ASHLAND INC.
Form 10-Q
May 04, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2012

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _________ to ___________

Commission file number 1-32532

ASHLAND INC.

(a Kentucky corporation)
I.R.S. No. 20-0865835

50 E. RiverCenter Boulevard
P.O. Box 391
Covington, Kentucky 41012-0391
Telephone Number (859) 815-3333

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 þ

No o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes þ No ¨

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

Large Accelerated Filer þ	Accelerated Filer o
Non-Accelerated Filer o	Smaller Reporting Company o
(Do not check if a smaller reporting company.)	

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

At March 31, 2012, there were 78,467,329 shares of Registrant's Common Stock outstanding.

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME

(In millions except per share data - unaudited)	Three months ended March 31 2012	Three months ended March 31 2011	Six months ended March 31 2012	Six months ended March 31 2011
SALES	$2,079	$1,557	$4,009	$2,989
COSTS AND EXPENSES				
Cost of sales (a) (b)	1,504	1,094	2,912	2,128
Selling, general and administrative expense (b) (c)	381	201	743	478
Research and development expense	31	20	61	39
	1,916	1,315	3,716	2,645
EQUITY AND OTHER INCOME	16	14	30	27
OPERATING INCOME	179	256	323	371
Net interest and other financing expense	(56)	(39)	(113)	(66)
Net gain (loss) on acquisitions and divestitures	1	-	(3)	21
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	124	217	207	326
Income tax expense - Note J	34	35	57	72
INCOME FROM CONTINUING OPERATIONS	90	182	150	254
Income (loss) from discontinued operations (net of income taxes) - Note D (d)	(2)	303	(1)	329
NET INCOME	$88	$485	$149	$583
BASIC EARNINGS PER SHARE - Note M				
Income from continuing operations	$1.15	$2.30	$1.93	$3.22
Income (loss) from discontinued operations	(.03)	3.83	(.02)	4.19
Net income	$1.12	$6.13	$1.91	$7.41
DILUTED EARNINGS PER SHARE - Note M				
Income from continuing operations	$1.13	$2.26	$1.89	$3.16
Income (loss) from discontinued operations	(.03)	3.76	(.02)	4.10
Net income	$1.10	$6.02	$1.87	$7.26
DIVIDENDS PAID PER COMMON SHARE	$.175	$.15	$.35	$.30

(a) Includes a noncash charge of $28 million for the six months ended March 31, 2012 related to the fair value assessment of inventory acquired from ISP at the date of acquisition.

(b) The three and six months ended March 31, 2011 include $120 million of income ($37 million and $83 million recognized within the cost of sales and selling, general and administrative expense captions, respectively) related to the actuarial gain on pension and postretirement benefit plans, recognized in the prior year quarter due to a required plan remeasurement from the Distribution sale, which is further discussed in note (d).

(c) The three and six months ended March 31, 2012 include restructuring charges of $38 million and $66 million, respectively, related to certain company wide restructuring and integration activities related to recent business realignments through acquisitions, divestitures and joint venture arrangements.

(d) Includes income in the prior year of $44 million and $68 million for the three and six months ended March 31, 2011, respectively, related to direct results of the Distribution business that was divested on March 31, 2011. Due to the sale qualifying for discontinued operation treatment, the direct results of this business have been presented within this caption. In addition, the three and six months ended March 31, 2011 include an after-tax gain of $256 million on the sale of the Distribution business.

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions - unaudited)	March 31 2012	September 30 2011
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$599	$737
Accounts receivable (a)	1,489	1,482
Inventories - Note G	949	925
Deferred income taxes	163	163
Other assets	83	80
	3,283	3,387
NONCURRENT ASSETS		
Goodwill - Note H	3,319	3,291
Intangibles - Note H	2,066	2,134
Asbestos insurance receivable (noncurrent portion) - Note L	431	448
Equity and other unconsolidated investments	200	193
Other assets	585	599
	6,601	6,665
PROPERTY, PLANT AND EQUIPMENT		
Cost	4,341	4,306
Accumulated depreciation and amortization	(1,519)	(1,392)
	2,822	2,914
TOTAL ASSETS	$12,706	$12,966
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term debt - Note I	$55	$83
Current portion of long-term debt - Note I	109	101
Trade and other payables	882	911
Accrued expenses and other liabilities	532	644
	1,578	1,739
NONCURRENT LIABILITIES		
Long-term debt (noncurrent portion) - Note I	3,588	3,648
Employee benefit obligations - Note K	1,504	1,566
Asbestos litigation reserve (noncurrent portion) - Note L	753	783
Deferred income taxes	408	404
Other liabilities	643	691
	6,896	7,092
STOCKHOLDERS' EQUITY	4,232	4,135
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$12,706	$12,966

(a) Accounts receivable includes an allowance for doubtful accounts of $31 million and $37 million at March 31, 2011 and September 30, 2011, respectively.

