AGCO CORP /DE
Form 10-Q
August 08, 2018

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarter ended June 30, 2018
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________ to _________

Commission File Number: 001-33767
AGCO CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware	58-1960019
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
4205 River Green Parkway Duluth, Georgia	30096
(Address of principal executive offices)	(Zip Code)

(770) 813-9200

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
x Yes o No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
x Yes o No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company” and “emerging growth company” in Rule 12b-2 of the Exchange Act. (Check one):

x Large accelerated filer	o Accelerated filer	o Non-accelerated filer	o Smaller reporting company	o Emerging growth company

(Do not check if a smaller reporting company)
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of August 3, 2018, there are 79,118,729 shares of the registrant’s common stock, par value of $0.01 per share, outstanding.

AGCO CORPORATION AND SUBSIDIARIES
INDEX

	Page Numbers
PART I. FINANCIAL INFORMATION:	
Item 1. Financial Statements (unaudited)	
Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017	3
Condensed Consolidated Statements of Operations for the Three Months Ended June 30, 2018 and 2017	4
Condensed Consolidated Statements of Operations for the Six Months Ended June 30, 2018 and 2017	5
Condensed Consolidated Statements of Comprehensive Income for the Three and Six Months Ended June 30, 2018 and 2017	6
Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2018 and 2017	7
Notes to Condensed Consolidated Financial Statements	8
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	37
Item 3. Quantitative and Qualitative Disclosures about Market Risk	45
Item 4. Controls and Procedures	45
PART II. OTHER INFORMATION:	
Item 1. Legal Proceedings	46
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	46
Item 6. Exhibits	47
SIGNATURES	48

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

AGCO CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited and in millions, except share amounts)

	June 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$280.6	$ 367.7
Accounts and notes receivable, net	1,047.1	1,019.4
Inventories, net	2,131.9	1,872.9
Other current assets	384.3	367.7
Total current assets	3,843.9	3,627.7
Property, plant and equipment, net	1,392.9	1,485.3
Investment in affiliates	411.2	409.0
Deferred tax assets	110.8	112.2
Other assets	153.5	147.1
Intangible assets, net	608.1	649.0
Goodwill	1,503.7	1,541.4
Total assets	$8,024.1	$ 7,971.7
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Current portion of long-term debt	$17.9	$ 24.8
Short-term borrowings	197.7	90.8
Accounts payable	898.3	917.5
Accrued expenses	1,385.5	1,407.9
Other current liabilities	201.1	209.6
Total current liabilities	2,700.5	2,650.6
Long-term debt, less current portion and debt issuance costs	1,728.0	1,618.1
Pensions and postretirement health care benefits	230.6	247.3
Deferred tax liabilities	122.6	130.5
Other noncurrent liabilities	244.3	229.9
Total liabilities	5,026.0	4,876.4
Commitments and contingencies (Note 16)		
Stockholders' Equity:		
AGCO Corporation stockholders' equity:		
Preferred stock; $0.01 par value, 1,000,000 shares authorized, no shares issued or outstanding in 2018 and 2017	—	—
Common stock; $0.01 par value, 150,000,000 shares authorized, 79,117,583 and 79,553,825 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively	0.8	0.8
Additional paid-in capital	121.4	136.6
Retained earnings	4,346.1	4,253.8
Accumulated other comprehensive loss	(1,533.5)	(1,361.6)
Total AGCO Corporation stockholders' equity	2,934.8	3,029.6

Noncontrolling interests	63.3	65.7
Total stockholders' equity	2,998.1	3,095.3
Total liabilities and stockholders' equity	$8,024.1	$ 7,971.7

See accompanying notes to condensed consolidated financial statements.

Table of Contents

AGCO CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited and in millions, except per share data)

	Three Months Ended June 30,				
	2018		2017		
Net sales	$	2,537.6	$	2,165.2	
Cost of goods sold	1,981.3		1,689.8		
Gross profit	556.3		475.4		
Selling, general and administrative expenses	271.8		234.6		
Engineering expenses	93.0		76.8		
Restructuring expenses	2.7		0.4		
Amortization of intangibles	18.2		13.8		
Bad debt expense	2.5		1.5		
Income from operations	168.1		148.3		
Interest expense, net	21.2		11.3		
Other expense, net	27.2		17.6		
Income before income taxes and equity in net earnings of affiliates	119.7		119.4		
Income tax provision	38.5		36.9		
Income before equity in net earnings of affiliates	81.2		82.5		
Equity in net earnings of affiliates	9.2		9.1		
Net income	90.4		91.6		
Net loss (income) attributable to noncontrolling interests	1.0		(0.1		)
Net income attributable to AGCO Corporation and subsidiaries	$	91.4	$	91.5	
Net income per common share attributable to AGCO Corporation and subsidiaries:					
Basic	$	1.15	$	1.15	
Diluted	$	1.14	$	1.14	
Cash dividends declared and paid per common share	$	0.15	$	0.14	
Weighted average number of common and common equivalent shares outstanding:					

Basic	79.3	79.5
Diluted	80.2	80.1

See accompanying notes to condensed consolidated financial statements.

