Instruments and Hedging**

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 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 effective portion of changes in fair value of hedges are initially recognized in accumulated other comprehensive income ( AOCI ) on the Consolidated Balance Sheet. Amounts recorded in AOCI are reclassified into earnings in the same period or periods during which the hedged transactions affect earnings. 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 does not hold derivative financial instruments of a speculative nature. The company is exposed to credit loss 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.

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. **Financial Instruments and Hedging Transactions (Continued)***Derivatives Designated as 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: sales, 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 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 interest rate swap contracts to manage interest rate exposures. In 2006 the company entered into and subsequently closed two forward starting swap contracts related to the issuance of its senior euro notes. The settlement payment was recorded in AOCI and is recognized in earnings as part of interest expense over the remaining life of the notes as the forecasted interest transactions occur.

*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, primarily receivables and payables. 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 following table summarizes the fair value of the company's outstanding derivatives as of September 30, 2009:

| (millions)  | Asset Derivatives      |            | Liability Derivatives     |            |
|---|------------------------|------------|---------------------------|------------|
|   | Balance Sheet Location | Fair Value | Balance Sheet Location    | Fair Value |
| <u>Derivatives designated as hedging instruments:</u> |                        |            |                           |            |
| Foreign currency forward contracts                    | Other current assets   | \$ 2.8     | Other current liabilities | \$ 6.8     |

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Derivatives not designated as hedging instruments:

| Foreign currency forward contracts | Other current assets |    | 3.3 | Other current liabilities |    | 3.2  |
|------------------------------------|----------------------|----|-----|---------------------------|----|------|
| Total Derivatives                  |                      | \$ | 6.1 |                           | \$ | 10.0 |

The company had foreign currency forward exchange contracts with notional values that totaled approximately \$397 million at September 30, 2009, and \$486 million at December 31, 2008.

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. Financial Instruments and Hedging Transactions (Continued)

For the third quarter and nine months ended September 30, 2009, the impact on AOCI and earnings from derivative contracts that qualified as cash flow hedges was as follows:

| (millions)  | Location                                     | Third Quarter | Nine Months |
|---|--|---------------|-------------|
| <u>Unrealized gain (loss) recognized into AOCI (effective portion)</u>      |  |               |             |
| Foreign currency forward contracts  | AOCI (equity)                                | \$ (1.4)      | \$ (4.2)    |
| <u>Gain (loss) reclassified from AOCI into income (effective portion)</u>   |  |               |             |
| Foreign currency forward contracts  | Cost of sales                                | \$ 3.3        | \$ 6.6      |
|   | Selling, general and administrative expenses | 0.5           | 3.0         |
|   |  | 3.8           | 9.6         |
| Interest rate swap contract   | Interest expense, net                        | (0.1)         | (0.3)       |
|   |  | \$ 3.7        | \$ 9.3      |
| <u>Gain (loss) recognized in income on derivative (ineffective portion)</u> |  |               |             |
| Foreign currency forward contracts  | Interest expense, net                        | \$ (0.4)      | \$ (1.2)    |

For the third quarter and nine months ended September 30, 2009, the impact on earnings from derivative contracts that are not designated as hedging instruments was as follows:

| (millions)                              | Location                                     | Third Quarter | Nine Months |
|---|--|---------------|-------------|
| <u>Gain (loss) recognized in income</u> |  |               |             |
| Foreign currency forward contracts      | Selling, general and administrative expenses | \$ (5.4)      | \$ 3.3      |
|   | Interest expense, net                        | (4.1)         | (5.4)       |
|   |  | \$ (9.5)      | \$ (2.1)    |

The amounts recognized in earnings above offset the earnings impact of the related foreign currency denominated assets and liabilities.

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. **Financial Instruments and Hedging Transactions (Continued)****Net Investment Hedge**

The company designates its euro 300 million (\$430 million as of September 30, 2009) senior notes and related accrued interest as a hedge of existing foreign currency exposures related to net investments the company has in certain European subsidiaries. Accordingly, the transaction gains and losses on the euronotes 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 transaction gains and losses related to the euronotes charged to shareholders equity were as follows:

| (millions)                             | Third Quarter Ended<br>September 30 |         | Nine Months Ended<br>September 30 |          |
|--|-------------------------------------|---------|-----------------------------------|----------|
|  | 2009                                | 2008    | 2009                              | 2008     |
| Transaction gains (losses), net of tax | \$ (3.3)                            | \$ 16.7 | \$ (31.1)                         | \$ (0.4) |

6. **Comprehensive Income**

| (millions)   | Third Quarter Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|--|-------------------------------------|----------|-----------------------------------|----------|
|  | 2009                                | 2008     | 2009                              | 2008     |
| Net income including noncontrolling interest                       | \$ 145.2                            | \$ 125.9 | \$ 302.4                          | \$ 368.0 |
| Other comprehensive income (loss), net of tax                      |                                     |          |                                   |          |
| Foreign currency translation                                       | 20.9                                | (86.4)   | 139.9                             | (26.5)   |
| Derivative instruments   | (3.7)                               | 3.6      | (10.8)                            | 4.0      |
| Pension and postretirement benefits                                | 2.5                                 | 1.5      | 5.4                               | 5.0      |
| Total  | 19.7                                | (81.3)   | 134.5                             | (17.5)   |
| Total comprehensive income, including noncontrolling interest      | 164.9                               | 44.6     | 436.9                             | 350.5    |
| Less: Comprehensive income attributable to noncontrolling interest | 0.4                                 | (0.9)    | 1.2                               | 0.3      |
| Comprehensive income attributable to Ecolab                        | \$ 164.5                            | \$ 45.5  | \$ 435.7                          | \$ 350.2 |





## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Business Acquisitions and Investments

In February 2009, the company acquired assets of the Stackhouse business of CORPAK Medsystems, Inc. Stackhouse is a leading developer, manufacturer and marketer of surgical helmets and smoke evacuators, primarily for use during orthopedic surgeries. The business, which has annual sales of approximately \$4 million, became part of the company's U.S. Cleaning & Sanitizing operations during the first quarter of 2009.