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
STATEMENTS OF CONSOLIDATED STOCKHOLDERS' EQUITY

(In millions - unaudited)	Common stock	Paid-in capital	Retained earnings	Accumulated other comprehensive income (a)	Total
BALANCE AT SEPTEMBER 30, 2011	$ 1	$ 627	$ 3,200	$ 307	$ 4,135
Total comprehensive income (loss) (b)			149	(32)	117
Dividend on common stock, $.35 per share			(27)		(27)
Common shares issued under stock incentive and other plans (c)		7			7
BALANCE AT MARCH 31, 2012	$ 1	$ 634	$ 3,322	$ 275	$ 4,232

(a) At March 31, 2012, the after-tax accumulated other comprehensive income of $275 million was comprised of unrecognized prior service credits as a result of certain employee benefit plan amendments of $61 million, net unrealized translation gains of $232 million, and net unrealized losses on interest rate hedges of $18 million.
(b) Reconciliations of net income to total comprehensive income (loss) follow.

	Three months ended March 31		Six months ended March 31	
(In millions)	2012	2011	2012	2011
Net income	$ 88	$ 485	$ 149	$ 583
Unrealized translation gain (loss), net of tax	85	132	(26)	114
Pension and postretirement obligation adjustment, net of tax	-	5	-	5
Net unrealized loss on interest rate hedges, net of tax	(1)	-	(6)	-
Total comprehensive income	$ 172	$ 622	$ 117	$ 702

(c) Common shares issued were 381,780 for the six months ended March 31, 2012.

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

4

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
STATEMENTS OF CONDENSED CONSOLIDATED CASH FLOWS

(In millions - unaudited)	Six months ended March 31 2012	2011
CASH FLOWS (USED) PROVIDED BY OPERATING ACTIVITIES FROM CONTINUING OPERATIONS		
Net income	$ 149	$ 583
Loss (income) from discontinued operations (net of income taxes)	1	(329)
Adjustments to reconcile income from continuing operations to cash flows from operating activities		
Depreciation and amortization	212	143
Debt issuance cost amortization	12	19
Deferred income taxes	3	20
Equity income from affiliates	(14)	(7)
Distributions from equity affiliates	1	3
Gain from sale of property and equipment	(1)	(2)
Stock based compensation expense	13	9
Stock contributions to qualified savings plans	-	13
Net (gain) loss on acquisitions and divestitures	1	(21)
Inventory fair value adjustment related to ISP acquisition	28	-
Actuarial gain on pension and postretirement plans	-	(120)
Change in operating assets and liabilities (a)	(377)	(234)
	28	77
CASH FLOWS (USED) PROVIDED BY INVESTING ACTIVITIES FROM CONTINUING OPERATIONS		
Additions to property, plant and equipment	(98)	(52)
Proceeds from disposal of property, plant and equipment	3	4
Purchase of operations - net of cash acquired	-	(5)
Proceeds from sale of available-for-sale securities	4	-
Proceeds from sale of operations or equity investments	42	40
	(49)	(13)
CASH FLOWS (USED) PROVIDED BY FINANCING ACTIVITIES FROM CONTINUING OPERATIONS		
Proceeds from issuance of long-term debt	2	11
Repayment of long-term debt	(57)	(299)
Repayment of short-term debt	(28)	(29)
Cash dividends paid	(27)	(24)
Proceeds from exercise of stock options	2	2
Excess tax benefits related to share-based payments	3	1
	(105)	(338)
CASH USED BY CONTINUING OPERATIONS	(126)	(274)
Cash (used) provided by discontinued operations		
Operating cash flows	(8)	5
Investing cash flows	-	979
Effect of currency exchange rate changes on cash and cash equivalents	(4)	2
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(138)	712

CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	737	417
CASH AND CASH EQUIVALENTS - END OF PERIOD	$599	$1,129

(a) Excludes changes resulting from operations acquired or sold.

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A – SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial reporting and Securities and Exchange Commission regulations. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. These statements omit certain information and footnote disclosures required for complete annual financial statements and, therefore, should be read in conjunction with Ashland's Annual Report on Form 10-K for the fiscal year ended September 30, 2011. Results of operations for the period ended March 31, 2012 are not necessarily indicative of results to be expected for the year ending September 30, 2012. Certain prior period data has been reclassified in the Condensed Consolidated Financial Statements and accompanying footnotes to conform to current period presentation.

Ashland is composed of four reporting segments: Ashland Specialty Ingredients (Specialty Ingredients), which in previous periods prior to the acquisition of ISP had been named Functional Ingredients, Ashland Water Technologies (Water Technologies), Ashland Performance Materials (Performance Materials) and Ashland Consumer Markets (Consumer Markets).

On August 23, 2011, Ashland completed the acquisition of International Specialty Products Inc. (ISP). ISP's operating results are included in the Specialty Ingredients reporting segment, with the exception of ISP's Elastomers business, which is included within the Performance Materials reporting segment. See Note B for additional information on the ISP acquisition. On March 31, 2011, Ashland completed the sale of substantially all of the assets and certain liabilities of Ashland Distribution (Distribution). As a result of this sale, the prior period operating results and cash flows related to Distribution have been reflected as discontinued operations. See Notes C, D and P for additional information on the Distribution divestiture and reporting segment results.

