

Edgar Filing: ASHLAND INC - Form 10-Q

ASHLAND INC
Form 10-Q
May 09, 2005

=====

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2005

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 number 1-2918

ASHLAND INC.
(a Kentucky corporation)
I.R.S. No. 61-0122250

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 No

Indicate by checkmark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes No

At March 31, 2005, there were 72,870,259 shares of Registrant's Common

Edgar Filing: ASHLAND INC - Form 10-Q

Stock outstanding. One Right to purchase one-thousandth of a share of Series A Participating Cumulative Preferred Stock accompanies each outstanding share of Registrant's Common Stock.

=====

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES STATEMENTS OF CONSOLIDATED INCOME

	Three months ended March 31	
(In millions except per share data)	2005	
REVENUES		
Sales and operating revenues	\$ 2,062	\$ 1,754
Equity income	69	69
Other income	18	18
	2,149	1,841
COSTS AND EXPENSES		
Cost of sales and operating expenses	1,754	1,754
Selling, general and administrative expenses	309	309
	2,063	2,063
OPERATING INCOME		
Net interest and other financial costs	86	86
	(29)	(29)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		
Income taxes	57	57
	(24)	(24)
INCOME (LOSS) FROM CONTINUING OPERATIONS		
Results from discontinued operations (net of income taxes) - Note B	33	33
	-	-
NET INCOME (LOSS)		
	\$ 33	\$ 33
BASIC EARNINGS (LOSS) PER SHARE - Note A		
Income (loss) from continuing operations	\$.45	\$.45
Results from discontinued operations	-	-
Net income (loss)	\$.45	\$.45
DILUTED EARNINGS (LOSS) PER SHARE - Note A		
Income from continuing operations	\$.44	\$.44
Results from discontinued operations	-	-
Net income (loss)	\$.44	\$.44

Edgar Filing: ASHLAND INC - Form 10-Q

DIVIDENDS PAID PER COMMON SHARE

\$.275 \$

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

2

 ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS

(In millions) March 31
2005

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$	74
Accounts receivable		1,352
Allowance for doubtful accounts		(42)
Inventories - Note A		546
Deferred income taxes		95
Refundable income taxes		125
Other current assets		83

 2,233

INVESTMENTS AND OTHER ASSETS

Investment in Marathon Ashland Petroleum LLC (MAP)		2,926
Goodwill		560
Asbestos insurance receivable (noncurrent portion)		381
Other noncurrent assets		413

 4,280

PROPERTY, PLANT AND EQUIPMENT

Cost		3,196
Accumulated depreciation, depletion and amortization		(1,894)

 1,302

\$ 7,815
 =====

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES

Debt due within one year		
Revolving credit facility	\$	228
Commercial paper		73
Short-term borrowing from MAP		177

Edgar Filing: ASHLAND INC - Form 10-Q

Current portion of long-term debt	248
Trade and other payables	1,254
Income taxes	30

	2,010
NONCURRENT LIABILITIES	
Long-term debt (less current portion)	1,086
Employee benefit obligations	436
Deferred income taxes	264
Reserves of captive insurance companies	201
Asbestos litigation reserve (noncurrent portion)	545
Other long-term liabilities and deferred credits	374
Commitments and contingencies - Notes D and G	

	2,906
COMMON STOCKHOLDERS' EQUITY	

	2,899

	\$ 7,815
	=====

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

3

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

(In millions)	Common stock	Paid-in capital	Retained earnings
	-----	-----	-----
BALANCE AT OCTOBER 1, 2003	\$ 68	\$ 350	\$ 1,961
Total comprehensive income (1)			17
Cash dividends			(38)
Issued 1,808,419 common shares under stock incentive and other plans	2	61	
	-----	-----	-----
BALANCE AT MARCH 31, 2004	\$ 70	\$ 411	\$ 1,940
	=====	=====	=====
BALANCE AT OCTOBER 1, 2004	\$ 72	\$ 478	\$ 2,262
Total comprehensive income (1)			126
Cash dividends			(40)
Issued 1,291,096 common shares under stock incentive and other plans	1	66	
	-----	-----	-----
BALANCE AT MARCH 31, 2005	\$ 73	\$ 544	\$ 2,348

Edgar Filing: ASHLAND INC - Form 10-Q

(1) Reconciliations of net income (loss) to total comprehensive income follow.

(In millions)	Three months ended March 31	
	2005	2004
Net income (loss)	\$ 33	\$ (16)
Unrealized translation adjustments	2	4
Related tax expense	-	-
Net unrealized gains (losses) on cash flow hedges	(1)	-
Total comprehensive income	\$ 34	\$ (12)

At March 31, 2005, the accumulated other comprehensive loss of \$66 million (after tax) was comprised of \$62 million, a minimum pension liability of \$129 million and net unrealized gains on cash flow hedges of \$25 million.

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

4

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS

(In millions)

CASH FLOWS FROM OPERATIONS

Income from continuing operations
Expense (income) not affecting cash
 Depreciation, depletion and amortization
 Deferred income taxes
 Equity income from affiliates
 Distributions from equity affiliates
 Other items
Change in operating assets and liabilities (1)

CASH FLOWS FROM FINANCING

Edgar Filing: ASHLAND INC - Form 10-Q

Proceeds from issuance of common stock
Repayment of long-term debt
Increase in short-term debt
Dividends paid

CASH FLOWS FROM INVESTMENT

Additions to property, plant and equipment
Purchase of operations - net of cash acquired
Proceeds from sale of operations
Other - net

CASH USED BY CONTINUING OPERATIONS

Cash used by discontinued operations

DECREASE IN CASH AND CASH EQUIVALENTS

CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD

CASH AND CASH EQUIVALENTS - END OF PERIOD

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

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

5

ASHLAND INC. CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - SIGNIFICANT ACCOUNTING POLICIES

Interim financial reporting

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. Although such statements are subject to any year-end audit adjustments which may be necessary, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. These financial statements should be read in conjunction with Ashland's Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 2004. Results of operations for the periods ended March 31, 2005, are not necessarily indicative of results to be expected for the year ending September 30, 2005.

Inventories

Edgar Filing: ASHLAND INC - Form 10-Q

(In millions)	March 31 2005	September 2004
Chemicals and plastics	\$ 442	\$ 3
Construction materials	84	
Petroleum products	72	
Other products	59	
Supplies	8	
Excess of replacement costs over LIFO carrying values	(119)	(
	\$ 546	\$ 4

Earnings (loss) per share

The following table sets forth the computation of basic and diluted earnings (loss) per share (EPS) from continuing operations.

(In millions except per share data)	Three months ended March 31	
	2005	2004
Numerator		
Numerator for basic and diluted EPS - Income (loss) from continuing operations	\$ 33	\$ (11)
Denominator		
Denominator for basic EPS - Weighted average common shares outstanding	73	69
Common shares issuable upon exercise of stock options	1	-
Denominator for diluted EPS - Adjusted weighted average shares and assumed conversions	74	69
Earnings (loss) per share from continuing operations		
Basic	\$.45	\$ (.16)
Diluted	\$.44	\$ (.16)

Edgar Filing: ASHLAND INC - Form 10-Q

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, a former subsidiary. During the six months ended March 31, 2004, Ashland recorded charges of \$29 million to increase its reserve for asbestos claims, the effect of which was partially offset by credits of \$14 million to increase its asbestos insurance receivable. The resulting \$15 million pretax charge to income, net of deferred income tax benefits of \$6 million, was reflected as an after-tax loss from discontinued operations of \$9 million in the Statement of Consolidated Income for the six months ended March 31, 2004. No increases to the asbestos reserve or insurance receivable were recorded in the six months ended March 31, 2005. See Note G for further discussion of Ashland's asbestos-related litigation. Also during the six months ended March 31, 2004, Ashland recorded a \$1 million decrease to the gain recorded in 2003 on the sale of its Electronic Chemicals business.

