ECOLAB INC.
Form 10-Q
August 04, 2016

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 June 30, 2016

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)

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

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

(Address of principal executive offices)(Zip Code)

1-800-232-6522

(Registrant's telephone number, including area code)

(Not Applicable)

(Former name, former address and former fiscal year,

if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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	Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company

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 June 30, 2016.

291,595,269 shares of common stock, par value $1.00 per share.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENT OF INCOME

(unaudited)

	Second Quarter Ended June 30		Six Months Ended June 30	
(millions, except per share amounts)	2016	2015	2016	2015
Net sales	$ 3,317.2	$ 3,389.1	$ 6,414.6	$ 6,686.7
Operating expenses				
Cost of sales (including special charges (a))	1,785.2	1,806.5	3,416.6	3,571.8
Selling, general and administrative expenses	1,093.3	1,079.2	2,181.5	2,216.0
Special (gains) and charges	26.2	65.6	32.5	73.4
Operating income	412.5	437.8	784.0	825.5
Interest expense, net	65.3	61.2	131.4	123.7
Income before income taxes	347.2	376.6	652.6	701.8
Provision for income taxes	83.6	67.8	157.0	157.6
Net income including noncontrolling interest	263.6	308.8	495.6	544.2
Net income attributable to noncontrolling interest	5.2	6.8	6.4	8.8
Net income attributable to Ecolab	$ 258.4	$ 302.0	$ 489.2	$ 535.4
Earnings attributable to Ecolab per common share				
Basic	$ 0.88	$ 1.02	$ 1.67	$ 1.80
Diluted	$ 0.87	$ 1.00	$ 1.64	$ 1.77
Dividends declared per common share	$ 0.350	$ 0.330	$ 0.700	$ 0.660
Weighted-average common shares outstanding				
Basic	292.4	296.2	293.4	297.2
Diluted	296.5	301.1	297.5	302.2

(a) Cost of sales includes special charges of $61.9 and $11.0 in the second quarter of 2016 and 2015, respectively, and $61.9 and $11.6 in the first six months of 2016 and 2015, respectively.

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

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

(millions)	Second Quarter Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Net income including noncontrolling interest	$ 263.6	$ 308.8	$ 495.6	$ 544.2
Other comprehensive income (loss), net of tax				
Foreign currency translation adjustments				
Foreign currency translation	77.8	(35.4)	(18.5)	(344.8)
Gain (loss) on net investment hedges	(12.9)	21.8	(27.9)	78.8
	64.9	(13.6)	(46.4)	(266.0)
Derivatives and hedging instruments	(20.2)	(2.9)	(30.7)	4.9
Pension and postretirement benefits				
Amortization of net actuarial loss and prior service costs included in net periodic pension and postretirement costs	5.5	8.1	11.1	16.1
Subtotal	50.2	(8.4)	(66.0)	(245.0)
Total comprehensive income, including noncontrolling interest	313.8	300.4	429.6	299.2
Comprehensive income attributable to noncontrolling interest	5.2	6.0	9.8	7.0
Comprehensive income attributable to Ecolab	$ 308.6	$ 294.4	$ 419.8	$ 292.2

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

CONSOLIDATED BALANCE SHEET

(unaudited)

(millions, except shares and per share amounts)	June 30 2016	December 31 2015
ASSETS		
Current assets		
Cash and cash equivalents	$ 167.4	$ 92.8
Accounts receivable, net	2,318.0	2,390.2
Inventories	1,331.7	1,388.2
Deferred income taxes	-	250.0
Other current assets	278.3	326.3
Total current assets	4,095.4	4,447.5
Property, plant and equipment, net	3,257.3	3,228.3
Goodwill	6,504.4	6,490.8
Other intangible assets, net	3,978.3	4,109.2
Other assets	389.2	365.9
Total assets	$ 18,224.6	$ 18,641.7
LIABILITIES AND EQUITY		
Current liabilities		
Short-term debt	$ 1,749.9	$ 2,205.3
Accounts payable	977.8	1,049.6
Compensation and benefits	459.9	509.0
Income taxes	86.6	52.2
Other current liabilities	964.2	948.3
Total current liabilities	4,238.4	4,764.4
Long-term debt	5,097.0	4,260.2
Postretirement health care and pension benefits	968.4	1,117.1
Deferred income taxes	1,023.4	1,281.2
Other liabilities	227.8	238.4
Total liabilities	11,555.0	11,661.3
Equity (a)		
Common stock	351.6	350.3
Additional paid-in capital	5,181.1	5,086.1
Retained earnings	6,444.6	6,160.3
Accumulated other comprehensive loss	(1,492.7)	(1,423.3)
Treasury stock	(3,884.1)	(3,263.5)
Total Ecolab shareholders' equity	6,600.5	6,909.9
Noncontrolling interest	69.1	70.5
Total equity	6,669.6	6,980.4
Total liabilities and equity	$ 18,224.6	$ 18,641.7

(a) Common stock, 800.0 million shares authorized, $1.00 par value per share, 291.6 million shares outstanding at June 30, 2016, 296.0 million shares outstanding at December 31, 2015. Shares outstanding are net of treasury stock.

