



NALCO HOLDING COMPANY
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NLC: BUY

SYMBOL:	NLC
CURRENT PRICE: (06.10.2010)	\$21.25
TARGET:	\$28.90
SHARES OUTSTANDING:	138.28 M
MARKET CAP:	3.11 B
52-WEEK HIGH:	\$29.25
52-WEEK LOW:	\$15.19
AVG. VOL. (50 DAYS):	1,001,800

HIGHLIGHTS

- Q1, 2010 already witnessed a 10% increase in revenue from corresponding period in previous year.
- Added 180 people in China and India in 2009. New research centers in China and Brazil with another expected in India.
- BP has acquired Nalco Holding's entire inventory of its Corexit oil dispersant as the oil giant tries to fight the Gulf of Mexico oil spill

RESEARCH REPORT: Nalco Holding Company (NLC)

OVERVIEW

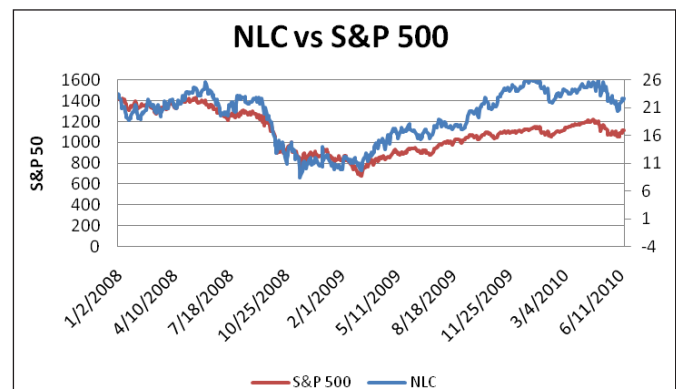
Nalco Holding Company is the global leader in water, energy, air and process technologies and services. It helps customers reduce energy, water and other natural resources consumption. Nalco business can be classified into three segments, Water Services, Paper Services and Energy Services. The company serves more than 70,000 customer locations in over 130 countries. Current employee strength is around 11,500 in more than 150 countries.

Nalco was founded in 1928 and its executive offices are located in Naperville, Illinois.

Nalco Holding holds the number one position in Water Services and Energy Services segments globally whereas it is ranked third in the Paper Services segment. Net sales of the company in FY2009 were \$3,746.8 million with Net profit of \$67.9 million. The company has witnessed a drop in its revenue in year 2009, mainly due to the global economic recession. The company has already identified the issues and formulated a strategic plan to again get into the growth phase. It expects Energy services and air protection segments will be growth drivers for the company. It also focuses more on fast growing economies like BRIC countries. We expect the company to grow at mid or high single digit rates for next few years. The company has also been very successful in cost cutting and we believe this trend will continue.

We believe Nalco Holding has a great prospect considering the water scarcity issue in many fast growing economies will force industries to use far less water and fully treat discharge.

Although Nalco Holding business segment may not witness spectacular growth like sunrise industries, it can certainly provide steady and less risky growth prospects. With the company being successful in managing its cost, we believe NLC stock seems a good buy with a target price of \$28.90.



Source: Yahoo Finance

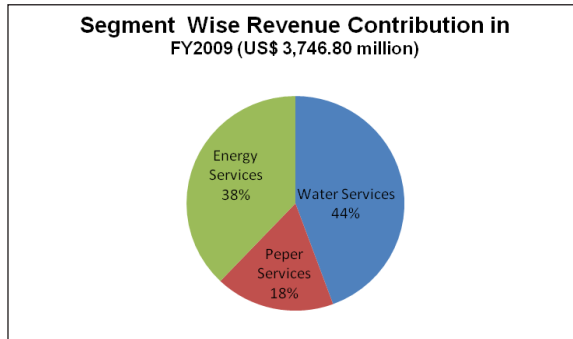
Key Forecasts

	FY 2009 A	FY 2010 E	FY 2011 E	FY 2012 E	FY 2013 E	FY 2014 E
Revenues (\$ million)	3,747	3,911	4,125	4,342	4,553	4,787
EBITDA (\$ million)	624	651	695	738	778	823
Profit before tax (\$ million)	136	247	290	332	375	425
Profit after tax (\$ million)	61	160	188	216	244	276
EPS	0.44	1.16	1.36	1.56	1.76	2.00
ROIC (%)	5%	12%	13%	13%	14%	14%

