TOWN SPORTS INTERNATIONAL HOLDINGS INC
Form DEF 14A
March 31, 2009

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SCHEDULE 14A
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT
SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities Exchange Act of 1934

Filed by the Registrant þ

Filed by a Party other than the Registrant o

Check the appropriate box:

o Preliminary Proxy Statement

o Confidential, for use of the Commission (as permitted by Rule 14a-6(e)(2))

þ Definitive Proxy Statement only

o Definitive Additional Materials

o Soliciting Material Pursuant to Rule 14a-11(c) or Rule 14a-12

TOWN SPORTS INTERNATIONAL HOLDINGS, INC.
(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment, of Filing Fee (Check the appropriate box):

þ No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

(5) Total fee paid:

o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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March 31, 2009

Dear Stockholders:

On behalf of the Board of Directors of Town Sports International Holdings, Inc., I cordially invite you to attend our Annual Meeting of Stockholders, which will be held on Thursday, May 14, 2009 at 10:00 a.m. (New York City time) at Crowne Plaza Times Square, 1506 Broadway, New York, New York 10019.

In accordance with rules approved by the Securities and Exchange Commission allowing companies to furnish proxy materials to their shareholders over the Internet, we are now primarily furnishing proxy materials to our stockholders on the Internet, rather than mailing paper copies of the materials (including our Annual Report to Stockholders for fiscal 2008) to each stockholder. We believe that this new e-proxy process will expedite our stockholders receipt of proxy materials, lower costs, and reduce the environmental impact of our annual meeting. We sent a Notice of Internet Availability of Proxy Materials or a full set of proxy materials on or about March 31, 2009 to our stockholders of record as of the close of business on March 17, 2009. We also provided access to our proxy materials over the Internet beginning on that date. If you received a Notice of Internet Availability of Proxy Materials by mail and did not receive, but would like to receive, a printed copy of our proxy materials, you should follow the instructions for requesting such materials included in the notice or on page 36 of this proxy statement. The formal Notice of Annual Meeting and the Proxy Statement follow.

It is important that your shares be represented and voted at the meeting, regardless of the size of your holdings. To have your vote recorded, you should vote over the Internet. In addition, if you have requested or received a paper copy of the proxy materials, you may vote by signing, dating and returning the proxy card sent to you in the envelope accompanying the proxy materials sent to you. We encourage you to vote by any of these methods even if you currently plan to attend the Annual Meeting.

If you decide to attend the Annual Meeting, you can still vote your shares in person if you wish. Please let us know whether you plan to attend meeting by indicating your plans when prompted over the Internet voting system or, if you have received a paper copy of the proxy materials, by marking the appropriate box on the proxy card sent to you. If you plan to attend the Annual Meeting, please bring this letter or proof of ownership and valid picture identification (such as a driver s license or passport) with you to the meeting, as this letter or proof of ownership and your picture identification will serve as your admittance pass to the meeting. If you choose to vote over the Internet or, if you have received a paper copy of the proxy materials, by completing the proxy card sent to you and later decide to attend the Annual Meeting and wish to change your proxy vote, you may do so automatically by voting in person at the Annual Meeting.

We look forward to seeing you at the Annual Meeting.

Sincerely,

Alexander Alimanestianu
Chief Executive Officer and President

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PROXY VOTING METHODS

If at the close of business on March 17, 2009, you were a shareholder of record or held shares through a broker or bank, you may vote your shares by proxy through the Internet or by mail, or you may vote in person at the Annual Meeting. For shares held through a broker or nominee, you may vote by submitting voting instructions to your broker or nominee. To reduce our administrative and postage costs, we ask that you vote through the Internet which is available 24 hours a day, seven days a week. You may revoke your proxies at the times and in the manners described on page 2 of the Proxy Statement.

If you are a shareholder of record or hold shares through a broker or bank and are voting by proxy, your vote must be *received* by 11:59 p.m. (Eastern Daylight Time) on May 13, 2009 to be counted.

To vote by proxy:

BY INTERNET

Go to the website *www.proxyvote.com* and follow the instructions, 24 hours a day, seven days a week.

You will need the 12-digit Control Number included on your Notice of Internet Availability of Proxy Materials or proxy card to obtain your records and to create an electronic voting instruction form.

BY MAIL

Request a proxy card from us (if you have not already received one) by following the instructions on your Notice of Internet Availability of Proxy Materials.

When you receive the proxy card, mark your selections on the proxy card.

Date and sign your name exactly as it appears on your proxy card.

Mail the proxy card in the postage-paid envelope that will be provided to you.

YOUR VOTE IS IMPORTANT. THANK YOU FOR VOTING.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC.
5 Penn Plaza (4th Floor)
New York, New York 10001

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS
TO BE HELD AT 10:00 A.M. ON THURSDAY, MAY 14, 2009

TO THE STOCKHOLDERS OF TOWN SPORTS INTERNATIONAL HOLDINGS, INC.:

NOTICE IS HEREBY GIVEN that the Annual Meeting of Stockholders (the Annual Meeting) of Town Sports International Holdings, Inc., a Delaware corporation (the Company), will be held at Crowne Plaza Times Square, 1506 Broadway, New York, New York 10019 on Thursday, May 14, 2009 at 10:00 a.m. (New York City time) for the following purposes:

(1) To elect eight members of the Company s Board of Directors as listed herein;

(2) To ratify the Audit Committee s appointment of PricewaterhouseCoopers LLP as the independent registered public accounting firm of the Company for the fiscal year ending December 31, 2009; and

(3) To act upon such other business as may properly come before the Annual Meeting or any adjournments of such meeting that may take place.

Only stockholders of record at the close of business on March 17, 2009 will be entitled to notice of, and to vote at, the Annual Meeting. The stock transfer books of the Company will remain open between the record date and the date of the Annual Meeting. A list of stockholders entitled to vote at the Annual Meeting will be available for inspection at the Annual Meeting and for a period of 10 days prior to the meeting during regular business hours at the offices of the Company.

All stockholders are cordially invited to attend the Annual Meeting in person. Whether or not you currently plan to attend the Annual Meeting in person, please vote over the Internet or, if you received a paper copy of the proxy materials, complete, date, sign and promptly mail the paper proxy card sent to you. You may revoke your proxy if you attend the Annual Meeting and wish to vote your shares in person. If you receive more than one Notice of Internet Availability of Proxy Materials and/or Proxy Card because your shares are registered in different names and addresses, you should ensure that you vote all of your shares by voting over the Internet or, if you received a paper copy of the proxy materials, by signing and returning each Proxy Card to assure that all your shares will be voted. You may revoke your proxy in the manner described in the Proxy Statement at any time prior to it being voted at the Annual Meeting. If you attend the Annual Meeting and vote by ballot, your proxy will be revoked automatically and only your vote at the Annual Meeting will be counted.

By Order of the Board of Directors

Alexander Alimanestianu
Chief Executive Officer and President

New York, New York

March 31, 2009

YOUR VOTE IS VERY IMPORTANT

REGARDLESS OF THE NUMBER OF SHARES YOU OWN. PLEASE READ THE ATTACHED PROXY STATEMENT CAREFULLY, VOTE OVER THE INTERNET OR, IF YOU RECEIVED A PAPER COPY OF THE PROXY MATERIALS, COMPLETE, DATE, SIGN AND PROMPTLY MAIL THE PAPER PROXY CARD SENT TO YOU AS SOON AS POSSIBLE AND RETURN IT IN THE ENCLOSED ENVELOPE.

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TOWN SPORTS INTERNATIONAL HOLDINGS, INC.
5 Penn Plaza (4th Floor)
New York, New York 10001

PROXY STATEMENT

GENERAL INFORMATION

This Proxy Statement is furnished to the stockholders of record of Town Sports International Holdings, Inc., a Delaware corporation (Town Sports or the Company), as of March 17, 2009, in connection with the solicitation of proxies on behalf of the Board of Directors of the Company for use at the Annual Meeting of Stockholders to be held on Thursday, May 14, 2009, and at any adjournments of such meeting that may take place. The Annual Meeting will be held at 10:00 a.m. (New York City time) at Crowne Plaza Times Square, 1506 Broadway, New York, New York 10019. In accordance with rules approved by the Securities and Exchange Commission (SEC), we sent a Notice of Internet Availability of Proxy Materials or a full set of these proxy materials on or about March 31, 2009 to our stockholders of record as of the close of business on March 17, 2009. We also provided access to our proxy materials over the Internet beginning on that date. If you received a Notice of Internet Availability of Proxy Materials by mail and did not receive, but would like to receive, a printed copy of our proxy materials, you should follow the instructions for requesting such materials included in the notice or on page 36 of this proxy statement.

Voting

The specific matters to be considered and acted upon at the Annual Meeting are:

(i) To elect eight members of the Company s Board of Directors (the Board) as listed herein;

(ii) To ratify of the Audit Committee s appointment of PricewaterhouseCoopers LLP as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2009; and

(iii) To act upon such other business as may properly come before the Annual Meeting.

These matters are described in more detail in this Proxy Statement.

On March 17, 2009, the record date for determination of stockholders entitled to notice of and to vote at the Annual Meeting, 22,532,166 shares of the Company s common stock were issued and outstanding. No shares of the Company s preferred stock were outstanding. Each stockholder is entitled to one vote for each share of common stock held by such stockholder on March 17, 2009. Stockholders may not aggregate their votes in the election of directors.

The stock transfer books of the Company will remain open between the record date and the date of the Annual Meeting. A list of stockholders entitled to vote at the Annual Meeting will be available for inspection at the Annual Meeting and for a period of ten days prior to the meeting during regular business hours at the offices of the Company.

The presence, in person or by proxy, at the Annual Meeting of the holders of a majority of the shares of common stock issued and outstanding and entitled to vote at the Annual Meeting is necessary to constitute a quorum in connection with the transaction of business at the Annual Meeting. Abstentions, broker non-votes and withheld votes are each counted as present for the purpose of determining the presence of a quorum.

With respect to the election of the members of the Board, if a quorum is present at the Annual Meeting, the eight nominees who receive the greatest number of votes properly cast (in person or by proxy) will be elected as directors. All other proposals must be approved by the affirmative vote of the holders of a majority of the shares of the common stock present at the Annual Meeting, in person or by proxy, and entitled to vote thereon or having voting power with respect thereto.

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Abstentions and Withheld Votes: With respect to the election of directors, votes may be cast in favor of or withheld from each nominee. Votes that are withheld will be excluded entirely from the vote with respect to the nominee from which they are withheld and will have the same effect as an abstention. Votes that are withheld will not have any effect on the outcome of the election of directors. Abstentions will have the effect of a vote against the other matters being voted on at the Annual Meeting.

Broker Non-Votes: Broker non-votes occur when shares held by a broker are not voted with respect to a proposal because (1) the broker has not received voting instructions from the stockholder who beneficially owns the shares and (2) the broker lacks the authority to vote the shares at his/her discretion. We believe that there can be no broker non-votes with respect to the matters being voted on at the Annual Meeting because brokers should have discretion under current stock exchange rules to vote uninstructed shares on both Proposal No. 1 and Proposal No. 2.

All votes will be tabulated by the inspector of election appointed for the meeting.

Under the General Corporation Law of the State of Delaware, stockholders are not entitled to dissenter s rights with respect to any matter to be considered and voted on at the Annual Meeting, and the Company will not independently provide stockholders with any such right.

Proxies

Unless revoked, all proxies representing shares entitled to vote that are delivered pursuant to this solicitation will be voted at the Annual Meeting and, where a choice has been specified on the proxy card, will be voted in accordance with such specification. Where a choice has not been specified on the proxy card, the proxy will be voted FOR the election of all the nominated directors listed herein, unless the authority to vote for the election of such directors is withheld. In addition, if no contrary instructions are given, the proxy will be voted FOR the approval of Proposal 2 described in this Proxy Statement and as the proxy holders deem advisable for all other matters as may properly come before the Annual Meeting. You may revoke or change your proxy at any time before the Annual Meeting by filing with the Corporate Secretary of the Company, at the Company s principal executive offices at 5 Penn Plaza (4th Floor), New York, New York 10001, a notice of revocation or another signed Proxy Card with a later date. You may also revoke your proxy by attending the Annual Meeting and voting in person. If you hold shares in street name, you may submit new voting instructions by contacting your bank, broker or other nominee. You may also change your vote or revoke your proxy in person at the Annual Meeting if you obtain a signed proxy from the record holder (broker or other nominee) giving you the right to vote the shares.

Voting Shares Without Attending the Annual Meeting

If you are a shareholder of record you may vote by granting a proxy. For shares held in street name, you may vote by submitting voting instructions to your broker or nominee. In all circumstances, you may vote:

By Internet If you have Internet access, you may submit your proxy by going to *www.proxyvote.com* and by following the instructions on how to complete an electronic proxy card. You will need the 12-digit Control Number included on your Notice or your proxy card in order to vote by Internet.

By Mail You may vote by mail by requesting a proxy card from us, indicating your vote by completing, signing and dating the card where indicated and by mailing or otherwise returning the card in the envelope that will be provided to you. You should sign your name exactly as it appears on the proxy card. If you are signing in a representative capacity (for example, as guardian, executor, trustee, custodian, attorney or officer of a corporation), indicate your name and title or capacity.

Internet voting facilities will close at 11:59 p.m. (Eastern Daylight Time) on May 13, 2009 for the voting of shares held by shareholders of record or held in street name.

Mailed proxy cards with respect to shares held of record or in street name must be received no later than May 13, 2009.

Voting Shares in Person at the Annual Meeting

First, you must satisfy the requirements for admission to the Annual Meeting (see below). Then, if you are a stockholder of record and prefer to vote your shares at the Annual Meeting, you must bring proof of identification along with your Notice or proof of ownership. You may vote shares held in street name at the Annual Meeting only if you obtain a signed proxy (legal proxy) from the record holder (broker or other nominee) giving you the right to vote the shares.

Even if you plan to attend the Annual Meeting, we encourage you to vote in advance by Internet or proxy card so that your vote will be counted even if you later were to decide not to attend the Annual Meeting.

Admission to the Annual Meeting

Please let us know whether you plan to attend meeting by indicating your plans when prompted over the Internet voting system or, if you have received a paper copy of the proxy materials, by marking the appropriate box on the proxy card sent to you. If you plan to attend the Annual Meeting, please bring the Notice accompanying this proxy statement or proof of ownership and valid picture identification (such as a driver s license or passport) with you to the meeting, as the Notice or proof of ownership and your picture identification will serve as your admittance pass to the meeting. If your shares are held beneficially in the name of a bank, broker or other holder of record and you wish to be admitted to attend the Annual Meeting, you must present proof of your ownership of Town Sports International Holdings, Inc. shares, such as a bank or brokerage account statement.

Solicitation

The Company will bear the entire cost of solicitation, including the preparation, assembly, printing and mailing of the Notice of Internet Availability of Proxy Materials, this Proxy Statement, the Proxy Card and any additional solicitation materials furnished to the stockholders. Copies of solicitation materials will be furnished to brokerage houses, fiduciaries and custodians holding shares in their names that are beneficially owned by others so that they may forward this solicitation material to such beneficial owners. In addition, the Company may reimburse such persons for their costs in forwarding the solicitation materials to such beneficial owners. The original solicitation of proxies by mail may be supplemented by a solicitation by telephone, facsimile, or other means (including by directors, officers or employees of the Company, to whom no additional compensation will be paid for any such services).

Deadline for Receipt of Stockholder Proposals

In order to be considered for inclusion in the Company s Proxy Statement and Proxy Card relating to the 2010 Annual Meeting of Stockholders, any proposal by a stockholder submitted pursuant to Rule 14a-8 of the Securities Exchange Act of 1934, as amended, must be received by the Company at its principal executive offices in New York, New York, on or before December 1, 2009.

Our bylaws require advance notice of business to be brought before a stockholders meeting, including nominations of persons for election as directors. On May 15, 2008, the stockholders of the Company approved the Second Amended and Restated By-Laws (the By-Laws) to revise the Company s advance notice provisions. Among other things, the amendments modified the advance notice timing requirements and expanded the information required to be provided by any stockholder who proposes director nominations or any other business for consideration at a stockholders meeting. To be timely, any proposal for consideration at the 2010 Annual Meeting of Stockholders submitted by a stockholder (other than for inclusion in the Company s Proxy Statement pursuant to Rule 14a-8) must be delivered to or mailed and received by the Corporate Secretary of the Company at the principal executive offices of the Company not earlier than the close of business on December 15, 2009 and not later than the close of business on January 14, 2010; and in any event such proposal will be considered timely only if it is otherwise in compliance with the requirements set forth in the By-Laws. The proxy solicited by the Board for the 2010 Annual Meeting of Stockholders will confer discretionary authority to vote as the proxy holders deem advisable on such stockholder proposals which are considered untimely.

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MATTERS TO BE CONSIDERED AT ANNUAL MEETING

PROPOSAL ONE ELECTION OF DIRECTORS

General

Upon the recommendation of the Nominating and Corporate Governance Committee of the Board (the Nominating and Corporate Governance Committee), the Board has proposed for election at the Annual Meeting the eight individuals listed below to serve, subject to the By-Laws, as directors of the Company. All directors are elected annually, and serve until the next Annual Meeting of the Stockholders and until the election and qualification of their successors. If any director is unwilling or unable to stand for re-election (which is not anticipated), the Board may reduce its size or designate a substitute. If a substitute is designated, proxy votes in favor of the original director candidate will be counted for the substituted candidate. All of the nominees for director currently serve as directors.

All of the nominees have consented to be named and, if elected, to serve, and management has no reason to believe that any of them will be unavailable to serve. If any of the nominees is unable or declines to serve as a director at the time of the Annual Meeting, the proxies may be voted in the discretion of the persons acting pursuant to the proxy for the election of other nominees. It is intended that the proxies delivered pursuant to this solicitation will be voted for the election of all such persons except to the extent the proxy is specifically marked to withhold such authority with respect to one or more of such persons. The proxies solicited by this Proxy Statement cannot be voted for a greater number of persons than the number of nominees named. Set forth below is certain information concerning the nominees, as of March 30, 2009.

YOUR BOARD UNANIMOUSLY RECOMMENDS A VOTE FOR EACH OF THESE DIRECTORS.

Name	Age	Position
Alexander A. Alimanestianu	50	Chief Executive Officer, President and Director
Keith E. Alessi	55	Director
Paul N. Arnold	62	Director
Bruce C. Bruckmann	55	Director
J. Rice Edmonds	38	Director
Jason M. Fish	51	Chairman of the Board
Thomas J. Galligan III	64	Director
Kevin McCall	55	Director

Alexander A. Alimanestianu has been our President and Chief Executive Officer since November 2007, when he also was elected as a director. Mr. Alimanestianu joined us in 1990 as Vice President and General Counsel and was appointed Executive Vice President, Development in 1995 and Chief Development Officer in January 2002. He was named President and Chief Development Officer in March 2006. Before joining the Company, Mr. Alimanestianu worked at a law firm that was our outside counsel.

Keith E. Alessi has served as a director since April 1997. Mr. Alessi has been the Executive Chairman of Westmoreland Coal Company since April 2008. From May 2007 until April 2008, Mr. Alessi served as President and Chief Executive Officer of Westmoreland. Mr. Alessi has been an adjunct lecturer at The Ross School of Business at the University of Michigan since 2001. From 2003 to 2006, Mr. Alessi was the Chairman of Lifestyles Improvement Centers LLC, a franchiser of hypnosis centers in the US and Canada. From 1999 to 2007, Mr. Alessi was an adjunct professor at Washington and Lee University School of Law. Mr. Alessi currently serves as a director and chairman of the audit committee for H&E Equipment Services, Inc. and serves as a director of MWI Veterinary Supply, Inc.

Paul N. Arnold has served as a director since April 1997. Mr. Arnold was our Chairman of the Board from May 2006 until February 2009. Mr. Arnold has served as Chairman and Chief Executive Officer of Cort Business Services, Inc., a Berkshire Hathaway company, a provider of rental furniture, since 2000. From 1992 to 2000, Mr. Arnold served as President, Chief Executive Officer and Director of Cort Business Services. Prior

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to 1992, Mr. Arnold held various positions over a 24-year period within Cort Furniture Rental, a division of Mohasco Industries. Mr. Arnold is currently a director of H&E Equipment Services, Inc.

Bruce C. Bruckmann has served as a director since December 1996. Since 1994, Mr. Bruckmann has served as a Managing Director of Bruckmann, Rosser, Sherrill & Co., LP, which we refer to in this Proxy Statement as BRS , a private equity firm. From 1983 until 1994, Mr. Bruckmann served as an officer and subsequently a Managing Director of Citicorp Venture Capital, Ltd. Mr. Bruckmann is currently a director of Mohawk Industries, Inc., H&E Equipment Services, Inc., Heritage-Crystal Clean, Inc. and MWI Veterinary Supply, Inc. and several private companies.

J. Rice Edmonds has served as a director since July 2002. Mr. Edmonds is the founder and Managing Director of Edmonds Capital, LLC, a private equity firm. From 1996 through September 2008, Mr. Edmonds was employed by BRS, most recently as a Managing Director. Prior to 1996, Mr. Edmonds worked in the high yield finance group of Bankers Trust. Mr. Edmonds is currently a director of McCormick & Schmick s Seafood Restaurants, Inc., The Sheridan Group, Inc. and several private companies.

Jason M. Fish has served as a director since December 1996. Mr. Fish was appointed our Chairman of the Board in February 2009. Since March 2009, Mr. Fish has been a consultant to CapitalSource, Inc., a commercial lender, of which he was a co-founder. From March 2008 until December 2008, Mr. Fish was employed by Meritage Group LP, a private investment firm. From September 2000 through December 2006, Mr. Fish was employed by CapitalSource as its President through 2005 and as its Chief Investment Officer and Vice Chairman in 2006. From January 2007 through February 2008, Mr. Fish was a consultant to CapitalSource. Prior to founding CapitalSource, Mr. Fish was employed from 1990 to 2000 by Farallon Capital Management, L.L.C., serving as a managing member from 1992 to 2000. Before joining Farallon, Mr. Fish worked at Lehman Brothers Inc., where he was a Senior Vice President responsible for its financial institution investment banking coverage on the West Coast.

Thomas J. Galligan III has served as a director since March 2007. Mr. Galligan is Executive Chairman and a member of the board of directors of Papa Gino s Holdings Corp. Mr. Galligan served as Chairman, President and Chief Executive Officer of Papa Gino s Holdings Corp. from May 1996 until October 2008 and Chairman and Chief Executive Officer until March 2009. Prior to joining Papa Gino s in March 1995 as Executive Vice President, Mr. Galligan held executive positions at Morse Shoe, Inc. and PepsiCo., Inc. Mr. Galligan is currently a director of Bay State Milling Co. and Dental Service of Massachusetts, Inc., and Chairman of the Board of the Massachusetts Restaurant Association and a Board Advisor to the Boston College Carroll School of Management.

Kevin McCall has served as a director since March 2007. Mr. McCall is President and Chief Executive Officer of Paradigm Properties, LLC and its investment management affiliate, Paradigm Capital Advisors, LLC. Prior to forming Paradigm in 1997, Mr. McCall held positions as a director of Aldrich, Eastman & Waltch, L.P. (now AEW Capital Management, L.P.) and as a Partner and Senior Vice President of Spaulding & Slye Company. Mr. McCall serves as a director of the Boston Center for Community & Justice, the Boston Museum, MetroLacrosse, Hearth, Inc., Building Impact and the National Association of Industrial & Office Parks Massachusetts Chapter.

Required Vote

Directors are elected by the affirmative vote of a plurality of the votes cast by the holders of common stock present in person or represented by proxy and entitled to vote on the election of directors. Withheld votes will have no effect on the outcome of the vote with respect to the election of directors.

Recommendation of the Board of Directors

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR THE ELECTION OF THE NOMINEES LISTED ABOVE.

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PROPOSAL TWO RATIFICATION OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

General

The Audit Committee of the Board (the Audit Committee) has appointed the firm of PricewaterhouseCoopers LLP to serve as the Company s independent registered public accounting firm for the fiscal year ending December 31, 2009, including each quarterly interim period, and the Board is asking the stockholders to ratify this appointment.

