Ecolab Inc.
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28941/0800/0399

Around the clock.
Around the world.

1998 Annual Report

Ecolab

Around the clock.
Around the world.

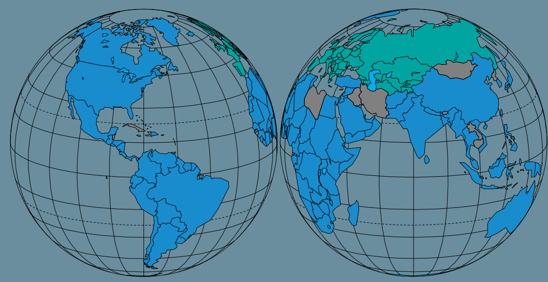
1998

Strategy

Since 1923, Ecolab has followed a strategy to Circle the Customer in institutional and industrial markets with an ever-widening array of value-added, premium products, systems and services. Today, Ecolab continues to grow by meeting the increasing breadth and depth of cleaning and sanitation requirements for these critcal markets.

Equally important, has been Ecolab's mission to Circle the Globe. We are dedicated to serving our customers whenever, wherever, they need us. We ensure they achieve the highest level of cleaning and sanitation, around the clock, around the world.

Global Coverage

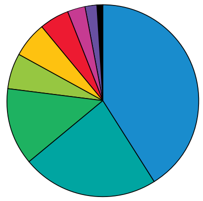


- Countries Served by Ecolab
- Countries Served by Henkel-Ecolab

Business Overview | **Business Mix** | **Customers/Markets**

Ecolab

Ecolab Reaching customers in more than 150 countries around the world to provide products, systems and services to meet all of their cleaning and sanitation needs is the premise behind Ecolab's Circle the Customer – Circle the Globe strategy. To this end, Ecolab develops and markets complementary offerings through seven business units in the United States: Institutional, Pest Elimination, Kay, Textile Care, Professional Products, Food & Beverage, and Water Care Services. In addition, as a global supplier, Ecolab reaches customers in Canada, Asia Pacific, Latin America and Africa through direct subsidiaries, joint ventures, export operations, licensees and distributors.



1998

- Institutional 41%
- International 23%
- Food & Beverage 13%
- Pest Elimination 6%
- Professional Products 6%
- Kay 5%
- Textile Care 3%
- Other Services 2%
- Water Care Services 1%

Customers:

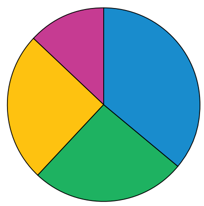
- Restaurants
- Hotels
- Quickservice operations
- Food retail (grocery)
- Schools
- Laundries
- Healthcare facilities
- Dairy farms and plants
- Food, beverage and brewery processing plants
- Office buildings
- Shopping malls
- Light industry
- Fleet and vehicle wash

Markets:

- United States
- Canada
- Asia Pacific
- Latin America
- Africa

Henkel-Ecolab

Henkel-Ecolab In Europe, Ecolab completes its Circle the Customer – Circle the Globe strategy through Henkel-Ecolab, a joint venture headquartered in Düsseldorf, Germany. Henkel-Ecolab's business mirrors that of Ecolab's elsewhere, offering the same premium products and services to global chains that require worldwide consistency, as well as serving individual customers.



1998

- Institutional 36%
- Professional Hygiene 26%
- Food & Beverage P3 25%
- Textile Hygiene (Textile Care) 13%

Customers:

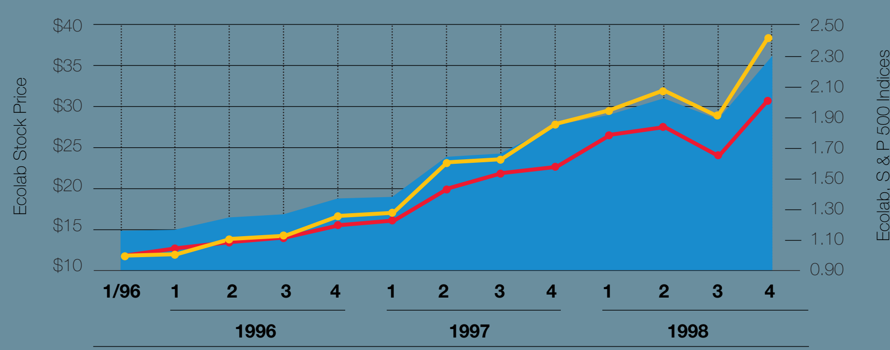
- Restaurants
- Hotels
- Laundries
- Healthcare facilities
- Dairy farms and plants
- Food, beverage and brewery processing plants
- Schools
- Office buildings
- Light industry

Market:

- Europe

Ecolab Stock Performance

	1998		1997	
Quarter	High	Low	High	Low
First	$29.63	$26.63	$19.56	$18.13
Second	$33.00	$28.19	$24.03	$19.06
Third	$33.11	$27.13	$24.94	$21.28
Fourth	$38.00	$26.13	$28.00	$23.06



- Ecolab Stock Price
- Ecolab Stock Price Index. Jan. 1, 1996 = 100
- S&P 500 Index. Jan 1, 1996 = 100

Services/Products	Sales	Sales-and-Service Associates

Institutional: Innovative warewashing, on-premise laundry, housekeeping, warehandling, water filtration and conditioning, kitchen equipment repair, vehicle wash, and pool and spa management products, programs and services for the foodservice and hospitality industries.

Pest Elimination: Commercial pest elimination and prevention services.

Kay: Cleaning and sanitation products and training programs for the quickservice restaurant, convenience store and food retail markets.

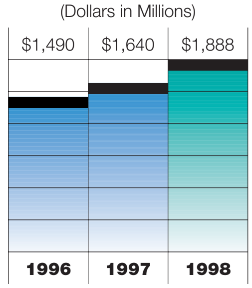
Textile Care: Cleaning and sanitizing products and services for large on-premise and commercial laundries.

Professional Products: Floor-care, carpet-care, odor-control, personal hand soap, surgical scrub, disinfecting and general sanitizing products, programs and systems for the commercial, industrial and healthcare markets.

Water Care Services: Water treatment programs for boilers, cooling water and waste treatment systems.

Food & Beverage: Cleaning and sanitizing products, equipment, systems and services for the agribusiness, beverage, brewery, dairy and food processing industries.

Sales
(Dollars in Millions)



December 31	1996	1997	1998
Institutional	2,125	2,260	2,405
Kay	95	100	120
Textile Care	135	130	125
Professional Products	200	200	190
Water Care	80	95	95
Food & Beverage	365	375	420
Pest Elimination	1,035	1,115	1,260
Other – U.S.	–	5	285
Canada	240	265	300
Asia Pacific*	455	505	750
Latin America	335	310	330
Africa	75	85	85
Total	5,140	5,445	6,365

*excludes Gibson in 1996 and 1997

Prior years have been restated to conform to the 1998 presentation.

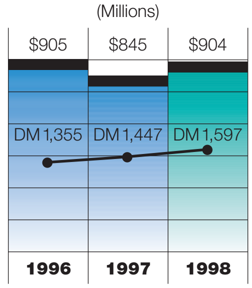
Institutional: Warewashing, housekeeping and related products and services for the hospitality and foodservice markets.

Professional Hygiene: Detergents, sanitizers, machines, equipment, floor-care and odor-control products for contract or in-house cleaning, and highly specialized disinfectants and other cleaning and sanitizing products for the healthcare industry.

Food & Beverage P3: Cleaning and sanitizing products for the agribusiness, beverage, brewery, dairy, food processing, pharmaceutical and cosmetic industries.

Textile Hygiene: Cleaning and sanitizing products and services for large commercial, on-premise and small independent laundries.

Sales
(Millions)



● Deutsche Marks

December 31	1996	1997	1998
Joint Venture	2,010	2,225	2,365

Prior years have been restated to conform to the 1998 presentation.

As Ecolab continues to become a more powerful and diverse global player, one thing remains unchanged – our ability to meet customers' needs. Wherever the customer is located; whatever hours it keeps. In fact, we've built our reputation by supplying products, systems and services as varied and far-reaching as those who use them. Around the clock, around the world, we help businesses run more successful operations, as well as keep them clean. It has earned us the trust of more than 350,000 customers worldwide. And it has earned us our reputation as industry leader.

Description of Business

Founded in 1923, Ecolab is the leading global developer and marketer of premium cleaning, sanitizing and maintenance products and services for the hospitality, institutional and industrial markets. Customers include hotels and restaurants; foodservice, healthcare and educational facilities; quickservice (fast-food) units; groceries; commercial laundries; light industry; dairy plants and farms; and food and beverage processors. Ecolab provides customized products, equipment and programs, backed by the industry's largest and best-trained sales-and-service force, which is more than 6,300 members strong.

Ecolab operates directly in 37 countries in North America, Asia Pacific, Latin America and Africa, employing more than 12,000 associates. In Europe, it reaches customers through a joint venture, Henkel-Ecolab, headquartered in Düsseldorf, Germany. Henkel-Ecolab does business in 26 countries, including Eastern European markets, and employs nearly 4,600 associates, including a direct sales-and-service force of nearly 2,400. Ecolab serves customers in more than 100 other countries through distributors, licensees and export operations.

Through the implementation of its Circle the Customer – Circle the Globe strategy, Ecolab continues to offer an increasing array of value-added, superior products, systems and services that complement each other and keep its customers' facilities cleaner, healthier and safer – everywhere in the world.

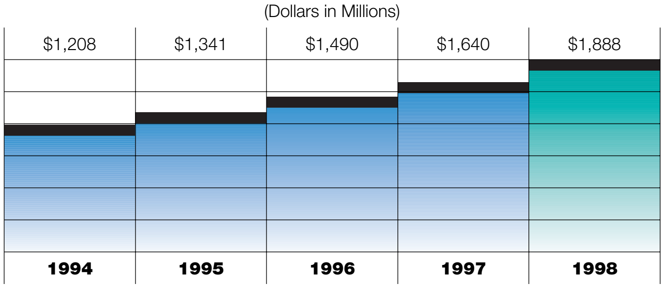
Ecolab common stock is traded on the New York Stock Exchange and the Pacific Exchange under the symbol ECL. Ecolab news releases and other selected investor information are available by calling 1-800-FACT-ECL (1-800-322-8325) or on the Internet at www.ecolab.com.

Contents

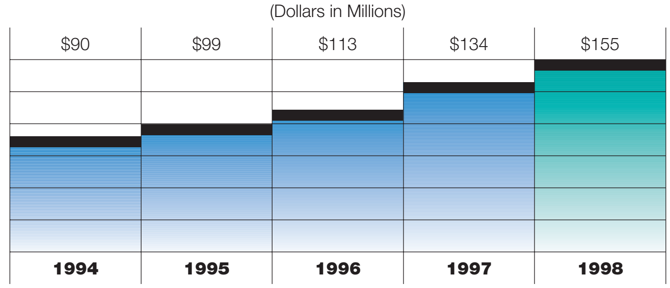
Financial Highlights

December 31 (thousands, except per share)	1998	1997	1996	Percent Change 1998	Percent Change 1997
Net Sales	**$1,888,226**	$1,640,352	$1,490,009	**15%**	10%
Income from Continuing Operations	**154,506**	133,955	113,185	**15**	18
Percent of Sales	**8.2%**	8.2%	7.6%		
Diluted Income from Continuing Operations per Common Share	**1.15**	1.00	0.85	**15**	18
Diluted Weighted-Average Common Shares Outstanding	**134,047**	133,822	132,817	**–**	1
Cash Dividends Declared per Common Share	**0.390**	0.335	0.290	**16**	16
Cash Provided by Continuing Operating Activities	**274,529**	235,098	254,269	**17**	(8)
Capital Expenditures	**147,631**	121,667	111,518	**21**	9
Shareholders' Equity	**690,541**	551,701	519,963	**25**	6
Return on Beginning Equity	**28.0%**	25.8%	24.8%		
Total Debt	**295,032**	308,268	176,292	**(4)**	75
Total Debt to Capitalization	**29.9%**	35.8%	25.3%		
Total Assets	**$1,470,995**	$1,416,299	$1,208,409	**4%**	17%

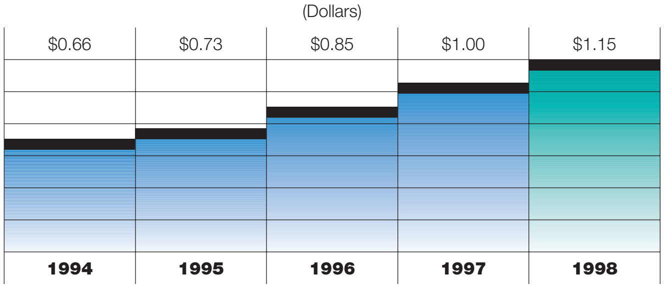
Net Sales
(Dollars in Millions)



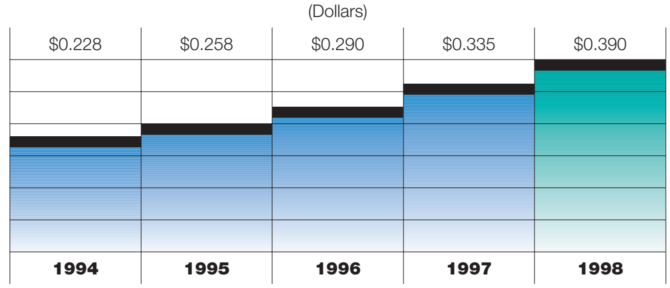
Income
(Dollars in Millions)



Diluted Income per Share
(Dollars)



Dividends Declared per Share
(Dollars)



Income and diluted income per share are continuing operations. 1994 reflects pro forma adjustments to eliminate unusual items associated with the company's December 1994 merger with Kay Chemical Company.

This Annual Report to Stockholders contains various "Forward-Looking Statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements, which represent Ecolab's expectations or beliefs concerning various future events, are based on current expectations. Therefore, they involve a number of risks and uncertainties that could cause actual results to differ from those of such Forward-Looking Statements. We refer readers to the Company's statement entitled "Forward-Looking Statements and Risk Factors," which is contained under Part I of the Company's Annual Report on Form 10-K for the year ended December 31, 1998, for further discussion of these matters. Additional risk factors may be described from time to time in Ecolab's filings with the Securities and Exchange Commission.

Allan L. Schuman,
President and Chief Executive Officer (left)

Michael E. Shannon,
Chairman of the Board, Chief Financial and Administrative Officer (right)

Once again, we promised results – and we delivered.

To Our Shareholders

Over the past 75 years, Ecolab has built its reputation by offering superior cleaning and sanitation performance – at any hour of the day, in every corner of the world. Our ability to demonstrate financial performance has been equally reliable. 1998 was no exception.

Once again, our results were outstanding. With aggressive growth goals and steady financial discipline, we achieved record highs in sales, earnings and earnings per share, and exceeded all three of our long-term financial objectives for the third consecutive year. This culminated with the value of Ecolab shares rising 31 percent in 1998, to close at a record year-end stock price and record market capitalization.

We also strengthened our business through strategic acquisitions, enhanced our coverage through major field sales investments, and further differentiated our business with new products, systems and services. As always, our Circle the Customer – Circle the Globe strategy drove these achievements, along with the dedicated, aggressive efforts of our nearly 17,000 associates worldwide – a number that reflects our undisputed global leadership position.

Specifically, here's what we accomplished in 1998.

We delivered record financial performance:

- Sales from wholly-owned operations increased 15 percent to a record $1.9 billion, with sales force investments, new products and services, and the integration of acquisitions driving sales gains. Our global sales coverage, including our European joint venture, Henkel-Ecolab, reached $2.8 billion.
- Income from continuing operations increased to $155 million, up 15 percent over 1997's income, to $1.15 per diluted share. Earnings benefited from innovative, differentiated new products; productivity improvements; and disciplined cost control. 1998 was Ecolab's sixth consecutive year of double-digit earnings per share growth.
- Return on beginning shareholders' equity reached a record 28 percent, exceeding our long-term financial objective of a 20 percent return for the seventh consecutive year.

- Cash flow from continuing operations increased 17 percent, also reaching an all-time high. Strong cash flow and moderate debt levels allowed us to maintain our objective of an investment grade balance sheet, and our debt continued to be rated within the "A" categories by the major rating agencies.
- Our stock price continued to climb. We began the year at $27.72 and ended at $36.19, posting a 31 percent increase and exceeding the Standard & Poor's 500 growth of 27 percent. This represents the fourth consecutive year in which we outperformed the S&P 500, and the seventh year of the past eight.
- In December, we raised our quarterly cash dividend by 11 percent to $0.105 per share from $0.095. This resulted in an indicated annual rate of $0.42 per share, and is in keeping with our policy of paying out between 30 and 40 percent of our earnings as dividends.

We grew our business:

- In 1998, we added 920 associates to our sales-and-service force through internal growth and acquisitions. Now 6,365 members strong, it continues to be the largest and best-trained sales-and-service organization in the industry. When including our Henkel-Ecolab joint venture, our sales-and-service force boasts 8,730 associates worldwide.
- We continued to aggressively implement our Circle the Customer – Circle the Globe strategy, introducing add-on services such as the *FresH$_2$O* point-of-use water filtration business and the *Ecoflo* Grease Elimination Program, both of which are being very well-received by foodservice customers. Our strong pipeline of new products also continued to perform well, including *GeoSystem 9000*, the next generation in warewashing solids, and *Vortexx*, a peracid sanitizer for food and beverage processing applications. In addition, we introduced *KayStar*, a multi-faceted program of cleaning and sanitizing products that helps quick-service restaurant customers enhance efficiency within their restaurant operations.
- We successfully integrated Gibson Chemical into existing operations and sold its non-core business units. This Australian-based acquisition has proven to be an extremely valuable addition to our business, and opportunities to leverage the combined strengths of Gibson and Ecolab associates look outstanding.

We made strategic acquisitions:

- In June, we further established our presence in the water filtration market with the acquisition of certain assets of Puremark International, a Fairfield, N.J.-based marketer of filtration and conditioning systems for foodservice operations. We also purchased certain assets of American Fluid Technologies, a Hopkins, Minn.-based provider of products and services for cleaning membrane systems used to process water in food, beverage, pharmaceutical and industrial applications.
- In July, we purchased GCS Service, Inc. of Danbury, Conn., a leading provider of commercial food equipment service and part sales. With the GCS acquisition, Ecolab became the largest supplier of this critical service – a key need of our chain accounts. We plan to build GCS into a nationally offered service.
- In November, we acquired selected assets of Vulcan Chemical Technologies Inc., of Sacramento, Calif., a supplier of chlorine dioxide generator technology for the food processing industry. This acquisition broadened our ability to meet that market's growing cleaning, sanitation and food safety needs.

• In December, we strengthened our presence in South Africa by purchasing selected assets of Brent Chemical Technologies of Johannesburg, a leading manufacturer and marketer of cleaning and sanitizing products and services for the South African food and beverage industry.

• In January 1999, we purchased Blue Coral Systems of Tucson, Ariz. Blue Coral is a leading marketer of a broad line of branded vehicle cleaning, appearance and specialty products for the vehicle wash industry. The acquisition makes us the market leader, bolstering our existing efforts in vehicle wash and essentially completing our national coverage.

We strengthened our global presence:

• Henkel-Ecolab's growth accelerated in 1998, helped by acquisitions and our investments to increase product differentiation and introduce more aggressive marketing efforts. Henkel-Ecolab sales increased 10 percent in 1998 when measured in Deutsche marks. Excluding businesses acquired during 1998, sales rose 5 percent. Profits were also good. Ecolab's equity from Henkel-Ecolab rose 19 percent to a record $16 million.

• We continued to improve our ability to serve customers around the world with new manufacturing plants in the Philippines, Kenya and Colombia, as well as plant expansions in Japan and Thailand. In addition, we expanded our warehouses in Georgia and Ohio.

We upheld our service tradition:

• In April, we opened Ecolab University, a state-of-the-art corporate training and development center located in St. Paul, Minn., that replaces our East and West Coast training facilities. Featuring the resources necessary to develop highly skilled and knowledgeable associates, Ecolab University is a powerful extension of our commitment to service excellence. Its location at our corporate headquarters centralizes training and helps familiarize new hires with the Ecolab culture.

• Ecolab was honored in 1998 to become the inaugural inductee into the Multi-Unit Food Service Operators' Hall of Fame. Ecolab had won MUFSO's prestigious equipment, supplies and service "Supplier of the Year" award in eight of the previous 10 years.

