

Nalco Holding CO
Form 10-Q
August 09, 2007

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 June 30, 2007

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
(State or other jurisdiction of
Incorporation or Organization)
1601 West Diehl Road
Naperville, IL 60563-1198
(630) 305-1000

16-1701300
(I.R.S. Employer
Identification Number)

(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

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b-2 of the Exchange Act).

Yes No

As of July 31, 2007, the number of shares of the registrant’s common stock, par value \$0.01 per share, outstanding was 144,362,609 shares.

QUARTERLY REPORT ON FORM 10-Q NALCO HOLDING COMPANY Quarter Ended June 30, 2007

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Nalco Holding Company and Subsidiaries
Condensed Consolidated Balance Sheets
(dollars in millions)

| | (Unaudited) June 30, 2007 | December 31, 2006 |
|---|---------------------------------|-------------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 68.6 | \$ 37.3 |
| Accounts receivable, less allowances of \$19.3 in 2007 and \$19.0 in 2006 | 754.4 | 695.3 |
| Inventories: | | |
| Finished products | 278.4 | 264.5 |
| Materials and work in process | 82.4 | 76.2 |
| | 360.8 | 340.7 |
| Prepaid expenses, taxes and other current assets | 90.7 | 94.1 |
| Total current assets | 1,274.5 | 1,167.4 |
| Property, plant, and equipment, net | 740.8 | 743.4 |
| Intangible assets: | | |
| Goodwill | 2,349.7 | 2,299.9 |
| Other intangibles, net | 1,144.9 | 1,169.5 |
| Other assets | 248.2 | 276.3 |
| Total assets | \$ 5,758.1 | \$ 5,656.5 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 286.5 | \$ 288.2 |
| Short-term debt | 93.3 | 150.2 |
| Other current liabilities | 252.2 | 281.0 |
| Total current liabilities | 632.0 | 719.4 |
| Other liabilities: | | |
| Long-term debt | 3,153.6 | 3,038.6 |
| Deferred income taxes | 280.8 | 314.3 |
| Accrued pension benefits | 411.3 | 430.7 |
| Other liabilities | 253.1 | 250.0 |
| Minority interest | 11.8 | 12.6 |
| Shareholders' equity | 1,015.5 | 890.9 |
| Total liabilities and shareholders' equity | \$ 5,758.1 | \$ 5,656.5 |

See accompanying notes to condensed consolidated financial statements.

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Nalco Holding Company and Subsidiaries
 Condensed Consolidated Statements of Operations
 (Unaudited)
 (dollars in millions, except per share amounts)

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|---|--|--|---|---|
| Net sales | \$ 970.9 | \$ 891.0 | \$ 1,880.2 | \$ 1,740.4 |
| Operating costs and expenses: | | | | |
| Cost of product sold | 536.7 | 499.5 | 1,040.2 | 974.5 |
| Selling, administrative, and research expenses | 293.0 | 266.8 | 581.4 | 538.3 |
| Amortization of intangible assets | 15.4 | 17.5 | 30.6 | 34.8 |
| Business optimization expenses | 2.3 | 1.8 | 2.3 | 5.6 |
| Total operating costs and expenses | 847.4 | 785.6 | 1,654.5 | 1,553.2 |
| Operating earnings | 123.5 | 105.4 | 225.7 | 187.2 |
| Other income (expense), net | — | (1.9) | (0.3) | (0.7) |
| Interest income | 1.9 | 2.3 | 4.5 | 4.0 |
| Interest expense | (68.2) | (68.1) | (136.5) | (134.4) |
| Earnings before income taxes and minority interests | 57.2 | 37.7 | 93.4 | 56.1 |
| Income tax provision | 13.7 | 14.4 | 28.4 | 22.3 |
| Minority interests | (1.7) | (1.8) | (3.6) | (3.5) |
| Net earnings | \$ 41.8 | \$ 21.5 | \$ 61.4 | \$ 30.3 |
| Net earnings per share: | | | | |
| Basic | \$ 0.29 | \$ 0.15 | \$ 0.43 | \$ 0.21 |
| Diluted | \$ 0.28 | \$ 0.15 | \$ 0.41 | \$ 0.21 |
| Weighted-average shares outstanding (millions): | | | | |
| Basic | 144.4 | 142.9 | 144.0 | 142.9 |
| Diluted | 148.0 | 146.6 | 148.0 | 146.6 |
| Cash dividends declared per share | \$ 0.035 | \$ — | \$ 0.07 | \$ — |

See accompanying notes to condensed consolidated financial statements.

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Nalco Holding Company and Subsidiaries
 Condensed Consolidated Statements of Cash Flows
 (Unaudited)
 (dollars in millions)

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| | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|---|--|--|
| Operating activities | | |
| Net earnings | \$ 61.4 | \$ 30.3 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation | 64.0 | 64.7 |
| Amortization | 30.6 | 34.8 |
| Amortization of deferred financing costs and accretion of senior discount notes | 22.3 | 21.1 |
| Other, net | (10.4) | (35.5) |
| Changes in operating assets and liabilities | (97.2) | (53.8) |
| Net cash provided by operating activities | 70.7 | 61.6 |
| Investing activities | | |
| Additions to property, plant, and equipment, net | (47.6) | (37.5) |
| Other, net | (1.0) | (4.2) |
| Net cash used for investing activities | (48.6) | (41.7) |
| Financing activities | | |
| Cash dividends | (5.0) | — |
| Changes in short-term debt, net | (8.3) | 28.1 |
| Proceeds from long-term debt | 48.8 | — |
| Repayments of long-term debt | (24.0) | (45.5) |
| Other, net | (4.1) | (2.2) |
| Net cash provided by (used for) financing activities | 7.4 | (19.6) |
| Effect of exchange rate changes on cash and cash equivalents | 1.8 | 0.5 |
| Increase in cash and cash equivalents | 31.3 | 0.8 |
| Cash and cash equivalents at beginning of period | 37.3 | 30.8 |
| Cash and cash equivalents at end of period | \$ 68.6 | \$ 31.6 |
| See accompanying notes to condensed consolidated financial statements. | | |

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Nalco Holding Company and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

June 30, 2007

1. Description of Business

We are engaged in 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.

2. Basis of Presentation

These 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, 2006.

The accompanying unaudited 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 six months ended June 30, 2007 are not necessarily indicative of results that may be expected for the year ended December 31, 2007.

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

3. Debt

Debt consists of the following:

| (dollars in millions) | June 30, 2007 | December 31, 2006 |
|--|------------------|-------------------------|
| Short-term | | |
| Checks outstanding and bank overdrafts | \$ 25.3 | \$ 25.8 |
| Notes payable to banks | 13.5 | 0.9 |
| Current maturities of long-term debt | 54.5 | 23.5 |
| Securitized trade accounts receivable facility | — | 100.0 |
| | \$ 93.3 | \$ 150.2 |
| Long-term | | |
| Term loan A, due November 2009 | \$ 71.3 | \$ 81.0 |
| Term loan B, due November 2010 | 887.0 | 911.0 |
| Senior notes, due November 2011 | 935.1 | 928.1 |
| Senior subordinated notes, due November 2013 | 735.1 | 728.1 |
| Unsecured notes, due May 2008 | 27.8 | 27.8 |
| Senior discount notes, due February 2014 | 402.8 | 385.6 |
| Securitized trade accounts receivable facility | 148.8 | — |
| Other | 0.2 | 0.5 |
| | 3,208.1 | 3,062.1 |
| Less: Current portion | 54.5 | 23.5 |
| | \$ 3,153.6 | \$ 3,038.6 |

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4. Shareholders' Equity

Shareholders' equity consists of the following:

| (dollars in millions, except per share amounts) | December | |
|---|------------------|-------------|
| | June 30, 2007 | 31, 2006 |
| 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; 144,362,254 and 143,055,013 shares issued and outstanding at June 30, 2007 and December 31, 2006, respectively | 1.4 | 1.4 |
| Additional paid-in capital | 742.3 | 740.9 |
| Retained earnings (accumulated deficit) | 43.0 | (16.2) |
| Accumulated other comprehensive income | 228.8 | 164.8 |
| Total shareholders' equity | \$ 1,015.5 | \$ 890.9 |

In November 2004, a warrant to purchase, for \$0.01 per share, up to 6,191,854 shares of Nalco Holding Company common stock was issued as part of a dividend to Nalco LLC, our sole stockholder on the record date of the dividend. Nalco LLC exercised warrants to acquire 1,265,806 shares of common stock during the six months ended June 30, 2007. At June 30, 2007, up to 3,541,049 shares of common stock could be purchased by Nalco LLC under the warrant, subject to certain vesting conditions.

