ECOLAB INC.
Form 10-Q
August 03, 2017

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, 2017

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.) |

1 Ecolab Place, 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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer | Accelerated filer |

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

Emerging growth company

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of June 30, 2017.

289,381,301 shares of common stock, par value $1.00 per share.

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED STATEMENT OF INCOME

(unaudited)

| (millions, except per share amounts) | Second Quarter Ended June 30 2017 | 2016 | Six Months Ended June 30 2017 | 2016 |
|---|---|---|---|---|
| Net sales | $ 3,462.7 | $ 3,317.2 | $ 6,624.3 | $ 6,414.6 |
| Operating expenses | | | | |
| Cost of sales (including special charges (a)) | 1,871.6 | 1,785.2 | 3,563.1 | 3,416.6 |
| Selling, general and administrative expenses | 1,115.3 | 1,093.3 | 2,205.9 | 2,181.5 |
| Special (gains) and charges | 36.8 | 26.2 | 43.0 | 32.5 |
| Operating income | 439.0 | 412.5 | 812.3 | 784.0 |
| Interest expense, net | 59.6 | 65.3 | 122.1 | 131.4 |
| Income before income taxes | 379.4 | 347.2 | 690.2 | 652.6 |
| Provision for income taxes | 81.3 | 83.6 | 135.3 | 157.0 |
| Net income including noncontrolling interest | 298.1 | 263.6 | 554.9 | 495.6 |
| Net income attributable to noncontrolling interest | 1.5 | 5.2 | 4.8 | 6.4 |
| Net income attributable to Ecolab | $ 296.6 | $ 258.4 | $ 550.1 | $ 489.2 |
| | | | | |
| Earnings attributable to Ecolab per common share | | | | |
| Basic | $ 1.02 | $ 0.88 | $ 1.90 | $ 1.67 |
| Diluted | $ 1.01 | $ 0.87 | $ 1.87 | $ 1.64 |
| | | | | |
| Dividends declared per common share | $ 0.370 | $ 0.350 | $ 0.740 | $ 0.700 |
| | | | | |
| Weighted-average common shares outstanding | | | | |
| Basic | 289.8 | 292.4 | 290.2 | 293.4 |
| Diluted | 294.1 | 296.5 | 294.6 | 297.5 |

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

(a) Cost of sales includes special charges of $24.4 and $61.9 in the second quarter of 2017 and 2016, respectively, and $25.9 and $61.9 in the first six months of 2017 and 2016, respectively.

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (LOSS)

(unaudited)

| (millions) | Second Quarter Ended June 30 2017 | 2016 | Six Months Ended June 30 2017 | 2016 |
|---|---|---|---|---|
| Net income including noncontrolling interest | $ 298.1 | $ 263.6 | $ 554.9 | $ 495.6 |
| Other comprehensive income (loss), net of tax | | | | |
| Foreign currency translation adjustments | | | | |
| Foreign currency translation | 44.0 | 77.8 | 125.2 | (18.5) |
| Loss on net investment hedges | (55.6) | (12.9) | (52.8) | (27.9) |
| | (11.6) | 64.9 | 72.4 | (46.4) |
| Derivatives and hedging instruments | 0.9 | (20.2) | (8.3) | (30.7) |
| Pension and postretirement benefits | | | | |
| Amortization of net actuarial loss and prior service costs included in net periodic pension and postretirement costs | 3.6 | 5.5 | 6.9 | 11.1 |
| | 3.6 | 5.5 | 6.9 | 11.1 |
| Subtotal | (7.1) | 50.2 | 71.0 | (66.0) |
| Total comprehensive income, including noncontrolling interest | 291.0 | 313.8 | 625.9 | 429.6 |
| Comprehensive income attributable to noncontrolling interest | 2.3 | 5.2 | 6.8 | 9.8 |
| Comprehensive income attributable to Ecolab | $ 288.7 | $ 308.6 | $ 619.1 | $ 419.8 |