In addition:

• A year after Pest Elimination's National Support Center was severely damaged by the Red River floods of 1997, the division opened a new facility in Grand Forks, N.D. The building was inaugurated in August, and it houses customer service, finance and administrative support for Pest Elimination's sales and service associates.

• Following 10 years of service, Philip L. Smith retired from Ecolab's board of directors in March 1999. We are grateful for the many contributions Phil provided Ecolab over the past decade, and we will miss his counsel.

• Jerry A. Grundhofer, president and chief executive officer of Firstar Corporation, a bank holding company based in Milwaukee, Wisc., and William L. Jews, president and chief executive officer of CareFirst, Inc., based in Owings Mills, Md., were elected directors by the board in March 1999. We welcome Jerry and Bill to Ecolab and look forward to their participation in guiding our future.

• After 32 years with Ecolab, Jerry Carlson, senior vice president, Corporate Planning & Development, retired in October. Jerry made countless contributions during his long and distinguished career with Ecolab. He served in a variety of positions, including general manager for the Institutional Division and twice heading International operations. We wish him the very best in his future pursuits.

Outlook

As we enter 1999, Ecolab continues to forge ahead.

We further strengthened the business in 1998, bolstering our field sales capabilities, introducing new, differentiated products and systems, expanding our global coverage and broadening the markets in which we do business.

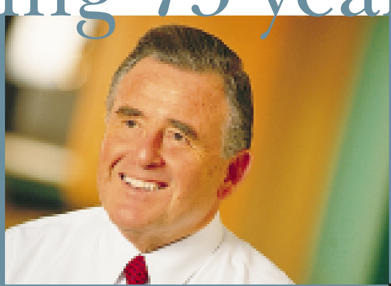
Consequently, we enter 1999 with a solid foundation. While we remain cautious about Asian and Latin American economies, we believe our aggressive efforts in those regions will yield strong results as they recover. Furthermore, our domestic hospitality and restaurant markets remain healthy, and the number and breadth of chain accounts demanding superior service and consistent global coverage continue to grow worldwide. With its extensive reach and long-standing reputation for excellence, Ecolab is uniquely qualified to help these customers run safer, more attractive and sanitary businesses in every corner of the globe.

Markets and economies may change, but Ecolab's singular focus on its Circle the Customer – Circle the Globe strategy remains unchanged. Around the clock, around the world, that focus continues to drive the actions of our dedicated team of associates and fuel our company's growth. By offering customers an increasing array of products and services wherever they do business, we will maintain our leadership position. Thus in 1999, we're confident we can promise shareholders, customers and associates superior results – and, as always, we'll deliver.

Allan L. Schuman
President and Chief Executive Officer

Michael E. Shannon
Chairman of the Board, Chief Financial and Administrative Officer

Celebrating 75 years

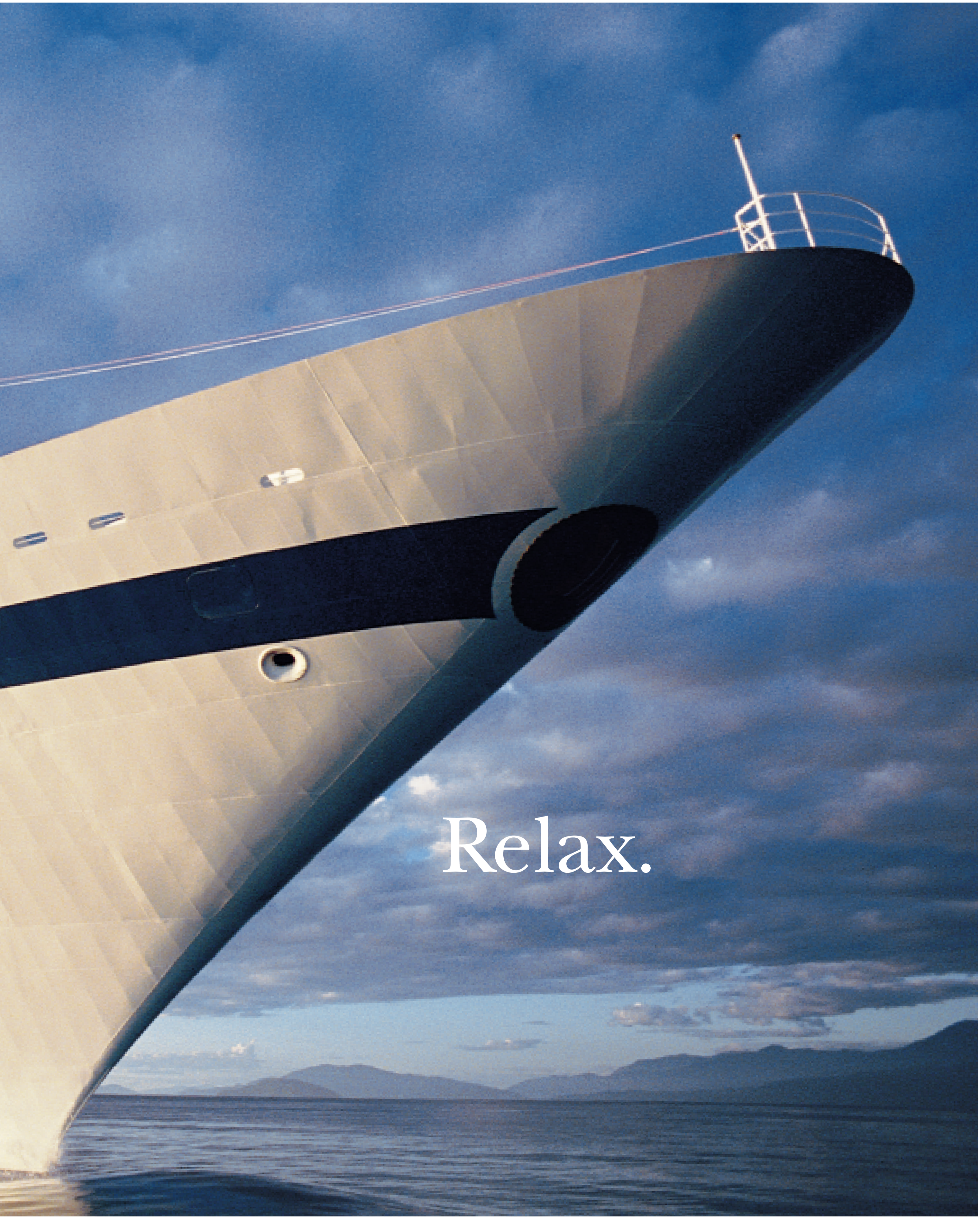


In 1923, Ecolab began with a single product, a single employee, and a single-minded dedication to being the industry leader. In 1998, as we celebrated our 75th anniversary, this powerful vision had become a reality. Today Ecolab is a $2.8 billion global enterprise employing nearly 17,000 associates worldwide. It serves industrial, institutional and hospitality customers in more than 150 countries – and it just keeps getting bigger every day.

Throughout its history, Ecolab has achieved this position by being better at what it does than anyone else. We've anticipated growing market needs, providing advanced products, services and systems, all of which help our customers run more profitable and successful businesses. We've continually moved the industry forward, contributing to a cleaner, more attractive and healthier world. Our size, scope and expertise today would undoubtedly surpass our early founders' wildest expectations.

1923
75
SPIRIT · PRIDE
DETERMINATION
PASSION
INTEGRITY
COMMITMENT
1998

I was proud to stand at the helm of this outstanding company as we celebrated our 75-year history of innovation and leadership. I also look forward to the upcoming years, because I know the best is yet to come.


Relax.

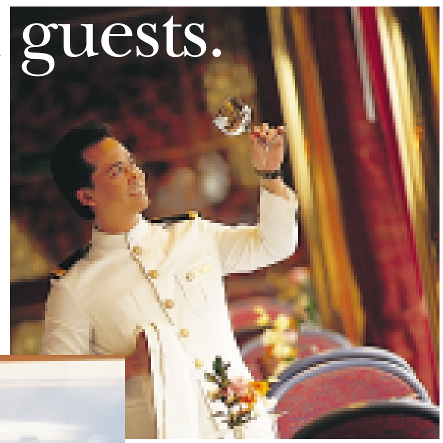
We help keep everything shipshape.

Cruise lines turn to Ecolab for the most effective sanitation programs available and reliable service on a global basis. We meet ships at port, providing a full range of time-saving, cost-effective solutions that make maintenance easier – and make guests' experiences safer and more pleasant. Ecolab. We help keep things clean and sanitary. Not just on cruise ships. But almost everywhere under the sun.

Institutional	Pest Elimination
Warewashing, on-premise laundry, housekeeping, water filtration and conditioning, kitchen equipment repair, vehicle wash, warehandling, and pool and spa management products, programs and services.	*Commercial pest elimination and prevention services.*

9:00 a.m. No dirty
Our hand soaps

11:30 a.m. Sparkling tableware washed with Ecolab products greets hungry brunch guests.



3:30 p.m. Let the sun shine in. Our products keep cabin windows streak-free.

1:20 p.m. **Temp**
programs help

4:00 p.m. As always, we've made happy hour glasses spotless.

5:45 p.m. No flies in the dining room thanks to Pest Elimination.

12:30 a.m. Sleepy passengers are welcomed by fresh, bright sheets – our advanced laundry systems keep them that way.

11:59 p.m.: Final

Kay	Textile Care	Professional Products	Water Care Services	Food & Beverage
Cleaning and sanitation products and training programs for the quickservice restaurant, convenience store and food retail markets.	*Cleaning and sanitizing products and services for large on-premise and commercial laundries.*	*Floor-care, carpet-care, odor-control, personal hand soap, surgical scrub, disinfecting and general sanitizing products, programs and systems for the commercial, industrial and healthcare markets.*	*Water treatment programs for boilers, cooling water and waste treatment systems.*	*Cleaning and sanitizing products, equipment and programs for the agribusiness, beverage, brewery, dairy and food processing industries.*

hands on deck.
keep them clean.

1:05 p.m. Our pool and spa programs make sure water is clean, pure and odor-free.

erature hits 92° F. Ecolab's Water Care ensure air conditioning is trouble-free.

10:45 p.m. Ecolab gives one shining performance after another, from kitchen to cabin to dining room.

ship inspection. We pass with flying colors.


Enjoy.

We make things worry-free.

Ecolab goes far beyond cleaning products and equipment. With innovative solutions and exceptional service, we help amusement parks – and other facilities – enhance productivity, increase efficiency, improve food and employee safety, and achieve superior sanitation results. Day and night, we work behind the scenes, helping our customers run more worry-free businesses, as well as keep them clean.

Institutional	Pest Elimination
Warewashing, on-premise laundry, housekeeping, water filtration and conditioning, kitchen equipment repair, vehicle wash, warehandling, and pool and spa management products, programs and services.	*Commercial pest elimination and prevention services.*

8:00 a.m.: Shuttle buses shine, thanks to Ecolab vehicle wash.

9:45 a.m. Beverages refresh guests. Our filters purify water in soft drink fountains, keeping sodas tasty to the last drop.

11:25 a.m. We have sanitation problems licked.

5:30 p.m. A dishmachine needs repair. Ecolab's prompt service prevents downtime.

2:35 p.m. Udderly Our products keep machine clean.

8:00 p.m. We make restaurant glassware and utensils sparkle. Wash after wash.

10:45 p.m. Walkways shine. Proper floor maintenance helps reduce slips and falls.

Kay	Textile Care	Professional Products	Water Care Services	Food & Beverage
Cleaning and sanitation products and training programs for the quickservice restaurant, convenience store and food retail markets.	*Cleaning and sanitizing products and services for large on-premise and commercial laundries.*	*Floor-care, carpet-care, odor-control, personal hand soap, surgical scrub, disinfecting and general sanitizing products, programs and systems for the commercial, industrial and healthcare markets.*	*Water treatment programs for boilers, cooling water and waste treatment systems.*	*Cleaning and sanitizing products, equipment and programs for the agribusiness, beverage, brewery, dairy and food processing industries.*

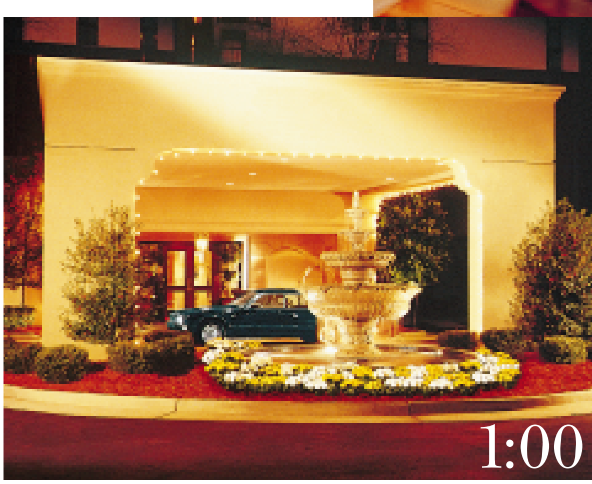
9:00 a.m. No spots on uniforms. Our cutting-edge laundry solutions removed them again.

12:30 p.m. After a morning of fun, a family lathers up with Ecolab hand sanitizer – and prevents the spread of germs.

2:00 p.m. Ecolab's odor-control programs keep busy rest rooms fresh, morning 'til night.

fantastic.

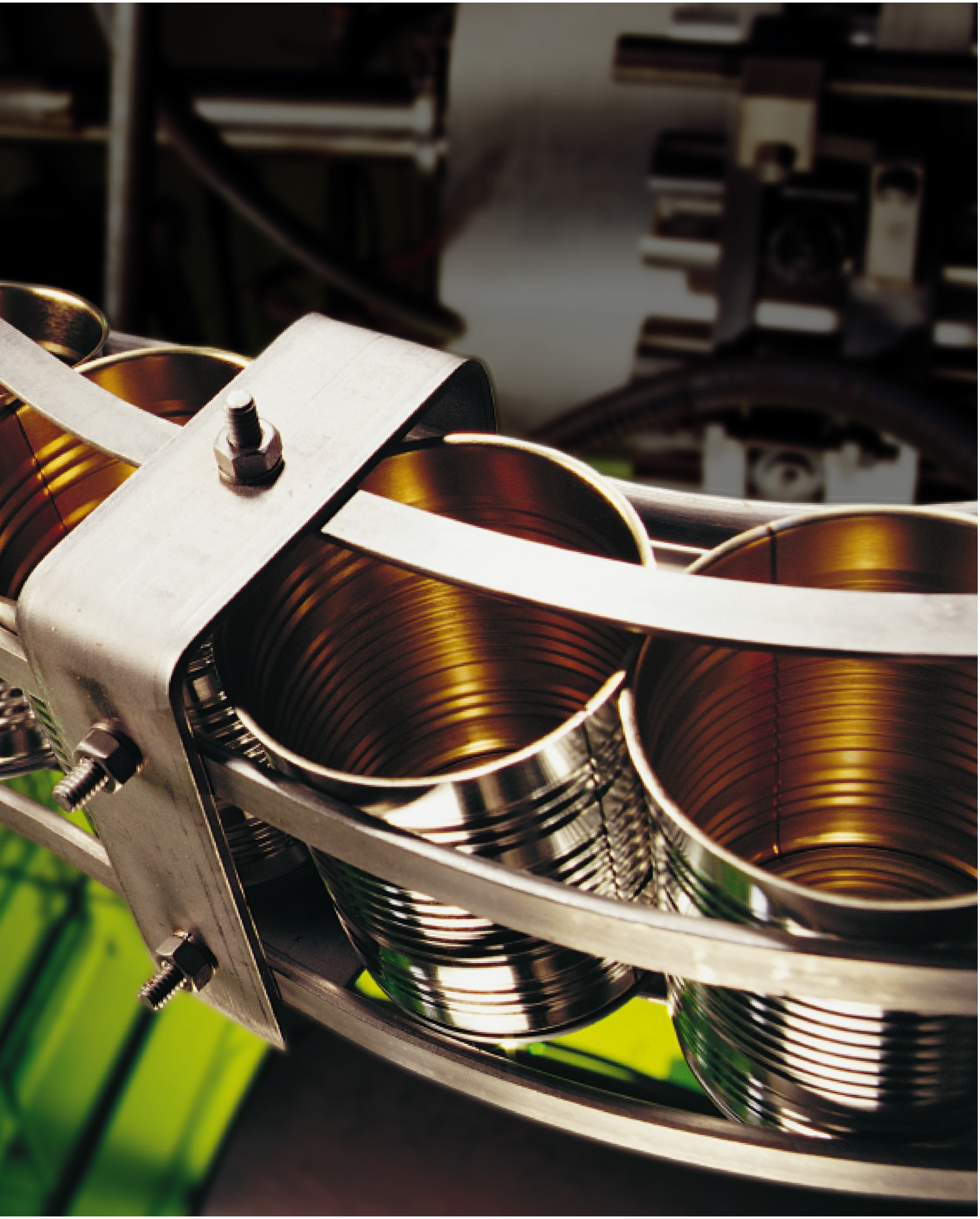
the yogurt



7:45 p.m. You retire to a spotless room. Fresh sheets, bright towels, clean bath.

1:00 a.m.: The clean-up crew calls it a night. Ecolab is still on call.


Rest assured.

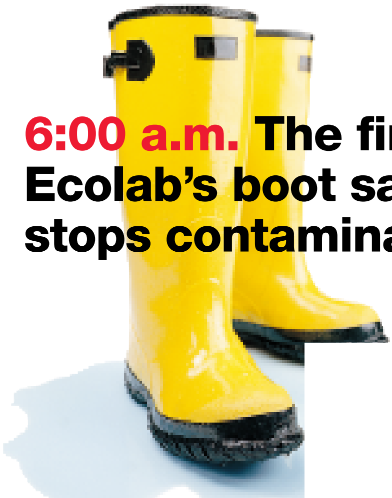


We clean right down to the bottom line.

In food and beverage processing plants, Ecolab helps ensure conditions are right for quality, safety and savings. From the moment raw materials enter a facility to the time products leave for supermarket shelves, our programs go to work. They help prevent cross-contamination from surfaces, systems, water, pests and even plant employees. Shift after shift, they help customers maintain top-quality results.

Institutional	Pest Elimination
Warewashing, on-premise laundry, housekeeping, water filtration and conditioning, kitchen equipment repair, vehicle wash, warehandling, and pool and spa management products, programs and services.	*Commercial pest elimination and prevention services.*

7:45 a.m. Wastewater is dis
by Ecolab, it complies with



6:00 a.m. The first shift arrives. Ecolab's boot sanitizer at doorway stops contaminants in their tracks.

9:15 a.m. Everyone is comfortable. Our cooling tower chemistry helps control scale, corrosion and microbiological activity, preventing breakdown.

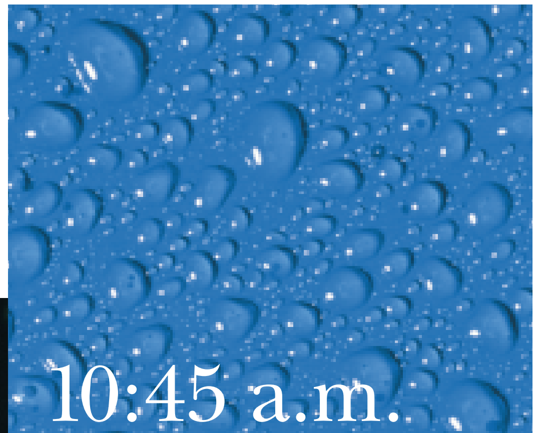
8:30 a.m. State certified specialist from Ecolab presents customized pest elimination solutions

2:45 p.m. A plant manager analyzes Ecolab's sanitation chemical usage report. Costs are down. Quality is up.

4:45 p.m. A poster reminds employees of proper hand washing procedures, courtesy of Ecolab.

Kay	Textile Care	Professional Products	Water Care Services	Food & Beverage
Cleaning and sanitation products and training programs for the quickservice restaurant, convenience store and food retail markets.	*Cleaning and sanitizing products and services for large on-premise and commercial laundries.*	*Floor-care, carpet-care, odor-control, personal hand soap, surgical scrub, disinfecting and general sanitizing products, programs and systems for the commercial, industrial and healthcare markets.*	*Water treatment programs for boilers, cooling water and waste treatment systems.*	*Cleaning and sanitizing products, equipment and programs for the agribusiness, beverage, brewery, dairy and food processing industries.*

charged. With treatment strictest of standards.



3:00 a.m. The *ECO2000* Rodent Bait Station keeps germ-carrying pests at bay.

10:45 a.m. Ecolab chemistry preserves water quality, front end to back.

