

Nalco Holding CO
Form 10-Q
April 27, 2011
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 March 31, 2011

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. 001-32342

NALCO HOLDING COMPANY

(Exact name of registrant as specified in its charter)

Delaware

16-1701300

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(State or other jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification Number)

1601 West Diehl Road

Naperville, IL 60563-1198

(630) 305-1000

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

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 Regulation 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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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

As of April 13, 2011, the number of shares of the registrant's common stock, par value \$0.01 per share, outstanding was 138,725,411 shares.

Table of Contents

QUARTERLY REPORT ON FORM 10-Q

NALCO HOLDING COMPANY

Quarter Ended March 31, 2011

TABLE OF CONTENTS

Part I. Financial Information

Item 1. Financial Statements (Unaudited)

Condensed Consolidated Balance Sheets
March 31, 2011 and December 31, 2010

2

Condensed Consolidated Statements of Operations
Three months ended March 31, 2011 and 2010

3

Condensed Consolidated Statements of Cash Flows
Three months ended March 31, 2011 and 2010

4

Notes to Condensed Consolidated Financial Statements
March 31, 2011

5

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

25

Item 3. Quantitative and Qualitative Disclosures About Market Risk

35

Item 4. Controls and Procedures

35

Part II. Other Information

Item 1. Legal Proceedings

36

Item 6. Exhibits

38

Signature

39

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

Nalco Holding Company and Subsidiaries

Condensed Consolidated Balance Sheets

(dollars in millions)

	(Unaudited)	
	March 31, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	\$ 118.7	\$ 128.1
Accounts receivable, less allowances of \$11.2 in 2011 and \$13.2 in 2010	799.8	765.5
Inventories:		
Finished products	287.2	246.0
Materials and work in process	100.3	84.0
	387.5	330.0
Prepaid expenses, taxes and other current assets	194.8	211.1
Total current assets	1,500.8	1,434.7
Property, plant, and equipment, net	745.8	729.1
Intangible assets:		
Goodwill	1,824.9	1,844.1
Other intangibles, net	1,016.6	1,023.3
Other assets	179.5	192.5
Total assets	\$ 5,267.6	\$ 5,223.7
Liabilities and equity		
Current liabilities:		
Accounts payable	\$ 383.5	\$ 356.5
Short-term debt	93.3	90.0
Other current liabilities	378.7	411.7
Total current liabilities	855.5	858.2
Other liabilities:		
Long-term debt	2,660.7	2,782.0
Deferred income taxes	272.9	260.3
Accrued pension benefits	394.0	405.6
Other liabilities	194.7	190.1
Total liabilities	4,377.8	4,496.2
Equity:		
Nalco Holding Company shareholders' equity	858.3	696.8

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Noncontrolling interests	31.5	30.7
Total equity	889.8	727.5
Total liabilities and equity	\$ 5,267.6	\$ 5,223.7

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Nalco Holding Company and Subsidiaries

Condensed Consolidated Statements of Operations

(Unaudited)

(dollars in millions, except per share amounts)

	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Net sales	\$ 1,061.4	\$ 956.6
Operating costs and expenses:		
Cost of product sold	617.7	523.5
Selling, administrative, and research expenses	322.1	297.8
Amortization of intangible assets	9.7	10.7
Restructuring expenses	1.0	1.5
Gain on divestitures	(136.0)	
Total operating costs and expenses	814.5	833.5
Operating earnings	246.9	123.1
Other income (expense), net	(6.1)	(18.9)
Interest income	0.2	2.2
Interest expense	(48.3)	(58.7)
Earnings before income taxes	192.7	47.7
Income tax provision	72.3	21.6
Net earnings	120.4	26.1
Less: Net earnings attributable to noncontrolling interests	3.0	0.9
Net earnings attributable to Nalco Holding Company	\$ 117.4	\$ 25.2
Net earnings per share attributable to Nalco Holding Company common shareholders:		
Basic	\$ 0.85	\$ 0.18
Diluted	\$ 0.84	\$ 0.18
Weighted-average shares outstanding (millions):		
Basic	138.7	138.3
Diluted	139.9	139.2
Cash dividends declared per share	\$ 0.035	\$ 0.035

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Nalco Holding Company and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(dollars in millions)

	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Operating activities		
Net earnings	\$ 120.4	\$ 26.1
Adjustments to reconcile net earnings to net cash (used for) provided by operating activities:		
Depreciation	32.3	30.2
Amortization	9.7	10.7
Gain on divestitures	(136.0)	
Amortization of deferred financing costs	2.9	3.0
Loss on early extinguishment of debt	2.8	
Other, net	22.4	29.3
Changes in operating assets and liabilities	(80.8)	(97.6)
Net cash (used for) provided by operating activities	(26.3)	1.7
Investing activities		
Additions to property, plant, and equipment, net	(36.5)	(26.4)
Business purchases	(6.4)	
Net proceeds from business divestitures	198.5	
Other, net	5.6	
Net cash provided by (used for) investing activities	161.2	(26.4)
Financing activities		
Cash dividends	(4.9)	(9.7)
Changes in short-term debt, net	1.1	130.6
Proceeds from long-term debt	63.8	
Repayments of long-term debt	(202.5)	
Redemption premium on early extinguishment of debt	(3.0)	
Deferred financing costs	(1.2)	
Other, net	(3.5)	0.6
Net cash (used for) provided by financing activities	(150.2)	121.5
Effect of exchange rate changes on cash and cash equivalents	5.9	(12.8)
(Decrease) increase in cash and cash equivalents	(9.4)	84.0
Cash and cash equivalents at beginning of period	128.1	127.6
Cash and cash equivalents at end of period	\$ 118.7	\$ 211.6

See accompanying notes to condensed consolidated financial statements.

Table of Contents

Nalco Holding Company and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

March 31, 2011

1. Description of Business and Basis of Presentation

Description of Business

We provide essential expertise for water, energy and air through the worldwide manufacture and sale of highly specialized service chemical programs. This includes production and service related to the sale and application of chemicals and technology used in water treatment, pollution control, energy conservation, oil production and refining, steelmaking, papermaking, mining, and other industrial processes.

Basis of Presentation

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Annual Report for Nalco Holding Company and subsidiaries for the fiscal year ended December 31, 2010.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. Management believes these financial statements include all normal recurring adjustments considered necessary for a fair presentation of our financial position and results of operations. Operating results for the three months ended March 31, 2011 are not necessarily indicative of results that may be expected for the year ended December 31, 2011. The condensed consolidated balance sheet as of December 31, 2010 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States.

Certain minor reclassifications have been made to the prior year data to conform to the current year presentation, which had no effect on net earnings or equity reported for any period.

In addition, during the first quarter 2011, we identified certain costs that were previously classified as selling, administrative and research expenses that we believe are more appropriately classified in cost of product sold. These expenses consisted of depreciation on certain manufacturing assets, incentive compensation for production employees, and compensation for certain engineers who provide product application services to customers. These reclassifications increased cost of product sold and reduced selling administrative and research expenses approximately \$9.2 million for the quarter ended March 31, 2010. The total amount to be reclassified to cost of product sold from selling, administrative and research expenses for fiscal year 2010 is approximately \$37.0 million. There is no impact to earnings before income taxes or net earnings as a result of these adjustments.

Table of Contents

2. Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance that amends earlier guidance addressing the accounting for contractual arrangements in which an entity provides multiple products or services (deliverables or elements) to a customer. The amendments address the unit of accounting for arrangements involving multiple deliverables and how arrangement consideration should be allocated to the separate units of accounting, when applicable, by establishing a selling price hierarchy for determining the selling price of a deliverable. The selling price used for each deliverable will be based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if vendor-specific objective evidence is not available, or estimated selling price (ESP) if neither vendor-specific nor third-party evidence is available.

This guidance changes the units of accounting for certain of our service-related offerings. Specifically, on-site technical expertise that is included in bundled customer solutions will now be a separate unit of accounting since ESP must now be used to determine selling price. Generally, most products and services now qualify as separate units of accounting. Products are typically considered delivered upon shipment.

In certain arrangements, which are usually reserved for our largest customers, we provide some combination or all of the following deliverables: (1) chemicals, (2) equipment and (3) on-site technical expertise. Differences in customer equipment and processes drive substantial variation in the application of our chemicals and the individual programs we create. In these multiple element arrangements, we usually remain the owner of any equipment at the customer site. Additionally, our representatives may have a regular presence at a customer's facility, which is usually provided under a contract. The regular presence of the representative permits us to closely track the results of the program and to make modifications to the program as necessary for the highest efficiency. This on-site presence is now allocated a portion of revenue.

For fiscal 2011 and future periods, pursuant to the new guidance, when a new or materially-modified sales arrangement contains multiple elements, we allocate revenue to each deliverable based on a selling price hierarchy. VSOE of fair value is based on the price charged when the element is sold separately. TPE of selling price is established by evaluating similar competitor services in stand-alone sales. However, as our on-site technical expertise and solutions are based on specific Nalco chemicals and each solution is generally highly customized, the comparable pricing of similar services typically cannot be obtained. Additionally, as we are unable to reliably determine what competitors' selling prices for services are on a stand-alone basis, we are not typically able to determine TPE. The best estimate of selling price is established considering multiple factors including, but not limited to, pricing practices in different geographies, market conditions, gross margin objectives and internal costs.

Table of Contents

2. Recent Accounting Pronouncements (continued)

The following types of commercial arrangements are the most commonly used for the sale of multiple deliverables:

Ship and Bill. Following the receipt of a purchase order from the customer, we invoice when the products are shipped, based on agreed pricing. At the end of each period, for those shipments where title to the product and the risks of loss and rewards of ownership do not transfer until the product has been received by the customer, or the service has not been performed, adjustments to revenues and cost of product sold are made to account for the delay. We recognize the service element of the ship and bill arrangements, in which we bundle the chemicals with on-site technical expertise, ratably over the term of the contract as we provide the services.