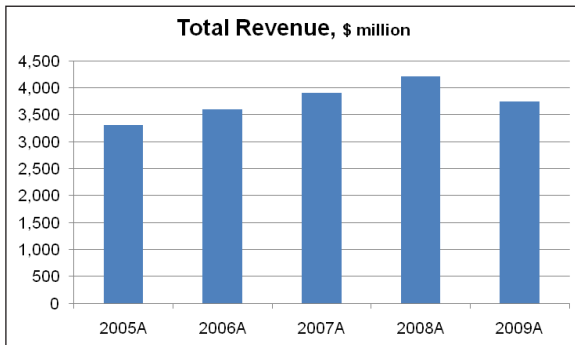
NALCO BUSINESS OVERVIEW

Nalco is the world's leading water treatment and process improvement services company. The company offers cost effective applications to reduce energy, water and other natural resources to its diversified customers across different industries. The company's business can be classified into three segments, Water services, Paper services and Energy services.

It holds the number one market position in global Water services and Energy services segments with 18% and 33% market share respectively. In the Paper services segment, it holds a 9% market share. Key strengths of the company are its global presence and large customer base. The company serves more than 70,000 customer locations in over 130 countries. Its largest customer contributes less than 4% of sales.



Source: Annual Report



Source: Annual Report

Before the year 2009, Nalco Holding was achieving a steady growth rate in its top line and between year 2004 and 2008, its top line had grown at a CAGR of around 8%. However the global economic recession has had a severe effect on the company's financials in 2009. Its revenue dropped by about 11% from the previous year, although a fraction of the drop is due to some divestiture.

As bulk of its revenue comes from matured markets, North America and Europe, the effect of economic slowdown was more pronounced on Nalco Holding.

IMMEDIATE GROWTH DRIVERS WILL BE ENERGY SERVICES SEGMENT AND BRIC COUNTRIES

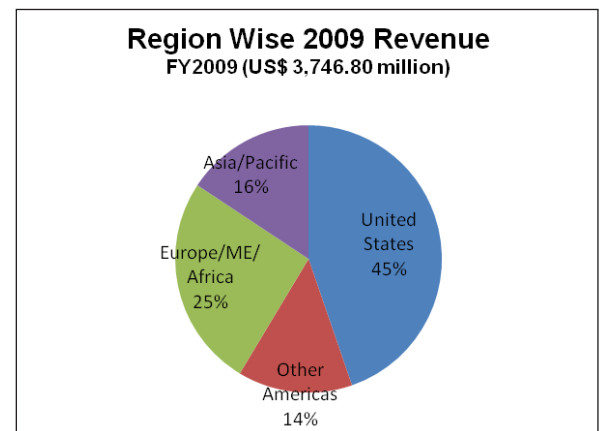
The company has formulated a strategic plan to again enter into the growth phase. Some of the important goals are,

- Focus on BRIC+ countries.
- Consider Energy Services and Air protection businesses as current growth drivers.

RESEARCH REPORT: Nalco Holding Company (NLC)

Business of Nalco depends a lot on the health of the economy. As the company now generates bulk of its revenue from matured markets like North America and Europe, it is difficult to grow its top line significantly. So Nalco is now focusing more on BRIC countries, which are witnessing the fastest growth in economy among all the regions. The company has added 180 people in china and India in 2009. This plan alone is estimated to contribute 2%+ growth to the company.

The company believes its energy services segment will be the growth driver now. This division provides services to the global drilling, oil and gas production, refining, and petrochemical industries. In addition to recovery, production and process enhancements, it delivers a full range of water treatment offerings to refineries and petrochemical plants. With global demand for energy continuing to grow for many years, coupled with rising demand from developing economies like India and China, we expect this segment will be a growth driver for the company.



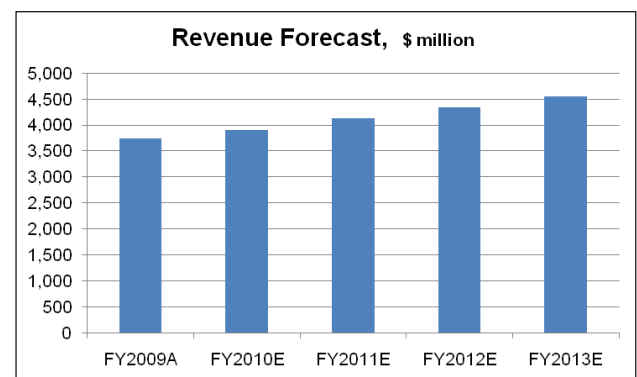
Source: Annual Report

WATER SERVICE WILL REMAIN THE LONG TERM BET

Nalco Holding is the global leader in Water services business. Although this segment is not growing in the matured market, we expect huge long term potential in this business segment. With increase in population, many of the faster developing countries are facing acute water scarcity thus forcing industries to consume less water and fully treat discharges. It is believed that investment in water services area will grow at 5% to 6% per annum for a long period in order to manage the severe water scarcity issue that is threatening a major part of the developing world.