Acquisitions during the first nine months of 2008 included our Ecovation acquisition and other immaterial acquisition activity.

Acquisitions in 2009 and 2008 are not material to the company's consolidated financial statements; therefore pro forma financial information is not presented. The aggregate purchase price of acquisitions and investments in affiliates has been reduced for any cash or cash equivalents acquired with the acquisitions.

Based upon purchase price allocations and subsequent adjustments thereto, the components of the aggregate purchase prices of the acquisitions and investments in affiliates made were as follows:

| (millions)   | Third Quarter Ended<br>September 30 |           | Nine Months Ended<br>September 30 |          |
|--|-------------------------------------|-----------|-----------------------------------|----------|
|  | 2009                                | 2008      | 2009                              | 2008     |
| Net tangible assets acquired (liabilities assumed) | \$ 0.2                              | \$ (10.5) | \$ 2.5                            | \$ 38.9  |
| Identifiable intangible assets                     |                                     |           |                                   |          |
| Customer relationships                             | 0.9                                 | 0.4       | 1.9                               | 10.7     |
| Intellectual property                              |                                     |           | 1.0                               | 26.8     |
| Trademarks   | 0.2                                 |           | 0.2                               | 16.0     |
| Other intangibles                                  |                                     | 0.3       |                                   | 9.9      |
| Total  | 1.1                                 | 0.7       | 3.1                               | 63.4     |
| Goodwill   | 0.7                                 | 11.0      | 1.5                               | 122.4    |
| Total aggregate purchase price                     | \$ 2.0                              | \$ 1.2    | \$ 7.1                            | \$ 224.7 |
| Liability for indemnification                      |                                     |           |                                   | (21.0)   |
| Net cash paid for acquisitions                     | \$ 2.0                              | \$ 1.2    | \$ 7.1                            | \$ 203.7 |

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Business Acquisitions and Investments (Continued)

The changes in the carrying amount of goodwill for each of the company's reportable segments for the quarter and nine months ended September 30, 2009 were as follows:

| (unaudited)<br>(millions)        | Cleaning &<br>Sanitizing | United States<br>Other<br>Services | Total    | International | Consolidated |
|----------------------------------|--------------------------|------------------------------------|----------|---------------|--------------|
| Balance as of December 31, 2008  | \$ 443.6                 | \$ 50.5                            | \$ 494.1 | \$ 773.6      | \$ 1,267.7   |
| Goodwill acquired during quarter | 0.3                      |                                    | 0.3      |               | 0.3          |
| Foreign currency translation     |                          |                                    |          | (7.2)         | (7.2)        |
| Balance as of March 31, 2009     | 443.9                    | 50.5                               | 494.4    | 766.4         | 1,260.8      |
| Goodwill acquired during quarter |                          |                                    |          | 0.5           | 0.5          |
| Foreign currency translation     |                          |                                    |          | 95.1          | 95.1         |
| Balance as of June 30, 2009      | 443.9                    | 50.5                               | 494.4    | 862.0         | 1,356.4      |
| Goodwill acquired during quarter |                          |                                    |          | 0.7           | 0.7          |
| Goodwill allocated to disposals  |                          |                                    |          | (0.2)         | (0.2)        |
| Foreign currency translation     |                          |                                    |          | 12.9          | 12.9         |
| Balance as of September 30, 2009 | \$ 443.9                 | \$ 50.5                            | \$ 494.4 | \$ 875.4      | \$ 1,369.8   |

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Net Income Attributable to Ecolab Per Common Share

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

| (millions, except per share)  | Third Quarter Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|---|-------------------------------------|----------|-----------------------------------|----------|
|   | 2009                                | 2008     | 2009                              | 2008     |
| Net income attributable to Ecolab   | \$ 145.0                            | \$ 126.2 | \$ 301.5                          | \$ 368.1 |
| Weighted-average common shares outstanding                                  |                                     |          |                                   |          |
| Basic   | 237.0                               | 247.5    | 236.5                             | 247.2    |
| Effect of dilutive stock options and awards                                 | 3.6                                 | 4.3      | 3.1                               | 4.5      |
| Diluted   | 240.6                               | 251.8    | 239.6                             | 251.7    |
| Net income attributable to Ecolab per common share                          |                                     |          |                                   |          |
| Basic   | \$ 0.61                             | \$ 0.51  | \$ 1.27                           | \$ 1.49  |
| Diluted   | \$ 0.60                             | \$ 0.50  | \$ 1.26                           | \$ 1.46  |
| Anti-dilutive stock options excluded from the computation of diluted shares | 5.9                                 | 3.1      | 9.5                               | 5.4      |
| Unvested restricted stock excluded from the computation of basic shares     | 0.1                                 | 0.1      | 0.1                               | 0.1      |

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Pension and Postretirement Plans