Use of estimates, risks and uncertainties

The preparation of Ashland's Condensed Consolidated Financial Statements requires management to make estimates and assumptions that affect the reported amounts of certain assets, liabilities, revenues, expenses and related disclosures of contingent assets and liabilities as well as qualifying subsequent events. Significant items that are subject to such estimates and assumptions include, but are not limited to, long-lived assets (including goodwill and intangible assets), employee benefit obligations, income taxes, and liabilities and receivables associated with asbestos litigation, environmental remediation and asset retirement obligations. Although management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, actual results could differ significantly from the estimates under different assumptions or conditions.

Ashland's results are affected by domestic and international economic, political, legislative, regulatory and legal actions. Economic conditions, such as recessionary trends, inflation, interest and monetary exchange rates, government fiscal policies, and changes in the prices of hydrocarbon-based products and other raw materials, can have a significant effect on operations. While Ashland maintains reserves for anticipated liabilities and carries various levels of insurance, Ashland could be affected by civil, criminal, regulatory or administrative actions, claims or proceedings relating to asbestos, environmental remediation or other matters.

Change in accounting policy regarding pension and other postretirement benefits

During the September quarter in 2011, Ashland elected to change its method of recognizing actuarial gains and losses for its defined benefit pension and other postretirement benefit plans. Previously, Ashland recognized the actuarial gains and losses as a component of Stockholders' Equity within the Condensed Consolidated Balance Sheet on an annual basis and amortized the gains and losses into operating results over the average future service period of active employees within the related plans. Ashland has elected to immediately recognize the change in the fair value of plan assets and net actuarial gains and losses annually in the fourth quarter of each year and whenever a plan is determined to qualify for a remeasurement during a year. The remaining components of pension and other postretirement benefits expense will be recorded on a quarterly basis. While Ashland's historical policy

6

NOTE A – SIGNIFICANT ACCOUNTING POLICIES (continued)

of recognizing pension and other postretirement benefit expense is acceptable under U.S. GAAP, Ashland believes that the new policy is preferable as it eliminates the delay in recognizing gains and losses within operating results. This change will also improve transparency within Ashland's operating results by immediately recognizing the effects of economic and interest rate trends on plan investments and assumptions in the year these gains and losses are actually incurred. This change in accounting policy has been applied retrospectively, adjusting all prior periods presented.

In conjunction with this change in accounting policy for pension and other postretirement benefits, Ashland also elected to change its method of accounting for certain costs included in inventory. Ashland has elected to exclude the amount of its pension and other postretirement benefit costs applicable to inactive participants from inventoriable costs and charge them directly to cost of sales. While Ashland's historical policy of including all pension and other postretirement benefit costs as a component of inventoriable costs was acceptable, Ashland believes that the new policy is preferable, as inventoriable costs will only include costs that are directly attributable to current manufacturing employees. Applying this change retrospectively, in connection with the change in accounting for pension and other postretirement benefit costs, did not have a significant impact on previously reported inventory, cost of sales or segment reported results in any of the prior period financial statements.

The effect of the accounting policy changes on the previously reported results for the three and six months ended March 31, 2011 resulted in increases in net income of $132 million and $144 million, respectively, and increases in diluted earnings per share from net income of $1.63 and $1.79, respectively.

New accounting standards

The adoption of new accounting standards and new accounting standards issued during the current year are included in interim financial reporting. A detailed listing of all new accounting standards relevant to Ashland is included in the Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

In December 2011, the FASB issued accounting guidance related to the offsetting of assets and liabilities on the balance sheet (ASC 210 Balance Sheet). The new guidance requires disclosures to provide information to help reconcile differences in the offsetting requirements under U.S. GAAP. This guidance will become effective for Ashland on October 1, 2013. The adoption of this guidance is not expected to have a material impact on the Condensed Consolidated Financial Statements.

NOTE B – ACQUISITIONS

International Specialty Products Inc. (ISP)

Background and financing

On August 23, 2011, Ashland completed its acquisition of ISP, a global specialty chemical manufacturer of innovative functional ingredients and technologies, in a transaction valued at $3.2 billion. ISP reported sales of $1.9 billion for the twelve month period ended September 30, 2011. The purchase price was an all cash transaction, reduced by the amount of ISP's net indebtedness at closing, and is subject to post-closing adjustments based on changes in ISP's net working capital as well as adjustments to the extent that certain change in control payments, termination costs for interest rate swaps, and accrued pension and other post-employment benefit liabilities of ISP exceed specified amounts. Ashland has included ISP within the Specialty Ingredients reportable segment, with the exception of ISP's Elastomers business line, a business with $410 million of sales for the twelve month period ended September 30, 2011, which has been included within the Performance Materials reportable segment. The acquisition was recorded by Ashland using the acquisition method of accounting in accordance with applicable U.S. GAAP whereby the total purchase price was allocated to tangible and intangible assets and liabilities acquired based on respective fair values.

On August 23, 2011, in conjunction with the ISP acquisition closing, Ashland entered into a $3.9 billion senior secured credit facility with a group of lenders (Senior Credit Facility). The Senior Credit Facility is comprised of

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE B – ACQUISITIONS (continued)

(i) a $1.5 billion term loan A facility, (ii) a $1.4 billion term loan B facility and (iii) a $1.0 billion revolving credit facility. Proceeds from borrowings under the term loan A facility and the term loan B facility were used, together with cash on hand, to finance the cash consideration paid for the ISP acquisition, as well as to finance the repayment of existing indebtedness of ISP in connection with the acquisition.