Components of amounts reflected in the income statements related to discontinued operations are presented in the following table.

(In millions)	Three months ended March 31	
	2005	2004
Pretax income (loss) from discontinued operations		
Reserves for asbestos-related litigation	\$ -	\$ (7)
Loss on disposal of Electronic Chemicals	-	-
Income taxes		
Reserves for asbestos-related litigation	-	2
Loss on disposal of Electronic Chemicals	-	-
Results from discontinued operations (net of income taxes)	\$ -	\$ (5)
	=====	=====

NOTE C - UNCONSOLIDATED AFFILIATES

Under Rule 3-09 of Regulation S-X, Ashland filed audited financial statements for Marathon Ashland Petroleum LLC (MAP) for the year ended December 31, 2004, on a Form 10-K/A on March 15, 2005. Unaudited income statement information for MAP is shown below.

MAP is organized as a limited liability company that has elected to be taxed as a partnership. Therefore, the parents are responsible for income taxes applicable to their share of MAP's taxable income. The net income reflected below for MAP does not include any provision for income taxes that will be incurred by its parents.

Edgar Filing: ASHLAND INC - Form 10-Q

(In millions)	Three months ended March 31	
	2005	2004
Sales and operating revenues	\$ 11,397	\$ 9,060
Income from operations	204	49
Net income	188	46
Ashland's equity income	66	13

7

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

NOTE C - UNCONSOLIDATED AFFILIATES (continued)

On April 28, 2005, Ashland announced that it had amended its agreement to transfer its 38-percent interest in MAP and two other businesses to Marathon Oil Corporation. Under the amended agreement, Ashland's interest in these businesses is valued at approximately \$3.7 billion compared to approximately \$3 billion in the earlier agreement, with substantially all the increase in value going directly to Ashland's shareholders in the form of Marathon stock. In addition, Marathon has agreed to pay the first \$200 million of any Section 355(e) tax, if any, as compared to the prior agreement where Ashland bore full responsibility for any Section 355(e) tax. The transaction is expected to be tax free to Ashland's shareholders and tax efficient to Ashland. The two other businesses are Ashland's maleic anhydride business and 60 Valvoline Instant Oil Change (VIOC) centers in Michigan and northwest Ohio, which are valued at \$94 million.

Under the terms of the amended agreement, Ashland's shareholders will receive Marathon common stock with an aggregate value of \$915 million. Based on the number of shares outstanding on March 31, 2005, shareholders would receive \$12.56 in Marathon stock per Ashland share. Ashland will receive cash and MAP accounts receivable totaling \$2.8 billion. In addition, MAP has not made quarterly cash distributions to Ashland and Marathon since March 18, 2004, and such distributions will continue to be suspended until the closing of the transaction. As a result, the final amount of cash to be received by Ashland will be increased by an amount equal to 38 percent of the cash accumulated from operations during the period prior to closing. At March 31, 2005, Ashland's share of this accumulated cash was \$560 million.

The transaction is subject to, among other things, approval by Ashland's shareholders, consent from public debt holders, finalization of the closing agreement with the Internal Revenue Service and customary antitrust review. Ashland and Marathon have agreed to use their reasonable best efforts to complete the transaction by June 30, 2005, with the termination date for the

Edgar Filing: ASHLAND INC - Form 10-Q

transaction extended to September 30, 2005.

NOTE D - LEASES AND OTHER COMMITMENTS

Leases

Under various operating leases, Ashland has made guarantees with respect to the residual value of the underlying property. If Ashland had canceled those leases at March 31, 2005, its maximum obligations under the residual value guarantees would have amounted to \$91 million. Ashland does not expect to incur any significant charge to earnings under these guarantees, \$24 million of which relates to real estate. These lease agreements are with unrelated third party lessors and Ashland has no additional contractual or other commitments to any party to the leases.

Other commitments

Ashland has guaranteed 38% of MAP's payments for certain crude oil purchases, up to a maximum guarantee of \$95 million. At March 31, 2005, Ashland's contingent liability under this guarantee amounted to the full \$95 million. Although Ashland has not made and does not expect to make any payments under this guarantee, it has recorded the fair value of the guarantee obligation, which is not significant.

NOTE E - EMPLOYEE BENEFIT PLANS

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. Among other things, the Act will expand Medicare to include an outpatient prescription drug benefit beginning in 2006, as well as provide a subsidy for sponsors of retiree health care

8

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

NOTE E - EMPLOYEE BENEFIT PLANS (continued)

plans that provide a benefit that is at least actuarially equivalent to the Medicare Act benefits. In May 2004, the Financial Accounting Standards Board issued Staff Position No. FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." Regulations implementing major provisions of the Act, including the determination of actuarial equivalency, were issued in January 2005. Effective May 1, 2005, Ashland amended its health care plan for retirees age 65 or older so that the company will always qualify for the subsidy and remeasured its postretirement benefit obligation as of that date. The remeasurement reduced the obligation by \$58 million and will reduce postretirement benefit costs by \$3 million over the last five months of the fiscal year 2005.

Edgar Filing: ASHLAND INC - Form 10-Q

Presently, Ashland anticipates contributing \$86 million to its U.S. pension plans and \$12 million to its non-U.S. pension plans during fiscal 2005. In addition, upon the closing of the proposed MAP transaction, Ashland plans to make an additional \$100 million contribution to its U.S. pension plans. As of March 31, 2005, contributions of \$15 million have been made to the U.S. plans and \$7 million to the non-U.S. plans.

The following table details the components of pension and other postretirement benefit costs.

(In millions)	Pension benefits		
	2005	2004	
Three months ended March 31			
Service cost	\$ 13	\$ 13	\$
Interest cost	19	17	
Expected return on plan assets	(19)	(16)	
Amortization of prior service credit	-	-	
Amortization of net actuarial loss	8	8	
	\$ 21	\$ 22	\$
Six months ended March 31			
Service cost	\$ 26	\$ 25	\$
Interest cost	39	35	
Expected return on plan assets	(38)	(31)	
Amortization of prior service credit	-	-	
Amortization of net actuarial loss	16	15	
	\$ 43	\$ 44	\$

NOTE F - ACQUISITIONS AND DIVESTITURES

During the six months ended March 31, 2005, Ashland Specialty Chemical acquired Dow Chemical's DERAKANE(R) epoxy vinyl ester resins business for approximately \$90 million. With this acquisition, Ashland Specialty Chemical's composite polymers business continues to build its innovative line of resin chemistries for composite manufacturing. The purchase included all technology and intellectual property assets associated with the DERAKANE resin business. No physical assets were transferred to Ashland. Also during the period, Ashland Distribution sold its ingestibles business and APAC made three small acquisitions and one small divestiture. Following is a progression of goodwill by segment for the six months ended March 31, 2005.