5. Pension and Other Postretirement Benefit Plans

The components of net periodic pension cost and the cost of other postretirement benefits for the three months and six months ended June 30, 2007 and 2006 were as follows:

| (dollars in millions) | Pension Benefits | | | |
|--------------------------------|--|--|--|--|
| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
| Service cost | \$ 7.1 | \$ 6.9 | \$ 14.2 | \$ 14.6 |
| Interest cost | 11.4 | 10.7 | 22.5 | 21.1 |
| Expected return on plan assets | (8.6) | (7.9) | (16.8) | (14.7) |
| Prior service cost | 0.1 | — | 0.1 | — |
| Net actuarial loss | 0.2 | 0.1 | 0.3 | 0.2 |
| Settlement charge | — | 0.1 | — | 0.4 |
| Net periodic cost | \$ 10.2 | \$ 9.9 | \$ 20.3 | \$ 21.6 |

Other Postretirement Benefits

(dollars in millions)

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| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|----------------------|--|--|--|--|
| Service cost | \$ 1.1 | \$ 1.2 | \$ 2.7 | \$ 2.8 |
| Interest cost | 1.9 | 1.7 | 4.1 | 4.0 |
| Prior service credit | (1.3) | (1.0) | (2.4) | (2.0) |
| Net actuarial gain | (0.1) | (0.1) | (0.1) | (0.1) |
| Net periodic cost | \$ 1.6 | \$ 1.8 | \$ 4.3 | \$ 4.7 |

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6. Business Optimization Expenses

We continue to redesign and optimize our business and work processes. Business process optimization expenses were \$2.3 million for the six months ended June 30, 2007, as employee severance and related costs were partly offset by the impact of a \$0.4 million reduction in the impairment provision for a facility that is held for sale. Business process optimization expenses, consisting mostly of employee severance and related costs, were \$5.6 million for the six months ended June 30, 2006.

7. Summary of Other Income (Expense)

The components of other income (expense), net for the three months and six months ended June 30, 2007 and 2006, include the following:

| (dollars in millions) | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|---|--|--|--|--|
| Franchise taxes | \$ (0.8) | \$ (0.7) | \$ (1.6) | \$ (1.5) |
| Equity in earnings of unconsolidated subsidiaries | 0.5 | 1.9 | 0.9 | 2.6 |
| Foreign currency exchange adjustments | 0.7 | (3.3) | 0.5 | (3.0) |
| Other | (0.4) | 0.2 | (0.1) | 1.2 |
| | \$ — | \$ (1.9) | \$ (0.3) | \$ (0.7) |

8. Income Taxes

Our effective income tax rate was 30.4% for the six months ended June 30, 2007. The rate varies from the U.S. federal statutory income tax rate of 35% primarily due to the incremental tax on dividends received from non-U.S. subsidiaries, foreign taxes provided at other than the 35% U.S. statutory rate, U.S. state income taxes, nondeductible expenses, and other permanent differences.

The aforementioned items also contributed to the variation between the U.S. federal statutory income tax rate and our effective income tax rate for the six months ended June 30, 2006.

The six months ended June 30, 2007, also include two discrete events related to our tax positions in The Netherlands. During the period, we completed our consultations with the tax authorities regarding their analysis of certain interest deductions incurred by our Dutch subsidiaries. The tax effect of these interest deductions represented \$7.9 million of previously unrecognized tax benefits. The Dutch tax inspector has concluded that all of the interest deductions we considered at risk are valid deductions under the applicable law. Therefore, we have reversed the reserve, and reduced tax expense during the period by \$7.9 million.

In addition, we determined that certain net loss carryforwards in The Netherlands are likely to expire without being utilized. Therefore, we established valuation allowances on those losses, which resulted in \$2.2 million of additional tax expense during the six months ended June 30, 2007.

We also implemented various foreign reorganizations during the first half of 2007 that provide tax savings. As a result, our annual estimated tax expense for 2007 has been lowered, which reduced the effective tax rate for the six months ended June 30, 2007.

Nalco Holding Company and its subsidiaries file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions, as required. With few exceptions, we are no longer subject to federal, state and local, or foreign income tax examinations by tax authorities for periods prior to 2001. To the extent that we are subject to additional tax assessments greater than \$150,000 that relate to tax periods before November 4, 2003, we are indemnified by our former shareholder, Suez, and therefore have recorded a receivable for the related indemnity claim. We record tax penalties and interest on tax deficiencies as part of income tax expense.

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, an interpretation of Statement of Financial

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8. Income Taxes (continued)

Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal periods beginning after December 15, 2006.

We adopted the provisions of FIN 48 on January 1, 2007. As a result of the adoption of FIN 48, we have recorded a decrease in the liability for unrecognized tax benefits of approximately \$13.5 million. Because a portion of this amount is subject to the Suez indemnity, we have also reduced the receivable by their share of the exposures, or \$5.6 million. The remaining \$7.9 million has been credited to retained earnings as of January 1, 2007.

| (dollars in millions) | Unrecognized Tax Benefit | Suez Portion | Nalco Portion |
|---------------------------|-----------------------------|-----------------|------------------|
| December 31, 2006 closing | \$ 26.0 | \$ 8.6 | \$ 17.4 |

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| | | | |
|---------------------------|---------|--------|--------|
| Change to adopt FIN 48 | (13.5) | (5.6) | (7.9) |
| January 1, 2007 opening | \$ 12.5 | \$ 3.0 | \$ 9.5 |
| Unrecognized tax position | \$ 12.1 | \$ 2.7 | \$ 9.4 |
| Interest | 0.4 | 0.3 | 0.1 |
| Penalties | — | — | — |
| January 1, 2007 opening | \$ 12.5 | \$ 3.0 | \$ 9.5 |

As of January 1, 2007, full recognition of the \$12.5 million of tax benefits not previously recorded would have resulted in a favorable impact to the income tax provision of \$9.2 million, a reduction of goodwill of \$0.3 million and a reduction of the Suez receivable of \$3.0 million.

During the first half of 2007, we recognized \$7.9 million of tax benefit due to the settlement of the previously described interest deduction issues in The Netherlands. Therefore, recognition of the remaining January 1, 2007 unrecognized tax benefit would result in a favorable impact to the income tax provision of \$1.3 million.

9. Comprehensive Income

Total comprehensive income and its components, net of related tax, for the three months and six months ended June 30, 2007 and 2006, were as follows:

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|--|--|--|--|--|
| (dollars in millions) | | | | |
| Net earnings | \$ 41.8 | \$ 21.5 | \$ 61.4 | \$ 30.3 |
| Other comprehensive income, net of income taxes: | | | | |
| Derivatives | (0.2) | (0.3) | 0.9 | (0.6) |
| Net prior service credit | (0.8) | — | (1.5) | — |
| Net actuarial loss | — | — | 0.1 | — |
| Foreign currency translation adjustments | 48.8 | 27.7 | 64.5 | 48.2 |
| Comprehensive income | \$ 89.6 | \$ 48.9 | \$ 125.4 | \$ 77.9 |

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10. Segment Information

We provide integrated water treatment and process improvement services for industrial and institutional applications, using technologically advanced solutions, combining chemical products and equipment, and consistent, reliable on-site service and expertise. These solutions and services enable our customers to improve production yields, lower manufacturing costs, extend asset lives and maintain environmental standards at costs that represent a small share of their overall production expense.

We are organized based on the end markets we serve. The organization is comprised of the following reportable segments:

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| | Months ended June 30, 2007 | Months ended June 30, 2006 | ended June 30, 2007 | ended June 30, 2006 |
|---|-------------------------------------|-------------------------------------|---------------------------|---------------------------|
| Segment direct contribution: | | | | |
| Industrial and Institutional Services | \$ 97.0 | \$ 85.0 | \$ 185.0 | \$ 165.1 |
| Energy Services | 67.2 | 55.3 | 123.0 | 103.9 |
| Paper Services | 30.7 | 26.8 | 55.7 | 53.2 |
| Other | (22.3) | (15.2) | (40.4) | (35.2) |
| Capital charge elimination | 20.9 | 18.9 | 41.0 | 38.1 |
| Total segment direct contribution | 193.5 | 170.8 | 364.3 | 325.1 |
| Expenses not allocated to segments: | | | | |
| Administrative expenses | 52.3 | 46.1 | 105.7 | 97.5 |
| Amortization of intangible assets | 15.4 | 17.5 | 30.6 | 34.8 |
| Business optimization expenses | 2.3 | 1.8 | 2.3 | 5.6 |
| Operating earnings | 123.5 | 105.4 | 225.7 | 187.2 |
| Other income (expense), net | — | (1.9) | (0.3) | (0.7) |
| Interest income | 1.9 | 2.3 | 4.5 | 4.0 |
| Interest expense | (68.2) | (68.1) | (136.5) | (134.4) |
| Earnings before income taxes and minority interests | \$ 57.2 | \$ 37.7 | \$ 93.4 | \$ 56.1 |

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.