Although stockholder ratification of the Audit Committee s appointment of PricewaterhouseCoopers LLP is not required, the Board considers it desirable for the stockholders to pass upon the selection of the independent registered public accounting firm. If the stockholders fail to ratify the appointment, the Audit Committee will reconsider its selection. Even if the selection is ratified, the Audit Committee may, in its discretion, direct the appointment of a different independent registered public accounting firm at any time during the year if the Audit Committee believes that such a change would be in the best interests of the Company and its stockholders.

A representative from PricewaterhouseCoopers LLP is expected to be present at the Annual Meeting, will have the opportunity to make a statement if he or she desires to do so and will be available to respond to appropriate questions.

Fees Billed to the Company by PricewaterhouseCoopers LLP

The aggregate fees billed by PricewaterhouseCoopers LLP for professional services rendered for the audit of the Company s annual financial statements for the fiscal years ended December 31, 2007 and 2008, for the reviews of the financial statements included in the Company s Quarterly Reports on Form 10-Q for those fiscal years and for other services rendered during those fiscal years on behalf of the Company were as follows:

Category	**2007**	**2008**
Audit Fees(1)	$ 1,193,300	$ 1,059,812
Audit-Related Fees(2)	$ 177,000	$ 27,636
Tax Fees(3)	$ 131,000	$ 107,000
All Other Fees(4)	$	$ 96,445

(1) Audit fees are for fees and expenses associated with professional services rendered by PricewaterhouseCoopers in connection with (i) the audits of the Company s annual consolidated financial statements and internal control over financial reporting, including services related to statutory audits of certain of our subsidiaries, (ii) reviews of unaudited interim financial statements included in the Company s quarterly reports on Form 10-Q and (iii) reviews of documents filed with the SEC.

(2) In 2007, audit-related fees were for due diligence related to acquisitions and divestitures and assurance and related services that were reasonably related to the performance of the audits or reviews of the Company s financial statements and not reported under the heading Audit Fees above. In 2008, audit-related fees were for assisting with the implementation of our new financial accounting software application and the review of the Form S-8 related to amendment to our 2006 Stock Incentive Plan.

(3) Tax fees are for tax compliance, tax consulting and tax planning services.

(4) All other fees are for assistance with review and response to communications with the SEC staff relating to disclosure matters.

The Audit Committee has determined that the provision of services discussed above is compatible with maintaining the independence of PricewaterhouseCoopers LLP from the Company.

Pre-Approval Policies and Procedures

The Audit Committee pre-approves all audit and permissible non-audit services. The Audit Committee has authorized each of its members to pre-approve audit, audit-related, tax and non-audit services, provided that such approved service is reviewed with the full Audit Committee at its next meeting.

As early as practicable in each fiscal year, the independent registered public accounting firm provides the Audit Committee with a schedule of the audit and other services that it expects to provide or may provide during the fiscal year. The schedule is specific as to the nature of the proposed services, the proposed fees and other details that the Audit Committee may request. The Audit Committee by resolution authorizes or declines the proposed services. Upon approval, the schedule serves as the budget for fees by specific activity or service for the fiscal year.

A schedule of additional services proposed to be provided by the independent registered public accounting firm or proposed revisions to services already approved, along with associated proposed fees, may be presented to the Audit Committee for its consideration and approval at any time. The schedule is required to be specific as to the nature of the proposed service, the proposed fee, and other details that the Audit Committee may request. The Audit Committee intends by resolution to authorize or decline authorization for each proposed new service.

The Audit Committee pre-approved 100% of the audit fees, audit-related fees and tax fees and all other services for the fiscal years ended December 31, 2008 and 2007.

Required Vote

The affirmative vote of the holders of a majority of the shares of common stock present in person or represented by proxy and having voting power is required to ratify the Audit Committee s selection of PricewaterhouseCoopers LLP. Abstentions will have the effect of a vote against this proposal.

Recommendation of the Board of Directors

THE BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT THE STOCKHOLDERS VOTE FOR THE RATIFICATION OF THE AUDIT COMMITTEE S SELECTION OF PRICEWATERHOUSECOOPERS LLP TO SERVE AS THE COMPANY S INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR THE FISCAL YEAR ENDING DECEMBER 31, 2009.

CORPORATE GOVERNANCE AND BOARD MATTERS

Director Independence

The Board affirmatively has determined that a majority of our directors Messrs. Alessi, Arnold, Edmonds, Fish, Galligan and McCall are independent under, and as required by, the listing standards of The Nasdaq Stock Market. Mr. Alimanestianu is not independent because he is our Chief Executive Officer and President, and Mr. Bruckmann is not independent because of the relationship between Town Sports and BRS, with which Mr. Bruckmann is affiliated. Mr. Robert Giardina, a former director of the Company during the fiscal year ended December 31, 2008, was not independent because he has been employed by the Company within the past three years and currently serves as a consultant to the Company. The relationship between Town Sports and BRS is described under Certain Relationships and Related Transactions Professional Services Agreement with BRS in this Proxy Statement.

Board Structure

The Board has eight members and the following four committees: Audit; Compensation; Nominating and Corporate Governance; and Finance. The membership during the last fiscal year and the function of each of the committees are described below.

Board Committees and Meetings

The Board held eight meetings during the fiscal year ended December 31, 2008, which is referred to in this Proxy Statement as the 2008 Fiscal Year . In the 2008 Fiscal Year, each director who was a member of the Board during 2008 attended or participated in 75% or more of the aggregate of (i) the total number of meetings of the Board, and (ii) the total number of meetings held by all committees of the Board on which such director served (in each case for meetings held during the period in the 2008 Fiscal Year for which such director served).

The Board meets in executive session, without the presence of any of the Company s officers, at least twice per year and upon the request of any independent director. Currently, all directors are independent, except for Messrs. Alimanestianu and Bruckmann.

All members of the Board are encouraged to attend the Company s annual meeting of stockholders. All but one of our directors serving at that time were present at the 2008 annual meeting of our stockholders.

Committee Membership

The following table sets forth the name of each director and the Board committee on which each such director is currently a member:

Name	**Audit**	**Compensation**	**Finance**	**Nominating and Corporate Governance**
Alexander A. Alimanestianu				
Keith E. Alessi	X			
Paul N. Arnold		X*		X
Bruce C. Bruckmann			X	
J. Rice Edmonds			X*	
Jason M. Fish		X	X	X
Thomas J. Galligan III	X*			X*
Kevin McCall	X	X		

* Committee Chair.

Audit Committee

The Audit Committee appoints our independent registered public accounting firm, subject to ratification by our stockholders, reviews the plan for and the results of the independent audit, approves the fees of our independent registered public accounting firm, reviews with management and the independent registered public accounting firm our quarterly and annual financial statements and our internal accounting, financial and disclosure controls, reviews and approves transactions between Town Sports and its officers, directors and affiliates and performs other duties and responsibilities as set forth in a charter approved by the Board. The Audit Committee currently consists of three members of our Board: Keith E. Alessi, Thomas J. Galligan III (Chair) and Kevin McCall. Each member of our Audit

Committee is independent, as independence is defined for purposes of Audit Committee membership by the listing standards of Nasdaq and the applicable rules and regulations of the SEC. The Audit Committee held four meetings during the 2008 Fiscal Year.

The Board has determined that each member of the Audit Committee is able to read and understand fundamental financial statements, including our balance sheet, income statement and cash flow statement, as required by Nasdaq rules. In addition, the Board has determined that both Messrs. Alessi and Galligan satisfy the Nasdaq rule requiring that at least one member of the Audit Committee of our Board have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the member s financial sophistication, including being, or having been, a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities. The Board has also determined that Messrs. Alessi and Galligan are audit committee financial experts as defined by the SEC.

Compensation Committee

The Compensation Committee of our Board evaluates performance and establishes and oversees executive compensation policy and makes decisions about base pay, incentive pay and any supplemental benefits for our executive officers. The Compensation Committee also administers our stock incentive plans and approves the grant of equity awards, the timing of the grants and the number of shares for which equity awards are to be granted to our executive officers, directors and other employees. The Compensation Committee also performs other duties and responsibilities as set forth in a charter approved by the Board. The Compensation Committee currently consists of three members of our Board: Paul N. Arnold (Chair); Jason M. Fish; and Kevin McCall. Each member of the Compensation Committee is independent, as independence is defined for purposes of Compensation Committee membership by the listing standards of Nasdaq. In addition, each member is a non-employee director , as defined under the applicable rules and regulations of the SEC, and an outside director, as defined under applicable federal tax rules. The Compensation Committee held four meetings during the 2008 Fiscal Year.

When considering decisions concerning the compensation of the executive officers listed in the Summary Compensation Table (the Named Executive Officers) (other than the Chief Executive Officer), the Compensation Committee asks for the Chief Executive Officer s recommendations, including his evaluation of each Named Executive Officer s performance. Each December, in connection with the preparation of the Company s annual budget for the immediate succeeding fiscal year, the Chief Executive Officer and the Chief Financial Officer review the compensation of all key employees of the Company, including the Named Executive Officers. Once the Chief Executive Officer and the Chief Financial Officer have finalized the budget, the compensation component of the budget for the Named Executive Officers is submitted to the Compensation Committee for its review and approval. Following its approval, the entire proposed budget is submitted to Board for its review and approval.

No Named Executive Officer has a role in determining or recommending compensation for outside directors.

In addition, the Compensation Committee has the authority under its charter to retain outside consultants or advisors, as it deems necessary or advisable. In making its determinations with respect to executive compensation, the Compensation Committee did not historically engage the services of a compensation consultant. However, beginning in 2008, the Compensation Committee retained the services of Axiom Consulting Partners (Axiom), an independent compensation consultant, to review the executive compensation program of the Company as it pertains to the Chief Executive Officer and the other executive officers.

Axiom maintains no other direct or indirect business relationships with the Company. All executive compensation services provided by Axiom are conducted under the direction or authority of the Compensation Committee, and all work performed by Axiom must be pre-approved by the Compensation Committee or the Chair of the Compensation Committee.

As requested by the Compensation Committee, in 2008, Axiom s services to the Compensation Committee included, among other things, advising with respect to individual compensation for the Named Executive Officers; reviewing and discussing possible aggregate levels of corporate-wide bonus payments and equity awards; preparing comparative analyses of executive compensation levels and elements at peer group companies; and advising as to whether our compensation exceeded or fell below targeted levels and whether the actual amounts paid were commensurate with our operating performance as compared to our peer group companies.

An Axiom representative participated in two of the four Compensation Committee meetings in 2008.

In 2008, we paid Axiom $42,850 for services rendered to the Compensation Committee.

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Nominating and Corporate Governance Committee

The Nominating and Corporate Governance Committee of our Board selects nominees to be recommended by the Board for election as directors and for any vacancies in such positions. The Nominating and Corporate Governance Committee also oversees the evaluation of our Board and management and oversees our Code of Ethics and Business Conduct. The Nominating and Corporate Governance Committee also performs other duties and responsibilities as set forth in a charter approved by the Board. The Nominating and Corporate Governance Committee currently consists of three members of our Board: Paul N. Arnold; Jason M. Fish; and Thomas Galligan (Chair). Each member of the Nominating and Corporate Governance Committee is independent, as independence is defined for purposes of Nominating and Corporate Governance Committee membership by the listing standards of Nasdaq. The Nominating and Corporate Governance Committee held no meetings during the 2008 Fiscal Year but acted by unanimous written consent in one instance.

The Nominating and Corporate Governance Committee considers director nominees on a case-by-case basis, and therefore has not formalized any specific, minimum qualifications that it believes must be met by a director nominee, identified any specific qualities or skills that it believes are necessary for one or more of our directors to possess, or formalized a process for identifying and evaluating nominees for director, including nominees recommended by stockholders.

The Nominating and Corporate Governance Committee s policy is to consider director candidates that are recommended by stockholders. The Nominating and Corporate Governance Committee will evaluate nominees for director recommended by stockholders in the same manner as nominees recommended by other sources. Stockholders wishing to bring a nomination for a director candidate at a stockholders meeting must give written notice to our Corporate Secretary, pursuant to the procedures set forth in the section of this Proxy Statement titled Communicating with the Board of Directors and subject to the deadline set forth in the section titled Deadline for Receipt of Stockholder Proposals. The stockholder s notice must set forth all information relating to each person whom the stockholder proposes to nominate that is required to be disclosed under applicable rules and regulations of the SEC and our By-Laws.

Finance Committee

The Finance Committee of our Board is responsible for (1) overseeing and reviewing the financial affairs and policies of the Company and the implementation of such policies, (2) overseeing all material potential business and financial transactions, and (3) any other duties assigned by the Board. The Finance Committee held two meetings during the 2008 Fiscal Year.

Communicating with the Board of Directors

Stockholders and other interested parties may communicate with the Board, including the non-management directors as a group, by writing to the Board, c/o Corporate Secretary, Town Sports International Holdings, Inc. at 5 Penn Plaza (4th Floor), New York, New York 10001. Inquiries will be reviewed by the Company s Corporate Secretary and will be distributed to the appropriate members of the Board depending on the facts and circumstances outlined in the communication received. For example, if a complaint concerning accounting, internal accounting controls or auditing matters was received, it would be forwarded by the Corporate Secretary to the Audit Committee. The Corporate Secretary has the authority to discard or disregard any communication that is unduly hostile, threatening, illegal or otherwise inappropriate.

Corporate Governance Documents

The Board has adopted a Code of Ethics and Business Conduct that applies to all officers, directors and employees, including our principal executive officer, principal financial officer and principal accounting officer or controller. The Code of Ethics and Business Conduct can be accessed in the Investor Relations Corporate Governance section of our website at www.mysportsclubs.com, as well as any amendments to, or waivers under, the Code of Ethics and Business Conduct with respect to our principal executive officer, principal financial officer and principal accounting officer or controller. Copies may be obtained without charge by writing to Town Sports International Holdings, Inc., 5 Penn Plaza (4th Floor), New York, New York

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10001, Attention: Investor Relations. Copies of the charters of the Audit Committee, Compensation Committee, Nominating and Corporate Governance Committee and Finance Committee of our Board of Directors, as well as copies of our certificate of incorporation and By-Laws, can also be accessed in the Investor Relations Corporate Governance section of our website at www.mysportsclubs.com.

Directors Compensation for the 2008 Fiscal Year

Under our director compensation policy currently in effect, directors who are also officers or employees of the Company receive no additional compensation for services as a director, committee participation or special assignments.

Directors who are not officers or employees of the Company or any of its subsidiaries (each, a Non-Employee Director) receive the following compensation:

Each Non-Employee Director will receive a $20,000 annual retainer, payable quarterly in arrears. For each year, commencing in 2008, any such Board member may elect (by giving written notice to the Company on or before the first business day of the applicable calendar year) to receive such annual retainer in the form of shares of common stock, payable quarterly in arrears under the 2006 Stock Incentive Plan (with the value of such shares of common stock being the Fair Market Value (as defined in the 2006 Stock Incentive Plan) thereof on the last business day of each calendar quarter). This annual retainer will be pro rated for any partial year.

The chairman of the Audit Committee will receive an additional $10,000 annual retainer, payable quarterly in arrears. For each year, commencing in 2008, the chairman of the Audit Committee may elect (by giving written notice to the Company on or before the first business day of the applicable calendar year) to receive such annual retainer in the form of shares of our common stock, payable quarterly in arrears under the 2006 Stock Incentive Plan (with the value of such shares of common stock being the Fair Market Value thereof on the last business day of each calendar quarter). This additional annual retainer will be pro rated for any partial year.

Each Non-Employee Director will receive an annual grant on the first business day of each calendar year of stock options to purchase 1,000 shares of our common stock with the exercise price being the Fair Market Value thereof on the date of the grant. Each annual grant will vest on the first anniversary of the grant.

Each new Non-Employee Director joining the Board will receive an initial grant of stock options to purchase 5,000 shares of our common stock with the exercise price being the Fair Market Value thereof on the date of the grant. The grant will vest in three equal installments on the first, second and third anniversaries of the grant. Each new Non-Employee Director will be eligible in the following year to receive the annual stock option grant referred to above.

Each Non-Employee Director will receive an additional $3,000 for each meeting of the Board that such director attends in person and an additional $1,000 for each meeting of the Board that such director attends via telephone.

Each Non-Employee Director who is a member of a committee (other than the Audit Committee) will receive an additional $1,000 for each committee meeting that such director attends in person and an additional $500 for each committee meeting that such director attends via telephone.

Each Non-Employee Director who is a member of the Audit Committee will receive an additional $2,500 for each Audit Committee meeting that such director attends in person and an additional $1,000 for each Audit

Committee meeting that such director attends via telephone.

We also reimburse directors for any out-of-pocket expenses incurred by them in connection with services provided in such capacity.

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The following table sets forth information concerning the compensation to each of our Non-Employee Directors in the 2008 Fiscal Year:

Name	Fees Earned or Paid in Cash ($)(1)	Option Awards ($)(2)	All Other Compensation ($)	Total ($)
Keith E. Alessi(3)	34,500	4,028		38,528
Paul N. Arnold	35,991	4,028		40,109
Bruce C. Bruckmann(4)	9,000			9,000
J. Rice Edmonds(4)	9,000			9,000
Jason M. Fish	35,491	4,028		39,519
Thomas J. Galligan III(3)	47,996	4,028		52,024
Kevin McCall	45,491	4,028		49,519
Robert Giardina(5)			45,000	45,000

(1) Messrs. Arnold, Fish, Galligan and McCall elected to receive their annual retainers, included in the amounts shown in this column, in shares of common stock of the Company rather than cash. Such shares were paid quarterly in arrears, the number of such shares being determined based on the fair market value of the Company s common stock on the date of payment.

(2) This column represents the dollar amount recognized for financial statement reporting purposes with respect to the 2008 Fiscal Year for the fair value of stock options granted to each of the Non-Employee Directors in Fiscal Year 2008 as well as prior fiscal years, in accordance with Financial Accounting Standards Board Revised Statement of Financial Accounting Standards No. 123, *Share-Based Payment* (FAS 123R). Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to all grants reflected in this column, refer to note 10(b) to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as filed with the SEC. These amounts reflect the Company s accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Non-Employee Directors.

(3) Prior to April 1, 2008, Mr. Alessi served as Chair of the Audit Committee, at which time Mr. Galligan became chairperson.

(4) Messrs. Bruckmann and Edmonds began receiving the compensation described above starting on September 16, 2008, in connection with the termination of the Professional Services Agreement, as further described below under Certain Relationships and Related Transactions Professional Services Agreement with BRS.

(5) Mr. Giardina resigned from the Company s Board of Directors on November 3, 2008. While on the Board, Mr. Giardina did not earn any compensation as a director pursuant to the terms of his Letter Agreement with the Company. Mr. Giardina earned $45,000 for consulting services provided to the Company in 2008. In addition, Mr. Giardina was entitled to severance benefits specified in his Letter Agreement. See Certain Relationships and Related Transactions Agreement with Robert Giardina for more information about the Company s consulting arrangement with Mr. Giardina and severance benefits paid to him by the Company.

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The following table details grants of stock option awards to each of our Non-Employee Directors in 2008. The table includes the grant date and grant date fair value of each 2008 stock option award, and the aggregate number of outstanding, unvested stock option awards as of December 31, 2008 owned by each Non-Employee Director who served as a director during the 2008 Fiscal Year:

Name	Grant Date(1)	Option Awards (#)	Grant Date Fair Value ($)(2)	Total Number of Outstanding Unvested Stock Option Awards (#)
Keith E. Alessi	1/2/2008	1,000	4,028	1,000
Paul N. Arnold	1/2/2008	1,000	4,028	1,000
Bruce C. Bruckmann(3)				
J. Rice Edmonds(3)				
Jason M. Fish	1/2/2008	1,000	4,028	1,000
Thomas J. Galligan III	1/2/2008	1,000	4,028	4,333.33
Kevin McCall	1/2/2008	1,000	4,028	4,333.33
Robert Giardina(4)				

(1) The 2008 Fiscal Year grants relate to the annual issuance of stock option grants to the Non-Employee Directors, which awards have an exercise price of $9.35 and vested on January 2, 2009.

(2) This column represents the full grant date fair value for financial statement reporting purposes with respect to the 2008 Fiscal Year of stock options granted to each of the Non-Employee Directors in Fiscal Year 2008, in accordance with FAS 123R. Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to the 2008 grants, refer to note 10(b) to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as filed with the SEC. These amounts reflect the Company s accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Non-Employee Directors.

(3) Messrs. Bruckmann and Edmonds did not receive a grant of stock options in the 2008 Fiscal Year because at the time the grants were made, they were not entitled to receive compensation for their services as directors pursuant to the Professional Services Agreement, as further described below under Certain Relationships and Related Transactions Professional Services Agreement with BRS.

(4) Mr. Giardina resigned from the Company s Board of Directors on November 3, 2008. While on the Board, Mr. Giardina did not earn any compensation as a director pursuant to the terms of his Letter Agreement with the Company. See Certain Relationships and Related Transactions Agreement with Robert Giardina for more information about the Company s consulting arrangement with Mr. Giardina and severance benefits paid to him by the Company.

Compensation Committee Interlocks and Insider Participation

Except as set forth below, during the 2008 Fiscal Year, there were no compensation committee interlocks (as that term is defined in SEC rules). The current members of the Compensation Committee are Messrs. Arnold, Fish and McCall, none of whom is a current or former officer or employee of the Company or any of its subsidiaries. During the 2008 Fiscal Year:

- none of the members of the Compensation Committee was an officer (or former officer) or employee of the Company or any of its subsidiaries;

none of the members of the Compensation Committee had a direct or indirect material interest in any transaction in which the Company was a participant and the amount involved exceeded $120,000, except that on March 13, 2009, Jason Fish, one of our directors and a member of the Compensation Committee, acquired through open market purchases $4,000,000 principal amount of our 11% Senior Discount Notes Due 2014 (described in Note 7 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008);

none of our executive officers served on the compensation committee (or another board committee with similar functions or, if none, the entire board of directors) of another entity where one of that entity s executive officers served on our Compensation Committee;

none of our executive officers was a director of another entity where one of that entity s executive officers served on our Compensation Committee; and

none of our executive officers served on the compensation committee (or another board committee with similar functions or, if none, the entire board of directors) of another entity where one of that entity s executive officers served as a director on our Board.

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OWNERSHIP OF SECURITIES

The following table sets forth information with respect to the beneficial ownership of our outstanding common stock as of March 15, 2009, by (1) each person or group of affiliated persons whom we know to beneficially own more than five percent of our common stock; (2) each of the Named Executive Officers; (3) each of our directors and director nominees; and (4) all of our current directors and executive officers as a group.

Name and Address	Number of Shares Beneficially Owned**	Percentage of Common Stock Outstanding***
5% Stockholders		
BRSE Associates, Inc.(1)	1,770,379	7.9%
Farallon Entities(2)	5,331,279	23.7%
Paradigm Capital Management, Inc.(3)	1,497,740	6.6%
Named Executive Officers and Directors		
Alexander A. Alimanestianu(4)	527,246	2.3%
Martin J. Annese(5)	25,000	*
Daniel Gallagher(6)	66,850	*
David Kastin(7)	12,500	*
Jennifer H. Prue(8)	66,100	*
Keith E. Alessi(9)	51,998	*
Paul N. Arnold(10)	46,641	*
Bruce C. Bruckmann(11)	806,994	3.6%
J. Rice Edmonds	7,000	*
Jason M. Fish(12)	5,701	*
Thomas J. Galligan III(13)	9,496	*
Kevin McCall(14)	8,034	*
Richard G. Pyle	419,740	1.9%
Directors and Executive Officers as a group (13 persons)(15)	1,648,561	7.2%

* Less than 1%.

** For purposes of this table, beneficial ownership is determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934 pursuant to which a person or group of persons is deemed to have beneficial ownership of any shares of common stock with respect to which such person has (or has the right to acquire within 60 days, i.e., by May 14, 2009 in this case) sole or shared voting power or investment power.

*** Percentage of beneficial ownership is based on 22,532,166 shares of common stock outstanding at March 15, 2009.

(1) Based on our review of the Schedule 13G filed with the SEC on February 12, 2009 by BRSE Associates, Inc., whose address is 126 East 56th Street, New York, New York 10022. Excludes shares held individually by Mr. Bruckmann and other individuals (and affiliates and family members thereof), each of whom are affiliated with BRSE Associates, Inc.