Edgar Filing: ASHLAND INC - Form 10-Q

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

NOTE F - ACQUISITIONS AND DIVESTITURES (continued)

(In millions)	APAC	Ashland Specialty Chemical	Va
Balance at October 1, 2004	\$ 411	\$ 96	\$
Goodwill acquired	-	43	
Currency translation adjustments	-	4	
Balance at March 31, 2005	\$ 411	\$ 143	\$

NOTE G - LITIGATION, CLAIMS AND CONTINGENCIES

Asbestos-related litigation

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. Although Riley was neither a producer nor a manufacturer of asbestos, its industrial boilers contained some asbestos-containing components provided by other companies.

A summary of asbestos claims activity follows. Because claims are frequently filed and settled in large groups, the amount and timing of settlements and number of open claims can fluctuate significantly from period to period.

(In thousands)	Six months ended March 31		Years ended S
	2005	2004	2004
Open claims - beginning of period	196	198	198
New claims filed	6	16	29
Claims settled	(3)	(3)	(7)
Claims dismissed	(10)	(11)	(24)
Open claims - end of period	189	200	196

Edgar Filing: ASHLAND INC - Form 10-Q

Since October 1, 2001, Riley has been dismissed as a defendant in 73% of the resolved claims. Amounts spent on litigation defense and claim settlements averaged \$1,812 per claim resolved in the six months ended March 31, 2005, compared to \$1,730 in the six months ended March 31, 2004, and annual averages of \$1,655 in 2004, \$1,610 in 2003 and \$723 in 2002. A progression of activity in the asbestos reserve is presented in the following table.

(In millions)	Six months ended March 31		Years ended	
	2005	2004	2004	
Asbestos reserve - beginning of period	\$ 618	\$ 610	\$ 610	\$
Expense incurred	-	29	59	
Amounts paid	(23)	(24)	(51)	
Asbestos reserve - end of period	\$ 595	\$ 615	\$ 618	\$

10

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

NOTE G - LITIGATION, CLAIMS AND CONTINGENCIES (continued)

During the December 2002 quarter, Ashland increased its reserve for asbestos claims by \$390 million to cover the litigation defense and claim settlement costs for probable and reasonably estimable future payments related to existing open claims, as well as an estimate of those that may be filed in the future. Prior to December 31, 2002, the asbestos reserve was based on the estimated costs that would be incurred to settle existing open claims. A range of estimates of future asbestos claims and related costs using various assumptions was developed with the assistance of Hamilton, Rabinovitz & Alschuler, Inc. (HR&A). The methodology used by HR&A to project future asbestos costs was based largely on Ashland's recent experience, including claim-filing and settlement rates, disease mix, open claims, and litigation defense and claim settlement costs. Ashland's claim experience was compared to the results of previously conducted epidemiological studies estimating the number of people likely to develop asbestos-related diseases. Those studies were undertaken in connection with national analyses of the population expected to have been exposed to asbestos. Using that information, HR&A estimated a range of the number of future claims that may be filed, as well as the related costs that may be incurred in resolving those claims.

From the range of estimates, Ashland recorded the amount it

Edgar Filing: ASHLAND INC - Form 10-Q

believed to be the best estimate, which represented the expected payments for litigation defense and claim settlement costs during the next ten years. Subsequent updates to this estimate have been made, with the assistance of HR&A, based on a combination of a number of factors including the actual volume of new claims, recent settlement costs, changes in the mix of alleged disease, enacted legislative changes and other developments impacting Ashland's estimate of future payments. Ashland's reserve for asbestos claims on an undiscounted basis amounted to \$595 million at March 31, 2005, compared to \$618 million at September 30, 2004 and \$615 million at March 31, 2004.

Projecting future asbestos costs is subject to numerous variables that are extremely difficult to predict. In addition to the significant uncertainties surrounding the number of claims that might be received, other variables include the type and severity of the disease alleged by each claimant, the long latency period associated with asbestos exposure, dismissal rates, costs of medical treatment, the impact of bankruptcies of other companies that are co-defendants in claims, uncertainties surrounding the litigation process from jurisdiction to jurisdiction and from case to case, and the impact of potential changes in legislative or judicial standards. Furthermore, any predictions with respect to these variables are subject to even greater uncertainty as the projection period lengthens. In light of these inherent uncertainties, Ashland believes its asbestos reserve represents the best estimate within a range of possible outcomes. As a part of the process to develop Ashland's estimates of future asbestos costs, a range of long-term cost models is developed that assumes a run-out of claims through 2055. These models are based on national studies that predict the number of people likely to develop asbestos-related diseases and are heavily influenced by assumptions regarding long-term inflation rates for indemnity payments and legal defense costs, as well as other variables mentioned previously. The total future litigation defense and claim settlement costs on an undiscounted basis has been estimated within a reasonably possible range of \$400 million to \$2.0 billion, depending on the number of years those costs extend and other combinations of assumptions selected. Ashland's reserve represents between 10 and 29 years of future costs, depending on the model selected. If actual experience is worse than projected relative to the number of claims filed, the severity of alleged disease associated with those claims or costs incurred to resolve those claims, Ashland may need to increase further the estimates of the costs associated with asbestos claims and these increases could potentially be material over time.

11

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

NOTE G - LITIGATION, CLAIMS AND CONTINGENCIES (continued)

Ashland has insurance coverage for most of the litigation defense and claim settlement costs incurred in connection with its asbestos claims, and coverage-in-place agreements exist with the

Edgar Filing: ASHLAND INC - Form 10-Q

insurance companies that provide substantially all of the coverage currently being accessed. As a result, increases in the asbestos reserve have been largely offset by probable insurance recoveries. The amounts not recoverable generally are due from insurers that are insolvent, rather than as a result of uninsured claims or the exhaustion of Ashland's insurance coverage.

Ashland retained the services of Tillinghast-Towers Perrin to assist management in estimating the value of probable insurance recoveries associated with Ashland's estimate of its asbestos liabilities. Such recoveries are based on management's assumptions and estimates surrounding the available or applicable insurance coverage. One such assumption is that all solvent insurance carriers remain solvent. Although coverage limits are resolved in the coverage-in-place agreement with Equitas Limited (Equitas) and other London companies, which collectively provide a significant portion of Ashland's insurance coverage for asbestos claims, there is a disagreement with these companies over the timing of recoveries. The resolution of this disagreement could have a material effect on the value of insurance recoveries from those companies. In estimating the value of future recoveries, Ashland has used the least favorable interpretation of this agreement under which the ultimate recoveries are extended for many years, resulting in a significant discount being applied to value those recoveries. Ashland will continue to apply this methodology until such time as the disagreement is resolved. On July 21, 2004, Ashland filed a demand for arbitration to resolve the dispute concerning the interpretation of this agreement.

At March 31, 2005, Ashland's receivable for recoveries of litigation defense and claim settlement costs from its insurers amounted to \$411 million, of which \$53 million relates to costs previously paid. Receivables from insurance companies amounted to \$435 million at September 30, 2004 and \$426 million at March 31, 2004. About 35% of the estimated receivables from insurance companies at March 31, 2005, are expected to be due from Equitas and other London companies. Of the remainder, approximately 90% is expected to come from companies or groups that are rated A or higher by A.M. Best.

Environmental proceedings

Ashland is subject to various federal, state and local environmental laws and regulations that require environmental assessment or remediation efforts (collectively environmental remediation) at multiple locations. At March 31, 2005, such locations included 91 waste treatment or disposal sites where Ashland has been identified as a potentially responsible party under Superfund or similar state laws, approximately 130 current and former operating facilities (including certain operating facilities conveyed to MAP) and about 1,220 service station properties. Ashland's reserves for environmental remediation amounted to \$157 million at March 31, 2005, compared to \$152 million at September 30, 2004 and \$169 million at March 31, 2004. Such amounts reflect Ashland's estimates of the most likely costs that will be incurred over an extended period to remediate identified conditions for which the costs are reasonably estimable, without regard to any third-party recoveries. Engineering studies, probability techniques, historical experience and other factors are used to identify and evaluate remediation alternatives and their related costs in determining the estimated reserves for environmental remediation.