Table of Contents

AGCO CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited and in millions, except per share data)

	Six Months Ended June 30, 2018		2017	
Net sales	$	4,545.1	$	3,792.8
Cost of goods sold	3,560.8		2,987.1	
Gross profit	984.3		805.7	
Selling, general and administrative expenses	536.4		457.3	
Engineering expenses	183.9		149.9	
Restructuring expenses	8.6		5.5	
Amortization of intangibles	33.9		27.2	
Bad debt expense	2.9		1.8	
Income from operations	218.6		164.0	
Interest expense, net	31.5		22.0	
Other expense, net	38.7		30.7	
Income before income taxes and equity in net earnings of affiliates	148.4		111.3	
Income tax provision	49.9		48.0	
Income before equity in net earnings of affiliates	98.5		63.3	
Equity in net earnings of affiliates	16.9		20.1	
Net income	115.4		83.4	
Net loss (income) attributable to noncontrolling interests	0.3		(2.0	)
Net income attributable to AGCO Corporation and subsidiaries	$	115.7	$	81.4
Net income per common share attributable to AGCO Corporation and subsidiaries:				
Basic	$	1.46	$	1.02
Diluted	$	1.44	$	1.02
Cash dividends declared and paid per common share	$	0.30	$	0.28
Weighted average number of common and common equivalent shares outstanding:				

Basic	79.4	79.5
Diluted	80.3	80.1

See accompanying notes to condensed consolidated financial statements.

Table of Contents

AGCO CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited and in millions)

	Three Months Ended June 30,	
	2018	2017
Net income	$90.4	$91.6
Other comprehensive (loss) income, net of reclassification adjustments:		
Foreign currency translation adjustments	(190.4)	(0.7)
Defined benefit pension plans, net of tax	3.0	2.9
Unrealized gain on derivatives, net of tax	1.5	2.8
Other comprehensive (loss) income, net of reclassification adjustments	(185.9)	5.0
Comprehensive (loss) income	(95.5)	96.6
Comprehensive loss attributable to noncontrolling interests	3.2	0.9
Comprehensive (loss) income attributable to AGCO Corporation and subsidiaries	$(92.3)	$97.5

	Six Months Ended June 30,	
	2018	2017
Net income	$115.4	$83.4
Other comprehensive (loss) income, net of reclassification adjustments:		
Foreign currency translation adjustments	(180.7)	42.0
Defined benefit pension plans, net of tax	6.1	5.8
Unrealized gain on derivatives, net of tax	0.6	6.1
Other comprehensive (loss) income, net of reclassification adjustments	(174.0)	53.9
Comprehensive (loss) income	(58.6)	137.3
Comprehensive loss (income) attributable to noncontrolling interests	2.4	(2.6)
Comprehensive (loss) income attributable to AGCO Corporation and subsidiaries	$(56.2)	$134.7

See accompanying notes to condensed consolidated financial statements.

Table of Contents

AGCO CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited and in millions)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income	$115.4	$83.4
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation	115.1	108.9
Amortization of intangibles	33.9	27.2
Stock compensation expense	22.5	22.6
Equity in net earnings of affiliates, net of cash received	(13.4)	(5.6)
Deferred income tax (benefit) provision	(14.3)	0.6
Other	1.3	1.8
Changes in operating assets and liabilities:		
Accounts and notes receivable, net	(83.0)	(94.3)
Inventories, net	(396.3)	(316.5)
Other current and noncurrent assets	(47.3)	(48.4)
Accounts payable	7.9	120.6
Accrued expenses	6.7	9.9
Other current and noncurrent liabilities	47.2	23.4
Total adjustments	(319.7)	(149.8)
Net cash used in operating activities	(204.3)	(66.4)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(89.8)	(92.3)
Proceeds from sale of property, plant and equipment	2.3	1.6
Investments in unconsolidated affiliates	(5.8)	(0.8)
Other	0.4	—
Net cash used in investing activities	(92.9)	(91.5)
Cash flows from financing activities:		
Proceeds from indebtedness	2,555.7	1,966.6
Repayments of indebtedness	(2,273.6)	(1,911.8)
Purchases and retirement of common stock	(34.3)	—
Payment of dividends to stockholders	(23.8)	(22.2)
Payment of minimum tax withholdings on stock compensation	(3.5)	(4.0)
Investments by noncontrolling interests	—	0.2
Net cash provided by financing activities	220.5	28.8
Effects of exchange rate changes on cash and cash equivalents	(10.4)	17.2
Decrease in cash and cash equivalents	(87.1)	(111.9)
Cash and cash equivalents, beginning of period	367.7	429.7
Cash and cash equivalents, end of period	$280.6	$317.8

See accompanying notes to condensed consolidated financial statements.

Table of Contents

AGCO CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements of AGCO Corporation and its subsidiaries (the "Company" or "AGCO") included herein have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") for interim financial information and the rules and regulations of the Securities and Exchange Commission ("SEC"). In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all adjustments, which are of a normal recurring nature, necessary to present fairly the Company's financial position, results of operations, comprehensive income (loss) and cash flows at the dates and for the periods presented. These condensed consolidated financial statements should be read in conjunction with the Company's audited consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. Results for interim periods are not necessarily indicative of the results for the year.

The Company has a wholly-owned subsidiary in Argentina that manufactures and distributes agricultural equipment and replacement parts within Argentina. As of June 30, 2018, on the basis of currently available data related to inflation indices and as a result of the devaluation of the Argentine peso relative to the United States dollar, the Argentinian economy was determined to be highly inflationary. A highly inflationary economy is one where the cumulative inflation rate for the three years preceding the beginning of the reporting period, including interim reporting periods, is in excess of 100 percent. In accordance with this designation and based on the guidance in ASC 830, "Foreign Currency Matters", the Company plans to change the functional currency of its wholly-owned subsidiary from the Argentinian peso to the U.S. dollar effective July 1, 2018. For the six months ended June 30, 2018, the Company's wholly-owned subsidiary in Argentina had net sales of approximately $49.2 million and total assets of approximately $118.8 million as of June 30, 2018.