1:30 p.m. Another shipment goes out. Our conveyor lubricants help keep bottles moving.

4:00 p.m. Ecolab – sponsored training session boosts employee efficiency.

11:35 p.m. There's no room for error. Our clean-in-place equipment dispenses precise concentrations of pipeline sanitizer – time after time.

Review of Operations

United States

Institutional

Highlights Institutional demonstrated record-breaking growth once again in 1998, enjoying its strongest performance in more than 16 years. Highlights for the year include:

• Achieved double-digit sales and earnings growth and increased market share, benefiting from aggressive new account gains, exceptional customer retention, cost-control initiatives and continued differentiation through new products, programs and services.

• Maintained its technology leadership position with 25 new products and systems launched in 1998, including *GeoSystem 9000*, a significant advancement in Ecolab's solids warewashing technology. Formulated without caustic soda, *GeoSystem* products provide many customer benefits, including safer and more effective use, and a more than 90 percent reduction in plastic packaging.

8:05 a.m.

Ecolab's revolutionary GeoSystem 9000 *warewashing program features nearly package-free solid products and state-of-the-art dispensing. The entire system is shape- and color-coded for proper usage and easy training and handling.*

• Continued to develop new market opportunities, including its *FresH$_2$O* point-of-use water filtration business for foodservice facilities. Through this program, Ecolab provides filters for purifying water in coffee machines, soft drink fountains and other restaurant equipment. During regular service calls, its specialists change and maintain the filters. This innovative program serves the more than $100 million U.S. water filtration market.

Restaurants and other foodservice operations count on Ecolab's complete programs to enhance food safety efforts. Ecolab offers a step-by-step assessment of food safety concerns, as well as ongoing consultation and practical, cost-effective solutions.

4:20 p.m.

• Grew its Vehicle Care business, primarily through the addition of national fleet accounts. Vehicle Care, which was created through the acquisition of Grace-Lee Products in 1997, also continued to achieve good sales with the independent car wash market.

• Further broadened its offering by acquiring GCS Service, a provider of commercial kitchen equipment repair services. This new venture fills a unique niche by offering both chain accounts and equipment manufacturers the benefit of working with a single, national equipment repair service supplier.

• Expanded its service coverage and productivity with the addition of 145 sales-and-service associates, and strengthened the service skills, product knowledge and sales proficiency of its personnel through training in the field and at Ecolab University.

• Achieved double-digit sales growth with its *Ecotemp* program, through which it provides customers low-temperature dishmachines that offer convenience, value and energy efficiency.

• Reached record-breaking double-digit sales growth with its *Raburn* business unit, capitalizing on its superior warehandling systems, and products and programs that help customers enhance food and employee safety.

• Launched the *Keystone* and *Eco-Clean Elite* programs, which are designed to grow sales made through distributors. These programs allow small independent customers to enjoy the efficiency, ease-of-use and safety benefits of Ecolab's products and systems.

• Continued to leverage Ecolab's Circle the Customer strategy, expanding alliances with Ecolab's other divisions to meet a broader range of customers' needs and achieve market share gains.

Outlook As we head into 1999, Institutional's momentum remains attractive. It will continue to retain, grow and gain foodservice, hospitality and healthcare business by building and expanding corporate and independent relationships, introducing differentiated products and systems, and capitalizing on sales force investments. It will also build on 1998 successes with its distributor and street businesses, and its *Ecotemp* and *Raburn* programs. In addition, new market opportunities such as Vehicle Care and *FresH$_2$O* will help propel the division's growth. Institutional will remain focused on providing the Ecolab Edge, which refers to its promise to offer customers innovative and differentiated solutions that help them run more profitable and successful businesses. With proven strategies and philosophies in place, Institutional expects to achieve market share gains and industry-leading growth once again in 1999.

Kay

Highlights With record sales in both its quickservice and food retail (grocery) areas, Kay increased sales and earnings in 1998. Highlights for the division include the following:

• Rolled out its *KayStar* automated dispensing program, which was placed in more than 10,000 quickservice restaurants nationwide.

• More than doubled its food retail cleaning and sanitation business, benefiting from the continued focus on food safety and the growing popularity of its *Quality Through Sanitation* program, which has been adopted by several of the United States' largest national grocery store chains.

• Continued to build its differentiated position through the roll out of new products and programs, including the *Exacta* dispensing system, *MatchUp* spray bottle system, and new offerings in hand care and rest room sanitation.

• Initiated a new product usage reporting system that provides customers with better information to control operational costs.

11:30 a.m.

Kay's program for quickservice restaurants not only keeps facilities clean and sanitary, but makes the process safer, simpler and more efficient. It includes everything from state-of-the-art laundry dispensers to floor-care programs to rest room cleaners.

Outlook Kay expects to achieve strong sales and earnings growth again in 1999. It will leverage successful new programs rolled out in 1998, as well as additional products and systems introduced in 1999. It will also benefit from new business with quickservice and food retail chains and improved market trends. By partnering with other divisions, Kay will continue to bring Ecolab's pest elimination, dishmachine and other programs to customers, serving their entire spectrum of cleaning and sanitation needs.

3:30 p.m.

Low-temperature technology such as Textile Care's patented TurboRev *detergent, offers industrial laundry customers time, energy and water savings. It meets their demands for optimum efficiency, while driving out the toughest of grease, grime and soils.*

Textile Care

Highlights Textile Care continued to be challenged by plant consolidations, as well as increased pricing pressures. In response, the division focused on offering differentiated products, systems and services to address changing market needs. 1998 accomplishments include:

• Introduced the Certified Laundry Technical Specialist program for the commercial laundry business. Textile Care specialists serving this market niche offer added value to customers through their industry expertise.

• Achieved double-digit growth with the *Turbo* product line, leveraging *TurboRev* low-temperature washing and *T-Jet 2000* dispensing technology.

• Grew its hospitality and commercial business with proprietary products and systems that help customers reduce total costs and enhance operational efficiencies.

Outlook Textile Care will remain competitive in a difficult market by leveraging its exceptional product and equipment technology and service expertise. New product introductions will enhance its growth prospects in 1999.

Professional Products

Highlights Professional Products showed sales and earnings progress in 1998. The year's highlights include:

• Grew sales in its core janitorial and infection-prevention markets through corporate account gains in the building service contractor, nonfood retail and healthcare markets.

• Introduced the *ISO-PRO* program for the more heavy-duty industrial market. This program features *Quik Fill Magnum*, a product and dispensing system that significantly reduces large industrial facilities' chemical and labor costs. In addition, Professional Products continued to capitalize on successful floor care, hand soap, and existing *Quik Fill* lines for commercial markets.

• Continued to provide added value to healthcare customers with offerings such as *ICare*, a complete infection-prevention system that includes training and employee recognition programs, as well as skin cleansing, instrument sterilization and surface disinfection products.

• Achieved record sales and earnings growth in its specialty group, benefiting from the strength of its *JaniSource* business for the mass distribution market and private label initiatives.

Differentiated products and systems continue to fuel the Professional Products Division's growth. Quik Fill Magnum, *introduced in 1998, offers large industrial facilities super-fast, high-volume dispensing that saves on time and labor.* ICARE *infection prevention programs are critical to healthcare customers.*

10:05 a.m.

Outlook In 1999, Ecolab's Professional Products Division will continue to aggressively pursue corporate account sales, add quality distribution where necessary, and introduce new products and programs for its healthcare, janitorial and specialty markets. Continued profit-improvement and cost-saving initiatives are expected to contribute to earnings gains.

Water Care Services

Highlights With its integration efforts complete, Water Care Services achieved increased growth throughout 1998. Specific accomplishments include:

• Improved sales and earnings by increasing business in the commercial laundry, cruise ship, healthcare and food processing industries; introducing new programs and technology; and successfully implementing cost-saving initiatives.

• Rolled out the *Balancer.com* pool and spa program, which was very well-received. Due to the program's success, *Balancer.com* was transferred to the Institutional Division for 1999 to leverage that group's much larger sales-and-service capabilities for the hospitality industry.

• Introduced *Crystal Mate* for boilers and *ReDoxx*, an air scrubber treatment program for food processing plants.

Outlook Water Care expects to achieve further sales and earnings growth in 1999. It will offer innovative new programs, technology and services to Ecolab's existing customer base, and leverage its growing national capabilities.

Food & Beverage

Highlights Food & Beverage enjoyed outstanding results in 1998 as it grew sales at double-digit rates and increased market share and profitability. Highlights for the year include:

• Achieved solid sales growth in the food processing market, in part through increased specialization of its sales force by industry. Growing concerns about food safety and tightening government regulations contributed to sales increases.

• Achieved exceptional results with its dairy and agribusiness segments, which grew at their fastest rates in several years. A key global contract and high success with patented offerings for large dairy farms fueled agribusiness growth.

• Increased market share and profitability in the meat and poultry segment, benefiting from the integration of the Chemidyne business, which was acquired in 1997. This acquisition, along with the introduction of new products, drove double-digit increases in meat and poultry sales.

3:00 a.m.

Ecolab's "total systems" approach to meeting food and beverage customers' needs includes sophisticated microprocessor-controlled systems such as Maxxum*, which formulates and allocates products and offers consistent, accurate sanitation results.*

• Posted record sales with its brewery business, capitalizing on solid relationships with major brewers, the launch of a highly successful complete brewery program, and enhanced sales force market expertise.

• Launched the next generation of PET lube technology for the soft drink industry. This offering, along with other technological advances, contributed to continued growth in the beverage market.

• Continued to broaden its offering, acquiring American Fluid Technologies, which provides products and services to clean membrane systems used in processing applications, and Vulcan Chemical Technologies, which supplies chlorine dioxide generator technology for the food processing industry. These acquisitions complement the division's existing businesses and provide further opportunities for growth.

Outlook Building off an outstanding 1998, Food & Beverage expects to continue to achieve further growth in all of its markets in 1999. Large dairy farm initiatives are expected to continue to pay off and contribute to agribusiness gains. A strong corporate account focus will fuel beverage and brewery growth, while new products and technology will bolster increases in the food processing arena. Acquisitions and new business opportunities will continue to play a key role in driving market share gains.

Pest Elimination

Highlights Pest Elimination accelerated sales and earnings growth in 1998. Specific accomplishments include:

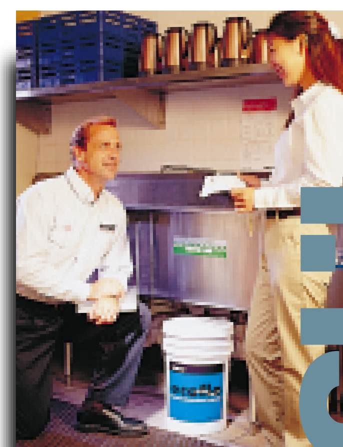
• Achieved double-digit sales growth in every segment of its business, benefiting from excellent customer retention, an expanded sales force, and new product and service offerings. Aggressive selling efforts and weather conditions that contributed to greater pest elimination needs throughout the United States also bolstered growth.

• Continued to capitalize on alliances with Ecolab's other divisions. *EcoPro*, a cross-divisional program introduced in 1997, helped Pest Elimination achieve double-digit sales increases in the food and beverage market. Market-specific programs for quickservice and other industries showed strong momentum as well.

• Delivered added value to customers with its new *ECO2000* Bait System. Featuring a proprietary cockroach bait that is carefully applied by Ecolab's service specialists, *ECO2000* offers exceptional results and significant labor savings. The tasteless, odorless bait is virtually nontoxic to humans, offering greater safety.

• Introduced the *Ecoflo* Grease Elimination Program for drain lines and grease traps, an add-on service that leverages the strength of the division's sales-and-service organization. *Ecoflo* utilizes unique chemistry that converts grease into harmless carbon dioxide and water.

Outlook Ecolab's Pest Elimination Division has strengthened its position and expects to grow its business in both existing and new markets in 1999. By offering superior, differentiated programs targeted to specific market segments, it expects to continue to achieve attractive sales and earnings growth.



Ecolab's Ecoflo *Grease Elimination Program takes the hassle out of managing drain line and grease trap buildup. Regular preventative maintenance by Ecolab's service specialists stops costly grease-related problems and cuts the need for grease trap pumping in half.*

1:15 a.m.

International

Africa

Highlights 1998 was a year of further development activity for Ecolab's Africa operations as it made progress on several key initiatives. Accomplishments include:

• Grew its Food & Beverage sales, benefiting from new brewery business and progress with major global corporate accounts.

• Successfully rolled out key products and systems, including Institutional's *Eco-Star* laundry program, and Food & Beverage's *Vortexx* and *Tsunami* product offerings for food processing plants.

• Further developed its business outside of South Africa, expanding into Angola, Mozambique, Uganda, Zambia and Zimbabwe.

Outlook With a strengthened management organization, Africa has improved its position for 1999 growth. Increased product penetration and global account gains will drive its success and allow it to play a growing role in Ecolab's Circle the Customer – Circle the Globe strategy.

Asia Pacific

Highlights The deepening economic crisis in Asia continued to present challenges. However, strengthened by recent acquisitions, Ecolab's Asia Pacific operations came through a difficult year in excellent fashion. Highlights for 1998 include the following:

• Achieved double-digit sales growth in local currencies excluding Gibson. This was led by strong Food & Beverage sales increases in Australia and Japan.

Ecolab's innovative warewashing products, programs and systems have established an unrivaled standard for superior performance, safety and ease of use in Asia Pacific countries, as well as everywhere else in the world.

1:38 p.m.

• Completed the integration of Gibson, strengthening Ecolab's presence in the institutional, food and beverage, and water care markets in Australia and New Zealand. With this acquisition, Ecolab became the market leader in the institutional and food and beverage markets in Australasia. Gibson performed very well in 1998, exceeding expectations.

• Integrated and rationalized the Henkel Japan business, which added significantly to Japan's Food & Beverage growth. Cross-selling *Oxonia Active* technology with Ecolab's cleaning and sanitation systems drove this success.

Outlook Difficult economic conditions are expected to continue to challenge Ecolab's Asia Pacific customers. However, by offering differentiated programs that help reduce costs, and focusing on aggressive sales efforts, carefully controlled expenses, new product introductions and the strength of recent acquisitions, Ecolab expects to outperform the market once again in 1999.

Canada

Highlights Canada continued to build on strong internal growth, superior account retention, new products and recent acquisitions to achieve strong sales and double-digit earnings growth in 1998. Highlights include:

• Grew its Institutional business, capitalizing on a robust tourism industry, an expanded distributor line, the 1997 Savolite acquisition and the launch of *GeoSystem 9000* warewashing technology.

• Increased Food & Beverage sales, benefiting from high account retention, the launch of *Paradigm*, *Tsunami* and *Matrixx*, and incremental business from the 1997 acquisition of Chemidyne.

• Achieved increased Textile Care sales through the annualization of the Savolite acquisition, a more highly trained and well-positioned sales force, and improved account retention.

Outlook With an increased investment in field sales personnel, a continued focus on independent accounts, and strong customer retention, Canada expects to achieve solid sales and earnings growth once again in 1999.

Latin America

Highlights Offsetting economic turbulence in South America, Latin America achieved solid sales and earnings growth in 1998. Accomplishments include:

• Achieved excellent sales growth in Venezuela, Mexico and Central America, primarily through an improved Mexican economy, and Institutional and Food & Beverage market share gains.

In Latin America, Ecolab's Eco-Star *on-premise laundry program continues to be a success. Backed by Ecolab's hallmark service,* Eco-Star's *advanced dispensing technology and superior liquid laundry line help customers produce excellent results and reduce overall costs.*

9:05a.m.

• Continued to grow its global account business, strengthening key partnerships in the soft drink and food processing markets.
• Rolled out additional differentiated products and systems, including *Oasis Compac*, *Vortexx* and *Eco-Star*.

Outlook Latin America will continue to focus on growth in 1999. Despite challenging conditions in Brazil, it will capitalize on organizational enhancements, market share gains and strong global account relationships. Programs launched in 1998 will offer customers cost and quality benefits and contribute to 1999 results.

Europe

Henkel-Ecolab

Highlights Sales force investments, differentiated products and systems, strategic acquisitions, and technology transfers enabled Henkel-Ecolab to post record sales and earnings increases in 1998. Achievements include:
• Grew net sales 10 percent to DM 1.6 billion. When converted to U.S. dollars, sales were $904 million. Ecolab's equity in the earnings of the joint venture increased 19 percent.
• Grew business in all divisions, with Institutional, Food & Beverage P3 and Professional Hygiene leading the way. Growth was accomplished through an increased focus on expanding and developing market segments, and by targeting independent accounts, which boosted the institutional and industrial divisions' sales mix and improved their chemical sales.
• Completed the acquisition of Darenas in the United Kingdom, merged the Ecosan business in Germany, and formed a partnership with Le Goff in France to further penetrate the market, and established operations in Romania, Croatia, Bulgaria and Russia to increase market expansion potential.
• Strengthened its institutional market position with the launch of a brand new *Oasis* program specially developed for the European markets, the introduction of the compact *Oasis Junior* dispenser, and the launch of its *Ecobrite* laundry program, which completes Henkel-Ecolab's *Eco* line of total hygiene solutions (*Ecoplus, Ecoguard, Ecosafe* and *Ecobrite*) for the institutional market.
• Introduced the *Quik Fill Compac* dispenser, the *Epicare* line of skin care products, the *4 Aces* farm hygiene products, and the Henkel-Ecolab Reverse Osmosis (*HERO*) system, a water-and energy-saving program that allows laundries to save and recycle up to 80 percent of the water they use.
• Developed and strengthened long-term distributor partnerships with the expansion of exclusive programs for European distribution markets.
• Prepared the joint venture's internal systems infrastructure for the introduction and implementation of the new Euro currency and for the Year 2000 computer readiness.

Outlook Building off a strong finish in 1998, Henkel-Ecolab expects to increase sales and earnings in 1999. Increased corporate account business, sales-and-service network expansions, differentiated products and systems, and the pursuit of new market opportunities are expected to drive Henkel-Ecolab's growth and allow it to continue to achieve market share gains.

3:45a.m.

Henkel-Ecolab's differentiated product and system platforms continue to bring European customers added benefits, while strengthening the joint venture's sales. Solid Ultra Surge *provides excellent overall cleaning and stain removal results.*

Financial Discussion

The following discussion and analysis provides information that management believes is useful in understanding the company's operating results, cash flows and financial condition. The discussion should be read in conjunction with the consolidated financial statements and related notes.

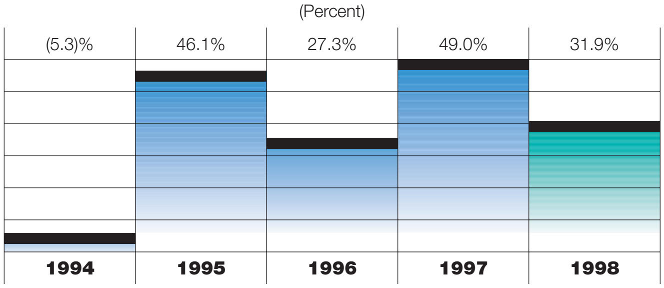
The financial discussion and other portions of this Annual Report to Shareholders contain various "Forward-Looking Statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These statements, which represent Ecolab's expectations or beliefs concerning various future events, are based on current expectations that involve a number of risks and uncertainties which could cause actual results to differ materially from those of such Forward-Looking Statements. We refer readers to the company's statement entitled "Forward-Looking Statements and Risk Factors" which is contained under Part I of the company's Annual Report on Form 10-K for the year ended December 31, 1998. Additional risk factors may be described from time to time in Ecolab's filings with the Securities and Exchange Commission.

1998 Overview

During 1998, Ecolab achieved its seventh consecutive year of record financial results and the company's stock outperformed the Standard & Poor's 500 index for the fourth year in a row. The company's more significant accomplishments for 1998 included:

- Ecolab's stock price rose 31 percent during 1998 and, including dividends, yielded a return of nearly 32 percent to shareholders.

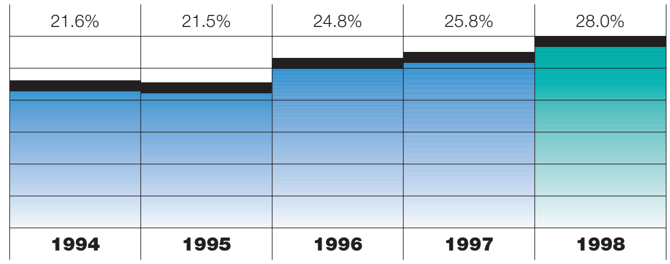
Total Return to Shareholders
(Percent)



Share appreciation plus dividends.