Edgar Filing: ASHLAND INC - Form 10-Q

Environmental remediation reserves are subject to numerous inherent uncertainties that affect Ashland's ability to estimate its share of the costs. Such uncertainties involve the nature and extent of contamination at each site, the extent of required cleanup efforts under existing environmental regulations, widely varying

12

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

NOTE G - LITIGATION, CLAIMS AND CONTINGENCIES (continued)

costs of alternate cleanup methods, changes in environmental regulations, the potential effect of continuing improvements in remediation technology, and the number and financial strength of other potentially responsible parties at multiparty sites. Ashland regularly adjusts its reserves as environmental remediation continues. Environmental remediation expense amounted to \$13 million for the six months ended March 31, 2005, compared to \$9 million for the six months ended March 31, 2004, and annual expense of \$2 million in 2004, \$22 million in 2003 and \$30 million in 2002.

No individual remediation location is material to Ashland, as its largest reserve for any site is less than 10% of the remediation reserve. As a result, Ashland's exposure to adverse developments with respect to any individual site is not expected to be material, and these sites are in various stages of ongoing remediation. Although environmental remediation could have a material effect on results of operations if a series of adverse developments occurs in a particular quarter or fiscal year, Ashland believes that the chance of such developments occurring in the same quarter or fiscal year is remote.

Other legal proceedings

In addition to the matters described above, there are various claims, lawsuits and administrative proceedings pending or threatened against Ashland and its current and former subsidiaries. Such actions are with respect to commercial matters, product liability, toxic tort liability, and other environmental matters, which seek remedies or damages, some of which are for substantial amounts. While these actions are being contested, their outcome is not predictable.

13

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
INFORMATION BY INDUSTRY SEGMENT

Edgar Filing: ASHLAND INC - Form 10-Q

	Three months end March 31	
(In millions)	2005	
REVENUES		
Sales and operating revenues		
APAC	\$ 388	\$
Ashland Distribution	956	
Ashland Specialty Chemical	434	
Valvoline	323	
Intersegment sales		
Ashland Distribution	(5)	
Ashland Specialty Chemical	(33)	
Valvoline	(1)	
	2,062	1
Equity income		
APAC	1	
Ashland Specialty Chemical	2	
Valvoline	-	
Refining and Marketing	66	
	69	
Other income		
APAC	3	
Ashland Distribution	3	
Ashland Specialty Chemical	9	
Valvoline	2	
Refining and Marketing	-	
Corporate	1	
	18	
	\$ 2,149	\$ 1
OPERATING INCOME		
APAC	\$ (46)	\$
Ashland Distribution	34	
Ashland Specialty Chemical	39	
Valvoline	24	
Refining and Marketing (1)	61	
Corporate	(26)	
	\$ 86	\$

(1) Includes Ashland's equity income from MAP, amortization related to Ashland's excess investment associated with refining and marketing.

Edgar Filing: ASHLAND INC - Form 10-Q

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
INFORMATION BY INDUSTRY SEGMENT

	Three months ended March 31	
	2005	
OPERATING INFORMATION		
APAC		
Construction backlog at March 31 (millions) (1)		
Net construction job revenues (millions) (2)	\$ 198	\$
Hot-mix asphalt production (million tons)	3.7	
Aggregate production (million tons)	6.5	
Ashland Distribution (3)		
Sales per shipping day (millions)	\$ 15.4	\$
Gross profit as a percent of sales	9.8%	
Ashland Specialty Chemical (3)		
Sales per shipping day (millions)	\$ 7.0	\$
Gross profit as a percent of sales	26.7%	
Valvoline		
Lubricant sales (million gallons)	42.2	
Premium lubricants (percent of U.S. branded volumes)	24.1%	
Refining and Marketing (4)		
Refinery runs (thousand barrels per day)		
Crude oil refined	922	
Other charge and blend stocks	171	
Refined product yields (thousand barrels per day)		
Gasoline	576	
Distillates	292	
Asphalt	72	
Other	168	
Total	1,108	
Refined product sales (thousand barrels per day) (5)	1,370	1
Refining and wholesale marketing margin (per barrel) (6)	\$ 2.88	\$
Speedway SuperAmerica (SSA)		
Retail outlets at March 31		
Gasoline and distillate sales (million gallons)	745	
Gross margin - gasoline and distillates (per gallon)	\$.1058	\$
Merchandise sales (millions)	\$ 560	\$
Merchandise margin (as a percent of sales)	25.6%	

- (1) Includes APAC's proportionate share of the backlog of unconsolidated joint ventures.
- (2) Total construction job revenues, less subcontract costs.
- (3) Sales are defined as sales and operating revenues. Gross profit is defined as sales and cost of sales and operating expenses.
- (4) Amounts represent 100% of MAP's operations, in which Ashland owns a 38% interest.
- (5) Total average daily volume of all refined product sales to MAP's wholesale, branded and re
- (6) Sales revenue less cost of refinery inputs, purchased products and manufacturing expenses,

Edgar Filing: ASHLAND INC - Form 10-Q

AND RESULTS OF OPERATIONS

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

CURRENT QUARTER - Ashland reported net income of \$33 million for the quarter ended March 31, 2005, compared to a net loss of \$16 million for the quarter ended March 31, 2004. Ashland's income from continuing operations amounted to \$33 million for the quarter ended March 31, 2005, compared to a loss of \$11 million for the quarter ended March 31, 2004. Results from discontinued operations, consisting of charges for asbestos liabilities, accounted for the difference in net income and income from continuing operations for the 2004 period.

Normal seasonality makes the March quarter Ashland's most difficult earnings period. The improved results reflect a sharp increase in operating income from refining and marketing and a 56% increase in operating income from the Chemical Sector, which consists of the Ashland Distribution, Ashland Specialty Chemical, and Valvoline divisions. However, the Transportation Construction Sector, which consists of Ashland Paving And Construction, Inc. (commercially known as APAC), experienced a larger operating loss due to lower production resulting from poor weather conditions.

YEAR-TO-DATE - Ashland reported net income of \$126 million for the six months ended March 31, 2005, compared to \$17 million for the six months ended March 31, 2004. Ashland's income from continuing operations amounted to \$126 million for the six months ended March 31, 2005, compared to \$27 million for the six months ended March 31, 2004. Results from discontinued operations, consisting primarily of charges for asbestos liabilities, accounted for the difference in net income and income from continuing operations for the 2004 period.

Ashland's record income from continuing operations for the six months ended March 31, 2005, resulted primarily from the dramatic improvement from refining and marketing and a 36% increase in operating income from the Chemical Sector. However, the Transportation Construction Sector experienced a larger operating loss due to lower production resulting from poor weather conditions. An analysis of operating income by industry segment follows.