11. Earnings Per Share

Basic earnings per share is computed by dividing net earnings 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.

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11. Earnings Per Share (continued)

Basic and diluted earnings per share were calculated as follows:

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|---------------|--|--|--|--|
| (in millions) | \$ 41.8 | \$ 21.5 | \$ 61.4 | \$ 30.3 |

Numerator for basic and diluted earnings per share:

Net earnings

Denominator for basic earnings per share – weighted

| | | | | |
|--|-------|-------|-------|-------|
| average common shares outstanding | 144.4 | 142.9 | 144.0 | 142.9 |
| Effect of dilutive securities: | | | | |
| Stock purchase warrant | 3.5 | 3.7 | 3.9 | 3.7 |
| Share-based compensation plans | 0.1 | — | 0.1 | — |
| Denominator for diluted earnings per share | 148.0 | 146.6 | 148.0 | 146.6 |

12. 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 named as a potentially responsible party (PRP) by the Environmental Protection Agency or state enforcement agencies at three 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. We are also remediating a small ground contamination that we discovered at our plant in Colombia and we cleaned a raw material spill at our plant near Botany, Australia. 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 June 30, 2007. These environmental reserves represent our current estimate of our proportional clean-up costs (and the cost to remediate the Colombia site) 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 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 six months ended June 30, 2007, 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 and the claimed presence of hazardous substances at our plants. 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.

12. Contingencies and Litigation (continued)

On November 27, 2006, the U.K. Health and Safety Executive (“HSE”) issued a criminal summons charging our U.K. subsidiary with a violation of the Health and Safety at Work Act. The summons was re-issued in the Crown Court of Worcester on July 23, 2007. The charge relates to a legionella outbreak that is claimed to have originated at cooling towers owned by one of the subsidiary’s customers. The legionella outbreak is believed to have resulted in two fatalities and multiple injuries. The customer, H. P. Bulmer Limited, is also charged.

On January 2, 2007, the HSE issued another criminal summons charging our U.K. subsidiary with a violation of the Health and Safety at Work Act. The second charge relates to the entry of one of the subsidiary’s employees into a claimed confined space at a customer site. The employee claims injuries as a result of entry into the confined space. The customer is also charged. We have plead guilty to this violation and a fine of £17,500 and fees of £17,300 were entered against our U.K. subsidiary, concluding this matter.

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 trademarks, employee matters, contracts, transactions, chemicals 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.

13. Guarantees

No significant guarantees were outstanding at June 30, 2007, other than subsidiary-related performance guarantees.

We had \$22.7 million of letters of credit outstanding at June 30, 2007.

14. Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for us as of the beginning of our fiscal year ended December 31, 2008. We are in the process of determining the effects, if any, that adoption of SFAS No. 157 will have on our financial statements.

In September 2006, the FASB issued SFAS No. 158, Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires an employer to recognize in its statement of financial position an asset for a plan’s overfunded status or a liability for a plan’s underfunded status, measure a plan’s assets and its obligations that determine its funded status as of the end of the employer’s fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in the year in which the changes occur. Those changes are to be reported in comprehensive income and as a separate component of shareholders’ equity. SFAS No. 158 does not change the amount of net periodic benefit cost included in net earnings. We adopted the recognition and disclosure provisions of SFAS No. 158 as of December 31, 2006, as required. We are required to adopt the measurement date provisions of SFAS No. 158 no later than December 31, 2008. Retrospective application of both the recognition and measurement date provisions of SFAS No. 158 is not permitted.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115. This statement is intended to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. It also establishes presentation and disclosure requirements

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14. Recent Accounting Pronouncements (continued)

designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The statement does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value, and it does not establish requirements for recognizing dividend income, interest income or interest expense. It also does not eliminate disclosure requirements included in other accounting standards. We are required to adopt SFAS No. 159 as of the beginning of our fiscal year ended December 31, 2008. We are in the process of determining the effects, if any, that adoption of SFAS No. 159 will have on our financial statements.

15. Subsequent Event

On July 31, 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.

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

The following discussion and analysis of our financial condition and results of operations includes references to the Transactions, defined as the November 2003 acquisition of Ondo Nalco Group, comprised of Nalco Company and Nalco International SAS Subsidiaries, by our subsidiary, Nalco Holdings LLC, from Suez ("Suez") and the related financings in connection with such acquisition (the "Acquisition").

"Safe Harbor" Statement Under Private Securities Litigation Reform Act of 1995

This Quarterly Report for the fiscal quarter ended June 30, 2007 (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," "forecast" conditional verbs, such as "will," "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. As stated elsewhere 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;
- 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;
- 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;
- 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, 2006.

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

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

EBITDA, Adjusted EBITDA and Free Cash Flow are measures used by management to measure operating performance. Adjusted EBITDA is also used to determine our compliance with financial covenants and our ability to engage in certain activities such as incurring additional debt and making certain payments.

EBITDA is defined as net earnings plus interest, taxes, depreciation and amortization. Adjusted EBITDA is defined as EBITDA further adjusted for certain cash and non-cash charges, as permitted under our senior discount note, senior note and senior subordinated note indentures and our senior credit facility. Free Cash Flow is defined as net cash provided by operating activities, less capital expenditures and minority interest charges.

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 consider the inclusion of supplementary

adjustments to EBITDA applied in presenting Adjusted EBITDA appropriate to provide additional information to investors to demonstrate compliance with our financing covenants. We believe Free Cash Flow provides investors with a measure of our ability to generate cash for the repayment of debt.

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. The most direct comparable GAAP financial measures of each non-GAAP financial measure, as well as the reconciliation between each 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.

Executive Level Overview

The quarter ended June 30, 2007 was a solid one for us. Organic sales and earnings growth continued on pace with our full-year expectations. Nominal revenues increased 9.0% to \$970.9 million from \$891.0 million in the year-earlier. Net income nearly doubled to \$41.8 million from \$21.5 million in the second quarter of 2006, aided in part by a lower effective tax rate. Diluted earnings per share (EPS) increased to 28 cents from 15 cents in the prior year.

Adjusted EBITDA gained 12.4% in the quarter to \$179.9 million from \$160.1 million, bringing year-to-date Adjusted EBITDA growth above the 10% threshold established as our growth expectation. Adjusted EBITDA is used to determine compliance with our debt covenants.

We had a number of strong business performances in the quarter along with a few ongoing challenges. On balance, we believe we are headed in the right direction to meet our expectations for the year.

Nalco's sales grew 5.9% organically in the quarter, with 3.1% additional growth coming from favorable foreign currency trends.

All three primary segments generated organic sales growth. Energy Services led our organic improvement with a 9.8% increase, with both our Upstream oil field production and Downstream businesses delivering very strong growth. Our Adomite business unit grew slowly in the quarter, but generated improved profitability. Energy Services has been our strongest performing business for an extended period of time and we expect it to continue in this leadership role.

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

Industrial and Institutional Services (I&IS) grew nicely at 7.2%. Sales increased at a rapid pace in Latin America, Asia-Pacific and in North America-based businesses supporting the Mining and Metals, and Food, Beverage and Pharmaceutical industries. Our North America Power and Institutional businesses and an Emerging Markets business serving Eastern Europe, the Middle East and North Africa also performed well.

The Institutional business now includes a Water ServTM alternate channel business model that is beginning to show momentum in serving small account customers. During the first six months, we generated \$38 million of sales in U.S. Water Serv alternate channel hubs that are in various stages of development. Most of the business in these hubs is transferred from our old Institutional business model, supplemented by smaller Manufacturing segment accounts,

start-up hub sales, and nearly 10% growth that has resulted from this new business model.