- For the third year in a row, the company exceeded all three of its long-term financial objectives of 15 percent growth in income per common share, 20 percent return on beginning shareholders' equity and an investment grade balance sheet.
- Income from continuing operations rose 15 percent to a record $155 million, or $1.15 per diluted share.

Return on Beginning Equity
(Percent)



- Return on beginning shareholders' equity reached a record 28 percent and the company recorded its seventh consecutive year of exceeding its long-term financial objective of a 20 percent return on beginning shareholders' equity.
- Cash provided by continuing operations increased 17 percent and also reached an all-time high. Strong cash flow and moderate debt levels allowed the company to maintain its long-term financial objective of an investment grade balance sheet for the sixth consecutive year, and the company's debt continued to be rated within the "A" categories by the major rating agencies.
- Net sales increased 15 percent and reached a record level of $1.9 billion.
- Operating income was a record $262 million for 1998 and increased 20 percent over the prior year. As a percent of net sales, operating income also reached an all-time high of 13.9 percent.
- The company's equity in earnings of the Henkel-Ecolab joint venture rose 19 percent for 1998 to a record level.
- The company increased its annual dividend rate for the seventh consecutive year. The annual dividend rate was increased 11 percent to an annual rate of $0.42 per common share. The company has paid dividends on its common stock for 62 consecutive years.
- The company continued to make strategic business acquisitions in order to broaden its product and service offerings in line with its Circle the Customer — Circle the Globe strategy. The integration of the Gibson business, which was acquired at the end of 1997, was completed and the business exceeded the company's expectations for 1998. Also during 1998, the company added commercial kitchen equipment repair services to its operations through the acquisition of GCS Service, Inc., and products and services were added to the U.S. Institutional and Food & Beverage businesses and in Japan through business acquisitions.

All of these acquisitions have been accounted for as purchases and, accordingly, the results of their operations have been included in the company's financial statements from the dates of acquisition. Additional information related to these acquisitions is included in Note 6 of the notes to consolidated financial statements.

Operating Results

Consolidated

(thousands, except per share)	1998	1997	1996
Net sales	**$1,888,226**	$1,640,352	$1,490,009
Operating income	**$ 261,980**	$ 218,504	$ 185,317
Income			
Continuing operations	**$ 154,506**	$ 133,955	$ 113,185
Discontinued operations	**38,000**		
Net income	**$ 192,506**	$ 133,955	$ 113,185
Diluted income per common share			
Continuing operations	**$ 1.15**	$ 1.00	$ 0.85
Discontinued operations	**0.28**		
Net income	**$ 1.44**	$ 1.00	$ 0.85

Consolidated net sales were nearly $1.9 billion for 1998, an increase of 15 percent over net sales of $1.6 billion in 1997. Both the company's United States and International operations reported double-digit sales growth and contributed to the consolidated sales improvement. Business acquisitions in 1998 and the annualized effect of businesses acquired in 1997 were significant to the company's growth accounting for approximately one-half of the overall sales growth for 1998. Changes in currency translation had a negative effect on sales growth and decreased the consolidated growth rate by three percentage points. The growth in sales also reflected the benefits of new products, new customers, competitive gains, investments in the growth and training of the sales-and-service force and a continuation of generally good conditions in the hospitality and lodging industries, particularly in the United States.

Consolidated operating income reached $262 million for 1998, an increase of 20 percent over operating income of $219 million in 1997. Business acquisitions contributed to the growth in operating income and accounted for approximately one-fifth of the increase. The consolidated operating income margin rose to 13.9 percent for 1998 and surpassed 1997's operating income margin of 13.3 percent to reach a new all-time high. A continuation of particularly strong growth in the U.S. Institutional and Food & Beverage operations and solid performances by the U.S. Pest Elimination and Kay businesses were the major contributors to the company's overall profit improvement. Operating income margin growth reflected lower selling, general and administrative expenses as a percentage of net sales, partially offset by a decrease in the gross profit margin from last year's all-time high. Selling, general and administrative expenses were 41.0 percent of net sales in 1998, a decease from 42.7 percent of net sales in 1997. Selling, general and administrative expense margins were down for both the company's United States and International operations with a significant decrease in the Asia Pacific region. The improvement in the selling, general and administrative expense margin reflected the benefits of tight cost controls, synergies from the integration of businesses acquired, improved sales productivity and strong sales growth. These benefits were partially offset by continued investments in the training and growth of the sales-and-service force. The gross profit margin was 54.9 percent of net sales for 1998, down slightly from last year's record gross profit margin of 56.0 percent. The decrease in gross profit margin reflected a comparison against an exceptionally strong period last year, the effects of business acquisitions and lower margins in the Asia Pacific region which was affected by economic and monetary problems. These negative effects on the gross profit margin were partially offset by the effects of sales of new products and good sales volume growth. Selling price increases continued to be constrained due to competitive pricing conditions in several of the markets in which the company does business.

Income from continuing operations for 1998 rose 15 percent to $155 million, or $1.15 per diluted share from $134 million, or $1.00 per diluted share in 1997. This improvement reflected double-digit growth in operating income and an increase in the company's equity in earnings of the Henkel-Ecolab joint venture. Earnings were negatively affected by increased net interest and income tax expenses compared with last year. Income from continuing operations was 8.2 percent of net sales in both 1998 and 1997.

In addition to ongoing operations, a tax issue related to the disposal of a business in 1992 was resolved during 1998, resulting in a one-time gain from discontinued operations of $38 million, or $0.28 per diluted share. As a result of tax losses on the disposition of this business, the company's U.S. federal income tax payments were reduced in 1992 through 1995 by approximately $58 million. However, pending final acceptance of the company's treatment of the losses, no income tax benefit was recognized for financial reporting purposes. During 1998, an agreement was reached with the Internal Revenue Service on the final tax treatment for the losses. This agreement resulted in the payment of approximately $39 million of income taxes and interest, and the recognition of the gain from discontinued operations.

Net income for 1998 totaled $193 million, or $1.44 per diluted share, compared with $134 million, or $1.00 per diluted share in 1997.

1997 compared with 1996

Consolidated net sales for 1997 were over $1.6 billion, an increase of 10 percent compared to net sales of nearly $1.5 billion in 1996. Both the company's U.S. and International operations contributed to this sales growth. Business acquisitions accounted for approximately one-fourth of the growth in sales for 1997. New product introductions, a larger sales-and-service force, new customers and competitive gains also added to the 1997 sales improvement.

Consolidated operating income increased 18 percent for 1997 and reached $219 million compared to consolidated operating income of $185 million in 1996. This growth included the benefits of business acquisitions, which accounted for approximately 20 percent of the increase. The consolidated operating income margin was 13.3 percent in 1997, a substantial improvement over the 1996 consolidated operating income margin of 12.4 percent. Most of the company's businesses contributed to these income improvements; however, strong performances by the core U.S. Institutional and Food & Beverage businesses during 1997 were the major contributors to the company's overall profit improvement. An improved and record level gross profit margin, reflecting good sales volume growth and a more stable raw material cost environment, more than offset a modestly higher selling, general and administrative expense margin and limited selling price increases.

Net income for 1997 reached $134 million, or $1.00 per share on a diluted basis, and increased 18 percent over last year's net income of $113 million, or $0.85 per share. Net income improved to 8.2 percent of net sales, compared to 7.6 percent in 1996. The increase in net income reflected the benefits of strong operating income performance, lower net interest expense and modestly higher equity in earnings of the Henkel-Ecolab joint venture, which were partially offset by increased income taxes.

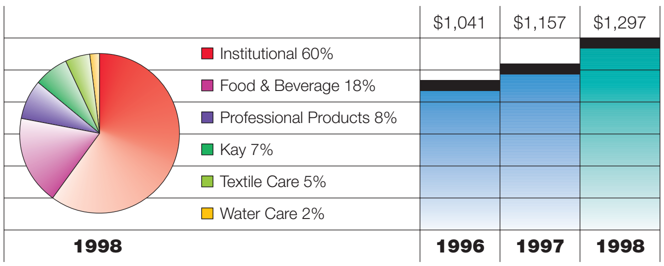
Operating Segment Performance

(thousands)	1998	1997	1996
Net sales			
United States			
Cleaning & Sanitizing	$1,296,797	$1,156,625	$1,040,823
Other Services	160,063	119,203	107,955
Total	1,456,860	1,275,828	1,148,778
International Cleaning & Sanitizing	440,668	335,337	305,938
Total	1,897,528	1,611,165	1,454,716
Effect of foreign currency translation	(9,302)	29,187	35,293
Consolidated	$1,888,226	$1,640,352	$1,490,009
Operating income			
United States			
Cleaning & Sanitizing	$ 218,500	$ 180,975	$ 152,979
Other Services	19,084	14,655	11,907
Total	237,584	195,630	164,886
International Cleaning & Sanitizing	29,787	22,519	19,151
Total	267,371	218,149	184,037
Corporate	(4,347)	(4,088)	(3,440)
Effect of foreign currency translation	(1,044)	4,443	4,720
Consolidated	$ 261,980	$ 218,504	$ 185,317
Operating income as a percent of sales			
United States			
Cleaning & Sanitizing	16.8%	15.6%	14.7%
Other Services	11.9	12.3	11.0
Total	16.3	15.3	14.4
International Cleaning & Sanitizing	6.8%	6.7%	6.3%

During 1998, the company adopted Statement of Financial Accounting Standards No. 131. As a result, the company defined its reportable segments and changed the information it reports about its operating segments. Operating segment information for prior years has been restated to conform to the 1998 presentation.

United States Cleaning & Sanitizing

Sales
(Dollars in Millions)

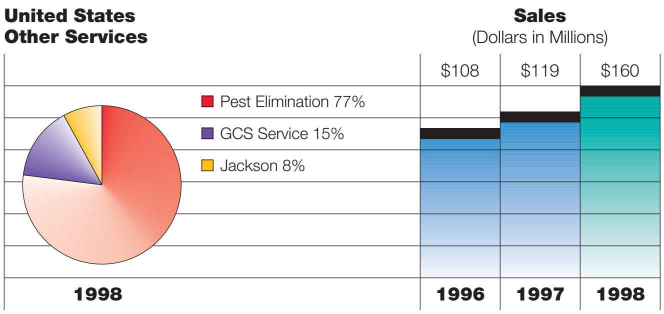


The company's operating segments have generally similar products and services and, generally, the company is organized to manage its operations geographically. Pursuant to the new standard, the company's operating segments have been aggregated into three reportable segments: United States Cleaning and Sanitizing operations, United States Other Services, and International Cleaning and Sanitizing operations. The company evaluates the performance of its International operations based on fixed management rates of currency exchange. Therefore, International sales and operating income totals shown above, as well as the International financial information included in this financial discussion, are based on translation into U.S. dollars at the fixed currency exchange rates used by management for 1998. All other accounting policies of the reportable segments are consistent with generally accepted accounting principles and the accounting policies of the company described in Note 2 of the notes to consolidated financial statements. Additional information about the company's reportable segments is included in Note 15 of the notes to consolidated financial statements.

Sales of the company's United States Cleaning and Sanitizing operations were nearly $1.3 billion for 1998 and increased 12 percent over sales approaching $1.2 billion in 1997. This sales increase reflected benefits from business acquisitions, a continuation of particularly strong performances by the company's core Institutional and Food & Beverage operations and double-digit growth in sales reported by Kay. Business acquisitions accounted for approximately 30 percent of the growth in sales of the United States Cleaning and Sanitizing operations. Sales in 1998 also benefited from new product introductions, new customers, competitive gains, a larger and better trained sales-and-service force and favorable trends in the hospitality and lodging industries. Selling price increases continued to be constrained due to competitive pricing conditions in several of the markets in which the company does business. Sales of the company's Institutional operations increased 11 percent for 1998. Institutional reported strong double-digit growth in its *Ecotemp,* laundry, specialty and housekeeping programs and solid growth in sales to warewashing markets. Institutional benefited from new customers, competitive gains, high customer retention and the addition of the Grace-Lee vehicle wash business, which added approximately 2 percentage points to the Institutional sales growth rate. Kay's U.S. operations reported sales growth of 10 percent for 1998 reflecting new business, continued growth in its food retail services business and retention of key customers. Textile Care sales increased 1 percent for 1998. Textile Care has a number of new product offerings, but continues to experience pressures from consolidations in the commercial laundry market and a difficult pricing environment. The company expects the U.S. Textile Care business to continue to experience challenging market conditions over the near term. Professional Products sales were up 6 percent, with double-digit growth in its specialty and brand name program and infection prevention products, and modest growth in its core janitorial business. Sales of the company's Water Care operations increased 6 percent for 1998, reflecting double-digit growth in its pool and spa and cruise ship businesses, partially offset by lower distributor sales to municipal markets. Food & Beverage reported sales growth of 15 percent for 1998. Food & Beverage sales growth included the benefits of businesses acquired in 1998 and the annualized effect of last year's acquisition of Chemidyne. Excluding the effect of these business acquisitions, Food & Beverage sales increased 8 percent and included strong growth in sales to the beverage and food processing markets and good growth in sales to the dairy markets, despite challenging consolidation and pricing conditions.

For 1998, sales of the company's United States Other Services operations increased 34 percent to $160 million, compared with $119 million last year. Sales for 1998 included the mid-year acquisition of GCS Service Inc. (GCS), a nationwide provider of commercial kitchen equipment repair services. Other

Services sales grew 14 percent excluding the GCS business acquisition. Pest Elimination reported sales growth of 14 percent for 1998 with strong sales across all of its business lines, including its core contract services business, its flying insect defense program and ancillary services. Pest Elimination had very good new contract growth during 1998, continued its high customer retention and benefited from weather conditions that contributed to greater pest elimination needs during 1998. Sales of the Jackson equipment business increased 18 percent for 1998, reflecting good sales to the quickservice or fast-food market.

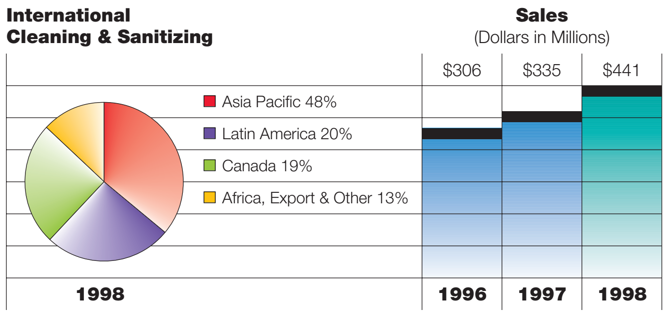


Management rate sales of the company's International Cleaning and Sanitizing operations were $441 million for 1998, up 31 percent over sales of $335 million in 1997. Sales in 1998 benefited from the acquisition of Gibson at the end of 1997 and from the addition of a business in Japan during 1998. These business acquisitions accounted for approximately two-thirds of International's sales growth for 1998. The Asia Pacific region, International's largest area of operation, reported sales growth of 56 percent. Excluding business acquisitions, Asia Pacific sales increased approximately 10 percent and reflected double-digit growth in Japan and Southeast Asia, modest growth in Australia and a decrease in sales in New Zealand. Sales to the Asia Pacific food and beverage markets were up significantly and the region recorded modest growth in sales to institutional markets. Latin America sales for 1998 increased 8 percent over the prior year. The region continued to be led by significant double-digit growth in Mexico. Sales were also up at double-digit rates in Venezuela and in Central America, while sales growth in Brazil was modest. Latin America recorded good growth in sales to both the institutional and food and beverage markets. Sales in Canada increased 9 percent for 1998 and included high single-digit growth in sales to both the institutional and food and beverage markets. Sales for the company's operations in Africa decreased 6 percent for 1998 as the company focused on integrating the various businesses acquired over the last couple of years.

Operating income of the company's United States Cleaning and Sanitizing operations was $219 million in 1998, an increase of 21 percent over operating income of $181 million in 1997. Business acquisitions accounted for approximately 10 percent of the growth in operating income for 1998. Operating income growth in the core Institutional and Food & Beverage businesses remained very strong and operating income in the Kay and Professional Products businesses was also up at double-digit rates. Textile Care and Water Care reported a decrease in operating income for 1998. The operating income margin for the U.S. Cleaning and Sanitizing operations improved to 16.8 percent of net sales, compared with 15.6 percent in 1997. The increased operating income margin reflected strong sales growth, including a continuation of strong performance in the core operations and in sales of new products, modest increases in raw material costs and the benefits of tight cost controls. The company continued to invest in its sales-and-service force during 1998 and added 255 associates to its U.S. Cleaning and Sanitizing operations.

United States Other Services reported an increase of 30 percent in operating income, to $19 million in 1998 from $15 million in the prior year. Excluding the GCS acquisition, operating income was up 27 percent. The operating income margin was down slightly, to 11.9 percent of net sales in 1998 from 12.3 percent last year, due in part to the addition of GCS. The increase in operating income for 1998 was driven by sales growth, productivity improvements and tight cost controls. 365 sales-and-service associates were added to the U.S. Other Services operations in 1998, including GCS associates.

International Cleaning and Sanitizing operations reported operating income of $30 million for 1998, an increase of 32 percent over 1997 operating income of $23 million. Business acquisitions accounted for approximately 90 percent of the growth in operating income for 1998. Operating income margins for the International Cleaning and Sanitizing operations were 6.8 percent of net sales in 1998 compared with 6.7 percent in the prior year. Operating income reflected significant double-digit growth in Latin America, good growth in Canada and a decrease in operating income in Africa and in the Asia Pacific region when the Gibson acquisition is excluded. The company continues to be cautious about near-term growth in Asia Pacific due to the lingering uncertain economic conditions in the region. The recent currency devaluation in Brazil is also expected to slow growth in Latin America during 1999. The company added 300 sales-and-service associates to its International Cleaning and Sanitizing operations during 1998, including associates of businesses acquired.



Operating income margins of the company's International operations are substantially less than the operating income margins realized for the company's U.S. operations. The lower International margins are due to the difference in scale of International operations, where operating locations are smaller in size, and to the additional costs of operating in numerous and diverse foreign jurisdictions. Proportionately larger investments in sales, technical support and administrative personnel are also necessary in order to facilitate growth of International operations.

1997 compared with 1996

Sales of the company's United States Cleaning and Sanitizing operations approached $1.2 billion in 1997 and increased 11 percent over sales of $1.0 billion in 1996. Sales reflected strong growth in the core Institutional and Food & Beverage operations and included benefits from business acquisitions and significant new product introductions. Business acquisitions accounted for approximately 25 percent of the sales growth for 1997. Sales of the U.S. Institutional division increased 10 percent for 1997. Institutional's growth reflected strong sales in all of its business units, significant new customer business and competitive gains, continued strong growth in its *Ecotemp* program and the successful rollout of its new *Keystone* product line sold through partnership with a distributor. Sales of Kay's U.S. operations increased 6 percent for 1997. Kay was unfavorably affected by a more competitive quickservice market; however, Kay added another major quickservice chain customer in 1997 and had good growth in sales to the food retail market, which it entered in 1996. Sales of Textile Care decreased 3 percent for 1997. Continued plant consolidations, particularly in laundries serving the healthcare market, increased competitive activity and comparison against periods that benefited significantly from new product introductions unfavorably affected Textile Care's sales growth. Professional Products reported sales growth of 12 percent for 1997. This sales improvement reflected the annualized effect of the 1996 acquisition of Huntington Laboratories, good growth in sales to corporate accounts, and the addition of new products to its commercial mass distribution line. Water Care sales were down 2 percent for 1997 and reflected the elimination of low margin business, consolidation of business acquisitions made over the past three years, integration of disparate product lines, and the refining of sales efforts. Food & Beverage reported a sales increase of 24 percent for 1997. Food & Beverage sales growth included the benefits of Chemidyne, a provider of cleaning and sanitizing products and equipment to the meat, poultry and processed food markets, which was acquired in August of 1997, and the annualized effect of the acquisition of Monarch in August of 1996. Excluding these business acquisitions, Food & Beverage sales growth was 9 percent for 1997 and included growth in sales to all of its markets with double-digit growth in sales to the food processing and beverage markets.

Sales of the United States Other Services operations were $119 million for 1997, up 10 percent over sales of $108 million in 1996. Pest Elimination reported 10 percent sales growth for 1997, despite increased competitive activity. Pest Elimination continued to develop new programs to leverage its alliances with Ecolab's other operations. Sales of the Jackson business increased 18 percent for 1997.