Production-based arrangements. Our billing is based on a customer's production-based formula (e.g., dollars per ton of paper produced) within certain technical parameters. We use a combination of our service chemicals, on-site technical expertise and equipment to satisfy the customer requirement. Because the chemicals and equipment used and on-site technical expertise required are highly correlated with the customer's production, revenue for each element is recognized monthly based on the production-based formula.

Usage-based arrangements. For these arrangements, we invoice according to the consumption of chemicals by the customer. The agreed price by kilogram or pound of chemical consumed also includes the availability of on-site expertise and the use of equipment to satisfy the customer requirement. Revenue is recognized monthly based on the usage-based formula which approximates when transfer of title occurs for chemical sales and a ratable recognition of service revenue.

The implementation of this amended accounting guidance did not have a material impact on our consolidated financial position and results of operations in the period of adoption. In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on total net revenues in periods after the initial adoption.

Our arrangements generally do not include any provisions for cancellation, termination, or refunds that would significantly impact recognized revenue.

We maintain internal controls over the establishment and updates of VSOE, TPE and ESP. We currently do not expect a material impact in the near term from changes in VSOE, TPE or ESP.

In October 2009, the FASB issued authoritative guidance that amends earlier guidance for revenue arrangements that include both tangible products and software elements. Tangible products containing software components and nonsoftware components that function together to deliver the tangible product's essential functionality are no longer within the scope of guidance for recognizing revenue from the sale of software, but would be accounted for in accordance with other authoritative guidance. The adoption of the guidance in the first quarter 2011 did not have any impact on our consolidated financial statements.

Table of Contents

2. Recent Accounting Pronouncements (continued)

In December 2010, the FASB issued authoritative guidance that amends the criteria for performing Step 2 of the goodwill impairment test for reporting units with zero or negative carrying amounts and requires performing Step 2 if qualitative factors indicate that it is more likely than not that a goodwill impairment exists. Any impairment to be recorded upon adoption is to be recognized as an adjustment to beginning retained earnings. We adopted the guidance in the first quarter 2011, which did not have any impact on our consolidated financial statements.

In December 2010, the FASB issued authoritative guidance that addresses diversity in practice about the interpretation of the pro forma revenue and earnings disclosure requirements for business combinations. The guidance clarifies that when presenting comparative financial statements, an entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance also requires a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. This guidance impacts disclosure requirements only, and upon its adoption in the first quarter 2011, did not have any impact on our financial statements.

3. Acquisitions and Dispositions

In the first quarter of 2011 we acquired the business assets of two companies for the initial price of \$5.7 million. Not including any future payments of contingent consideration, the remaining purchase price of approximately \$0.9 million is expected to be paid in the next nine months. On a preliminary basis, the purchase price, including the estimated fair value of contingent consideration, exceeded the fair value of the net tangible assets acquired by approximately \$6.0 million, of which \$3.3 million was allocated to goodwill and \$2.7 million was allocated to other intangible assets. The goodwill of these acquisitions is expected to be deductible for tax purposes.

In January 2011, we completed the sale of our personal care products business to Lubrizol Corporation. Proceeds from the sale were \$157.9 million, net of selling and other expenses of \$6.3 million, and resulted in a gain of \$111.9 million before income taxes. The sale included goodwill, customer relationships, dedicated personal care products employees and other related assets. The sale did not include any supply chain-related assets. We will continue to supply certain products to Lubrizol relating to the personal care products business.

In February 2011, we completed the sale of our marine chemicals business to Norway's Wilhelmsen Ships Service. Proceeds from the sale were \$40.6 million, net of selling and other expenses of \$0.4 million, and resulted in a gain of \$24.1 million before income taxes. The sale included goodwill, customer relationships, products and dedicated marine chemicals employees. The sale did not include any supply chain-related assets.

Table of Contents

3. Acquisitions and Dispositions (continued)

The marine chemicals and personal care products businesses were not presented as discontinued operations because their operations and cash flows were not clearly distinguished from the rest of the entity. The assets sold in these two transactions, consisting mostly of goodwill and customer relationships, were not separately classified as held for sale, because the amounts were not material relative to the total balances of the respective assets at December 31, 2010. For the year ended December 31, 2010, the marine chemicals and personal care products businesses contributed approximately \$70 million and \$25 million to net sales and earnings before income taxes, respectively.

In January 2010, we acquired a 50.1% controlling financial interest in Nalco Africa, a new entity formed with Protea Chemicals, one of Africa's largest suppliers of industrial chemicals and services. Protea Chemicals is a division of the Omnia Group, a diversified and specialist chemical services company located in Johannesburg, South Africa. The new entity enables us to re-enter the water and process treatment markets of southern Africa. The business combination did not involve the transfer of consideration, but under the terms of a technical assistance and license agreement executed at the time of the combination, we have licensed to Nalco Africa rights to certain of our patents, know-how and trademarks. The fair value of the business acquired was \$20.1 million, of which \$16.0 million was allocated to goodwill, \$5.7 million was allocated to other intangible assets, and \$1.6 million was allocated to a deferred tax liability. The goodwill consists primarily of our expectation of future sales growth in this geographic market and intangible assets that do not qualify for separate recognition. The goodwill was allocated to the Water Services segment and is not expected to be deductible for tax purposes. The fair value of the business acquired was measured using internal cash flow estimates (i.e., Level 3 in the fair value hierarchy established by authoritative guidance issued by the FASB for fair value measurements).

The pro forma impact as if the aforementioned acquisitions had occurred at the beginning of the respective years is not significant.

Table of Contents**4. Goodwill**

Changes in the carrying value of goodwill for the three months ended March 31, 2011 are summarized below:

(dollars in millions)	Water Services	Paper Services	Energy Services	Total
Balance as of January 1, 2011:				
Goodwill	\$ 1,279.5	\$ 549.1	\$ 564.6	\$ 2,393.2
Accumulated impairment losses		(549.1)		(549.1)
	1,279.5		564.6	1,844.1
Acquisitions	1.5		1.8	3.3
Divestitures	(56.6)			(56.6)
Effect of foreign currency translation	25.6		8.5	34.1
Balance as of March 31, 2011:				
Goodwill	1,250.0	549.1	574.9	2,374.0
Accumulated impairment losses		(549.1)		(549.1)
	\$ 1,250.0	\$	\$ 574.9	\$ 1,824.9

5. Debt

Debt consists of the following:

(dollars in millions)	March 31, 2011	December 31, 2010
Short-term		
Checks outstanding and bank overdrafts	\$ 26.0	\$ 24.0
Notes payable to banks	56.8	55.5
Current maturities of long-term debt	10.5	10.5
	\$ 93.3	\$ 90.0
Long-term		
Securitized trade accounts receivable facility	\$ 125.0	\$ 67.8
Term loan B, due October 2017 (including discount of \$3.0 in 2011 and \$3.1 in 2010)	643.8	645.3
Term loan C, due May 2016 (including discount of \$21.5 in 2011 and \$22.5 in 2010)	274.7	274.5
Term loan C-1, due May 2016 (including discount of \$4.1 in 2011 and \$4.3 in 2010)	95.4	95.4
Senior notes, due January 2019	750.0	750.0
Senior notes (euro), due January 2019	283.6	267.4
Senior discount notes, due February 2014 (including premium of \$0.4 in 2010)		200.4
Senior notes, due May 2017 (including discount of \$8.2 in 2011 and \$8.5 in 2010)	491.8	491.5
Other	6.9	0.2
	2,671.2	2,792.5
Less: Current portion	10.5	10.5
	\$ 2,660.7	\$ 2,782.0

Table of Contents**5. Debt (continued)**

Using the proceeds from the sale of our marine chemicals business and personal care products business we repaid the remaining \$200.4 million of senior discount notes in March 2011. In connection with this transaction we incurred a \$2.8 million loss on early extinguishment of debt.

We had \$21.1 million of letters of credit outstanding at March 31, 2011 under our senior secured credit facilities.

6. Equity

Equity consists of the following:

(dollars in millions, except per share amounts)	March 31, 2011	December 31, 2010
Nalco Holding Company shareholders' equity:		
Preferred stock, par value \$0.01 per share; authorized 100,000,000 shares; none issued	\$	\$
Common stock, par value \$0.01 per share; authorized 500,000,000 shares; 148,261,354 and 147,925,072 shares issued at March 31, 2011 and December 31, 2010, respectively	1.4	1.4
Additional paid-in capital	804.8	800.7
Treasury stock, at cost; 9,535,943 shares at March 31, 2011 and December 31, 2010	(211.3)	(211.3)
Retained earnings (accumulated deficit)	66.9	(45.6)
Accumulated other comprehensive income:		
Net prior service credit	31.4	32.4
Net actuarial loss	(94.3)	(95.6)
Currency translation adjustments	259.4	214.8
Nalco Holding Company shareholders' equity	858.3	696.8
Noncontrolling interests	31.5	30.7
Total equity	\$ 889.8	\$ 727.5

In July 2007, our Board of Directors authorized a \$300 million share repurchase program and gave our management discretion in determining the conditions under which shares may be purchased from time to time. The program has no stated expiration date. As of December 31, 2010, we had repurchased 9,535,943 shares at a cost of \$211.3 million. No additional shares were repurchased during the three months ended March 31, 2011.