APAC

CURRENT QUARTER - APAC reported an operating loss of \$46 million for the March 2005 quarter, compared to a loss of \$33 million for the March 2004 quarter. The March quarter is typically the most difficult for APAC. The increased loss reflects lower production, driven primarily by poor weather conditions in APAC's operating area, and higher hydrocarbon costs. Net construction job revenues (total construction job revenues less subcontract costs) decreased 4% from the prior year period. Production of hot-mix asphalt decreased 16%, while liquid asphalt costs increased 12%. Higher equipment and plant fuel costs contributed \$4 million to the decline in operating results. Equity income from APAC's joint venture project at Atlanta's Hartsfield Airport declined \$2

Edgar Filing: ASHLAND INC - Form 10-Q

million as that project nears completion. On the positive side, aggregate production, which is less affected by weather, increased 7%, due in part to the opening of a new quarry in Naples, Florida. During the quarter, APAC won two major highway construction jobs in Tennessee and Florida totaling \$135 million. At March 31, APAC's construction backlog, which consists of work awarded and funded but not yet performed, was a record \$2.1 billion.

16

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS

APAC (continued)

YEAR-TO-DATE - APAC reported an operating loss of \$40 million for the six months ended March 31, 2005, compared to a loss of \$2 million for the six months ended March 31, 2004. The decline was due to the same factors described in the current quarter comparison. Net construction job revenues decreased 5% from the prior year period. Production of hot-mix asphalt decreased 11%, while liquid asphalt costs increased 10%. Higher equipment and plant fuel costs contributed \$8 million to the decline in operating results. Equity income from APAC's joint venture project at Atlanta's Hartsfield Airport declined \$5 million as that project nears completion. On the positive side, aggregate production, which is less affected by weather, increased 11%, due in part to the opening of a new quarry in Naples, Florida.

Ashland Distribution

CURRENT QUARTER - Ashland Distribution achieved its second consecutive all-time record quarter, with operating income of \$34 million for the March 2005 quarter, up 79% over the \$19 million reported for the March 2004 quarter. Sales revenues were up 21% due to the division's ability to pass through price increases. Gross profit as a percent of sales improved to 9.8%, compared to 9.7% in the prior year quarter. Ashland Distribution is building solid momentum for continued growth by creating consistent processes, sustaining a low-cost model and delivering value to its customers.

YEAR-TO-DATE - Ashland Distribution achieved all-time record operating income of \$59 million for the six months ended March 31, 2004, up 84% over the \$32 million reported for the same period a year ago. The increase reflects the same factors described in the current quarter comparison. Sales revenues increased 25% and gross profit as a percent of sales remained constant at 9.7%.

Ashland Specialty Chemical

CURRENT QUARTER - Ashland Specialty Chemical achieved an all-time record quarter, with operating income of \$39 million for the March 2005 quarter, up 105% over the \$19 million reported for the March 2004 quarter. The improvement reflects increased operating income from both the thermoset resins and water technologies businesses. Sales revenues grew by 32% due in part to an 8% increase in thermoset resin volumes. Partial recovery of margins during the quarter and the sale of an idle plant in Plaquemine, La., which

Edgar Filing: ASHLAND INC - Form 10-Q

resulted in a pre-tax gain of \$7 million, also contributed to the division's record performance. Results of the domestic thermoset businesses included four additional shipping days in the March 2004 quarter, reflecting a move to a calendar month end for revenue recognition, which increased revenues by \$9 million and operating income by \$4 million for that period.

YEAR-TO-DATE - Ashland Specialty Chemical reported operating income of \$61 million for the six months ended March 31, 2005, compared to \$42 million for the six months ended March 31, 2004, reflecting improvements in both the thermoset resins and water technologies businesses. The 2005 period included approximately \$4 million in net, non-recurring gains principally related to the termination of a product supply contract in the December 2004 quarter, in addition to the \$7 million pre-tax gain on the sale of the idle plant in the March 2005 quarter. Although sales and operating revenues were up 28%, reflecting in part an 8% increase in sales volumes for the thermoset resins businesses, gross profit as a percent of sales declined from 29.7% to 25.5%. Tightness in certain petrochemical markets caused raw material costs to escalate at a faster pace than could be recovered through increased selling prices.

17

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS

Valvoline

CURRENT QUARTER - Operating income from the Valvoline division was \$24 million in the March 2005 quarter, essentially even with the record achieved in the March 2004 quarter. Price increases enabled Valvoline to maintain profits despite softer volumes and high raw material costs. While U.S.-branded lubricant sales volumes declined 7%, premium lubricant sales volumes increased by 5%.

YEAR-TO-DATE - Operating income from the Valvoline division was \$42 million for the six months ended March 31, 2005, compared to \$45 million for the six months ended March 31, 2004. The decline was primarily due to a 7% decrease in branded lubricant sales volumes. Partially offsetting this decrease was a 4% increase in premium lubricant sales volumes and a 26% improvement in international results, primarily in Europe and Latin America.

Refining and Marketing

CURRENT QUARTER - Operating income from Refining and Marketing, which consists primarily of equity income from Ashland's 38% ownership interest in MAP, amounted to \$61 million for the quarter ended March 31, 2005, compared to \$2 million for the March 2004 quarter. Equity income from MAP's refining and wholesale marketing operations increased \$51 million, reflecting greater discounts on high-sulfur crude oil and increased refinery throughputs due to less planned maintenance. Crude oil throughput was 17% higher than during the March 2004 quarter. MAP's refining and wholesale marketing margin increased to \$2.88 per barrel, compared to \$1.44

Edgar Filing: ASHLAND INC - Form 10-Q

in the March 2004 quarter. During the March 2005 quarter, MAP realized a \$12 million loss and recorded a \$61 million mark-to-market charge for crack spread derivative contracts. MAP also recorded a \$73 million in-transit crude oil charge during the March 2005 quarter. These items reduced Ashland's equity income from MAP's refining and wholesale marketing operations by \$55 million. Equity income from MAP's retail operations (Speedway SuperAmerica and a 50% interest in the Pilot Travel Centers joint venture) increased \$3 million, reflecting higher merchandise sales volumes and margins. Equity income from MAP's transportation operations increased \$5 million, reflecting increased revenues.

YEAR-TO-DATE - Operating income from Refining and Marketing amounted to \$197 million for the six months ended March 31, 2005, compared to \$27 million for the six months ended March 31, 2004. Equity income from MAP's refining and wholesale marketing operations increased \$153 million, reflecting the same factors described in the current quarter comparison. MAP's refining and wholesale marketing margin increased \$1.89 per barrel and crude oil throughput increased 12% compared to the prior year period. Equity income from MAP's retail operations increased \$14 million, reflecting higher merchandise sales and margins for SSA, and higher product volumes and margins and higher merchandise volumes for PTC. Equity income from MAP's transportation operations increased \$4 million, reflecting increased revenues.

On April 28, 2005, Ashland announced that it had amended its agreement to transfer its 38-percent interest in MAP and two other businesses to Marathon Oil Corporation. Under the amended agreement, Ashland's interest in these businesses is valued at approximately \$3.7 billion compared to approximately \$3 billion in the earlier agreement, with substantially all the increase in value going directly to Ashland's shareholders in the form of Marathon stock. In addition, Marathon has agreed to pay the first \$200 million of any Section 355(e) tax, if any, as compared to the prior agreement where Ashland bore full responsibility for any Section 355(e) tax. The transaction is expected to be tax free to Ashland's shareholders and tax efficient to Ashland. The two other businesses are Ashland's maleic anhydride business and 60 Valvoline Instant Oil Change (VIOC) centers in Michigan and northwest Ohio, which are valued at \$94 million.