International Cleaning and Sanitizing sales were $335 million for 1997 and increased 10 percent over sales of $306 million in 1996. Sales growth included the benefits of business acquisitions and significant new product introductions. Businesses acquired in Canada and Africa in 1997 and the annualization of 1996 Canadian business acquisitions accounted for approximately 50 percent of International's sales growth for 1997. Asia Pacific had sales growth of 9 percent for 1997 with double-digit growth in Japan, modest growth in New Zealand and flat results in Australia. Latin America reported sales growth of 9 percent for 1997. Growth in the Latin America region was led by significant double-digit growth in Mexico and included good growth in Brazil. Canada had sales growth of 16 percent for 1997, with approximately 70 percent of its growth due to business acquisitions. International sales results also benefited from businesses acquired in Central Africa during 1997. Sales in South Africa decreased during 1997, principally due to the elimination of low margin business.

Operating income of the United States Cleaning and Sanitizing operations reached $181 million in 1997, an increase of 18 percent over operating income of $153 million in 1996. Business acquisitions accounted for approximately 20 percent of operating income growth for 1997. With the exception of Textile Care, all of the company's U.S. Cleaning and Sanitizing operations reported increased operating income, with particularly strong growth in the core Institutional and Food & Beverage operations. The U.S. Cleaning and Sanitizing operating income margin improved to 15.6 percent of net sales from 14.7 percent in 1996. The improved operating income margin reflected the benefits of strong core business sales, sales of new products, stable raw material costs, sales productivity improvements and tight cost controls, which were partially offset by investments in the sales-and-service force.

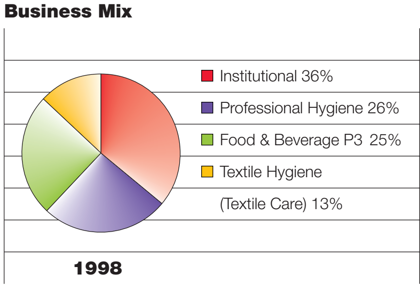
United States Other Services operating income was $15 million for 1997, up 23 percent over operating income of $12 million in 1996. The operating income margin improved from 11.0 percent of net sales in 1996 to 12.3 percent of net sales in 1997. The improvement in operating income reflected strong sales, productivity improvements and tight cost controls.

Operating income of the company's International Cleaning and Sanitizing operations totaled $23 million in 1997, an increase of 18 percent over operating income of $19 million in 1996. Operating income margins improved to 6.7 percent of net sales in 1997 compared with 6.3 percent in 1996. Double-digit operating income growth in Asia Pacific and Canada more than offset a decrease in operating income in the Latin America region which was principally due to investments in Brazil and Argentina.

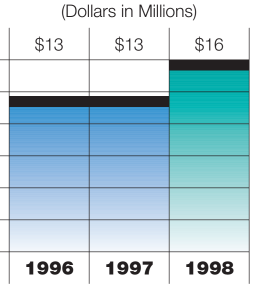
Henkel-Ecolab Joint Venture

The company operates cleaning and sanitizing businesses in Europe through a 50 percent economic interest in the Henkel-Ecolab joint venture. The company includes the operations of Henkel-Ecolab in its financial statements using the equity method of accounting. The company's equity in earnings of Henkel-Ecolab, including royalty income and after deduction of intangible amortization, was $16 million in 1998, a 19 percent increase over 1997. When measured in Deutsche marks, net income of Henkel-Ecolab increased 18 percent for 1998. This improvement reflected increased sales, the benefits of cost controls and a lower overall effective income tax rate.

Henkel-Ecolab Business Mix



Ecolab's Equity in Earnings
(Dollars in Millions)



Henkel-Ecolab sales, although not consolidated in Ecolab's financial statements, increased 10 percent when measured in Deutsche marks. Excluding businesses acquired in the United Kingdom and Germany, sales increased 5 percent for 1998 with good growth across most divisions and regions. Sales in Germany continued to be weak due in part to government and private spending cutbacks. When measured in U.S. dollars, Henkel-Ecolab sales were up 7 percent for 1998.

1997 compared with 1996

The company's equity in earnings of Henkel-Ecolab was $13 million for 1997, a 3 percent increase over 1996. Results were negatively affected by the stronger U.S. dollar. When measured in Deutsche marks, Henkel-Ecolab's net income increased 11 percent and reflected increased sales, improved gross margins and lower interest expense. Henkel-Ecolab sales increased 7 percent when measured in Deutsche marks. When measured in U.S. dollars, sales were negatively affected by the strengthening U.S. dollar and decreased 7 percent.

Corporate

Corporate operating expense was $4 million in 1998 and 1997 and $3 million in 1996. Corporate operating expense includes overhead costs directly related to the joint venture.

Interest and Income Taxes

Net interest expense for 1998 was $22 million, an increase of 72 percent over net interest expense of $13 million in 1997. This increase was due to debt incurred at the end of 1997 for the Gibson business acquisition and for additional borrowings related to other business acquisitions, income tax payments to settle an outstanding tax issue and share repurchases during 1998.

Net interest expense decreased 12 percent to less than $13 million in 1997, compared to net interest expense of over $14 million in 1996. This decrease was principally due to a scheduled debt repayment on the company's 9.68 percent senior notes and to increased interest income earned on higher average levels of cash and cash equivalents held during 1997.

The company's effective income tax rate was 42.4 percent for 1998, and increased from an effective income tax rate of 41.5 percent in 1997. This increase was principally due to a higher overall effective rate on earnings of International operations and to the effects of business acquisitions. International's effective income tax rate varies from year to year with the pre-tax income mix of the various countries in which the company operates.

The company's effective income tax rate was 41.5 percent for 1997, a modest increase from the 1996 effective income tax rate of 41.4 percent. This increase was due to a slightly higher overall effective rate on earnings of International operations.

Year 2000 Conversion

The company has completed an assessment of Year 2000 compliance for its critical operating and application systems located at its St. Paul-based headquarters. These include customer-oriented systems such as sales and order processing, billing and collections and associated infrastructure. As a result, the company has remediated or is replacing portions of its software and hardware. The company has tested these systems by simulating the occurrence of the Year 2000 in an orchestrated manner. Approximately 95 percent of the systems proved compliant and the goal is to complete the remaining renovation and testing by July 1999. The costs related to complete this activity are not expected to exceed $7.0 million, in both capital and expense, of which approximately $5.5 million has been incurred to date. The company does not consider these costs to be material to results of operations, financial position, or liquidity.

Each business unit not on the St. Paul system is responsible for developing and implementing a Year 2000 compliance plan for its critical operating and application systems (including assessment, remediation, validation and implementation) subject to the oversight and coordination of a special corporate-wide Year 2000 management team. The goal was for these business units to complete all compliance activities by December 31, 1998. The business units have reported approximately 90 percent achievement of Year 2000 compliance. Where compliance has not been achieved, appropriate remedial plans have been adopted. The Year 2000 management team is currently auditing the plans as presented by the business units to ensure corporate-wide consistency in these efforts and, to the extent determined necessary, will participate in tests based on the simulation of Year 2000. The goal is to achieve full compliance by July 1999.

The company has completed an assessment of its dispensing and cleaning systems which are at customer locations, for date/time sensitivity. The installed base of such cleaning and dispensing systems which has not been determined to be Year 2000 compliant is estimated at less than 0.5 percent of all systems in place at customer sites. The company believes that Year 2000 compliant alternatives have been designed and identified and that the systems can be retrofitted by July 1999.

The company has completed the assessment stage of analyzing its manufacturing and building maintenance operations for date/time sensitivity relative to Year 2000. While some issues have been identified, the company believes that it can modify its processes or retrofit equipment to become Year 2000 compliant and is in the process of doing so with the intention of completing the process by July 1999.

The company does not have final estimates for the costs of full Year 2000 remediation other than for St. Paul-based operating and application systems but it believes the costs, when aggregated with costs for the St. Paul-based systems, will not be material to the company's results of operations, financial position, or liquidity. The costs will be funded by operating cash flows.

The company intends to complete its Year 2000 remediation efforts primarily with in-house resources, but has and will continue to use consultants for specific tasks.

Failures caused by the Year 2000 of key suppliers and vendors could cause supply interruptions. Therefore, the company has contacted key suppliers and vendors in order to determine the status of their Year 2000 remediation plans. In the company's experience, its key suppliers and vendors are aware of the Year 2000 issue and represent that they have plans for being compliant on a timely basis. The company intends to continue to monitor progress and may take further actions to verify the accuracy of vendor and supplier representations.

The company is dependent upon its customers for sales and cash flow and customers' Year 2000 failures could result in reduced sales, increased inventory or receivable levels and cash flow reductions. While these events are possible, the company's customer base is wide and diverse and the company does not, at this point, believe that customers' Year 2000 failures will have a material effect on the company. The company will continue to monitor this issue and will consider further actions as may be warranted in the circumstances.

The company recognizes the need for Year 2000 contingency plans and will be developing such plans during 1999.

The Henkel-Ecolab joint venture is conducting its own Year 2000 compliance program.

The company recognizes that issues related to Year 2000 constitute a material known uncertainty. The company also recognizes the importance of ensuring its operations will not be adversely affected by Year 2000 issues. It believes that the processes described above will be effective to manage the risks associated with Year 2000 compliance. However, there can be no assurance that the process can be completed on the timetable described above, that it will be 100 percent effective in identifying all Year 2000 issues, or that the remediation processes for its own operations will be completely effective. The issues related to vendors or suppliers are more difficult because their Year 2000 compliance programs are not within the company's direct control. These uncertainties relating to Year 2000, however, are ones which the company believes it shares with companies in similar businesses. Additional information is found under the company's statement entitled "Forward-Looking Statements and Risk Factors" which is contained under Part I of the company's Annual Report on Form 10-K for the year ended December 31, 1998.

The failure to identify and remediate Year 2000 problems or, the failure of key third parties who do business with the company or governmental/regulatory agencies to timely remediate their Year 2000 issues could cause system failures or errors, business interruptions and in a worst case scenario, the inability to engage in normal business practices for an unknown length of time. Litigation could also ensue. The effect on the company's results of operations, financial position, or liquidity could be materially adverse.

Euro Currency Conversion

The company's principal activities in Europe are not conducted directly. Rather, such activities are conducted through its Henkel-Ecolab joint venture.

On January 1, 1999, 11 of the 15 member countries of the European Monetary Union established fixed conversion rates between their existing currencies and a new currency, the Euro. During a transition period from January 1, 1999 through January 1, 2002, the Euro will replace the national currencies that exist in the participating countries.

The transition to the Euro creates a number of sales, marketing, finance and accounting issues. These issues are being addressed by the management of the Henkel-Ecolab joint venture.

While the company will continue to evaluate the impact of the Euro introduction over time, based on currently available information and the nature of the company's exposures, the company does not, at this time, believe that the transition to the Euro will have a material adverse impact on the company's results of operations, financial position, or liquidity.

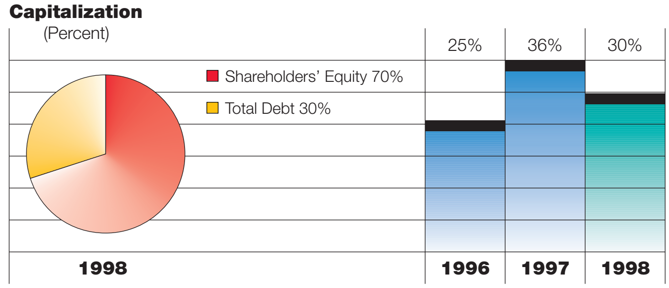
Financial Position, Cash Flows and Liquidity

Financial Position

The company has maintained its long-term financial objective of an investment grade balance sheet since 1993. The company's debt was rated within the "A" categories by the major rating agencies throughout 1998. Significant changes to the company's balance sheet during 1998 included the following:

- The company has added assets and liabilities to its balance sheet during the last two years through business acquisitions. Other noncurrent assets reflect significant additions for the GCS business and a cleaning and sanitizing business acquired in Japan during 1998, and the acquisitions of Gibson and Chemidyne in 1997. Significant levels of accounts receivable, inventories, property, plant and equipment and other current liabilities were also added during 1998 and 1997 as a result of these business acquisitions. During 1998, net assets (principally accounts receivable, inventories and property, plant and equipment) related to certain Gibson businesses and duplicate facilities were reclassified to other current assets and the majority of these net assets were sold.

Total Debt to Capitalization
(Percent)



- Total debt was $295 million at December 31, 1998, compared with total debt of $308 million at year-end 1997 and $176 million at year-end 1996. The increase in total debt during 1997 included $116 million of borrowings incurred under the company's Multicurrency Credit Agreement to finance the purchase of the outstanding common shares of Gibson, and $22 million of debt which was included on Gibson's balance sheet at the time of acquisition. During 1998, the company replaced long-term debt under its Multicurrency Credit Agreement with approximately $60 million of Australian-dollar-denominated debt under a medium-term note agreement and approximately $30 million of Australian-dollar-denominated commercial paper. At December 31, 1998, the company had $44 million of U.S.-dollar-denominated debt outstanding under its Multicurrency Credit Agreement related primarily to business acquisitions, funding for income tax payments to settle an outstanding tax issue and share repurchases. As of December 31, 1998, the ratio of total debt to capitalization was 30 percent compared to 36 percent at year-end 1997 and 25 percent at year-end 1996. The improvement in the total debt to capitalization ratio for 1998 was principally due to increased shareholders' equity, which resulted from strong earnings performance and the 1998 gain from discontinued operations.

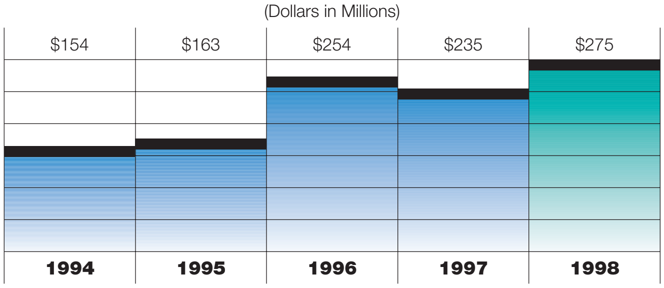
- Working capital levels have remained fairly constant over the last three year ends. Working capital was $104 million at year-end 1998, compared with working capital levels of $105 million and $108 million at year-end 1997 and 1996, respectively.
- Other noncurrent liabilities decreased to $68 million at December 31, 1998 from $125 million at year-end 1997 and $138 million at year-end 1996. During 1998, the company resolved a tax issue related to the disposal of a business in 1992. As a result, the company reduced its noncurrent liabilities through the payment of income taxes of approximately $39 million and the recognition of a gain from discontinued operations of $38 million.

Cash Flows

For 1998, cash flows from continuing operating activities reached a record $275 million, compared to $235 million in 1997 and $254 million in 1996. Operating cash flows for 1998 included strong earnings performance and the additional cash flows from businesses acquired. Operating cash flows for 1997 were unfavorably affected by a cash outflow due to an $18 million income tax deposit against outstanding federal income tax issues that had been accrued for in other noncurrent liabilities, and the reversal of favorable timing of payments which affected the fourth quarter of 1996. Operating cash flows for 1997 also included higher dividends from the Henkel-Ecolab joint venture.

Cash used for discontinued operating activities in 1998 reflects income taxes paid related to a business which was discontinued in 1992.

Cash from Continuing Operating Activities
(Dollars in Millions)



Cash flows used for investing activities included capital expenditures of $148 million in 1998, $122 million in 1997 and $112 million in 1996. Worldwide additions of merchandising equipment, primarily cleaning and sanitizing product dispensers, accounted for approximately 70 percent of each year's capital expenditures. The company has also expanded its manufacturing facilities over the last few years through construction and business acquisitions in order to meet sales requirements more efficiently. The majority of cash flows used in 1998 for businesses acquired were related to the year-end 1997 Gibson acquisition and a cleaning and sanitizing business acquired in Japan in early 1998. Cash flows used for businesses acquired included Gibson in 1997 and Huntington and Monarch in 1996. Investing activities cash flows for 1998 also included the proceeds from the sale of certain Gibson businesses and duplicate facilities which the company chose not to retain.

Cash used for financing activities included cash flows used for reacquired shares, cash dividends and net cash used of $9 million to reduce short-term and long-term debt during 1998.

In 1998, the company increased its annual dividend rate for the seventh consecutive year. The company has paid dividends on its common stock for 62 consecutive years. Cash dividends declared per share of common stock, by quarter, for each of the last three years were as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1998	**$0.095**	**$0.095**	**$0.095**	**$0.105**	**$0.39**
1997	0.08	0.08	0.08	0.095	0.335
1996	0.07	0.07	0.07	0.08	0.29

Liquidity

The company maintains a committed line of credit under the Multicurrency Credit Agreement for general corporate financing needs. The agreement includes a competitive bid feature to minimize the cost of the company's borrowings. The company also has a $200 million shelf registration as an additional source of liquidity. The company believes its existing cash balances, cash generated by operating activities, including cash flows from the Henkel-Ecolab joint venture, available credit, and additional credit available based on a strong financial position, are more than adequate to fund all of its 1999 requirements for growth, possible acquisitions, new program investments, scheduled debt repayments and dividend payments.

Consolidated **Statement of Income**

Year ended December 31 (thousands, except per share)	1998	1997	1996
Net Sales	**$1,888,226**	$1,640,352	$1,490,009
Cost of Sales	**851,173**	722,084	674,953
Selling, General and Administrative Expenses	**775,073**	699,764	629,739
Operating Income	**261,980**	218,504	185,317
Interest Expense, Net	**21,742**	12,637	14,372
Income From Continuing Operations Before Income Taxes and Equity in Earnings of Henkel-Ecolab	**240,238**	205,867	170,945
Provision for Income Taxes	**101,782**	85,345	70,771
Equity in Earnings of Henkel-Ecolab Joint Venture	**16,050**	13,433	13,011
Income From Continuing Operations	**154,506**	133,955	113,185
Gain From Discontinued Operations	**38,000**		
Net Income	**$ 192,506**	$ 133,955	$ 113,185
Basic Income Per Common Share			
Income From Continuing Operations	**$ 1.20**	$ 1.03	$ 0.88
Gain From Discontinued Operations	**0.29**		
Net Income	**$ 1.49**	$ 1.03	$ 0.88
Diluted Income Per Common Share			
Income From Continuing Operations	**$ 1.15**	$ 1.00	$ 0.85
Gain From Discontinued Operations	**0.28**		
Net Income	**$ 1.44**	$ 1.00	$ 0.85
Weighted-Average Common Shares Outstanding			
Basic	**129,157**	129,446	128,991
Diluted	**134,047**	133,822	132,817

See notes to consolidated financial statements.

Consolidated Balance Sheet

December 31 (thousands, except per share)	1998	1997	1996
Assets			
Cash and cash equivalents	$ 28,425	$ 61,169	$ 69,275
Accounts receivable, net	246,695	246,041	205,026
Inventories	165,627	154,831	122,248
Deferred income taxes	36,256	34,978	29,344
Other current assets	26,511	12,482	9,614
Current Assets	503,514	509,501	435,507
Property, Plant and Equipment, Net	420,205	395,562	332,314
Investment in Henkel-Ecolab Joint Venture	253,646	239,879	285,237
Other Assets	293,630	271,357	155,351
Total Assets	$1,470,995	$1,416,299	$1,208,409
Liabilities and Shareholders' Equity			
Short-term debt	$ 67,991	$ 48,884	$ 27,609
Accounts payable	124,646	130,682	103,803
Compensation and benefits	79,431	74,317	71,533
Income taxes	244	13,506	26,977
Other current liabilities	127,479	137,075	97,849
Current Liabilities	399,791	404,464	327,771
Long-Term Debt	227,041	259,384	148,683
Postretirement Health Care and Pension Benefits	85,793	76,109	73,577
Other Liabilities	67,829	124,641	138,415
Shareholders' Equity (common stock, par value $1.00 per share; shares outstanding: 1998 – 129,479; 1997 – 129,127; 1996 – 129,600)	690,541	551,701	519,963
Total Liabilities and Shareholders' Equity	$1,470,995	$1,416,299	$1,208,409

See notes to consolidated financial statements.