7. Pension and Other Postretirement Benefit Plans

We have several noncontributory, defined benefit pension plans covering most employees in the U.S. and those with certain foreign subsidiaries. We also provide a supplementary, nonqualified, unfunded plan for U.S. employees whose pension benefits exceed ERISA limitations. The components of net periodic pension cost for the three months ended March 31, 2011 and 2010 were as follows:

(dollars in millions)	U.S.		Non-U.S.	
	Three Months ended March 31, 2011	Three Months ended March 31, 2010	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Service cost	\$	\$	\$ 2.4	\$ 2.4
Interest cost	6.1	6.1	5.8	4.7
Expected return on plan assets	(5.6)	(4.8)	(4.6)	(3.6)
Prior service credit	(0.6)	(0.5)	(0.4)	(0.3)

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Net actuarial loss	3.5	1.0	0.1	0.1
Settlements			0.7	
Net periodic pension cost	\$ 3.4	\$ 1.8	\$ 4.0	\$ 3.3

Table of Contents**7. Pension and Other Postretirement Benefit Plans (continued)**

We also have defined benefit postretirement plans that provide medical and life insurance benefits for substantially all U.S. retirees and eligible dependents. The components of net periodic cost of postretirement benefits other than pensions for the three months ended March 31, 2011 and 2010 were as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Service cost	\$ 0.9	\$ 1.1
Interest cost	1.5	2.3
Prior service credit	(0.5)	(0.2)
Net actuarial gain	(1.7)	(0.4)
Net periodic cost	\$ 0.2	\$ 2.8

8. Restructuring Expenses

We continuously redesign and optimize our business and work processes, and restructure our organization accordingly. Restructuring expenses were \$1.0 million and \$1.5 million for the three months ended March 31, 2011 and 2010, respectively.

A restructuring accrual of \$8.0 million as of March 31, 2011 was included in other current liabilities on the condensed consolidated balance sheet. All restructuring-related payments in the first three months of 2011 were funded with cash from operations. We expect that future payments also will be funded with cash from operations. Activity in the restructuring accrual for the three months ended March 31, 2011 is summarized as follows:

(dollars in millions)	Severance, Termination Benefits and Other
Balance as of December 31, 2010	\$ 11.5
Charges to restructuring expense	1.0
Cash payments	(5.0)
Currency translation adjustments	0.5
Balance as of March 31, 2011	\$ 8.0

Table of Contents**9. Summary of Other Income (Expense), Net**

The components of other income (expense), net for the three months ended March 31, 2011 and 2010, include the following:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Loss on early extinguishment of debt	\$ (2.8)	\$ (0.4)
Franchise taxes	(0.4)	(0.4)
Equity in earnings (loss) of unconsolidated subsidiaries	(1.3)	0.2
Foreign currency exchange adjustments	(0.8)	(17.3)
Other	(0.8)	(1.4)
Other income (expense), net	\$ (6.1)	\$ (18.9)

Foreign currency exchange adjustments

The \$17.3 million of foreign currency exchange adjustments for three months ended March 31, 2010 was mostly attributable to our subsidiary in Venezuela.

Effective January 1, 2010, Venezuela's economy was designated as highly inflationary under U.S. generally accepted accounting principles, since it had experienced a rate of general inflation in excess of 100% over the last three-year period. Accordingly, the functional currency of our subsidiary company in Venezuela was changed to the U.S. dollar, and all gains and losses resulting from the remeasurement of its financial statements since January 1, 2010 were recorded in the statement of operations. Our Venezuelan subsidiary accounted for approximately 2% of our consolidated net sales for the year ended December 31, 2010.

On January 8, 2010, the Venezuelan government announced the devaluation of the bolivar fuerte and the establishment of a two-tier exchange structure. As a result, the official exchange rate changed from 2.15 to 2.60 for essential items and 4.30 for non-essential items. We remeasured our Venezuelan subsidiary's balance sheet accounts to reflect the devaluation by using the exchange rate for non-essential items, which resulted in a foreign exchange loss of \$23.2 million during the quarter ended March 31, 2010. Because about half of the products imported by our Venezuelan subsidiary are classified as essential, this loss was subsequently reduced by approximately \$5 million of foreign exchange gains that were recognized during the three months ended March 31, 2010, when payments were made using the exchange rate for essential products. We remeasure the financial statements of our Venezuelan subsidiary at the 4.30 exchange rate, the rate at which we expect to remit dividends.

In December 2010, the Venezuelan government announced the elimination of the two-tier exchange rate structure, effective January 1, 2011, and the official exchange rate of 4.30 was established for substantially all items. As a result, the exchange rate for essential items cannot be used for our unsettled amounts. The elimination of the two-tier rate structure did not have a significant impact on our financial position or results of operations.

We do not expect any significant ongoing impact of the currency devaluation on our results of operations.

Table of Contents**10. Income Taxes**

The income tax provision of \$72.3 million for the three months ended March 31, 2011 reflects an effective tax rate of 37.5% and differs from the U.S. federal statutory income tax rate of 35% primarily because of the tax consequences related to the gains on our divestitures. Those gains included the negative impact of nondeductible goodwill, partly offset by a favorable tax impact associated with their geographic mix.

The income tax provision of \$21.6 million for the three months ended March 31, 2010 was unfavorably impacted by the tax consequences of U.S. healthcare reform legislation enacted in the first quarter 2010. The resulting one-time write-off of previously accrued tax benefits associated with the subsidy for postretirement prescription drug benefits increased our tax provision by \$2.6 million. Also in the first quarter 2010, the Venezuelan government devalued its currency, resulting in a foreign exchange loss from remeasurement of the balance sheet accounts of our Venezuelan subsidiary. The loss produced relatively small tax benefits, which when compared to the U.S. federal statutory income tax rate resulted in a \$2.1 million increase to the income tax provision.

For both the quarters ended March 31, 2011 and March 31, 2010, the income tax provision also varied from the U.S. federal statutory income tax rate due to foreign taxes provided at other than the 35% U.S. statutory rate, U.S. state income taxes, foreign tax credits, nondeductible expenses and other permanent differences.

11. Comprehensive Income

Total comprehensive income and its components, net of related tax, for the three months ended March 31, 2011 and 2010, were as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Net earnings	\$ 120.4	\$ 26.1
Other comprehensive income (loss), net of income taxes:		
Amortization of net prior service credit	(1.0)	(0.7)
Amortization of net actuarial loss	1.3	0.2
Foreign currency translation adjustments	44.5	(23.4)
Comprehensive income	165.2	2.2
Less: Comprehensive income attributable to noncontrolling interests	2.9	0.7
Comprehensive income attributable to Nalco Holding Company	\$ 162.3	\$ 1.5

12. Segment Information

We operate three reportable segments:

Water Services This segment serves the global water treatment and process chemical needs of the industrial, institutional, and municipal markets.

Paper Services This segment serves the process chemicals and water treatment needs of the global pulp and paper industry.

Table of Contents**12. Segment Information (continued)**

Energy Services This segment serves the process chemicals and water treatment needs of the global petroleum and petrochemical industries in both upstream and downstream applications.

We evaluate the performance of our segments based on **direct contribution**, which is defined as net sales, less cost of product sold, selling and service expenses, marketing expenses and research expenses directly attributable to each segment. There are no intersegment revenues.

Net sales by reportable segment were as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Water Services	\$ 442.9	\$ 413.6
Paper Services	197.4	178.3
Energy Services	421.1	364.7
Net sales	\$ 1,061.4	\$ 956.6

The following table presents direct contribution by reportable segment and reconciles the total segment direct contribution to earnings before income taxes:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Segment direct contribution:		
Water Services	\$ 67.8	\$ 78.5
Paper Services	29.1	29.8
Energy Services	82.3	80.9
Total segment direct contribution	179.2	189.2
Expenses not allocated to segments:		
Administrative expenses	57.6	53.9
Amortization of intangible assets	9.7	10.7
Restructuring expenses	1.0	1.5
Gain on divestitures	(136.0)	
Operating earnings	246.9	123.1
Other income (expense), net	(6.1)	(18.9)
Interest income	0.2	2.2
Interest expense	(48.3)	(58.7)
Earnings before income taxes	\$ 192.7	\$ 47.7

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Administrative expenses primarily represent the cost of support functions, including information technology, finance, human resources and legal, as well as expenses for support facilities, executive management and management incentive plans.

Table of Contents**13. Earnings Per Share**

Basic earnings per share is computed by dividing net earnings attributable to Nalco Holding Company common shareholders by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock.

Basic and diluted earnings per share were calculated as follows:

(in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Numerator for basic and diluted earnings per share attributable to Nalco Holding Company common shareholders:		
Net earnings attributable to Nalco Holding Company	\$ 117.4	\$ 25.2
Denominator for basic earnings per share attributable to Nalco Holding Company common shareholders weighted average common shares outstanding	138.7	138.3
Effect of dilutive securities:		
Share-based compensation plans ¹	1.2	0.9
Denominator for diluted earnings per share attributable to Nalco Holding Company common shareholders	139.9	139.2

¹ Share-based compensation plans excludes 0.5 million and 0.8 million shares at March 31, 2011 and 2010, respectively, due to their anti-dilutive effect.

14. Contingencies and Litigation

Various claims, lawsuits and administrative proceedings are pending or threatened against us, arising from the ordinary course of business with respect to commercial, contract, intellectual property, product liability, employee, environmental and other matters. Historically, these matters have not had a material impact on our consolidated financial position. However, we cannot predict the outcome of any litigation or the potential for future litigation.

We have been notified or named as a potentially responsible party (PRP) by the Environmental Protection Agency, state enforcement agencies or private parties at seven pending waste sites where some financial contribution is or may be required. These agencies have also identified many other parties who may be responsible for clean-up costs at these waste disposal sites. Our financial contribution to remediate these sites is not expected to be material. There has been no significant financial impact on us up to the present, nor is it anticipated that there will be in the future, as a result of these matters. We have made and will continue to make provisions for these costs if our liability becomes probable and when costs can be reasonably estimated.

Our undiscounted reserves for known environmental clean-up costs were \$2.1 million at March 31, 2011. These environmental reserves represent our current estimate of our proportional clean-up costs and are based upon negotiation and agreement with enforcement agencies, our previous experience with respect to clean-up activities, a detailed review by us of known conditions, and information about other PRPs. They are not reduced by any possible recoveries from insurance companies or other PRPs not

Table of Contents

14. Contingencies and Litigation (continued)

specifically identified. Although we cannot determine whether or not a material effect on future operations is reasonably likely to occur, given the evolving nature of environmental regulations, we believe that the recorded reserve levels are appropriate estimates of the potential liability. Although settlement will require future cash outlays, it is not expected that such outlays will materially impact our liquidity position.