In urban hubs where we have been at this the longest – giving us the most developed processes – we are growing at an even stronger pace as quality sales engineers are gaining strong support from route specialists and inside sales. From a profitability standpoint, we are doing better than originally expected, delivering direct contribution margins on par with the Company even as we continue the people investments we need to support rapid expansion. These investments add near-term expense with the value created in future periods.

Paper Services grew organic sales at 1.9%, but importantly delivered improved profitability on the strength of new products that have been well received in the marketplace because they create significant additional value for Paper customers. In North America and Western Europe, our Paper customers are still not healthy in many grades. Paper production continued to decline across most grades in North America during the quarter. Against this backdrop, we are focusing on innovation as the key driver of our performance improvement.

We are excited about what our new technology does for our customers – and for us. Two of our newest technologies showing strong market acceptance are EXTRA WHITE™ brightness enhancers and PARETO™ wet-end optimization technology. These programs improve the customer's operating costs and/or product quality, generating sustainability and profitability benefits. Where we have focused our new technology introduction efforts, we have stabilized the business from a sales perspective and returned margins back to solid levels. Now, we are focused on speeding the pace at which we roll out important technologies on a global basis. We also continue to invest in R&D to provide us with the ongoing ability to bring differentiated, new offerings to our customers.

Other segment sales declined 7.4% due primarily to quarter-over-quarter variations in revenue recognition adjustments, and despite good performance in Japan and reasonable performance in India. Direct contribution losses in the segment were \$7.1 million higher than in the quarter ended June 30, 2006 because of two primary items. The nearly \$4 million variation in revenue recognition adjustments fell almost entirely to the direct contribution level. We have historically applied our corporate revenue recognition adjustments to the Other segment. These adjustments are primarily made for shipments reflected in Division results, but which were shipped late enough in the quarter that they would not have been received by customers and properly recognized as revenue in the period. Normally, the variation in these adjustments is small enough to not be meaningful, but the variation compared to the second quarter of 2006 was noticeable in this period. In addition, spending in the Supply Chain was above expected levels.

From a regional perspective, we generated double-digit organic sales growth in Asia and Latin America, along with nearly 7% growth in North America during the quarter. We continued to struggle in Europe, with less than 1% organic sales growth. However, we are confident that the management and organizational changes made in the region during the second quarter will help generate improvement in the coming quarters.

Cost savings achieved in the quarter ended June 30, 2007 totaled \$19 million, bringing the year-to-date total to \$32 million. We remain on track with our plan to achieve \$75 million cost savings in the year.

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

We converted to upgraded SAP systems in late April that will allow us to further improve our productivity as we implement process changes. Productivity improvements are expected once we get past the normal performance decline that comes immediately following any sizable process change.

The second quarter contained a few additional items of note:

- While we have had raw material and freight cost increases, we have offset them with price increases.
- In addition to business performance improvement, a reduced tax rate in the quarter contributed to net income and EPS growth. EPS was about 4 cents higher in the quarter due to the favorable settlement of a Dutch tax issue for which we had accrued a tax contingency reserve in early 2006.
- At a corporate level, increased administrative expenses related to legal entity reorganizations, variable incentive accruals and cost savings program implementation expenses also slowed earnings improvement.

Free Cash Flow was slightly better than last year at a negative \$15.4 million in the quarter, with significant working capital use for receivables associated with our Nalco Business Transformation/SAP upgrade. This use is expected to reverse in the next two quarters as we gain experience with components of the new and improved order-to-cash process. In addition to working capital use, we had the normal cash flow impact in the second quarter of paying our semi-annual interest payments. These payments are made in May and November each year. Net cash provided by operating activities is reconciled to Free Cash Flow as follows:

| (dollars in millions) | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 |
|--|--|--|
| Net cash provided by operating activities | \$ 12.8 | \$ 2.8 |
| Minority interests | (1.7) | (1.8) |
| Additions to property, plant, and equipment, net | (26.5) | (22.9) |
| Free cash flow | \$ (15.4) | \$ (21.9) |
| Year-to-Date Results | | |

For the six months ended June 30, 2007, sales are up 8.0% to \$1.88 billion from \$1.74 billion for the prior-year period, with organic revenue growth at 5.1% and the remaining 2.9% growth due to currency impacts. Year-to-date net income doubled to \$61.4 million from \$30.3 million, diluted EPS nearly doubled to 41 cents from 21 cents, and Adjusted EBITDA is up 11.2% over year-ago results.

Energy Services remains the growth leader for the six months ended June 30, increasing organic revenues by 8.7%. I&IS is near our corporate average with 5.3% organic growth, with Paper Services and the Other segment trailing at 0.6% and 1.2%, respectively.

Again this year, we expect to generate the majority of our Free Cash Flow during the third quarter, with some additional cash generation in the fourth quarter. Through six months, our Free Cash Flow stands at \$19.5 million versus \$20.6 million generated in the first half of 2006. Net cash provided by operating activities is reconciled to Free Cash Flow as follows:

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

| | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|--|--|--|
| (dollars in millions) | | |
| Net cash provided by operating activities | \$ 70.7 | \$ 61.6 |
| Minority interests | (3.6) | (3.5) |
| Additions to property, plant, and equipment, net | (47.6) | (37.5) |
| Free cash flow | \$ 19.5 | \$ 20.6 |
| Share Repurchase Program | | |

Our Board has authorized a \$300 million share repurchase program that will enable us to use Free Cash Flow to purchase outstanding shares. Our internal cash flow generation adequately covers our investments to accelerate growth in sales and earnings, our dividends, and required debt amortization, while permitting this additional return to investors through share repurchases. There is no set timetable for share repurchases, and we intend to make our share repurchases on an opportunistic basis.

Forward-looking Projections

We are positioned to deliver on our commitments for the year of 5% organic sales growth, 10% Adjusted EBITDA improvement, 30% improvement in Free Cash Flow and a 50% increase in reported EPS. The effective tax rate for the full year is now expected to be about 32% to 33%, with the rate in the second half of the year expected to be around 33% to 34%. Improvements in the full-year tax rate over previous projections result from resolution of the Dutch tax issue and ongoing benefits from foreign tax planning transactions.

Our focus during the remainder of the year will be on completing implementation of a number of work process initiatives, gaining incremental price as we expect overall raw material costs to continue to increase, and supporting reinvigorated efforts to generate growth in Western Europe while maintaining positive momentum in the rest of our businesses.

While we have had a solid start to 2007, we have a lot of work ahead of us to meet our targets in 2007 and set the stage for accelerated growth in future years.

Results of Operations – Consolidated

Quarter Ended June 30, 2007 Compared to the Quarter Ended June 30, 2006

Net sales for the three months ended June 30, 2007 were \$970.9 million, a 9.0% increase from the \$891.0 million reported for the three months ended June 30, 2006. On an organic basis, which excludes the impacts of changes in foreign currency translation rates and acquisitions and divestitures, net sales were up 5.9%. Overall, growth was reported by all geographic regions, with double-digit improvement in Latin America and Asia Pacific.

Gross profit, defined as the difference between net sales and cost of product sold, of \$434.2 million for the three months ended June 30, 2007 increased by \$42.7 million, or 10.9%, over the \$391.5 million for the three months ended June 30, 2006. On an organic basis, gross profit increased by 7.7%. Contributing to the improvement was the impact of higher sales volumes and cost savings. Gross profit margin for the three months ended June 30, 2007 was 44.7%

compared to 43.9% for the three months ended June 30, 2006.

Selling, administrative, and research expenses for the three months ended June 30, 2007 of \$293.0 million increased \$26.2 million, or 9.8%, from \$266.8 million for the three months ended

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

June 30, 2006. On an organic basis, selling, administrative, and research expenses increased 6.5%. This was mostly attributable to higher salaries, employee incentives, employee benefits, travel, and outside consulting related to our work process redesign initiatives and the rationalization of our legal entity structure. Partly offsetting these changes were lower expenses for supplies and bad debts.

Amortization of intangible assets was \$15.4 million and \$17.5 million for the three months ended June 30, 2007 and 2006, respectively. The decrease was attributable to lower amortization of customer relationships, which are amortized using an accelerated method.

Business optimization expenses, representing mostly employee severance and related costs associated with the continuing redesign and optimization of business and work processes, were \$2.3 million for the three months ended June 30, 2007 and \$1.8 million for the three months ended June 30, 2006.

Other income (expense), net was nil for the three months ended June 30, 2007, a favorable difference of \$1.9 million from the net expense reported in the year-ago quarter. A favorable change in foreign currency transaction gains and losses of \$4.0 million contributed to the variance, with lower earnings by our affiliate entities and miscellaneous charges offsetting a portion of the net gain.