(2) Based on our review of the Schedule 13D filed with the SEC on January 6, 2009 by the entities and persons set forth below, whose address is One Maritime Plaza, Suite 2100, San Francisco, California 94111. Consists of 1,396,011 shares directly held by Farallon Capital Partners, L.P. (FCP), 1,574,334 shares directly held by Farallon Capital Institutional Partners, L.P. (FCIP), 1,021,256 shares directly held by Farallon Capital Institutional Partners II, L.P. (FCIP II), 2,500 shares directly held by Farallon Capital Institutional Partners III, L.P. (FCIP III), 2,500 shares directly held by Tinicum Partners, L.P. (Tinicum), 254,063 shares directly held by RR Capital Partners, L.P. (RR), 65,981 shares directly held by

Farallon Capital Offshore Investors II, L.P. (FCOI II), 465,337 shares directly held by Farallon FCP, Ltc. (FCP Trust), 524,778 shares directly held by Farallon FCIP, Ltd. (FCIP Trust) and 24,519 shares directly held by Farallon FCOI II, Ltd. (collectively with FCP, FCIP, FCIP II, FCIP III, Tinicum, RR, FCOI II, the FCP Trust, and the FCIP Trust, the Farallon Entities). As the general partner of each of the Farallon Entities, Farallon Partners, L.L.C. (FPLLC) may, for purposes of Rule 13d-3 under the Exchange Act, be deemed to own beneficially the shares held by the Farallon Entities. As managing members of FPLLC, William F. Duhamel, Richard B. Fried, Daniel J. Hirsch, Monica R. Landry, Douglas M. MacMahon, William F. Mellin, Stephen L. Millham, Jason E. Moment, Ashish H. Pant, Rajiv A. Patel, Andrew J. M. Spokes, Thomas F. Steyer, Richard H. Voon and Mark C. Wehrly, may each, for purposes of Rule 13d-3 under the Exchange Act, be deemed to own beneficially the shares held by the Farallon Entities. FPLLC and each of its managing members disclaim any beneficial ownership of such shares. All of the above-mentioned entities and individuals disclaim group attribution.

(3) Based on our review of the Schedule 13G filed with the SEC on February 17, 2009 by Paradigm Capital Management, Inc., whose address is 9 Elk Street, Albany, New York 12207. All of the shares listed in the Schedule 13G are owned by advisory clients of Paradigm.

(4) Includes 75,000 shares of common stock issuable upon exercise of options before May 14, 2009.

(5) Includes 25,000 shares of common stock issuable upon exercise of options before May 14, 2009.

(6) Includes 58,450 shares of common stock issuable upon exercise of options before May 14, 2009.

(7) Includes 2,500 shares of common stock issuable upon exercise of options before May 14, 2009. Also includes 10,000 shares of restricted stock, which vests annually, in four equal installments, commencing on the first anniversary of the grant date (June 13, 2008).

(8) Includes 57,700 shares of common stock issuable upon exercise of options before May 14, 2009.

(9) Includes 2,000 shares of common stock issuable upon exercise of options before May 14, 2009.

(10) Includes 2,000 shares of common stock issuable upon exercise of options before May 14, 2009.

(11) Includes 41,599 shares held by family members or by partnership investments of Mr. Bruckmann and 354,077 shares held in trust for the benefit of Mr. Bruckmann s children, in which Mr. Bruckmann s wife is the trustee; Mr. Bruckmann disclaims beneficial ownership of these shares. Excludes shares held by BRSE Associates, Inc., of which Mr. Bruckmann disclaims beneficial ownership.

(12) Includes 2,000 shares of common stock issuable upon exercise of options before May 14, 2009.

(13) Includes 4,333 shares of common stock issuable upon exercise of options before May 14, 2009.

(14) Includes 4,333 shares of common stock issuable upon exercise of options before May 14, 2009.

(15) Includes 238,816 shares of common stock issuable upon exercise of options on or before May 14, 2009. Excludes the shares owned by Richard G. Pyle who was no longer an executive officer on March 15, 2009.

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SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

The members of our Board, our executive officers and persons who hold more than 10% of our outstanding common stock are subject to the reporting requirements of Section 16(a) of the Securities Exchange Act of 1934, as amended, which requires them to file reports with respect to their ownership of our common stock and their transactions in such common stock. Based solely upon a review of (1) the copies of Section 16(a) reports which Town Sports has received from such persons or entities for transactions in our common stock and their common stock holdings for the 2008 Fiscal Year, and (2) the written representations received from one or more of such persons or entities that no annual Form 5 reports were required to be filed by them for the 2008 Fiscal Year, Town Sports believes that all reporting requirements under Section 16(a) for such fiscal year were met in a timely manner by its directors, executive officers and beneficial owners of more than ten percent of its common stock.

EXECUTIVE OFFICERS

The executive officers of Town Sports, and their ages and positions as of March 15, 2009, are:

Name	Age	Position
Alexander A. Alimanestianu	50	Chief Executive Officer, President and Director
Martin J. Annese	50	Chief Operating Officer
Daniel Gallagher	41	Senior Vice President Chief Financial Officer
David M. Kastin	41	Senior Vice President General Counsel and Corporate Secretary
Jennifer H. Prue	59	Chief Information Officer
James Rizzo	61	Senior Vice President Human Resources

Mr. Alimanestianu s biography follows the table listing our directors. Biographies for our other executive officers are:

Martin J. Annese joined us in April 2008 as Chief Operating Officer. Prior to that time, Mr. Annese was employed as an executive performance consultant at Woodstone Consulting Company, a management consulting firm, since 2006. From 1997 through 2005, Mr. Annese held various senior level positions at Starbucks Coffee Company, most recently as Senior Vice President, Northeast Zone, responsible for more than 1,100 stores. From 1983 through 1997, Mr. Annese held several executive level positions at PepsiCo, Inc. From 1980 till 1983, Mr. Annese was a Senior Auditor at Arthur Young and Company.

Daniel Gallagher joined us in February 1999 as Vice President Finance. He was promoted to Senior Vice President Finance in November 2007. On January 22, 2008 we announced Mr. Gallagher s promotion to Senior Vice President Chief Financial Officer, effective as of March 31, 2008. Mr. Gallagher is a former Certified Public Accountant in the State of New York and holds a Bachelors of Science in Accounting from Villanova University. Mr. Gallagher began his career with Coopers and Lybrand in the Business Assurance Practice (audit). After the merger of Coopers and Lybrand with Price Waterhouse, his career continued in a management role and joined the Mergers and Acquisition Consulting Group in 1998.

David M. Kastin joined us in August 2007 as our Senior Vice President General Counsel and Corporate Secretary. From March 2007 through July 2007, Mr. Kastin was Senior Associate General Counsel and Corporate Secretary of Sequa Corporation, a diversified manufacturer. From March 2003 through December 2006, Mr. Kastin was in-house counsel at Toys R Us, Inc., most recently as Vice President Deputy General Counsel. From 1996 through 2003, Mr. Kastin was an associate in the corporate and securities departments at several prominent New York law firms, including Bryan Cave LLP. From September 1992 through October 1996, Mr. Kastin was a Staff Attorney in the Northeast Regional Office of the U.S. Securities and Exchange Commission.

Jennifer H. Prue joined us in 2000 as Vice President and Chief Information Officer. In 2002, she was promoted to Senior Vice President. Prior to joining us, she was employed by Integrated Management Services as a regional vice president where she served clients in various technology consulting roles, including as acting chief information officer, within the financial services, energy, and manufacturing industries. Prior to her years in consulting, Ms. Prue served in senior management roles in both accounting and information services in service and manufacturing industries, including Tupperware US.

James Rizzo joined us in February 2007 as our Senior Vice President Human Resources. From October 1998 until February 2007, Mr. Rizzo was Vice President-Human Resources for Duane Reade Inc., where he was also a member of the company s strategic executive committee. From April 1995 until September 1998, Mr. Rizzo was President and Chief Operating Officer for Holbrook-Patterson, Inc. From 1989 until 1995, Mr. Rizzo was Vice President Human Resources at Childcraft, Inc. a subsidiary of The Walt Disney Corp. He also was President of Personnel Systems Company and held senior Human Resource positions with Talbots Inc., Hit or Miss Stores and the Melville Corporation.

EXECUTIVE COMPENSATION

Compensation Discussion and Analysis

Compensation Objectives and Strategy

The Company s compensation program for our executive officers is designed to attract and retain the caliber of officers needed to ensure the Company s continued growth and profitability and to reward them for their performance, the Company s performance and for creating longer term value for the Company s stockholders. The primary objectives of the program are to:

Attract and retain top tier executive talent who will draw upon their experience across industries to lead the Company in meeting its objectives

Our overall compensation levels are targeted to attract and retain the best executives in light of the competition for executive talent. The Compensation Committee generally targets total direct compensation (base salary plus annual non-equity incentive compensation at target plus stock-based long-term incentive opportunity) at the market median for target performance. However, the competitiveness of individual components (such as base salary, annual non-equity incentive compensation or long-term incentive opportunity) may at times be below or above the market median due to performance achievement against goals, diversity of executive background, employment history and/or labor market demands.

Motivate and reward the achievement of critical strategic, operational and financial objectives through highly transparent programs that directly link performance and pay

A significant component of an executive officer s total compensation package is annual non-equity incentive compensation which links an executive officer s compensation directly to specific financial performance goals of the Company. If the Company does not meet the financial performance targets set by the Compensation Committee, the executive officers generally would not receive any annual non-equity incentive compensation.

Reward for collective accomplishments to support the Company s strong team orientation while promoting individual accountability through achievement of individual goals and milestones

Compensation depends in significant measure on Company results, but individual accomplishments are also important factors in determining each Named Executive Officer s compensation. For example, annual non-equity incentive compensation is based not only on the financial performance of the Company, but may be adjusted based on a review of the individual performance of an executive. The Compensation Committee also has the ability to award discretionary cash bonuses based on the individual s achievements throughout the year.

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Align the interests of executives with those of shareholders

The Compensation Committee believes that the interests of executives and shareholders should be substantially aligned. Accordingly, a portion of the total compensation for the Named Executive Officers is in the form of stock-based compensation, which the Compensation Committee believes keeps the interests of executives aligned with those of the Company s stockholders and promotes a long-term commitment to the Company.

The Company s executive compensation programs are approved and administered by the Compensation Committee of the Board. Working with management, the Compensation Committee has developed a compensation and benefits strategy that rewards performance and behaviors and reinforces a culture that the Compensation Committee believes will drive long-term success.

Compensation Determination Process

The Compensation Committee is responsible for setting our executive compensation objectives and policies, establishing our executive compensation program consistent with those objectives and policies and determining the compensation for our executive officers. Determining the appropriate level of executive compensation is not an exact science and involves careful deliberation and business judgment. See Corporate Governance and Board Matters Committee Membership Compensation Committee for more information on the Compensation Committee and its practices.

The compensation of the Chief Executive Officer (CEO) is determined by the Compensation Committee based on (1) the Compensation Committee s assessment of the Company s overall performance and the individual performance of the CEO, (2) previous compensation levels provided to the CEO and (3) comparable compensation data for the Compensation Comparison Group (as defined below) provided by Axiom.

With respect to compensation for the other Named Executive Officers, the Compensation Committee considers a variety of factors, including Company and individual performance, the recommendations of the CEO, and comparable compensation data for the Compensation Comparison Group provided by Axiom.

The Compensation Committee, with the assistance of Axiom and the CEO (with respect to the other Named Executive Officers only), seeks to set the target for total direct compensation (that is, the sum of base salary, annual non-equity incentive compensation and stock-based long-term incentive awards) of our executives, including the Named Executive Officers, at levels that are competitive with equivalent positions at a select group of companies that the Compensation Committee believes to be an appropriate reference group (the Compensation Comparison Group). Data for the Compensation Comparison Group includes (1) information about a peer group of companies and (2) data from well-established, publicly available general industry compensation surveys that have been calibrated to compare to companies of the Company s size. The peer group is a group primarily consisting of employee-intensive companies of comparable size that deliver brand-oriented, upscale, discretionary fitness and lifestyle-oriented services in comparatively large facilities, concentrated in and around metropolitan areas. The second group is composed of public companies with median revenue and/or market capitalization comparable to that of the Company. We regard the peer group as potential competition for executive talent. The Compensation Committee believes that the inclusion of information regarding general industry compensation practices reflects the labor market for those executive positions that are not industry-specific, adding to the validity and reliability of the comparison.

In 2008, the Company s peer group consisted of the following companies: Bally Total Fitness Holding Corp.; Big 5 Sporting Goods Corp.; California Pizza Kitchen, Inc.; The Cheesecake Factory, Inc.; Golfsmith Int l Holdings, Interstate Hotels and Resorts; Life Time Fitness, Inc.; McCormick & Schmick s Seafood Restaurants, Inc.; Morton s Restaurant Group Inc.; PF Chang s China Bistro; Sport Chalet, Inc.; The Sports Club Company, Inc.; and Standard

Parking Corp.

Pay Levels and Benchmarking

Pay levels for the Named Executive Officers are determined based on a number of factors, including the individual s roles and responsibilities within the Company, the individual s experience and expertise, the pay

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levels for peers within the Company, pay levels in the marketplace for similar positions, and performance of the individual and the Company as a whole. In determining the pay levels, the Compensation Committee considers all forms of compensation and benefits. Prior to the engagement of Axiom, the Compensation Committee did not historically establish benchmarks for the compensation of the Named Executive Officers, and instead, determined compensation levels based on the compensation of other executives of the Company and the general performance of the Company. In 2008, the Company, with the assistance of Axiom, began to benchmark the compensation of executives against that of the Compensation Comparison Group. The Compensation Committee has begun to target total direct compensation (that is, the sum of base salary, annual cash bonuses and stock-based long-term incentive awards) at the market median for target performance. However, as noted above, notwithstanding the Company s overall pay positioning objectives, pay opportunities for specific individuals vary based on a number of factors such as performance achievement against goals, the diversity of executive backgrounds, employment history and labor market demands.

Compensation Structure

Pay Elements Overview

The Company utilizes five main components of compensation:

Base Salary fixed cash compensation to attract and retain key executives, recognizing and rewarding the application of their skills and experience in fulfillment of their position responsibilities.

Annual Incentive variable cash compensation paid in accordance with the achievement of established annual objectives.

Annual Discretionary Bonus variable cash compensation paid based on an employee s individual performance throughout the year.

Long-term Incentives equity based compensation that grows in value in accordance with long-term value creation, aligning executive and shareholder interests, and giving executives an opportunity to participate in the Company s success over time.

Benefits and Perquisites these may include disability insurance, medical and dental insurance benefits and retirement savings and free membership to the clubs.

Pay Elements Details

1. Base Salary

As part of its review of the annual budget for the immediate succeeding fiscal year, the Board reviews the base salaries and other compensation for our Named Executive Officers and makes adjustments as warranted based on individual responsibilities and performance, Company performance in light of market conditions and competitive practice. Salary adjustments for any given year are generally approved at the end of the immediately preceding year and implemented during the first quarter of the calendar year.

Historically, salary increases have been based on cost of living increases and range from 3-4%. The 2008 salaries of the Named Executive Officers, other than Mr. Gallagher, were increased by 3-4% over annualized 2007 levels. Salary increases for Named Executive Officers are generally consistent with those of other management employees. Given current market conditions, there will be no salary increases based on cost of living increases for the 2009 fiscal year.

Mr. Gallagher received a salary increase in the 2008 Fiscal Year of $62,500 and an additional increase of $25,000 effective January 1, 2009 in connection with his promotion to Chief Financial Officer, based on the Compensation Committee s review of base salaries of other internal management positions and an informal review of base salaries for competitive positions at other companies. Following the engagement of Axiom as the Company s independent compensation consultant, the Compensation Committee reviewed Mr. Gallagher s compensation arrangements with Axiom and concluded that Mr. Gallagher s new salary was competitive with the median of base salaries for the Compensation Comparison Group for executives in similar positions.

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In connection with Mr. Annese s hiring in April 2008, the Compensation Committee set Mr. Annese s base salary in consultation with Axiom, in order to target Mr. Annese s base salary to be competitive with the median of the Compensation Comparison Group for executives in similar positions.

Base salaries for the Company s most highly compensated employees, including the Named Executive Officers for 2008, were slightly above the competitive median salaries within the Compensation Comparison Group (13% based on the calculations of the compensation consultant). Individual salaries may range above or below the median based on a variety of factors, including the potential impact of the executive s role at the Company, the terms of the executive s employment agreement, if any, the experience the executive brings to the position and the performance and potential of the executive in his or her role.

2. Annual Incentive Compensation

Annual incentive compensation for designated key employees is paid under our 2006 Annual Performance Bonus Plan (the Bonus Plan). The Bonus Plan is designed to grant bonus awards to such individuals as an incentive to contribute to our profitability. The Compensation Committee administers the plan and selects the key employees, which may include Named Executive Officers, who are eligible to participate in the Bonus Plan each year. Bonus targets are set at a percentage of base salary and are paid based on the Company s achievement of performance goals established on or before March 15th of the applicable calendar year and the attainment of personal performance objectives established individually by each employee at the beginning of each year. We seek to calibrate annual term incentive opportunities to generate less-than-median awards when goals are not fully achieved and greater-than-median awards when goals are exceeded. On average, for the 2008 Fiscal Year, the annual incentive compensation targets for the Company s most highly compensated employees, including the Named Executive Officers, were at the median for the Compensation Comparison Group.

Under the Bonus Plan, participants are eligible to receive bonus awards that may be expressed, at the Compensation Committee s discretion, as a fixed dollar amount, a percentage of compensation (whether base pay, total pay or otherwise) or an amount determined pursuant to a formula. Annual non-equity incentive awards are contingent upon the attainment of certain pre-established performance targets established by the Compensation Committee, which may include, without limitation, the following:

- earnings per share;
- return on equity, assets or capital;
- gross or net revenues;
- earnings before interest, taxes, depreciation and amortization (EBITDA); or
- such other goals established by the Committee.

The amount of an annual non-equity incentive compensation award may also depend on the performance of the employee.

For the 2008 Fiscal Year, bonuses were based on an Adjusted EBITDA target as follows:

	Goal	Actual Performance

Adjusted EBITDA (as defined)	$ 122,268,598	$ 111,936,920

The definition of Adjusted EBITDA for executive bonus computation purposes is earnings before interest, taxes, depreciation, amortization and compensation expense incurred in connection with stock options of the Company and items of a non-recurring nature. In the 2008 Fiscal Year, these non-recurring items included various legal, compliance and other expenses. In addition, goodwill and fixed asset impairment charges were not deducted when determining the calculation of Adjusted EBITDA. All of these adjustments were approved by the Compensation Committee. See Narrative Supplement to the Summary Compensation Table and the 2008 Grants of Plan-Based Awards Table for more information on the payment and calculation of amounts under the Bonus Plan. The determination of the amount of the annual non-equity incentive compensation award is also subject to the executive officer s attainment of personal performance objectives established individually by each employee at the beginning of each year.

3. Discretionary Cash Bonus

In the 2008 Fiscal Year, the Compensation Committee decided to award, in addition to awards under the Bonus Plan, additional cash bonuses to certain Named Executive Officers in recognition of their personal performance. These bonuses were fully discretionary and were awarded after a discussion with the Chief Executive Officer and a review of each Named Executive Officer s performance throughout the year. In connection with awarding discretionary cash bonuses, the Compensation Committee considered the significant accomplishments and overall leadership of the executive, competitive pay levels for the executive and (except in the case of the Chief Executive Officer) the recommendation of the Chief Executive Officer. In respect of the 2008 Fiscal Year, the following discretionary bonuses were awarded to the Named Executive Officers: Mr. Gallagher ($31,250); Mr. Annese ($68,438); and Mr. Kastin ($15,000).

4. Long-term Incentives Equity-Based Awards

The Company and the Compensation Committee believe that equity-based awards are an important factor in aligning the long-term financial interest of the officers and stockholders. The Compensation Committee designs long-term incentive awards to ensure that our executive officers have a continuing stake in the long-term success of the Company, that the total compensation realized by our executive officers reflects our multi-year performance as measured by the efficient use of capital and changes in shareholder value, and that a large portion of the total compensation opportunity is earned over a multi-year period and is forfeitable in the event of termination of employment.

The Compensation Committee continually evaluates the use of equity-based awards and intends to continue to use such awards in the future as part of designing and administering the Company s compensation program. The Company expects to make grants at regular intervals.

The Compensation Committee may grant equity incentives under the Company s 2004 Common Stock Option Plan, as amended, in the form of non-qualified and incentive stock options and the 2006 Stock Incentive Plan, as amended (the 2006 Stock Incentive Plan), in the form of stock options (non-qualified and incentive stock options), stock appreciation rights, restricted stock, performance shares and other stock-based awards (including restricted stock units (RSUs) and deferred stock units).

The Company follows a practice of granting equity incentives in the form of stock options on an annual basis to employees. On occasion, the Company may also make awards of restricted stock. The Company also may make grants to new employees on the commencement of employment and to key employees following a significant change in job responsibilities or to meet specific retention objectives. Grants are issued on the date they are approved by the Compensation Committee, except in certain circumstances, such as for new hires, who may be granted awards on the second day after the Company releases its financial results for that quarter. The exercise price for stock options is the grant date closing market price per share. Historically, the Compensation Committee has granted stock options and restricted stock which vest in four equal annual installments, beginning on the first anniversary of the grant date, and subject to continuous employment from the date of grant until the applicable vesting date. We believe that this vesting schedule reinforces the long-term orientation of our compensation philosophy. In the past, some options have contained accelerated vesting features upon the achievement by the Company of pre-determined equity value targets. The Compensation Committee has not awarded other stock-based awards in the past.

In the Fiscal Year 2008, the Compensation Committee granted stock options to our Named Executive Officers as indicated in the 2008 Grants of Plan-Based Awards Table which vest in four equal annual installments, beginning on the first anniversary of the grant date, and subject to continuous employment from the date of grant until the applicable vesting date. In determining the amount of the equity and equity-based awards to be granted to the Named Executive Officers in 2008, the Compensation Committee targeted the annual grant to be competitive with the Compensation Comparison Group. In addition, in the 2008 Fiscal Year, the Compensation Committee granted Mr. Kastin shares of restricted stock in recognition of the Compensation

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Committee s view that his previous equity grant of stock options made during the 2007 fiscal year failed to serve adequately as a retention device given the high exercise price of the options. The Compensation Committee believes that the restricted stock grant, because it provides both depreciation risk and appreciation opportunity, more effectively aligns Mr. Kastin s interests with those of the Company s stockholders.

5. Other Benefits and Perquisites

The Company s executive compensation program includes other benefits and perquisites. We maintain a 401(k) plan for our eligible employees and Named Executive Officers with annual matching contributions up to $500 per year which vest over four years. In addition, for all employees we also provide medical benefits and free memberships in the Company s clubs. In the past, perquisites included, in some cases, automobile allowances and accommodation allowances, although such allowances were discontinued before the beginning of 2008. The Company annually reviews these other benefits and perquisites and makes adjustments as warranted based on competitive practices, the Company s performance and the individual s responsibilities and performance.

The Compensation Committee has approved these other benefits and perquisites as a reasonable component of the Company s executive compensation program. See the All Other Compensation column in the Summary Compensation Table for further information regarding these benefits.

Pay Mix

We utilize the particular elements of compensation described above because we believe that it provides a well-proportioned mix of low-risk compensation, retention value and at-risk compensation that produces short-term and long-term performance incentives and rewards. By following this approach, we provide the Named Executive Officers a measure of security in the minimum level of compensation that such individuals are eligible to receive, while motivating the Named Executive Officers to focus on the business metrics that will produce a high level of performance for the Company and long-term benefits for stockholders, as well as reducing the risk of recruitment of top executive talent by competitors. The mix of metrics used for the Bonus Plan and the 2006 Stock Incentive Plan likewise provides an appropriate balance between short-term financial performance and long-term financial and stock performance.

For our Named Executive Officers, the mix of compensation is weighted toward at-risk pay (annual incentives and long-term incentives). Maintaining this pay mix results in a pay-for-performance orientation for our Named Executive Officers, which is aligned with the Company s stated compensation philosophy of providing compensation commensurate with performance.

In accordance with our philosophy that overall compensation should be competitive and that the compensation of the Named Executive Officers should be at least partially dependent upon individual and Company performance, these executives are eligible to receive a higher portion of total annual compensation in the form of performance-based annual bonuses and stock-based long-term compensation as compared to other Company employees. In addition, in support of pay-for-performance objectives, the portion of total direct compensation delivered through stock-based long-term incentives increases with an executive s role and level of responsibility. As a result, the most senior executives are held most accountable for achieving multi-year performance objectives and changes in shareholder value.