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 2017 | December 31 2016 |
|---|---|---|
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | $ 260.7 | $ 327.4 |
| Accounts receivable, net | 2,446.8 | 2,341.2 |
| Inventories | 1,469.8 | 1,319.4 |
| Other current assets | 354.8 | 291.4 |
| Total current assets | 4,532.1 | 4,279.4 |
| Property, plant and equipment, net | 3,497.4 | 3,365.0 |
| Goodwill | 7,003.8 | 6,383.0 |
| Other intangible assets, net | 4,061.6 | 3,817.8 |
| Other assets | 428.5 | 485.0 |
| Total assets | $ 19,523.4 | $ 18,330.2 |
| LIABILITIES AND EQUITY | | |
| Current liabilities | | |
| Short-term debt | $ 1,770.6 | $ 541.3 |
| Accounts payable | 1,123.6 | 983.2 |
| Compensation and benefits | 445.4 | 516.3 |
| Income taxes | 53.0 | 87.4 |
| Other current liabilities | 925.8 | 891.2 |
| Total current liabilities | 4,318.4 | 3,019.4 |
| Long-term debt | 5,909.3 | 6,145.7 |
| Postretirement health care and pension benefits | 1,040.1 | 1,019.2 |
| Deferred income taxes | 1,028.7 | 970.2 |
| Other liabilities | 238.2 | 204.8 |
| Total liabilities | 12,534.7 | 11,359.3 |
| Equity (a) | | |
| Common stock | 354.1 | 352.6 |
| Additional paid-in capital | 5,375.5 | 5,270.8 |
| Retained earnings | 7,312.6 | 6,975.0 |
| Accumulated other comprehensive loss | (1,643.9) | (1,712.9) |
| Treasury stock | (4,478.6) | (3,984.4) |
| Total Ecolab shareholders’ equity | 6,919.7 | 6,901.1 |
| Noncontrolling interest | 69.0 | 69.8 |
| Total equity | 6,988.7 | 6,970.9 |
| Total liabilities and equity | $ 19,523.4 | $ 18,330.2 |

(a) Common stock, 800.0 million shares authorized, $1.00 par value per share, 289.4 million shares outstanding at June 30, 2017 and 291.8 million shares outstanding at December 31, 2016. 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 2017 | 2016 |
|---|---|---|
| OPERATING ACTIVITIES | | |
| Net income including noncontrolling interest | $ 554.9 | $ 495.6 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation | 286.3 | 276.0 |
| Amortization | 150.9 | 145.3 |
| Deferred income taxes | (14.1) | (28.8) |
| Share-based compensation expense | 57.5 | 53.6 |
| Excess tax benefits from share-based payment arrangements | - | (19.6) |
| Pension and postretirement plan contributions | (37.0) | (192.0) |
| Pension and postretirement plan expense | 17.3 | 28.6 |
| Restructuring charges, net of cash paid | 20.3 | (27.1) |
| Asset charges and write-downs | - | 50.9 |
| Other, net | 12.6 | 12.7 |
| Changes in operating assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable | 16.0 | 62.5 |
| Inventories | (95.8) | 40.6 |
| Other assets | (9.6) | 19.7 |
| Accounts payable | 84.0 | (79.2) |
| Other liabilities | (183.6) | 36.0 |
| Cash provided by operating activities | 859.7 | 874.8 |
| INVESTING ACTIVITIES | | |
| Capital expenditures | (340.2) | (303.7) |
| Capitalized software expenditures | (38.0) | (22.2) |
| Property and other assets sold | 2.5 | 11.4 |
| Acquisitions and investments in affiliates, net of cash acquired | (826.5) | (9.4) |
| Deposit into acquisition related escrow | (1.7) | - |
| Restricted cash activity | 53.8 | - |
| Cash used for investing activities | (1,150.1) | (323.9) |
| FINANCING ACTIVITIES | | |
| Net issuances (repayments) of commercial paper and notes payable | 909.8 | (342.4) |
| Long-term debt borrowings | - | 793.8 |
| Long-term debt repayments | (5.3) | (130.0) |
| Reacquired shares | (501.1) | (637.9) |
| Dividends paid | (222.9) | (217.6) |
| Exercise of employee stock options | 54.6 | 40.7 |
| Excess tax benefits from share-based payment arrangements | - | 19.6 |
| Acquisition related liabilities and contingent consideration | (8.2) | (3.4) |
| Other, net | (0.9) | - |

| | | |
|---|---|---|
| Cash provided by (used for) financing activities | 226.0 | (477.2) |
| Effect of exchange rate changes on cash and cash equivalents | (2.3) | 0.9 |
| Increase (decrease) in cash and cash equivalents | (66.7) | 74.6 |
| Cash and cash equivalents, beginning of period | 327.4 | 92.8 |
| Cash and cash equivalents, end of period | $ 260.7 | $ 167.4 |

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, 2017 and 2016 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, 2016 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, 2016.

During the first quarter of 2017, the Company adopted the accounting guidance issued in March 2016 that amends certain aspects of share-based compensation for employees, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classifications on the Consolidated Statement of Cash Flows. Under the new guidance, all excess tax benefits or deficiencies are to be recognized prospectively as discrete income tax items on the Consolidated Statement of Income, while previous guidance required realized excess tax benefits or deficiencies to be recognized in additional paid-in capital. The Company recorded $10.8 million and $26.8 million of excess tax benefits during the second quarter and first six months of 2017, respectively. The extent of excess tax benefits is subject to variation in stock price and stock option exercises. Adoption of the accounting standard also eliminated the requirement that excess tax benefits be realized before they can be recognized, and as a result, the Company recorded a $1.9 million cumulative-effect adjustment for previously unrecognized excess tax benefits.