Recent Accounting Pronouncements

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-02, "Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" ("ASU 2018-02"), which allows for the election to reclassify the disproportionate income tax effects of the Tax Cuts and Jobs Act (the "2017 Tax Act")on items within accumulated other comprehensive income (loss) to retained earnings. These disproportionate income tax effect items are referred to as "stranded tax effects." The amendments within ASU 2018-02 only relate to the reclassification of the income tax effects of the 2017 Tax Act. Certain disclosures are required in the period of adoption as to whether an entity has elected to reclassify the stranded tax effects. ASU 2018-02 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. The standard should be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. corporate income tax rate in the 2017 Tax Act is recognized. Early adoption is permitted for any interim or annual period. The Company is currently evaluating the impact of adopting this standard on the Company's results of operations, financial condition and cash flows, but does not expect the impact to be material.

In August 2017, the FASB issued ASU 2017-12, "Targeted Improvements to Accounting for Hedging Activities" ("ASU 2017-12"), which aligns an entity's risk management activities and financial reporting for hedge relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. The amendments include 1) the ability to apply hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk, 2) new alternatives for measuring the hedged item for fair value hedges of interest rate risk, 3) elimination of the requirement to separately measure and report hedge ineffectiveness, 4) requirement to present the earnings effect of the hedging instrument in the same income statement

line in which the earnings effect of the hedged item is reported and 5) less stringent requirements for effectiveness testing, hedge documentation and applying the critical terms match method. ASU 2017-12 is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods using a prospective approach. Early adoption is permitted for any interim or annual period. The amendments should be applied to existing hedging relationships on the date of adoption. The Company adopted ASU 2017-12 on January 1, 2018. The standard did not have a material impact on the Company's results of operations, financial condition and cash flows.

In March 2017, the FASB issued ASU 2017-07, "Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost" ("ASU 2017-07"), which requires the service cost component of net periodic pension and

postretirement benefit cost be included in the same line item as other compensation costs arising from services rendered by employees. The other components of net periodic pension and postretirement benefit cost are required to be classified outside the subtotal of income from operations. Of the components of net periodic pension and postretirement benefit cost, only the service cost component will be eligible for asset capitalization. ASU 2017-07 is effective for annual periods beginning after December 15, 2017, and interim periods within those annual periods, using a retrospective approach for the presentation of the service cost component and other components of net periodic pension and postretirement benefit cost in the statement of operations; and a prospective approach for the capitalization of the service cost component of net periodic pension and postretirement benefit cost in assets. Early adoption is permitted for any interim or annual period. ASU 2017-07 allows a practical expedient for applying the retrospective presentation requirements. The Company adopted ASU 2017-07 on January 1, 2018 and retrospectively applied the standard to the presentation of the other components of net periodic pension and postretirement benefit costs in the Company's Condensed Consolidated Statements of Operations. As part of the adoption, the Company elected to use the practical expedient, which allowed the Company to use the information previously disclosed as the basis for applying the retrospective presentation requirements of the standard. For the three months ended June 30, 2017, the Company reclassified approximately $0.1 million of income related to the other components of net periodic pension and postretirement costs from "Selling, general and administrative expenses" and "Engineering expenses" to "Other expenses, net." For the six months ended June 30, 2017, there was no net impact to "Selling, general and administrative expenses," "Engineering expenses" or "Other expenses, net" as a result of the restrospective application of ASU 2017-07.

In January 2017, the FASB issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment" ("ASU 2017-04"), which eliminates Step 2 from the goodwill impairment test. Under the standard, an entity should perform its goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, resulting in an impairment charge that is the amount by which the carrying amount exceeds the reporting unit's fair value. The impairment charge, however, should not exceed the total amount of goodwill allocated to a reporting unit. The impairment assessment under ASU 2017-04 applies to all reporting units, including those with a zero or negative carrying amount. ASU 2017-04 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods using a prospective approach. Early adoption is permitted for any interim or annual goodwill impairment test performed on testing dates after January 1, 2017. The Company is currently evaluating the impact of adopting this standard on the Company's results of operations, financial condition and cash flows, but does not expect the impact to be material.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"), which requires measurement and recognition of expected versus incurred credit losses for financial assets held. ASU 2016-13 is effective for annual periods beginning after December 15, 2019, and interim periods within those annual periods. This standard will likely impact the results of operations and financial condition of the Company's finance joint ventures and as a result, will likely impact the Company's "Investment in affiliates" and "Equity in net earnings of affiliates" upon adoption. The Company's finance joint ventures are currently evaluating the standard's impact to their results of operations and financial condition.