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

| (unaudited)<br>(millions)                       | U.S. Pension Benefits<br>(qualified and non-qualified plans) |         | International<br>Pension Benefits |        | U.S.<br>Postretirement<br>Health Care Benefits |        |
|---|--|---------|-----------------------------------|--------|--|--------|
|   | 2009   | 2008    | 2009                              | 2008   | 2009   | 2008   |
| Service cost                                    | \$ 11.8  | \$ 11.2 | \$ 3.5                            | \$ 5.1 | \$ 0.5   | \$ 0.6 |
| Interest cost on benefit obligation             | 14.8   | 13.0    | 6.0                               | 6.7    | 2.4  | 2.4    |
| Expected return on plan assets                  | (18.9)   | (17.6)  | (4.0)                             | (4.9)  | (0.4)  | (0.6)  |
| Recognition of net actuarial loss               | 4.0  | 2.2     | 0.4                               | 0.3    | 1.1  | 1.1    |
| Amortization of prior service cost<br>(benefit) | 0.1  | 0.3     | 0.1                               | 0.1    | (1.5)  | (1.6)  |
| Curtailement and settlement loss                |  |         | 0.5                               |        |  |        |
| Total expense                                   | \$ 11.8  | \$ 9.1  | \$ 6.5                            | \$ 7.3 | \$ 2.1   | \$ 1.9 |

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

| (unaudited)<br>(millions)                       | U.S. Pension Benefits<br>(qualified and non-qualified plans) |         | International<br>Pension Benefits |         | U.S.<br>Postretirement<br>Health Care Benefits |        |
|---|--|---------|-----------------------------------|---------|--|--------|
|   | 2009   | 2008    | 2009                              | 2008    | 2009   | 2008   |
| Service cost                                    | \$ 35.4  | \$ 33.6 | \$ 10.8                           | \$ 15.2 | \$ 1.5   | \$ 1.8 |
| Interest cost on benefit obligation             | 44.4   | 39.0    | 18.4                              | 20.1    | 7.2  | 7.2    |
| Expected return on plan assets                  | (56.7)   | (52.8)  | (12.2)                            | (14.6)  | (1.2)  | (1.8)  |
| Recognition of net actuarial loss               | 12.0   | 6.6     | 1.2                               | 0.8     | 3.3  | 3.3    |
| Amortization of prior service cost<br>(benefit) | 0.3  | 0.9     | 0.3                               | 0.2     | (4.5)  | (4.8)  |
| Curtailement and settlement loss                |  |         | 0.4                               |         | 0.9  |        |
| Total expense                                   | \$ 35.4  | \$ 27.3 | \$ 18.9                           | \$ 21.7 | \$ 7.2   | \$ 5.7 |

During the current year the company took actions under its restructuring program that reduced the number of active participants in both the U.S. and International pension and U.S. postretirement health care benefit plans. As a result of these actions, the company recognized curtailement and settlement charges related to the U.S. postretirement health care benefits plan and select International pension plans that are included as a component of restructuring charges as discussed in Note 2. The actions were not significant to the U.S. pension plan; therefore, no curtailement was recognized.



## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Pension and Postretirement Plans (Continued)

The company is not required to make any contributions to its U.S. pension plan and postretirement health care benefits plan for 2009. However, the company made \$50 million and \$75 million voluntary contributions to the U.S. pension plan in the first and third quarter of 2009, respectively.

Certain international pension benefit plans are required to be funded in accordance with local government requirements. The company contributed \$20 million to its international pension benefit plans during the first nine months of 2009. The company currently estimates that it will contribute approximately \$6 million more to the international pension benefit plans during the remainder of 2009.

10. Operating Segments

Financial information for each of the company's reportable segments is as follows:

| (millions)                             | Third Quarter Ended<br>September 30 |            | Nine Months Ended<br>September 30 |            |
|--|-------------------------------------|------------|-----------------------------------|------------|
|  | 2009                                | 2008       | 2009                              | 2008       |
| <b>Net Sales</b>                       |                                     |            |                                   |            |
| United States                          |                                     |            |                                   |            |
| Cleaning & Sanitizing                  | \$ 693.2                            | \$ 695.5   | \$ 1,987.2                        | \$ 2,012.6 |
| Other Services                         | 117.6                               | 124.7      | 340.0                             | 356.0      |
| Total                                  | 810.8                               | 820.2      | 2,327.2                           | 2,368.6    |
| International                          | 692.0                               | 684.1      | 1,973.4                           | 1,953.3    |
| Effect of foreign currency translation | 43.6                                | 122.0      | 35.5                              | 332.3      |
| Consolidated                           | \$ 1,546.4                          | \$ 1,626.3 | \$ 4,336.1                        | \$ 4,654.2 |
| <b>Operating Income</b>                |                                     |            |                                   |            |
| United States                          |                                     |            |                                   |            |
| Cleaning & Sanitizing                  | \$ 141.1                            | \$ 120.4   | \$ 370.0                          | \$ 332.8   |
| Other Services                         | 18.4                                | 17.9       | 49.9                              | 37.9       |
| Total                                  | 159.5                               | 138.3      | 419.9                             | 370.7      |
| International                          | 71.0                                | 66.7       | 144.5                             | 174.7      |
| Effect of foreign currency translation | 5.7                                 | 15.8       | 5.1                               | 43.5       |
| Corporate                              | (13.2)                              | (19.4)     | (84.0)                            | (16.3)     |
| Consolidated                           | \$ 223.0                            | \$ 201.4   | \$ 485.5                          | \$ 572.6   |

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The International amounts included above are based on translation into U.S. dollars at the fixed currency exchange rates used by management for 2009.