Purchase price allocation

The all-cash purchase price of ISP was $2,177 million. The following table summarizes the values of the assets acquired and liabilities assumed at the date of acquisition.

Purchase price allocation (in millions)		At August 23, 2011
Assets:		
Cash	$	186
Accounts receivable		286
Inventory		381
Other current assets		51
Intangible assets		1,101
Goodwill		1,234
Property, plant and equipment		1,140
Other noncurrent assets		85
Liabilities:		
Accounts payable		(175)
Accrued expenses		(211)
Debt		(1,196)
Deferred tax - net		(570)
Employee benefit obligations		(72)
Other noncurrent liabilities		(63)
Total purchase price	$	2,177

As of March 31, 2012, the purchase price allocation for the acquisition was preliminary and subject to completion. Adjustments to the current fair value estimates in the above table may occur as the process conducted for various valuations and assessments is finalized. Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the estimated future economic benefits arising from other assets acquired that could not be individually identified and separately recognized.

Intangible assets identified

Ashland identified $135 million of in-process research and development (IPR&D) projects within the acquired ISP business that, as of the date of acquisition, had not been established in the market place. These projects consist of various enhancements of existing products or new potential applications for products. Ashland used various valuation models based on discounted probable future cash flows on a project-by-project basis in identifying 23 projects as distinct assets. With the adoption of ASC Topic 805, “Business Combinations,” on October 1, 2009, identified IPR&D acquired in a business combination is capitalized and tested for impairment annually and when events and circumstances indicate an impairment may have occurred. As such, these assets have and will continue to be subjected to future impairment or amortization as the individual projects continue through the various stages of the feasibility assessment process.

Ashland also identified approximately $174 million of certain product trade names, within the Specialty Ingredients business, that have been designated as indefinite-lived assets. Ashland’s designation of an indefinite life for these assets took many factors into consideration, including the current market leadership position of the brands as well as their recognition worldwide in the industry. The remaining $792 million of identified finite-lived intangible assets

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE B – ACQUISITIONS (continued)

are being amortized over the estimated useful life in proportion to the economic benefits consumed. Ashland considered the useful lives of the customer relationships and developed technology to be 18 years and 8 to 15 years, respectively. The determination of the useful lives is based upon various industry studies, historical acquisition experience, economic factors, and future cash flows of the combined company. In addition, Ashland reviewed certain technological trends and also considered the relative stability in the current ISP customer base.

The following details the total intangible assets identified.

Intangible asset type (in millions)		Value	Life (years)
Customer relationships - Specialty Ingredients	$	266	18
Developed technology - Specialty Ingredients		498	8 - 15
Developed technology - Performance Materials		19	8 - 15
IPR&D - Specialty Ingredients		135	Indefinite
Product trade names - Specialty Ingredients		174	Indefinite
Product trade names - Specialty Ingredients		3	4
Product trade names - Performance Materials		6	4
Total	$	1,101	

NOTE C– DIVESTITURES

Synlubes business divestiture

In January 2012, Ashland completed the sale of its aviation and refrigerant lubricants business, a polyol/ester-based synlubes (Synlubes) business previously included within the Water Technologies business segment to Monument Chemical Inc., a Heritage Group Company. Annual sales of the business were approximately $50 million. Total net assets related to this business totaled $20 million as of the date of sale and primarily consisted of property, plant and equipment. The transaction resulted in a pretax loss of less than $1 million recognized during the March 2012 quarter.

PVAc business divestiture

In January 2012, Ashland completed the sale of its polyvinyl acetate homopolymer and copolymer (PVAc) business previously included within the Performance Materials business segment to Celanese Corporation. Annual sales of the business were approximately $45 million. Total net assets related to this business totaled $20 million as of the date of sale and primarily consisted of property, plant and equipment. The sale included the transfer of the PVAc business, inventory and related technology, but did not include any real estate or manufacturing facilities. Ashland's PVAc business included two brands, Flexbond™ and Vinac™ emulsions. To support the transition, the products will be temporarily toll manufactured by Ashland for Celanese Corporation. The transaction resulted in a pretax gain of $2 million recognized during the March 2012 quarter.

Ashland Distribution

On March 31, 2011, Ashland completed the sale to Nexeo Solutions, LLC (Nexeo) of substantially all of the assets and certain liabilities of its global distribution business which previously comprised the Ashland Distribution (Distribution) segment. The transaction was an asset sale with the total post-closing adjusted cash proceeds received by Ashland of $972 million, before transaction fees and taxes. Ashland recognized an after-tax gain of $256 million during the three and six months ended March 31, 2011. Because this transaction signified Ashland's exit from the distribution business, the results of operations and cash flows of Distribution have been classified as discontinued operations for all periods presented. During the year following the sale of Distribution, certain

9

NOTE C – DIVESTITURES (continued)

indirect corporate costs included within selling, general and administrative expense that were previously allocated to the Distribution reporting segment that did not qualify for discontinued operations accounting classification were reported as costs within the Unallocated and other section of continuing operations, and for the three months ended March 31, 2012 and 2011 were $0 million and $5 million, respectively, and were $5 million and $15 million for the six months ended March 31, 2012 and 2011, respectively.