REVENUE TO GROW AT MID TO HIGHER SINGLE DIGIT RATES

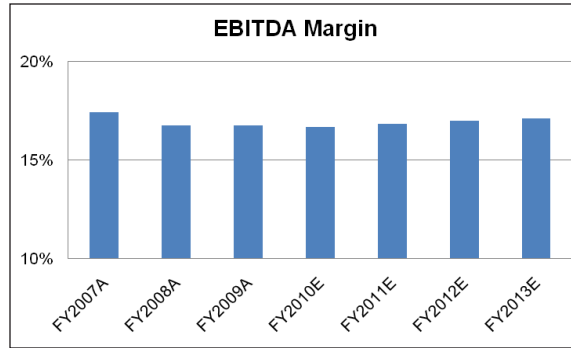
Global economy is on its path to recovery and so we expect Nalco Holding to again show growth in its revenue. BRIC countries, especially China and India have already shown spectacular growth in industrial production. With the economy seeming to be out of recession and developing countries growing at close to 10% per annum, we expect Nalco Holdings top line to grow at around 5% to 7% per year for next few years. We expect the company to cross the \$4.5 billion revenue turnover in year 2013. With its major business and the water services segment having a long term growth potential, we believe the company will continue to grow at around 5% per annum for a long period.



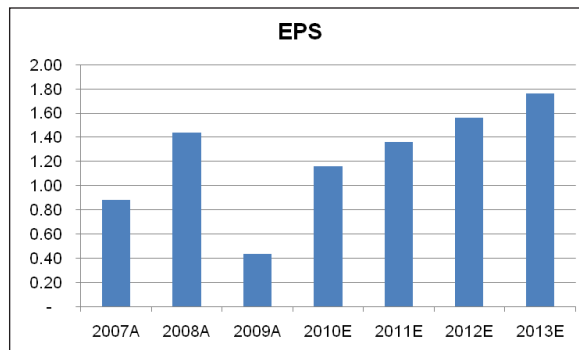
Source: Own Analysis

WE EXPECT EBITDA MARGIN TO REMAIN AT CURRENT LEVEL

Nalco Holding has been successful in its cost cutting effort. In 2009, its comprehensive cost productivity plan yielded savings of \$122 million. The current EBITDA margin of the company is around 16.5%. We expect the company to operate in this range in the long run as well. As the company is now entering into emerging economies. It is also expecting revenue from its other sectors other than the cash cow to contribute more to the total revenue. We expect cost control measures will be offset by expenses related to the new strategic plans. It enjoys the advantage of having multiple hours of video in these segments and also database of customers that includes prospective travelers and houses for sale. As a lead generator for any house sale transaction, the company will receive 25% of the total commission a broker gets in U.S. which is generally 6% of the house value. The company has obtained its own broker license. Similar commission is also expected from any transaction in the tour and travel space.



Source: Annual Report & Own Analysis



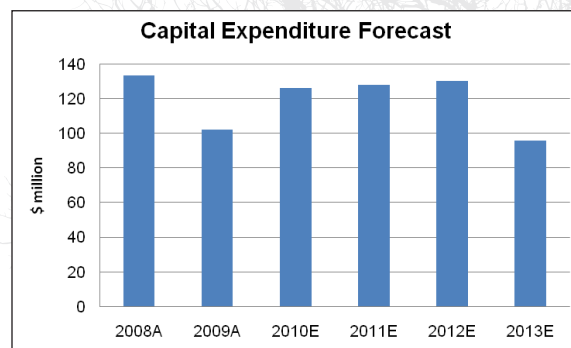
Source: Annual Report & Own Analysis

With increase in revenue and marginal improvement in EBITDA margin, we expect Earnings per Share of the company to reach \$1.76 in year 2013.

(Note: FY2008 EPS calculation excludes goodwill Impairment)

CAPITAL EXPENDITURE WILL REMAIN AT CURRENT LEVEL

Nalco Holding has spent around \$350 million in last three years on account of additions to property, plant, and equipment. We expect the company to incur capital expenditures in this range for next few years.



Source: Annual Report & Own Analysis

RESEARCH REPORT: Nalco Holding Company (NLC)

VALUATION

The stock is being currently traded at \$0.50

We have used a Discounted Cash Flow (DCF) method to value the stock. We expect the company to spend around \$1.5million every year as capital expenditure for its expansion and maintenance.