Expenditures for the three months ended March 31, 2011, relating to environmental compliance and clean-up activities, were not significant.

We have been named as a defendant in lawsuits based on claimed involvement in the supply of allegedly defective or hazardous materials or products and the claimed presence of hazardous substances at our plants. We have also been named as a defendant in lawsuits where our products have not caused injuries, but the claimants seek amounts so they might be monitored in the future for potential injuries arising from our products. The plaintiffs in these cases seek damages for alleged personal injury or potential injury resulting from exposure to our products or other chemicals. These matters have had a de minimis impact on our business historically, and we do not anticipate these matters will present any material risk to our business in the future. Notwithstanding, we cannot predict the outcome of any such lawsuits or the involvement we might have in these matters in the future.

In the ordinary course of our business, we are also a party to a number of lawsuits and are subject to various claims relating to patents, trademarks, employee matters, contracts, transactions, chemicals, services and other matters, the outcome of which, in our opinion, should not have a material effect on our consolidated financial position. However, we cannot predict the outcome of any litigation or the potential for future litigation. Were an unfavorable ruling to occur, there exists the possibility of a material adverse impact on the results of operations for the period in which the ruling occurs. We maintain accruals where the outcome of the matter is probable and can be reasonably estimated.

Matters Related to Deepwater Horizon Incident Response

On April 22, 2010, the deepwater drilling platform, the Deepwater Horizon, operated by a subsidiary of BP plc, sank in the Gulf of Mexico after a catastrophic explosion and fire that began on April 20, 2010. A massive oil spill resulted. Approximately one week following the incident, subsidiaries of BP plc, under the authorization of the responding federal agencies, formally requested Nalco Company, an indirect subsidiary of Nalco Holding Company, to supply large quantities of COREXIT® 9500, a Nalco oil dispersant product listed on the U.S. EPA National Contingency Plan Product Schedule. Nalco Company responded immediately by providing available COREXIT and increasing production to supply the product to BP's subsidiaries for use, as authorized and directed by agencies of the federal government throughout the incident. Prior to the incident, Nalco Holding Company and its subsidiaries had not provided products or services or otherwise had any involvement with the Deepwater Horizon platform. On July 15, 2010, BP announced that it had capped the leaking well, and the application of dispersants by the responding parties ceased shortly thereafter.

Table of Contents**14. Contingencies and Litigation (continued)**

On May 1, 2010, the President appointed retired U.S. Coast Guard Commandant Admiral Thad Allen to serve as the National Incident Commander in charge of the coordination of the response to the incident at the national level. The EPA directed numerous tests of all the dispersants on the National Contingency Plan Product Schedule, including those provided by Nalco Company, to ensure decisions about ongoing dispersant use in the Gulf of Mexico are grounded in the best available science. We cooperated with this testing process and continued to supply COREXIT 9500, as requested by BP and government authorities. After review and testing of a number of dispersants, on June 30, 2010, and on August 2, 2010, the EPA released toxicity data for eight oil dispersants.

The use of dispersants by the responding parties has been one tool used by the government and BP to avoid and reduce damage to the Gulf area from the spill. Since the spill occurred, the EPA and other federal agencies have closely monitored conditions in areas where dispersant has been applied. We have encouraged ongoing monitoring and review of COREXIT and other dispersants and have cooperated fully with the governmental review and approval process. However, in connection with its provision of COREXIT, Nalco Company has been named in several lawsuits as described below.

Putative Class Action Litigation

In June, July and August 2010, Nalco Company was named, along with other unaffiliated defendants, in six putative class action complaints filed in either the United States District Court for the Eastern District of Louisiana (Parker, et al. v. Nalco Company, et al., Civil Action No. 2:10-cv-01749-CJB-SS; Harris, et al. v. BP, plc, et al., Civil Action No. 2:10-cv-02078-CJB-SS), the United States District Court for the Southern District of Alabama, Southern Division (Lavigne, et al. v. BP PLC, et al., Civil Action No. 1:10-cv-00222-KD-C; Wright, et al. v. BP, plc, et al., Civil Action No. 1:10-cv-00397-B) or the United States District Court for the Northern District of Florida, Pensacola Division (Walsh, et al. v. BP, PLC, et al., Civil Action No. 3:10-cv-00143-RV-MD; Petitjean, et al. v. BP, plc, et al., Civil Action No. 3:10-cv-00316-RS-EMT) on behalf of various potential classes of persons who live and work in or derive income from the Coastal Zone. In April 2011, Nalco was named in an additional class action: *Irelan v. BP Products, Inc., et al.*, (E.D.La.). The *Parker*, *Lavigne* and *Walsh* cases have since been voluntarily dismissed. Each of the remaining actions contains substantially similar allegations, generally alleging, among other things, negligence relating to the use of our COREXIT dispersant in connection with the Deepwater Horizon oil spill. The plaintiffs in each of these putative class action lawsuits are generally seeking awards of unspecified compensatory and punitive damages, and attorneys' fees and costs.

Other Related Claims

In July, August, September, October and December 2010, Nalco Company was also named, along with other unaffiliated defendants, in eight complaints filed by individuals in either the United States District Court for the Eastern District of Louisiana (*Ezell v. BP, plc, et al.*, Civil Action No. 2:10-cv-01920-KDE-JCW), the United States District Court for the Southern District of Alabama, Southern Division (*Monroe v. BP, plc, et al.*, Civil Action No. 1:10-cv-00472-M; *Hill v. BP, plc, et al.*, Civil Action No. 1:10-cv-00471-CG-N; *Hudley v. BP, plc, et al.*, Case No 10-cv-00532-N), the United States District Court for the Northern District of Florida, Tallahassee Division (*Capt Ander, Inc. v. BP, plc, et al.*,

Table of Contents**14. Contingencies and Litigation (continued)**

Civil Action No. 4:10-cv-00364-RH-WCS), the United States District Court for the Southern District of Mississippi, Southern Division (*Trehern v. BP, plc, et al.*, Civil Action No. 1:10-cv-00432-HSO-JMR) or the United States District Court for the Southern District of Texas (*Chatman v. BP Exploration & Production*, Case No. 10-cv-04329; *Brooks v. Tidewater Marine LLC, et al.*, Case No. 11-cv-00049). In April 2011, Nalco was also named in *Best v British Petroleum plc, et al.*, (MDL No. 2179), *Black v. BP Exploration & Production, Inc., et al.* Civ. No. 2:11-cv-867, (E.D.La.); *Pearson v. BP Exploration & Production, Inc.*, Civ. No. 2:11-cv-863, (E.D.La.); and *Coco v. BP Products North America, Inc.*, (E.D.La.). The complaints generally allege, among other things, negligence and injury resulting from the use of our COREXIT dispersant in connection with the Deepwater Horizon oil spill. The complaints seeks unspecified compensatory and punitive damages, and attorneys fees and costs. The *Chatman* case was voluntarily dismissed. Nalco, the incident defendants and the other responder defendants have also been named as a third party defendant by Transocean Deepwater Drilling, Inc. and its affiliates (*In re the Complaint and Petition of Triton Asset Leasing GmbH, et al*, MDL No. 2179, Civil Action 10-2771) and more recently as a third party defendant by Cameron International Corporation and Halliburton Energy Services, Inc. in the multi-district litigation (the MDL).

All of the cases pending against Nalco Company have been (or are expected to be) administratively transferred for pre-trial purposes to a judge in the United States District Court for the Eastern District of Louisiana with other related cases under *In Re: Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, on April 20, 2010*, Case No. 10-md-02179 (E.D. La.). Pursuant to orders issued by Judge Barbier in the MDL, the claims have been consolidated in several master complaints, including one naming Nalco and others who responded to the Gulf Oil Spill (known as the B3 Bundle). Plaintiffs are required by Judge Barbier to prepare a list designating previously-filed lawsuits that assert claims within the B3 Bundle regardless of whether the lawsuit named each defendant named in the B3 Bundle master complaint. We have received a draft list from the plaintiffs steering committee. The draft list identifies fifteen cases in the B3 Bundle, some of which are putative class actions. Six cases previously filed against Nalco are not included in the B3 Bundle.

We believe the claims are without merit and intend to defend these lawsuits vigorously. We also believe that we have rights to contribution and/or indemnification (including legal expenses) from third parties. However, we cannot predict the outcome of these lawsuits, the involvement we might have in these matters in the future or the potential for future litigation.

15. Financial Instruments

We use derivative instruments to manage our foreign exchange exposures, and we have also used derivative instruments to manage our energy cost exposures. All derivative instruments are recognized in the consolidated balance sheets at fair value. Changes in the fair value of derivatives that are not hedges are recognized in earnings as they occur. If the derivative instruments are designated as hedges, depending on their nature, the effective portions of changes in their fair values are either offset in earnings against the changes in the fair values of the items being hedged, or reflected initially in accumulated other comprehensive income (AOCI) and subsequently recognized in earnings when the hedged items are recognized in earnings. The ineffective portions of changes in the fair values of derivative instruments designated as hedges are immediately recognized in earnings.

Table of Contents**15. Financial Instruments (continued)**

Counterparties to derivative financial instruments expose us to credit-related losses in the event of nonperformance, but we do not expect any counterparties to fail to meet their obligations given their high credit ratings. We also mitigate our risk of material losses by diversifying our selection of counterparties.

Net Investment Hedges

We use euro-denominated borrowings of Nalco Company, as a hedge of our net investment in subsidiary companies whose assets, liabilities, and operations are measured using the euro as their functional currency. Because of the high degree of effectiveness between the hedging instruments and the exposure being hedged, fluctuations in the value of the euro-denominated debt due to exchange rate changes are offset by changes in the net investment. Accordingly, changes in the value of the euro-denominated debt are recognized in foreign currency translation adjustments, a component of AOCI, to offset changes in the value of our net investment in subsidiary companies whose financial statements are measured using the euro as their functional currency.