Ashland has retained and agreed to indemnify Nexeo for certain liabilities of the Distribution business arising prior to the closing of the sale. This includes pension and other postretirement benefits, as well as certain other liabilities, including certain litigation and environmental liabilities relating to the pre-closing period, as described in the definitive agreement. The ongoing effects of the pension and postretirement plans for former Distribution employees are reported within the Unallocated and other section of continuing operations.

As part of this sale, Ashland is receiving transition service fees for ongoing administrative and other services being provided to Nexeo. During the three and six months ended March 31, 2012, Ashland recognized transition service fees of $8 million and $16 million, respectively, which offset costs of providing transition services and are classified within the selling, general and administrative expense caption of the Statements of Consolidated Income. While the transition service agreements vary in duration depending upon the type of service provided, Ashland has implemented cost reductions as the transition services are phased out.

Casting Solutions Joint Venture

In July 2010, Ashland and Süd-Chemie AG (Süd-Chemie) signed an agreement for the formation of an expanded 50/50 global joint venture serving the foundry chemical sector. The transaction closed on November 30, 2010 and combined three businesses: (i) Ashland’s Casting Solutions business group, (ii) Süd-Chemie’s Foundry-Products and Specialty Resins business unit, and (iii) Ashland-Südchemie-Kernfest GmbH (ASK), the then existing 50% owned European-based joint venture between Ashland and Süd-Chemie, for which Ashland historically only recognized equity income of the joint venture within its consolidated results. Upon formation of the expanded global joint venture, Ashland used valuation methodologies for certain contributions that primarily consisted of various discounted cash flow models in recording its equity interest at approximately $120 million. This investment basis was based on the fair value of the net assets of the Casting Solutions business group as well as the carrying value of Ashland’s 50% equity interest in ASK.

Upon deconsolidation of the Casting Solutions business group, Ashland recognized a pretax gain of $23 million during 2011, of which $5 million and $23 million were recognized during the three and six months ended March 31, 2011, respectively. The gain was attributable to the fair market value of the net assets contributed to the joint venture exceeding the related carrying values. For the majority of the valuation of the Casting Solutions assets and liabilities, Ashland utilized the discounted cash flow method; however, the adjusted book value method was also used in some areas of the valuation. The gain was included in the net gain on acquisitions and divestitures caption in the Statements of Consolidated Income. The values of assets and liabilities contributed on the closing date of the transaction by Ashland to the expanded global joint venture, excluding equity interests, were as follows:

(In millions)	Assets (liabilities)
Cash	$ 9
Accounts receivable	52
Inventories	21
Property, plant and equipment	34
Goodwill	52
Trade and other payables	(24)
Other noncurrent assets (liabilities) - net	11
	$ 155

10

NOTE C – DIVESTITURES (continued)

In addition, Ashland determined that the formation of the expanded global joint venture did not change Ashland's ability to exercise significant influence over operating and financing policies of the joint venture, which could have required a fair market value assessment of assets and liabilities. Therefore, Ashland accounted for this part of the formation of the expanded global joint venture at historical cost, and no gain or loss was recognized.

Ashland's equity interest in the expanded joint venture qualifies for equity method accounting treatment under U.S. GAAP. As a result, beginning on December 1, 2010, the results of the Performance Materials segment no longer includes the sales, cost of sales, selling, general and administrative expense and corresponding taxes related to the Casting Solutions business; however, Ashland includes the financial results of the joint venture within operating income of the Performance Materials segment and in the equity and other income caption of the Statements of Consolidated Income.

NOTE D – DISCONTINUED OPERATIONS

As previously described in Note C, on March 31, 2011 Ashland completed the sale of substantially all of the assets and certain liabilities of Distribution. Ashland has determined that this sale qualifies as a discontinued operation, in accordance with U.S. GAAP, since Ashland does not have significant continuing involvement in the distribution business. As a result, operating results and cash flows related to Distribution have been reflected as discontinued operations in the Statement of Consolidated Income and Statement of Condensed Consolidated Cash Flows. Sales for the three and six months ended March 31, 2011 were $1,013 million and $1,868 million, respectively. The results of operations for the three and six months ended March 31, 2011 are included in the table below. Ashland has made subsequent adjustments to the gain on sale of Distribution, primarily relating to the tax effects of the sale, during the six months ended March 31, 2012.

Ashland's divestiture of Ashland Paving And Construction (APAC) during 2006 qualified as a discontinued operation. As a result, the previous operating results, assets and liabilities related to APAC have been reflected as discontinued operations in the Condensed Consolidated Financial Statements. Ashland has made subsequent adjustments to the gain on the sale of APAC, primarily relating to the tax effects of the sale, during the three and six month periods ended March 31, 2011. Such adjustments to these and other divested businesses may continue to occur in future periods and are reflected in the period they are determined and recorded in the discontinued operations caption in the Statements of Consolidated Income.