Chief Executive Officer Compensation

Mr. Alimanestianu s annual compensation consists primarily of base salary, annual incentive bonus and stock options. Mr. Alimanestianu s annual compensation is higher than that of the other Named Executive Officers due to his extensive experience and history with the Company and the higher demands of the chief executive officer position. For the 2008 Fiscal Year, Mr. Alimanestianu s annual compensation consisted of:

$505,870 base salary;

$200,000 annual incentive compensation;

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A grant on December 4, 2008 of options to purchase 50,000 shares of common stock at $2.44 per share, which was the closing price of the Company s common stock on that date; and

Participation in other benefit plans and perquisites as explained elsewhere in this Proxy Statement.

Based on performance results for the 2008 Fiscal Year, Mr. Alimanestianu would have been eligible to receive a bonus of up to $249,458 under the Bonus Plan, subject to Committee determination regarding the actual amount and form of his bonus payment. However, in connection with the Committee s determination of actual bonus awards under the Bonus Plan, Mr. Alimanestianu suggested that the Committee consider reducing the amount of his actual bonus to $200,000 and to instead reallocate $49,458 for the benefit of employees. Based in part on Mr. Alimanestianu s recommendation, the Committee ultimately approved a $200,000 bonus payment to Mr. Alimanestianu for the 2008 Fiscal Year. No determination has been made yet regarding Mr. Alimanestianu s request to allocate $49,458 for the benefit of employees.

Post-Termination Compensation and Benefits

Other than Ms. Prue, none of the Named Executive Officers have employment agreements with the Company. Ms. Prue s employment agreement and Mr. Kastin s offer letter with the Company each contain severance arrangements in the event that the executive is terminated without cause. Mr. Kastin s severance arrangement reflects a negotiation between Mr. Kastin and the Company at the time Mr. Kastin was hired and was considered at the time by the Compensation Committee to be appropriate to retain Mr. Kastin. All Named Executive Officers have entered into an executive severance agreement providing for specified severance benefits upon a termination of the executive s employment with the Company without cause or by the executive for good reason within six months following a change in control of the Company. The Compensation Committee believes that severance in connection with a termination or reduction in responsibilities in connection with a change in control is necessary to attract and retain the talent necessary for our long-term success. These severance arrangements allow our executives to focus on duties at hand and provide security should their employment be terminated as a result of involuntary termination without cause or a constructive discharge in connection with a change in control of the Company. Under these severance arrangements, the executives will be required to comply with a non-competition covenant for a period of up to one year and will receive in return one year of salary, a pro rata annual bonus, continuation of health and dental coverage for up to one year and continuation of fitness club membership for one year. The Compensation Committee believes that these benefits are reasonable given that the executive s employment opportunities for a period following termination will be constrained by the non-competition covenants contained in the severance agreements. These executive severance agreements are more fully described under Potential Payments Upon Termination or Change-in-Control.

As more fully described under Certain Relationships and Related Transactions Agreement with Richard Pyle , we entered into a letter agreement with Mr. Pyle in connection with his resignation from the Company as chief financial officer which provides for, among other things, a pro rata bonus for the fiscal year ending December 31, 2008, continued health and dental coverage, continued club membership and consulting fees. The Compensation Committee considered the severance arrangement with Mr. Pyle to be appropriate given Mr. Pyle s more than 20 years of service to the Company (and its predecessors).

Under the stock option agreements entered into between the Company and certain Named Executive Officers, if the Named Executive Officer resigns or the Named Executive Officer s employment is terminated by the Company for any reason, if the Company wishes to enforce specified non-competition and non-solicitation covenants for a period of up to one year, the Company must pay the Named Executive Officer severance compensation equal to no less than such Named Executive Officer s base salary during such period. The Compensation Committee believes that discretionary enforcement of non-competition and non-solicitation arrangements is beneficial to the competitive position of the Company and that the corresponding severance compensation is reasonable in such circumstances.

Compensation Committee Discretion

The Compensation Committee retains the discretion to decrease all forms of incentive payouts based on significant individual or Company performance shortfalls. Likewise, the Compensation Committee retains the discretion to increase payouts and/or consider special awards for significant achievements, including but not limited to superior management, investment or strategic accomplishments and/or consummation of acquisitions.

Impact of Tax and Accounting

As a general matter, the Compensation Committee would take into account the various tax and accounting implications of compensation vehicles employed by the Company.

When determining amounts of grants under the 2006 Stock Incentive Plan to Named Executive Officers and employees, the Compensation Committee examines the accounting cost associated with the grants. Under FAS 123R, grants of stock options, restricted stock, restricted stock units and other share-based payments result in an accounting charge for the Company. The accounting charge is equal to the fair value of the instruments being issued. For restricted stock and restricted stock units, the cost is equal to the fair value of the stock on the date of grant times the number of shares or units granted. This expense is amortized over the requisite service period, or vesting period of the instruments. The Compensation Committee also carefully considers the impact of using market conditions (for example, share price or total stockholder return) as a performance metric under the 2006 Stock Incentive Plan, mindful of the fact that even if the condition is not achieved, the accounting charge would not be reversible.

Section 162(m) of the Internal Revenue Code generally prohibits any publicly held corporation from taking a federal income tax deduction for compensation paid in excess of $1,000,000 in any taxable year to the corporation s Chief Executive Officer and next 3 highest compensated executive officers (other than the Chief Financial Officer), unless the compensation qualifies as performance-based compensation within the meaning of Section 162(m). However, pursuant to an exception under Section 162(m) applicable to plans in effect prior to a company s public offering, our Bonus Plan is expected to be exempt from the $1,000,000 limit until the earliest to occur of: (1) the expiration of the plan; (2) the material modification of the plan; and (3) the first meeting of stockholders at which directors are to be elected that occurs after the close of the third calendar year following the calendar year in which the Company s initial public offering occurred. With respect to the 2006 Stock Incentive Plan, we generally intend to structure performance based awards to qualify as performance-based compensation within the meaning of Section 162(m). While it is the Compensation Committee s policy to maximize the effectiveness of our executive compensation plans in this regard, we reserve the right to pay compensation that is not deductible under Section 162(m) if appropriate and in the best interests of the Company and our stockholders.

Conclusion

The level and mix of compensation for each of our Named Executive Officers is considered within the context of our historical compensation practices as well as the factors outlined above. The Compensation Committee believes that each of the compensation packages for our Named Executive Officers is appropriate in light of our industry and related industries and our competitive position therein. The Compensation Committee intends to continue to work closely with its compensation consultant, Axiom, to ensure that the Company provides competitive compensation packages to its Named Executive Officers.

Compensation Committee Report

The Compensation Committee has reviewed and discussed the Compensation Discussion and Analysis with management and based on the review and discussions, the Compensation Committee recommended to our Board that the Compensation Discussion and Analysis be included in this proxy statement and incorporated by reference into our annual report on Form 10-K.

Submitted by the Compensation Committee of the Company s Board of Directors on March 16, 2009:

Paul N. Arnold
Jason M. Fish, Chair
Kevin McCall

Summary Compensation Table

The following table sets forth the compensation earned for all services rendered to us in all capacities in the fiscal years ended December 31, 2008, 2007 and 2006 by our Named Executive Officers, which include our Chief Executive Officer, Chief Financial Officer, each of our three other most highly compensated executive officers who served in those capacities during 2008 and our former Chief Financial Officer.

Name and Principal Position	Year	Salary ($)	Bonus ($)	Stock Awards ($)(5)	Option Awards ($)(5)	Non-Equity Incentive Plan Compensation ($)(6)	All Other Compensation ($)	Total ($)
Alexander A. Alimanestianu(1)	2008	505,870			61,322	200,000	500(7)	767,692
Chief Executive Officer	2007	420,109			43,758	481,479	500(7)	945,846
and President	2006	364,380			44,936	396,385	500(7)	806,201
Martin J. Annese(2)	2008	218,750	68,438		67,219	51,562	500(7)	406,469
Chief Operating Officer								
Daniel Gallagher(3)	2008	259,375	31,250		117,753	68,750	500(7)	477,628
Senior Vice President Chief Financial Officer								
David M. Kastin	2008	283,250	15,000	10,748	29,657	35,407	500(7)	374,562
Senior Vice President General Counsel and Corporate Secretary								
Jennifer H. Prue	2008	259,255			74,553	34,222	500(7)	368,530
Chief Information Officer	2007	200,478			81,307	96,569	54,361(8)	432,715
	2006	170,515			47,063	96,633	66,407(9)	380,618
Richard G. Pyle(4)	2008	88,080				23,400	203,500(10)	314,980
Former Chief Financial Officer	2007	373,846			43,758	377,945	500(7)	805,436
	2006	352,785			44,936	396,385	14,321(11)	808,427

(1) Mr. Alimanestianu was appointed Chief Executive Officer of the Company effective November 1, 2007.

(2) Mr. Annese was appointed Chief Operating Officer of the Company effective April 28, 2008.

(3) Mr. Gallagher was promoted to Chief Financial Officer of the Company effective March 31, 2008.

(4) Effective March 31, 2008, Mr. Pyle resigned as Chief Financial Officer of the Company and is no longer an employee or executive officer. Mr. Pyle provides consulting services to the Company pursuant to a Letter Agreement. For further information, see Certain Relationships and Related Transactions Agreement with Richard Pyle.

(5) This column represents the dollar amount recognized for financial statement reporting purposes with respect to each fiscal year for the fair value of restricted stock or stock options granted to each of the Named Executive

Officers in that fiscal year as well as in prior fiscal years, in accordance with FAS 123R. Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to all grants reflected in this column, refer to note 10(b) to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as filed with the SEC. See the 2008 Grants of Plan-Based Awards table for information on options granted in 2008. These amounts reflect the Company s accounting expense for these awards, and do not correspond to the actual value that will be recognized by the Named Executive Officers.

(6) Reflects incentive compensation paid under the Company s Bonus Plan in 2009 for the 2008 Fiscal Year, in 2008 for the 2007 Fiscal Year and in 2007 for the 2006 Fiscal Year, respectively.

(7) Represents a 401(k) matching contribution of $500.

(8) Includes an accommodation allowance of $52,091, long-term disability premium of $1,770 and a 401(k) matching contribution of $500. Commencing in October 2007, Ms. Prue s accommodation allowance was integrated into her base salary.

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(9) Includes an accommodation allowance of $64,137, long-term disability premium of $1,770, and a 401(k) matching contribution of $500.

(10) Includes severance payment of $171,756, health and dental benefits of $9,303, consulting fee of $20,000, long-term disability premium of $941, a 401(k) matching contribution of $500 and the continuation of membership to the Company s fitness clubs.

(11) Includes automobile allowance of $11,374, long-term disability premium of $2,447 and a 401(k) matching contribution of $500.

2008 Grants of Plan-Based Awards

The following table sets forth information concerning awards under our equity incentive plans granted to each of the Named Executive Officers in the 2008 Fiscal Year.

Name	Grant Date	Estimated Possible Payouts Under Non-Equity Incentive Plan Awards(1) Threshold ($)	Target ($)	Maximum ($)	All Other Stock Awards: Number of Shares of Stock or Units(2)	All Other Option Awards: Number of Securities Underlying Options(2)	Exercise or Base Price of Option Awards ($/Sh)	Grant Date Fair Value of Option Awards ($)(3)
Alexander A. Alimanestianu	12/4/2008					50,000	2.44	71,062
		249,459	498,917	748,375				
Martin J. Annese	5/6/2008					100,000	9.54	455,851
	12/4/2008					100,000	2.44	142,123
		51,563	103,125	154,686				
Daniel Gallagher	3/4/2008					100,000	7.73	344,372
	12/4/2008					100,000	2.44	142,123
		68,750	137,500	206,250				
David M. Kastin	6/13/2008				10,000			
	6/13/2008					30,000	9.83	142,292
	12/4/2008					30,000	2.44	42,637
		35,407	70,813	106,219				
Jennifer H. Prue	12/4/2008					30,000	2.44	42,637
		38,889	77,777	116,665				
Richard G. Pyle(4)		23,400	46,800	70,200				

(1) These amounts are established under our Bonus Plan. For additional information, see Executive Compensation Narrative Supplement to the Summary Compensation Table and the 2008 Grants of Plan-Based Awards Table Terms of Non-Equity Based Awards .

(2) All shares of restricted stock and stock options were granted under our 2006 Stock Incentive Plan.

(3) This column shows the full grant date fair value of restricted stock and stock options granted in 2008 under FAS 123R. The grant date fair value is the amount that the Company will expense in its financial statements over the award s required period of service. Pursuant to SEC rules, the amounts shown exclude the effect of estimated forfeitures related to service-based vesting conditions. For additional information on the valuation assumptions with respect to the 2008 grants, refer to note 10(b) to the Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008, as filed with the SEC.

(4) Mr. Pyle resigned from our Company effective March 31, 2008 and his non-equity incentive plan awards have been pro-rated to reflect his departure.

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Narrative Supplement to the Summary Compensation Table and the 2008 Grants of Plan-Based Awards Table

Terms of Non-Equity Based Awards

Calculation

Payments under the Bonus Plan are based on the Company s achievement of certain financial targets and upon the individual employee s achievement of previously established personal performance objectives.

Company Performance

For the 2008 Fiscal Year, each of the Named Executive Officer s payments under the Bonus Plan in respect of Company performance was based on a percentage of his or her base salary. If the Company achieved its target Adjusted EBITDA ($122,268,598 for the 2008 Fiscal Year), each of the Named Executive Officers would receive (subject to adjustment for personal performance described below) the following percentage of his or her base salary: Mr. Alimanestianu (100%); Messrs. Gallagher, Annese and Pyle (50%), Ms. Prue; (30%) and Mr. Kastin (25%) (each amount the Target Bonus). If the Company either failed to achieve target Adjusted EBITDA or exceeded such target, the Target Bonus amounts would be adjusted as follows:

Achievement of Percentage of Adjusted EBITDA Target	Percentage of Target Bonus Awarded
0-89.99%	0%
90-94.99%	50%
95-99.99%	75%
100-102.99%	100%
103-104.99%	135%
Greater than 105%	150%

Individual Performance

All Named Executive Officers have individual performance goals for each fiscal year. Individual performance goals are set by each Named Executive Officer during the first quarter of each fiscal year and vary depending on the Company s business and strategic plan and objectives, and each executive s individual responsibilities. Each Named Executive Officer s individual performance goals are approved by the Chief Executive Officer. The Chief Executive Officer s goals are approved by the Compensation Committee. At the end of each fiscal year, the Compensation Committee with the assistance of the Chief Executive Officer reviews each Named Executive Officer s performance during the year against the pre-established performance goals. Achieving the target individual performance rating for all individual performance objectives would yield a rating of 100%. To the extent that any Named Executive Officer has not met the pre-established goals for that year, that Named Executive Officer s bonus award under the Bonus Plan is reduced to the extent the goals were not obtained.

Payment

Annual non-equity incentive awards will be paid in cash after the end of the performance period in which they are earned, as determined by the Compensation Committee, but not later than the later of (1) March 15 after the end of the applicable year and (2) two and one-half months after the expiration of the fiscal year in which the performance period with respect to which the annual non-equity incentive award is earned ends. In addition, annual non-equity incentive awards will not be paid until the Company s independent registered public accounting firm has issued its report with respect to the audit of the Company s consolidated financial statements for the applicable fiscal year. Unless otherwise determined by the Compensation Committee, no annual non-equity incentive award, full or pro rata, will be paid to any individual whose employment has ceased prior to the date such award is paid.

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Terms of Equity-Based Awards

Vesting Schedule

Option and restricted stock awards vest ratably over four years following the date of grant, subject to acceleration upon a change of control.

Forfeiture

Absent death, disability or retirement, unvested option awards are generally forfeited at termination of employment following a 90-day post-termination exercise period if the termination was involuntary. If the termination was voluntary by the employee, the option may be exercised during the 30-day period following termination. In the event the employee is terminated for cause, the option expires on the date of termination. In the event of death, disability or retirement prior to the complete exercise of a vested option award, the vested portion of the option may be exercised in whole or in part, within one year after the date of death, disability or retirement, as the case may be, and in all cases, prior to the option expiration. Unvested restricted stock awards are generally forfeited at termination of employment.

Covenants

The option and restricted stock awards contain confidentiality provisions and non-compete and non-solicitation provisions that apply to our executive officers.

Option awards granted under the 2006 Stock Incentive Plan have an exercise price equal to the closing price of the underlying shares on the date of grant. The grant date is the same as the day the Compensation Committee took action to approve the awards. All equity award grants to Executive Officers are approved by the Compensation Committee.

Outstanding Equity Awards at End of the 2008 Fiscal Year

The following table set forth information concerning unexercised stock options and unvested restricted stock for each of the Named Executive Officers as of the end of the 2008 Fiscal Year.

	Option Awards(1)				**Stock Awards(1)**
	Number of Securities	**Number of Securities**	**Equity Incentive Plan Awards: Number of**		**Market Value of**
ont style="DISPLAY: inline; FONT-FAMILY: Times New Roman; FONT-SIZE: 12pt">As previously described in Note C, on March 31, 2011					

Ashland completed the sale of substantially all of the assets and certain liabilities of Distribution. Ashland has determined that this sale qualifies as a discontinued operation, in accordance with U.S. GAAP, since Ashland does not have significant continuing involvement in the distribution business. As a result, operating results and cash flows related to Distribution have been reflected as discontinued operations in the Statement of Consolidated Income and Statement of Condensed Consolidated Cash Flows. Sales for the three months ended December 31, 2010 were $856 million. The results of operations for the three months ended December 31, 2010 are included in the table below. Ashland has made subsequent adjustments to the gain on sale of Distribution, primarily relating to the tax effects of the sale, during the three months ended December 31, 2011.

Ashland's divestiture of Ashland Paving And Construction (APAC) during 2006 qualified as a discontinued operation. As a result, the previous operating results, assets and liabilities related to APAC have been reflected as discontinued operations in the Condensed Consolidated Financial Statements. Ashland has made subsequent

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

NOTE D – DISCONTINUED OPERATIONS (continued)

adjustments to the gain on the sale of APAC, primarily relating to the tax effects of the sale, during the three month period ended December 31, 2010. Such adjustments to these and other divested businesses may continue to occur in future periods and are reflected in the period they are determined and recorded in the discontinued operations caption in the Statements of Consolidated Income.

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

Components of amounts reflected in the Statements of Consolidated Income related to discontinued operations are presented in the following table for the three months ended December 31, 2011 and 2010.

	Three months ended December 31	
(In millions)	2011	2010
Income (loss) from discontinued operations (net of tax)		
Distribution (a)	$ (1)	$ 26
Asbestos-related litigation reserves and receivables	6	1
Gain (loss) on disposal of discontinued operations (net of tax)		
Distribution	(4)	-
APAC	-	1
Total income from discontinued operations (net of tax)	$ 1	$ 28

(a) For the three months ended December 31, 2010, the pretax income reported for Distribution was $36 million.

NOTE E – RESTRUCTURING ACTIVITIES

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

During 2011, Ashland announced steps to reduce stranded costs resulting from the divestiture of Distribution and the contribution of the Casting Solutions business to the expanded global joint venture with Süd-Chemie. In addition, Ashland is currently taking action to integrate ISP subsequent its purchase in August 2011. As a first step to address cost reduction opportunities resulting from these transactions, Ashland announced a voluntary severance offer (VSO) in June 2011 to approximately 1,500 regular, full-time, non-union, U.S.-based employees, primarily within various shared resource groups as well as certain positions within the Specialty Ingredients business, ultimately resulting in

150 employees being formally approved for the VSO. An involuntary program was also initiated as a further step to capture targeted saving levels from these transactions and other business cost saving initiatives. The VSO and involuntary program resulted in a severance charge of $34 million during the September 2011 quarter. The involuntary program continued during the December 2011 quarter and resulted in an additional severance charge of $28 million classified within the selling, general and administrative expense caption of the Statement of Consolidated Income for the three months ended December 31, 2011. Additional charges related to the involuntary program may be incurred in subsequent periods from ongoing efforts to maximize operational efficiencies as a result of these transactions. As of December 31, 2011, the restructuring reserve for these programs totaled $56 million.

As of December 31, 2011 and 2010, the $8 million and $21 million, respectively, in remaining restructuring reserves for previously announced programs consisted of severance payments from the 2009 Hercules Integration Plan, which resulted in 12 permanent facility closings and a reduction in the global workforce of over 2,000

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

NOTE E – RESTRUCTURING ACTIVITIES (continued)

employees from 2008 through 2010 and the Performance Materials restructuring, which consisted of several plant closings and an operational redesign to eliminate excess capacity that was announced during 2010.

The following table details, at December 31, 2011 and 2010, the amount of restructuring reserves related to the programs discussed above, and the related activity in these reserves for the three months ended December 31, 2011 and 2010. The reserves are included in accrued expenses and other liabilities in the Condensed Consolidated Balance Sheet.

(In millions)		Severance
Balance as of September 30, 2011	$	45
Restructuring reserve		28
Utilization (cash paid or otherwise settled)		(9)
Balance at December 31, 2011	$	64
Balance as of September 30, 2010	$	26
Utilization (cash paid or otherwise settled)		(5)
Balance at December 31, 2010	$	21

NOTE F – FAIR VALUE MEASUREMENTS

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

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

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

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

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

The following table summarizes financial asset instruments subject to recurring fair value measurements as of December 31, 2011.

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

NOTE F – FAIR VALUE MEASUREMENTS (continued)

(In millions)	Carrying value	Total fair value	Quoted prices in active markets for identical assets Level 1	Significant other observable inputs Level 2	Significant unobservable inputs Level 3
Assets					
Cash and cash equivalents	$ 466	$ 466	$ 466	$ -	$ -
Auction rate securities	10	10	-	-	10
Deferred compensation investments (a)	173	173	60	113	-
Investments of captive insurance company (a)	2	2	2	-	-
Total assets at fair value	$ 651	$ 651	$ 528	$ 113	$ 10
Liabilities					
Interest rate swap derivatives	$ 29	$ 29	$ -	$ 29	$ -

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

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

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

Foreign currency derivatives	1	1	-	1	-
Total assets at fair value	$ 935	$ 935	$ 815	$ 110	$ 10
Liabilities					
Interest rate swap derivatives	$ 20	$ 20	$ -	$ 20	$ -

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

Level 3 instruments

Auction rate securities

At December 31, 2011 and September 30, 2011, Ashland held at par value $12 million of student loan auction rate securities for which there was not an active market with consistent observable inputs. In February 2008, the auction rate securities market became largely illiquid, as there was not enough demand to purchase all of the securities that holders desired to sell at par value during certain auctions. Since this time, the market for auction rate securities has failed to achieve equilibrium. Due to the uncertainty as to when active trading will resume in the auction rate securities market, Ashland believes the recovery period for certain of these securities may extend beyond a twelve-month period. As a result, these instruments have been classified as noncurrent assets in the Condensed Consolidated Balance Sheet.

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

NOTE F – FAIR VALUE MEASUREMENTS (continued)

During the three months ended December 31, 2011 and 2010, there was no activity related to Ashland's auction rate securities.

Derivative and hedging activities

Currency hedges

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

Ashland contracts with counter-parties to buy and sell foreign currencies to offset the impact of exchange rate changes on transactions denominated in non-functional currencies, including short-term inter-company loans. These contracts generally require exchange of one foreign currency for another at a fixed rate at a future date and generally have maturities of less than twelve months. All contracts are marked-to-market with net changes in fair value recorded within the selling, general and administrative expense caption. The impacts of these contracts were largely offset by gains and losses resulting from the impact of changes in exchange rates on transactions denominated in non-functional currencies. The following table summarizes the losses recognized during the three months ended December 31, 2011 and 2010 within the Statement of Consolidated Income.

	Three months ended December 31	
(In millions)	2011	2010
Foreign currency derivative gain	$ 1	$ -

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

(In millions)	December 31 2011	September 30 2011
Foreign currency derivative assets	$ -	$ 1
Notional contract values	52	62
Foreign currency derivative liabilities	$ -	$ -
Notional contract values	45	35

Interest rate hedges

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

The fair value of Ashland's interest rate swap assets and liabilities are calculated using standard pricing models. These models utilize inputs derived from observable market data such as interest rate spot rates and forward rates, and are deemed to be Level 2 measurements within the fair value hierarchy. Counterparties to these interest rate

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

NOTE F – FAIR VALUE MEASUREMENTS (continued)

swap agreements are highly rated financial institutions which Ashland believes carry only a minimal risk of nonperformance. The following table summarizes the fair values of the outstanding interest rate swap instruments as of December 31, 2011 and September 30, 2011.