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

CONSOLIDATED STATEMENT OF CASH FLOWS

(unaudited)

(millions)	Six Months Ended June 30 2016	2015
OPERATING ACTIVITIES		
	$	$
Net income including noncontrolling interest	495.6	544.2
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation	276.0	285.8
Amortization	145.3	149.9
Deferred income taxes	(28.8)	(34.9)
Share-based compensation expense	53.6	47.1
Excess tax benefits from share-based payment arrangements	(19.6)	(31.4)
Pension and postretirement plan contributions	(192.0)	(38.0)
Pension and postretirement plan expense	28.6	58.1
Restructuring charges, net of cash paid	(27.1)	(4.6)
Venezuelan charges	-	30.2
Loss on sale of business	-	13.7
Asset charges and write-downs	50.9	-
Other, net	12.7	7.0
Changes in operating assets and liabilities, net of effect of acquisitions:		
Accounts receivable	62.5	22.2
Inventories	40.6	(66.0)
Other assets	19.7	(58.4)
Accounts payable	(79.2)	(145.7)
Other liabilities	36.0	(142.6)
Cash provided by operating activities	874.8	636.6
INVESTING ACTIVITIES		
Capital expenditures	(303.7)	(327.5)
Capitalized software expenditures	(22.2)	(14.3)
Property and other assets sold	11.4	6.8
Acquisitions and investments in affiliates, net of cash acquired	(9.4)	(14.7)
Divestiture of businesses	-	0.3
Release from acquisition related escrow	-	9.4
Cash used for investing activities	(323.9)	(340.0)
FINANCING ACTIVITIES		
Net issuances (repayments) of commercial paper and notes payable	(342.4)	449.6
Long-term debt borrowings	793.8	595.6
Long-term debt repayments	(130.0)	(380.0)
Reacquired shares	(637.9)	(726.3)
Dividends paid	(217.6)	(202.5)
Exercise of employee stock options	40.7	49.0
Excess tax benefits from share-based payment arrangements	19.6	31.4

Acquisition related liabilities and contingent consideration	(3.4)	(0.8)
Cash used for financing activities	(477.2)	(184.0)
Effect of exchange rate changes on cash and cash equivalents	0.9	(11.6)
Increase in cash and cash equivalents	74.6	101.0
Cash and cash equivalents, beginning of period	92.8	209.6
Cash and cash equivalents, end of period	$ 167.4	$ 310.6

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

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

1. CONSOLIDATED FINANCIAL INFORMATION

The unaudited consolidated financial information for the second quarter and six months ended June 30, 2016 and 2015 reflect, in the opinion of company management, all adjustments necessary for a fair presentation of the financial position, results of operations, comprehensive income (loss) and cash flows of Ecolab Inc. ("Ecolab" or "the company") for the interim periods presented. Any adjustments consist of normal recurring items.

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, 2015 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, 2015.

During the first quarter of 2016, the company early-adopted the accounting guidance issued in November 2015 that requires all deferred tax assets and liabilities to be classified as noncurrent on the Consolidated Balance Sheet, using the prospective application method. Periods prior to the first quarter of 2016 have not been retrospectively adjusted for adoption of this guidance. Previous guidance required the deferred taxes for each jurisdiction to be presented as a net current asset or liability and net noncurrent asset or liability. As a result of the new guidance, each jurisdiction now only has one net noncurrent deferred tax asset or liability. The new guidance does not change the existing requirement that only permits offsetting deferred tax assets and liabilities within a single jurisdiction.