Net interest expense, defined as the combination of interest income and interest expense, of \$66.3 million for the three months ended June 30, 2007 increased by \$0.5 million from the \$65.8 million reported for the three months ended June 30, 2006. Translation rate changes due to the weaker U.S. dollar versus the euro increased interest expense by \$1.2 million, and accretion of our senior discount notes was \$0.7 million higher than a year ago. The net impact of a lower average debt level and higher interest rates on our variable rate debt compared to the year-ago period offset these increases.

The effective tax rate for the three months ended June 30, 2007 was 24.0%. The rate varies from the U.S. federal statutory income tax rate of 35% primarily due to the incremental tax on dividends received from non-U.S. subsidiaries, foreign taxes provided at other than the 35% U.S. statutory rate, U.S. state income taxes, nondeductible expenses, and other permanent differences.

The aforementioned items also contributed to the variation between the U.S. federal statutory income tax rate and our effective income tax rate for the three months ended June 30, 2006.

The three months ended June 30, 2007 also include two discrete events related to our tax positions in The Netherlands. During the period, we completed consultations with the local tax authority regarding certain interest deductions. The tax authority concluded that the deductions are valid under local law. Therefore, we reversed an existing tax reserve, which resulted in a \$7.9 million reduction in tax expense in the quarter.

In addition, we determined that certain net loss carryforwards in The Netherlands are likely to expire without being utilized. Therefore, we established valuation allowances on those losses, which resulted in \$2.2 million of additional tax expense in the quarter.

During the quarter, we also implemented various foreign reorganizations that provide tax savings. As a result, our annual estimated tax expense for 2007 has been lowered, which reduced the effective tax rate for the quarter.

Minority interest expense was \$0.1 million lower than the \$1.8 million for the three months ended June 30, 2006. Our non-wholly owned subsidiaries in India and Spain reported lower earnings in the current quarter versus last year. These changes were nearly offset by higher earnings by our non-wholly owned subsidiaries in Saudi Arabia and Malaysia.

Six Months Ended June 30, 2007 Compared to the Six Months Ended June 30, 2006

Net sales for the six months ended June 30, 2007 were \$1,880.2 million, an increase of 8.0% over the \$1,740.4 million reported for the six months ended June 30, 2006. On an organic basis, which excludes

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

the impacts of changes in foreign currency translation rates and acquisitions and divestitures, net sales were up 5.1%. Overall, growth was reported by all geographic regions, with Latin America most favorable, citing double-digit improvement.

Gross profit, defined as the difference between net sales and cost of product sold, of \$840.0 million for the six months ended June 30, 2007 rose \$74.1 million, or 9.7%, over the \$765.9 million for the first half of 2006. On an organic basis, gross profit increased by 6.5%. Contributing to the improvement was the impact of higher sales volumes and cost savings.

Gross profit margin for the six months ended June 30, 2007 was 44.7% compared to 44.0% for the six months ended June 30, 2006.

Selling, administrative, and research expenses for the six months ended June 30, 2007 of \$581.4 million increased \$43.1 million, or 8.0%, from \$538.3 million for the six months ended June 30, 2006. Organically, selling, administrative, and research expenses increased 4.9%. This was mostly attributable to higher salaries, employee incentives, employee benefits, travel, and outside consulting related to our work process redesign initiatives and the rationalization of our legal entity structure. Partly offsetting these changes were lower supplies and bad debt expenses in 2007.

Amortization of intangible assets was \$30.6 million and \$34.8 million for the six months ended June 30, 2007 and 2006, respectively. The decrease was attributable to lower amortization of customer relationships, which are amortized using an accelerated method.

Business optimization expenses, representing mostly employee severance and related costs associated with the continuing redesign and optimization of business and work processes, were \$2.3 million and \$5.6 million for the six months ended June 30, 2007 and 2006, respectively.

Other income (expense), net was a net expense of \$0.3 million and \$0.7 million for the six months ended June 30, 2007 and 2006, respectively. The \$0.4 million favorable difference was mainly attributed to a favorable change in foreign currency transaction gains and losses of \$3.5 million, which were offset by lower earnings by our affiliate entities and miscellaneous charges.

Net interest expense, defined as the combination of interest income and interest expense, of \$132.0 million for the six months ended June 30, 2007 increased by \$1.6 million from the \$130.4 million reported for the six months ended June 30, 2006. Translation rate changes due to the weaker U.S. dollar versus the euro increased interest expense by \$2.2 million, and accretion of our senior discount notes was \$1.4 million higher than a year ago. The net impact of a lower average debt level and higher interest rates on our variable rate debt compared to the year-ago period partly offset these increases.

The effective tax rate for the six months ended June 30, 2007 was 30.4%. The rate varies from the U.S. federal statutory income tax rate of 35% primarily due to the incremental tax on dividends received from non-U.S. subsidiaries, foreign taxes provided at other than the 35% U.S. statutory rate, U.S. state income taxes, nondeductible expenses, and other permanent differences.

The aforementioned items also contributed to the variation between the U.S. federal statutory income tax rate and our effective income tax rate for the six months ended June 30, 2006.

As a result of adopting Financial Accounting Standards Board Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes, effective January 1, 2007, we now record tax benefits based on the prescribed “more likely than not” standard. This reduced our liability for unrecognized tax benefits based on our previous “probable” standard by \$13.5 million, of which \$5.6 million was indemnified by our former shareholder, Suez. As a result, \$7.9 million was credited to retained earnings as of January 1, 2007.

The six months ended June 30, 2007 also include two discrete events related to our tax positions in The Netherlands. During the period, we completed consultations with the local tax authority regarding

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

certain interest deductions. The tax authority concluded that the deductions are valid under local law. Therefore, we reversed an existing tax reserve, which resulted in a \$7.9 million reduction in tax expense in the six months ended June 30, 2007.

In addition, we determined that certain net loss carryforwards in The Netherlands are likely to expire without being utilized. Therefore, we established valuation allowances on those losses, which resulted in \$2.2 million of additional tax expense in the six months ended June 30, 2007.

We also implemented various foreign reorganizations during the first half of 2007 that provide tax savings. As a result, our annual estimated tax expense for 2007 has been lowered, which reduced the effective tax rate for the period.

Minority interest expense was \$0.1 million higher than the \$3.5 million for the six months ended June 30, 2006. While our non-wholly owned subsidiary in India reported lower earnings year-over-year, this change was offset by higher

earnings by most of our other non-wholly owned subsidiaries, most notably Saudi Arabia and Japan.

Results of Operations – Segment Reporting

Quarter Ended June 30, 2007 Compared to the Quarter Ended June 30, 2006

Net sales by reportable segment for the three months ended June 30, 2007 and June 30, 2006 may be compared as follows:

| | Three Months Ended | | % Change | Attributable to Changes in the Following Factors | | |
|-------------------------------------|--------------------|------------------|----------|---|-------------------------------|---------|
| | June 30, 2007 | June 30, 2006 | | Currency Translation | Acquisitions/ Divestitures | Organic |
| (dollars in millions) | | | | | | |
| Industrial & Institutional Services | \$ 435.2 | \$ 392.4 | 10.9% | 3.7% | — | 7.2% |
| Energy Services | 292.2 | 259.5 | 12.6% | 2.8% | — | 9.8% |
| Paper Services | 186.7 | 178.4 | 4.7% | 2.8% | — | 1.9% |
| Other | 56.8 | 60.7 | (6.3)% | 1.1% | — | (7.4)% |
| Net sales | \$ 970.9 | \$ 891.0 | 9.0% | 3.1% | — | 5.9% |

The Industrial and Institutional Services division reported sales of \$435.2 million for the three months ended June 30, 2007, a 10.9% increase over the \$392.4 million for the year-ago-period. Organically, sales grew 7.2%. Most of the businesses within the division generated improved performance. Latin America, Pacific, and the North America-based businesses servicing the Mining and Metals and Food, Beverage and Pharmaceutical industries recorded double-digit sales growth, while notable increases were also made by our North America Power and Institutional businesses and our Emerging Markets business serving Eastern Europe, the Middle East and North Africa. Lower organic sales in Western Europe and businesses supporting the Marine, Finishing Technologies, and Cosmetics industries partly offset these gains.

The Energy Services division reported sales of \$292.2 million for the three months ended June 30, 2007, a 12.6% gain over the \$259.5 million for the three months ended June 30, 2006. Organically, sales improved by 9.8%. Both our Upstream oil field production and Downstream businesses accounted for the majority of this increase with double-digit organic growth. Our Adomite business also reported a modest sales improvement.