## ECOLAB INC.

## CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. Operating Segments (Continued)

Consistent with the company's internal management reporting, the Corporate segment includes special gains and charges reported on the Consolidated Statement of Income. The Corporate segment also includes investments in the development of business systems and other corporate investments the company is making as part of ongoing efforts to improve efficiency and returns.

Total service revenue for the U.S. Other Services and International segments, at public exchange rates are as follows:

| (millions)          | Third Quarter Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|---------------------|-------------------------------------|----------|-----------------------------------|----------|
|                     | 2009                                | 2008     | 2009                              | 2008     |
| U.S. Other Services | \$ 99.9                             | \$ 105.7 | \$ 287.5                          | \$ 296.8 |
| International       | 43.4                                | 48.8     | 122.8                             | 141.7    |

11. Goodwill and Other Intangible Assets

The company tests goodwill for impairment on an annual basis during the second quarter. If circumstances change significantly, the company would also test a reporting unit for impairment during interim periods between its annual tests. During the second quarter ended June 30, 2009, the company completed its annual test for goodwill impairment. Based on this testing, no adjustment to the carrying value of goodwill was necessary.

Goodwill and other intangible assets arise principally from business acquisitions. Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired. Other intangible assets include primarily customer relationships, intellectual property, trademarks and other technology. Other intangible assets are amortized on a straight-line basis over their estimated economic lives. The weighted-average useful life of other intangible assets was 13 years as of both September 30, 2009 and 2008.

The straight-line method of amortization reflects an appropriate allocation of the cost of the intangible assets to earnings in proportion to the amount of economic benefits obtained by the company in each reporting period. Total amortization expense related to other intangible assets during the third quarters ended September 30, 2009 and 2008 was \$10.3 million and \$11.5 million, respectively. Total amortization expense related to other intangible assets during the nine months ended September 30, 2009 and 2008 was \$31.9 million and \$37.4 million, respectively. As of September 30, 2009, future estimated amortization expense related to amortizable other identifiable intangible assets will be:

(unaudited)



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(millions)

|                                      |    |    |
|--------------------------------------|----|----|
| 2009 (Remainder: three-month period) | \$ | 11 |
| 2010                                 |    | 41 |
| 2011                                 |    | 40 |
| 2012                                 |    | 39 |
| 2013                                 |    | 37 |

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. New Accounting Pronouncements

In September 2006, the FASB issued *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value and expanded disclosures about fair value measurement. In February 2008, the FASB deferred the effective date of this pronouncement for one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis and amended to add a scope exception for leasing transactions subject to the guidance *Accounting for Leases* from its application. The company adopted this pronouncement effective January 1, 2008 for financial assets and liabilities measured on a recurring basis and effective January 1, 2009 for non-financial assets and liabilities. The adoption did not have an impact on the company's consolidated results of operations and financial position.

In December 2007, the FASB issued a revised standard on *Business Combinations*. The revised standard establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. The revised standard also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The company adopted this revised standard effective January 1, 2009. The adoption did not have a material impact on the company's consolidated results of operations and financial position.

In December 2007, the FASB issued *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51*. This standard establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. This standard also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. The company adopted this standard effective January 1, 2009, and revised its 2008 financial statements in accordance with the guidance. The revision includes a reclassification of \$0.3 million and \$0.1 million from selling, general and administrative expenses to net income attributable to noncontrolling interest on the Consolidated Statement of Income for the third quarter and nine months ended September 30, 2008, respectively, and a reclassification of \$7.4 million from other liabilities to noncontrolling interest on the Consolidated Balance Sheet as of December 31, 2008. The adoption did not have a material impact on the company's consolidated results of operations and financial position.

In March 2008, the FASB issued *Disclosures about Derivative Instruments and Hedging Activities*. This guidance requires companies to provide greater transparency through disclosures about how and why the company uses derivative instruments. This includes how derivative instruments and related hedged items are accounted for, the level of derivative activity entered into by the company and how derivative instruments and related hedged items affect the company's financial position, results of operations, and cash flows. The company adopted this standard in the first quarter of 2009 and has included the required disclosures in Note 5.

In December 2008, the FASB issued *Employers' Disclosures about Postretirement Benefit Plan Assets* which requires more detailed disclosures regarding employers' plan assets, including their investment strategies, major categories of plan assets, concentration of risk, and valuation methods used to measure the fair value of plan assets. The guidance is effective for fiscal years ending after December 15, 2009.



ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. New Accounting Pronouncements (Continued)

In April 2009, the FASB issued a new guidance, *Interim Disclosures about Fair Value of Financial Instruments* that amends two previously issued standards. The first amendment is to *Disclosures about Fair Value of Financial Instruments*, and requires disclosures about fair value of financial instruments for interim and annual financial statements. The second amendment is to *Interim Financial Reporting*, and requires those disclosures in summarized financial information at interim reporting periods. The company early adopted this guidance in the first quarter of 2009 and has included the required disclosures in Note 5.

In May 2009, the FASB issued *Subsequent Events*. This guidance establishes a formal standard of accounting for and disclosures of events that occur after the balance sheet date but before the financial statements are issued. This statement includes a new requirement to disclose the date events were evaluated and the basis for that date. The company adopted this standard in the second quarter of 2009. The company has evaluated and determined that there were no material subsequent events required to be disclosed as of November 6, 2009, the date these financial statements were issued.