The carrying value of euro-denominated debt designated as a net investment hedge was \$283.6 million and \$267.4 million at March 31, 2011 and December 31, 2010, respectively. Gains (losses) from the net investment hedge reported as a component of other comprehensive income in the foreign currency translation adjustment account were as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Gain (loss) before tax	\$ (16.2)	\$ 17.7
Income tax (benefit)	(6.1)	6.7
Net gain (loss)	\$ (10.1)	\$ 11.0

We formally assess, on a quarterly basis, whether the euro-denominated debt is effective at offsetting changes in the value of the underlying exposure. No hedge ineffectiveness was recorded in earnings during the three months ended March 31, 2011 and 2010.

Cash Flow Hedges

We have used derivative instruments such as foreign exchange forward contracts to hedge the variability of the cash flows from certain forecasted royalty payments due to changes in foreign exchange rates, and we have used commodity forward contracts to manage our exposure to fluctuations in the cost of natural gas used in our business. These instruments are designated as cash flow hedges, with changes in their fair values included in AOCI to the extent the hedges are effective. Amounts included in AOCI are reclassified into earnings in the same period during which the hedged transaction is recognized in earnings. Changes in fair value representing hedge ineffectiveness are recognized in current earnings. No derivative instruments were designated as a cash flow hedge at March 31, 2011 and December 31, 2010, and no cash flow hedges were discontinued during the three months ended March 31, 2011 and March 31, 2010.

Table of Contents**15. Financial Instruments (continued)***Fair Value Hedges*

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, are recognized in current earnings. No derivative instruments were designated as a fair value hedge at March 31, 2011 and December 31, 2010.

Derivatives Not Designated as Hedging Instruments

We use foreign currency contracts to offset the impact of exchange rate changes on recognized assets and liabilities denominated in non-functional currencies, including intercompany receivables and payables. The gains or losses on these contracts, as well as the offsetting losses or gains resulting from the impact of changes in exchange rates on recognized assets and liabilities denominated in non-functional currencies, are recognized in current earnings.

Derivative instruments are not held or issued for trading or speculative purposes.

The notional amounts of derivative instruments outstanding as of March 31, 2011 and December 31, 2010 were as follows:

(dollars in millions)	March 31, 2011	December 31, 2010
Derivatives designated as hedges:		
None	\$	\$
Total derivatives designated as hedges		
Derivatives not designated as hedges:		
Foreign exchange contracts	158.2	87.9
Total derivatives	\$ 158.2	\$ 87.9

The fair value and balance sheet presentation of derivative instruments as of March 31, 2011 and December 31, 2010 were as follows:

(dollars in millions)	Balance Sheet Location			
	March 31, 2011	December 31, 2010	March 31, 2011	December 31, 2010
Asset derivatives:				
Derivatives not designated as hedges:				
Foreign exchange contracts	Prepaid expenses, taxes and other current assets	\$ 0.6	\$ 1.1	\$ 0.6
		\$ 0.6	\$ 1.1	
Liability derivatives:				
Derivatives not designated as hedges:				
Foreign exchange contracts	Other current liabilities	\$ 0.2	\$ 0.3	\$ 0.2
		\$ 0.2	\$ 0.3	

Table of Contents**15. Financial Instruments (continued)**

For the three months ended March 31, 2011 and 2010, we had no derivative instruments that qualified as cash flow hedges, so there was no impact on AOCI and earnings from such instruments.

For the three months ended March 31, 2011 and 2010, the impact on earnings from derivative instruments that were not designated as hedges was as follows:

(dollars in millions)	Location	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Gain recognized in earnings:			
Foreign exchange contracts	Other income (expense), net	\$ 0.2	\$ 1.3

16. Fair Value Measurements

Authoritative guidance issued by the FASB defines fair value as the price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. The guidance establishes a fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels:

- Level 1 Quoted prices in active markets that are accessible at the measurement date for identical assets and liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.
- Level 2 Observable inputs other than quoted prices in active markets.
- Level 3 Unobservable inputs for which there is little or no market data available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

Table of Contents

16. Fair Value Measurements (continued)

The fair value of financial assets and liabilities measured at fair value on a recurring basis was as follows:

(dollars in millions)	Balance March 31, 2011	Level 1	Level 2	Level 3
Assets:				
Foreign exchange forward contracts	\$ 0.6	\$	\$ 0.6	\$
Money market funds held in rabbi trusts	0.5	0.5		
	\$ 1.1	\$ 0.5	\$ 0.6	\$
Liabilities:				
Foreign exchange forward contracts	\$ 0.2	\$	\$ 0.2	\$
Contingent consideration	21.3			21.3
	\$ 21.5	\$	\$ 0.2	\$ 21.3

(dollars in millions)	Balance December 31, 2010	Level 1	Level 2	Level 3
Assets:				
Foreign exchange forward contracts	\$ 1.1	\$	\$ 1.1	\$
Money market funds held in rabbi trusts	12.5	12.5		
	\$ 13.6	\$ 12.5	\$ 1.1	\$
Liabilities:				
Foreign exchange forward contracts	\$ 0.3	\$	\$ 0.3	\$
Contingent consideration	20.1			20.1
	\$ 20.4	\$	\$ 0.3	\$ 20.1

Foreign exchange forward contracts are valued using quoted forward foreign exchange prices at the reporting date. Money market funds held in rabbi trusts are valued using quoted prices in active markets. Contingent consideration obligations are measured based on the probability-weighted present value of the consideration expected to be transferred.

Changes in the fair value of contingent consideration obligations for the three months ended March 31, 2011 were as follows:

(dollars in millions)	Three Months ended March 31, 2011

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Balance as of January 1, 2011	\$	20.1
Liabilities recognized at acquisition date		1.1
Losses recognized in earnings		0.1
Balance as of March 31, 2011	\$	21.3

The carrying values of cash and cash equivalents, trade accounts receivable, accounts payable and short-term debt approximate their fair values at March 31, 2011 and December 31, 2010, because of the short-term maturities and nature of these balances.

Table of Contents

16. Fair Value Measurements (continued)

The estimated fair value of long-term debt at March 31, 2011 and December 31, 2010 was \$2,749.2 million and \$2,864.9 million, respectively, and the related carrying value was \$2,660.7 million and \$2,782.0 million, respectively. The fair value of our fixed-rate borrowings was estimated based on their quoted market prices. The carrying value of amounts outstanding under our senior secured credit facilities is considered to approximate fair value because interest accrues at rates that fluctuate with interest rate trends. The carrying value of other long-term debt outstanding also approximates fair value due to the variable nature of their interest rates.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

Key financial highlights for the first quarter 2011 include:

A 9.4% organic improvement in sales contributed to an 11.0% increase in reported first quarter 2011 revenues from the year-ago period to \$1,061.4 million. We define organic changes as reported changes less the impacts of foreign currency translation rate changes and acquisitions and divestitures. Favorable changes in currency translation rates increased sales 2.0%, while recent dispositions, net of acquisitions, accounted for a 0.4% decrease in sales.

We continued to see increasing raw material costs which contributed to the first quarter 2011 gross profit margin decreasing to 41.8% from 45.3% for the year-ago period.

Net earnings attributable to Nalco Holding Company were \$117.4 million for the first quarter of 2011, an increase of \$92.2 million from the year-ago period. Excluding the after-tax gain on the divestitures of our marine chemicals and personal care products businesses, net earnings attributable to Nalco Holding Company were \$33.9 million for the three months ended March 31, 2011.

First quarter 2011 diluted net earnings per share attributable to Nalco Holding Company common shareholders was 84 cents, or 66 cents higher than the 18 cents reported in the first quarter of 2010. Adjusted Earnings Per Share, which excludes the after-tax impacts of restructuring expenses and other specified transactions that are unusual in nature, was 26 cents for the first quarter 2011, compared to 31 cents in the year-ago quarter. Adjusted Earnings Per Share is reconciled to the diluted earnings per share as follows:

	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Adjusted Earnings Per Share	\$ 0.26	\$ 0.31
Restructuring expenses, net of tax	(0.01)	(0.01)
Loss on early extinguishment of debt and other refinancing expenses, net of tax	(0.01)	
Gain on divestitures, net of tax	0.60	
Foreign exchange loss from devaluation of Venezuelan bolivar fuerte, net of tax		(0.10)
Deferred tax adjustment for reduced tax deductibility of postretirement prescription drug benefits		(0.02)
Diluted earnings per share, as reported	\$ 0.84	\$ 0.18

The effective income tax rate was 37.5% for the first quarter of 2011 compared to 45.3% for the year-ago quarter.

Table of Contents

The rate for the first quarter of 2011 was higher than the U.S. federal statutory income tax rate of 35% primarily because of the tax consequences related to the gains on our divestitures. Those gains included the negative impact of nondeductible goodwill, partly offset by a favorable tax impact associated with their geographic mix.

Limited deductibility of the foreign exchange loss caused by the devaluation of the bolivar fuerte in January 2010 and a tax adjustment necessitated by U.S. healthcare reform legislation passed in March 2010 accounted for most of the variation between the effective tax rate for the first quarter of 2010 and the U.S. federal statutory income tax rate.