The Paper Services division reported sales of \$186.7 million for the three months ended June 30, 2007, a 4.7% increase over the \$178.4 million reported for the second quarter of 2006. Organically, sales grew 1.9% from the year-ago period as a result of new products that were recently introduced to the market. Our Pacific regions reported impressive double-digit sales growth and Latin America

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

continues with strong market growth. Although modest sales growth was reported by North America, a decline in paper production and difficult market conditions still plague North America and Western Europe.

The “Other” segment reported \$56.8 million of sales for the three months ended June 30, 2007, a \$3.9 million drop from the year-ago period. Despite improved performances by our Katayama Nalco joint venture and subsidiary in India, quarter-over-quarter variations in revenue recognition adjustments contributed to most of the 7.4% organic decline in sales.

Direct contribution is defined as the difference between net sales and operating costs, including cost of product sold, selling and service expenses, marketing expenses, research expenses and capital charges. Direct contribution by reportable segment for the three months ended June 30, 2007 and June 30, 2006 may be compared as follows:

| | Three Months Ended | | % Change | Attributable to Changes in the Following Factors | | |
|-------------------------------------|--------------------|------------------|----------|---|-------------------------------|---------|
| | June 30, 2007 | June 30, 2006 | | Currency Translation | Acquisitions/ Divestitures | Organic |
| (dollars in millions) | | | | | | |
| Industrial & Institutional Services | \$ 97.0 | \$ 85.0 | 14.1% | 3.6% | — | 10.5% |
| Energy Services | 67.2 | 55.3 | 21.6% | 2.9% | — | 18.7% |
| Paper Services | 30.7 | 26.8 | 14.5% | 2.8% | — | 11.7% |
| Other | (22.3) | (15.2) | (46.9)% | (4.5)% | — | (42.4)% |

Direct contribution of the Industrial and Institutional Services division was \$97.0 million for the three months ended June 30, 2007, an increase of 14.1% over the \$85.0 million reported for the three months ended June 30, 2006.

Organically, direct contribution improved 10.5%. Increased sales volume and higher gross margin contributed to the improvement. Operating expenses were up 6.6% organically, mostly due to increased salaries, employee incentives, employee benefits, travel, and bad debt expenses.

The Energy Services division reported direct contribution of \$67.2 million for the three months ended June 30, 2007, a 21.6% increase over the \$55.3 million reported for the year-ago period. On an organic basis, direct contribution increased 18.7%. Higher sales volume and improved margins accounted for the increase. Operating expenses were up 11.4% organically, with the largest increases in salaries, employee incentives, employee benefits, and travel expenses.

The Paper Services division reported direct contribution of \$30.7 million for the three months ended June 30, 2007, a 14.5% increase from the direct contribution reported for the three months ended June 30, 2006. Organically, direct contribution increased 11.7% as a result of price gains and changes in product mix. Operating expenses were higher by 9.3% organically. Most of the expense increases were for employee incentives, employee benefits, travel and bad debts.

The direct contribution loss of \$22.3 million reported in “Other” for the three months ended June 30, 2007, represented an increase of \$7.1 million from the \$15.2 million direct contribution loss reported in the second quarter 2006, which was mostly attributable to variations in revenue recognition adjustments and higher Supply Chain costs.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations(continued)
Six Months Ended June 30, 2007 Compared to Six Months Ended June 30, 2006

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Net sales by reportable segment for the six months ended June 30, 2007 and June 30, 2006 may be compared as follows:

| | Six Months Ended | | % Change | Attributable to Changes in the Following Factors | | |
|-------------------------------------|------------------|---------------|----------|--|---------------------------|---------|
| | June 30, 2007 | June 30, 2006 | | Currency Translation | Acquisitions/Divestitures | Organic |
| (dollars in millions) | | | | | | |
| Industrial & Institutional Services | \$ 841.5 | \$ 773.9 | 8.7% | 3.4% | — | 5.3% |
| Energy Services | 564.2 | 506.1 | 11.5% | 2.8% | — | 8.7% |
| Paper Services | 366.0 | 354.5 | 3.2% | 2.6% | — | 0.6% |
| Other | 108.5 | 105.9 | 2.6% | 1.4% | — | 1.2% |
| Net sales | \$ 1,880.2 | \$ 1,740.4 | 8.0% | 2.9% | — | 5.1% |

The Industrial and Institutional Services division reported sales of \$841.5 million for the six months ended June 30, 2007, an 8.7% increase over the \$773.9 million for the six months ended June 30, 2006. On an organic basis, sales rose 5.3%. Most of that growth came from Latin America, Pacific and the North American Mining, Chemical and Institutional businesses, as well as our Emerging Markets business in Eastern Europe, the Middle East and North Africa. Lower sales in Western Europe and Finishing Technologies partly offset these gains.

The Energy Services division reported sales of \$564.2 million for the six months ended June 30, 2007, an 11.5% improvement over the \$506.1 million for the year-ago-period. Organically, sales increased 8.7%. Both our Upstream oil field production and Downstream businesses accounted for the majority of this increase with strong organic growth. Our Adomite business also reported a modest sales improvement.

The Paper Services division reported sales of \$366.0 million for the six months ended June 30, 2007, a 3.2% increase over the \$354.5 million reported for the first half of 2006. Organically, sales grew 0.6% from the year-ago period. Latin America reported impressive double-digit sales growth and strong market growth was posted in the Pacific region. North America sales were flat and European sales declined on an organic basis, reflecting the decline in paper production and difficult market conditions that still plague North America and Western Europe.

Improved performances by our Katayama Nalco joint venture and subsidiary in India, as well as variations in revenue recognition adjustments, contributed to the 1.2% organic growth in sales reported by the “Other” segment.

Direct contribution by reportable segment for the six months ended June 30, 2007 and June 30, 2006 may be compared as follows:

| | Six Months Ended | | % Change | Attributable to Changes in the Following Factors | | |
|-------------------------------------|------------------|---------------|----------|--|---------------------------|---------|
| | June 30, 2007 | June 30, 2006 | | Currency Translation | Acquisitions/Divestitures | Organic |
| (dollars in millions) | | | | | | |
| Industrial & Institutional Services | 185.0 | \$ 165.1 | 12.0% | 3.5% | — | 8.5% |
| Energy Services | 123.0 | 103.9 | 18.5% | 3.0% | — | 15.5% |
| Paper Services | 55.7 | 53.2 | 4.7% | 2.3% | — | 2.4% |
| Other | (40.4) | (35.2) | (14.8)% | (4.2)% | — | (10.6)% |

Direct contribution of the Industrial and Institutional Services division was \$185.0 million for the six months ended June 30, 2007, an improvement of 12.0% over the \$165.1 million reported for the year-ago period. Organically, direct

contribution improved 8.5%. Increased sales volume and higher gross margin contributed to the improvement. Operating expenses were up 5.3% organically, mostly due to increased salaries, employee incentives, employee benefits, and bad debt expenses.

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

The Energy Services division reported direct contribution of \$123.0 million for the six months ended June 30, 2007, an 18.5% increase over the \$103.9 million reported for the first half of 2006. On an organic basis, direct contribution rose 15.5%. Higher sales volume and improved margins accounted for the increase. Operating expenses were up 8.4% organically, with the largest increases in salaries, employee incentives, employee benefits, travel, and bad debt expenses.

The Paper Services division reported direct contribution of \$55.7 million for the six months ended June 30, 2007, a 4.7% increase over the direct contribution reported for the six months ended June 30, 2006. Organically, direct contribution was up 2.4% as a result of growth in Latin America and the Pacific and changes in product mix. Operating expenses were higher by 6.0% organically. Salaries, employee incentives, employee benefits, and training expenses increased as bad debt expenses decreased.

The direct contribution loss of \$40.4 million reported in "Other" for the six months ended June 30, 2007, represented an increase of \$5.2 million from the \$35.2 million direct contribution loss reported in the first half of 2006, which was mostly attributable to an increase in Supply Chain costs.

Liquidity and Capital Resources

Operating activities. Historically, our main source of liquidity has been our solid cash flow generated by operating activities. For the six months ended June 30, 2007, cash provided by operating activities was \$70.7 million, an increase of \$9.1 million from the same period last year. The improvement was mostly attributable to the increase in net earnings and lower contributions to the principal U.S. pension plan, partly offset by higher working capital usage for receivables and variable incentive payments made in 2007 because we surpassed our 2006 targets.