Consolidated Statement of Cash Flows

Year ended December 31 (thousands)	1998	1997	1996
Operating Activities			
Net income	$ 192,506	$ 133,955	$ 113,185
Less: gain from discontinued operations	38,000		
Income from continuing operations	154,506	133,955	113,185
Adjustments to reconcile income from continuing operations to cash provided by continuing operations:			
Depreciation	99,276	84,415	75,185
Amortization	22,695	16,464	14,338
Deferred income taxes	(2,012)	(2,074)	(6,878)
Equity in earnings of joint venture	(16,050)	(13,433)	(13,011)
Joint venture royalties and dividends	10,451	25,367	15,769
Other, net	1,526	4,630	1,023
Changes in operating assets and liabilities:			
Accounts receivable	1,352	(21,231)	2,809
Inventories	(11,667)	(14,395)	(6,852)
Other assets	(7,631)	(10,993)	(5,255)
Accounts payable	(7,794)	20,876	16,397
Other liabilities	29,877	11,517	47,559
Cash provided by continuing operations	274,529	235,098	254,269
Cash used for discontinued operations	(38,887)		
Cash provided by operating activities	235,642	235,098	254,269
Investing Activities			
Capital expenditures	(147,631)	(121,667)	(111,518)
Property disposals	7,060	3,424	3,284
Businesses acquired	(40,206)	(157,234)	(54,911)
Sale of Gibson businesses and assets	14,226		
Other, net	4,766	(1,240)	(1,449)
Cash used for investing activities	(161,785)	(276,717)	(164,594)
Financing Activities			
Notes payable	24,820	9,280	(42,045)
Long-term debt borrowings	117,740	117,000	75,000
Long-term debt repayments	(151,143)	(15,210)	(35,690)
Reacquired shares	(52,984)	(60,795)	(22,790)
Cash dividends on common stock	(49,000)	(41,456)	(36,096)
Other, net	5,679	26,278	17,088
Cash provided by (used for) financing activities	(104,888)	35,097	(44,533)
Effect of exchange rate changes on cash	(1,713)	(1,584)	(585)
Increase (Decrease) in Cash and Cash Equivalents	(32,744)	(8,106)	44,557
Cash and cash equivalents, beginning of year	61,169	69,275	24,718
Cash and cash equivalents, end of year	$ 28,425	$ 61,169	$ 69,275

Bracketed amounts indicate a use of cash.
See notes to consolidated financial statements.

Consolidated Statement of Comprehensive Income and Shareholders' Equity

(thousands)	Common Stock	Additional Paid-in Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Income: Translation	Treasury Stock	Total
Balance December 31, 1995	$ 70,078	$171,765	$325,674	$ (6,484)	$ 16,272	$(120,647)	$456,658
Net income			113,185				113,185
Foreign currency translation					(9,485)		(9,485)
Comprehensive income							103,700
Cash dividends on common stock			(37,409)				(37,409)
Stock options	673	14,824					15,497
Stock awards		522	2,912	(3,638)		1,779	1,575
Reacquired shares						(22,790)	(22,790)
Amortization				2,732			2,732
Balance December 31, 1996	70,751	187,111	404,362	(7,390)	6,787	(141,658)	519,963
Net income			133,955				133,955
Foreign currency translation					(35,730)		(35,730)
Comprehensive income							98,225
Cash dividends on common stock			(43,367)				(43,367)
Stock options	648	15,877					16,525
Stock awards		5,093		(5,200)		1,427	1,320
Business acquisitions		12,454				3,946	16,400
Reacquired shares						(60,795)	(60,795)
Amortization				3,430			3,430
Stock dividend	71,398	(71,398)					
Balance December 31, 1997	142,797	149,137	494,950	(9,160)	(28,943)	(197,080)	551,701
Net income			**192,506**				**192,506**
Foreign currency translation					**(937)**		**(937)**
Comprehensive income							**191,569**
Cash dividends on common stock			**(50,309)**				**(50,309)**
Stock options	**1,059**	**16,047**					**17,106**
Stock awards		**6,833**		**(6,163)**		**1,198**	**1,868**
Business acquisitions	**850**	**26,195**				**220**	**27,265**
Reacquired shares						**(52,984)**	**(52,984)**
Amortization				**4,325**			**4,325**
Balance December 31, 1998	**$144,706**	**$198,212**	**$637,147**	**$(10,998)**	**$ (29,880)**	**$(248,646)**	**$690,541**

Common Stock Activity

Year ended December 31 (shares)	1998 Common Stock	1998 Treasury Stock	1997 Common Stock	1997 Treasury Stock	1996 Common Stock	1996 Treasury Stock
Shares, beginning of year	**142,796,652**	**(13,669,624)**	70,750,741	(5,950,518)	70,078,398	(5,376,917)
Stock options	**1,058,686**		648,085		672,343	
Stock awards		**206,366**		124,440		150,010
Business acquisitions	**850,445**	**33,083**		308,343		
Reacquired shares		**(1,796,868)**		(1,317,077)		(723,611)
Stock dividend			71,397,826	(6,834,812)		
Shares, end of year	**144,705,783**	**(15,227,043)**	142,796,652	(13,669,624)	70,750,741	(5,950,518)

See notes to consolidated financial statements.

One: Nature of Business

The company is the leading global developer and marketer of premium cleaning and sanitizing products and services for the hospitality, institutional and industrial markets. Customers include hotels and restaurants; foodservice, healthcare and educational facilities; quickservice (fast-food) units; commercial laundries; light industry; dairy plants and farms; and food and beverage processors around the world.

Two: Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of the company and all majority-owned subsidiaries. The company accounts for its investment in the Henkel-Ecolab joint venture under the equity method of accounting. International subsidiaries and the Henkel-Ecolab joint venture are included in the financial statements on the basis of their November 30 fiscal year ends.

Foreign Currency Translation

Financial position and results of operations of the company's international subsidiaries and the Henkel-Ecolab joint venture generally are measured using local currencies as the functional currency. Assets and liabilities of these operations are translated at the exchange rates in effect at each fiscal year end. Income statement accounts are translated at the average rates of exchange prevailing during the year. Translation adjustments arising from the use of differing exchange rates from period to period are included in accumulated other comprehensive income in shareholders' equity.

Cash and Cash Equivalents

Cash equivalents include highly liquid investments with a maturity of three months or less when purchased.

Inventory Valuations

Inventories are valued at the lower of cost or market. Domestic chemical inventory costs are determined on a last-in, first-out (lifo) basis. Lifo inventories represented 45 percent, 40 percent and 44 percent of consolidated inventories at year-end 1998, 1997 and 1996, respectively. All other inventory costs are determined on a first-in, first-out (fifo) basis.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Merchandising equipment consists principally of various systems that dispense cleaning and sanitizing products and low-temperature dish-washing machines. The dispensing systems are accounted for on a mass asset basis, whereby equipment is capitalized and depreciated as a group and written off when fully depreciated. Depreciation and amortization are charged to operations using the straight-line method over the assets' estimated useful lives.

Intangible Assets

Intangible assets arise principally from business acquisitions and are stated at cost. The assets are amortized on a straight-line basis over their estimated economic lives, generally not exceeding 30 years.

Long-Lived Assets

The company periodically assesses the recoverability of long-lived and intangible assets based on anticipated future earnings and operating cash flows.

Income Per Common Share

The computations of the basic and diluted per share amounts for the company's continuing operations were as follows:

(thousands, except per share)	**1998**	1997	1996
Income from continuing operations	**$ 154,506**	$ 133,955	$ 113,185
Weighted-average common shares outstanding			
Basic (actual shares outstanding)	**129,157**	129,446	128,991
Effect of dilutive stock options	**4,890**	4,376	3,826
Diluted	**134,047**	133,822	132,817
Income from continuing operations per common share			
Basic	**$ 1.20**	$ 1.03	$ 0.88
Diluted	**$ 1.15**	$ 1.00	$ 0.85

Stock options granted in 1998 for approximately 2.2 million shares were not dilutive and, therefore, were not included in the computation of diluted income per common share amounts for 1998.

Use of Estimates

The preparation of the company's financial statements requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

3 Three: Balance Sheet Information

December 31 (thousands)	1998	1997	1996
Accounts Receivable, Net			
Accounts receivable	$ 259,588	$ 256,919	$ 214,369
Allowance for doubtful accounts	(12,893)	(10,878)	(9,343)
Total	$ 246,695	$ 246,041	$ 205,026
Inventories			
Finished goods	$ 73,983	$ 67,823	$ 52,232
Raw materials and parts	93,862	89,716	73,060
Excess of fifo cost over lifo cost	(2,218)	(2,708)	(3,044)
Total	$ 165,627	$ 154,831	$ 122,248
Property, Plant and Equipment, Net			
Land	$ 12,584	$ 18,184	$ 7,969
Buildings and leaseholds	157,302	145,021	129,781
Machinery and equipment	258,107	232,940	208,704
Merchandising equipment	435,998	379,531	330,277
Construction in progress	11,038	19,862	11,745
	875,029	795,538	688,476
Accumulated depreciation and amortization	(454,824)	(399,976)	(356,162)
Total	$ 420,205	$ 395,562	$ 332,314
Other Assets			
Intangible assets, net	$ 236,659	$ 217,120	$ 96,865
Investments in securities		5,000	5,000
Deferred income taxes	27,256	23,444	26,582
Other	29,715	25,793	26,904
Total	$ 293,630	$ 271,357	$ 155,351
Short-Term Debt			
Notes payable	$ 52,441	$ 33,440	$ 12,333
Long-term debt, current maturities	15,550	15,444	15,276
Total	$ 67,991	$ 48,884	$ 27,609
Long-Term Debt			
7.19% senior notes, due 2006	$ 75,000	$ 75,000	$ 75,000
9.68% senior notes, due 1995-2001	42,857	57,143	71,429
6.00% medium-term notes, due 2001	62,761		
Multicurrency Credit Agreement, due 2002	44,000	116,450	
Other	17,973	26,235	17,530
	242,591	274,828	163,959
Long-term debt, current maturities	(15,550)	(15,444)	(15,276)
Total	$ 227,041	$ 259,384	$ 148,683

The 9.68 percent senior notes include covenants regarding consolidated shareholders' equity and amounts of certain long-term debt.

The company has a $275 million Multicurrency Credit Agreement with a consortium of banks. The company may borrow varying amounts from time to time on a revolving credit basis, with loans denominated in G-7 currencies, Australian dollars or certain other currencies, if available. The company has the option of borrowing based on various short-term interest rates. The agreement includes a covenant regarding the ratio of total debt to capitalization. Amounts outstanding under the agreement at year-end 1998 were denominated in U.S. dollars and had an average annual interest rate of 6.7 percent and amounts outstanding at year-end 1997 were denominated in Australian dollars and had an average annual interest rate of 5.2 percent.

In August 1998, the company issued approximately $60 million of Australian-dollar-denominated medium-term notes that mature in November 2001. The company also issued approximately $30 million of Australian-dollar-denominated commercial paper (notes payable). The proceeds from these debt issuances were used to reduce debt under the company's Multicurrency Credit Agreement.

In October 1996, the company filed a shelf registration with the Securities and Exchange Commission for the issuance of up to $200 million of debt securities. The filing is intended to enhance the company's future financial flexibility in funding general business needs.

As of December 31, the weighted-average interest rate on notes payable was 7.4 percent for 1998, 5.4 percent for 1997 and 5.1 percent for 1996.

As of December 31, 1998, the aggregate annual maturities of long-term debt for the next five years were: 1999 – $15,550,000; 2000 – $15,714,000; 2001 – $77,799,000; 2002 – $45,820,000 and 2003 – $10,374,000.

Interest expense was $25,012,000 in 1998, $18,043,000 in 1997 and $19,084,000 in 1996. Total interest paid was $25,198,000 in 1998, $18,168,000 in 1997 and $16,897,000 in 1996.

Other noncurrent liabilities included income taxes payable of $30 million at December 31, 1998, $82 million at December 31, 1997 and $100 million at December 31, 1996. During 1998, the company resolved a tax issue related to the disposal of a business in 1992. The company paid approximately $39 million and recognized a gain from discontinued operations of $38 million related to the settlement of this issue.

4 Four: Financial Instruments

Foreign Currency and Interest Rate Instruments

The company uses hedging and derivative financial instruments to limit financial risk related to foreign currency exchange rates, interest rates and other market risks. The company does not hold hedging or derivative financial instruments of a speculative nature.

The company enters into foreign currency forward and option contracts to hedge specific foreign currency exposures related to intercompany debt, Henkel-Ecolab and subsidiary royalties and other intercompany transactions. These contracts generally expire within one year. Gains and losses on these contracts are deferred and recognized as part of the specific transactions hedged. The cash flows from these contracts are classified in the same category as the transaction hedged in the Consolidated Statement of Cash Flows.

The company had foreign currency forward exchange contracts with a face amount denominated primarily in Deutsche marks and totaling approximately $71 million at December 31, 1998, $70 million at December 31, 1997 and $115 million at December 31, 1996. The unrealized gains and losses on these contracts were not significant.

At December 31, 1998, the company had entered into an interest rate swap agreement which is effective November 2001 through November 2004. This agreement provides for a fixed rate of interest on an amount equal to one-half of the debt under the company's medium-term notes. The fair value of the company's interest rate swap agreement was not significant as of December 31, 1998.

Fair Value of Other Financial Instruments

The carrying amount and the estimated fair value of other financial instruments held by the company were:

December 31 (thousands)	1998	1997	1996
Carrying amount			
Cash and cash equivalents	$ 28,425	$ 61,169	$ 69,275
Long-term investments in securities		5,000	5,000
Short-term debt	67,991	48,884	27,609
Long-term debt	227,041	259,384	148,683
Fair Value			
Long-term debt	$ 235,131	$ 266,926	$ 155,558

The carrying amounts of cash equivalents and short-term debt approximate fair value because of their short maturities.

The fair value of long-term debt is based on quoted market prices for the same or similar issues.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, a new standard of accounting and reporting for derivative instruments and hedging activities. The company is required to adopt the new standard in the first quarter of 2000. Although a full analysis of all of the requirements of the new standard has not been completed, the company's use of derivative and hedging financial instruments is limited and, therefore, the company does not anticipate that the impact of the new standard will be significant.

5 Five: Gain From Discontinued Operations

During the third quarter of 1998, the company resolved a tax issue related to the disposal of a business in 1992. As a result of tax losses on the disposition of this business, the company's U.S. federal income tax payments were reduced in 1992 through 1995 by a total of approximately $58 million. However, pending final acceptance of the company's treatment of the losses, no income tax benefit was recognized for financial reporting purposes. During 1998, an agreement was reached with the Internal Revenue Service on the final tax treatment for the losses. This agreement resulted in the payment of approximately $39 million of income taxes and interest, and the recognition of a gain from discontinued operations of $38 million or $0.28 per diluted share for the year ended December 31, 1998.

6 Six: Business Acquisitions

Gibson Business Acquisition

During 1997, the company completed a public tender offer for all of the outstanding stock of Gibson Chemical Industries Limited (Gibson) located in Melbourne, Australia. Gibson is a manufacturer and marketer of cleaning and sanitizing products, primarily for the Australian and New Zealand institutional, healthcare and industrial markets.

The acquisition was accounted for as a purchase. The purchase price of the shares and the direct costs of the transaction totaled approximately $130 million and were initially financed through the company's Multicurrency Credit Agreement. The excess of the purchase price over the net tangible assets acquired was approximately $88 million and is being amortized on a straight-line basis over useful lives averaging 25 years. The assets acquired and the liabilities assumed in the transaction were included in the company's Consolidated Balance Sheet as of the November 30, 1997 effective date.

The following unaudited pro forma financial information reflects the combined results of the company and the retained Gibson businesses assuming the acquisition had occurred at the beginning of 1997. Pro forma adjustments have been included to give effect to amortization of the excess of the purchase price over the net tangible assets acquired, interest expense on debt incurred to finance the acquisition and the related income tax effects. In accordance with the pro forma adjustment guidelines, cost savings from efficiencies and synergies have not been reflected in the information shown below.

(thousands, except per share)	1997
Net sales	$ 1,741,006
Income from continuing operations	131,455
Diluted income from continuing operations per common share	$ 0.98

The pro forma results are presented for information purposes only and are not necessarily indicative of the results of operations which actually would have resulted had the combination occurred at the beginning of 1997 or of future results of operations of the consolidated businesses.

Other Business Acquisitions

In December 1997, the company acquired a cleaning and sanitizing business in Japan from Henkel KGaA. Sales of the acquired business were approximately $10 million in 1997.

In June 1998, the company acquired certain assets of American Fluid Technologies (AFT), which is based in Hopkins, Minnesota. AFT provides cleaning and optimization products and services for membrane systems used to process water for food, beverage, pharmaceutical and industrial applications. AFT has become part of the company's Food & Beverage operations. AFT sales were approximately $3 million in 1997.

Also in June 1998, the company acquired certain assets of Puremark International, a Fairfield, New Jersey-based manufacturer of systems which help purify and condition water used in foodservice soda fountain dispensers, ice makers, coffee makers and similar items. The acquired business had sales of approximately $2 million in 1997, and has become part of the company's Institutional operations.

In July 1998, the company issued approximately 850,000 shares of common stock to purchase GCS Service, Inc., a Danbury, Connecticut-based provider of commercial kitchen equipment repair services. GCS Service, Inc. sales were $48 million in 1997.

In November 1998, the company acquired selected assets of Vulcan Chemical Technologies, Inc. of Sacramento, California. This business supplies chlorine dioxide generator technology for the food processing industry and has become part of the company's Food & Beverage operations. Annual sales of the business acquired were approximately $6 million in 1997.

These acquisitions have been accounted for as purchases and, accordingly, the results of their operations have been included in the financial statements of the company from the dates of acquisition. Net sales and operating income of these businesses were not significant to the company's consolidated results of operations, financial position and cash flows.

7 Seven: Henkel-Ecolab Joint Venture

The company and Henkel KGaA, Düsseldorf, Germany, each own 50 percent of Henkel-Ecolab, a joint venture of their respective European institutional and industrial cleaning and sanitizing businesses. The joint venture's results of operations and the company's equity in earnings of the joint venture included:

(thousands)	**1998**	1997	1996
Joint venture			
Net sales	**$ 904,217**	$ 844,689	$ 905,402
Gross profit	**500,107**	470,698	497,909
Income before income taxes	**65,946**	63,640	65,091
Net income	**$ 38,540**	$ 33,701	$ 34,808
Ecolab equity in earnings			
Ecolab equity in net income	**$ 19,270**	$ 16,851	$ 17,404
Ecolab royalty income from joint venture, net of income taxes	**4,550**	4,583	4,730
Amortization expense for the excess of cost over the underlying net assets of the joint venture	**(7,770)**	(8,001)	(9,123)
Equity in earnings of Henkel-Ecolab joint venture	**$ 16,050**	$ 13,433	$ 13,011

The company's investment in the Henkel-Ecolab joint venture includes the unamortized excess of the company's investment over its equity in the joint venture's net assets. This excess was $142 million at December 31, 1998, and is being amortized on a straight-line basis over estimated economic useful lives of up to 30 years.

Condensed balance sheet information for the Henkel-Ecolab joint venture was:

December 31 (thousands)	**1998**	1997	1996
Current assets	**$ 368,604**	$ 345,692	$ 425,225
Noncurrent assets	**179,188**	145,601	142,227
Current liabilities	**242,630**	224,155	309,599
Noncurrent liabilities	**$ 82,097**	$ 77,303	$ 75,360

Eight: Income Taxes

Income from continuing operations before income taxes and equity in earnings of Henkel-Ecolab consisted of:

(thousands)	1998	1997	1996
Domestic	$ 213,781	$ 173,851	$ 144,888
Foreign	26,457	32,016	26,057
Total	$ 240,238	$ 205,867	$ 170,945

The provision for income taxes consisted of:

(thousands)	1998	1997	1996
Federal and state	$ 92,094	$ 76,399	$ 66,868
Foreign	11,700	11,020	10,781
Currently payable	103,794	87,419	77,649
Federal and state	(3,596)	(3,675)	(6,748)
Foreign	1,584	1,601	(130)
Deferred	(2,012)	(2,074)	(6,878)
Provision for income taxes	$ 101,782	$ 85,345	$ 70,771

The company's overall net deferred tax assets (current and noncurrent) were comprised of the following:

December 31 (thousands)	1998	1997	1996
Deferred tax assets			
Postretirement health care and pension benefits	$ 34,940	$ 30,991	$ 29,596
Other accrued liabilities	47,601	41,611	39,151
Loss carryforwards	3,999	3,541	4,780
Other, net	9,821	12,766	8,814
Valuation allowance	(1,462)	(1,462)	(1,462)
Total	94,899	87,447	80,879
Deferred tax liabilities			
Property, plant and equipment basis differences	26,605	27,606	23,496
Other, net	4,782	1,419	1,457
Total	31,387	29,025	24,953
Net deferred tax assets	$ 63,512	$ 58,422	$ 55,926

A reconciliation of the statutory U.S. federal income tax rate to the company's effective income tax rate was:

	1998	1997	1996
Statutory U.S. rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	4.3	4.2	4.2
Foreign operations	1.4	0.6	0.5
Other, net	1.7	1.7	1.7
Effective income tax rate	42.4%	41.5%	41.4%

Cash paid for income taxes was approximately $122 million in 1998, $100 million in 1997 and $72 million in 1996. In 1998, approximately $39 million of payments resulted from the settlement of a tax issue related to the disposal of a business in 1992.