EBITDA was \$279.8 million for the first quarter of 2011, a 94.0% increase from year-ago EBITDA of \$144.2 million. Adjusted EBITDA, which adjusts EBITDA for restructuring expenses and certain other unusual items, decreased 10.1% to \$147.6 million in the first quarter 2011 from \$164.1 million in the year-ago quarter. Net earnings attributable to Nalco Holding Company is reconciled to EBITDA and Adjusted EBITDA as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Net earnings attributable to Nalco Holding Company	\$ 117.4	\$ 25.2
Income tax provision	72.3	21.6
Interest expense, net of interest income	48.1	56.5
Depreciation	32.3	30.2
Amortization	9.7	10.7
EBITDA	279.8	144.2
Restructuring expenses	1.0	1.5
Loss on early extinguishment of debt	2.8	
Gain on divestitures	(136.0)	
Foreign exchange loss from devaluation of Venezuelan bolivar fuerte		18.4
Adjusted EBITDA	\$ 147.6	\$ 164.1

Free Cash Flow, defined as cash from operating activities less capital expenditures and net earnings attributable to noncontrolling interests, was negative \$65.8 million in the first quarter of 2011, an unfavorable change of \$40.2 million from Free Cash Flow of negative \$25.6 million in the year-ago period. The change resulted mostly from uses of cash for capital investment and decreased cash from net earnings after adjusting for the gain on dispositions. Net cash (used for) provided by operating activities is reconciled to Free Cash Flow as follows:

(dollars in millions)	Three Months ended March 31, 2011	Three Months ended March 31, 2010
Net cash (used for) provided by operating activities	\$ (26.3)	\$ 1.7
Net earnings attributable to noncontrolling interests	(3.0)	(0.9)
Additions to property, plant, and equipment, net	(36.5)	(26.4)
Free cash flow	\$ (65.8)	\$ (25.6)

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)****Outlook**

Adjusted EBITDA is expected to be roughly \$735 million for the year, with an Adjusted Earnings Per Share of roughly \$1.65. Productivity targets remain at \$100 million and Free Cash Flow is still expected to be roughly \$85 million. Free Cash Flow for 2011 will be affected by (1) the payment of an estimated \$50 million of taxes on the divestiture gains, (2) an estimated \$5 million to \$10 million reduction in cash flow, representing EBITDA of the divested businesses, partly offset by interest savings on the senior discount notes redeemed using proceeds from the divestitures, and (3) higher cash flow requirements of \$30 million to \$35 million for profit sharing and rent for our Naperville facility. While rent expense for our Naperville facility in 2011 will remain constant at \$10.6 million, rent payments will be \$18.0 million higher in 2011 than they were in 2010 and \$22.4 million higher than they will be in 2012 and beyond. Capital expenditures are projected to increase to approximately \$200 million as we expand manufacturing capabilities, primarily in BRIC+ countries, and as we invest in customer automation and other high-value specialty equipment. The effective tax rate for 2011 is still expected to approximate 35%.

Results of Operations Consolidated**Quarter Ended March 31, 2011 Compared to the Quarter Ended March 31, 2010**

Net sales for the three months ended March 31, 2011 were \$1,061.4 million, an 11.0% increase from the \$956.6 million reported for the quarter ended March 31, 2010. On an organic basis, which excludes the impacts of changes in foreign currency translation rates and acquisitions and divestitures, net sales rose 9.4%. Geographically, North America and Latin America showed the strongest improvement, with organic increases of 12.6% and 12.1%, respectively. Asia/Pacific reported 6.8% organic growth, while the Europe, Africa and Middle East region posted a 4.2% organic sales increase.

Gross profit, defined as the difference between net sales and cost of product sold, of \$443.7 million for the quarter ended March 31, 2011 increased by \$10.6 million, or 2.4%, from the \$433.1 million for the year-ago period. On an organic basis, gross profit was up 1.8%, as the result of higher sales volume and process efficiencies. However, due to escalating raw material costs, gross margin deteriorated by 3.5 percentage-points to 41.8% for the quarter ended March 31, 2011 compared to 45.3% for the year-ago quarter.

Selling, administrative, and research expenses for the three months ended March 31, 2011 of \$322.1 million increased \$24.3 million, or 8.2%, from \$297.8 million for the year-ago period. On an organic basis, selling, administrative, and research expenses increased 6.0%, reflecting increased investment in headcount to support growth, partly offset by productivity improvements. Changes in currency translation rates accounted for an additional 1.9% increase from the first quarter of 2010.

Amortization of intangible assets was \$9.7 million and \$10.7 million for the three months ended March 31, 2011 and 2010, respectively. The decrease was attributable to lower amortization of customer relationships, which are amortized using an accelerated method.

Restructuring expenses, representing mostly employee severance and related costs associated with the continuing redesign and optimization of business and work processes, were \$1.0 million and \$1.5 million for the three months ended March 31, 2011 and March 31, 2010, respectively.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

Other income (expense), net changed favorably by \$12.8 million for the three months ended March 31, 2011 compared to the year-ago period. The change was primarily caused by a favorable change in foreign currency transaction gains and losses of \$16.5 million, which was mostly attributable to losses reported in the first quarter of 2010 resulting from the devaluation of the Venezuelan bolivar fuerte. See Note 9 to the condensed consolidated financial statements in Part I, Item 1, for further explanation. Partially offsetting this favorable variance were debt extinguishment costs of \$2.8 million during the first quarter 2011.

Net interest expense, defined as the combination of interest income and interest expense, of \$48.1 million for the three months ended March 31, 2011 decreased by \$8.4 million from the \$56.5 million reported for the three months ended March 31, 2010. Lower average debt levels compared to 2010, combined with lower-rate debt, drove a \$10.4 million decrease in interest expense from the prior-year period. Interest income decreased \$2.0 million compared to the first quarter 2010, reflecting lower cash balances.

The income tax provision of \$72.3 million for the three months ended March 31, 2011 reflects an effective tax rate of 37.5%. The income tax provision for this period differs from the U.S. federal statutory income tax rate of 35% primarily because of the tax consequences related to the gains on our divestitures. Those gains included the negative impact of nondeductible goodwill, partly offset by a favorable tax impact associated with their geographic mix.

The income tax provision of \$21.6 million for the three months ended March 31, 2010 was unfavorably impacted by the tax consequences of U.S. healthcare reform legislation enacted in the first quarter 2010. The resulting one-time write-off of previously accrued tax benefits associated with the subsidy for postretirement prescription drug benefits increased our tax provision by \$2.6 million. Also in the first quarter 2010, the Venezuelan government devalued its currency, resulting in a foreign exchange loss from remeasurement of the balance sheet accounts of our Venezuelan subsidiary. The loss produced relatively small tax benefits, which when compared to the U.S. federal statutory income tax rate resulted in a \$2.1 million increase to the income tax provision.

For both the quarters ended March 31, 2011 and March 31, 2010, the income tax provision also varied from the U.S. federal statutory income tax rate due to foreign taxes provided at other than the 35% U.S. statutory rate, U.S. state income taxes, foreign tax credits, nondeductible expenses and other permanent differences.

Based upon the status of examinations in multiple tax jurisdictions and expanded audit and controversy in multiple non-U.S. jurisdictions, it is reasonably possible that the total amount of unrecognized tax benefits could increase during the next 12 months within a range of \$7 million to \$20 million.

As of December 31, 2010, we had \$86.5 million of net deferred tax assets offset by valuation allowances. Substantially all of these related to multiple foreign tax jurisdictions. After evaluating our prior 36-month cumulative earnings history together with other positive and negative evidence, we could not determine as of March 31, 2011 that it is more likely than not some or all of these net deferred tax assets will be realized.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

We will continue to monitor our prior 36-month earnings history together with all other available evidence, both positive and negative, in determining whether it is more likely than not we will realize our net deferred tax assets. Based on current expectations, it is at least reasonably possible we may have enough positive evidence to release a portion, approximately \$24 million to \$34 million, of our valuation allowance against certain foreign deferred tax assets during 2011, perhaps as early as the second quarter.

Net earnings attributable to noncontrolling interests of \$3.0 million for the three months ended March 31, 2011 was \$2.1 million more than the \$0.9 million reported in the year-ago period.

Results of Operations – Segment Reporting*Quarter Ended March 31, 2011 Compared to the Quarter Ended March 31, 2010*

Net sales by reportable segment for the three months ended March 31, 2011 and March 31, 2010 may be compared as follows:

(dollars in millions)	Three Months Ended		Attributable to Changes in the Following Factors			
	March 31, 2011	March 31, 2010	% Change	Translation	Acquisitions/ Divestitures	Organic
Water Services	\$ 442.9	\$ 413.6	7.1%	2.3%	(2.0)%	6.8%
Paper Services	197.4	178.3	10.7%	2.1%		8.6%
Energy Services	421.1	364.7	15.5%	1.8%	1.0%	12.7%
Net sales	\$ 1,061.4	\$ 956.6	11.0%	2.0%	(0.4)%	9.4%

Water Services reported sales of \$442.9 million for the quarter ended March 31, 2011, a 7.1% increase from the \$413.6 million for the first quarter 2010. Organic sales growth was 6.8%, as the mining, chemicals, power and primary metals businesses reported solid increases. North America and Latin America contributed significantly to the organic sales improvement, with increases of 10.5% and 6.1%, respectively. Asia/Pacific grew 8.7% organically, and the Europe, Africa and Middle East region reported an organic sales increase of 1.5%. The net sales decrease resulting from acquisitions/divestitures was primarily due to the first quarter 2011 divestitures of businesses partially offset by sales attributable to acquisitions made in 2010.

Paper Services reported sales of \$197.4 million for the three months ended March 31, 2011, a 10.7% improvement from the \$178.3 million reported for the year-ago period. Organic sales grew 8.6%, with increases in each region. Latin America and Asia/Pacific reported significant increases of 28.5% and 12.6%, respectively. Organic sales grew 6.0% and 4.3% in North America and the Europe, Africa and Middle East regions, respectively.

Table of Contents**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)**

Energy Services reported sales of \$421.1 million for the three months ended March 31, 2011, a 15.5% increase from the \$364.7 million for the quarter ended March 31, 2010. Organic sales grew a significant 12.7%, driven by strong increases in the North America and Latin America upstream oil field chemicals business. Overall, organic sales increased 17.3% and 13.3% in North America and Latin America, respectively, while the Europe, Africa and Middle East region grew 8.9% and Asia/Pacific was flat compared to the year-ago period.