The increase in working capital usage for receivables is expected to be temporary, and resulted largely from the April 2007 upgrade to our current SAP enterprise-resource planning system and the implementation of several limited work process changes in North America and Europe that are primarily designed to improve our order-to-cash processes.

Variable incentive payments were not made in 2006 for 2005 variable incentive plans because actual results fell short of that year's targets.

Investing activities. Cash used for investing activities was \$48.6 million for the six months ended June 30, 2007, which was mostly attributable to net property additions of \$47.6 million.

Cash used for investing activities was \$41.7 million for the six months ended June 30, 2006. This was mostly the result of net property additions of \$37.5 million.

Financing activities. Net cash provided by financing activities totaled \$7.4 million during the six months ended June 30, 2007, which was mostly attributable to a \$48.8 million increase in borrowings against our receivables facility, partly offset by \$35.8 million of term loan repayments and the payment of \$5.0 million of common stock dividends. Upon the expiration of our \$100 million receivables facility in June 2007, we entered into a new three-year receivables facility that provides up to \$160 million in funding.

Net cash used for financing activities totaled \$19.6 million during the six months ended June 30, 2006, which was mostly attributable to a net decrease in borrowings.

Since the Transactions, we have been highly leveraged. 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 and the aforementioned \$160 million receivables facility, in each case subject to certain conditions. 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.

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

Senior credit facilities. On November 4, 2003, we entered into senior credit facilities which provided for a revolving credit facility, a \$300 million six-year term loan A facility (including an €88.0 million tranche) which matures in November 2009 and a \$1,300 million seven-year term loan B facility which matures in November 2010. Borrowings under the senior credit facilities bear interest at a floating base rate plus an applicable margin. The applicable margin for borrowings under the revolving credit facility and the term loan A facility is 1.00% with respect to base rate borrowings and 2.00% with respect to LIBOR or Eurocurrency borrowings and may be increased subject to changes in certain leverage ratios. The applicable margin for borrowings under the term loan B facility is 0.75% with respect to base rate borrowings and 1.75% with respect to LIBOR or Eurocurrency borrowings. The applicable margin for borrowings under the term loan B facility is not subject to adjustment.

In addition to paying interest on outstanding principal under the senior credit facilities, we are required to pay a commitment fee to the lenders under the revolving credit facility in respect of the unutilized commitments at a rate equal to 0.50%. We also pay customary letter of credit fees.

The term loan A facility was scheduled to amortize each year in quarterly amounts at a rate of 5% per annum in year one, 10% per annum in year two, 15% per annum in year three, 20% per annum in year four and 25% per annum in each of years five and six.

The term loan B facility was scheduled to amortize each year in an amount equal to 1% per annum in equal quarterly installments for the first six years and nine months, with the remaining amount payable on November 4, 2010.

At June 30, 2007, the outstanding balance of the term loan A and term loan B facilities was \$71.3 million and \$887.0 million, respectively.

Principal amounts outstanding under the revolving credit facility will be due and payable in full at maturity on November 4, 2009. At June 30, 2007, no borrowings were outstanding under the revolving credit facility.

The senior credit facilities contain a number of covenants that, among other things, restrict, subject to certain exceptions, our ability and the ability of our subsidiaries (including Nalco Company) to sell assets, incur additional indebtedness or issue preferred stock, repay other indebtedness, pay dividends and distributions or repurchase certain capital stock, create liens on assets, make investments, loans or advances, make certain acquisitions, engage in mergers or consolidations, enter into sale and leaseback transactions, engage in certain transactions with affiliates, amend certain material agreements governing our indebtedness, change the business conducted by us and our subsidiaries (including Nalco Company) and enter into hedging agreements. In addition, the senior credit facilities require Nalco Company to maintain the following significant financial covenants: a maximum total leverage ratio, a minimum interest coverage ratio and a maximum capital expenditures limitation. We were in compliance with all covenants at June 30, 2007.

Senior notes, senior subordinated notes and senior discount notes. As part of the Transactions in November 2003, Nalco Company issued \$665 million aggregate principal amount of 7¾% U.S. dollar-denominated senior notes due 2011, €200 million aggregate principal amount of 7¾% euro-denominated senior notes due 2011, \$465 million aggregate principal amount of 87/8% U.S. dollar-denominated senior subordinated notes due 2013 and €200 million aggregate principal amount of 9% euro-denominated senior subordinated notes due 2013.

On January 21, 2004, our subsidiaries, Nalco Finance Holdings LLC and Nalco Finance Holdings Inc., issued \$694.0 million aggregate principal amount at maturity of 9.0% senior discount notes due 2014. Prior to February 1, 2009, interest will accrue on the notes in the form of an increase in the accreted value of such notes. The accreted value of each note will increase from the date of issuance until February 1, 2009 at a rate of 9.0% per annum, reflecting the accrual of non-cash interest, such that the accreted value will equal the principal amount at maturity on February 1, 2009. Cash interest

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

payments on the notes will be due and payable beginning in 2009. Our primary source of liquidity for such payments will be cash flow generated from the operations of subsidiaries, including Nalco Holdings LLC and Nalco Company. However, the terms of Nalco Company's senior credit agreement limit the amount of dividends and other transfers by Nalco Holdings LLC and our other subsidiaries to the issuers of the senior discount notes. In addition, the terms of certain of the indentures governing the existing senior notes and senior subordinated notes of Nalco Company significantly restrict Nalco Company and our other subsidiaries from paying dividends, making distributions and otherwise transferring assets to the issuers of the senior discount notes. The ability of Nalco Company to make such payments is governed by a formula based on 50% of its consolidated net income (which, as defined in such indentures, excludes impairment charges, amortization charges from purchase accounting and any after-tax extraordinary, unusual or nonrecurring gains and losses).

In addition, as a condition to making such payments to the issuers based on such formula, Nalco Holdings LLC must have an Adjusted EBITDA to interest expense ratio of at least 2.0 to 1 after giving effect to any such payments. Notwithstanding such restrictions, such indentures permit an aggregate of \$50.0 million of such payments to be made whether or not there is availability under the formula or the conditions to its use are met.

In December 2004, Nalco Finance Holdings LLC and Nalco Finance Holdings Inc. redeemed a portion of the senior discount notes with an accreted value of \$162.3 million using proceeds from the November 2004 initial public offering of common stock of Nalco Holding Company. After the partial redemption, the aggregate principal amount at

maturity of the notes declined to \$460.8 million from \$694.0 million.

The indentures governing the senior notes, the senior subordinated notes and senior discount notes limit our ability and the ability of our restricted subsidiaries to:

- incur additional indebtedness;
- pay dividends on or make other distributions or repurchase certain capital stock;
- make certain investments;
- enter into certain types of transactions with affiliates;
- limit dividends or other payments by our restricted subsidiaries;
- use assets as security in other transactions; and
- sell certain assets or merge with or into other companies.

Subject to certain exceptions, the indentures governing the senior notes, the senior subordinated notes and the senior discount notes permit our restricted subsidiaries and us to incur additional indebtedness, including secured indebtedness.

Covenant compliance. The breach of covenants in our senior credit agreement that are tied to ratios based on Adjusted EBITDA could result in a default under that agreement and the lenders could elect to declare all amounts borrowed due and payable. Any such acceleration would also result in a default under our indentures. Additionally, under our debt agreements, our ability to engage in activities such as incurring additional indebtedness, making investments and paying dividends is also tied to ratios based on Adjusted EBITDA.

Adjusted EBITDA is used to determine our compliance with many of the covenants contained in the indentures governing the notes and in our senior credit agreement. Adjusted EBITDA is defined as EBITDA further adjusted to exclude unusual items and other adjustments permitted in calculating covenant compliance under the indentures and our senior credit facility. We believe that the inclusion of supplementary adjustments to

EBITDA applied in presenting Adjusted EBITDA are appropriate to provide additional information to investors to demonstrate compliance with our financing covenants.