As of December 31, 1998, undistributed earnings of international subsidiaries and the Henkel-Ecolab joint venture of approximately $30 million and $50 million, respectively, were considered to have been reinvested indefinitely and, accordingly, the company has not provided U.S. income taxes on such earnings. If those earnings were remitted to the company, applicable income taxes would be offset substantially by available foreign tax credits.

Nine: Stock Incentive and Option Plans

The company's stock incentive and option plans provide for grants of stock options and stock awards. Common shares available for grant as of December 31 were 1,835,714 for 1998, 5,274,652 for 1997 and 840,096 for 1996.

Options may be granted to purchase shares of the company's stock at not less than fair market value at the date of grant. Options generally become exercisable over periods of up to four years from date of grant and expire within ten years from date of grant. A summary of stock option activity and average exercise prices is as follows:

Shares	1998	1997	1996
Granted	3,342,555	1,031,760	1,266,680
Exercised	(1,058,686)	(1,295,170)	(1,344,686)
Canceled	(174,800)	(63,416)	(102,666)
December 31:			
Outstanding	10,989,491	8,880,422	9,207,248
Exercisable	6,134,840	5,922,150	5,859,968

Average exercise price per share	1998	1997	1996
Granted	$43.33	$21.72	$15.26
Exercised	8.05	8.50	7.65
Canceled	37.47	14.07	12.16
December 31:			
Outstanding	21.44	11.92	10.35
Exercisable	$11.01	$ 9.66	$ 8.75

Information related to stock options outstanding and stock options exercisable as of December 31, 1998 is as follows:

Options Outstanding			
Range of Exercise Prices	Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price
$ 5.69-$ 9.31	1,846,329	2.6 years	$ 7.23
$10.13-$11.59	2,850,450	5.4 years	$11.10
$13.41-$18.91	2,119,525	7.1 years	$14.65
$20.63-$33.31	1,938,187	9.1 years	$26.68
$49.00	2,235,000	9.2 years	$49.00

Options Exercisable		
Range of Exercise Prices	Options Exercisable	Weighted-Average Exercise Price
$ 5.69-$ 9.31	**1,846,329**	**$ 7.23**
$10.13-$11.59	**2,741,250**	**$11.08**
$13.41-$18.91	**1,302,005**	**$14.42**
$20.63-$33.31	**245,256**	**$21.88**

Stock awards are generally subject to restrictions, including forfeiture in the event of termination of employment. The value of a stock award at date of grant is charged to income over the periods during which the restrictions lapse.

The company measures compensation cost for its stock incentive and option plans using the intrinsic value-based method of accounting.

Had the company used the fair value-based method of accounting to measure compensation expense for its stock incentive and option plans beginning in 1995 and charged compensation cost against income, over the vesting periods, based on the fair value of options at the date of grant, income from continuing operations and the related diluted per common share amounts for 1998, 1997 and 1996 would have been reduced to the following pro forma amounts:

(thousands, except per share)	1998	1997	1996
Income from continuing operations			
As reported	**$ 154,506**	$ 133,955	$ 113,185
Pro forma	**150,773**	131,763	111,761
Diluted income from continuing operations per common share			
As reported	**1.15**	1.00	0.85
Pro forma	**$ 1.12**	$ 0.98	$ 0.84

The weighted-average grant-date fair value of options granted in 1998, 1997 and 1996 and the significant assumptions used in determining the underlying fair value of each option grant on the date of grant utilizing the Black-Scholes option-pricing model were as follows:

	1998	1997	1996
Weighted-average grant-date fair value of options granted			
Granted at market prices	**$ 7.65**	$ 5.94	$ 4.15
Granted at prices exceeding market	**$ 1.78**		
Assumptions			
Risk-free interest rate	**5.5%**	6.2%	6.2%
Expected life	**6 years**	6 years	6 years
Expected volatility	**17.8%**	19.6%	20.9%
Expected dividend yield	**1.5%**	1.8%	1.9%

10 Ten: Shareholders' Equity

During 1998, the company adopted Statement of Financial Accounting Standards No. 130, a new standard for reporting comprehensive income, which includes all changes in shareholders' equity with the exception of additional investments by shareholders or distributions to shareholders. The format of the Consolidated Statement of Comprehensive Income and Shareholders' Equity has been changed to present information about comprehensive income. For the company, comprehensive income includes net income and foreign currency translation that is charged or credited to shareholders' equity.

The company's common stock was split two for one in the form of a 100 percent stock dividend paid January 15, 1998 to shareholders of record on December 26, 1997. All per share and number of share data have been retroactively restated to reflect the stock split, except for the Consolidated Statement of Comprehensive Income and Shareholders' Equity.

Authorized common stock, par value $1.00 per share, was 200 million shares in 1998 and 1997 and 100 million shares in 1996. Treasury stock is stated at cost. Dividends declared per share of common stock were $0.39 for 1998, $0.335 for 1997 and $0.29 for 1996.

The company has 15 million shares, without par value, of authorized but unissued preferred stock.

Each share of outstanding common stock entitles the holder to one-half of a preferred stock purchase right. A right entitles the holder, upon occurrence of certain events, to buy one one-hundredth of a share of Series A Junior Participating Preferred Stock at a purchase price of $115, subject to adjustment. The rights, however, will not become exercisable unless and until, among other things, any person or group acquires 15 percent or more of the outstanding common stock of the company, or the company's board of directors declares a holder of 10 percent or more of the outstanding common stock to be an "adverse person" as defined in the rights plan. Upon the occurrence of either of these events, the rights will become exercisable for common stock of the company (or in certain cases common stock of an acquiring company) having a market value of twice the exercise price of a right. The rights provide that the holdings by Henkel KGaA or its affiliates, subject to compliance by Henkel with certain conditions, will not cause the rights to become exercisable nor cause Henkel to be an "adverse person." The rights are redeemable under certain circumstances at one cent per right and, unless redeemed earlier, will expire on March 11, 2006.

Ten: Shareholders' Equity *(continued)*

The company maintains a share repurchase program which is intended to offset the dilutive effect of shares issued for employee benefit plans. The company also reacquires shares for general corporate purposes under a separate program established in 1995. As of December 31, 1998 there were approximately 3.6 million shares remaining to be purchased under this program. The company reacquired 1,626,900 shares of its common stock in 1998, 2,561,400 shares in 1997 and 1,260,400 shares in 1996 under these programs through open and private market purchases. The company anticipates that it will continue to periodically reacquire shares under its share repurchase programs.

Eleven: Rentals and Leases

The company leases sales and administrative office facilities, distribution center facilities, automobiles and computers and other equipment under operating leases. Rental expense under all operating leases was $42,076,000 in 1998, $38,155,000 in 1997 and $35,071,000 in 1996. As of December 31, 1998, future minimum payments under operating leases with noncancelable terms in excess of one year were:

(thousands)	
1999	$ 13,032
2000	8,727
2001	5,932
2002	3,925
2003	2,827
Thereafter	15,420
Total	$ 49,863

Twelve: Research Expenditures

Research expenditures that related to the development of new products and processes, including significant improvements and refinements to existing products, were $32,815,000 in 1998, $30,420,000 in 1997 and $28,676,000 in 1996.

Thirteen: Environmental Compliance Costs

The company and certain subsidiaries are party to various environmental actions that have arisen in the ordinary course of business. These include possible obligations to investigate and mitigate the effects on the environment of the disposal or release of certain chemical substances at various sites, such as Superfund sites and other operating or closed facilities. The effect of these actions on the company's financial position, results of operations and cash flows to date has not been significant. The company is currently participating in environmental assessments and remediation at a number of locations and environmental liabilities have been accrued reflecting management's best estimate of future costs. Potential insurance reimbursements are not anticipated. While the final resolution of these contingencies could result in expenses different than current accruals, and therefore have an impact on the company's consolidated financial results in a future reporting period, management believes the ultimate outcome will not have a significant effect on the company's consolidated results of operations, financial position or liquidity.

Fourteen: Retirement Plans

The company has a noncontributory defined benefit pension plan covering substantially all of its U.S. employees. Plan benefits are based on years of service and highest average compensation for five consecutive years of employment. Various international subsidiaries also have defined benefit pension plans.

The company provides postretirement health care benefits to substantially all U.S. employees. The plan is contributory based on years of service and family status, with retiree contributions adjusted annually. Employees outside the U.S. are generally covered under government-sponsored programs and the cost for providing benefits under company plans was not significant.

A reconciliation of changes in the benefit obligations and fair value of assets of its U.S. pension and postretirement health care benefits plans is as follows:

	Pension Benefits			Postretirement Benefits		
(thousands)	**1998**	1997	1996	**1998**	1997	1996
Benefit obligation, beginning of year	**$ 287,027**	$ 240,116	$ 217,008	**$ 91,121**	$ 71,549	$ 59,447
Service cost	**16,336**	13,330	12,615	**5,668**	4,325	3,298
Interest cost	**20,563**	18,371	16,084	**6,382**	5,711	4,398
Plan participants' contributions				**741**	767	578
Changes in assumptions	**27,194**	22,495	1,189	**9,768**	6,957	5,675
Actuarial loss (gain)	**732**	(1,402)	(644)	**(4,431)**	5,057	1,615
Benefits paid	**(8,027)**	(8,534)	(6,136)	**(2,572)**	(3,245)	(3,462)
Business acquisitions		2,651				
Benefit obligation, end of year	**$ 343,825**	$ 287,027	$ 240,116	**$ 106,677**	$ 91,121	$ 71,549
Fair value of plan assets, beginning of year	**$ 237,304**	$ 196,839	$ 167,231	**$ 16,764**	$ 11,885	$ 9,269
Actual return on plan assets	**32,256**	28,531	20,389	**2,261**	1,609	863
Company contributions	**17,388**	17,453	15,355	**3,239**	5,748	4,637
Plan participants' contributions				**741**	767	578
Benefits paid	**(8,027)**	(8,534)	(6,136)	**(2,572)**	(3,245)	(3,462)
Business acquisitions		3,015				
Fair value of plan assets, end of year	**$ 278,921**	$ 237,304	$ 196,839	**$ 20,433**	$ 16,764	$ 11,885

A reconciliation of the funded status and the actuarial assumptions for the U.S. pension and postretirement health care benefits plans is as follows:

	Pension Benefits			Postretirement Benefits		
(thousands)	**1998**	1997	1996	**1998**	1997	1996
Funded status	**$ (64,904)**	$ (49,723)	$ (43,277)	**$ (86,244)**	$ (74,357)	$ (59,664)
Unrecognized actuarial loss	**59,647**	46,028	37,763	**21,468**	17,280	5,984
Unrecognized prior service cost	**16,175**	18,056	20,325	**(8,546)**	(9,097)	(9,648)
Unrecognized net transition asset	**(9,120)**	(10,523)	(11,926)			
Prepaid (accrued) benefit costs	**$ 1,798**	$ 3,838	$ 2,885	**$ (73,322)**	$ (66,174)	$ (63,328)
Weighted-average actuarial assumptions						
Discount rate for service and interest cost, at beginning of year	**7.25%**	7.75%	7.50%	**7.25%**	7.75%	7.50%
Projected salary increases	**5.1**	5.1	5.1			
Expected return on assets	**9.0**	9.0	9.0	**9.0**	9.0	9.0
Discount rate for year-end benefit obligation	**6.75%**	7.25%	7.75%	**6.75%**	7.25%	7.75%

For postretirement benefit measurement purposes, 8.5 percent (for pre-age 65 retirees) and 6.9 percent (for post-age 65 retirees) annual rates of increase in the per capita cost of covered health care were assumed for 1999. The rates were assumed to decrease gradually to 6.5 percent and 5.5 percent, respectively, at 2001 and remain at that level thereafter. Health care costs which are eligible for subsidy by the company are limited to a 4 percent annual increase beginning in 1996 for most employees.

14 Fourteen: Retirement Plans *(continued)*

Pension and postretirement health care benefits expense for the company's U.S. and International operations was:

	Pension Benefits			Postretirement Benefits		
(thousands)	**1998**	1997	1996	**1998**	1997	1996
Service cost – employee benefits earned during the year	**$ 16,336**	$ 13,330	$ 12,615	**$ 5,668**	$ 4,325	$ 3,298
Interest cost on benefit obligation	**20,563**	18,371	16,084	**6,382**	5,711	4,398
Expected return on plan assets	**(20,128)**	(17,183)	(14,983)	**(1,463)**	(1,016)	(525)
Recognition of net actuarial loss	**2,179**	1,407	1,634	**351**	125	
Amortization of prior service cost (benefit)	**1,881**	1,905	1,905	**(551)**	(551)	(551)
Amortization of net transition asset	**(1,403)**	(1,403)	(1,403)			
Total U.S. expense	**19,428**	16,427	15,852	**10,387**	8,594	6,620
International expense	**1,251**	1,112	1,261			
Total expense	**$ 20,679**	$ 17,539	$ 17,113	**$ 10,387**	$ 8,594	$ 6,620

The company also has noncontributory non-qualified defined benefit plans which provide for benefits to employees in excess of limits permitted under its U.S. pension plan. The recorded obligation for these plans was approximately $12 million at December 31, 1998 and the annual expense for these plans was approximately $3 million in 1998 and approximately $2 million in 1997 and 1996.

Assumed health care cost trend rates have a significant effect on the amounts reported for the company's postretirement health care benefits plan. A one-percentage point change in the assumed health care cost trend rates would have the following effects:

	1 Percentage Point	
(thousands)	Increase	Decrease
Effect on total of postretirement service and interest cost components	**$ 440**	**$ (386)**
Effect on postretirement benefit obligation	**6,056**	**(5,350)**

Savings Plan

The company provides a 401(k) savings plan for substantially all U.S. employees. Employee contributions of up to 6 percent of eligible compensation are matched 50 percent by the company. The company's contributions are invested in Ecolab common stock and amounted to $7,383,000 in 1998, $7,156,000 in 1997 and $6,622,000 in 1996.

15 Fifteen: Operating Segments

During 1998, the company adopted Statement of Financial Accounting Standards No. 131. The new standard changes the information the company reports about its operating segments. Operating segment information for prior years has been restated to conform to the 1998 presentation.

The company's operating segments have generally similar products and services and the company is organized to manage its operations geographically. The company's operating segments have been aggregated into three reportable segments.

The "United States Cleaning & Sanitizing" segment provides cleaning and sanitizing products and services to United States markets through its Institutional, Kay, Textile Care, Professional Products, Water Care and Food & Beverage operations.

The "United States Other Services" segment includes all other U.S. operations of the company. This segment provides pest elimination and commercial dishwashing and equipment services through its Pest Elimination, GCS Service and Jackson operations.

The company's "International Cleaning & Sanitizing" segment provides cleaning and sanitizing product and service offerings to international markets in Asia Pacific, Latin America, Africa, Canada and through its Export operations.

Information on the customers, markets and products and services of each of the company's operating segments is included on the inside front cover, in the Business Overview section of this Annual Report.

The company evaluates the performance of its international operations based on fixed management currency exchange rates. All other accounting policies of the reportable segments are consistent with generally accepted accounting principles and the accounting policies of the company described in Note 2 of these notes to consolidated financial statements. The profitability of the company's operating segments is evaluated by management based on operating income. Intersegment sales and transfers were not significant.

Financial information for each of the company's reportable segments is as follows:

	United States				Other		
(thousands)	Cleaning & Sanitizing	Other Services	Total United States	International Cleaning & Sanitizing	Foreign Currency Translation	Corporate	Consolidated
Net sales							
1998	**$1,296,797**	**$160,063**	**$1,456,860**	**$440,668**	**$ (9,302)**		**$1,888,226**
1997	1,156,625	119,203	1,275,828	335,337	29,187		1,640,352
1996	1,040,823	107,955	1,148,778	305,938	35,293		1,490,009
Operating income							
1998	**218,500**	**19,084**	**237,584**	**29,787**	**(1,044)**	**$ (4,347)**	**261,980**
1997	180,975	14,655	195,630	22,519	4,443	(4,088)	218,504
1996	152,979	11,907	164,886	19,151	4,720	(3,440)	185,317
Depreciation & amortization							
1998	**87,456**	**3,145**	**90,601**	**25,638**	**143**	**5,589**	**121,971**
1997	76,130	2,716	78,846	17,604	278	4,151	100,879
1996	67,793	2,167	69,960	15,968	207	3,388	89,523
Total assets							
1998	**701,341**	**77,491**	**778,832**	**334,606**	**6,749**	**350,808**	**1,470,995**
1997	641,441	36,448	677,889	374,136	20,571	343,703	1,416,299
1996	564,735	31,762	596,497	182,293	20,190	409,429	1,208,409
Capital expenditures							
1998	**109,976**	**4,383**	**114,359**	**32,182**	**393**	**697**	**147,631**
1997	90,914	3,539	94,453	24,821	1,528	865	121,667
1996	$ 86,582	$ 1,707	$ 88,289	$ 22,375	$ 290	$ 564	$ 111,518

Corporate operating expense includes overhead costs directly related to the Henkel-Ecolab joint venture. Corporate assets are principally cash and cash equivalents and the company's investment in the Henkel-Ecolab joint venture.

The company has two classes of products and services within its United States and International Cleaning and Sanitizing operations which comprise 10 percent or more of consolidated net sales. Worldwide sales of warewashing products were approximately 28 percent, 31 percent and 31 percent of consolidated net sales in 1998, 1997 and 1996, respectively. Sales of laundry products and services on a worldwide basis were approximately 13 percent, 14 percent and 14 percent of consolidated net sales in 1998, 1997 and 1996 respectively.

Long-lived assets of the company's United States and International operations were as follows:

December 31 (thousands)	**1998**	1997	1996
United States	**$ 332,072**	$ 294,372	$ 269,065
International	**81,046**	99,069	53,783
Corporate	**3,931**	3,812	3,214
Effect of foreign currency translation	**3,156**	(1,691)	6,252
Consolidated	**$ 420,205**	$ 395,562	$ 332,314

16

Sixteen: Quarterly Financial Data (Unaudited)

(thousands, except per share)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1998					
Net sales					
United States					
Cleaning & Sanitizing	$ 303,435	$ 324,347	$ 343,771	$ 325,244	$1,296,797
Other Services	29,179	34,907	48,536	47,441	160,063
International Cleaning & Sanitizing	102,963	109,696	113,560	114,449	440,668
Effect of foreign currency translation	785	(490)	(5,830)	(3,767)	(9,302)
Total	436,362	468,460	500,037	483,367	1,888,226
Cost of sales	195,909	210,116	224,365	220,783	851,173
Selling, general and administrative expenses	186,733	194,604	196,501	197,235	775,073
Operating income					
United States					
Cleaning & Sanitizing	44,606	52,644	65,128	56,122	218,500
Other Services	2,930	4,725	6,905	4,524	19,084
International Cleaning & Sanitizing	6,995	7,881	8,935	5,976	29,787
Corporate	(910)	(1,479)	(1,149)	(809)	(4,347)
Effect of foreign currency translation	99	(31)	(648)	(464)	(1,044)
Total	53,720	63,740	79,171	65,349	261,980
Interest expense, net	5,406	5,400	5,069	5,867	21,742
Income from continuing operations before income taxes and equity in earnings of Henkel-Ecolab	48,314	58,340	74,102	59,482	240,238
Provision for income taxes	20,289	24,475	31,794	25,224	101,782
Equity in earnings of Henkel-Ecolab joint venture	2,563	3,824	4,704	4,959	16,050
Income from continuing operations	30,588	37,689	47,012	39,217	154,506
Gain from discontinued operations			38,000		38,000
Net income	$ 30,588	$ 37,689	$ 85,012	$ 39,217	$ 192,506
Diluted income per common share					
Income from continuing operations	$ 0.23	$ 0.28	$ 0.35	$ 0.29	$ 1.15
Gain from discontinued operations			0.28		0.28
Net income	$ 0.23	$ 0.28	$ 0.63	$ 0.29	$ 1.44
Weighted-average common shares outstanding					
Basic	128,958	128,667	129,573	129,431	129,157
Diluted	133,934	133,803	134,319	134,154	134,047
1997					
Net sales					
United States					
Cleaning & Sanitizing	$ 264,623	$ 289,974	$ 306,129	$ 295,899	$1,156,625
Other Services	26,080	29,659	32,635	30,829	119,203
International Cleaning & Sanitizing	74,465	84,406	86,484	89,982	335,337
Effect of foreign currency translation	8,592	7,771	7,625	5,199	29,187
Total	373,760	411,810	432,873	421,909	1,640,352
Cost of sales	165,726	183,322	188,178	184,858	722,084
Selling, general and administrative expenses	164,604	175,685	177,899	181,576	699,764
Operating income					
United States					
Cleaning & Sanitizing	36,262	44,137	55,665	44,911	180,975
Other Services	2,179	3,047	5,073	4,356	14,655
International Cleaning & Sanitizing	4,444	5,493	5,938	6,644	22,519
Corporate	(881)	(1,050)	(1,044)	(1,113)	(4,088)
Effect of foreign currency translation	1,426	1,176	1,164	677	4,443
Total	43,430	52,803	66,796	55,475	218,504
Interest expense, net	2,998	3,054	3,351	3,234	12,637
Income before income taxes and equity in earnings of Henkel-Ecolab	40,432	49,749	63,445	52,241	205,867
Provision for income taxes	16,577	20,397	26,613	21,758	85,345
Equity in earnings of Henkel-Ecolab joint venture	2,349	3,542	3,657	3,885	13,433
Net income	$ 26,204	$ 32,894	$ 40,489	$ 34,368	$ 133,955
Diluted net income per common share	$ 0.20	$ 0.25	$ 0.30	$ 0.26	$ 1.00
Weighted-average common shares outstanding					
Basic	129,548	129,779	129,462	128,993	129,446
Diluted	133,520	133,963	133,930	133,740	133,822

Report of Management

Management is responsible for the integrity and objectivity of the consolidated financial statements. The statements have been prepared in accordance with generally accepted accounting principles and, accordingly, include certain amounts based on management's best estimates and judgments.