Direct contribution by reportable segment for the three months ended March 31, 2011 and March 31, 2010 may be compared as follows:

(dollars in millions)	Three Months Ended		Attributable to Changes in the Following Factors			
	March 31, 2011	March 31, 2010	% Change	Currency Translation	Acquisitions/Divestitures	Organic
Water Services	\$ 67.8	\$ 78.5	(13.7)%	1.8%	(6.8)%	(8.7)%
Paper Services	29.1	29.8	(2.4)%	2.1%		(4.5)%
Energy Services	82.3	80.9	1.8%	1.3%	(0.3)%	0.8%

Direct contribution of Water Services was \$67.8 million for the three months ended March 31, 2011, a 13.7% decrease from the \$78.5 million reported for the first quarter 2010. Organically, direct contribution declined 8.7%, and first quarter 2011 direct contribution as a percent of sales decreased to 15.3% from the year-ago 19.0%, driven by increasing raw material costs and increased investment in headcount to support growth that offset organic sales growth.

Paper Services reported direct contribution of \$29.1 million for the three months ended March 31, 2011, a 2.4% decrease from the direct contribution of \$29.8 million reported for the three months ended March 31, 2010. Organically, direct contribution decreased 4.5%, driven by increasing raw material costs that more than offset organic increases in sales. As a percent of sales, first quarter 2011 direct contribution decreased to 14.7% from the 16.7% reported for the year-ago period.

Energy Services reported direct contribution of \$82.3 million for the three months ended March 31, 2011, compared to \$80.9 million for the year-ago period, an increase of 1.8%. Organically, direct contribution increased 0.8%. Despite a significant organic sales increase, escalating raw material costs and increased investment in headcount to support growth almost completely offset the impact of higher sales.

Liquidity and Capital Resources

Operating activities. Historically, our main source of liquidity has been our cash flow generated by operating activities. For the three months ended March 31, 2011, cash used for operating activities was \$26.3 million, a decrease of \$28.0 million from the \$1.7 million cash provided by operating activities for the same period last year. The change was primarily the result of a decrease in cash from net earnings after adjusting for the gain on divestitures.

Table of Contents

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

Investing activities. Cash provided by investing activities was \$161.2 million for the three months ended March 31, 2011, which was mostly the result of \$198.5 million in net proceeds from the divestitures of our marine chemicals business and personal care products business and other investing activities of \$5.6 million. These sources of cash were partly offset by net property additions of \$36.5 million and business acquisitions of \$6.4 million.

Cash used for investing activities was \$26.4 million for the three months ended March 31, 2010, which was attributable to net property additions.

Financing activities. Net cash used for financing activities totaled \$150.2 million during the three months ended March 31, 2011. Net borrowings decreased \$137.6 million which was driven primarily by the redemption of \$200.0 million aggregate principal amount at maturity 2014 senior discount notes due 2014, using proceeds from the business divestitures. Partially offsetting this use of cash was a \$57.2 million increase in borrowings against our receivables securitization facility. Other uses of cash during the period included cash dividends of \$4.9 million, the payment of accrued deferred financing costs of \$1.2 million and a \$3.0 million premium to redeem our 2014 senior discount notes.

A net increase in borrowings of \$130.6 million, resulting from utilization of our receivables securitization facility, partly offset by cash dividends of \$9.7 million, accounted for most of the \$121.5 million of net cash provided by financing activities for the three months ended March 31, 2010.

Our liquidity requirements are significant, primarily due to debt service requirements as well as research and development and capital investment. Our primary source of liquidity will continue to be cash flow generated from operations, but we also have availability under a \$250 million revolving credit facility that expires in May 2014 and a \$150 million receivables facility that expires in June 2013, in each case subject to certain conditions. Under the terms of our senior secured credit facilities, we also have additional term loan borrowing capacity of roughly \$415 million as of March 31, 2011. We believe that our financial position and financing structure will provide flexibility in worldwide financing activities and permit us to respond to changing conditions in credit markets.

Senior secured credit facilities. At March 31, 2011, we had no borrowings under our revolving credit facility. We had \$228.9 million of borrowing capacity available, which reflects reduced availability as a result of \$21.1 million in outstanding letters of credit.

Our senior secured credit facilities, as amended, allow for additional term loan borrowings that would not cause the secured leverage ratio of Nalco Holdings LLC (an indirect subsidiary company of Nalco Holding Company) and its subsidiaries on a consolidated basis to exceed 2.00 to 1.00. This represented roughly \$415 million of additional term loan borrowing capacity as of March 31, 2011.

Table of Contents

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

At March 31, 2011, the outstanding balance of our term loan B facility was \$643.8 million, net of an unamortized discount of \$3.0 million, the balance of our term loan C facility was \$274.7 million, net of an unamortized discount of \$21.5 million and the outstanding balance of our term loan C-1 facility was \$95.4 million, net of an unamortized discount of \$4.1 million.

Senior notes. In December 2010, Nalco Company, an indirect subsidiary of Nalco Holding Company, issued \$750 million aggregate principal amount of 6.625% senior unsecured notes (Dollar Notes) and 200 million aggregate principal amount of 6.875% senior unsecured notes (Euro Notes), and, together with the dollar notes, the 2010 Notes) that are both due in January 2019. The outstanding balance of the Dollar Notes and Euro Notes was \$750.0 million and \$283.6 million, respectively, at March 31, 2011.

Senior subordinated notes. In 2009, Nalco Company issued \$500.0 million aggregate principal amount of 8.25% senior unsecured notes (the 2009 Notes) at a discount of \$10.7 million. The outstanding balance of the 2009 Notes was \$491.8 million, net of an unamortized discount of \$8.2 million, at March 31, 2011.

Senior discount notes. In 2004, Nalco Finance Holdings LLC, a direct subsidiary of Nalco Holding Company, and Nalco Finance Holdings Inc. (together, the Issuers), issued \$694.0 million aggregate principal amount at maturity of 9.00% senior discount notes due in 2014. After a series of redemptions, the aggregate principal amount at maturity was \$200.0 million at December 31, 2010. In March 2011 the entire remaining outstanding balance of the senior discount notes was redeemed.

Covenants. The senior secured credit facilities, the 2009 Notes and the 2010 Notes contain a number of financial and non-financial covenants. We were in compliance with all such covenants at March 31, 2011.

Local lines of credit. Certain of our non-U.S. subsidiaries have lines of credit to support local requirements. As of March 31, 2011, the aggregate outstanding balance under these local lines of credit was approximately \$76.3 million.

Receivables facility. Nalco Company entered into a three-year receivables facility in June 2010 that provides up to \$150 million in funding from a commercial paper conduit. This facility is treated as a general financing agreement resulting in the borrowings and related receivables being shown as liabilities and assets, respectively, on our consolidated balance sheet and the costs associated with the receivables facility being recorded as interest expense.

Of the \$150.0 million available for borrowing based on the amount of receivables eligible for financing as of February 28, 2011, we had \$125.0 million of outstanding borrowings as of March 31, 2011.

Table of Contents

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

Recent Accounting Pronouncements

See Note 2 to the condensed consolidated financial statements, included in Part I, Item 1, for information on recent accounting pronouncements

Safe Harbor Statement Under Private Securities Litigation Reform Act of 1995

This Quarterly Report for the fiscal quarter ended March 31, 2011 (the "Quarterly Report") includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenue or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, business trends and other information that is not historical information. When used in this Quarterly Report, the words estimates, expects, anticipates, projects, plans, intends, believes, forecasts, or future conditional verbs, such as should, could or may, and variations of such words or similar expressions are intended to identify forward-looking statements. All forward-looking statements, including, without limitation, management's examination of historical operating trends and data are based upon our current expectations and various assumptions. Our expectations, beliefs and projections are expressed in good faith and we believe there is a reasonable basis for them. However, there can be no assurance that management's expectations, beliefs and projections will be achieved.

There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this Quarterly Report. Additionally, important factors could cause our actual results to differ materially from the forward-looking statements we make in this Quarterly Report. Such risks, uncertainties and other important factors include, among others:

our substantial leverage;

limitations on flexibility in operating our business contained in our debt agreements;

increases in interest rates as a result of our variable rate indebtedness;

pricing pressure from our customers;

our ability to respond to the changing needs of a particular industry and develop new offerings;

technological change and innovation;

risks associated with our non-U.S. operations;

fluctuations in currency exchange rates;

high competition in the markets in which we operate;

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products or services claims that might arise out of our activities;

litigation surrounding the use of our COREXIT dispersant;

adverse changes to environmental, health and safety regulations;

operating hazards in our production facilities;

inability to achieve expected cost savings;

difficulties in securing the raw materials we use;

significant increases in the costs of raw materials we use and our ability to pass any future raw material price increases through to our customers;

Table of Contents

our significant pension benefit obligations and the current underfunding of our pension plans;

our ability to realize the full value of our intangible assets;

our ability to attract and retain skilled employees, particularly research scientists, technical sales professionals and engineers; and

our ability to protect our intellectual property rights.

There may be other factors that may cause our actual results to differ materially from the forward-looking statements. For further information regarding risk factors, please refer to Part I, Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2010.

All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this Quarterly Report and are expressly qualified in their entirety by the cautionary statements included in this Quarterly Report. We undertake no obligation to update or revise forward-looking statements which may be made to reflect events or circumstances that arise after the date made or to reflect the occurrence of unanticipated events.

Use of Non-GAAP Financial Measures

Direct contribution, EBITDA, Adjusted EBITDA, Adjusted Effective Tax Rate, Adjusted Earnings Per Share and Free Cash Flow are measures used by management to evaluate operating performance.

Direct contribution is defined as net sales, less cost of product sold, selling and service expenses, marketing expenses, and research expenses. EBITDA is defined as net earnings attributable to Nalco Holding Company plus interest, taxes, depreciation and amortization. Adjusted EBITDA is defined as EBITDA further adjusted for restructuring expenses and certain unusual items. Adjusted Effective Tax Rate is defined as the income tax provision, excluding the tax expense (benefit) of specified transactions, divided by earnings (loss) before income taxes, excluding the earnings (loss) before income taxes attributable to those specified transactions. Adjusted Earnings Per Share is defined as diluted net earnings per share attributable to Nalco Holding Company common shareholders, adjusted for the per-share impact of restructuring expenses, which fluctuate significantly from year to year, and other specified transactions that are unusual in nature. Free Cash Flow is defined as net cash provided by operating activities, less capital expenditures and net earnings attributable to noncontrolling interests.