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

The following table summarizes the unrealized loss on interest rate hedges recognized in AOCI during the three months ended December 31, 2011, as well as the loss reclassified from AOCI to income during the three months ended December 31, 2011. The loss reclassified to income was recorded in the net interest and other financing expense caption within the Statement of Consolidated Income.

(In millions)	Change in unrealized loss in AOCI	Loss reclassified from AOCI to income
Interest rate hedges	$ 14	$ 5

During 2009, Ashland purchased a three year interest rate cap on a notional amount of $300 million of variable rate debt. This interest rate cap fixes Ashland's interest rate on that outstanding variable interest rate debt when LIBOR interest rates equal or exceed 7% on a reset date. This instrument does not qualify for hedge accounting and therefore gains or losses reflecting changes in fair value, along with the amortization of the upfront premium paid by Ashland to purchase the instrument, are reported in the Statements of Consolidated Income within the net interest and other financing expense caption. As of December 31, 2011 and September 30, 2011, the fair value on the interest rate cap was less than $1 million and recorded within the other noncurrent assets caption of the Condensed Consolidated Balance Sheet.

Other financial instruments

At December 31, 2011 and September 30, 2011, Ashland's long-term debt had a carrying value of $3,728 million and $3,749 million, respectively, compared to a fair value of $3,969 million and $3,953 million, respectively. The fair values of long-term debt are based on quoted market prices or, if market prices are not available, the present values of the underlying cash flows discounted at Ashland's incremental borrowing rate.

NOTE G – INVENTORIES

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

(In millions)	December 31 2011	September 30 2011
Finished products	$ 661	$ 620
Raw materials, supplies and work in process	370	364
LIFO reserve	(50)	(59)
	$ 981	$ 925

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

NOTE H – GOODWILL AND OTHER INTANGIBLES

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

The following is a progression of goodwill by segment for the period ended December 31, 2011.

(In millions)	Specialty Ingredients	Water Technologies	Performance Materials	Consumer Markets	Total
Balance at September 30, 2011	$ 2,092	$ 676	$ 357	$ 166	$ 3,291
Acquisitions (a)	49	-	-	-	49
Currency translation adjustment	(25)	(12)	(9)	-	(46)
Balance at December 31, 2011	$ 2,116	$ 664	$ 348	$ 166	$ 3,294

(a) The adjustment primarily relates to updates to the post-closing adjustments from the ISP acquisition.

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

IPR&D and certain intangible assets within trademarks and trade names have been classified as indefinite-lived and had a balance of $599 million as of December 31, 2011 and September 30, 2011. In accordance with U.S. GAAP, Ashland annually reviews these intangible assets for possible impairment or whenever events or changes in circumstances indicate that carrying amounts may not be recoverable. In conjunction with the July 1, 2011 annual assessment of indefinite-lived intangible assets, Ashland's models did not indicate any impairment. Intangible assets were comprised of the following as of December 31, 2011 and September 30, 2011.

	December 31, 2011		
(In millions)	Gross carrying amount	Accumulated amortization	Net carrying amount
Trademarks and trade names	$ 536	$ (33)	$ 503

Intellectual property		845		(100	)		745	
Customer relationships		833		(129	)		704	
IPR&D		135		-			135	
Other intangibles		35		(34	)		1	
Total intangible assets	$	2,384	$	(296	)	$	2,088	

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

NOTE H – GOODWILL AND OTHER INTANGIBLES (continued)

	September 30, 2011		
(In millions)	Gross carrying amount	Accumulated amortization	Net carrying amount
Trademarks and trade names	$ 536	$ (31)	$ 505
Intellectual property	848	(87)	761
Customer relationships	846	(116)	730
IPR&D	135	-	135
Other intangibles	35	(32)	3
Total intangible assets	$ 2,400	$ (266)	$ 2,134

Amortization expense recognized on intangible assets for the three months ended December 31 was $30 million for 2011 and $17 million for 2010 and is primarily included in the selling, general and administrative expense caption of the Statements of Consolidated Income. Estimated amortization expense for future periods is $119 million in 2012 (includes three months actual and nine months estimated), $117 million in 2013, $115 million in 2014, $114 million in 2015 and $111 million in 2016.

NOTE I – DEBT

The following table summarizes Ashland’s current and long-term debt as of the reported Condensed Consolidated Balance Sheet dates.

(In millions)	December 31 2011	September 30 2011
Term Loan A, due 2016 (a)	$ 1,481	$ 1,500
Term Loan B, due 2018 (a)	1,396	1,400
9.125% notes, due 2017	633	633
6.50% junior subordinated notes, due 2029 (b)	128	128
6.60% notes, due 2027 (b)	12	12
Medium-term notes, due 2013-2019, interest at a weighted-average rate of 8.4% at December 31, 2011 (7.7% to 9.4%)	21	21
8.80% debentures, due 2012	20	20
Hercules Nanjing - term notes, due 2013	36	35
Other international loans, interest at a weighted-average rate of 7.0% at December 31, 2011 (2.0% to 11.8%)	76	81
Other	1	2
Total debt	3,804	3,832
Short-term debt	(76)	(83)

Current portion of long-term debt		(121)		(101)
Long-term debt (less current portion)	$	3,607	$	3,648

(a) Senior credit facilities.
(b) Retained instrument from the Hercules acquisition.

The scheduled aggregate maturities of debt by year are as follows: $146 million remaining in 2012, $137 million in 2013, $176 million in 2014, $172 million in 2015, $1,064 million in 2016 and $664 million in 2017. Total borrowing capacity remaining under the $1 billion revolving credit facility was $916 million, representing a reduction of $84 million for letters of credit outstanding at December 31, 2011.

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

NOTE I – DEBT (continued)

Covenant restrictions

The Senior Credit Facility (Term Loan A, Term Loan B and revolving credit facility) contains usual and customary representations, warranties and affirmative and negative covenants, including financial covenants for leverage and fixed charge coverage ratios, limitations on liens, additional indebtedness, further negative pledges, investments, payment of dividends, mergers, sale of assets and restricted payments, and other customary limitations. As of December 31, 2011, Ashland is in compliance with all debt agreement covenants.

Financial covenants

The maximum consolidated leverage ratios permitted under the Senior Credit Facility are as follows: 4.00 from the period December 31, 2011 through March 31, 2012, 3.75 as of June 30, 2012, 3.50 as of September 30, 2012, 3.00 from the period December 31, 2012 through September 30, 2013 and 2.75 as of December 31, 2013 and each quarter thereafter. At December 31, 2011, Ashland's calculation of the consolidated leverage ratio was 3.0 compared to the maximum consolidated leverage ratio permitted under the Senior Credit Facility of 4.00.

The minimum required consolidated fixed charge coverage ratios under the Senior Credit Facility are 1.50 from the period December 31, 2011 through June 30, 2012, 1.75 as of September 30, 2012 and 2.00 as of December 31, 2012 and each quarter thereafter. At December 31, 2011, Ashland's calculation of the fixed charge coverage ratio was 3.3 compared to the minimum required consolidated ratio of 1.50.

NOTE J – INCOME TAXES

Ashland's effective tax rate is generally subjected to adjustments related to discrete items and changes within foreign effective tax rates resulting from income or loss fluctuations. The overall effective tax rate was 27.7% for the three months ended December 31, 2011 and included two discrete tax benefits of $9 million for both the $28 million severance and restructuring charge and the $25 million fair value assessment of inventory charge recorded during the current quarter.

The overall effective tax rate was 34.3% for the three months ended December 31, 2010 and included certain discrete items such as a $16 million tax expense from the $19 million pretax gain associated with the fair market value of the Casting Solutions contribution and a $4 million tax benefit associated with research and development tax credits for 2010. In addition, the effective tax rate during this period was favorably impacted by $3 million from other miscellaneous discrete tax items.

Changes in unrecognized tax benefits are summarized as follows for the three months ended December 31, 2011.

(In millions)

Balance at October 1, 2011	$	160	
Increases related to positions taken on items from prior years		4	
Decreases related to positions taken on items from prior years		(14	)
Increases related to positions taken in the current year		1	
Balance at December 31, 2011	$	151	

Ashland expects to conclude certain audits during the year ending September 30, 2012. As a result, it is reasonably possible that the amount of the unrecognized tax benefits may increase or decrease within the next twelve months which may have a material effect on the Condensed Consolidated Financial Statements. However, an estimate of the range of possible change cannot be made at this time due to the uncertainty of the resolution of the open audits.

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

NOTE K – EMPLOYEE BENEFIT PLANS

As discussed in Notes A and P, Ashland elected during 2011 to change its method of recognizing actuarial gains and losses for its defined benefit pension and postretirement benefit plans. This accounting change was applied retrospectively, adjusting all prior periods presented.

For the three months ended December 31, 2011, Ashland contributed $3 million to the U.S. benefit plans and $9 million to the non-U.S. benefit plans. Ashland expects to make additional contributions to the U.S. plans of approximately $92 million and to the non-U.S. plans of $18 million during the remainder of 2012. The following table details the components of pension and other postretirement benefit costs.

	Pension benefits		Other postretirement benefits	
(In millions)	2011	2010	2011	2010
Three months ended December 31				
Service cost	$ 10	$ 13	$ 1	$ 1
Interest cost	49	50	3	4
Expected return on plan assets	(57)	(57)	-	-
Amortization of prior service credit	(1)	(1)	(4)	(1)
	$ 1	$ 5	$ -	$ 4

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES

Asbestos litigation

Ashland and Hercules, a wholly-owned subsidiary of Ashland, have liabilities from claims alleging personal injury caused by exposure to asbestos. To assist in developing and annually updating independent reserve estimates for future asbestos claims and related costs given various assumptions, Ashland retained Hamilton, Rabinovitz & Associates, Inc. (HR&A). The methodology used by HR&A to project future asbestos costs is based largely on recent experience, including claim-filing and settlement rates, disease mix, enacted legislation, open claims, and litigation defense. The claim experience of Ashland and Hercules are separately compared to the results of previously conducted third party epidemiological studies estimating the number of people likely to develop asbestos-related diseases. Those studies were undertaken in connection with national analyses of the population expected to have been exposed to asbestos. Using that information, HR&A estimates a range of the number of future claims that may be filed, as well as the related costs that may be incurred in resolving those claims.

Ashland asbestos-related litigation

The claims alleging personal injury caused by exposure to asbestos asserted against Ashland result primarily from indemnification obligations undertaken in 1990 in connection with the sale of Riley Stoker Corporation, a former subsidiary. The amount and timing of settlements and number of open claims can fluctuate significantly from period to period. A summary of Ashland asbestos claims activity, excluding those related to Hercules, follows.

	Three months ended December 31		Years ended September 30		
(In thousands)	2011	2010	2011	2010	2009
Open claims - beginning of period	72	83	83	100	115
New claims filed	1	-	2	2	2
Claims settled	-	-	(1)	(1)	(1)
Claims dismissed	(3)	(4)	(12)	(18)	(16)
Open claims - end of period	70	79	72	83	100

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

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES (continued)

Ashland asbestos-related liability

From the range of estimates, Ashland records the amount it believes to be the best estimate of future payments for litigation defense and claim settlement costs, which generally approximates the mid-point of the estimated range of exposure from model results. Ashland reviews this estimate and related assumptions quarterly and annually updates the results of a non-inflated, non-discounted approximate 50-year model developed with the assistance of HR&A. During the most recent annual update of this estimate, completed during the June 2011 quarter, it was determined that the liability for asbestos claims should be increased by $41 million. Total reserves for asbestos claims were $533 million at December 31, 2011 compared to $543 million at September 30, 2011.

A progression of activity in the asbestos reserve is presented in the following table.

	Three months ended December 31		Years ended September 30		
(In millions)	2011	2010	2011	2010	2009
Asbestos reserve - beginning of period	$ 543	$ 537	$ 537	$ 543	$ 572
Reserve adjustment	-	-	41	28	5
Amounts paid	(10)	(11)	(35)	(34)	(34)
Asbestos reserve - end of period	$ 533	$ 526	$ 543	$ 537	$ 543

Ashland asbestos-related receivables

Excluding the Hercules asbestos claims further described below, Ashland has insurance coverage for most of the litigation defense and claim settlement costs incurred in connection with its asbestos claims, and coverage-in-place agreements exist with the insurance companies that provide most of the coverage currently being accessed. As a result, increases in the asbestos reserve have been largely offset by probable insurance recoveries. The amounts not recoverable generally are due from insurers that are insolvent, rather than as a result of uninsured claims or the exhaustion of Ashland’s insurance coverage.

For the Ashland asbestos-related obligations, Ashland has estimated the value of probable insurance recoveries associated with its asbestos reserve based on management’s interpretations and estimates surrounding the available or applicable insurance coverage, including an assumption that all solvent insurance carriers remain solvent. Approximately 72% of the estimated receivables from insurance companies are expected to be due from domestic insurers, of which approximately 85% have a credit rating of B+ or higher by A. M. Best, as of December 31, 2011. The remainder of the insurance receivable is due from London insurance companies, which generally have lower credit quality ratings, and from Underwriters at Lloyd’s, whose insurance policy obligations have been transferred to a Berkshire Hathaway entity. Ashland discounts this piece of the receivable based upon the projected timing of the receipt of cash from those insurers unless likely settlement amounts can be determined.

During 2010, Ashland entered into a new agreement with a number of London market insurance companies with respect to coverage for asbestos-related insurance claims. As a result, a $12 million increase to the Ashland asbestos receivable was recorded within the Condensed Consolidated Balance Sheet, which had a $9 million (after-tax) effect on the Statement of Consolidated Income within the discontinued operations caption. During the December 2011 quarter, Ashland received $7 million in cash after reaching a settlement with certain insolvent London market insurance companies. The cash received from this settlement during the current quarter was recognized as an after-tax gain of $6 million within discontinued operations of the Statement of Consolidated Income since Ashland's policy is to not record asbestos receivables for any carriers that are insolvent. In addition, Ashland had agreed to arbitrate a dispute regarding whether there is a significant deductible in the London market companies' policies in three policy periods that must be satisfied before the policies begin providing coverage for Riley Stoker asbestos claims. The London market companies had contended that Ashland must bear certain self-insured retentions in respect of Riley Stoker asbestos liabilities before the London coverage attaches in these three years, and Ashland disputed that such self-insured retentions must be satisfied. The parties conducted an arbitration

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

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES (continued)

hearing on this dispute in June 2011, and a decision was rendered by the arbitrator in October 2011 that essentially supported Ashland's previously stated position on these claims.

At December 31, 2011, Ashland's receivable for recoveries of litigation defense and claim settlement costs from insurers amounted to $423 million (excluding the Hercules receivable for asbestos claims), of which $56 million relates to costs previously paid. Receivables from insurers amounted to $431 million at September 30, 2011. During 2011, the model used for purposes of valuing the asbestos reserve described above, and its impact on valuation of future recoveries from insurers, was updated. This model update along with the potential settlement adjustments resulted in an additional $42 million increase in the receivable for probable insurance recoveries.

A progression of activity in the Ashland insurance receivable (excluding Hercules) is presented in the following table.

	Three months ended December 31		Years ended September 30		
(In millions)	2011	2010	2011	2010	2009
Insurance receivable - beginning of period	$ 431	$ 421	$ 421	$ 422	$ 458
Receivable adjustment	-	-	42	36	8
Amounts collected	(8)	(7)	(32)	(37)	(44)
Insurance receivable - end of period	$ 423	$ 414	$ 431	$ 421	$ 422

Hercules asbestos-related litigation

Hercules, a wholly-owned subsidiary of Ashland, has liabilities from claims alleging personal injury caused by exposure to asbestos. Such claims typically arise from alleged exposure to asbestos fibers from resin encapsulated pipe and tank products which were sold by one of Hercules' former subsidiaries to a limited industrial market. The amount and timing of settlements and number of open claims can fluctuate significantly from period to period. A summary of Hercules' asbestos claims activity follows.

	Three months ended December 31		Years ended September 30		
(In thousands)	2011	2010	2011	2010	2009(a)
Open claims - beginning of period	21	20	20	21	27
New claims filed	-	2	2	-	1
Claims dismissed	-	-	(1)	(1)	(7)
Open claims - end of period	21	22	21	20	21

(a) Beginning of period represents acquisition date of November 13, 2008.

Hercules asbestos-related liability

From the range of estimates, Ashland records the amount it believes to be the best estimate of future payments for litigation defense and claim settlement costs, which generally approximates the mid-point of the estimated range of exposure from model results. Ashland reviews this estimate and related assumptions quarterly and annually updates the results of a non-inflated, non-discounted approximate 50-year model developed with the assistance of HR&A. During the most recent annual update of this estimate, completed during the June 2011 quarter, it was determined that the liability for Hercules asbestos related claims should be decreased by $48 million. Total reserves for asbestos claims were $305 million at December 31, 2011 compared to $311 million at September 30, 2011.

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

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES (continued)

A progression of activity in the asbestos reserve is presented in the following table.

(In millions)	Three months ended December 31 2011	2010	Years ended September 30 2011	2010	2009 (a)
Asbestos reserve - beginning of period	$ 311	$ 375	$ 375	$ 484	$ 233
Reserve adjustment (b)	-	-	(48)	(93)	261
Amounts paid	(6)	(5)	(16)	(16)	(10)
Asbestos reserve - end of period	$ 305	$ 370	$ 311	$ 375	$ 484

(a) Beginning of period represents acquisition date of November 13, 2008.
(b) Includes purchase accounting adjustments recorded during 2010 and 2009 as part of purchase price allocations for the Hercules acquisition.

Hercules asbestos-related receivables

For the Hercules asbestos-related obligations, certain reimbursements pursuant to coverage-in-place agreements with insurance carriers exist. As a result, increases in the asbestos reserve are partially offset by probable insurance recoveries. Ashland has estimated the value of probable insurance recoveries associated with its asbestos reserve based on management’s interpretations and estimates surrounding the available or applicable insurance coverage, including an assumption that all solvent insurance carriers remain solvent. The estimated receivable consists exclusively of domestic insurers, of which approximately 96% have a credit rating of B+ or higher by A. M. Best, as of December 31, 2011.

As of December 31, 2011 and September 30, 2011, the receivables from insurers amounted to $48 million. As previously mentioned, during 2011 the model used for purposes of valuing the asbestos reserve and its impact on valuation of future recoveries from insurers was updated. This model update along with likely settlement adjustments caused a $20 million reduction in the receivable for probable insurance recoveries.

A progression of activity in the Hercules insurance receivable is presented in the following table.

(In millions)	Three months ended December 31 2011	2010	Years ended September 30 2011	2010	2009 (a)
Insurance receivable - beginning of period	$ 48	$ 68	$ 68	$ 118	$ 35
Receivable adjustment	-	-	(20)	(50)	83

Insurance receivable - end of period	$ 48	$ 68	$ 48	$ 68	$ 118

(a) Beginning of period represents acquisition date of November 13, 2008.

Asbestos litigation cost projection

Projecting future asbestos costs is subject to numerous variables that are extremely difficult to predict. In addition to the significant uncertainties surrounding the number of claims that might be received, other variables include the type and severity of the disease alleged by each claimant, the long latency period associated with asbestos exposure, dismissal rates, costs of medical treatment, the impact of bankruptcies of other companies that are co-defendants in claims, uncertainties surrounding the litigation process from jurisdiction to jurisdiction and from case to case, and the impact of potential changes in legislative or judicial standards. Furthermore, any predictions with respect to these variables are subject to even greater uncertainty as the projection period lengthens. In light of these inherent uncertainties, Ashland believes that the asbestos reserves for Ashland and Hercules represent the best estimate within a range of possible outcomes. As a part of the process to develop these estimates of future asbestos costs, a range of long-term cost models was developed. These models are based on national studies that predict the number of people likely to develop asbestos-related diseases and are heavily influenced by assumptions regarding long-term

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

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES (continued)

inflation rates for indemnity payments and legal defense costs, as well as other variables mentioned previously. Ashland has currently estimated in various approximate 50-year models that it is reasonably possible that total future litigation defense and claim settlement costs on an inflated and undiscounted basis could range as high as approximately $900 million for the Ashland asbestos-related litigation and approximately $500 million for the Hercules asbestos-related litigation (or approximately $1.4 billion in the aggregate), depending on the combination of assumptions selected in the various models. If actual experience is worse than projected, relative to the number of claims filed, the severity of alleged disease associated with those claims or costs incurred to resolve those claims, Ashland may need to further increase the estimates of the costs associated with asbestos claims and these increases could be material over time.

Environmental remediation and asset retirement obligations

Ashland is subject to various federal, state and local environmental laws and regulations that require environmental assessment or remediation efforts (collectively environmental remediation) at multiple locations. At December 31, 2011, such locations included 92 waste treatment or disposal sites where Ashland has been identified as a potentially responsible party under Superfund or similar state laws, 157 current and former operating facilities (including certain operating facilities conveyed to Marathon Ashland Petroleum LLC in 2005) and about 1,225 service station properties, of which 101 are being actively remediated.

Ashland’s reserves for environmental remediation amounted to $243 million at December 31, 2011 compared to $246 million at September 30, 2011, of which $201 million at December 31, 2011 and $204 million at September 30, 2011 were classified in other noncurrent liabilities on the Condensed Consolidated Balance Sheets.

The following table provides a reconciliation of the changes in the environmental contingencies and asset retirement obligations during the three months ended December 31, 2011 and 2010.

	Three months ended December 31	
(In millions)	2011	2010
Reserve - beginning of period	$ 246	$ 207
Disbursements, net of cost recoveries	(8)	(7)
Revised obligation estimates and accretion	5	4
Reserve - end of period	$ 243	$ 204

The total reserves for environmental remediation reflect Ashland’s estimates of the most likely costs that will be incurred over an extended period to remediate identified conditions for which the costs are reasonably estimable, without regard to any third-party recoveries. Engineering studies, probability techniques, historical experience and other factors are used to identify and evaluate remediation alternatives and their related costs in determining the estimated reserves for environmental remediation. Ashland continues to discount certain environmental sites and regularly adjusts its reserves as environmental remediation continues. Ashland has estimated the value of its probable insurance recoveries associated with its environmental reserve based on management's interpretations and estimates surrounding the available or applicable insurance coverage. At December 31, 2011 and September 30, 2011, Ashland's recorded receivable for these probable insurance recoveries was $33 million.

Components of environmental remediation expense included within the selling, general and administrative expense caption of the Statements of Consolidated Income are presented in the following table for the three months ended December 31, 2011 and 2010.

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

NOTE L – LITIGATION, CLAIMS AND CONTINGENCIES (continued)

(In millions)	Three months ended December 31 2011	2010
Environmental expense	$ 4	$ 3
Accretion	1	1
Legal expense	1	1
Total expense	6	5
Insurance receivable	(2)	(1)
Total expense, net of receivable activity (a)	$ 4	$ 4

(a) Net expense of $1 million for the three months ended December 31, 2011 and 2010 relates to divested businesses which qualified for treatment as discontinued operations and for which the environmental liabilities were retained by Ashland. These amounts are classified within the income from discontinued operations caption of the Statements of Consolidated Income.

Environmental remediation reserves are subject to numerous inherent uncertainties that affect Ashland's ability to estimate its share of the costs. Such uncertainties involve the nature and extent of contamination at each site, the extent of required cleanup efforts under existing environmental regulations, widely varying costs of alternate cleanup methods, changes in environmental regulations, the potential effect of continuing improvements in remediation technology, and the number and financial strength of other potentially responsible parties at multiparty sites. Although it is not possible to predict with certainty the ultimate costs of environmental remediation, Ashland currently estimates that the upper end of the reasonably possible range of future costs for identified sites could be as high as approximately $400 million. No individual remediation location is material, as the largest reserve for any site is less than 10% of the remediation reserve.

Other legal proceedings and claims

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

NOTE M – EARNINGS PER SHARE

The following is the computation of basic and diluted earnings per share (EPS) from continuing operations. Stock options, SARs and warrants (assumed as part of the Hercules acquisition) available to purchase shares outstanding for each reporting period whose grant price was greater than the average market price of Ashland Common Stock for each applicable period were not included in the computation of income from continuing operations per diluted share because the effect of these instruments would be antidilutive. The total number of these shares outstanding was approximately 1.0 million and 2.0 million as of December 31, 2011 and 2010, respectively.