With respect to the unaudited financial information of the company for the second quarter and six months ended June 30, 2016 and 2015 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. Their separate report dated August 4, 2016 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:

	Second Quarter Ended June 30		Six Months Ended June 30	
(millions)	2016	2015	2016	2015
Cost of sales				
Restructuring related activities	$ 0.9	$ 1.6	$ 0.9	$ 2.2
Energy related charges	51.0	-	51.0	-
Fixed asset impairment and other inventory charges	10.0	-	10.0	-
Venezuela related activities	-	9.4	-	9.4
Subtotal	61.9	11.0	61.9	11.6
Special (gains) and charges				
Restructuring related activities	(2.1)	18.9	0.9	21.0
Champion and Nalco integration costs	-	4.5	-	10.2
Energy related charges	12.6	-	12.6	-
Venezuela related activities	(7.8)	20.8	(7.8)	20.8
Other	23.5	21.4	26.8	21.4
Subtotal	26.2	65.6	32.5	73.4
Total special (gains) and charges	$ 88.1	$ 76.6	$ 94.4	$ 85.0

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

Restructuring Charges

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

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

Energy Restructuring Plan

In April 2013, following the completion of the acquisition of privately held Champion Technologies and its related company Corsicana Technologies (collectively “Champion”), the company commenced plans to undertake restructuring and other cost-saving actions to realize its acquisition-related cost synergies as well as streamline and strengthen Ecolab’s position in the global energy market (the “Energy Restructuring Plan”). Actions associated with the acquisition to improve the effectiveness and efficiency of the business included a reduction of the combined business’s global workforce. Actions also included leveraging and simplifying its global supply chain, including the reduction of plant, distribution center and redundant facility locations and product line optimization.

Restructuring charges within the Energy Restructuring Plan were substantially completed during the fourth quarter of 2015. The company recorded charges of $1.7 million ($0.9 million after tax) and $13.1 million ($9.1 million after tax) during the second quarter of 2016 and 2015, respectively. During the six months ended June 30, 2016 and 2015, the company recorded charges of $4.6 million ($2.6 million after tax) and $14.1 million ($9.9 million after tax), respectively.

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

Employee

(millions)	Termination Costs	Asset Disposals	Other	Total
2013 - 2015 Activity				
Recorded expense and accrual	$ 55.6	$ 13.2	$ 15.3	$ 84.1
Net cash payments	(44.3)	3.9	(2.1)	(42.5)
Non-cash charges	-	(17.1)	-	(17.1)
Effect of foreign currency translation	0.4	-	-	0.4
Restructuring liability, December 31, 2015	11.7	-	13.2	24.9
2016 Activity				
Recorded expense (income) and accrual	(0.4)	0.8	4.2	4.6
Net cash payments	(4.1)	-	(4.3)	(8.4)
Non-cash charges	-	(0.8)	-	(0.8)
Restructuring liability, June 30, 2016	$ 7.2	$ -	$ 13.1	$ 20.3

The majority of cash payments under this plan are related to severance, with the current accrual expected to be paid over a period of a few months to several quarters. The company anticipates the remaining cash expenditures will continue to be funded from operating activities.

Combined Restructuring Plan

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

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

Restructuring charges within the Combined Plan were substantially completed during the fourth quarter of 2015. The company recorded gains of $2.9 million ($2.8 million after tax) and $2.8 million ($2.7 million after tax) during the second quarter and first six months of 2016, respectively, primarily related to the sale of certain facilities. The company recorded charges of $7.3 million ($5.5 million after tax) and $9.0 million ($6.3 million after tax), during the second quarter and first six months of 2015, respectively.

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

(millions)	Employee Termination Costs	Asset Disposals	Other	Total
2011 - 2015 Activity				
Recorded expense and accrual	$ 349.7	$ 6.1	$ 48.4	$ 404.2
Net cash payments	(281.3)	16.3	(38.1)	(303.1)
Non-cash net charges	0.6	(22.4)	(4.7)	(26.5)
Effect of foreign currency translation	(9.4)	-	-	(9.4)
Restructuring liability, December 31, 2015	59.6	-	5.6	65.2
2016 Activity				
Recorded expense (income) and accrual	(0.7)	(2.3)	0.2	(2.8)
Net cash payments	(19.1)	3.5	(1.4)	(17.0)
Non-cash net charges	-	(1.2)	-	(1.2)
Effect of foreign currency translation	1.9	-	-	1.9
Restructuring liability, June 30, 2016	$ 41.7	$ -	$ 4.4	$ 46.1

The majority of cash payments under this plan are related to severance, with the current accrual expected to be paid over a period of a few months to several quarters. The company anticipates the remaining cash expenditures will continue to be funded from operating activities.