Ashland is subject to liabilities from claims alleging personal injury caused by exposure to asbestos. Such claims result primarily from indemnification obligations undertaken in 1990 in connection with the sale of Riley Stoker Corporation (Riley), a former subsidiary of Ashland, and from the acquisition of Hercules during 2009, a wholly-owned subsidiary of Ashland. Adjustments to the recorded litigation reserves and related insurance receivables are recorded within discontinued operations and continue periodically, primarily reflecting updates to the original estimates. See Note L for more information related to the adjustments on asbestos liabilities and receivables.

Components of amounts reflected in the Statements of Consolidated Income related to discontinued operations are presented in the following table for the three and six months ended March 31, 2012 and 2011.

(In millions)	Three months ended March 31 2012	Three months ended March 31 2011	Six months ended March 31 2012	Six months ended March 31 2011
Income (loss) from discontinued operations (net of tax)				
Distribution (a)	$ (2)	$ 44	$ (3)	$ 68
Asbestos-related litigation reserves and receivables	-	-	6	1
Gain (loss) on disposal of discontinued operations (net of tax)				
Distribution (a)	-	256	(4)	256
APAC	-	3	-	4
Total (loss) income from discontinued operations (net of tax)	$ (2)	$ 303	$ (1)	$ 329

(a) For the three and six months ended March 31, 2011, the pretax income reported for Distribution was $421 million and $457 million, respectively.

11

NOTE E – RESTRUCTURING ACTIVITIES

Ashland periodically implements restructuring programs related to acquisitions, divestitures or other cost reduction programs in order to enhance profitability through streamlined operations and an improved overall cost structure for each business.

Severance costs

During 2011, Ashland announced steps to reduce stranded costs resulting from the divestiture of Distribution and the contribution of the Casting Solutions business to the expanded global joint venture with Süd-Chemie. In addition, Ashland is currently taking action to integrate ISP subsequent to its purchase in August 2011. As a first step to address cost reduction opportunities resulting from these transactions, Ashland announced a voluntary severance offer (VSO) in June 2011 to approximately 1,500 regular, full-time, non-union, U.S.-based employees, primarily within various shared resource groups as well as certain positions within the Specialty Ingredients business, ultimately resulting in 150 employees being formally approved for the VSO. An involuntary program was also initiated as a further step to capture targeted saving levels from these transactions and other business cost saving initiatives. The VSO and involuntary program resulted in a severance charge of $34 million during the September 2011 quarter. The involuntary program continued during 2012 and resulted in an expense of $25 million being recognized within the selling, general and administrative expense caption during the six months ended March 31, 2012. Additional charges related to the involuntary program may be incurred in subsequent periods from ongoing efforts to maximize operational efficiencies as a result of these transactions. As of March 31, 2012, the restructuring reserve for these programs totaled $46 million.

As of March 31, 2012 and 2011, the remaining $6 million and $18 million, respectively, in restructuring reserves for previously announced programs consisted of severance payments from the 2009 Hercules Integration Plan, which resulted in 12 permanent facility closings and a reduction in the global workforce of over 2,000 employees from 2008 through 2010 and the 2010 Performance Materials restructuring, which consisted of several plant closings and an operational redesign to eliminate excess capacity.

Facility costs

During the three and six months ended March 31, 2012, Ashland incurred a $20 million lease abandonment charge related to its exit from an office facility that was retained as part of the Hercules acquisition. The costs related to the reserve will be paid over the remaining lease term through May 2016. Also during the March 2012 quarter, in order to maximize operational efficiencies, Ashland abandoned a construction project for a multi-purpose facility in China. This project abandonment resulted in a $16 million charge which primarily related to expenses incurred for engineering and construction in progress. Both charges were recognized within the selling, general and administrative expense caption during the three and six months ended March 31, 2012.

The following table details, as of March 31, 2012 and 2011, the amount of restructuring reserves related to the programs discussed above, and the related activity in these reserves for the six months ended March 31, 2012 and 2011. The reserves are included in accrued expenses and other liabilities in the Condensed Consolidated Balance

Sheet.

(In millions)		Severance		Facility costs		Total
Balance as of September 30, 2011	$	45	$	-	$	45
Restructuring reserve		25		20		45
Utilization (cash paid or otherwise settled)		(18)		(1)		(19)
Balance at March 31, 2012	$	52	$	19	$	71
Balance as of September 30, 2010	$	26	$	-	$	26
Utilization (cash paid or otherwise settled)		(8)		-		(8)
Balance at March 31, 2011	$	18	$	-	$	18

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE F – FAIR VALUE MEASUREMENTS

As required by U.S. GAAP, Ashland uses applicable guidance for defining fair value, the initial recording and periodic remeasurement of certain assets and liabilities measured at fair value and related disclosures for instruments measured at fair value. Fair value accounting guidance establishes a fair value hierarchy, which prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). An instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the instrument's fair value measurement. The three levels within the fair value hierarchy are described as follows:

Level 1 — Observable inputs such as unadjusted quoted prices in active markets for identical assets or liabilities.