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

NOTE M – EARNINGS PER SHARE (continued)

	Three months ended December 31	
(In millions except per share data)	2011	2010
Numerator		
Numerator for basic and diluted EPS – Income from continuing operations	$ 60	$ 71
Denominator		
Denominator for basic EPS – Weighted-average common shares outstanding	78	79
Share based awards convertible to common shares	1	1
Denominator for diluted EPS – Adjusted weighted-average shares and assumed conversions	79	80
EPS from continuing operations		
Basic	$ .77	$ .92
Diluted	$ .76	$ .91

NOTE N – CAPITAL STOCK

In March 2011, the Board of Directors of Ashland approved a $400 million stock repurchase program. Under the program that began on April 1, 2011, Ashland purchased common shares through a $200 million 10b5-1 automatic trading plan. Effective May 31, 2011, as a result of the announcement of the ISP acquisition, Ashland terminated the 10b5-1 automatic trading program. Purchases under the plan amounted to $71 million, or 1.2 million shares. Ashland still has the ability to make discretionary purchases of Ashland Common Stock on the open market, pursuant to the Board's original $400 million share repurchase authorization. During the three months ended December 31, 2011, Ashland did not execute any share repurchases.

During the current quarter, the Board of Directors of Ashland announced and paid a quarterly cash dividend of 17.5 cents per share to eligible shareholders of record. This amount was an increase from the quarterly cash dividend of 15 cents per share paid during the prior year quarter.

NOTE O – STOCK INCENTIVE PLANS

Ashland has stock incentive plans under which key employees or directors are granted stock-settled stock appreciation rights (SARs), performance share awards or nonvested stock awards. Each program is typically a long-term incentive plan designed to link employee compensation with increased shareholder value or reward superior performance and encourage continued employment with Ashland. Ashland recognizes compensation expense for the grant date fair value of stock-based awards over the applicable vesting period. Stock-based compensation expense was $6 million and $4 million for the three months ended December 31, 2011 and 2010, respectively, and is included in the selling, general and administrative expense caption of the Statements of Consolidated Income.

SARs

SARs are granted to employees or directors at a price equal to the fair market value of the stock on the date of grant and typically become exercisable over periods of one to three years. Unexercised SARs lapse essentially ten years after the date of grant. SARs granted for the three months ended December 31, 2011 and 2010 were 0.7 million and 0.6 million, respectively. As of December 31, 2011, there was $23 million of total unrecognized compensation costs related to SARs. That cost is expected to be recognized over a weighted-average period of 2.5 years. Ashland estimates the fair value of SARs granted using the Black-Scholes option-pricing model. This model requires several

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

NOTE O – STOCK INCENTIVE PLANS (continued)

assumptions, which Ashland has developed and updates based on historical trends and current market observations. The accuracy of these assumptions is critical to the estimate of fair value for these equity instruments.

Nonvested stock awards

Nonvested stock awards are granted to employees or directors at a price equal to the fair market value of the stock on the date of grant and generally vest over a one-to-five-year period. However, such shares are subject to forfeiture upon termination of service before the vesting period ends. Nonvested stock awards entitle employees or directors to vote the shares and to receive any dividends or dividend equivalents. Nonvested stock awards granted for the three months ended December 31, 2011 and 2010 were 5,000 and 12,100 shares, respectively. As of December 31, 2011, there was $6 million of total unrecognized compensation costs related to nonvested stock awards. That cost is expected to be recognized over a weighted-average period of 2.3 years.

Performance shares

Ashland sponsors a long-term incentive plan that awards performance shares/units to certain key employees that are tied to Ashland's overall financial performance relative to the financial performance of selected industry peer groups. Awards are granted annually, with each award covering a three-year performance cycle. Each performance share/unit is convertible to one share of Ashland Common Stock. These plans are recorded as a component of stockholders' equity in the Condensed Consolidated Balance Sheets. Performance measures used to determine the actual number of performance shares issuable upon vesting include an equal weighting of Ashland's total shareholder return (TSR) performance and Ashland's return on investment (ROI) performance as compared to the performance peer groups and/or internal targets over the three-year performance cycle. TSR relative to peers is considered a market condition while ROI is considered a performance condition under applicable U.S. GAAP. Nonvested performance shares/units do not entitle employees to vote the shares or to receive any dividends thereon. Performance shares/units granted for the three months ended December 31, 2011 and 2010 were 0.2 million. As of December 31, 2011, there was $15 million of total unrecognized compensation costs related to performance shares/units. That cost is expected to be recognized over a weighted-average period of 2.4 years.

NOTE P – SEGMENT INFORMATION

Following the ISP acquisition and the Distribution divestiture during 2011, Ashland's businesses are now managed along four industry segments: Specialty Ingredients, Water Technologies, Performance Materials and Consumer Markets.

Specialty Ingredients, which was formerly known as Functional Ingredients and now includes the majority of the former operations of ISP, offers industry-leading products, technologies and resources for solving formulation and product performance challenges in a variety of markets including personal care, pharmaceutical, food and beverage, coatings, construction and energy.

Water Technologies is a leading specialty chemical supplier to the pulp, mining, food and beverage, paper, chemical processing, general manufacturing, institutional and municipal markets.

Performance Materials is a global producer of specialty resins and adhesives serving the construction, transportation, infrastructure, packaging and converting, marine and energy markets. As previously discussed in Note B, on November 30, 2010 Ashland completed the transaction to expand the global joint venture with Süd-Chemie, serving the foundry chemical sector. As part of the transaction, Ashland transferred its existing Casting Solutions business to the expanded joint venture. Effective December 1, 2010, Ashland's share of the joint venture's results of operations are recorded as equity income in the Statements of Consolidated Income. Therefore, financial results beginning December 1, 2010 for Performance Materials do not include the sales, cost of sales, selling, general and administrative expense and corresponding taxes related to this business. Ashland includes the

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

NOTE P – SEGMENT INFORMATION (continued)

financial results of the joint venture within operating income of the Performance Materials' segment and the equity and other income caption of the Statements of Consolidated Income. In addition, as part of the ISP acquisition, the Elastomers line of business was included within the Performance Materials segment.

Consumer Markets is a leading innovator, marketer and supplier of high-performing lubricants, automotive chemicals and appearance products, including those marketed under the ValvolineTM brands, and is an operator and franchisor of Valvoline Instant Oil ChangeTM centers.

Segment results

The following table presents for each segment the net sales and operating income for the three months ended December 31, 2011 and 2010. Results of Ashland's reportable segments are presented based on its management structure and internal accounting practices. The structure and practices are specific to Ashland; therefore, the financial results of Ashland's business segments are not necessarily comparable with similar information for other comparable companies. Ashland occasionally modifies its expense allocation methodologies to the reportable segments as internal accounting practices are improved, more refined information becomes available and businesses change. Revisions to Ashland's methodologies that are deemed insignificant are applied on a prospective basis, while significant changes are applied on a retroactive basis. The unallocated and other caption includes pension and postretirement expenses (excluding service costs) as well as certain specific company-wide restructuring activities that were significant, such as the restructuring plans described in Note E, and other costs or adjustments that relate to former businesses that Ashland no longer operates, including the Distribution business.

Change in expense allocation for pension and other postretirement benefit plans

As discussed in Notes A and K, Ashland elected during 2011 to change its method of recognizing actuarial gains and losses for its defined benefit pension and other postretirement benefit plans. In connection with this change in accounting policy for pension and other postretirement benefits, Ashland also elected to change its method of accounting for certain costs included in inventory. Ashland has elected to exclude the amount of its pension and other postretirement benefit costs applicable to inactive participants from inventoriable costs and charge them directly to cost of sales. While Ashland's historical policy of including all pension and other postretirement benefit costs as a component of inventoriable costs was acceptable, Ashland believes that the new policy is preferable, as inventoriable costs will only include costs that are directly attributable to current manufacturing employees. Applying this change retrospectively, in connection with the change in accounting for pension and other postretirement benefit costs, did not have a significant impact on previously reported inventory, cost of sales or segment reported results in any of the prior period financial statements. The financial information disclosed in the following table for each business segment reflects the retrospective application of this expense allocation change on the three months ended December 31, 2010.

In addition, as a further attempt to properly match actual operational expenses each business segment is incurring, Ashland has changed its expense allocation for pension and other postretirement benefit plans during 2011. Previously, Ashland allocated all components of pension and other postretirement benefit plan expenses to each business segment on a ratable basis. Ashland now allocates only the service cost component of these plans to the actual business segment that incurred this expense. All other components of pension and other postretirement benefit plan expense are recorded within Unallocated and other. Ashland believes the revised expense allocation will more appropriately match the cost incurred for active employees to the respective business segment. The financial information disclosed in the following tables for each business segment reflects the retrospective application of this expense allocation change on each period.

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

NOTE P – SEGMENT INFORMATION (continued)

	Three months ended December 31	
(In millions - unaudited)	2011	2010
SALES		
Specialty Ingredients (a)	$ 628	$ 216
Water Technologies	449	451
Performance Materials (b)	378	326
Consumer Markets	475	440
	$ 1,930	$ 1,433
OPERATING INCOME (LOSS)		
Specialty Ingredients	$ 71	$ 22
Water Technologies	21	28
Performance Materials	33	8
Consumer Markets	47	67
Unallocated and other	(28)	(11)
	$ 144	$ 114

(a) The three months ended December 31, 2011 include $358 million in sales related to ISP, which was acquired on August 23, 2011.

(b) The three months ended December 31, 2011 include $92 million in sales related to ISP's Elastomers business, which was acquired on August 23, 2011. The three months ended December 31, 2010 include only two months of customary sales related to the Casting Solutions business, as Ashland contributed this business to its expanded global joint venture with Süd-Chemie on November 30, 2010.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements including, without limitation, statements made under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" (MD&A), within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. In addition, Ashland may from time to time make forward-looking statements in its Annual Report to Shareholders, quarterly reports and other filings with the Securities and Exchange Commission, news releases and other written and oral communications. These forward-looking statements are based on Ashland's expectations and assumptions, as of the date such statements are made, regarding Ashland's future operating performance and financial condition, the economy and other future events or circumstances. Ashland's expectations and assumptions include, without limitation, those mentioned within the MD&A, internal forecasts and analyses of current and future market conditions and trends, management plans and strategies, operating efficiencies and economic conditions (such as prices, supply and demand, cost of raw materials, and the ability to recover raw material cost increases through price increases), and risks and uncertainties associated with the following: the possibility that the benefits anticipated from the acquisition of International Specialty Products Inc. (ISP) will not be fully realized, the substantial indebtedness Ashland has incurred to finance the acquisition of ISP (including the possibility that such debt and related restrictive covenants may adversely affect Ashland's future cash flows, results of operations, financial condition and its ability to repay debt), severe weather, natural disasters, and legal proceedings and claims (including environmental and asbestos matters). Various risks and uncertainties may cause actual results to differ materially from those stated, projected or implied by any forward-looking statements, including, without limitation, risks and uncertainties affecting Ashland that are described in its most recent Form 10-K (including Item 1A Risk Factors) filed with the SEC, which is available on Ashland's website at http://investor.ashland.com or on the SEC's website at www.sec.gov. Ashland believes its expectations and assumptions are reasonable, but there can be no assurance that the expectations reflected herein will be achieved. Ashland undertakes no obligation to subsequently update any forward-looking statements made in this Form 10-Q or otherwise except as required by securities or other applicable law.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

The following discussion should be read in conjunction with the Condensed Consolidated Financial Statements and the accompanying Notes to Condensed Consolidated Financial Statements herein.

BUSINESS OVERVIEW

Ashland profile

Ashland is a leading, global specialty chemical company that provides products, services and solutions that meet customer needs throughout a variety of industries. Ashland's chemistry is used in a wide variety of markets and applications, including architectural coatings, automotive, construction, energy, food and beverage, personal care, pharmaceutical, tissue and towel, and water treatment. With approximately 15,000 employees worldwide, Ashland serves customers in more than 100 countries.

Ashland's sales generated outside of North America were 48% and 45% for the three months ended December 31, 2011 and 2010, respectively. Sales by region expressed as a percentage of total consolidated sales for the three months ended December 31 were as follows:

Sales by Geography	2011	(a)	2010	
North America	52	%	55	%
Europe	27	%	24	%
Asia Pacific	14	%	13	%
Latin America & other	7	%	8	%
	100	%	100	%

(a) Includes sales from the acquired operations of International Specialty Products Inc. (ISP).

Business segments

Ashland's reporting structure is composed of four reporting segments: Ashland Specialty Ingredients (Specialty Ingredients) which in previous years was known as Ashland Functional Ingredients, Ashland Water Technologies (Water Technologies), Ashland Performance Materials (Performance Materials) and Ashland Consumer Markets (Consumer Markets). For further descriptions of each business segment see the "Results of Operations – Business Segment Review" beginning on page 38.

The contribution to sales by each business segment expressed as a percentage of total consolidated sales for the three months ended December 31 were as follows:

Sales by Business Segment	2011 (a)	2010
Specialty Ingredients	32%	15%
Water Technologies	23%	31%
Performance Materials	20%	23%
Consumer Markets	25%	31%
	100%	100%

(a) Includes sales from the acquired operations of ISP.

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

KEY DEVELOPMENTS

During 2012 and other previous periods, the following operational decisions and economic developments had an impact on Ashland's current and future cash flows, results of operations and financial position.

Acquisitions/Divestitures

International Specialty Products acquisition

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

Distribution divestiture

On March 31, 2011, Ashland completed the sale to Nexeo Solutions, LLC (Nexeo) of substantially all of the assets and certain liabilities of its global distribution business which previously comprised the Ashland Distribution (Distribution) segment. The transaction was an asset sale with the total post-closing adjusted cash proceeds received by Ashland of $972 million, before transaction fees and taxes. Ashland recognized an after-tax gain of $271 million during 2011. Because this transaction signified Ashland's exit from the distribution business, the results of operations and cash flows of Distribution have been classified as discontinued operations for the prior year period. Certain indirect corporate costs included within selling, general and administrative expense that were previously allocated to the Distribution reporting segment that do not qualify for discontinued operations accounting classification are now reported as costs within the Unallocated and other section of continuing operations, and for the three months ended December 31, 2011 and 2010 were $5 million and $7 million, respectively. Ashland is currently implementing plans to reduce these stranded costs.

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

As part of this sale, Ashland is receiving transition service fees for ongoing administrative and other services being provided to Nexeo. During the three months ended December 31, 2011, Ashland recognized transition service fees of $8 million, which offset costs of providing transition services and are classified within the selling, general and administrative expense caption of the Statements of Consolidated Income. While the transition service agreements vary in duration, depending upon the type of service provided, Ashland is implementing plans to reduce costs as the transition services are phased out.

Casting Solutions joint venture

In July 2010, Ashland and Süd-Chemie AG (Süd-Chemie) signed an agreement for the formation of an expanded global joint venture serving the foundry chemical sector. The transaction closed on November 30, 2010 and combined three businesses: (i) Ashland’s Casting Solutions business group, (ii) Süd-Chemie’s Foundry-Products and Specialty Resins business unit, and (iii) Ashland-Südchemie-Kernfest GmbH (ASK), the then existing 50% owned European-based joint venture between Ashland and Süd-Chemie, for which Ashland historically only

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recognized equity income of the joint venture within its consolidated results. Ashland recognized a pretax gain of $23 million during 2011 of which $19 million was recognized during the December 2010 period, attributable to the fair market value of the net assets contributed to the joint venture.

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

Synlubes business divestiture

In November 2011, Ashland announced that it had entered into a definitive agreement to sell its aviation and refrigerant lubricants business, a polyol/ester-based synlubes (synlubes) business included within the Water Technologies business segment to Monument Chemical Inc., a Heritage Group Company. Annual sales of the business are approximately $50 million. Total net assets related to this business totaled $21 million as of December 31, 2011 and primarily consisted of property, plant and equipment. The transaction was closed in January 2012 and is expected to have a nominal gain that will be recognized in the March 2012 quarter.

PVAc business divestiture

In November 2011, Ashland announced that it had entered into a definitive agreement to sell its polyvinyl acetate homopolymer and copolymer (PVAc) business included within the Performance Materials business segment to Celanese Corporation. Annual sales of the business are approximately $45 million. Total net assets related to this business totaled $23 million as of December 31, 2011 and primarily consisted of property, plant and equipment. The sale agreement includes the transfer of the PVAc business, inventory and related technology, but does not include any real estate or manufacturing facilities. Ashland's PVAc business includes two brands, Flexbond™ and Vinac™ emulsions. To support the transition, the products will be temporarily toll manufactured by Ashland for the Celanese Corporation. The transaction was closed in January 2012 and is expected to have a nominal gain that will be recognized in the March 2012 quarter.

Restructuring and integration programs

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

During the prior year, Ashland announced steps to reduce stranded costs resulting from the divestiture of Distribution and the contribution of the Casting Solutions business to the expanded global joint venture with Süd-Chemie. Targeted cost reductions for the Distribution and Casting Solutions' stranded costs are $40 million. In addition, Ashland is currently implementing plans to integrate ISP, subsequent to its purchase in August

2011. Targeted synergy cost reductions related to this acquisition are $50 million.

Steps to address cost reduction opportunities included Ashland's announced voluntary severance offer (VSO) in June 2011 to approximately 1,500 regular, full-time, non-union, U.S.-based employees, primarily within various shared resource groups as well as certain positions within the Specialty Ingredients business, which ultimately resulted in 150 employees being formally approved for the VSO. An involuntary program was also initiated in 2011 as a further step to capture targeted saving levels from these transactions and other business cost savings initiatives. The VSO and involuntary programs resulted in a severance charge of $34 million during the September 2011 quarter. The involuntary program continued during the December 2011 quarter, and resulted in an additional severance charge of $28 million classified within the selling, general and administrative expense caption of the Statement of Consolidated Income for the three months ended December 31, 2011. As of December 31, 2011, approximately $30 million of annualized cost savings have been achieved from these cost reduction programs primarily through reductions in supply chain, IT and finance resource groups.

ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
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Additional charges related to the involuntary program may occur in subsequent periods from ongoing efforts to maximize operational efficiencies as a result of these transactions. The remaining cost savings are expected to be completed by the end of the March 2012 quarter for the Distribution and Casting Solutions stranded costs, while the majority of ISP synergy savings are expected to be completed by the end of fiscal 2012, with the remaining completed during 2013 once full implementation of Ashland's ERP platform is completed. As of December 31, 2011, the restructuring reserve for these programs totaled $56 million.

Financing activities

Senior secured credit facility

On August 23, 2011, in conjunction with the ISP acquisition closing, Ashland entered into a $3.9 billion senior secured credit facility with a group of lenders (the Senior Credit Facility). The Senior Credit Facility is comprised of (i) a $1.5 billion term loan A facility, (ii) a $1.4 billion term loan B facility and (iii) a $1.0 billion revolving credit facility. Proceeds from borrowings under the term loan A facility and the term loan B facility were used, together with cash on hand, to finance the cash consideration paid for the ISP acquisition, as well as to finance the repayment of existing indebtedness of ISP in connection with the acquisition.

Former senior credit facility

During March 2011, Ashland terminated its previous term loan A facility due 2014, paying off the outstanding balance of $289 million with funds received from the sale of Distribution. As a result of the termination of this facility, Ashland recognized an $11 million charge for the remaining debt issuance costs related to the loan fees paid to originate the loan, which is included in the net interest and other financing expense caption in the Statements of Consolidated Income.

On March 31, 2010, as part of a refinancing of its then-existing senior credit facilities, Ashland entered into a credit agreement with a group of lenders. The credit agreement provided for an aggregate principal amount of $850 million in senior secured credit facilities, consisting of a $300 million four-year term loan A facility and a $550 million revolving credit facility. The proceeds from the borrowings from the term loan A facility were used, together with proceeds from the accounts receivable securitization facility, and cash on hand to repay all amounts outstanding under Ashland's previous senior secured facilities and to pay for fees and expenses incurred in connection with the credit facilities and the related transactions. As discussed above, the term loan A facility was terminated and repaid in March 2011, and the revolving credit facility was replaced with a new $1.0 billion revolving credit facility as part of the August 23, 2011 current Senior Credit Facility.

Other financing activities

Ashland's corporate credit ratings have remained unchanged from those reported in its Form 10-K filed in late November of 2011. Standard & Poor's ratings are BB, while Moody's Investor Services are Ba1, with a stable outlook from both. Subsequent changes to these ratings may have an affect on Ashland's borrowing rate or ability to access capital markets in the future. As of December 31, 2011, Ashland's access to cash has remained largely unchanged with a total of approximately $1.4 billion of liquidity, defined as cash and availability under liquidity facilities including the current revolving credit facility.

Based on Ashland's current debt structure included in Note I of Notes to Condensed Consolidated Financial Statements and the debt restructuring during the prior year in conjunction with the closing of the ISP transaction, future annual interest expense is expected to range from approximately $220 million to $230 million based on applicable fixed and floating interest rates, assuming interest rates remain stable.

Stock repurchase and annual dividend increase

In March 2011, the Board of Directors of Ashland approved a $400 million stock repurchase program. Under the program that began on April 1, 2011, Ashland purchased common shares through a $200 million 10b5-1 automatic trading plan. Effective May 31, 2011, as a result of the announcement of the pending ISP acquisition, Ashland terminated the 10b5-1 automatic trading program. Purchases under the plan amounted to $71 million, or 1.2 million shares. Ashland still has the ability to make discretionary purchases of Ashland Common Stock on the open market, pursuant to the Board's original $400 million share repurchase authorization.

In May 2011, the Board of Directors of Ashland announced a quarterly cash dividend of 17.5 cents per share, 70 cents per share on an annual basis, to eligible shareholders of record. This amount was paid for quarterly dividends in June, September and December 2011, and was an increase from the quarterly cash dividend of 15 cents per share paid during the first and second quarters of the prior year.

RESULTS OF OPERATIONS – CONSOLIDATED REVIEW

Use of non-GAAP measures

Based on clarification and interpretive guidance from the Securities and Exchange Commission regarding the use of non-GAAP measures, Ashland has included within this document certain non-GAAP measures which include EBITDA (operating income plus depreciation and amortization), adjusted EBITDA (EBITDA adjusted for key items, which may include pro forma affects for significant acquisitions or divestitures, as applicable), adjusted EBITDA margin (adjusted EBITDA, which can include pro forma adjustments, divided by sales or sales adjusted for pro forma results) and free cash flow (cash flows by operating activities from continuing operations minus cash dividends paid and additions to property, plant and equipment). Such measurements are not prepared in accordance with U.S. GAAP and should not be construed as an alternative to reported results determined in accordance with U.S. GAAP. Management believes the use of such non-GAAP measures on a consolidated and business segment basis assists investors in understanding the ongoing operating performance by presenting the financial results between periods on a more comparable basis. In addition, certain financial covenants related to Ashland's Senior Credit Facility are based on similar non-GAAP measures. The non-GAAP information provided is unique to Ashland and may not be consistent with the methodologies used by other companies.

Consolidated review

Net income

Ashland's net income amounted to $61 million and $99 million for the three months ended December 31, 2011 and 2010, respectively, or $0.77 and $1.25 diluted earnings per share, respectively. Ashland's net income is primarily affected by results within operating income, net interest and other financing expense, income taxes, discontinued operations and other significant events or transactions that are unusual or nonrecurring.

Income from continuing operations, which excludes results from discontinued operations, amounted to $60 million and $71 million for the three months ended December 31, 2011 and 2010, respectively, or $0.76 and $0.91 per diluted earnings per share, respectively. Operating income was $144 million and $114 million for the three months ended December 31, 2011 and 2010, respectively. See the "Operating income" discussion for an analysis of these results.

Ashland incurred pretax net interest and other financing expense of $57 million and $27 million for the three months ended December 31, 2011 and 2010, respectively. The increase in interest expense during the current quarter compared to the prior year quarter was due to increased borrowings under the new senior secured credit facility entered into in August of 2011, in conjunction with the ISP acquisition closing. Borrowings were used to finance the cash consideration paid for the ISP acquisition and the repayment of existing indebtedness of ISP assumed by Ashland.