The Company’s adoption also resulted in associated excess tax benefits being classified as an operating activity in the statement of cash flows prospectively beginning January 1, 2017 with no changes to the prior year. Based on the adoption methodology applied, employee taxes paid remain classified as a financing activity on the statement of cash flows, and the statement of cash flows classification of prior periods has not changed. With regards to forfeitures, the new guidance allows companies either to continue to estimate the number of awards that will be forfeited or to account for forfeitures as they occur. The Company has elected to continue to estimate the number of awards that will be forfeited based on an estimate of the number of outstanding awards expected to vest.

With respect to the unaudited financial information of the Company for the second quarter and six months ended June 30, 2017 and 2016 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 3, 2017 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) | Second Quarter Ended June 30 2017 | 2016 | Six Months Ended June 30 2017 | 2016 |
|---|---|---|---|---|
| Cost of sales | | | | |
| Restructuring activities | 2.2 | 0.9 | 2.2 | 0.9 |
| Acquisition and integration costs | 11.1 | - | 12.6 | - |
| Energy related charges | - | 51.0 | - | 51.0 |
| Other | 11.1 | 10.0 | 11.1 | 10.0 |
| Subtotal | 24.4 | 61.9 | 25.9 | 61.9 |
| | | | | |
| Special (gains) and charges | | | | |
| Restructuring activities | 30.8 | (2.1) | 30.5 | 0.9 |
| Acquisition and integration costs | 4.6 | 1.0 | 10.9 | 3.3 |
| Energy related charges | - | 12.6 | - | 12.6 |
| Venezuela related gain | (5.3) | (7.8) | (5.3) | (7.8) |
| Other | 6.7 | 22.5 | 6.9 | 23.5 |
| Subtotal | 36.8 | 26.2 | 43.0 | 32.5 |
| | | | | |
| Total special (gains) and charges | $ 61.2 | $ 88.1 | $ 68.9 | $ 94.4 |

For segment reporting purposes, special (gains) and charges are not allocated to reportable segments, which is consistent with the Company’s internal management reporting.

### Restructuring activities

The Company’s restructuring activities are associated with plans to enhance its efficiency and effectiveness and sharpen its competitiveness. 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 activities have been included as a component of both cost of sales and special (gains) and charges on the Consolidated Statement of Income. Restructuring liabilities have been classified as a component of both other current and other noncurrent liabilities on the Consolidated Balance Sheet.

During the second quarter of 2017, the Company commenced restructuring and other cost-saving actions in order to streamline its operations. These actions include a reduction of the Company's global workforce by approximately 530 positions, as well as asset disposals and lease terminations. As a result of these actions, the Company expects to incur $40 to $45 million ($30 to $35 million after tax) of restructuring charges. During the second quarter of 2017, the Company recorded restructuring charges of $33.0 million ($25.0 million after tax) related primarily to employee termination costs. The remaining charges are expected to be recognized during the second half of 2017. As of June 30, 2017, the restructuring liability balance related to these actions was $28.4 million. The Company anticipates that the majority of the pretax charges will represent net cash expenditures which are expected to be paid over a period of a few months to several quarters and will be funded from operating activities. Cash payments during the second quarter of 2017 were minimal.

Net restructuring gains and charges related to the Company's Energy and Combined restructuring plans during 2017 were minimal. During the second quarter and first six months of 2016, net restructuring activities included net restructuring gains of $1.2 million ($1.9 million after tax) and net restructuring charges of $1.8 million ($0.1 million gain after tax), respectively. The restructuring liability balance was $28.4 million and $39.6 million as of June 30, 2017 and December 31, 2016, respectively. The reduction in liability was driven primarily by severance and other cash payments. The remaining accrual is expected to be paid over a period of a few months to several quarters and continues to be funded from operating activities.

Acquisition and integration related costs

Acquisition and integration costs reported in cost of sales on the Consolidated Statement of Income include $11.1 million ($7.0 million after tax) and $12.6 million ($8.0 million after tax) during the second quarter and first six months of 2017, respectively, related primarily to recognition of accelerated rent expense upon the closure of Swisher Hygiene Inc. ("Swisher") plants and disposal of excess inventory. The second quarter and first six months of 2017 also include amounts related to recognition of fair value step-up in the Laboratoires Anios ("Anios") inventory.

Acquisition and integration costs reported in special (gains) and charges on the Consolidated Statement of Income include $4.6 million ($3.0 million after tax) and $10.9 million ($7.3 million after tax) of acquisition costs, advisory and legal fees, and integration charges for the Anios and Swisher acquisitions during the second quarter and first six months of 2017, respectively.

During the second quarter and first six months of 2016, the Company incurred acquisition and integration charges of $1.0 million ($0.7 million after tax) and $3.3 million ($2.1 million after tax), respectively. Further information related to the Company’s acquisitions is included in Note 3.

Energy related charges

Oil industry activity remained depressed during 2016 when compared with 2014 levels, 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 the conditions in place during 2016, 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. No such charges were incurred in 2017.