Level 2 — Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3 — Unobservable inputs for the asset or liability for which there is little, if any, market activity at the measurement date. Unobservable inputs reflect Ashland's own assumptions about what market participants would use to price the asset or liability. The inputs are developed based on the best information available in the circumstances, which might include occasional market quotes or sales of similar instruments or Ashland's own financial data such as internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant management judgment.

For assets that are measured using quoted prices in active markets (Level 1), the total fair value is the published market price per unit multiplied by the number of units held without consideration of transaction costs. Assets and liabilities that are measured using significant other observable inputs (Level 2) are primarily valued by reference to quoted prices of similar assets or liabilities in active markets (market approach), adjusted for any terms specific to that asset or liability. For all other assets and liabilities for which unobservable inputs are used (Level 3), fair value is derived through the use of fair value models, such as a discounted cash flow model or other standard pricing models that Ashland deems reasonable.

The following table summarizes financial asset instruments subject to recurring fair value measurements as of March 31, 2012.

(In millions)	Carrying value	Total fair value	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3

Assets					
Cash and cash equivalents	$ 599	$ 599	$ 599	$ -	$ -
Auction rate securities	6	6	-	-	6
Deferred compensation investments (a)	177	177	59	118	-
Investments of captive insurance company (a)	2	2	2	-	-
Total assets at fair value	$ 784	$ 784	$ 660	$ 118	$ 6
Liabilities					
Interest rate swap derivatives	$ 30	$ 30	$ -	$ 30	$ -

(a) Included in other noncurrent assets in the Condensed Consolidated Balance Sheets.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE F – FAIR VALUE MEASUREMENTS (continued)

The following table summarizes financial asset instruments subject to recurring fair value measurements as of September 30, 2011.

(In millions)	Carrying value	Total fair value	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3
Assets					
Cash and cash equivalents	$ 737	$ 737	$ 737	$ -	$ -
Auction rate securities	10	10	-	-	10
Deferred compensation investments (a)	185	185	76	109	-
Investments of captive insurance company (a)	2	2	2	-	-
Foreign currency derivatives	1	1	-	1	-
Total assets at fair value	$ 935	$ 935	$ 815	$ 110	$ 10
Liabilities					
Interest rate swap derivatives	$ 20	$ 20	$ -	$ 20	$ -

(a) Included in other noncurrent assets in the Condensed Consolidated Balance Sheets.

Derivative and hedging activities

Currency hedges

Ashland conducts business in a variety of foreign currencies. Accordingly, Ashland regularly uses foreign currency derivative instruments to manage exposure on certain transactions denominated in foreign currencies to curtail the earnings volatility effects of short-term assets and liabilities denominated in currencies other than the functional currency of an entity.

Ashland contracts with counter-parties to buy and sell foreign currencies to offset the impact of exchange rate changes on transactions denominated in non-functional currencies, including short-term inter-company loans. These contracts generally require exchange of one foreign currency for another at a fixed rate at a future date and generally have maturities of less than twelve months. All contracts are marked-to-market with net changes in fair value recorded within the selling, general and administrative expense caption. The impacts of these contracts were largely offset by gains and losses resulting from the impact of changes in exchange rates on transactions denominated in non-functional currencies. The following table summarizes the gains and losses recognized during the three and six months ended March 31, 2012 and 2011 within the Statement of Consolidated Income.

	Three months ended March 31		Six months ended March 31	
(In millions)	2012	2011	2012	2011
Foreign currency derivative gain (loss)	$ 2	$ -	$ 3	$ (1)

The following table summarizes the fair values of the outstanding foreign currency derivatives as of March 31, 2012 and September 30, 2011 included in other current assets and trade and other payables of the Condensed Consolidated Balance Sheet.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE F – FAIR VALUE MEASUREMENTS (continued)

(In millions)	March 31 2012	September 30 2011
Foreign currency derivative assets (a)	$ -	$ 1
Notional contract values	57	62
Foreign currency derivative liabilities (a)	$ -	$ -
Notional contract values	46	35

(a) Fair values of assets and liabilities of $0 denote values less than $1 million.

Interest rate hedges

During 2011, Ashland entered into interest rate swap agreements in order to manage the variable interest rate risk associated with term loans A and B that were borrowed in conjunction with the ISP acquisition. As of March 31, 2012 and September 30, 2011, the total notional value of interest rate swaps related to term loans A and B equaled $1.5 billion and $650 million, respectively. These instruments qualify for hedge accounting treatment and are designated as cash flow hedges whereby Ashland records these hedges at fair value, with the effective portion of the gain or loss reported as a component of accumulated other comprehensive income (AOCI) and subsequently recognized in the Statements of Consolidated Income when the hedged item affects net income. There was no hedge ineffectiveness with these instruments during the three and six months ended March 31, 2012.

The fair value of Ashland's interest rate swap assets and liabilities are calculated using standard pricing models. These models utilize inputs derived from observable market data such as interest rate spot rates and forward rates, and are deemed to be Level 2 measurements within the fair value hierarchy. Counterparties to these interest rate swap agreements are highly rated financial institutions which Ashland believes carry only a minimal risk of nonperformance. The following table summarizes the fair values of the outstanding interest rate swap instruments as of March 31, 2012 and September 30, 2011.