In February 2016, the FASB issued ASU 2016-02, "Leases" ("ASU 2016-02"), which supersedes the existing lease guidance under current U.S. GAAP. ASU 2016-02 is based on the principle that entities should recognize assets and liabilities arising from leases. The standard does not significantly change the lessees' recognition, measurement and presentation of expenses and cash flows from the previous accounting standard and leases continue to be classified as finance or operating. ASU 2016-02's primary change is the requirement for entities to recognize a lease liability for payments and a right-of-use asset representing the right to use the leased asset during the term of an operating lease arrangement. Lessees are permitted to make an accounting policy election to not recognize the asset and liability for

leases with a term of 12 months or less. Lessors' accounting under the standard is largely unchanged from the previous accounting standard. In addition, ASU 2016-02 expands the disclosure requirements of lease arrangements. The standard is effective for reporting periods beginning after December 15, 2018, and interim periods within those annual periods. Early adoption is permitted. Upon adoption, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. In July 2018, the FASB issued ASU 2018-11, "Targeted Improvements", which allows for a new, optional transition method that provides the option to use the effective date as the date of initial application on transition. Under this option, the comparative periods would continue to apply the legacy guidance in Accounting Standard Codification ("ASC") 840, including the disclosure requirements, and a cumulative effect adjustment would be recognized in the period of adoption rather than the earliest period presented. The Company is currently evaluating the impact of adopting this standard on the Company's results of operations, financial condition and cash flows, but the Company has elected not to early adopt the standard for the year ended December 31, 2018.

Table of Contents

Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("ASU 2014-09"), which provides a single, comprehensive revenue recognition model for all contracts with customers with a five-step analysis in determining when and how revenue is recognized. The new model requires revenue recognition to depict the transfer of promised goods or services to customers at an amount that reflects the consideration expected to be received in exchange for those goods or services. Additional disclosures also are required to enable users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers, including significant judgments and changes in those judgments. Entities have the option to apply the new standard under a full retrospective approach to each prior reporting period presented, or a modified retrospective approach with the cumulative effect of initial adoption and application within the Condensed Consolidated Statement of Stockholders' Equity.

The Company adopted ASU 2014-09 with an application date of January 1, 2018 using the modified retrospective approach. Under this method, the Company recognized the cumulative effect of initially applying ASU 2014-09 as an adjustment to the opening balance of stockholders' equity as of January 1, 2018 within "Retained earnings." The cumulative effect was approximately $0.4 million, which was related to the recognition of contract assets and contract liabilities for the value of the expected replacement parts returns. The comparative information has not been adjusted and continues to be reported under ASU 2009-13, "Revenue Recognition." The details of the significant changes and quantitative impact of the changes are discussed below.

The Company has enhanced its accounting policies and practices, business processes, systems and controls, as well as designed and implemented specific internal controls over the implementation and adherence to the standard, including new disclosure requirements.

Replacement Parts Returns

The Company has various promotional and annual return programs with respect to the sale of replacement parts whereby the Company's dealers, distributors and other customers can return specified replacement parts pursuant to such programs. The Company previously recognized revenue for the sale of replacement parts and recorded a corresponding provision for the amount of expected returns at the time of sale. Pursuant to the adoption of ASU 2014-09, the Company recognized a contract asset for the right to recover returned replacement parts at cost, reflected within "Other current assets" in the Company's Condensed Consolidated Balance Sheets. Conversely, the provision for expected returns is recorded at the sales value of expected returns, reflected as a contract liability within "Accrued expenses." The Company's estimates of returns are based on the terms of the promotional and annual return programs and anticipated returns in the future.

The following table summarizes the impact of adopting ASU 2014-09 on the Company' s Condensed Consolidated Balance Sheet as of June 30, 2018 (in millions):

	As Reported	Balances Without Adoption of ASU 2014-09	Increase (Decrease) Due to Adoption
Assets			
Accounts and notes receivable, net	$ 1,047.1	$ 1,046.9	$ 0.2
Other current assets	384.3	373.0	11.3
Total current assets	3,843.9	3,832.4	11.5
Total assets	8,024.1	8,012.6	11.5

Liabilities and Stockholders’ Equity			
Accrued expenses	$ 1,385.5	$ 1,373.3	$ 12.2
Total current liabilities	2,700.5	2,688.3	12.2
Retained earnings	4,346.1	4,346.8	(0.7)
Total stockholder’s equity	2,998.1	2,998.8	(0.7)
Total liabilities and stockholder’s equity	8,024.1	8,012.6	11.5

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

The impact of adopting ASU 2014-09 on the Condensed Consolidated Statement of Operations and Condensed Consolidated Statement of Cash Flows for the three and six months ended June 30, 2018 was not material.

2. RESTRUCTURING EXPENSES

Beginning in 2014 through 2018, the Company announced and initiated several actions to rationalize employee headcount at various manufacturing facilities and various administrative offices located in Europe, South America, China and the United States in order to reduce costs in response to softening global market demand and lower production volumes. The aggregate headcount reduction was approximately 3,370 employees between 2014 and 2017. During the six months ended June 30, 2018, the Company recorded severance and related costs associated with further rationalizations in Europe, South America and the United States, in connection with the termination of approximately 340 employees. Restructuring expenses activity during the six months ended June 30, 2018 is summarized as follows (in millions):

	Write-down of Property, Plant and Equipment	Employee Severance	Total
Balance as of December 31, 2017	$ —	$ 10.9	$10.9
First quarter 2018 provision	—	5.9	5.9
First quarter 2018 cash activity	—	(3.7)	(3.7)
Foreign currency translation	—	0.1	0.1
Balance as of March 31, 2018	—	13.2	13.2
Second quarter 2018 provision	0.3	2.4	2.7
Less: Non-cash activity	(0.3)	—	(0.3)
Cash expense	—	2.4	2.4
Second quarter 2018 cash activity	—	(4.7)	(4.7)
Foreign currency translation	—	(0.8)	(0.8)
Balance as of June 30, 2018	$ —	$ 10.1	$10.1