The inventory write-downs and related disposal costs of $31.1 million include 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 2017, the Company had $4.3 million of corresponding severance remaining to be paid, which is expected to be paid in the next several 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.

Venezuela related gain

Effective as of the end of the fourth quarter of 2015, the Company deconsolidated its Venezuelan subsidiaries. During the second quarter of 2017 and 2016, the Company recorded gains of $5.3 million ($3.3 million after tax) and $7.8 million ($4.9 million after tax), respectively, resulting from U.S. dollar cash recoveries of intercompany receivables written off at the time of deconsolidation.

Other

During the second quarter and first six months of 2017, the Company recorded charges of $17.8 million ($14.4 million after tax) and $18.0 million ($14.5 million after tax), respectively, related to a Global Energy vendor contract termination and litigation related charges. These charges have been included as a component of both cost of sales and special (gains) and charges on the Consolidated Statement of Income.

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. This charge has been included as a component of cost of sales on the Consolidated Statement of Income.

Additionally, during the second quarter and first six months of 2016, the Company recorded charges of $22.5 million ($13.9 million after tax) and $23.5 million ($15.1 million after tax), respectively, primarily consisting of litigation related charges. These charges have been included as a component of special (gains) and charges on the Consolidated Statement of Income.

3. ACQUISITIONS AND DISPOSITIONS

Acquisitions

The Company makes acquisitions that align with its strategic business objectives. The assets and liabilities of the acquired entities have been recorded as of the acquisition date, at their respective fair values, and are included in the Consolidated Balance Sheet and results of the Company from the date of acquisition. The purchase price allocation is based on estimates of the fair value of assets acquired and liabilities assumed. The aggregate purchase price of acquisitions has been reduced for any cash or cash equivalents acquired with the acquisition. Acquisitions during the first six months of 2017 and 2016 were not material to the Company's consolidated financial statements; therefore, pro forma financial information is not presented.

Anios Acquisition

On February 1, 2017, the Company acquired Anios for total consideration of $798.3 million in cash, including satisfaction of outstanding debt. Anios is a leading European manufacturer and marketer of hygiene and disinfection products for the healthcare, food service, and food and beverage processing industries. Anios provides an innovative product line that expands the solutions the Company is able to offer while also providing a complementary geographic footprint within the healthcare market. With pre-acquisition annual sales of approximately $245 million, the acquired business became part of the Company's Global Institutional reportable segment during the first quarter of 2017. During 2016, the Company deposited €50 million in an escrow account that was released back to the Company upon closing of the transaction in February 2017. As shown within Note 4, this was recorded as restricted cash within other assets on the Consolidated Balance Sheet as of December 31, 2016.

The Company incurred certain acquisition and integration costs associated with the transaction that were expensed and are reflected in the Consolidated Statement of Income. A total of $3.4 million ($2.3 million after tax) of charges were incurred during the second quarter of 2017, of which $1.6 million ($1.0 million after tax) were included in cost of sales and are related to recognition of fair value step-up in Anios inventory. A total of $9.4 million ($6.5 million after tax) of charges were incurred during the first six months of 2017, of which $3.1 million ($2.1 million after tax) were included in cost of sales and are related to recognition of fair value step-up in Anios inventory.

The Anios acquisition has been accounted for using the acquisition method of accounting, which requires, among other things, that most assets acquired and liabilities assumed be recognized at fair value as of the acquisition date. Certain estimated values are not yet finalized and are subject to change. Amounts for certain deferred tax assets and liabilities, environmental reserves, certain tangible and intangible assets, income tax uncertainties, and goodwill remain subject to change, as information necessary to complete the analysis is obtained. The Company expects to finalize these by the filing of the 2017 Form 10-K.

The following table summarizes the preliminary value of Anios assets acquired and liabilities assumed as of the acquisition date.

| (millions) | |
|---|---|
| Tangible assets | $ 142.7 |
| Identifiable intangible assets: | |
| Customer relationships | 252.0 |
| Trademarks | 65.7 |
| Other technology | 16.1 |
| Total assets acquired | 476.5 |
| | |
| Total liabilities assumed | 196.3 |
| | |
| Goodwill | 518.1 |
| Total consideration transferred | 798.3 |
| | |
| Long-term debt repaid upon close | 192.8 |
| Net consideration transferred to sellers | $ 605.5 |

Net tangible assets are primarily comprised of accounts receivable of $66.2 million, property, plant and equipment of $25.6 million and inventory of $29.7 million.

Customer relationships, trademarks, and other technology are being amortized over weighted average lives of 20, 17, and 11 years, respectively.

Goodwill of $518.1 million arising from the acquisition consists largely of the synergies and economies of scale expected through adding complementary geographies and innovative products to the Company's healthcare portfolio. The goodwill was assigned to the Healthcare operating segment within the Global Institutional reportable segment. None of the goodwill recognized is expected to be deductible for income tax purposes.