To meet its responsibility, management has established and maintains a system of internal controls that provides reasonable assurance regarding the integrity and reliability of the financial statements and the protection of assets from unauthorized use or disposition. These systems are supported by qualified personnel, by an appropriate division of responsibilities and by an internal audit function. There are limits inherent in any system of internal controls since the cost of monitoring such systems should not exceed the desired benefit. Management believes that the company's system of internal controls is effective and provides an appropriate cost/benefit balance.

The Board of Directors, acting through its Audit Committee composed solely of outside directors, is responsible for determining that management fulfills its responsibilities in the preparation of financial statements and maintains financial control of operations. The Audit Committee recommends to the Board of Directors the appointment of the company's independent accountants, subject to ratification by the shareholders. It meets regularly with management, the internal auditors and the independent accountants.

The independent accountants provide an objective, independent review as to management's discharge of its responsibilities insofar as they relate to the fair presentation of the consolidated financial statements. Their report is presented separately.

Allan L. Schuman

Allan L. Schuman
President and Chief Executive Officer

Michael E. Shannon

Michael E. Shannon
Chairman of the Board,
Chief Financial and Administrative Officer

Report of Independent Accountants

To the Shareholders and Directors
Ecolab Inc.

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of income, comprehensive income and shareholders' equity and cash flows present fairly, in all material respects, the financial position of Ecolab Inc. as of December 31, 1998, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of Ecolab Inc.'s management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

February 22, 1999
Saint Paul, Minnesota

Summary Operating and Financial Data

December 31 (thousands, except per share)	1998	1997	1996	1995
Operations				
Net sales				
United States	$ 1,456,860	$ 1,275,828	$ 1,148,778	$ 1,030,126
International (at average rates of currency exchange during the year)	431,366	364,524	341,231	310,755
Europe (at average rates of currency exchange during the year)				
Total	1,888,226	1,640,352	1,490,009	1,340,881
Cost of sales	851,173	722,084	674,953	603,167
Selling, general and administrative expenses	775,073	699,764	629,739	575,028
Merger costs and nonrecurring expenses				
Operating income	261,980	218,504	185,317	162,686
Interest expense, net	21,742	12,637	14,372	11,505
Income from continuing operations before income taxes and equity in earnings of Henkel-Ecolab	240,238	205,867	170,945	151,181
Provision for income taxes	101,782	85,345	70,771	59,694
Equity in earnings of Henkel-Ecolab joint venture	16,050	13,433	13,011	7,702
Income from continuing operations	154,506	133,955	113,185	99,189
Income (loss) from discontinued operations	38,000			
Extraordinary loss and changes in accounting principles				
Net income (loss)	192,506	133,955	113,185	99,189
Preferred stock dividends				
Net income (loss) to common shareholders, as reported	192,506	133,955	113,185	99,189
Pro forma adjustments				
Pro forma net income (loss) to common shareholders	$ 192,506	$ 133,955	$ 113,185	$ 99,189
Income (loss) per common share, as reported				
Basic — continuing operations	$ 1.20	$ 1.03	$ 0.88	$ 0.75
Basic — net income (loss)	1.49	1.03	0.88	0.75
Diluted — continuing operations	1.15	1.00	0.85	0.73
Diluted — net income (loss)	1.44	1.00	0.85	0.73
Pro forma income (loss) per common share				
Basic — continuing operations	1.20	1.03	0.88	0.75
Basic — net income (loss)	1.49	1.03	0.88	0.75
Diluted — continuing operations	1.15	1.00	0.85	0.73
Diluted — net income (loss)	$ 1.44	$ 1.00	$ 0.85	$ 0.73
Weighted-average common shares outstanding — basic	129,157	129,446	128,991	132,193
Weighted-average common shares outstanding — diluted	134,047	133,822	132,817	134,956
Selected Income Statement Ratios				
Gross profit	54.9%	56.0%	54.7%	55.0%
Selling, general and administrative expenses	41.0	42.7	42.3	42.9
Operating income	13.9	13.3	12.4	12.1
Income from continuing operations before income taxes	12.7	12.6	11.5	11.3
Income from continuing operations	8.2	8.2	7.6	7.4
Effective income tax rate	42.4%	41.5%	41.4%	39.5%
Financial Position				
Current assets	$ 503,514	$ 509,501	$ 435,507	$ 358,072
Property, plant and equipment, net	420,205	395,562	332,314	292,937
Investment in Henkel-Ecolab joint venture	253,646	239,879	285,237	302,298
Other assets	293,630	271,357	155,351	107,573
Total assets	$ 1,470,995	$ 1,416,299	$ 1,208,409	$ 1,060,880
Current liabilities	$ 399,791	$ 404,464	$ 327,771	$ 310,538
Long-term debt	227,041	259,384	148,683	89,402
Postretirement health care and pension benefits	85,793	76,109	73,577	70,666
Other liabilities	67,829	124,641	138,415	133,616
Shareholders' equity	690,541	551,701	519,963	456,658
Total liabilities and shareholders' equity	$ 1,470,995	$ 1,416,299	$ 1,208,409	$ 1,060,880
Selected Cash Flow Information				
Cash provided by operating activities	$ 235,642	$ 235,098	$ 254,269	$ 166,463
Depreciation and amortization	121,971	100,879	89,523	76,279
Capital expenditures	147,631	121,667	111,518	109,894
EBITDA from continuing operations	383,951	319,383	274,840	238,965
Cash dividends declared per common share	$ 0.39	$ 0.335	$ 0.29	$ 0.2575
Selected Financial Measures/Other				
Total debt and preferred stock	$ 295,032	$ 308,268	$ 176,292	$ 161,049
Total debt and preferred stock to capitalization	29.9%	35.8%	25.3%	26.1%
Book value per common share	$ 5.33	$ 4.27	$ 4.01	$ 3.53
Return on beginning equity	28.0%	25.8%	24.8%	21.5%
Dividends/diluted net income per common share	33.9%	33.5%	34.1%	35.3%
Annual common stock price range	$38.00-26.13	$28.00-18.13	$19.75-14.56	$15.88-10.00
Number of employees	12,007	10,210	9,573	9,026

Pro forma results for 1994 and prior years reflect adjustments to eliminate unusual items associated with Ecolab's merger with Kay Chemical Company in December 1994. All per share, shares outstanding and market price data reflect the two-for-one stock splits declared in 1997 and 1993. Other assets includes net assets of Ecolab Europe and discontinued operations prior to 1992. Other liabilities includes $110 million of convertible preferred stock at year-end 1989 and 1990. The ratios of return on

1994	1993	1992	1991	1990	1989	1988
$ 942,070	$ 867,415	$ 816,405	$ 757,564	$ 712,579	$ 646,895	$ 589,715
265,544	234,981	241,229	201,738	184,220	179,705	159,374
				150,809	122,871	122,250
1,207,614	1,102,396	1,057,634	959,302	1,047,608	949,471	871,339
533,143	491,306	485,206	447,356	495,086	461,256	433,734
529,507	481,639	446,814	393,700	425,983	383,512	337,707
8,000					12,978	
136,964	129,451	125,614	118,246	126,539	91,725	99,898
12,909	21,384	35,334	30,489	28,321	31,628	31,097
124,055	108,067	90,280	87,757	98,218	60,097	68,801
50,444	33,422	27,392	29,091	32,494	19,411	21,285
10,951	8,127	8,600	4,573			
84,562	82,772	71,488	63,239	65,724	40,686	47,516
			(274,693)	(4,408)	(29,379)	4,238
	715		(24,560)			
84,562	83,487	71,488	(236,014)	61,316	11,307	51,754
			(4,064)	(7,700)	(429)	
84,562	83,487	71,488	(240,078)	53,616	10,878	51,754
5,902	(2,667)	(2,797)	(2,933)	(2,956)	(3,196)	(2,622)
$ 90,464	$ 80,820	$ 68,691	$ (243,011)	$ 50,660	$ 7,682	$ 49,132
$ 0.63	$ 0.61	$ 0.53	$ 0.51	$ 0.56	$ 0.34	$ 0.41
0.63	0.62	0.53	(2.05)	0.52	0.09	0.44
0.62	0.60	0.52	0.50	0.56	0.34	0.40
0.62	0.61	0.52	(2.05)	0.51	0.09	0.43
0.67	0.59	0.51	0.48	0.53	0.31	0.38
0.67	0.60	0.51	(2.08)	0.49	0.06	0.42
0.66	0.58	0.50	0.48	0.53	0.31	0.38
$ 0.66	$ 0.59	$ 0.50	$ (2.08)	$ 0.49	$ 0.06	$ 0.41
135,100	135,056	134,408	117,050	103,298	118,516	117,188
137,306	137,421	136,227	118,178	104,258	120,196	119,586
55.9%	55.4%	54.1%	53.4%	52.7%	51.4%	50.2%
44.6	43.7	42.2	41.1	40.6	41.7	38.7
11.3	11.7	11.9	12.3	12.1	9.7	11.5
10.3	9.8	8.5	9.1	9.4	6.3	7.9
7.0	7.5	6.8	6.6	6.3	4.3	5.5
40.7%	30.9%	30.3%	33.1%	33.1%	32.3%	30.9%
$ 401,179	$ 311,051	$ 264,512	$ 293,053	$ 216,612	$ 370,875	$ 265,291
246,191	219,268	207,183	198,086	187,735	203,056	194,509
284,570	255,804	289,034	296,292			
88,416	105,607	98,135	152,857	480,911	420,115	444,827
$ 1,020,356	$ 891,730	$ 858,864	$ 940,288	$ 885,258	$ 994,046	$ 904,627
$ 253,665	$ 201,498	$ 192,023	$ 240,219	$ 177,643	$ 201,585	$ 181,758
105,393	131,861	215,963	325,492	208,147	228,632	257,500
70,882	72,647	63,393	56,427	8,742	12,859	12,768
128,608	93,917	29,179	11,002	138,792	135,343	11,590
461,808	391,807	358,306	307,148	351,934	415,627	441,011
$ 1,020,356	$ 891,730	$ 858,864	$ 940,288	$ 885,258	$ 994,046	$ 904,627
$ 169,346	$ 175,674	$ 120,217	$ 128,999	$ 154,208	$ 123,215	$ 113,514
66,869	60,609	60,443	55,653	61,024	53,113	48,282
88,457	68,321	59,904	53,752	58,069	54,430	62,125
203,833	190,060	186,057	173,899	187,563	144,838	148,180
$ 0.2275	$ 0.1975	$ 0.17875	$ 0.175	$ 0.1675	$ 0.165	$ 0.16
$ 147,213	$ 151,281	$ 236,695	$ 407,221	$ 353,886	$ 382,764	$ 300,448
24.2%	27.9%	39.8%	57.0%	50.1%	47.9%	40.5%
$ 3.41	$ 2.90	$ 2.66	$ 2.30	$ 3.41	$ 3.55	$ 3.73
21.6%	23.3%	23.3%	13.6%	12.9%	2.5%	12.9%
36.7%	32.4%	34.4%	42.7%	32.8%	183.3%	37.2%
$11.75-9.63	$11.91-9.07	$9.57-6.66	$8.38-4.88	$7.78-4.16	$8.94-6.22	$6.94-5.32
8,206	7,822	7,601	7,428	8,106	7,845	7,684

beginning equity and dividends/diluted net income per common share exclude the change in accounting principle and the loss on the ChemLawn divestiture in 1991. Number of employees excludes ChemLawn operations.

Board of Directors

Leslie S. Biller Chief Operating Officer and Vice Chairman, Wells Fargo & Company (diversified financial services), Director since 1997, Compensation* and Governance Committees

Ruth S. Block Retired Executive Vice President and Chief Insurance Officer, The Equitable (insurance and investment products), Director since 1985, Compensation and Finance Committees

Jerry A. Grundhofer President and Chief Executive Officer, Firstar Corporation (multi-bank holding company), Director since 1999, Compensation and Governance Committees

James J. Howard Chairman of the Board, President and Chief Executive Officer, Northern States Power Company (public utility company), Director since 1991, Audit and Governance* Committees

William L. Jews President and Chief Executive Officer, CareFirst, Inc. (health care service holding company), Director since 1999, Audit and Finance Committees

Joel W. Johnson Chairman of the Board, President and Chief Executive Officer, Hormel Foods Corporation (food products), Director since 1996, Compensation and Governance Committees

Jerry W. Levin President and Chief Executive Officer, Sunbeam Corporation (household consumer products), Director since 1992, Compensation and Governance Committees

Reuben F. Richards Retired Chairman of the Board, Terra Industries Inc. (agribusiness), Director since 1983, Audit and Finance* Committees

Richard L. Schall Consultant, Retired Vice Chairman of the Board and Chief Administrative Officer, Dayton Hudson Corporation (national retailer), Director since 1978, Audit* and Finance Committees

Roland Schulz Executive Vice President and Member of Executive Board, Henkel KGaA (household and personal care products and adhesives), Director since 1993, Finance Committee

Allan L. Schuman President and Chief Executive Officer, Ecolab Inc., Director since 1991, Governance Committee

Michael E. Shannon Chairman of the Board, Chief Financial and Administrative Officer, Ecolab Inc., Director since 1991, Finance Committee

Hugo Uyterhoeven Timken Professor of Business Administration Emeritus, Graduate School of Business Administration, Harvard University, Director since 1992, Audit and Finance Committees

Albrecht Woeste Chairman of the Shareholders' Committee and Supervisory Board, Henkel KGaA (household and personal care products and adhesives), Director since 1991, Audit and Governance Committees

*Committee Chair

Officers

Allan L. Schuman
President and Chief Executive Officer

Michael E. Shannon
Chairman of the Board, Chief Financial and Administrative Officer

Lawrence T. Bell
Vice President-Law and General Counsel

Alan P. Blumenfeld
Vice President-Chief Information Officer

Peter D'Almada
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Senior Vice President and Controller

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James L. McCarty
Senior Executive Vice President-Institutional Group

Maurizio Nisita
Senior Vice President-Global Operations

Mary J. Schumacher
Vice President-New Business Development and Marketing

C. William Snedeker
Vice President and General Manager-Pest Elimination

John P. Spooner
Executive Vice President-International Group

F. William Tuominen, Ph.D.
Senior Vice President and Chief Technical and Environmental Officer

Shareholder Information

Common Stock

Stock trading symbol ECL

- Ecolab common stock is listed and traded on the New York Stock Exchange ("NYSE") and the Pacific Exchange ("PCX"). Ecolab shares are also traded on an unlisted basis on certain other exchanges.
- Options are traded on the NYSE.
- Ecolab common stock is included in the Chemicals (Specialty) Group of the Standard & Poor's 500 Stock Index.

As of March 1, 1999, Ecolab had 5,544 shareholders of record. The closing stock price on March 1, 1999 was $39.69 per share.

Dividend Policy

Ecolab has paid common stock dividends for 62 consecutive years.

- Quarterly cash dividends are usually paid on the 15th of January, April, July and October.
- Dividends of $0.08 per share were declared in February, May and August 1997. Dividends of $0.095 per share were declared in December 1997, and February, May and August 1998. A dividend of $0.105 per share was declared in December 1998.

Earnings and Corporate News

Corporate news releases, including earnings and other financial information, are available at:

- Web site: **www.ecolab.com**
- Telephone: 1-800-FACT-ECL (800-322-8325); Alaska, Hawaii and international callers dial (402) 573-9859
- E-mail: financial.info@ecolab.com

Copies of Ecolab's Form 10-K, 10-Q and 8-K reports as filed with the Securities and Exchange Commission are available free of charge. These documents may be obtained on-line or by contacting:

- Ecolab Inc. Attention: Corporate Secretary
  Telephone: (651) 293-2233
  E-mail: investor.info@ecolab.com

Independent Accountants

PricewaterhouseCoopers LLP
650 Third Avenue South
Minneapolis, MN 55402

Investor Inquiries

Securities analysts, portfolio managers and representatives of financial institutions seeking information about Ecolab may contact:

- Michael J. Monahan
  External Relations, vice president
  Telephone: (651) 293-2809

Shareholder Services

Annual Meeting

The annual meeting of stockholders will be held on Friday, May 14, 1999, at 10 a.m. at the McKnight Theatre in the Ordway Music Theatre,
345 Washington Street, St. Paul, MN 55102.

Dividend Reinvestment

Shareholders of record may elect to reinvest their dividends. Plan participants may also elect to purchase Ecolab common stock through this service. To enroll in the plan, shareholders should contact the transfer agent for a brochure and authorization form.

Recorded News and On-line Resources

Call 1-800-FACT-ECL (800-322-8325); Alaska, Hawaii and international callers dial (402) 573-9859.

- Visit Ecolab's web site at **www.ecolab.com** for financial results and investor information.
- New Account Access! Shareholders of record may now view their shareholder account information on-line at **http://gateway.equiserve.com**. For log-in assistance, shareholders may call the transfer agent toll free at 1-877-843-9327. International callers may dial (201) 536-8071.

Research Coverage

Investors may contact the following firms which have recently provided research coverage on Ecolab:

- Credit Suisse First Boston; Dain Rauscher Wessels, Inc.; Gabelli & Co.; Goldman, Sachs & Co.; Ingalls & Snyder LLC; J.P. Morgan Securities; Merrill Lynch & Co.; Morgan Stanley, Dean Witter, Discover & Co.; PaineWebber Incorporated; Standard & Poor's; and Value Line.

The reference to such firms does not imply any endorsement of the information by Ecolab.

Transfer Agent, Registrar and Paying Agent

First Chicago Trust Company of New York,
a division of EquiServe LLP

- Telephone: (201) 324-0313; or 1-800-322-8325; TDD/Hearing Impaired: (201) 222-4955
- E-mail: fctc@em.fcnbd.com
- Web site: **www.equiserve.com**

The transfer agent provides telephone assistance Monday-Friday 8:30 a.m. to 7 p.m. (Eastern Time). Round-the-clock service is also available on-line and to callers using touch-tone telephones.

Transfer Agent mailing addresses:

- For items delivered by courier:
  Mail Suite 4680, 8th Floor
  14 Wall Street, New York, NY 10005
- General written inquiries:
  P.O. Box 2500, Jersey City, NJ 07303-2500
- Stock transfer correspondence:
  P.O. Box 2506, Jersey City, NJ 07303-2506
- Dividend Reinvestment Plan correspondence:
  P.O. Box 2598, Jersey City, NJ 07303-2598