3. STOCK COMPENSATION PLANS

The Company recorded stock compensation expense as follows for the three and six months ended June 30, 2018 and 2017 (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of goods sold	$1.1	$1.0	$1.9	$1.6
Selling, general and administrative expenses	12.5	9.8	20.9	21.2
Total stock compensation expense	$13.6	$10.8	$22.8	$22.8

Stock Incentive Plan

Under the Company's 2006 Long Term Incentive Plan (the "2006 Plan"), up to 10,000,000 shares of AGCO common stock may be issued. As of June 30, 2018, of the 10,000,000 shares reserved for issuance under the 2006 Plan, approximately 3,498,486 shares were available for grant, assuming the maximum number of shares are earned related

to the performance award grants discussed below. The 2006 Plan allows the Company, under the direction of the Board of Directors' Compensation Committee, to make grants of performance shares, stock appreciation rights, restricted stock units and restricted stock awards to employees, officers and non-employee directors of the Company.

Long-Term Incentive Plan and Related Performance Awards

The weighted average grant-date fair value of performance awards granted under the 2006 Plan during the six months ended June 30, 2018 and 2017 was $71.40 and $61.83, respectively.

Table of Contents

During the six months ended June 30, 2018, the Company granted 441,740 performance awards related to varying performance periods. The awards granted assume the maximum target level of performance is achieved, as applicable. The compensation expense associated with all awards granted under the 2006 Plan is amortized ratably over the vesting or performance period based on the Company's projected assessment of the level of performance that will be achieved and earned. Performance award transactions during the six months ended June 30, 2018 were as follows and are presented as if the Company were to achieve its maximum levels of performance under the plan awards:

Shares awarded but not earned at January 1	1,645,078
Shares awarded	441,740
Shares forfeited	(42,900)
Shares earned	—
Shares awarded but not earned at June 30	2,043,918

As of June 30, 2018, the total compensation cost related to unearned performance awards not yet recognized, assuming the Company's current projected assessment of the level of performance that will be achieved and earned, was approximately $47.6 million, and the weighted average period over which it is expected to be recognized is approximately two years. The compensation cost not yet recognized could be higher or lower based on actual achieved levels of performance.

Restricted Stock Unit Awards

During the six months ended June 30, 2018, the Company granted 110,404 restricted stock unit ("RSU") awards. These awards entitle the participant to receive one share of the Company's common stock for each RSU granted and vest one-third per year over a three-year requisite service period. The compensation expense associated with these awards is amortized ratably over the requisite service period for the awards that are expected to vest. The weighted average grant-date fair value of the RSUs granted under the 2006 Plan during the six months ended June 30, 2018 and 2017 was $71.40 and $61.83, respectively. RSU transactions during the six months ended June 30, 2018 were as follows:

Shares awarded but not vested at January 1	237,468
Shares awarded	110,404
Shares forfeited	(5,178)
Shares vested	(117,172)
Shares awarded but not vested at June 30	225,522

As of June 30, 2018, the total compensation cost related to the unvested RSUs not yet recognized was approximately $11.2 million, and the weighted average period over which it is expected to be recognized is approximately two years.

Stock-Settled Appreciation Rights

Compensation expense associated with the stock-settled appreciation rights ("SSAR") awards is amortized ratably over the requisite service period for the awards that are expected to vest. The Company estimated the fair value of the grants using the Black-Scholes option pricing model. SSAR transactions during the six months ended June 30, 2018 were as follows:

SSARs outstanding at January 1	1,060,192
SSARs granted	157,700
SSARs exercised	(80,475)
SSARs canceled or forfeited	(7,400)
SSARs outstanding at June 30	1,130,017

As of June 30, 2018, the total compensation cost related to the unvested SSARs not yet recognized was approximately $5.1 million, and the weighted average period over which it is expected to be recognized is approximately three years.

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

Director Restricted Stock Grants

The 2006 Plan provides for annual restricted stock grants of the Company's common stock to all non-employee directors. The 2018 grant was made on April 26, 2018 and equated to 17,226 shares of common stock, of which 12,629 shares of common stock were issued after shares were withheld for taxes. The Company recorded stock compensation expense of approximately $1.1 million during the six months ended June 30, 2018 associated with this grant.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of acquired intangible assets during the six months ended June 30, 2018 are summarized as follows (in millions):

	Trademarks and Tradenames	Customer Relationships	Patents and Technology	Land Use Rights	Total
Gross carrying amounts:					
Balance as of December 31, 2017	$ 208.4	$ 600.4	$ 160.0	$ 9.1	$977.9
Foreign currency translation	(3.1)	(10.1)	(2.7)	(0.2)	(16.1)
Balance as of June 30, 2018	$ 205.3	$ 590.3	$ 157.3	$ 8.9	$961.8

	Trademarks and Tradenames	Customer Relationships	Patents and Technology	Land Use Rights	Total
Accumulated amortization:					
Balance as of December 31, 2017	$ 61.4	$ 279.7	$ 73.4	$ 3.0	$417.5
Amortization expense and impairment charge	8.1	20.5	5.2	0.1	33.9
Foreign currency translation	(1.0)	(7.2)	(1.9)	—	(10.1)
Balance as of June 30, 2018	$ 68.5	$ 293.0	$ 76.7	$ 3.1	$441.3

	Trademarks and Tradenames
Indefinite-lived intangible assets:	
Balance as of December 31, 2017	$ 88.6
Foreign currency translation	(1.0)
Balance as of June 30, 2018	$ 87.6

The Company currently amortizes certain acquired intangible assets, primarily on a straight-line basis, over their estimated useful lives, which range from three to 50 years.