Other Acquisitions

Excluding the Anios acquisition, during the first six months of 2017, the Company paid $27.9 million for acquisitions, of which $18.4 million was attributed to certain identifiable intangible assets. The weighted average useful life of these identifiable intangible assets acquired was 12 years. Additionally, there were immaterial purchase price adjustments related to prior year acquisitions.

During the first six months of 2016, the Company paid $12.8 million for acquisitions, of which $2.5 million was attributed to certain identifiable intangible assets. The weighted average useful life of these identifiable intangible assets acquired was 5 years. Additionally, there were immaterial purchase price adjustments related to prior year acquisitions.

Dispositions

There were no business dispositions during the first six months of 2017 or 2016.

4. BALANCE SHEET INFORMATION

| (millions) | June 30 2017 | December 31 2016 |
|---|---|---|
| Accounts receivable, net | | |
| Accounts receivable | $ 2,517.2 | $ 2,408.8 |
| Allowance for doubtful accounts | (70.4) | (67.6) |
| Total | $ 2,446.8 | $ 2,341.2 |
| | | |
| Inventories | | |
| Finished goods | $ 986.5 | $ 860.0 |
| Raw materials and parts | 447.6 | 408.4 |
| Inventories at FIFO cost | 1,434.1 | 1,268.4 |
| FIFO cost to LIFO cost difference | 35.7 | 51.0 |
| Total | $ 1,469.8 | $ 1,319.4 |
| | | |
| Other current assets | | |
| Prepaid assets | $ 132.6 | $ 98.3 |
| Taxes receivable | 131.6 | 105.0 |
| Derivative assets | 44.2 | 46.3 |
| Other | 46.4 | 41.8 |
| Total | $ 354.8 | $ 291.4 |
| | | |
| Property, plant and equipment, net | | |
| Land | $ 216.6 | $ 211.0 |
| Buildings and leasehold improvements | 1,122.6 | 1,121.2 |
| Machinery and equipment | 2,159.0 | 2,035.8 |
| Merchandising and customer equipment | 2,327.3 | 2,199.4 |
| Capitalized software | 570.1 | 531.1 |
| Construction in progress | 390.9 | 344.1 |
| | 6,786.5 | 6,442.6 |
| Accumulated depreciation | (3,289.1) | (3,077.6) |
| Total | $ 3,497.4 | $ 3,365.0 |
| | | |
| Other intangible assets, net | | |
| Intangible assets not subject to amortization | | |
| Trade names | $ 1,230.0 | $ 1,230.0 |
| Intangible assets subject to amortization | | |
| Customer relationships | $ 3,519.5 | $ 3,206.1 |
| Trademarks | 374.2 | 303.3 |
| Patents | 454.9 | 446.5 |
| Other technology | 228.0 | 210.5 |
| | 4,576.6 | 4,166.4 |
| Accumulated amortization | | |
| Customer relationships | (1,275.6) | (1,148.2) |
| Trademarks | (137.6) | (125.2) |
| Patents | (171.6) | (157.3) |
| Other technology | (160.2) | (147.9) |

| | | |
|---|---|---|
| | (1,745.0) | (1,578.6) |
| Net intangible assets subject to amortization | 2,831.6 | 2,587.8 |
| Total | $ 4,061.6 | $ 3,817.8 |
| | | |
| Other assets | | |
| Deferred income taxes | $ 102.0 | $ 92.3 |
| Pension | 32.9 | 27.2 |
| Derivative assets | 1.3 | 21.5 |
| Restricted cash | - | 53.0 |
| Other | 292.3 | 291.0 |
| Total | $ 428.5 | $ 485.0 |

| (millions) | June 30 2017 | December 31 2016 |
|---|---|---|
| Other current liabilities | | |
| Discounts and rebates | $ 309.6 | $ 275.2 |
| Dividends payable | 107.2 | 108.0 |
| Interest payable | 48.2 | 37.3 |
| Taxes payable, other than income | 108.1 | 103.7 |
| Derivative liabilities | 36.6 | 24.6 |
| Restructuring | 51.7 | 30.5 |
| Other | 264.4 | 311.9 |
| Total | $ 925.8 | $ 891.2 |
| | | |
| Accumulated other comprehensive loss | | |
| Unrealized loss on derivative financial instruments, net of tax | $ (16.8) | $ (8.5) |
| Unrecognized pension and postretirement benefit expense, net of tax | (518.4) | (511.4) |
| Cumulative translation, net of tax | (1,108.7) | (1,193.0) |
| Total | $ (1,643.9) | $ (1,712.9) |

## 5. DEBT AND INTEREST

### Short-term Debt

The following table provides the components of the Company's short-term debt obligations as of June 30, 2017 and December 31, 2016.

| (millions) | June 30 2017 | December 31 2016 |
|---|---|---|
| Short-term debt | | |
| Commercial paper | $ 918.0 | $ - |
| Notes payable | 41.8 | 29.9 |
| Long-term debt, current maturities | 810.8 | 511.4 |
| Total | $ 1,770.6 | $ 541.3 |

Line of Credit

As of June 30, 2017, the Company had in place a $2.0 billion multi-year credit facility which expires in December 2019. The credit facility has been established with a diverse syndicate of banks and supports the Company's U.S. and Euro commercial paper programs. There were no borrowings under the Company's credit facility as of either June 30, 2017 or December 31, 2016.