In June 2009, the FASB issued an amendment to *Accounting for Transfers of Financial Assets*, which eliminates the concept of a qualified special purpose entity ( QSPE ). This guidance also establishes criteria for qualifying for sale accounting when only a portion of the financial asset is transferred. This guidance is effective for the fiscal years and interim periods beginning after November 15, 2009. The company does not have any QSPEs (as defined under previous standards). The adoption is not expected to have a material impact on the company's consolidated financial statements.

In June 2009, the FASB issued *Amendments to FASB Interpretation No. 46(R)*, which amends the consolidation criteria for variable interest entities ( VIE ). This guidance changes the model for determining who consolidates the VIE and addresses how often this analysis is performed. The guidance is effective for fiscal years and interim periods beginning after November 15, 2009 and is not expected to have a material impact on the company's consolidated financial statements.

No other new accounting pronouncement issued or effective has had or is expected to have a material impact on the company's consolidated financial statements.

13. Commitments and Contingencies

The company and certain subsidiaries are party to various lawsuits, claims and environmental actions that have arisen in the ordinary course of business. These include antitrust, patent infringement, product liability and wage hour lawsuits and possible obligations to investigate and mitigate the effects on the environment of the disposal or release of certain chemical substances at various sites, such as Superfund sites and other operating or closed facilities. Because litigation is inherently uncertain, and unfavorable rulings or developments could occur, there can be no certainty that the company may not ultimately incur charges in excess of presently recorded liabilities. A future adverse ruling, settlement or

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unfavorable development could result in future charges that could have a material adverse effect on the company's results of operations or cash flows in the period in which they are recorded. The company currently believes that such future charge, if any, would not have a material adverse effect on the company's consolidated financial position.

ECOLAB INC.

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. Commitments and Contingencies (Continued)

The company records liabilities where a contingent loss is probable and can be reasonably estimated. If the reasonable estimate of a probable loss is a range, the company records the most probable estimate of the loss or the minimum amount when no amount within the range is a better estimate than any other amount. The company discloses a contingent liability even if the liability is not probable or the amount is not estimable, or both, if there is a reasonable possibility that a material loss may have been incurred.

As previously disclosed, an arbitration decision in conjunction with a settlement was rendered on September 24, 2007, concerning two California class-action lawsuits involving wage hour claims affecting former and current employees of the company's Pest Elimination Division. On August 19, 2009, a panel of the Court of Appeals of the State of California, Second Appellate District, denied the company's appeal of the lower court's confirmation of the arbitration decision relating to the settlement. The company determined not to seek further appeal. Accordingly, on October 13, 2009, the company paid the full judgment and settlement amount of \$34.6 million, which included post-award interest and employer's taxes, to the settlement administrator in final satisfaction of the two suits. The company had previously accrued for this payment.

The company is a defendant in other wage hour lawsuits in the Southern District of New York, one of which has been certified for class-action status. The company has entered into a settlement agreement covering these suits which is subject to court approval. The company has fully accrued for the settlement amount, which is not material to the company's consolidated results of operations or financial position.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders and Directors

Ecolab Inc.

We have reviewed the accompanying consolidated balance sheet of Ecolab Inc. and its subsidiaries as of September 30, 2009 and the related consolidated statements of income for each of the three and nine-month periods ended September 30, 2009 and 2008 and the consolidated statement of cash flows for the nine-month periods ended September 30, 2009 and 2008. These interim financial statements are the responsibility of Ecolab's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2008, and the related consolidated statements of income, of comprehensive income and changes in shareholders' equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 27, 2009, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2008, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP

PRICEWATERHOUSECOOPERS LLP

Minneapolis, Minnesota

November 6, 2009

ECOLAB INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF  
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following discussion and analysis provides information that we believe is useful in understanding our operating results, cash flows and financial condition. The discussion should be read in conjunction with both the unaudited consolidated financial information and related notes included in this Form 10-Q, and the Management's Discussion and Analysis of Financial Condition and Result of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2008. The discussion contains various Forward-Looking Statements within the meaning of the Private Securities Litigation Reform Act of 1995. We refer readers to the statement entitled Forward-Looking Statements located at the end of Part I of this report.

**Overview of the third quarter ended September 30, 2009**

Our third quarter results were once again led by new account gains, pricing and cost savings actions which offset the negative effects of the global recession and unfavorable foreign currency exchange.

Both 2009 and 2008 results of operations included significant special gains and charges, as well as discrete tax items which impact the year over year comparisons.

**Sales Performance**

- Consolidated net sales decreased 5% to \$1.5 billion. Net sales were negatively impacted by unfavorable foreign currency exchange during the quarter. When measured in fixed rates of currency exchange, sales were about even with the prior year.
- U.S. Cleaning & Sanitizing sales were \$693 million for the third quarter compared to \$696 million in the prior year. Results were led by 11% Healthcare sales growth. Kay sales grew 4%, Food & Beverage reported 2% growth, while Institutional reported a 4% sales decline.
- U.S. Other Services sales declined 6% to \$118 million. Pest Elimination reported a 4% decline and GCS reported an 11% decrease in sales.
- International sales, when measured in fixed rates of currency exchange, increased 1% to \$692 million in the third quarter. Latin America and Canada enjoyed strong sales growth of 8% and 6%, respectively, while Asia Pacific reported 2% sales growth. Europe/Middle East/Africa ( EMEA ) sales declined 1% in the quarter. When measured at public currency rates, International sales declined 9%.