Table of Contents

Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

Changes in the carrying amount of goodwill during the six months ended June 30, 2018 are summarized as follows (in millions):

	North America	South America	Europe/Middle East	Asia/ Pacific/Africa	Consolidated
Balance as of December 31, 2017	$ 611.1	$ 136.4	$ 671.0	$ 122.9	$ 1,541.4
Adjustment	—	—	1.9	—	1.9
Foreign currency translation	—	(19.3)	(18.2)	(2.1)	(39.6)
Balance as of June 30, 2018	$ 611.1	$ 117.1	$ 654.7	$ 120.8	$ 1,503.7

Goodwill is tested for impairment on an annual basis and more often if indications of impairment exist. The Company conducts its annual impairment analyses as of October 1 each fiscal year.

5. INDEBTEDNESS

Long-term debt consisted of the following at June 30, 2018 and December 31, 2017 (in millions):

	June 30, 2018	December 31, 2017
1.056% Senior term loan due 2020	$ 232.9	$ 239.8
Credit facility, expiring 2020	799.9	471.2
Senior term loans due 2021	116.4	119.9
5 7/8% Senior notes due 2021	115.9	305.3
Senior term loans due between 2019 and 2026	436.6	449.7
Other long-term debt	46.8	61.0
Debt issuance costs	(2.6)	(4.0)
	1,745.9	1,642.9
Less: Current portion of other long-term debt	(17.9)	(24.8)
Total long-term debt, less current portion	$ 1,728.0	$ 1,618.1

1.056% Senior Term Loan

In December 2014, the Company entered into a term loan with the European Investment Bank, which provided the Company with the ability to borrow up to €200.0 million. The €200.0 million (or approximately $232.9 million as of June 30, 2018) of funding was received on January 15, 2015 with a maturity date of January 15, 2020. The Company has the ability to prepay the term loan before its maturity date. Interest is payable on the term loan at 1.056% per annum, payable quarterly in arrears.

Credit Facility

The Company's revolving credit and term loan facility consists of an $800.0 million multi-currency revolving credit facility and a €312.0 million (or approximately $363.3 million as of June 30, 2018) term loan facility. The maturity date of the credit facility is June 26, 2020. Under the credit facility agreement, interest accrues on amounts outstanding, at the Company's option, depending on the currency borrowed, at either (1) LIBOR or EURIBOR plus a margin ranging from 1.0% to 1.75% based on the Company's leverage ratio, or (2) the base rate, which is equal to the higher of (i) the administrative agent's base lending rate for the applicable currency, (ii) the federal funds rate plus 0.5%, and (iii) one-month LIBOR for loans denominated in U.S. dollars plus 1.0% plus a margin ranging from 0.0% to 0.25% based on the Company's leverage ratio. As is more fully described in Note 10, the Company entered into an interest rate swap in 2015 to convert the term loan facility's floating interest rate to a fixed interest rate of 0.33% plus the

applicable margin over the remaining life of the term loan facility. As of June 30, 2018, the Company had $799.9 million of outstanding borrowings under the credit facility and the ability to borrow approximately $363.4 million under the facility. Approximately $436.6 million was outstanding under the multi-currency revolving credit facility and €312.0 million (or approximately $363.3 million) was outstanding under the term loan facility as of June 30, 2018. As of December 31, 2017, approximately $97.0 million was outstanding under the Company’s multi-currency revolving credit facility, and the Company had the ability to borrow approximately $703.0 million under the facility.

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

Approximately €312.0 million (or approximately $374.2 million) was outstanding under the term loan facility as of December 31, 2017.

During 2015, the Company designated its €312.0 million ($363.3 million as of June 30, 2018) term loan facility as a hedge of its net investment in foreign operations to offset foreign currency translation gains or losses on the net investment. See Note 10 for additional information about the net investment hedge.

Senior Term Loans Due 2021

In April 2016, the Company entered into two term loan agreements with Coöperatieve Centrale Raiffeisen-Boerenleenbank B.A. (“Rabobank”), in the amount of €100.0 million and €200.0 million, respectively. The provisions of the two term loans were identical in nature. In December 2017, the Company repaid its €200.0 million (or approximately $239.8 million) term loan. The Company's €100.0 million (or approximately $116.4 million as of June 30, 2018) remains outstanding. The Company had the ability to prepay the term loans before their maturity date on April 26, 2021. Interest is payable on the remaining term loan per annum, paid quarterly in arrears, equal to the EURIBOR plus a margin ranging from 1.0% to 1.75% based on the Company’s net leverage ratio.