Commercial Paper

The Company's commercial paper program is used as a potential source of liquidity and consists of a $2.0 billion U.S. commercial paper program and a $2.0 billion Euro commercial paper program. The maximum aggregate amount of commercial paper that may be issued by the Company under its commercial paper programs may not exceed $2.0 billion.

As of June 30, 2017, the Company had $581.0 million and $337.0 million (€300 million) of commercial paper outstanding under its U.S. and Euro programs, respectively. As of December 31, 2016, the Company had no commercial paper outstanding under either program.

Long-term Debt

The following table provides the components of the Company's long-term debt obligations, including current maturities, as of June 30, 2017 and December 31, 2016.

| (millions) | Maturity by Year | June 30 2017 | December 31 2016 |
|---|---|---|---|
| Long-term debt | | | |
| Public notes (2017 principal amount) | | | |
| Five year 2012 senior notes ($500 million) | 2017 | $ 499.1 | $ 498.9 |
| Three year 2015 senior notes ($300 million) | 2018 | 299.1 | 298.9 |
| Three year 2016 senior notes ($400 million) | 2019 | 396.4 | 395.9 |
| Five year 2015 senior notes ($300 million) | 2020 | 298.8 | 298.6 |
| Ten year 2011 senior notes ($1.25 billion) | 2021 | 1,245.3 | 1,244.8 |
| Seven year 2016 senior notes ($400 million) | 2023 | 397.3 | 397.0 |
| Seven year 2016 senior notes (€575 million) | 2024 | 637.6 | 608.4 |
| Ten year 2015 senior notes (€575 million) | 2025 | 640.7 | 604.3 |
| Ten year 2016 senior notes ($750 million) | 2026 | 742.5 | 742.1 |
| Thirty year 2011 senior notes ($750 million) | 2041 | 739.0 | 738.7 |
| Thirty year 2016 senior notes ($250 million) | 2046 | 245.9 | 245.9 |
| Private notes (2017 principal amount) | | | |
| Series A private placement senior notes ($250 million) | 2018 | 248.9 | 248.9 |
| Series B private placement senior notes ($250 million) | 2023 | 249.3 | 249.2 |
| Capital lease obligations | | 5.1 | 5.2 |
| Other | | 75.1 | 80.3 |
| Total debt | | 6,720.1 | 6,657.1 |
| Long-term debt, current maturities | | (810.8) | (511.4) |
| Total long-term debt | | $ 5,909.3 | $ 6,145.7 |

Public Notes

The Company's public notes may be redeemed by the Company at its option at redemption prices that include accrued and unpaid interest and a make-whole premium. Upon the occurrence of a change of control accompanied by a downgrade of the public notes below investment grade rating, within a specified time period, the Company would be required to offer to repurchase the public notes at a price equal to 101% of the aggregate principal amount thereof, plus any accrued and unpaid interest to the date of repurchase. The public notes are senior unsecured and unsubordinated obligations of the Company and rank equally with all other senior and unsubordinated indebtedness of the Company.

Private Notes

The Company’s private notes may be redeemed by the Company at its option at redemption prices that include accrued and unpaid interest and a make-whole premium. Upon the occurrence of specified changes of control involving the Company, the Company would be required to offer to repurchase the private notes at a price equal to 100% of the aggregate principal amount thereof, plus any accrued and unpaid interest to the date of repurchase. Additionally, the Company would be required to make a similar offer to repurchase the private notes upon the occurrence of specified merger events or asset sales involving the Company, when accompanied by a downgrade of the private notes below investment grade rating, within a specified time period. The private notes are unsecured senior obligations of the Company and rank equal in right of payment with all other senior indebtedness of the Company. The private notes shall be unconditionally guaranteed by subsidiaries of the Company in certain circumstances, as described in the note purchase agreement as amended.

Covenants

The Company is in compliance with its debt covenants as of June 30, 2017.

Net Interest Expense

Interest expense and interest income recognized during the second quarter and the first six months of 2017 and 2016 were as follows:

| | Second Quarter Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|
| (millions) | 2017 | 2016 | 2017 | 2016 |
| Interest expense | $ 63.7 | $ 71.5 | $ 130.3 | $ 140.4 |
| Interest income | (4.1) | (6.2) | (8.2) | (9.0) |
| Interest expense, net | $ 59.6 | $ 65.3 | $ 122.1 | $ 131.4 |

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## 6. GOODWILL AND OTHER INTANGIBLE ASSETS

### Goodwill

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business combination. The Company's reporting units are its operating segments.