Financial Performance

- Operating income increased 11% to \$223 million. Excluding the impact of special gains and charges from both years, operating income increased 8% compared to the third quarter of 2008.
- Net income attributable to Ecolab increased 15% to \$145 million. Excluding the impact of special gains and charges, and discrete tax items, net income attributable to Ecolab increased 6%.
- Diluted net income attributable to Ecolab per share increased 20% to \$0.60 for the third quarter of 2009 compared to \$0.50 in the third quarter of 2008. Third quarter 2009 results were reduced by \$0.01 per share of special gains and charges and discrete tax items. Third quarter 2008 results were reduced by \$0.05 per share of special gains and charges and discrete tax items.
- Our reported effective income tax rate was 30.2% for the third quarter of 2009 compared to 32.1% for the third quarter of 2008. Excluding the tax rate impact of special gains and charges, and discrete tax items, our adjusted effective income tax rate was 32.0% and 30.4% for the third quarter of 2009 and 2008, respectively.

Results of Operations – Third Quarter and Nine Months Ended September 30, 2009

Net Sales

Consolidated net sales for the third quarter ended September 30, 2009 were \$1.5 billion, a decrease of 5% compared to last year. For the first nine months of 2009, net sales decreased 7% to \$4.3 billion. When measured in fixed rates of currency exchange, sales for both the third quarter and first nine months of 2009 were about even with the comparable prior year periods. The components of the quarter and year-to-date sales decline are shown below.

| (percent)                   | Third Quarter Ended<br>September 30, 2009 | Nine Months Ended<br>September 30, 2009 |
|-----------------------------|---|---|
| Volume                      | (3)%                                      | (4)%                                    |
| Price changes               | 3   | 4                                       |
| Foreign currency exchange   | (5)                                       | (7)                                     |
| Acquisitions & divestitures |   |   |
| Total sales decrease        | (5)%                                      | (7)%                                    |

Gross Profit Margin

The gross profit margin ( gross margin )(defined as the difference between net sales less cost of sales divided by net sales) was 50.6% and 48.7% for the third quarter of 2009 and 2008, respectively. Our gross margin increase for the third quarter was driven by pricing and favorable delivered product costs. For the nine-month year to date period, the gross margin was 49.3% in 2009 and 49.0% in 2008. The 2009 year to date gross margin was negatively impacted by restructuring special charges included in cost of sales of \$9.4 million which reduced our reported gross margin by 0.3 percentage points. Our year to date gross margin increase was driven by pricing and cost savings initiatives, which more than

offset higher delivered product costs, especially in Europe, and lower sales volume.

Selling, General and Administrative Expense

Selling, general and administrative expenses as a percentage of consolidated net sales were 35.8% for the third quarter of 2009 compared to 35.6% in 2008. The increase in ratio for the third quarter was due to continued investments in our business and other cost increases which more than offset savings from our recent restructuring, pricing leverage and well-managed spending. For the nine-month period, selling, general, and administrative expenses were 36.8% of sales in 2009 and 36.9% of sales in 2008. Year to date, the savings from our recent restructuring, pricing leverage and well-managed spending more than offset investments and cost increases to reduce the ratio. We continue to make key business investments that drive innovation and efficiency, through R&D and information technology systems.

Special Gains and Charges

Special gains and charges reported on the Consolidated Statement of Income included the following items:

| (millions)                          | Third Quarter Ended<br>September 30 |         | Nine Months Ended<br>September 30 |          |
|-------------------------------------|-------------------------------------|---------|-----------------------------------|----------|
|                                     | 2009                                | 2008    | 2009                              | 2008     |
| Cost of sales                       |                                     |         |                                   |          |
| Restructuring charges               | \$ 1.3                              | \$      | \$ 9.4                            | \$       |
| Special gains and charges           |                                     |         |                                   |          |
| Restructuring charges               | 4.0                                 |         | 52.6                              |          |
| Business structure and optimization | 0.7                                 | 8.6     | 2.3                               | 14.3     |
| Gain on sale of plant               |                                     |         |                                   | (24.0)   |
| Gain on sale of business            |                                     |         |                                   | (1.7)    |
| Other non-recurring items           | 0.7                                 | 3.2     | 2.0                               | 5.8      |
| Total                               | 5.4                                 | 11.8    | 56.9                              | (5.6)    |
| Total special gains and charges     | \$ 6.7                              | \$ 11.8 | \$ 66.3                           | \$ (5.6) |

In the first quarter of 2009, we announced plans to undertake restructuring and other cost-saving actions during 2009 in order to streamline operations and improve efficiency and effectiveness. As a result of these actions, we recorded restructuring expense of \$5 million (\$4 million after tax) or \$0.02 per diluted share and \$62 million (\$44 million after tax) or \$0.18 per diluted share, during the third quarter and nine months ended September 30, 2009, respectively. Restructuring expense on the Consolidated Statement of Income has been included both as a component of cost of sales and as a component of special gains and charges, as shown in the table above.

We anticipate additional restructuring expenses during the remainder of 2009, which are expected to result in total pretax charges of approximately \$70 million (\$50 million after tax) for the full year 2009. These actions are expected to provide annualized pretax savings of approximately \$75 million (\$50 million after tax), with pretax savings of \$50 million to be realized in 2009. We anticipate that approximately \$65 million of the total restructuring charges represent cash expenditures, of which \$33 million has been paid as of September 30, 2009 and the majority of the remainder is expected to be paid within the next twelve months. Further details related to these restructuring expenses are included in Note 2.