We followed a CAPM method to calculate the Weighted Average Cost of Capital (WACC). We considered a 0:100 debt equity ratio. Risk free rate is taken as the current yield from 10 years T-Note. Beta is taken as 2 which is higher than the industry average. Small companies operating in this industry have beta of around 1.5 to 1.7. We finally got the optimum WACC as 17.10%. We are assuming a terminal value till year 2050 for our valuation. For calculation of stock price we have assumed that 3.5 million preferred shares will be converted into common stock. We are getting per share NAV of around \$7.70.

RISKS

1. The company is susceptible to change in technology. The company needs to keep it update with any new technology that may result in its business facing stiff competition from other players offering new technology and better services.
2. The company is highly leveraged with current long term debt at around \$2.70 billion against a present market cap of \$3.11 billion.
3. Its significant non-U.S. operations expose it to global economic and political changes that could impact its profitability.

CONCLUSION

Nalco Holding Company is a well diversified company providing services to companies in different industries and across the globe. The business of the company is relatively less risky as it provides services which are now considered essential. With global water scarcity seeming to be a major problem in a short period for now, we see the company has a good prospect to grow by leveraging its position as the leader in this segment. With Earnings per Share expected to be around \$2 per share in year 2014, we expect the company to be an outperformer and put a target price of around \$28.90 per share.

VALUATION MATRIX

Risk Free Rate	3.60%
Risk Premium	6.75%
Beta	1.25
COE	12.04%
Cost of Debt	8.50%
Debt equity ratio	30:70
Tax rate	35%
WACC	10.08%
Terminal Growth Rate	2.70%

RATIOS

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018
Standard ratios											
Sales growth (%)	7%	-11%	5%	5%	5%	5%	5%	5%	6%	5%	5%
EBITDA growth (%)	3%	-11%	4%	7%	6%	5%	6%	5%	6%	5%	4%
EBT growth (%)	-236%	-148%	82%	17%	15%	13%	13%	10%	10%	8%	6%
EPS growth (%)	-378%	-118%	166%	17%	15%	13%	13%	10%	10%	8%	6%
EBITDA margin (%)	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%	17%
EBT margin (%)	-7%	4%	6%	7%	8%	8%	9%	9%	10%	10%	10%
Net profit margin (%)	-8%	2%	4%	5%	5%	5%	6%	6%	6%	7%	7%
Return on avg assets (%)	-6%	1%	7%	8%	8%	9%	9%	9%	10%	10%	9%
Return on avg equity (%)	-45%	14%	30%	27%	26%	24%	23%	22%	21%	20%	18%
ROIC (%)	-22%	5%	12%	13%	13%	14%	14%	14%	14%	13%	13%
ROIC - WACC (%)	-32%	-5%	2%	3%	3%	3%	4%	4%	4%	3%	3%

COMPANY FINANCIALS FISCAL YEAR ENDING 28-FEBRUARY

	FY 2009 A	FY 2010 E	FY 2011 E	FY 2012 E	FY 2013 E	FY 2014 E
Income Statement Analysis (US\$ million)						
Net Sales	3,747	3,911	4,125	4,342	4,553	4,787
Other Income	-18	0	0	0	0	0
Total Revenue	3,729	3,911	4,125	4,342	4,553	4,787
EBITDA	624	651	695	738	778	823
Profit before tax	136	247	290	332	375	425
Net Income	61	160	188	216	244	276
EBITDA Margin (%)	17%	17%	17%	17%	17%	17%
Net Margin (%)	2%	4%	5%	5%	5%	6%
Balance Sheet & Other Fin. Data (US\$ million)						
Current Assets	1,245	1,287	1,339	1,391	1,441	1,496
Total Assets	4,965	5,133	5,333	5,524	5,735	5,972
Current Liability	926	958	997	1,038	1,078	1,122
Long Term Debt	2,714	2,714	2,714	2,714	2,714	2,714
Shareholder funds	472	608	768	919	1,090	1,283
Capital Expenditure	102	126	128	130	96	93
Return on average Assets (%)	1%	7%	8%	8%	9%	9%
Return on average Equity (%)	14%	3%	10%	18%	22%	22%
Per share data (US\$)						
Tangible Book Value	12	13	14	15	17	19
EPS	0.44	1.16	1.36	1.56	1.76	2.00

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- BUY — The stock appears attractively valued and we feel the stock's total return will exceed that of the market over the next 12 months.
- HOLD — The stock appears appropriately valued and we believe the stock's total return will be inline with the market over the next 12 months.
- SELL — The stock appears over valued and we believe the stock's total return will be below the market over the next 12 months.

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