5 7/8% Senior Notes

The Company’s 5 7/8% senior notes due December 1, 2021 constitute senior unsecured and unsubordinated indebtedness. Interest is payable on the notes semi-annually in arrears. At any time prior to September 1, 2021, the Company may redeem the notes, in whole or in part from time to time, at its option, at a redemption price equal to the greater of (i) 100% of the principal amount plus accrued and unpaid interest, including additional interest, if any, to, but excluding, the redemption date, or (ii) the sum of the present values of the remaining scheduled payments of principal and interest (exclusive of interest accrued to the date of redemption) discounted to the redemption date at the treasury rate plus 0.5%, plus accrued and unpaid interest, including additional interest, if any. Beginning September 1, 2021, the Company may redeem the notes, in whole or in part from time to time, at its option, at a redemption price equal to 100% of the principal amount plus accrued and unpaid interest, including additional interest, if any. As is more fully described in Note 10, the Company entered into an interest rate swap in 2015 to convert the senior notes’ fixed interest rate to a floating interest rate over the remaining life of the senior notes. During 2016, the Company terminated the interest rate swap. As a result, the Company recorded a deferred gain of approximately $7.3 million associated with the termination, which is being amortized as a reduction to “Interest expense, net” over the remaining term of the 5 7/8% senior notes through December 1, 2021.

In May 2018, the Company completed a cash tender offer to purchase any and all of its outstanding 5 7/8% senior notes at a cash purchase price of $1,077.50 per $1,000.00 of senior notes. As a result of the tender offer, the Company repurchased approximately $185.9 million of principal amount of the senior notes for approximately $200.3 million, plus accrued interest. The repurchase resulted in a loss on extinguishment of debt of approximately $15.7 million, including associated fees. The Company also recorded approximately $3.0 million of accelerated amortization of the deferred gain related to the terminated interest rate swap instrument associated with the senior notes discussed above. Both the loss on extinguishment and the accelerated amortization were reflected in “Interest expense, net,” for the three and six months ended June 30, 2018. As of June 30, 2018 and December 31, 2017, the unamortized portion of the deferred gain was approximately $1.8 million and $5.3 million, respectively. The amortization for the three and six months ended June 30, 2018 was approximately $3.2 million and $3.5 million, respectively. The amortization for the three and six months ended June 30, 2017 was approximately $0.4 million and $0.7 million, respectively.

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

Senior Term Loans Due Between 2019 and 2026

The Company has an aggregate amount of indebtedness of €375.0 million (or approximately $436.6 million as of June 30, 2018) through a group of seven related term loan agreements. The provisions of the term loan agreements are identical in nature, with the exception of interest rate terms and maturities. The Company has the ability to prepay the term loans before their maturity dates. Interest is payable on the term loans in arrears either semi-annually or annually as provided below (in millions):

Maturity Date	Floating or Fixed Interest Rate	Interest Rate	Interest Payment	Term Loan Amount
October 19, 2019	Floating	EURIBOR + 0.75%	Semi-Annually	€1.0
October 19, 2019	Fixed	0.75%	Annually	55.0
October 19, 2021	Floating	EURIBOR + 1.00%	Semi-Annually	25.5
October 19, 2021	Fixed	1.00%	Annually	166.5
October 19, 2023	Floating	EURIBOR + 1.25%	Semi-Annually	1.0
October 19, 2023	Fixed	1.33%	Annually	73.5
October 19, 2026	Fixed	1.98%	Annually	52.5
				€375.0

Senior Term Loans Due Between 2021 and 2028

On August 1, 2018, the Company borrowed an aggregate amount of indebtedness of €338.0 million (or approximately $394.7 million) through a group of seven related term loan agreements. Proceeds from the borrowings were used to repay borrowings under the Company’s revolving credit facility. The provisions of the term loan agreements are identical in nature, with the exception of interest rate terms and maturities. The Company has the ability to prepay the term loans before their maturity dates. Interest is payable on the term loans in arrears either semi-annually or annually as provided below (in millions):

Maturity Date	Floating or Fixed Interest Rate	Interest Rate	Interest Payment	Term Loan Amount
August 1, 2021	Floating	EURIBOR + 0.70%	Semi-Annually	€32.0
August 1, 2021	Fixed	0.70%	Annually	40.0
August 1, 2023	Floating	EURIBOR + 0.90%	Semi-Annually	72.5
August 1, 2023	Fixed	1.20%	Annually	99.5
August 1, 2025	Floating	EURIBOR + 1.10%	Semi-Annually	30.5
August 1, 2025	Fixed	1.67%	Annually	32.5
August 1, 2028	Fixed	2.26%	Annually	31.0
				€338.0

Short-Term Borrowings

As of June 30, 2018 and December 31, 2017, the Company had short-term borrowings due within one year of approximately $197.7 million and $90.8 million, respectively, primarily in China, Brazil and Europe.
Standby Letters of Credit and Similar Instruments

The Company has arrangements with various banks to issue standby letters of credit or similar instruments, which guarantee the Company’s obligations for the purchase or sale of certain inventories and for potential claims exposure

for insurance coverage. At June 30, 2018 and December 31, 2017, outstanding letters of credit totaled $14.1 million and $15.2 million, respectively.