Operating Income

Reported operating income increased 11% for the third quarter of 2009. The operating income increase was impacted by the year over year comparison of special gains and charges. Excluding the impact of special gains and charges, operating income increased 8% in the third quarter. Excluding the impact of special gains and charges, and unfavorable currency exchange, fixed currency operating income increased 14% in the third quarter as pricing, favorable delivered product costs, cost savings from our recent restructuring and well-managed spending more than offset continued investment in the business and other costs in the quarter. Reported operating income for the first nine months of 2009 declined 15% compared to 2008. The operating income decline was driven by special gains and charges. Excluding the impact of special gains and charges, operating income for the first nine months of 2009 fell 3%. Excluding the impact of special gains and charges, and unfavorable currency exchange, fixed currency operating income for the first nine months of 2009 increased 4% as pricing and cost savings efforts more than offset the increased delivered product and other costs during the period.

Interest Expense, Net

Net interest expense totaled \$15.1 million in the third quarter of 2009, compared with \$16.0 million in the third quarter of 2008. The decrease in our third quarter net interest expense was primarily due to lower average interest rates and lower borrowing on our U.S. commercial paper program during the period. Net interest expense was \$46.1 million for both the first nine months of 2009 and 2008.

Provision for Income Taxes

The following table provides a summary of our reported tax rate:

| (percent)   | Third Quarter Ended<br>September 30 |       | Nine Months Ended<br>September 30 |       |
|---|-------------------------------------|-------|-----------------------------------|-------|
|   | 2009                                | 2008  | 2009                              | 2008  |
| Reported tax rate   | 30.2%                               | 32.1% | 31.2%                             | 30.1% |
| Tax rate impact of special gains and charges and discrete tax items | 1.8                                 | (1.7) | 0.4                               | 1.8   |
| Non-GAAP nominal tax rate*  | 32.0%                               | 30.4% | 31.6%                             | 31.9% |

\*Non-GAAP nominal tax rate is defined as the reported tax rate, excluding the tax rate impact of special gains and charges and discrete tax items. We believe that disclosing this non-GAAP financial measure helps investors understand the underlying tax rate because it facilitates the comparison of current and prior period tax rates by eliminating the effect of non-recurring items. This non-GAAP measure should not be regarded as a substitute for the corresponding GAAP measure but instead should be utilized as a supplemental measure in evaluating our business.

The decrease in the non-GAAP nominal tax rate for first nine months of 2009 over the respective 2008 rate, which excludes the tax rate impact of special gains and charges and discrete tax items, is due primarily to increased tax benefits from international operations, including global rate reductions. The 2009 third quarter non-GAAP nominal tax rate is higher than 2008 primarily due to lower tax benefits derived from our international operations which increased the third quarter 2009 rate above the expected full year rate, and tax benefits in the prior year which

reduced the third quarter 2008 rate.

Provision for Income Taxes (Continued)

Our reported tax rate for the third quarter and first nine months of 2009 was lower than our non-GAAP nominal tax rate primarily due to the tax rate impact of discrete tax benefits of \$4.8 million and \$4.1 million, respectively. The 2009 discrete tax benefits are primarily due to a \$4.4 million third quarter benefit related to prior year reserve adjustments.

Our reported tax rate for the nine months ended 2008 was lower than our non-GAAP nominal tax rate due to the tax rate impact of the \$4.8 million discrete tax benefits recorded in the first quarter of 2008, as well as the tax rate impact of a \$24 million tax free gain on the sale of a European plant, included in special gains and charges, recorded in the second quarter of 2008. Our reported tax rate for the third quarter of 2008 is higher than our non-GAAP nominal tax rate primarily due to a discrete tax charge of \$2.1 million recorded in the third quarter of 2008.

Net Income Attributable to Ecolab

Net income attributable to Ecolab increased 15% to \$145 million in the third quarter of 2009. On a per share basis, reported diluted net income attributable to Ecolab per share increased 20% to \$0.60 per share compared to \$0.50 per share in 2008. The third quarter of 2009 includes \$5.5 million, net of tax, of special gains and charges, and discrete tax benefits of \$4.8 million, which together reduced the reported per share amount by \$0.01. Currency translation had an unfavorable impact of approximately \$7 million, net of tax, or \$0.03 per share for the third quarter of 2009 compared to 2008. The third quarter of 2008 included \$9.2 million, net of tax, of net charges reported in special gains and charges, and \$2.1 million of discrete tax charges, which together decreased the reported per share amount by \$0.05.

Net income attributable to Ecolab for the first nine months of 2009 decreased 18% to \$302 million. On a per share basis, diluted net income attributable to Ecolab per share decreased 14% to \$1.26, compared to \$1.46 per share in 2008. Amounts for the first nine months of 2009 include \$47.6 million, net of tax, of special gains and charges and net discrete tax benefits of \$4.1 million. These items together reduced the reported per share amount by \$0.18. Currency translation had an unfavorable impact of approximately \$27 million, net of tax, or \$0.11 per share for the first nine months of 2009 compared to 2008. The first nine months of 2008 included \$10.5 million, net of tax, of net gains reported in special gains and charges and \$2.7 million of discrete tax benefits. These items increased reported diluted net income attributable to Ecolab per share by \$0.05.