18

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS

Refining and Marketing (continued)

Under the terms of the amended agreement, Ashland's shareholders will receive Marathon common stock with an aggregate value of \$915 million. Based on the number of shares outstanding on March 31, 2005, shareholders would receive \$12.56 in Marathon stock per Ashland share. Ashland will receive cash and MAP accounts receivable totaling \$2.8 billion. In addition, MAP has not made quarterly cash distributions to Ashland and Marathon since March 18, 2004, and such distributions will continue to be suspended

Edgar Filing: ASHLAND INC - Form 10-Q

until the closing of the transaction. As a result, the final amount of cash to be received by Ashland will be increased by an amount equal to 38 percent of the cash accumulated from operations during the period prior to closing. At March 31, 2005, Ashland's share of this accumulated cash was \$560 million.

The transaction is subject to, among other things, approval by Ashland's shareholders, consent from public debt holders, finalization of the closing agreement with the Internal Revenue Service and customary antitrust review. Ashland and Marathon have agreed to use their reasonable best efforts to complete the transaction by June 30, 2005, with the termination date for the transaction extended to September 30, 2005.

Corporate

Corporate expenses amounted to \$26 million in the quarter ended March 31, 2005, compared to \$21 million in the March 2004 quarter. The increase reflects a \$5 million loss recognized on a foreign-currency-denominated prepaid royalty payment received in 2002. Corporate expenses amounted to \$53 million for the six months ended March 31, 2005, compared to \$42 million for the six months ended March 31, 2004. In addition to the loss on the prepaid royalty, the December 2004 quarter included a \$7 million charge for estimated future obligations to make certain insurance premium payments related to past loss experience.

Net interest and other financial costs

Net interest and other financial costs amounted to \$29 million in both the March 2005 and March 2004 quarters. For the six months ended March 31, 2005, net interest and other financial costs amounted to \$61 million, compared to \$59 million for the six months ended March 31, 2004. The increase reflects a \$2 million loss in the December 2004 quarter on the early retirement of a capitalized lease obligation.

Discontinued operations

As described in Notes B and G to the Condensed Consolidated Financial Statements, Ashland's results from discontinued operations include charges associated with estimated future asbestos liabilities less probable insurance recoveries. Such amounts are summarized below.

(In millions)	Three months ended March 31	
	2005	2004
Pretax income (loss) from discontinued operations		
Reserves for asbestos-related litigation	\$ -	\$ (7)
Loss on disposal of Electronic Chemicals	-	-
Income taxes		
Reserves for asbestos-related litigation	-	2
Loss on disposal of Electronic Chemicals	-	-
	-----	-----

Edgar Filing: ASHLAND INC - Form 10-Q

Results from discontinued operations (net of income taxes)	\$	-	\$	(5)
	=====		=====	

19

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL POSITION

Liquidity

Cash flows from operations, a major source of Ashland's liquidity, amounted to a deficit of \$238 million for the six months ended March 31, 2005, compared to positive cash flows of \$58 million for the six months ended March 31, 2004. Ashland received no cash distributions from MAP in the 2005 period, compared to distributions of \$146 million in the 2004 period. Pursuant to the terms of the agreement entered into between Ashland and Marathon, MAP has not made quarterly cash distributions to Ashland and Marathon since March 18, 2004, and such distributions will continue to be suspended until the closing of the transaction. As a result, the final amount of cash to be received by Ashland will be increased by an amount equal to 38 percent of the cash accumulated from operations during the period prior to closing. At March 31, 2005, Ashland's share of this accumulated cash was \$560 million. Also impacting cash flows from operations, Ashland has made \$173 million in net federal tax payments in the 2005 period, compared to \$30 million in the 2004 period.

Ashland's financial position has enabled it to obtain capital for its financing needs and to maintain investment grade ratings on its senior debt of Baa2 from Moody's and BBB from Standard & Poor's (S&P). On April 29, 2005, following the announcement of the amendment to the agreement whereby Ashland would transfer its interest in MAP to Marathon, Moody's announced it would likely cut Ashland's senior debt rating to Ba1, the highest non-investment grade rating. Ratings downgrades below investment grade can significantly increase a company's borrowing costs. In December 2004, S&P raised Ashland's commercial paper rating to A-2 from A-3, increasing the availability of the commercial paper market to Ashland. Moody's continues to rate Ashland's commercial paper at P-3. Ashland has two revolving credit agreements providing for up to \$650 million in borrowings. The agreement providing for up to \$350 million in borrowings expires on March 21, 2010. The agreement providing for up to \$300 million in borrowings expires on March 20, 2006. Ashland has utilized the latter facility to fund currently maturing long-term debt, the early retirement of a capital lease, and certain other lease payments, and had \$228 million outstanding under this facility at March 31, 2005. While the revolving credit agreements contain covenants limiting new borrowings based on Ashland's stockholders' equity, these agreements would have permitted an additional \$2.4 billion of borrowings at March 31, 2005. Additional permissible borrowings are increased (decreased) by 150% of any increase (decrease) in stockholders' equity.

Edgar Filing: ASHLAND INC - Form 10-Q

At March 31, 2005, working capital (excluding debt due within one year) amounted to \$949 million, compared to \$926 million at September 30, 2004, and \$768 million at March 31, 2004. Ashland's working capital is affected by its use of the LIFO method of inventory valuation. That method valued inventories below their replacement costs by \$119 million at March 31, 2005, compared to \$95 million at September 30, 2004, and \$81 million at March 31, 2004. Liquid assets (cash, cash equivalents and accounts receivable) amounted to 69% of current liabilities at March 31, 2005, compared to 84% at September 30, 2004, and 89% at March 31, 2004.

Capital resources

For the six months ended March 31, 2005, property additions amounted to \$127 million, compared to \$86 million for the same period last year. Ashland anticipates meeting its remaining 2005 capital requirements for property additions of approximately \$150 million, excluding any buyouts of current leases, and dividends of approximately \$40 million, from internally generated funds, supplemented by short-term borrowings or proceeds from the MAP transaction as necessary.

20

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital resources (continued)

In 2004, Ashland initiated a multi-year SAP enterprise resource planning (ERP) project that is expected to be implemented world-wide across Ashland's Chemical Sector to achieve increased efficiency and effectiveness in supply chain, financial, and environmental, health and safety processes. Overall costs for this project through 2007 are expected to total approximately \$90 million, of which approximately \$80 million will be capitalized, including \$25 million of capitalized costs expected to be spent in 2005. While extensive planning is underway to support a smooth implementation of the ERP system, such implementations carry substantial project risk, including the potential for business interruption and associated adverse impacts on operating results.

Ashland's debt level amounted to \$1.81 billion at March 31, 2005, compared to \$1.55 billion at September 30, 2004, and \$1.56 billion at March 31, 2004. Debt as a percent of capital employed amounted to 38.5% at March 31, 2005, compared to 36.4% at September 30, 2004, and 40.1% at March 31, 2004. At March 31, 2005, Ashland's debt included \$507 million of floating-rate obligations, including \$478 million of short-term debt and \$29 million of long-term debt, and the interest rates on an additional \$122 million of fixed-rate, medium-term notes were effectively converted to floating rates through interest rate swap agreements. In addition, Ashland's costs under its sale of receivables program and various operating leases are based on the floating-rate interest costs on \$186 million of third-party debt underlying those transactions. As

Edgar Filing: ASHLAND INC - Form 10-Q

a result, Ashland was exposed to short-term interest rate fluctuations on \$815 million of debt obligations at March 31, 2005.

ASBESTOS-RELATED LITIGATION AND ENVIRONMENTAL REMEDIATION

For a discussion of Ashland's asbestos-related litigation and environmental remediation matters, see Note G to the Condensed Consolidated Financial Statements.