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

Adjusted EBITDA is calculated as follows:

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|-----------------------|--|--|--|--|
| (dollars in millions) | | | | |
| Net earnings | \$ 41.8 | \$ 21.5 | \$ 61.4 | \$ 30.3 |
| Interest, net | 66.3 | 65.8 | 132.0 | 130.4 |
| Income tax provision | 13.7 | 14.4 | 28.4 | 22.3 |

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| | | | | |
|------------------------------------|----------|----------|----------|----------|
| Depreciation | 32.2 | 32.3 | 64.0 | 64.7 |
| Amortization | 15.4 | 17.5 | 30.6 | 34.8 |
| EBITDA | \$ 169.4 | \$ 151.5 | \$ 316.4 | \$ 282.5 |
| Non-cash charges (1) | 4.0 | 6.5 | 13.5 | 16.0 |
| Business optimization expenses (2) | 2.3 | 1.8 | 2.3 | 5.6 |
| Unusual items (3) | 5.7 | 2.0 | 9.3 | 2.7 |
| Other adjustments (4) | (1.5) | (1.7) | (3.6) | (2.8) |
| Adjusted EBITDA | \$ 179.9 | \$ 160.1 | \$ 337.9 | \$ 304.0 |

(1) Non-cash charges are further detailed on the following table:

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|--|--|--|--|--|
| (dollars in millions) | | | | |
| Asset write-offs | \$ — | \$ 0.2 | \$ — | \$ 1.1 |
| Profit sharing expense and 401(k) funded by Suez | 6.5 | 6.4 | 13.2 | 11.8 |
| Other | (2.5) | (0.1) | 0.3 | 3.1 |
| Non-cash charges | \$ 4.0 | \$ 6.5 | \$ 13.5 | \$ 16.0 |
| Profit Sharing and 401(k) Expense Funded by Suez | | | | |

In conjunction with the Acquisition, we entered into an agreement with Suez whereby Suez will reimburse us for certain profit-sharing and 401(k) matching contributions made by us to the Profit-Sharing Trust.

Other

Other non-cash charges include the non-cash impact on earnings of our equity investments and minority interests. Non-cash charges also includes the non-cash portion of rent expense under the sublease that we entered into with Suez in conjunction with the Acquisition.

(2) Business optimization expenses include costs associated with the redesign and optimization of work processes. See Note 6 to Item 1 for more information.

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

(3) Unusual items are further detailed on the following table:

| | Three Months ended June 30, 2007 | Three Months ended June 30, 2006 | Six Months ended June 30, 2007 | Six Months ended June 30, 2006 |
|-----------------------|--|--|--|--|
| (dollars in millions) | | | | |
| Pension settlement | \$ — | \$ 0.1 | \$ — | \$ 0.4 |

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| | | | | |
|---------------------------------------|--------|--------|--------|--------|
| Loss (gain) on sales, net of expenses | 1.1 | 0.5 | 1.3 | 0.6 |
| Other unusual items | 4.6 | 1.4 | 8.0 | 1.7 |
| | \$ 5.7 | \$ 2.0 | \$ 9.3 | \$ 2.7 |

(4) We are required to make adjustments to EBITDA for franchise taxes and 401(k) matching contributions.

Our covenant levels and ratios for the four quarters ended June 30, 2007 are as follows:

| | June 30, 2007 | |
|--|---------------|--------|
| | Required | Actual |
| Senior credit facility (1) | | |
| Minimum Adjusted EBITDA to cash interest ratio | 1.80x | 3.26x |
| Maximum net debt to Adjusted EBITDA ratio | 5.50x | 3.89x |
| Indentures (2) | | |
| Minimum Adjusted EBITDA to fixed charge ratio required to incur additional debt pursuant to ratio provisions | 2.00x | 2.83x |

(1) During 2007, our senior credit facility requires us to maintain an Adjusted EBITDA to cash interest ratio at a minimum of 1.80x and a net debt to Adjusted EBITDA ratio at a maximum of 5.50x, in each case for the most recent four quarter period. Failure to satisfy these ratio requirements would constitute a default under the senior credit agreement. If our lenders failed to waive any such default, our repayment obligations under the senior credit agreement could be accelerated, which would also constitute a default under our indentures.

(2) Our ability to incur additional debt and make certain restricted payments under our indentures, subject to specified exceptions, is tied to an Adjusted EBITDA to fixed charge ratio of at least 2.0 to 1, except that we may incur certain debt and make certain restricted payments and certain permitted investments without regard to the ratio, such as up to an aggregate principal amount of \$1,950 million (including \$958.3 million that was outstanding under our term loan facilities as of June 30, 2007) and investments in similar business and other investments equal to 6% of Nalco Holding Company consolidated assets.

Local lines of credit. Certain of our non-U.S. subsidiaries have lines of credit to support local requirements. As of June 30, 2007, the aggregate outstanding balance under these local lines of credit was approximately \$38.6 million. Certain of these lines of credit are equally and ratably secured with obligations under our senior credit facilities.

Receivables facility. Nalco Company entered into a three-year receivables facility on June 25, 2004 that provided up to \$100 million in funding from a commercial paper conduit sponsored by JPMorgan Chase Bank, one of the lenders under Nalco Company's senior credit facilities. The facility expired on June 25, 2007.

On June 22, 2007, Nalco Company entered into a new three-year receivables facility. This facility provides up to \$160 million in funding from a commercial paper conduit sponsored by Bank of America, N.A., one of the lenders under Nalco Company's senior credit facilities, based on availability of eligible receivables and satisfaction of other customary conditions.

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

Availability of funding under the receivables facility depends primarily upon the outstanding trade accounts receivable balance from time to time. Aggregate availability is determined by using a formula that reduces the gross receivables balance by factors that take into account historical default and dilution rates, excessive concentrations and average days outstanding and the costs of the facility. Based on the terms of this facility and on the criteria described above, as of June 30, 2007, approximately \$229.2 million of our accounts receivable balance was considered eligible for financing under the program, of which approximately \$145.4 million would have been available for funding. As of June 30, 2007, we had \$148.8 million of outstanding borrowings under this facility, which was funded on June 22, 2007, based on the amount of receivables eligible for financing as of May 31, 2007.

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.

Share Repurchase Program

On July 31, 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.

There is no set timetable for share repurchases, and we intend to be opportunistic in the market. We are presently planning to make any share repurchases only from Free Cash Flow and not from incremental debt.

Recent Accounting Pronouncements

See Note 14 to the condensed consolidated financial statements, included in Part I, Item 1, for information on recent accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to our exposures to market risk since December 31, 2006.

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 as of June 30, 2007.

(b) Changes in internal controls over financial reporting.

During the quarter ended June 30, 2007, there were no material changes in our internal controls over financial reporting. During the quarter, we upgraded our current SAP enterprise-resource planning system and implemented several limited work process changes in North America and Europe that are primarily designed to improve our order-to-cash processes. There were limited changes in our internal controls over financial reporting related to these work process changes and the software upgrade. While there are inherent risks associated with implementing software upgrades and work process changes, we believe that our controls in the affected areas continue to be designed appropriately and operate effectively.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

On November 27, 2006, the U.K. Health and Safety Executive (“HSE”) issued a criminal summons charging our U.K. subsidiary with a violation of the Health and Safety at Work Act. The summons was re-issued in the Crown Court of Worcester on July 23, 2007. The charge relates to a legionella outbreak that is claimed to have originated at cooling towers at the subsidiary’s customers. The legionella outbreak is believed to have resulted in two fatalities and multiple injuries. The customer, H. P. Bulmer Limited, is also charged. The subsidiary received a statement of facts from the HSE on April 20, 2007.

Item 4. Submission of Matters to a Vote of Security Holders

The Annual Meeting of Shareholders was held on May 3, 2007. At the meeting, Dr. William H. Joyce and Mr. Rodney F. Chase were each elected by the shareholders to a term to expire in 2010.

| Nominee | For | Against | Withheld |
|------------------|-------------|---------|-----------|
| William H. Joyce | 119,467,650 | -0- | 1,949,274 |
| Rodney F. Chase | 115,510,478 | -0- | 5,906,274 |

Messrs. Marchese, O’Neill, Pertz and Sanders each have terms of office as directors that continued after the 2007 Annual Meeting.

The shareholders also ratified the appointment of Ernst & Young LLP as the Independent Registered Public Accounting Firm for 2007:

| For | Against | Abstain |
|-------------|---------|---------|
| 121,361,995 | 46,149 | 8,780 |

The shareholders also approved the Amended and Restated 2004 Stock Incentive Plan:

| For | Against | Abstain |
|------------|-----------|-----------|
| 92,731,582 | 2,545,842 | 2,751,422 |

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

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SIGNATURE

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

NALCO HOLDING COMPANY
/s/ BRADLEY J. BELL
Name: Bradley J. Bell
Title: Executive Vice President and
Chief Financial Officer

Dated: August 9, 2007

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