Segment Results

Sales for each of our reportable segments are as follows:

| (millions)                             | Third Quarter Ended<br>September 30 |            | Nine Months Ended<br>September 30 |            |
|--|-------------------------------------|------------|-----------------------------------|------------|
|  | 2009                                | 2008       | 2009                              | 2008       |
| Net Sales                              |                                     |            |                                   |            |
| United States                          |                                     |            |                                   |            |
| Cleaning & Sanitizing                  | \$ 693.2                            | \$ 695.5   | \$ 1,987.2                        | \$ 2,012.6 |
| Other Services                         | 117.6                               | 124.7      | 340.0                             | 356.0      |
| Total                                  | 810.8                               | 820.2      | 2,327.2                           | 2,368.6    |
| International                          | 692.0                               | 684.1      | 1,973.4                           | 1,953.3    |
| Effect of foreign currency translation | 43.6                                | 122.0      | 35.5                              | 332.3      |
| Consolidated                           | \$ 1,546.4                          | \$ 1,626.3 | \$ 4,336.1                        | \$ 4,654.2 |

U.S. Cleaning & Sanitizing sales were similar to the prior year in the third quarter and decreased 1% for the first nine months of 2009 compared to the prior year. Sales for our large U.S. Cleaning & Sanitizing businesses were as follows:

- **Institutional** Sales declined 4% and 5% for the third quarter and first nine months of 2009, respectively. New account gains, success with new products and pricing enabled us to outperform continued lower demand from our lodging and foodservice customers. We continue to see strong results for our Apex solids warewashing line due to customer demand for energy and cost savings solutions. We have not yet seen improvement in Institutional's major end markets and do not expect a significant pick-up this year.
- **Food & Beverage** - Sales increased 2% in the third quarter as strong results for our core Food & Beverage business were partially offset by lower Ecovation sales. Food & Beverage enjoyed good gains in the dairy, beverage and food markets as pricing, corporate account wins and new products offset soft results in agri and meat & poultry. Sales for the year to date period declined 1% compared to the prior year. The year to date sales comparison was negatively impacted by the timing of a large Ecovation project sale in the first quarter of 2008. Excluding the impact of Ecovation, Food & Beverage continues to perform well as sales grew 4% and 5% for the third quarter and first nine months of 2009, respectively.
- **Kay** - Sales grew 4% in the third quarter of 2009 compared to a very strong third quarter last year when sales grew 21%. For the first nine months of 2009, sales grew 8%. Kay QSR sales grew moderately in the quarter benefiting from existing customer growth. The food retail business showed strong results due to growth at new accounts.
- **Healthcare** Sales increased 11% for both the third quarter and first nine months of 2009. Business acquisitions contributed 3% and 2% to the third quarter and year-to-date sales growth, respectively. Continued solid growth from our infection barrier business and skin care products led the results. Sales growth has also benefited from H1N1 related sales of hand sanitizers.

Segment Results (Continued)

U.S. Other Services sales decreased 6% in the third quarter and 4% for the first nine months of 2009 compared to the prior year periods. Sales for our U.S. Other Services businesses were as follows:

- Pest Elimination - Sales declined 4% for the third quarter and were down 1% for the first nine months of 2009. Gains in the quick service restaurant and food & beverage plant market were offset by soft conditions in restaurants and lodging. Both contract services and non-contract sales were lower. New account gains are being offset by customer cancellations as our customers are focusing on reducing their spending due to the continued soft economy.
- GCS Service - Sales declined 11% and 13% for the third quarter and first nine months of 2009, respectively, compared to the prior year periods. Both service and direct parts sales continued to be soft. New account wins were more than offset by slower foodservice business conditions which has resulted in prospective customers delaying their decision to buy contract services.

We evaluate the performance of our International operations based on fixed management rates of currency exchange. Fixed currency rate sales for our International operations increased 1% for both the third quarter and first nine months of 2009. When measured at public currency rates, International sales decreased 9% and 12% for the third quarter and first nine months of 2009, respectively. Fixed currency sales changes for our International regions were as follows:

- EMEA - Sales declined 1% for both the third quarter and first nine months of 2009. Third quarter sales growth in the U.K., France and Italy was offset by lower sales in Germany. The EMEA region continues to be negatively impacted by the current economic recession in Europe. From a divisional perspective, our Healthcare business continued to show solid growth in the region while Institutional and Food & Beverage reported modest sales declines. Textile Care and Pest Elimination also reported sales declines for the quarter.
- Asia Pacific - Sales increased 2% in the third quarter and are up 3% for the first nine months of 2009, compared to the prior year. Sales growth in the region continued to be led by growth in Food & Beverage due to increased product penetration and new account gains. From a country perspective, sales growth has been driven by growth in China, Australia and New Zealand. Sales growth reflected the impact of economic uncertainty and low levels of business travel and tourism in the region.
- Latin America We continue to experience strong sales growth in Latin America as sales in the region increased 8% for both the third quarter and first nine months of 2009. Our Institutional, Food & Beverage and Pest Elimination businesses all showed strong gains in the region against weak economic conditions. Sales growth was led by continued strong growth in Brazil and Venezuela.
- Canada Sales increased 6% and 8% for the third quarter and first nine months of 2009, respectively, compared to the prior year periods. Sales growth was led by strong results from Food & Beverage, driven by new account gains and product price increases. Institutional also reported sales growth for both the quarter and year to date periods led by pricing and success with distributor partners.

Segment Results (Continued)

Operating income for each of our reportable segments is as follows:

**Third Quarter Ended  
September 30**

**Nine Months Ended**