During the second quarter of 2017, the Company completed its annual assessment for goodwill impairment across its eleven reporting units through a quantitative analysis, utilizing a discounted cash flow approach, which incorporates assumptions regarding future growth rates, terminal values, and discount rates. The two-step quantitative process involved comparing the estimated fair value of each reporting unit to the reporting unit's carrying value, including goodwill. If the fair value of a reporting unit exceeds its carrying value, goodwill of the reporting unit is considered not to be impaired, and the second step of the impairment test is unnecessary. If the carrying amount of the reporting unit exceeds its fair value, the second step of the goodwill impairment test would be performed to measure the amount of impairment loss to be recorded, if any. The Company's goodwill impairment assessment for 2017 indicated the estimated fair value of each of its reporting units exceeded its carrying amount by a significant margin.

If circumstances change significantly, the Company would also test a reporting unit's goodwill for impairment during interim periods between its annual tests. There has been no impairment of goodwill in any of the years presented.

The changes in the carrying amount of goodwill for each of the Company's reportable segments during the six months ended June 30, 2017 were as follows:

| (millions) | Global Industrial | Global Institutional | Global Energy | Other | Total |
|---|---|---|---|---|---|
| December 31, 2016 | $ 2,522.3 | $ 653.4 | $ 3,093.6 | $ 113.7 | $ 6,383.0 |
| Reclassifications (a) | 62.7 | (62.7) | - | - | - |
| December 31, 2016 revised | $ 2,585.0 | $ 590.7 | $ 3,093.6 | $ 113.7 | $ 6,383.0 |
| Current year business combinations (b) | 4.1 | 518.1 | - | - | 522.2 |
| Prior year business combinations (c) | - | - | 0.3 | - | 0.3 |
| Effect of foreign currency translation | 36.9 | 15.8 | 44.0 | 1.6 | 98.3 |
| June 30, 2017 | $ 2,626.0 | $ 1,124.6 | $ 3,137.9 | $ 115.3 | $ 7,003.8 |

(a) Relates to establishment of the Life Sciences reporting unit, and goodwill being allocated to Life Sciences based on fair value allocation of goodwill. The Life Sciences reporting unit is included in the Industrial reportable segment and is comprised of operations previously recorded in the Food & Beverage and Healthcare reporting units, which are aggregated and reported in the Global Industrial and Global Institutional reportable segments, respectively. See Note 14 for further information.

(b) Represents goodwill associated with current year acquisitions. Of the goodwill acquired, the Company expects $4.1 million of the goodwill related to businesses acquired to be tax deductible.

(c) Represents purchase price allocation adjustments for 2016 acquisitions deemed preliminary as of December 31, 2016.

Other Intangible Assets

The Nalco trade name is the Company's principal indefinite life intangible asset. During the second quarter of 2017, the Company completed its annual test for indefinite life intangible asset impairment using a relief from royalty method of assessment, which incorporates assumptions regarding future sales projections and discount rates. Based on this testing, the estimated fair value of the asset exceeded its carrying value by a significant margin; therefore, no adjustment to the $1.2 billion carrying value of this asset was necessary. There has been no impairment of the Nalco trade name intangible asset since it was acquired.

The Company's intangible assets subject to amortization primarily include customer relationships, trademarks, patents and other technology. The fair value of identifiable intangible assets is estimated based upon discounted future cash flow projections and other acceptable valuation methods. Other intangible assets are amortized on a straight-line basis over their estimated economic lives. Total amortization expense related to other intangible assets during the second quarter of 2017 and 2016 was $77.1 million and $72.7 million, respectively. Total amortization expense related to other intangible assets during the first six months of 2017 and 2016 was $150.9 million and $145.3 million, respectively. Estimated amortization for the remaining six month period of 2017 related to other amortizable intangible assets is expected to be approximately $157 million.

7. FAIR VALUE MEASUREMENTS

The Company’s financial instruments include cash and cash equivalents, restricted cash, accounts receivable, accounts payable, commercial paper, notes payable, foreign currency forward contracts, interest rate swap agreements and long-term debt.

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

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

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

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

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

| | June 30, 2017 | | | |
|---|---|---|---|---|
| (millions) | Carrying | Fair Value Measurements | | |
| | Amount | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Foreign currency forward contracts | $ 68.8 | $ - | $ 68.8 | $ - |

| | | | | |
|---|---|---|---|---|
| Liabilities | | | | |
| Foreign currency forward contracts | 83.3 | - | 83.3 | - |
| Interest rate swap agreements | 3.9 | - | 3.9 | - |

| | December 31, 2016 | | | |
|---|---|---|---|---|
| (millions) | Carrying | Fair Value Measurements | | |
| | Amount | Level 1 | Level 2 | Level 3 |
| Assets | | | | |
| Foreign currency forward contracts | $ 93.4 | $ - | $ 93.4 | $ - |
| Liabilities | | | | |
| Foreign currency forward contracts | 46.7 | - | 46.7 | - |
| Interest rate swap agreements | 3.5 | - | 3.5 | - |

The carrying value of foreign currency forward contracts is at fair value, which is determined based on foreign currency exchange rates as of the balance sheet date, and is classified within Level 2. The carrying value of interest rate swap contracts is at fair value, which is determined based on current interest rates and forward interest rates as of the balance sheet date and is classified within Level 2. For purposes of fair value disclosure above, derivative values are presented gross. See further discussion of gross versus net presentation of the Company's derivatives within Note 8.