FORWARD LOOKING STATEMENTS

Management's Discussion and Analysis contains 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 statements include those that refer to Ashland's operating performance, earnings, benefits expected to be obtained through the SAP ERP implementation and expectations about the MAP transaction. Although Ashland believes its expectations are based on reasonable assumptions, it cannot assure the expectations reflected herein will be achieved. These forward-looking statements are based upon internal forecasts and analyses of current and future market conditions and trends, management plans and strategies, weather, operating efficiencies and economic conditions, such as prices, supply and demand, cost of raw materials, and legal proceedings and claims (including environmental and asbestos matters) and are subject to a number of risks, uncertainties, and assumptions that could cause actual results to differ materially from those we describe in the forward-looking statements. The risks, uncertainties, and assumptions include the risks associated with the ERP implementation, including the potential for business interruption and associated adverse impacts on operating results; the possibility that Ashland will be unable to fully realize the benefits anticipated from the MAP transaction; the possibility the transaction may not close including as a result of failure to finalize the closing agreement with the Internal Revenue Service or failure of Ashland to obtain the approval of its shareholders; the possibility that Ashland may be required to modify some aspect of the transaction to obtain regulatory approvals; and other risks that are described from time to time in the Securities and Exchange Commission (SEC) reports of Ashland. Other factors and risks affecting Ashland are contained in Risks and Uncertainties in Note A to the Consolidated Financial Statements in Ashland's annual report on Form 10-K, as amended, for the fiscal year ended September 30, 2004. Ashland undertakes no obligation to subsequently update or revise these forward-looking statements.

21

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Ashland's market risk exposure at March 31, 2005 is generally consistent with the types and amounts of market risk exposures presented in Ashland's Annual Report on Form 10-K, as amended, for the fiscal year ended September 30, 2004.

ITEM 4. CONTROLS AND PROCEDURES

(a) As of the end of the period covered by this quarterly

Edgar Filing: ASHLAND INC - Form 10-Q

report, Ashland, under the supervision and with the participation of its management, including Ashland's Chief Executive Officer and its Chief Financial Officer, evaluated the effectiveness of Ashland's disclosure controls and procedures pursuant to Rule 13a-15(b) and 15d-15(b) promulgated under the Securities Exchange Act of 1934, as amended. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective.

- (b) There were no significant changes in Ashland's internal control over financial reporting, or in other factors, that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, Ashland's internal control over financial reporting.

22

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Asbestos-Related Litigation - 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. Although Riley was neither a producer nor a manufacturer of asbestos, its industrial boilers contained some asbestos-containing components provided by other companies.

The majority of lawsuits filed involve multiple plaintiffs and multiple defendants, with the number of defendants in many cases exceeding 100. The monetary damages sought in the asbestos-related complaints that have been filed in state or federal courts vary as a result of jurisdictional requirements and practices, though the vast majority of these complaints either do not specify monetary damages sought or merely recite that the monetary damages sought meet or exceed the required jurisdictional minimum in which the complaint was filed. Plaintiffs have asserted specific dollar claims for damages in approximately 5% of the 50,900 active lawsuits pending as of March 31, 2005. In these active lawsuits, less than 0.2% of the active lawsuits involve claims between \$0 and \$100,000; approximately 1.6% of the active lawsuits involve claims between \$100,000 and \$1 million; less than 1% of the active lawsuits involve claims between \$1 million and \$5 million; less than 0.2% of the active lawsuits involve claims between \$5 million and \$10 million; approximately 2% of the active lawsuits involve claims between \$10 million and \$15 million; and less than 0.02% of the active lawsuits involve claims between \$15 million and \$100 million. The variability of requested damages, coupled with the actual experience of resolving claims over an extended period, demonstrates that damages requested in any particular lawsuit or complaint bear little or no relevance to the merits or disposition value of a particular case. Rather, the amount potentially recoverable by a specific plaintiff or group of plaintiffs is determined by other factors such as product identification or lack thereof, the type and severity of the disease alleged, the number and culpability of other defendants, the impact of bankruptcies of other companies that are co-defendants in claims, specific defenses available to certain defendants, other potential causative factors and the specific jurisdiction in which the claim is made.

Edgar Filing: ASHLAND INC - Form 10-Q

For additional information regarding liabilities arising from asbestos-related litigation, see Note G of "Notes to Condensed Consolidated Financial Statements" in this quarterly report on Form 10-Q.

U.S. Department of Justice ("USDOJ") Antitrust Division Investigation - In November 2003, Ashland received a subpoena from the USDOJ relating to a foundry resins grand jury investigation. Ashland has provided responsive records to the subpoena. As is frequently the case when such investigations are in progress, a number of civil actions have since been filed in multiple jurisdictions, most of which are seeking class action status for classes of customers of foundry resins. These cases have been consolidated for pretrial purposes in the United States District Court, Southern District of Ohio. Ashland will vigorously defend the actions.

Environmental Proceedings - (1) Under the federal Comprehensive Environmental Response Compensation and Liability Act (as amended) and similar state laws, Ashland may be subject to joint and several liability for clean-up costs in connection with alleged releases of hazardous substances at sites where it has been identified as a "potentially responsible party" ("PRP"). As of March 31, 2005, Ashland had been named a PRP at 91 waste treatment or disposal sites. These sites are currently subject to ongoing investigation and remedial activities, overseen by the United States Environmental Protection Agency (the "USEPA") or a state agency, in which Ashland is typically participating as a member of a PRP group. Generally, the type of relief sought includes remediation of contaminated soil and/or groundwater, reimbursement for past costs of site clean-up and administrative oversight, and/or long-term monitoring of environmental conditions at the sites. The ultimate costs are not predictable with assurance.

For additional information regarding environmental matters and reserves, see Note G of "Notes to Condensed Consolidated Financial Statements" in this quarterly report on Form 10-Q.

(2) On May 13, 2002, Ashland entered into a plea agreement with the U.S. Attorney's Office for the District of Minnesota and the U.S. Department of Justice regarding a May 16, 1997, sewer fire at the St. Paul Park, Minnesota refinery, which is now owned by MAP. As part of the plea agreement, Ashland entered guilty pleas to two misdemeanors, paid a \$3.5 million fine related to violations of the Clean Air Act ("CAA"), paid \$3.55 million as restitution to the employees injured in the fire, and paid \$200,000 as restitution to the responding rescue units. Ashland also agreed to complete certain upgrades to the St. Paul Park refinery's process sewers, junction boxes and

23

drains to meet standards established by Subpart QQQ of the New Source Performance Standards of the CAA (the "Refinery Upgrades"). The Refinery Upgrades, completed before 2004, have been acknowledged and accepted by the appropriate agencies.

In addition, as part of the plea agreement, Ashland entered into a deferred prosecution agreement, wherein prosecution of a separate count of the indictment charging Ashland with violating Subpart QQQ was deferred for four years. The deferred prosecution agreement provided that if Ashland satisfied the terms and conditions of the plea agreement and completed the Refinery Upgrades, the deferred prosecution agreement would terminate and the United States would dismiss that count with prejudice. Ashland satisfied these terms and conditions and the deferred prosecution was

Edgar Filing: ASHLAND INC - Form 10-Q

dismissed by the court on February 22, 2005.

As part of its sentence, Ashland was placed on probation for five years. The primary condition of probation is an obligation not to commit future federal, state, or local crimes. If Ashland were to commit such a crime, it would be subject not only to prosecution for that new violation, but the government could also seek to revoke Ashland's probation. The probation office has retained an independent environmental consultant to review and monitor Ashland's compliance with applicable environmental requirements and the terms and conditions of probation. The court also included other customary terms and restrictions of probation in its probation order.