Non-Restructuring Special (Gains) and Charges

Energy Related Charges

Oil industry activity remained depressed during the second quarter of 2016, resulting from continued excess oil supply pressures, which have negatively impacted exploration and production investments in the energy industry, particularly in North America. As a result of these conditions and their corresponding impact on the company's business outlook, the company recorded total charges of $63.6 million ($42.9 million after tax) during the second quarter and first six months of 2016, comprised of inventory write downs and related disposal costs, fixed asset charges, headcount reductions and other charges.

The inventory write-downs and related disposal costs of $31.1 million include lower of cost or market adjustments due to the significant decline in activity and related prices of certain specific-use and other products, coupled with declines in replacement costs, as well as estimated costs to dispose the respective excess inventory. The fixed asset charges of $18.2 million resulted from the write-down of certain assets related to the reduction in certain aspects of our North American Global Energy segment, as well as abandonment of certain projects under construction. The carrying value of the corresponding fixed assets was reduced to zero. The employee termination costs of $12.8 million include a reduction in the Global Energy segment's global workforce to better align its workforce with anticipated activity levels in the near term. As of the end of the second quarter of 2016, the company had $11.9 million of corresponding severance remaining to be paid, which is expected to paid in the next twelve months and be funded from operating activities.

The charges discussed above have been included as a component of both cost of sales and special (gains) and charges on the Consolidated Statement of Income.

See discussion of the company's goodwill and intangible asset impairment review in Note 6.

Venezuela related activities

Effective as of the end of the fourth quarter of 2015, the company deconsolidated its Venezuelan subsidiaries. Prior to deconsolidation, during the second quarter of 2015, the company remeasured its Venezuelan bolivar operations within its Water and Paper operating units from the official exchange rate at the time of 6.3 bolivares to 1 U.S. dollar to the Marginal Currency System ("SIMADI") rate at the time of approximately 200 bolivares to 1 U.S. dollar and recorded a devaluation charge of $30.2 million ($30.2 million after tax).

During the second quarter and first six months of 2016 the company recorded a gain of $7.8 million ($4.9 million after tax) resulting from U.S. dollar cash recoveries of intercompany receivables written off at the time of deconsolidation.

Champion and Nalco integration costs

Integration related special charges for the Champion acquisition and Nalco merger were completed during the fourth quarter of 2015, and the company did not incur any special charges related to such transactions during the first six months of 2016. As a result of the Champion acquisition, the company incurred charges of $4.3 million ($2.8 million after tax) and $9.5 million ($6.0 million after tax) during the second quarter and the first six months of 2015, respectively. As a result of the Nalco merger, the company incurred charges of $0.2 million ($0.1 million after tax) and $0.7 million ($0.6 million after tax) during the second quarter and the first six months of 2015, respectively.

Other special (gains) and charges

During the second quarter and first six months of 2016, the company recorded a charge of $10.0 million ($6.3 million after tax) related to a fixed asset impairment and related inventory charges. The fixed asset impairment corresponds to additional charges of certain U.S. production equipment and buildings, resulting from further lower production, initially impaired during the fourth quarter of 2015. The impaired facility is a specialized facility used for dry polymer production. Due to market contraction in the oil and the mining industries, and the aggressive competitive pricing environment for dry polymers, the facility has not reached production volumes to recover the value of the underlying fixed assets. Subsequent to the second quarter charge, the remaining value of the underlying fixed assets is less than $5 million. Inventory charges include lower of cost or market adjustments due to the significant decline in activity and related prices of the corresponding dry polymer products.

The company also recorded charges of $23.5 million ($14.6 million after tax) and $26.8 million ($17.2 million after tax) during the second quarter and first six months of 2016, respectively, primarily consisting of litigation related charges.

The company recorded charges of $21.4 million ($13.4 million after tax) during the second quarter and first six months of 2015, related to recognition of a loss on the sale of a portion of its Ecovation business, and other litigation related charges.

3. ACQUISITIONS AND DISPOSITIONS

Acquisitions

Acquisitions during the first six months of 2016 and all of 2015 were not material to the company's consolidated financial statements. The aggregate purchase price of acquisitions has been reduced for any cash or cash equivalents acquired with the acquisitions. Based upon purchase price allocations, the components of the aggregate purchase prices of completed acquisitions and immaterial purchase price adjustments during the second quarter and first six months of 2016 and 2015 are shown in the following table.

	Second Quarter Ended June 30		Six Months Ended June 30	
(millions)	2016	2015	2016	2015
Net tangible assets acquired	$ (2.9)	$ 2.4	$ 10.7	$ 3.5
Identifiable intangible assets				