Direct contribution provides investors with the measurement used by our management to evaluate the performance of our segments. We believe EBITDA is useful to the investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in our industry. We believe Adjusted EBITDA, Adjusted Effective Tax Rate and Adjusted Earnings Per Share are useful for investors to fully understand our operating performance. We believe Free Cash Flow provides investors with a measure of our ability to generate cash prior to financing activities.

Direct contribution, EBITDA, Adjusted EBITDA and Free Cash Flow are not recognized terms under U.S. GAAP and do not purport to be alternatives to net earnings as an indicator of operating performance or to cash flows from operating activities as a measure of liquidity. Adjusted Effective Tax Rate and Adjusted Earnings Per Share also are not recognized terms

Table of Contents

under U.S. GAAP. Adjusted Effective Tax Rate does not purport to be an alternative to the actual effective tax rate as a measure of the relationship between the income tax provision and earnings (loss) before income taxes, and Adjusted Earnings Per Share does not purport to be an alternative to diluted earnings per share as a measure of operating performance. Direct contribution is reconciled to consolidated earnings before income taxes in Note 11 of our consolidated financial statements included in Part I, Item 1 of this Quarterly Report. The most direct comparable GAAP financial measures of each other non-GAAP financial measure, as well as the reconciliation between each other non-GAAP financial measure and the GAAP financial measure, are presented in the discussions of the non-GAAP financial measures below. Because not all companies use identical calculations, our measures may not be comparable to other similarly titled measures of other companies.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our exposures to market risk since December 31, 2010.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures.

Our chief executive officer and chief financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) as of the end of the period, have concluded that our disclosure controls and procedures were effective.

(b) Changes in internal controls over financial reporting.

There were no changes in our internal controls over financial reporting that occurred during the first quarter of 2011 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

MATTERS RELATED TO DEEPWATER INCIDENT RESPONSE

On April 22, 2010, the deepwater drilling platform, the Deepwater Horizon, operated by a subsidiary of BP plc, sank in the Gulf of Mexico after a catastrophic explosion and fire that began on April 20, 2010. A massive oil spill resulted. Approximately one week following the incident, subsidiaries of BP plc, under the authorization of the responding federal agencies, formally requested Nalco Company, an indirect subsidiary of Nalco Holding Company, to supply large quantities of COREXIT 9500, a Nalco oil dispersant product listed on the U.S. EPA National Contingency Plan Product Schedule. Nalco Company responded immediately by providing available COREXIT and increasing production to supply the product to BP's subsidiaries for use, as authorized and directed by agencies of the federal government. Prior to the incident, Nalco Holding Company and its subsidiaries had not provided products or services or otherwise had any involvement with the Deepwater Horizon platform. On July 15, 2010, BP announced that it had capped the leaking well, and the application of dispersants by the responding parties ceased shortly thereafter.

On May 1, 2010, the President appointed retired U.S. Coast Guard Commandant Admiral Thad Allen to serve as the National Incident Commander in charge of the coordination of the response to the incident at the national level. The EPA directed numerous tests of all the dispersants on the National Contingency Plan Product Schedule, including those provided by Nalco Company, to ensure decisions about ongoing dispersant use in the Gulf of Mexico are grounded in the best available science. We cooperated with this testing process and continued to supply COREXIT 9500, as requested by BP and government authorities. After review and testing of a number of dispersants, on June 30, 2010, and on August 2, 2010, the EPA released toxicity data for eight oil dispersants. The data is available on the EPA Web site at www.epa.gov/bpspill/dispersants-testing.html.

The use of dispersants by the responding parties has been one tool used by the government and BP to avoid and reduce damage to the Gulf area from the spill. Since the spill occurred, the EPA and other federal agencies have closely monitored conditions in areas where dispersant has been applied. We have encouraged ongoing monitoring and review of COREXIT and other dispersants and have cooperated fully with the governmental review and approval process. However, in connection with its provision of COREXIT, Nalco Company has been named in several lawsuits as described below.

Putative Class Action Litigation

In June, July and August 2010, Nalco Company was named, along with other unaffiliated defendants, in six putative class action complaints filed in either the United States District Court for the Eastern District of Louisiana (Parker, et al. v. Nalco Company, et al., Civil Action No. 2:10-cv-01749-CJB-SS; Harris, et al. v. BP, plc, et al., Civil Action No. 2:10-cv-02078-CJB-SS), the United States District Court for the Southern District of Alabama, Southern Division (Lavigne, et al. v. BP PLC, et al., Civil Action No. 1:10-cv-00222-KD-C; Wright, et al. v. BP, plc, et al., Civil Action No. 1:10-cv-00397-B) or the United States District Court for the Northern District of Florida, Pensacola Division (Walsh, et al. v. BP, PLC, et al., Civil Action No. 3:10-cv-00143-RV-MD; Petitjean, et al. v. BP, plc, et al.,

Table of Contents
Item 1. Legal Proceedings (continued)

Civil Action No. 3:10-cv-00316-RS-EMT) on behalf of various potential classes of persons who live and work in or derive income from the Coastal Zone. In April 2011, Nalco was named in an additional class action: *Irelan v. BP Products, Inc., et al.*, (E.D.La.). The *Parker, Lavigne* and *Walsh* cases have since been voluntarily dismissed. Each of the remaining actions contains substantially similar allegations, generally alleging, among other things, negligence relating to the use of our COREXIT dispersant in connection with the Deepwater Horizon oil spill. The plaintiffs in each of these putative class action lawsuits are generally seeking awards of unspecified compensatory and punitive damages, and attorneys' fees and costs.

Other Related Claims

In July, August, September, October and December 2010, Nalco Company was also named, along with other unaffiliated defendants, in eight complaints filed by individuals in either the United States District Court for the Eastern District of Louisiana (*Ezell v. BP, plc, et al.*, Civil Action No. 2:10-cv-01920-KDE-JCW), the United States District Court for the Southern District of Alabama, Southern Division (*Monroe v. BP, plc, et al.*, Civil Action No. 1:10-cv-00472-M; *Hill v. BP, plc, et al.*, Civil Action No. 1:10-cv-00471-CG N; *Hudley v. BP, plc, et al.*, Case No. 10-cv-00532-N), the United States District Court for the Northern District of Florida, Tallahassee Division (*Capt Ander, Inc. v. BP, plc, et al.*, Civil Action No. 4:10-cv-00364-RH-WCS), the United States District Court for the Southern District of Mississippi, Southern Division (*Trehern v. BP, plc, et al.*, Civil Action No. 1:10-cv-00432-HSO-JMR) or the United States District Court for the Southern District of Texas (*Chatman v. BP Exploration & Production*, Case No. 10-cv-04329; *Brooks v. Tidewater Marine LLC, et al.*, Case No. 11-cv-00049). In April 2011, Nalco was also named in *Best v British Petroleum plc, et al.*, (MDL No. 2179), *Black v. BP Exploration & Production, Inc., et al.* Civ. No. 2:11-cv-867, (E.D.La.); *Pearson v. BP Exploration & Production, Inc.*, Civ. No. 2:11-cv-863, (E.D.La.); and *Coco v. BP Products North America, Inc.*, (E.D.La.). The complaints generally allege, among other things, negligence and injury resulting from the use of our COREXIT dispersant in connection with the Deepwater Horizon oil spill. The complaints seek unspecified compensatory and punitive damages, and attorneys' fees and costs. The *Chatman* case was voluntarily dismissed. Nalco, the incident defendants and the other responder defendants have also been named as a third party defendant by Transocean Deepwater Drilling, Inc. and its affiliates (*In re the Complaint and Petition of Triton Asset Leasing GmbH, et al*, MDL No. 2179, Civil Action 10-2771) and more recently as a third party defendant by Cameron International Corporation and Halliburton Energy Services, Inc. in the multi-district litigation (the MDL).

All of the cases pending against Nalco Company have been (or are expected to be) administratively transferred for pre-trial purposes to a judge in the United States District Court for the Eastern District of Louisiana with other related cases under *In Re: Oil Spill by the Oil Rig Deepwater Horizon in the Gulf of Mexico, on April 20, 2010*, Case No. 10-md-02179 (E.D. La.). Pursuant to orders issued by Judge Barbier in the MDL, the claims have been consolidated in several master complaints, including one naming Nalco and others who responded to the Gulf Oil Spill (known as the B3 Bundle). Plaintiffs are required by Judge Barbier to prepare a list designating previously-filed lawsuits that assert claims within the B3 Bundle regardless of whether the lawsuit named each defendant named in the B3 Bundle master complaint. We have received a draft list from the plaintiffs' steering committee. The draft list identifies fifteen cases in the B3 Bundle, some of which are putative class actions. Six cases previously filed against Nalco are not included in the B3 Bundle.

We believe the claims are without merit and intend to defend these lawsuits vigorously. We also believe that we have rights to contribution and/or indemnification (including legal expenses) from third parties. However, we cannot predict the outcome of these lawsuits, the involvement we might have in these matters in the future or the potential for future litigation.

Table of Contents

Item 6. Exhibits

(a) The following are included herein:

Exhibit 31.1	Certification of Chief Executive Officer, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer, Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32.1	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.INS*	XBRL Instance Document
Exhibit 101.SCH*	XBRL Taxonomy Extension Schema
Exhibit 101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
Exhibit 101.LAB*	XBRL Taxonomy Extension Label Linkbase
Exhibit 101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

* Pursuant to Rule 406T of Regulation S-T, the XBRL-related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall be deemed furnished and not filed .

Table of Contents

SIGNATURE

The registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

NALCO HOLDING COMPANY

/s/ KATHRYN A. MIKELLS

Name: Kathryn A. Mikells

Title: Executive Vice President and

Chief Financial Officer

Dated: April 27, 2011