(In millions)	Consolidated balance sheet caption	March 31 2012	September 30 2011
Interest rate swap liabilities	Accrued expenses and other liabilities	$ 18	$ 17
Interest rate swap liabilities	Other noncurrent liabilities	12	3

The following table summarizes the unrealized loss on interest rate hedges recognized in AOCI during the three and six months ended March 31, 2012, as well as the loss reclassified from AOCI to the Statement of Consolidated Income during the three and six months ended March 31, 2012. The loss reclassified to the Statement of Consolidated Income was recorded in the net interest and other financing expense caption.

	Three months ended	Six months ended

(In millions)	March 31, 2012	March 31, 2012
Change in unrealized loss in AOCI	$ 6	$ 20
Loss reclassified from AOCI to income	5	10

During 2009, Ashland purchased a three year interest rate cap on a notional amount of $300 million of variable rate debt. This interest rate cap fixed Ashland's interest rate on that outstanding variable interest rate debt when LIBOR interest rates equaled or exceeded 7% on a reset date. This instrument expired during the March 2012 quarter and did not result in any gain or loss.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE F – FAIR VALUE MEASUREMENTS (continued)

Other financial instruments

At March 31, 2012 and September 30, 2011, Ashland's long-term debt had a carrying value of $3,697 million and $3,749 million, respectively, compared to a fair value of $3,784 million and $3,953 million, respectively. The fair values of long-term debt are based on quoted market prices or, if market prices are not available, the present values of the underlying cash flows discounted at Ashland's incremental borrowing rates, and are deemed to be Level 2 measurements within the fair value hierarchy.

NOTE G – INVENTORIES

Inventories are carried at the lower of cost or market. Certain chemicals, plastics and lubricants are valued at cost using the last-in, first-out (LIFO) method. The remaining inventories are stated at cost using the weighted-average cost method or the first-in, first-out method. The following table summarizes Ashland's inventories as of the reported Condensed Consolidated Balance Sheet dates.

(In millions)	March 31 2012	September 30 2011
Finished products	$ 656	$ 620
Raw materials, supplies and work in process	362	364
LIFO reserve	(69)	(59)
	$ 949	$ 925

NOTE H – GOODWILL AND OTHER INTANGIBLES

Goodwill

In accordance with U.S. GAAP, Ashland reviews goodwill and indefinite-lived intangible assets for impairment annually and when events and circumstances indicate an impairment may have occurred. The annual assessment is performed as of July 1 and consists of Ashland determining each reporting unit's current fair value compared to its current carrying value. Ashland has determined that its reporting units for allocation of goodwill include the Specialty Ingredients, Water Technologies and Consumer Markets reportable segments and the Composite Polymers/Specialty Polymers/Adhesives and Elastomers reporting units within the Performance Materials reportable segment. Prior to its sale to Nexeo, Distribution was treated as a separate reporting unit for allocation of goodwill. Ashland performed its most recent annual goodwill impairment test as of July 1, 2011, and determined at that time that no impairment existed.

The following is a progression of goodwill by segment for the period ended March 31, 2012.

(In millions)	Specialty Ingredients	Water Technologies	Performance Materials	Consumer Markets	Total
Balance at September 30, 2011	$ 2,092	$ 676	$ 357	$ 166	$ 3,291
Acquisitions (a)	49	-	-	-	49
Divestitures (b)	-	(4)	(5)	-	(9)
Currency translation adjustment	(10)	2	(4)	-	(12)
Balance at March 31, 2012	$ 2,131	$ 674	$ 348	$ 166	$ 3,319

(a) The adjustment primarily relates to updates to the post-closing adjustments from the ISP acquisition, which principally occurred in the December 2011 quarter.

(b) The reductions to goodwill of $4 million and $5 million resulted from Ashland's sale of its Synlubes and PVAc businesses during the March 2012 quarter.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE H – GOODWILL AND OTHER INTANGIBLES (continued)

Other intangible assets

Intangible assets principally consist of trademarks and trade names, intellectual property, customer lists, IPR&D and sale contracts and those classified as finite are amortized on a straight-line basis over their estimated useful lives. The cost of definite-lived trademarks and trade names is amortized principally over 4 to 25 years, intellectual property over 5 to 20 years, customer relationships over 3 to 24 years and other intangibles over 2 to 50 years.

IPR&D and certain intangible assets within trademarks and trade names have been classified as indefinite-lived and had a balance of $598 million and $599 million as of March 31, 2012 and September 30, 2011, respectively. The $1 million decrease in indefinite-lived intangible assets relates to a trademark that was included as part of Ashland's sale of its PVAc business.

In accordance with U.S. GAAP, Ashland annually reviews indefinite-lived intangible assets for possible impairment or whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. In conjunction with the July 1, 2011 annual assessment of indefinite-lived intangible assets, Ashland's models did not indicate any impairment. Intangible assets were comprised of the following as of March 31, 2012 and September 30, 2011.

	March 31, 2012		
(In millions)	Gross carrying amount	Accumulated	Net carrying