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

The fair value of long-term debt is based on quoted market prices for the same or similar debt instruments classified as Level 2. The carrying amount and the estimated fair value of long-term debt, including current maturities, held by the Company were:

| (millions) | June 30 2017 | | December 31 2016 | |
|---|---|---|---|---|
| | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Long-term debt, including current maturities | $ 6,720.1 | $ 7,115.9 | $ 6,657.1 | $ 6,963.9 |

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## 8. DERIVATIVES AND HEDGING TRANSACTIONS

The Company uses foreign currency forward contracts, interest rate swap agreements and foreign currency debt to manage risks associated with foreign currency exchange rates, interest rates and net investments in foreign operations. The Company does not hold derivative financial instruments of a speculative nature or for trading purposes. The Company records 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. Cash flows from derivatives are classified in the statement of cash flows in the same category as the cash flows from the items subject to designated hedge or undesignated (economic) hedge relationships. The Company evaluates hedge effectiveness at inception and on an ongoing basis. If a derivative is no longer expected to be effective, hedge accounting is discontinued. Hedge ineffectiveness, if any, is recorded in earnings.

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

### Derivative Positions Summary

Certain of the Company's derivative transactions are subject to master netting arrangements that allow the Company to net settle contracts with the same counterparties. These arrangements generally do not call for collateral and as of the applicable dates presented in the following table no cash collateral had been received or pledged related to the underlying derivatives.

The respective net amounts are included in other current assets, other non-current assets, other current liabilities and other liabilities on the Consolidated Balance Sheet.

The following table summarizes the gross fair value and the net value of the Company's outstanding derivatives.

| | Asset Derivatives | | Liability Derivatives | |
|---|---|---|---|---|
| | June 30 | December 31 | June 30 | December 31 |
| (millions) | 2017 | 2016 | 2017 | 2016 |
| Derivatives designated as hedging instruments | | | | |
| Foreign currency forward contracts | $ 21.8 | $ 73.4 | $ 16.8 | $ 19.8 |
| Interest rate swap agreements | - | - | 3.9 | 3.5 |

| | | | | |
|---|---|---|---|---|
| Derivatives not designated as hedging instruments | | | | |
| Foreign currency forward contracts | 47.0 | 20.0 | 66.5 | 26.9 |
| Gross value of derivatives | 68.8 | 93.4 | 87.2 | 50.2 |
| Gross amounts offset in the Consolidated Balance Sheet | (23.3) | (25.7) | (23.3) | (25.7) |
| Net value of derivatives | $ 45.5 | $ 67.7 | $ 63.9 | $ 24.5 |

The following table summarizes the notional values of the Company's outstanding derivatives.

| | Notional Values | |
|---|---|---|
| | June 30 | December 31 |
| (millions) | 2017 | 2016 |
| Foreign currency forward contracts (a) | $ 5,288 | $ 4,317 |
| Interest rate agreements | $ 1,450 | $ 1,450 |

(a) Includes net investment hedge forward contracts of €40 million and €0 million as of June 30, 2017 and December 31, 2016, respectively.

Cash Flow Hedges

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

The Company occasionally enters into treasury lock and forward starting interest rate swap agreements to manage interest rate exposure. During 2016, 2015, and 2014 the Company entered into and subsequently closed a series of treasury lock and forward starting interest rate swap agreements, in conjunction with its public debt issuances. The agreements were designated and effective as cash flow hedges of the expected interest payments related to the anticipated future debt issuances. Amounts recorded in AOCI are recognized as part of interest expense over the remaining life of the notes as the forecasted interest transactions occur.

The effective portion of gains and losses recognized into AOCI and earnings from derivative contracts that qualified as cash flow hedges was as follows:

| | | Second Quarter Ended June 30 | | Six Months Ended June 30 | |
|---|---|---|---|---|---|
| (millions) | | 2017 | 2016 | 2017 | 2016 |
| Unrealized gain (loss) recognized into AOCI | | | | | |
| Foreign currency forward contracts | AOCI (equity) | $ (28.9) | $ (23.8) | $ (44.3) | $ (27.5) |
| Interest rate swap agreements | AOCI (equity) | - | (4.6) | - | (12.9) |
| | Total | (28.9) | (28.4) | (44.3) | (40.4) |
| Gain (loss) recognized in income | | | | | |
| Foreign currency forward contracts | Cost of sales | | | | |