(3) In 1990, contamination of groundwater at Ashland's former Canton, Ohio, refinery (now owned and operated by MAP) was first identified and reported to Ohio's Environmental Protection Agency ("OEPA"). Since that time, Ashland has voluntarily conducted investigation and remediation activities and regularly communicated with OEPA regarding this matter. Ashland and the state of Ohio have exchanged Consent Order drafts and have met to negotiate the terms of such an order. The state filed a complaint in February 2004, but simultaneously expressed an interest in continuing Consent Order settlement discussions. Following the filing of the complaint, Ashland, OEPA and Ohio's Office of the Attorney General have continued to work to finalize a Consent Order. The state has advised that it will assess a penalty as part of the overall settlement and has made an initial request for \$650,000.

Class Action Lawsuit Related to MAP Transaction - On April 8, 2005, Shiva Singh filed a complaint in the Supreme Court of the State of New York in New York County on behalf of himself and others similarly situated against Ashland, and the individual members of Ashland's Board of Directors. The complaint also names Marathon Oil Corporation ("Marathon"), MAP and Credit Suisse First Boston LLC ("CSFB") as defendants. The action arises out of the proposed transaction announced on March 19, 2004 in which Ashland would transfer its entire 38% interest in MAP as well as certain other businesses to Marathon (the "proposed transaction"). The complaint also alleges breach of fiduciary duty as well as aiding and abetting breach of fiduciary duty and negligence against Ashland, its directors, Marathon and MAP. The complaint also alleges breach of fiduciary duty and negligence as well as aiding and abetting breach of fiduciary duty and negligence against CSFB.

The complaint seeks to recover from defendants an unstated sum of damages. The complaint also seeks to enjoin the proposed transaction (and any related shareholder vote) between Ashland and Marathon to require defendants to fully disclose all material facts before completion of any such transaction; and to require defendants to obtain a current, independent fairness opinion concerning the proposed transaction. To the extent that the proposed transaction is consummated prior to the entry of the court's final judgment, the complaint asks the court to rescind such transaction(s) and award damages. The complaint also seeks reasonable attorneys' fees, costs and expenses. Ashland believes the lawsuit is without merit.

Other Legal Proceedings - In addition to the matters described above, there are various claims, lawsuits and administrative proceedings pending or threatened against Ashland and its current and former subsidiaries. Such actions are with respect to commercial matters, product liability, toxic tort liability, and other environmental matters, which seek remedies or damages, some of which are for substantial amounts. While these actions are being contested, their outcome is not predictable.

Edgar Filing: ASHLAND INC - Form 10-Q

ITEM 5. OTHER INFORMATION

On April 28, 2005, Ashland announced that it has amended its agreement to transfer its 38-percent interest in MAP and two other businesses to Marathon. Under the amended agreement, Ashland's interest in these businesses is valued at approximately \$3.7 billion compared to approximately \$3 billion in the earlier agreement, with substantially all the increase in value going directly to Ashland's shareholders in the form of Marathon stock. In addition, Marathon has agreed to pay the first \$200 million of any Section 355(e) tax, if any, as compared to the prior agreement where Ashland bore full responsibility for any Section 355(e) tax. The transaction is expected to be

24

tax free to Ashland's shareholders and tax efficient to Ashland. The two other businesses are Ashland's maleic anhydride business and 60 Valvoline Instant Oil Change ("VIOC") centers in Michigan and northwest Ohio, which are valued at \$94 million.

Under the terms of the amended agreement, Ashland's shareholders will receive Marathon common stock with an aggregate value of \$915 million. Based on the number of shares outstanding on March 31, 2005, shareholders would receive \$12.56 in Marathon stock per Ashland share. Ashland will receive cash and MAP accounts receivable totaling \$2.8 billion. In addition, MAP has not made quarterly cash distributions to Ashland and Marathon since March 18, 2004, and such distributions will continue to be suspended until the closing of the transaction. As a result, the final amount of cash to be received by Ashland will be increased by an amount equal to 38 percent of the cash accumulated from operations during the period prior to closing. At March 31, 2005, Ashland's share of this accumulated cash was \$560 million.

Under the terms of the earlier agreement, the closing was conditioned on receipt of private letter rulings from the Internal Revenue Service ("IRS") with respect to certain tax issues. Under the terms of the amended agreement, Ashland and Marathon expect to enter into a closing agreement with the IRS that will resolve these tax issues. Under the closing agreement, the retention by Ashland of certain contingent liabilities related to previously-owned businesses will reduce Ashland's tax basis. Ashland estimates this basis reduction may increase any Section 355(e) tax on the transaction by approximately \$66 million. Marathon has agreed to pay the first \$200 million of any Section 355(e) tax. Ashland would pay up to the next \$175 million of Section 355(e) tax, if required. Any remaining Section 355(e) tax would be shared equally by Ashland and Marathon. Based on the number of Ashland shares outstanding as of March 31, 2005, and Ashland's current estimate of Ashland's tax basis, Ashland expects that it would be required to pay Section 355(e) tax only if Ashland's stock price on the closing date exceeds approximately \$74.50 per share.

Ashland intends to use a substantial portion of the transaction proceeds to retire all or most of its outstanding debt and certain other financial obligations. After payment of these obligations and including Ashland's current estimate of MAP's final cash distribution, Ashland expects to have a net cash position of roughly \$1.1 billion.

The transaction is subject to, among other things, approval by Ashland's shareholders, consent from public debt holders, finalization of the closing agreement with the IRS and customary antitrust review. Ashland and Marathon have agreed to use their reasonable best efforts to complete

Edgar Filing: ASHLAND INC - Form 10-Q

the transaction by June 30, 2005, with the termination date for the transaction extended to September 30, 2005.

ITEM 6. EXHIBITS

(a) Exhibits

- 4 Amendment No. 2 dated as of April 27, 2005, to the Rights Agreement, dated as of May 16, 1996, between Ashland Inc. and the Rights Agent.
- 10 Ashland Inc. Deferred Compensation Plan for Employees (2005), as amended.
- 12 Computation of Ratio of Earnings to Fixed Charges.
- 31.1 Certificate of James J. O'Brien, Chief Executive Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certificate of J. Marvin Quin, Chief Financial Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certificate of James J. O'Brien, Chief Executive Officer of Ashland, and J. Marvin Quin, Chief Financial Officer of Ashland, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

25

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Ashland Inc.

(Registrant)

Date: May 9, 2005

/s/ J. Marvin Quin

J. Marvin Quin
Senior Vice President and
Chief Financial Officer (on
behalf of the Registrant and
as principal financial
officer)

26

EXHIBIT INDEX

Exhibit No.	Description
-----	-----

Edgar Filing: ASHLAND INC - Form 10-Q

- 4 Amendment No. 2 dated as of April 27, 2005, to the Rights Agreement, dated as of May 16, 1996, between Ashland Inc. and the Rights Agent.
- 10 Ashland Inc. Deferred Compensation Plan for Employees (2005), as amended.
- 12 Computation of Ratio of Earnings to Fixed Charges.
- 31.1 Certificate of James J. O'Brien, Chief Executive Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certificate of J. Marvin Quin, Chief Financial Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certificate of James J. O'Brien, Chief Executive Officer of Ashland, and J. Marvin Quin, Chief Financial Officer of Ashland, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.