During the three months ended December 31, 2011 Ashland reported a $4 million charge recorded below operating income on the Statement of Consolidated Income in the net gain (loss) on acquisitions and divestitures caption related to ISP transaction costs and subsequent adjustments to the 2005 transfer of Ashland's 38% interest in the Marathon Ashland Petroleum joint venture and two other small businesses to Marathon Oil Corporation (Marathon) (MAP Transaction). During the three months ended December 31, 2010 Ashland reported a $21 million gain recorded within the net gain (loss) on acquisitions and divestitures caption, which primarily related to a

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nonrecurring gain from the fair market value of the Casting Solutions net assets contributed to the expanded global joint venture with Süd-Chemie exceeding the recorded amounts. This remeasurement resulted in a pretax gain of $19 million, or $3 million after tax. For further information on each of these items see the related income statement caption discussion in the comparative Statements of Consolidated Income analysis.

The effective income tax rates of 27.7% and 34.3% for the three months ended December 31, 2011 and 2010, respectively, were both affected by discrete items disclosed in further detail within the income tax expense caption discussion in the comparative Statements of Consolidated Income analysis.

Discontinued operations, which are reported net of taxes, resulted in income of $1 million and $28 million for the three months ended December 31, 2011 and 2010, respectively. The prior period results include the direct operating results of Distribution and various adjustments related to previously recorded divestitures, while both the current and prior year quarter includes asbestos adjustments. For further information on items reported within this caption, see the discontinued operations caption discussion in the comparative Statements of Consolidated Income analysis.

Operating income

Operating income amounted to $144 million and $114 million for the three months ended December 31, 2011 and 2010, respectively. The increase in operating income for the current quarter was primarily the result of including ISP's operating results subsequent its purchase in the September 2011 quarter. The current quarter results also included a noncash charge of $25 million related to the fair value assessment of inventory acquired from ISP at the date of acquisition as well as $28 million for severance and restructuring charges from Ashland's ongoing stranded cost and ISP integration programs. The prior year quarter included a $7 million accelerated depreciation charge for plant closure costs associated with capacity reductions in the composites line of business within Performance Materials and a $3 million charge for transaction and start-up costs associated with the expanded global joint venture with Süd-Chemie. Excluding these items noted above, operating income for the current quarter remained flat as compared to the prior year quarter as a significant increase in Specialty Ingredients income was primarily offset by declines in the Consumer Markets and Water Technologies business segment results.

Operating income for the three months ended December 31, 2011 and 2010 included depreciation and amortization of $104 million and $73 million (which includes accelerated depreciation of $7 million for the December 31, 2010 quarter), respectively. EBITDA totaled $248 million and $187 million for the three months ended December 31, 2011 and 2010, respectively. Adjusted EBITDA results in the table below have been prepared to illustrate the ongoing effects of Ashland's operations, which exclude certain key items because management believes the use of such non-GAAP measures on a consolidated and business segment basis assists investors in understanding Ashland's ongoing operating performance by presenting the financial results between periods on a more comparable basis. The inventory fair value adjustment of $25 million in the current quarter relates to the portion of acquired inventory sold during the period that was recorded at fair value in conjunction with the acquisition of ISP. The ISP business results of $76 million in the prior year quarter relates to the operating income earned and depreciation and amortization expense for the period in which Ashland did not yet own this business and is included herein to provide a comparison to the prior year quarter.

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

	Three months ended December 31	
(In millions)	2011	2010
Operating income	$ 144	$ 114
Depreciation and amortization (a)	104	73
EBITDA	248	187
Severance	28	-
Inventory fair value adjustment	25	-
Results of ISP business prior to acquisition	-	76
Casting Solutions transaction and start-up costs	-	3
Adjusted EBITDA	$ 301	$ 266

(a) Includes $7 million of accelerated depreciation for the three months ended December 31, 2010.

Statements of Consolidated Income – caption review

A comparative analysis of the Statements of Consolidated Income by caption is provided as follows for the three months ended December 31, 2011 and 2010.

	Three months		
(In millions)	2011	2010	Change
Sales	$ 1,930	$ 1,433	$ 497

Sales for the current quarter increased $497 million, or 35%, compared to the prior year quarter primarily as a result of the acquisition of ISP in August 2011 and increases in pricing, implemented to recover the effects of increases in raw material costs, which increased sales $450 million and $146 million, respectively, or 42%, in total. Favorable mix of product sold increased sales an additional $20 million, or 1%. Volume decreased sales $58 million, or 4%, while the contribution of the Casting Solutions business in November 2010 to the expanded global joint venture with Süd-Chemie reduced sales by $60 million, or 4%. Unfavorable currency exchange rates decreased sales $1 million.

	Three months		
(In millions)	2011	2010	Change
Cost of sales	$ 1,408	$ 1,035	$ 373
Gross profit as a percent of sales	27.0 %	27.8 %	

Cost of sales for the current quarter increased $373 million, or 36%, compared to the prior year quarter primarily due to the acquisition of ISP and escalating raw material costs that increased cost of sales $305 million and $127 million, respectively, or 42%, in total. Change in product mix increased cost of sales by an additional $10 million, or 1%. Decreased volume reduced cost of sales $46 million, or 4%, while the net contribution of the Casting Solutions business in November 2010 to the expanded global joint venture with Süd-Chemie caused a decrease of $48 million, or 5%. The current quarter also includes a noncash charge of $25 million related to the fair value assessment of inventory acquired from ISP at the date of acquisition.

	Three months		
(In millions)	2011	2010	Change
Selling, general and administrative expense	$ 362	$ 276	$ 86
As a percent of sales	18.8 %	19.3 %	

Selling, general and administrative expenses for the current quarter increased 31% compared to the prior year quarter, however, expenses as a percent of sales declined 0.5 percentage points. Increases in expenses in the current quarter included $28 million for severance and restructuring charges as well as the inclusion of ISP costs, which added an additional $62 million.

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ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
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	Three months		
(In millions)	2011	2010	Change
Research and development expense	$ 30	$ 20	$ 10

Research and development expenses during the current quarter increased $10 million as compared to the prior year quarter. The increase relates to the inclusion of ISP costs during the current quarter, which added an additional $10 million compared to the prior year quarter.

	Three months		
(In millions)	2011	2010	Change
Equity and other income			
Equity income	$ 6	$ 3	$ 3
Other income	8	9	(1)
	$ 14	$ 12	$ 2

Total equity and other income increased 17% during the current quarter compared to the prior year quarter. The increase in equity income during the current quarter primarily related to equity income from the Performance Materials business segment. This increase was the result of operational results for the expanded global joint venture with Süd-Chemie for the full quarter as compared to one month in the prior year quarter. Certain start-up costs of $2 million associated with the joint venture were also incurred during the prior year quarter. See Note C of Notes to Condensed Consolidated Financial Statements for additional information on this joint venture.

	Three months		
(In millions)	2011	2010	Change
Net interest and other financing (expense) income			
Interest expense	$ (57)	$ (29)	$ (28)
Interest income	2	3	(1)
Other financing costs	(2)	(1)	(1)
	$ (57)	$ (27)	$ (30)

The combined increase, excluding interest income, in interest expense and other financing costs of $29 million in the current quarter compared to the prior year quarter was due to borrowings under the new senior secured credit facility entered into in August of 2011 in conjunction with the ISP acquisition. Borrowings were used to finance the cash consideration paid for the ISP acquisition and the repayment of existing indebtedness of ISP assumed by Ashland.

	Three months		
(In millions)	2011	2010	Change
Net gain (loss) on acquisitions and divestitures			

Süd-Chemie joint venture	$ -	$ 19	$ (19)
ISP transaction costs	(2)	-	(2)
MAP Transaction	(2)	2	(4)
	$ (4)	$ 21	$ (25)

Net gain (loss) on acquisitions and divestitures during the current quarter includes ISP transaction costs as well as subsequent adjustments to the 2005 transfer of Ashland's 38% interest in the Marathon Ashland Petroleum joint venture and two other small businesses to Marathon Oil Corporation (Marathon) (MAP Transaction). Net gain (loss) on acquisitions and divestitures during the prior year quarter includes the remeasurement gain from Ashland's fair market value assessment of the Casting Solutions net assets contributed to the expanded global joint venture with Süd-Chemie exceeding the previously recorded amounts as well as subsequent adjustments to the MAP Transaction. See Note C of Notes to Condensed Consolidated Financial Statements for additional information on the Süd-Chemie joint venture.

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ASHLAND INC. AND CONSOLIDATED SUBSIDIARIES
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	Three months		
(In millions)	2011	2010	Change
Income tax expense	$ 23	$ 37	$ (14)
Effective tax rate	27.7 %	34.3 %	

The overall effective tax rate of 27.7% for the current quarter included two discrete tax benefits of $9 million for both the $28 million severance and restructuring charge and the $25 million fair value assessment of inventory charge recorded during the current quarter. The overall effective tax rate 34.3% for the prior year quarter included a $16 million tax expense from the $19 million pretax gain associated with the fair market value of the Casting Solutions contribution and a $4 million tax benefit associated with research and development tax credits for the prior year quarter. Ashland currently estimates the effective tax rate for 2012 to be in the low 30% range, excluding key items.

	Three months		
(In millions)	2011	2010	Change
Income (loss) from discontinued operations (net of income taxes)			
Distribution	$ (5)	$ 26	$ (31)
APAC	-	1	(1)
Asbestos-related litigation reserves	6	1	5
	$ 1	$ 28	$ (27)

As a result of Distribution's sale to Nexeo on March 31, 2011 and in accordance with U.S. GAAP provisions, the operating results related to Distribution for the prior year have been reflected as discontinued operations (net of income taxes). During the current quarter, subsequent tax adjustments were made to the gain on the sale of Distribution along with an environmental reserve adjustment, resulting in a $5 million charge to discontinued operations. These charges were more than offset by a net $6 million asbestos receivable recovery after reaching a settlement with certain insolvent London insurance carriers.

The operational results of Distribution included in discontinued operations for the prior year quarter included sales of $856 million with gross profit margin of 8.8%. Additionally, during the prior year quarter, subsequent tax adjustments were made to the gain on the sale of APAC (divested in 2006) along with favorable net adjustments to the asbestos reserve and related receivables as a result of Ashland's ongoing assessment of these matters. See Notes C and D of Notes to Condensed Consolidated Financial Statements for further information.

RESULTS OF OPERATIONS – BUSINESS SEGMENT REVIEW

Results of Ashland's business segments are presented based on its management structure and internal accounting practices. The structure and practices are specific to Ashland; therefore, the financial results of Ashland's business segments are not necessarily comparable with similar information for other comparable companies. Ashland allocates all costs to its business segments except the non-service elements for pension and postretirement expenses as well as costs related to certain significant company-wide restructuring activities, such as the current restructuring plans described in Note E of Notes to Condensed Consolidated Financial Statements, and other costs or adjustments that relate to former businesses that Ashland no longer operates. Ashland refines its expense allocation methodologies to the reportable segments from time to time as internal accounting practices are improved, more information becomes available and businesses change. Revisions to Ashland's methodologies that are deemed insignificant are applied on a prospective basis.

As previously discussed, Ashland's businesses are managed along four industry segments: Specialty Ingredients, Water Technologies, Performance Materials and Consumer Markets. As a result of Distribution's sale to Nexeo, the operating results and assets and liabilities related to Distribution have been reflected as discontinued operations for all periods presented. For additional information, see Note P of Notes to Condensed Consolidated Financial Statements.

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During the September quarter in 2011, Ashland elected to change its method of recognizing actuarial gains and losses for its defined benefit pension plans and other postretirement benefit plans. Previously, Ashland recognized the actuarial gains and losses as a component of Stockholders' Equity within the Condensed Consolidated Balance Sheet on an annual basis and amortized the gains and losses into operating results over the average future service period of active employees within the related plans. Ashland has elected to immediately recognize the change in the fair value of plan assets and net actuarial gains and losses annually in the fourth quarter of each year and whenever a plan is determined to qualify for a remeasurement during a year. The remaining components of pension and other postretirement benefits expense will be recorded on a quarterly basis. While Ashland's historical policy of recognizing pension and other postretirement benefit expense is considered acceptable under U.S. GAAP, Ashland believes that the new policy is preferable as it eliminates the delay in recognizing gains and losses within operating results. This change will also improve transparency within Ashland's operating results by immediately recognizing the effects of economic and interest rate trends on plan investments and assumptions in the year these gains and losses are actually incurred. This change in accounting policy has been applied retrospectively, adjusting all prior periods presented.

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

In addition, as a further attempt to properly match actual operational expenses each business segment is incurring, Ashland has changed its expense allocation for pension and other postretirement benefit plans during 2011. Previously, Ashland allocated all components of pension and other postretirement benefit plan expenses to each business segment on a ratable basis. Ashland now allocates only the service cost component of these plans to the actual business segment that incurred this expense. All other components of pension and other postretirement benefit plan expense are recorded within Unallocated and other. Ashland believes the revised expense allocation will more appropriately match the cost incurred for active employees to the respective business segment. The financial information disclosed in the following tables for each business segment reflects the retrospective application of this expense allocation change on each period.

The following table shows sales, operating income and statistical operating information by business segment for the three months ended December 31, 2011 and 2010.

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

(In millions)	2011	2010
Sales		
Specialty Ingredients	$ 628	$ 216
Water Technologies	449	451
Performance Materials	378	326
Consumer Markets	475	440
	$ 1,930	$ 1,433
Operating income (loss)		
Specialty Ingredients	$ 71	$ 22
Water Technologies	21	28
Performance Materials	33	8
Consumer Markets	47	67
Unallocated and other	(28)	(11)
	$ 144	$ 114
Depreciation and amortization		
Specialty Ingredients	$ 64	$ 24
Water Technologies	19	21
Performance Materials	12	18
Consumer Markets	9	9
Unallocated and other	-	1
	$ 104	$ 73
Operating information		
Specialty Ingredients (a) (b)		
Sales per shipping day	$ 10.3	$ 3.5
Metric tons sold (thousands)	98.2	38.5
Gross profit as a percent of sales	29.6 %	31.2 %
Water Technologies (a)		
Sales per shipping day	$ 7.4	$ 7.3
Gross profit as a percent of sales	30.8 %	31.6 %
Performance Materials (a) (b)		
Sales per shipping day	$ 6.2	$ 5.3
Metric tons sold (thousands)	137.4	124.4
Gross profit as a percent of sales	19.2 %	14.6 %
Consumer Markets (a)		
Lubricant sales gallons	36.7	40.4
Premium lubricants (percent of U.S. branded volumes)	29.3 %	30.2 %
Gross profit as a percent of sales	25.3 %	30.9 %

(a) Sales are defined as sales and operating revenues. Gross profit is defined as sales, less cost of sales.

(b) Amounts for the three months ended December 31, 2010 exclude pre-acquisition results of ISP.

The EBITDA and adjusted EBITDA amounts presented below within this business section are provided as a means to enhance the understanding of financial measurements that Ashland has internally determined to be relevant measures of comparison for each segment. Each of these non-GAAP measures is defined as follows: EBITDA (operating income plus depreciation and amortization), adjusted EBITDA (EBITDA adjusted for key items, which may include pro forma affects for significant acquisitions or divestitures, as applicable), and adjusted EBITDA margin (adjusted EBITDA, which may include pro forma adjustments, divided by sales or sales adjusted for pro forma results).

Specialty Ingredients

Specialty Ingredients, which was formerly known as Functional Ingredients, offers industry-leading products, technologies and resources for solving formulation and product performance challenges in a variety of markets including personal care, pharmaceutical, food and beverage, coatings, construction and energy.

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

On August 23, 2011, Ashland completed its acquisition of ISP, a global specialty chemical manufacturer of innovative functional ingredients and technologies, in a transaction valued at $3.2 billion. ISP reported sales of $1.9 billion for the twelve months ended September 30, 2011. Ashland has included ISP within the Specialty Ingredients reporting segment, with the exception of ISP's Elastomers business line, a business with $410 million of sales for the twelve months ended September 30, 2011, which has been included within the Performance Materials reportable segment.

In November 2010, Specialty Ingredients' new hydroxyethylcellulose (HEC) production facility in Nanjing, China became operational. At a cost of $90 million, the new facility represents Ashland's largest single investment in China and the Asia Pacific region. This manufacturing facility increased Specialty Ingredients' HEC production capacity by 10,000 metric tons per year and can be expanded to produce up to 20,000 metric tons per year.

December 2011 quarter compared to December 2010 quarter

Specialty Ingredients' sales increased 191% to $628 million in the current quarter compared to $216 million in the prior year quarter, primarily as a result of the acquisition of ISP, which increased sales $358 million, or 166%. Higher pricing increased sales $26 million, or 12%, while the mix of product sold increased sales an additional $19 million, or 9%. Volume increased sales $8 million, or 4%, during the current quarter as metric tons sold increased to 98.2 thousand. Favorable currency exchange added $1 million to sales.

Gross profit during the current quarter increased $118 million compared to the prior year quarter. The inclusion of ISP's operations (excluding the Elastomers business) in the current quarter increased gross profit by $96 million, which included a noncash charge of $25 million related to the fair value assessment of inventory acquired from ISP at the date of acquisition, while favorable product mix sold increased gross profit an additional $10 million. Increased selling prices more than offset higher manufacturing costs, causing an additional $8 million increase in gross profit. Increased volume improved gross profit by $4 million. In total, gross profit margin during the current quarter decreased 1.6 percentage points to 29.6% compared to the prior year quarter, primarily as a result of the nonrecurring charge related to the fair value of inventory acquired from ISP, which had a negative 4.0 percentage point impact to the gross profit margin.

Selling, general and administrative expenses (which include research and development expenses throughout the business segment discussion and analysis) increased $69 million, or 150%, during the current quarter as compared to the prior year quarter, primarily due to increases from the ISP acquisition of $68 million and increases in salaries, benefits and incentive compensation of $1 million.

Operating income totaled $71 million for the current quarter compared to $22 million in the prior year quarter. EBITDA increased $89 million to $135 million in the current quarter, while adjusted EBITDA increased $45 million to $160 million in the current quarter. Adjusted EBITDA margin increased 3.7 percentage points in the current quarter to 25.5%.

EBITDA and Adjusted EBITDA reconciliation

The following EBITDA and adjusted EBITDA presentation for the three months ended December 31, 2011 and 2010 below is provided as a means to enhance the understanding of financial measurements that Ashland has internally determined to be relevant measures of comparison for the results of Specialty Ingredients. Adjusted EBITDA results have been prepared to illustrate the ongoing effects of Ashland's operations, which exclude certain key items. The inventory fair value adjustment of $25 million in the current quarter relates to the portion of acquired inventory sold during the period that was recorded at fair value in conjunction with the acquisition of ISP. The ISP business results of $69 million, which excludes the ISP Elastomers business, during the prior year quarter relate to the operating income and depreciation and amortization recognized for the period in which Ashland did not yet own this business and is included herein to provide a comparison to the prior year quarter.

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

	Three months ended December 31	
(In millions)	2011	2010
Operating income	$ 71	$ 22
Depreciation and amortization	64	24
EBITDA	135	46
Inventory fair value adjustment	25	-
Results of the ISP business prior to acquisition, excluding Elastomers business	-	69
Adjusted EBITDA	$ 160	$ 115

Water Technologies

Water Technologies is a leading specialty chemical supplier to the pulp, mining, food and beverage, paper, chemical processing, general manufacturing, institutional and municipal markets.

December 2011 quarter compared to December 2010 quarter

Water Technologies' sales decreased slightly to $449 million in the current quarter compared to $451 million in the prior year quarter. Higher product pricing increased sales $36 million, or 8%, while volume declines reduced sales $35 million, or 8%. Unfavorable currency exchange decreased sales an additional $3 million, or 1%.

Gross profit decreased $6 million in the current quarter compared to the prior year quarter. Decreased volumes were the primary factor in the gross profit decline resulting in an $8 million decrease, while unfavorable currency exchange reduced gross profit an additional $1 million. These decreases, however, were partially offset by favorable pricing as compared to the prior year quarter, which increased gross profit by $3 million. In total, gross profit margin during the current quarter decreased .8 percentage points to 30.8% compared to the prior year quarter.

Selling, general and administrative expenses were unchanged during the current quarter as compared to the prior year quarter, as increases in technical service and research and development were offset by decreased marketing and administration costs. Equity and other income decreased $1 million during the current quarter as compared to the prior year quarter.

Operating income totaled $21 million during the current quarter compared to $28 million during the prior year quarter. EBITDA decreased $9 million to $40 million in the current quarter, while EBITDA margin decreased 2.0 percentage points in the current quarter to 8.9%. There were no unusual or key items that affected comparability for EBITDA during the current and prior year quarters.

EBITDA and Adjusted EBITDA reconciliation

The following EBITDA and adjusted EBITDA presentation for the three months ended December 31, 2011 and 2010 below is provided as a means to enhance the understanding of financial measurements that Ashland has internally determined to be relevant measures of comparison for the results of Water Technologies. There were no unusual or key items that affected comparability for EBITDA during the current and prior year quarters.

	Three months ended December 31	
(In millions)	2011	2010
Operating income	$ 21	$ 28
Depreciation and amortization	19	21
EBITDA	$ 40	$ 49

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Performance Materials

Performance Materials is a global producer of specialty resins and adhesives serving the construction, transportation, infrastructure, packaging and converting, marine and energy markets.

On August 23, 2011, Ashland completed its acquisition of ISP, a global specialty chemical manufacturer of innovative functional ingredients and technologies, in a transaction valued at $3.2 billion. ISP reported sales of $1.9 billion for the twelve months ended September 30, 2011. Ashland has included ISP within the Specialty Ingredients reporting segment, with the exception of ISP's Elastomers business line, a business with $410 million of sales for the twelve months ended September 30, 2011, which has been included within the Performance Materials reportable segment.

In July 2010, Ashland and Süd-Chemie AG (Süd-Chemie) signed an agreement for the formation of an expanded global joint venture serving the foundry chemical sector. The transaction closed on November 30, 2010 and combined three businesses: (i) Ashland's Casting Solutions business group, (ii) Süd-Chemie's Foundry-Products and Specialty Resins business unit, and (iii) Ashland-Südchemie-Kernfest GmbH (ASK), the then existing 50% owned European-based joint venture between Ashland and Süd-Chemie, for which Ashland historically only recognized equity income of the joint venture within its consolidated results. Ashland's Casting Solutions and ASK businesses recorded sales of $279 million and $145 million, respectively, during each businesses' most recent completed year prior to the closing. The Foundry-Products and Specialty Resins business unit of Süd-Chemie contributed to the joint venture generated sales of approximately $146 million for its most recently completed year prior to the closing.

Ashland's equity interest in the expanded joint venture qualifies for equity method accounting treatment under U.S. GAAP. As a result, operational results beginning on December 1, 2010, for Performance Materials do not include the sales, cost of sales, selling, general and administrative expense and corresponding taxes related to this business. Ashland includes the financial results of the joint venture within operating income of the Performance Materials segment and in the equity and other income caption of the Statements of Consolidated Income. In addition, the expanded joint venture has resulted in certain stranded costs that Ashland has implemented cost reduction plans to eliminate.

December 2011 quarter compared to December 2010 quarter

Performance Materials' sales increased 16% to $378 million in the current quarter compared to $326 million in the prior year quarter. The acquisition of ISP's Elastomers business contributed $92 million, or 28%, in sales, while the exclusion of sales from December 2010 forward, related to the contribution of the Casting Solutions business into an expanded global joint venture, reduced sales $60 million, or 18%. Higher product pricing increased sales an additional $25 million, or 8%, primarily as a result of pricing increases in the composites line of business that were announced to fully offset increases in raw material costs. Volume decreased sales by $3 million, or 1%, excluding acquisitions and divestitures, while change in product mix and unfavorable currency exchange decreased sales an additional $2 million, or 1%.

Gross profit increased $25 million in the current quarter compared to the prior year quarter. The prior period quarter included plant closure charges of $7 million related to accelerated depreciation. These charges were incurred as part of the previously announced capacity reduction within this business in reaction to a substantial overall decline in industry demand as well as Ashland's continued overall effort to optimize each businesses' cost structure. The acquisition of ISP's Elastomers business contributed an additional $24 million in gross profit during the current quarter, while the exclusion of the financial results for the Casting Solutions business decreased gross profit by $10 million. Pricing increased gross profit by $5 million, while unfavorable currency exchange and volume reduced gross profit by $1 million. In total, gross profit margin during the current quarter increased 4.6 percentage points to 19.2%, as compared to the prior year quarter, primarily as a result of the plant closure charges incurred in the prior year quarter, which reduced margin by 2.1 percentage points, as well as the margin associated with sales from the acquisition of ISP's Elastomers business.

Selling, general and administrative expenses increased $3 million, or 7%, during the current quarter compared to the prior year quarter, primarily due to increases in incentive compensation and benefits of $5 million and the

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acquisition of ISP's Elastomers business of $5 million, offset by reductions in salaries, benefits and other related expenses associated with the transferred Casting Solutions business of $7 million. Equity and other income increased $3 million during the current quarter compared to the prior year quarter, primarily due to transaction and start-up costs associated with the expanded global joint venture with Süd-Chemie incurred in the prior year quarter.

Operating income totaled $33 million in the current quarter compared to $8 million in the prior year quarter. EBITDA increased $19 million to $45 million in the current quarter, while adjusted EBITDA increased $5 million to $45 million in the current quarter. Adjusted EBITDA margin increased 1.9 percentage points to 11.9% in the current quarter.

EBITDA and Adjusted EBITDA reconciliation

The following EBITDA and adjusted EBITDA presentation for the three months ended December 31, 2011 and 2010 below is provided as a means to enhance the understanding of financial measurements that Ashland has internally determined to be relevant measures of comparison for the results of Performance Materials. Adjusted EBITDA results have been prepared to illustrate the ongoing effects of Ashland's operations, which exclude certain key items. The ISP Elastomers business results of $12 million during the prior year quarter relate to the operating income and depreciation and amortization recognized for the period in which Ashland did not yet own this business and is included herein to provide a comparison to the prior year quarter.

	Three months ended December 31	
(In millions)	2011	2010
Operating income	$ 33	$ 8
Depreciation and amortization (a)	12	18
EBITDA	45	26
Results of ISP Elastomers business prior to acquisition	-	12
Casting Solutions joint venture start-up costs	-	2
Adjusted EBITDA	$ 45	$ 40

(a) Includes $7 million of accelerated depreciation for the three months ended December 31, 2010.

Consumer Markets

Consumer Markets is a leading innovator and supplier of high-performance lubricants, automotive chemicals and appearance products, including those marketed under the Valvoline™ brands, and is an operator and franchisor of Valvoline Instant Oil Change™ centers.

During the prior year, Consumer Markets introduced a new automotive oil product line called Valvoline™ NextGen™. NextGen™ is the first major brand of motor oil in the industry made of 50% recycled oil, and like other Valvoline™ motor oils it is backed by Valvoline's engine guarantee. Valvoline™ expects this new product to continue to enhance its overall position within the automotive oil industry.

December 2011 quarter compared to December 2010 quarter

Consumer Markets' sales increased 8% to $475 million in the current quarter compared to $440 million in the prior year quarter. Higher product pricing was the primary factor in sales growth between quarters, resulting in a $59 million, or 13%, increase in sales, while changes in product mix sold resulted in an additional $2 million, or 1%, increase in sales. Volume decreased sales by $26 million, or 6%, in the current quarter as lubricant gallons sold declined to 36.7 million gallons during the current quarter compared to 40.4 million gallons in the prior year quarter.

Gross profit decreased $16 million during the current quarter compared to the prior year quarter, primarily due to lubricant volume declines and raw material cost increases resulting in decreases of $10 million and $7 million, respectively. Product mix increased gross profit $1 million. In total, gross profit margin during the current quarter

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declined 5.6 percentage points to 25.3% as the volume declines and significant increases in raw material costs resulted in the lower gross margin compared to the prior year quarter.

Selling, general and administrative expenses increased $4 million, or 5%, during the current quarter as compared to the prior year quarter, primarily as a result of increases in payroll related expenses of $3 million.

Operating income totaled $47 million in the current quarter as compared to $67 million in the prior year quarter. EBITDA decreased $20 million to $56 million in the current quarter, while EBITDA margin decreased 5.5 percentage points to 11.8% in the current quarter. There were no unusual or key items that affected comparability for EBITDA during the current and prior year quarters.

EBITDA and Adjusted EBITDA reconciliation

The following EBITDA presentation for the three months ended December 31, 2011 and 2010 below is provided as a means to enhance the understanding of financial measurements that Ashland has internally determined to be relevant measures of comparison for the results of Consumer Markets. There were no unusual or key items that affected comparability for adjusted EBITDA during the current and prior year quarters.

	Three months ended December 31	
(In millions)	2011	2010
Operating income	$ 47	$ 67
Depreciation and amortization	9	9
EBITDA	$ 56	$ 76

Unallocated and other

Unallocated and other recorded costs of $28 million and $11 million for the three months ended December 31, 2011 and 2010, respectively. Unallocated and other includes pension and other postretirement net periodic costs or income that have not been allocated to business segments. These costs (or income items) include interest cost, return on assets and adjustments to the prior service cost as these items are considered financing activities managed at the corporate level, as opposed to service costs which are allocated to the appropriate business segment. These items resulted in income of $9 million in the current quarter and $4 million in the prior year quarter.

Other costs, other than pension and other postretirement net periodic costs income described above, for the current quarter primarily related to $28 million for severance charges associated with Ashland's involuntary program and the ongoing ISP integration, corporate costs previously allocated to Distribution of $5 million, and $4 million for net environmental charges and other legacy costs associated with adjustments to ongoing obligations of previously divested businesses. Other costs for the prior year quarter primarily related to corporate costs previously allocated to Distribution of $11 million, environmental charges of $3 million and transaction costs of $1 million associated with the expanded global joint venture with Süd-Chemie.

FINANCIAL POSITION

Liquidity

Ashland's cash flows from operating, investing and financing activities, as reflected in the Statements of Consolidated Cash Flows, are summarized as follows for the three months ended December 31, 2011 and 2010. As of December 31, 2011, the amount of cash and cash equivalents held by foreign subsidiaries subject to currency controls, which may limit Ashland's ability to remit the funds to satisfy corporate obligations, was not significant.

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(In millions)	2011	2010
Cash provided (used) by:		
Operating activities from continuing operations	$ (181)	$ (38)
Investing activities from continuing operations	(43)	(2)
Financing activities from continuing operations	(43)	(3)
Discontinued operations	(3)	(1)
Effect of currency exchange rate changes on cash and cash equivalents	(1)	1
Net decrease in cash and cash equivalents	$ (271)	$ (43)

Operating activities

Cash flows generated from operating activities from continuing operations, a major source of Ashland's liquidity, amounted to a cash outflow of $181 million in the current quarter and $38 million in the prior year quarter. The cash results during each period are primarily driven by net income, depreciation and amortization (including debt issuance cost amortization), and changes in working capital, which are fluctuations within accounts receivable, inventory, trade payables and accrued expenses. Ashland continues to emphasize working capital management as a high priority and focus within the company.

During the current and prior year quarters, working capital was an outflow of $254 million and $175 million, respectively. Both period outflows were primarily a result of increased inventory, resulting from restocking of certain key products that were low or to support sales growth in various areas of business as well as reduced trade payables and accrued expense balances, primarily the result of incentive compensation payouts to employees from the previous prior year paid during the quarter and an increase in selected vendor payments that historically occurs at the end of the calendar year. In addition, the current quarter working capital use of cash also included a $92 million outflow for change in control payments associated with the ISP acquisition.

Operating cash flows for the current quarter included income from continuing operations of $60 million and noncash adjustments of $104 million for depreciation and amortization and a $25 million inventory fair value adjustment related to the ISP acquisition. Operating cash flows for the prior year quarter included income from continuing operations of $71 million, and noncash adjustments of $73 million for depreciation and amortization and a $19 million gain related to the formation of the expanded global joint venture with Süd-Chemie.

Investing activities

Cash used by investing activities was $43 million for the current quarter as compared to $2 million for the prior year quarter. The significant cash investing activities for the current quarter included cash outflows of $44 million for capital expenditures. The significant cash investing activities for the prior year quarter included cash outflows of $22 million for capital expenditures and $5 million for purchased plant operations in Performance Materials and Consumer Markets offset by cash inflows of $21 million related to a cash equalization distribution from the expanded joint venture with Süd-Chemie, in accordance with the joint venture agreement, and $4 million from proceeds from disposals of property, plant and equipment.

Financing activities

Cash used by financing activities was $43 million in the current quarter and $3 million in the prior year quarter. Significant cash financing activities for the current quarter included repayments of long- and short-term debt of $23 million and $7 million, respectively, and cash dividends paid of $.175 per share, for a total of $14 million. Financing activities for the current quarter also included cash inflows of $1 million for proceeds from the exercise of stock options and excess tax benefits related to share-based payments. Significant cash financing activities for the prior year quarter included repayments of long-term debt of $10 million and cash dividends paid of $.15 per share, for a total of $12 million. These cash outflows were partially offset by proceeds from long- and short-term debt of $11 million and $6 million, respectively. Financing activities for the prior year quarter also included cash inflows of $2 million for proceeds from the exercise of stock options and excess tax benefits related to share-based payments.

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Cash used by discontinued operations

The prior year quarter includes the results of operations of the Distribution business which amounted to net cash inflows of $7 million. The remaining cash outflow fluctuations in each period related to other previously divested businesses and principally related to payment of asbestos and environmental liabilities.

Free cash flow and other liquidity resources

The following represents Ashland's calculation of free cash flow for the disclosed periods.

	Three months ended December 31	
(In millions)	2011	2010
Cash flows used by operating activities from continuing operations	$ (181)	$ (38)
Adjustments:		
Additions to property, plant and equipment	(44)	(22)
Cash dividends paid	(14)	(12)
ISP acquisition - change in control payment (a)	92	-
Free cash flows	$ (147)	$ (72)

(a) Since payment was generated from investment activity, this amount has been included within this calculation.

At December 31, 2011, working capital (current assets minus current liabilities, excluding long-term debt due within one year) amounted to $1,720 million, compared to $1,749 million at September 30, 2011. Ashland's working capital is affected by its use of the LIFO method of inventory valuation that valued inventories below their replacement costs by $50 million at December 31, 2011 and $59 million at September 30, 2011. Liquid assets (cash, cash equivalents and accounts receivable) amounted to 125% of current liabilities at December 31, 2011, compared to 128% at September 30, 2011.

The following summary reflects Ashland's cash and unused borrowing capacity as of December 31, 2011 and September 30, 2011.

(In millions)	December 31 2011	September 30 2011
Cash and investment securities		
Cash and cash equivalents	$ 466	$ 737
Unused borrowing capacity		
Revolving credit facility	$ 916	$ 914

Total borrowing capacity remaining under the $1.0 billion revolving credit facility was $916 million, representing a reduction of $84 million for letters of credit outstanding at December 31, 2011. In total, Ashland's available liquidity position, which includes cash and the revolving credit facility, was $1,382 million at December 31, 2011 as compared to $1,651 million at September 30, 2011. In August 2011, Ashland increased the borrowing capacity under its revolving credit facility in conjunction with the ISP acquisition. For further information see the "Key Developments" discussion within Management's Discussion and Analysis.

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Capital resources

Debt

The following summary reflects Ashland's debt as of December 31, 2011 and September 30, 2011.

(In millions)	December 31 2011	September 30 2011
Short-term debt	$ 76	$ 83
Long-term debt (including current portion)	3,728	3,749
Total debt	$ 3,804	$ 3,832

On August 23, 2011, in conjunction with the ISP acquisition closing, Ashland entered into a $3.9 billion senior secured credit facility with a group of lenders (the Senior Credit Facility). The Senior Credit Facility is comprised of (i) a $1.5 billion term loan A facility, (ii) a $1.4 billion term loan B facility and (iii) a $1.0 billion revolving credit facility. Proceeds from borrowings under the term loan A facility and the term loan B facility were used, together with cash on hand, to finance the cash consideration paid for the ISP acquisition, as well as to finance the repayment of existing indebtedness of ISP in connection with the acquisition. On March 31, 2011, Ashland repaid its previous term loan A balance of $289 million with proceeds from the Distribution sale. For further information see the "Key Developments" discussion within Management's Discussion and Analysis.

The current portion of long-term debt was $121 million at December 31, 2011 and $101 million at September 30, 2011. Debt as a percent of capital employed was 48% at December 31, 2011 and at September 30, 2011. At December 31, 2011 Ashland's total debt had an outstanding principal balance of $3,978 million and discounts of $174 million. The scheduled aggregate maturities of debt by year are as follows: $146 million remaining in 2012, $137 million in 2013, $176 million in 2014, $172 million in 2015, $1,064 million in 2016 and $664 million in 2017.

Based on Ashland's current debt structure included in Note I of Notes to Condensed Consolidated Financial Statements and the debt restructuring in conjunction with the closing of the ISP transaction on August 23, 2011, future annual interest expense is expected to range from approximately $220 million to $230 million based on applicable fixed and floating interest rates, assuming interest rates remain stable.

Covenant restrictions

The Senior Credit Facility contains certain usual and customary representations, warranties, and usual and affirmative and negative covenants, including financial covenants for leverage and fixed charge coverage ratios, limitations on liens, additional indebtedness, further negative pledges, investments, payment of dividends, mergers, sale of assets and restricted payments, and other customary limitations. As of December 31, 2011, Ashland is in compliance with all debt agreement covenants.

The maximum consolidated leverage ratios permitted under the Senior Credit Facility are as follows: 4.00 from

December 31, 2011 through March 31, 2012, 3.75 as of June 30, 2012, 3.50 as of September 30, 2012, 3.00 from the period December 31, 2012 through September 30, 2013 and 2.75 as of December 31, 2013 and each quarter thereafter.

The Senior Credit Facility defines the consolidated leverage ratio as the ratio of consolidated indebtedness minus cash and cash equivalents to consolidated EBITDA for any measurement period. In general, the Senior Credit Facility defines consolidated EBITDA as net income plus consolidated interest charges, taxes, depreciation and amortization expense, fees and expenses related to capital market transactions, restructuring and integration charges, noncash stock and equity compensation expense, and any other nonrecurring expenses or losses that do not represent a cash item in such period or any future period; less any noncash gains or other items increasing net income. In general, consolidated indebtedness includes debt plus all purchase money indebtedness, banker's acceptances and bank guaranties, deferred purchase price of property or services, attributable indebtedness, and guaranties.

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The permitted consolidated fixed charge coverage ratios under the Senior Credit Facility are 1.50 from December 31, 2011 through June 30, 2012, 1.75 as of September 30, 2012 and 2.00 as of December 31, 2012 and each quarter thereafter.

The Senior Credit Facility defines the consolidated fixed charge coverage ratio as the ratio of consolidated EBITDA less the aggregate amount of all cash capital expenditures to consolidated fixed charges for any measurement period. In general consolidated fixed charges are defined as the sum of consolidated interest charges, the aggregate principal amount of all regularly scheduled principal payments and the aggregate amount of all restricted payments, which include any dividend or other distribution with respect to any capital stock or other equity interest.

At December 31, 2011, Ashland's calculation of the consolidated leverage ratio was 3.0 compared to the maximum consolidated leverage ratio permitted under the Senior Credit Facility of 4.00. At December 31, 2011, Ashland's calculation of the fixed charge coverage ratio was 3.3 compared to the permitted minimum consolidated ratio under the Senior Credit Facility of 1.50. Any change in consolidated EBITDA of $100 million would have an approximate .3x effect on the consolidated leverage ratio and a .4x effect on the fixed charge coverage ratio. Any change in consolidated indebtedness of $100 million would affect the consolidated leverage ratio by approximately .1x.

Ashland projects that cash flow from operations and other available financial resources such as cash on hand and revolving credit should be sufficient to meet investing and financing requirements to enable Ashland to comply with the covenants and other terms of its financing obligations. These projections are based on various assumptions that include, but are not limited to: operational results, working capital cash generation, capital expenditures, pension funding requirements and tax payments and receipts.

Stockholders' equity

Stockholders' equity decreased $70 million since September 30, 2011 to $4,065 million at December 31, 2011. This decrease was primarily due to deferred translation losses of $111 million, regular cash dividends of $14 million, unrealized losses on interest rate swaps of $5 million and a $1 million reduction in common shares issued under stock incentive and other plans partially offset by net income during the quarter of $61 million.

In March 2011, the Board of Directors of Ashland approved a $400 million stock repurchase program. Under the program that began on April 1, 2011, Ashland purchased common shares through a $200 million 10b5-1 automatic trading plan. Effective May 31, 2011, as a result of the announcement of the pending ISP acquisition, Ashland terminated the 10b5-1 automatic trading program. Purchases under the plan amounted to $71 million, or 1.2 million shares. Ashland still has the ability to make discretionary purchases of Ashland Common Stock on the open market, pursuant to the Board's original $400 million share repurchase authorization.

In May 2011, the Board of Directors of Ashland announced a quarterly cash dividend of 17.5 cents per share, 70 cents per share on an annual basis, to eligible shareholders of record. This amount was paid for quarterly dividends in June, September and December 2011, and was an increase from the quarterly cash dividend of 15 cents per share paid during the first and second quarters of the prior year. In conjunction with Ashland's existing debt facilities, Ashland is subject to various covenants that may restrict certain future payments, which could include quarterly dividend payments, although Ashland does not anticipate that will occur.

Capital expenditures

Ashland is currently forecasting approximately $350 million of capital expenditures for 2012 funded primarily from operating cash flows. Capital expenditures were $44 million for the three months ended December 31, 2011 and averaged $186 million during the last three years. Under the Senior Credit Facility, Ashland is not subject to a capital expenditure limit.

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APPLICATION OF CRITICAL ACCOUNTING POLICIES

The preparation of Ashland's Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales and expenses, and the disclosures of contingent assets and liabilities. Significant items that are subject to such estimates and assumptions include, but are not limited to, long-lived assets (including goodwill and other intangible assets), employee benefit obligations, income taxes, other liabilities and receivables associated with asbestos litigation and environmental remediation. These accounting policies are discussed in detail in "Management's Discussion and Analysis – Application of Critical Accounting Policies" in Ashland's Annual Report on Form 10-K for the fiscal year ended September 30, 2011. Although management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, actual results could differ significantly from the estimates under different assumptions or conditions. Management has reviewed the estimates affecting these items with the Audit Committee of Ashland's Board of Directors. No material changes have been made to the valuation techniques during the three months ended December 31, 2011.

OUTLOOK

Ashland's focus on product pricing contributed significant improvements during the current quarter in the gross profit margin and profitability despite a slight overall decline in volume. Ashland expects overall volume trends to improve during fiscal 2012 from the current quarter's levels. Specialty Ingredients is expected to continue its overall growth as global capacity expansion plans are ongoing to meet strong customer demand. Consumer Markets' and Performance Materials' volume levels should improve with seasonal demand, while Water Technologies is expected to be impacted by the overall economy as the business implements several actions to increase profitability.

Execution on the $90 million cost reduction programs continue to progress as $30 million of annualized run rate cost savings has been achieved through December with an additional $10 million expected by the end of the March 2012 quarter, effectively removing all stranded costs from the Distribution divestiture and the expanded Casting Solutions joint venture. The remaining $50 million of cost reductions are expected to come from synergies related to the ISP acquisition, with the majority of these savings occurring by the end of fiscal 2012. In addition, building liquidity remains a priority as Ashland expects to generate free cash flow during the remainder of 2012, in order to be in position to retire higher interest bearing debt during June of 2013.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Ashland's market risk exposure at December 31, 2011 is generally consistent with the types and amounts of market risk exposures presented in Ashland's Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

ITEM 4. CONTROLS AND PROCEDURES

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

(b) During the three months ended December 31, 2011, there were no significant changes in Ashland's internal control over financial reporting, or in other factors, that occurred during the period covered by this quarterly report that have materially affected, or are reasonably likely to materially affect, Ashland's internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The following is a description of Ashland's material legal proceedings.

Asbestos-Related Litigation

Ashland is subject to liabilities from claims alleging personal injury caused by exposure to asbestos. Such claims result primarily from indemnification obligations undertaken in 1990 in connection with the sale of Riley Stoker Corporation (Riley), a former subsidiary. Although Riley was neither a producer nor a manufacturer of asbestos, its industrial boilers contained some asbestos-containing components provided by other companies.

Hercules, a wholly-owned subsidiary of Ashland, is also subject to liabilities from asbestos-related personal injury lawsuits involving claims which typically arise from alleged exposure to asbestos fibers from resin encapsulated pipe and tank products which were sold by one of Hercules' former subsidiaries to a limited industrial market.

Ashland and Hercules are also defendants in lawsuits alleging exposure to asbestos at facilities formerly or presently owned or operated by Ashland or Hercules.

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

Environmental Proceedings

(1) CERCLA and Similar State Law Sites – Under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 and similar state laws, Ashland and its subsidiaries may be subject to joint and several liability for cleanup costs in connection with alleged releases of hazardous substances at sites where it has been identified as a "potentially responsible party" (PRP). As of December 31, 2011, Ashland and its subsidiaries have been identified as a PRP by U.S. federal and state authorities, or by private parties seeking contribution, for the cost of environmental investigation and/or cleanup at 92 waste treatment or disposal sites. These sites are currently subject to ongoing investigation and remedial activities, overseen by the United States Environmental Protection Agency (USEPA) or a state agency, in which Ashland or its subsidiaries are typically participating as a member of a PRP group. Generally, the type of relief sought includes remediation of contaminated soil and/or groundwater, reimbursement for past costs of site cleanup and administrative oversight and/or long-term monitoring of environmental conditions at the sites. The ultimate costs are not predictable with assurance.

(2) Hopewell, Virginia Clean Air Act Compliance Inspection – In April 2007, Hercules' Hopewell, Virginia manufacturing facilities were subject to a Clean Air Act (CAA) compliance inspection by the USEPA and the VADEQ. In April 2008, the results of the inspection were provided to Hercules. The inspection uncovered areas of potential noncompliance with air emissions regulations. In March 2011, Hercules received from the USEPA a proposed consent decree which included certain remedial actions and a proposed penalty assessment in excess of $100,000. Hercules is engaged in negotiations with the USEPA and the VADEQ concerning this matter. While it is reasonable to believe that this matter could potentially involve penalties exceeding $100,000, the potential liability with respect to this matter should not be material to Ashland.

(3) Hattiesburg, Mississippi Resource Conservation and Recovery Act Matter – In November 2008, the Mississippi Department of Environmental Quality (MDEQ) issued a Notice of Violation to Hercules' now-closed Hattiesburg, Mississippi manufacturing facility alleging that a storm water retention basin at the facility had been operated as a

hazardous waste storage and treatment facility without a permit in violation of the Resource Conservation and Recovery Act. Ashland has been working with the MDEQ to settle this matter in the context of the shutdown and ongoing remediation of the Hattiesburg facility. The MDEQ proposed a settlement penalty in excess of $100,000. In May 2011, the USEPA issued an inspection report from a September 2010 inspection with allegations similar to those of the MDEQ and promulgated an information request. While it is reasonable to believe that this matter will involve a penalty from the MDEQ and/or the USEPA exceeding $100,000, the potential liability with respect to this matter should not be material to Ashland.

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

Other Pending Legal Proceedings

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

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ITEM 1A. RISK FACTORS

During the period covered by this report, there were no material changes from the risk factors previously disclosed in Ashland's Annual Report on Form 10-K for the fiscal year ended September 30, 2011.

ITEM 6. EXHIBITS

(a) Exhibits

12	Computation of Ratio of Earnings to Fixed Charges.
31.1	Certificate of James J. O'Brien, Chief Executive Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate of Lamar M. Chambers, Chief Financial Officer of Ashland pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certificate of James J. O'Brien, Chief Executive Officer of Ashland, and Lamar M. Chambers, Chief Financial Officer of Ashland pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document.
101.SCH*	XBRL Taxonomy Extension Schema Document.
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB*	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document.

*Attached as Exhibit 101 to this report are the following documents formatted in XBRL (Extensible Business Reporting Language): (i) Statements of Consolidated Income for the three months ended December 31, 2011 and December 31, 2010; (ii) Condensed Consolidated Balance Sheets at December 31, 2011 and September 30, 2011; (iii) Statements of Consolidated Stockholders' Equity at December 31, 2011; (iv) Statements of Condensed Consolidated Cash Flows for the three months ended December 31, 2011 and December 31, 2010; and (v) Notes to Condensed Consolidated Financial Statements. Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURE

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

	Ashland Inc. (Registrant)
January 30, 2012	/s/Lamar M. Chambers Lamar M. Chambers Senior Vice President and Chief Financial Officer (on behalf of the Registrant and as principal financial officer)

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EXHIBIT INDEX

Exhibit No.	Description
12	Computation of Ratio of Earnings to Fixed Charges.
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**Submitted electronically with this report.