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

6. INVENTORIES

Inventories at June 30, 2018 and December 31, 2017 were as follows (in millions):

	June 30, 2018	December 31, 2017
Finished goods	$781.2	$ 684.1
Repair and replacement parts	611.4	605.9
Work in process	264.1	178.7
Raw materials	475.2	404.2
Inventories, net	$2,131.9	$ 1,872.9

7. PRODUCT WARRANTY

The warranty reserve activity for the three and six months ended June 30, 2018 and 2017 consisted of the following (in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Balance at beginning of period	$325.8	$270.1	$316.0	$255.6
Accruals for warranties issued during the period	50.2	53.4	108.7	104.9
Settlements made (in cash or in kind) during the period	(34.1)	(38.2)	(90.0)	(78.1)
Foreign currency translation	(17.1)	11.6	(9.9)	14.5
Balance at June 30	$324.8	$296.9	$324.8	$296.9

The Company's agricultural equipment products generally are warranted against defects in material and workmanship for a period of one to four years. The Company accrues for future warranty costs at the time of sale based on historical warranty experience. Approximately $281.0 million and $273.6 million of warranty reserves are included in "Accrued expenses" in the Company's Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, respectively. Approximately $43.8 million and $42.4 million of warranty reserves are included in "Other noncurrent liabilities" in the Company's Condensed Consolidated Balance Sheets as of June 30, 2018 and December 31, 2017, respectively.

Table of Contents
Notes to Condensed Consolidated Financial Statements - Continued
(unaudited)

8. NET INCOME PER COMMON SHARE

Basic net income per common share is computed by dividing net income by the weighted average number of common shares outstanding during each period. Diluted net income per common share assumes the exercise of outstanding SSARs and the vesting of performance share awards and RSUs using the treasury stock method when the effects of such assumptions are dilutive. A reconciliation of net income attributable to AGCO Corporation and its subsidiaries and weighted average common shares outstanding for purposes of calculating basic and diluted net income per share for the three and six months ended June 30, 2018 and 2017 is as follows (in millions, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Basic net income per share:				
Net income attributable to AGCO Corporation and subsidiaries	$91.4	$91.5	$115.7	$81.4
Weighted average number of common shares outstanding	79.3	79.5	79.4	79.5
Basic net income per share attributable to AGCO Corporation and subsidiaries	$1.15	$1.15	$1.46	$1.02
Diluted net income per share:				
Net income attributable to AGCO Corporation and subsidiaries	$91.4	$91.5	$115.7	$81.4
Weighted average number of common shares outstanding	79.3	79.5	79.4	79.5
Dilutive SSARs, performance share awards and RSUs	0.9	0.6	0.9	0.6
Weighted average number of common shares and common share equivalents outstanding for purposes of computing diluted net income per share	80.2	80.1	80.3	80.1
Diluted net income per share attributable to AGCO Corporation and subsidiaries	$1.14	$1.14	$1.44	$1.02

SSARs to purchase approximately 0.4 million and 0.3 million shares of the Company’s common stock for the three and six months ended June 30, 2018 and 2017, respectively, were outstanding but not included in the calculation of weighted average common and common equivalent shares outstanding because they had an antidilutive impact.

9. INCOME TAXES

At June 30, 2018 and December 31, 2017, the Company had approximately $167.1 million and $163.4 million, respectively, of unrecognized tax benefits, all of which would affect the Company’s effective tax rate if recognized. At June 30, 2018 and December 31, 2017, the Company had approximately $56.6 million and $61.8 million, respectively, of accrued or deferred taxes related to uncertain income tax positions connected with ongoing income tax audits in various jurisdictions that it expects to settle or pay in the next 12 months. The Company accrues interest and penalties related to unrecognized tax benefits in its provision for income taxes. At June 30, 2018 and December 31, 2017, the Company had accrued interest and penalties related to unrecognized tax benefits of $25.0 million and $23.0 million, respectively. Generally, tax years 2012 through 2017 remain open to examination by taxing authorities in the United States and certain other foreign tax jurisdictions.

On December 22, 2017, the 2017 Tax Act was enacted in the United States. The 2017 Tax Act includes a number of changes to existing U.S. tax laws that impact the Company, including a reduction of the U.S. corporate income tax rate from 35 percent to 21 percent for tax years beginning after December 31, 2017. The 2017 Tax Act also provides for a one-time transition tax on certain foreign earnings and the acceleration of depreciation for certain assets placed into service after September 27, 2017, as well as prospective changes beginning in 2018, including the repeal of the domestic manufacturing deduction, capitalization of research and development expenditures, additional limitations on

executive compensation and limitations on the deductibility of interest.

In 2017, the Company recorded a provision in accordance with Staff Accounting Bulletin No. 118, which provides SEC Staff guidance for the application of ASC 740, “Income Taxes”, in the reporting period in which the 2017 Tax Act was enacted. The provision reflected both the income tax effects of the 2017 Tax Act for which the accounting under ASC 740 was complete as well as provisional amounts for those specific income tax effects of the 2017 Tax Act for which the accounting

under ASC 740 is incomplete but a reasonable estimate was determined. The Company did not identify any items for which the income tax effects of the 2017 Tax Act have not been completed and a reasonable estimate could not be determined as of December 31, 2017.

The final impact of the tax reform legislation may differ materially due to factors such as further refinement of the Company's calculations, changes in interpretations and assumptions that the Company and its advisors have made, additional guidance that may be issued in the future by the U.S. government and actions that the Company may take as a result of the tax reform legislation. Additional information and analysis are needed for factors such as whether non-U.S. entities are subject to withholding taxes, have reserve requirements, or have projected working capital and other capital needs in the country where the earnings were generated that would result in a decision to indefinitely reinvest a portion or all of their earnings. When more guidance and interpretations are released, specifically with respect to the transition tax and future repatriation of foreign earnings to the U.S., the Company will complete its accounting and revise any provisional estimates, if required. For the six months ended June 30, 2018, the Company did not make any adjustments to the provisional amounts recorded as of December 31, 2017.

The Company has previously established valuation allowances to fully or partially reserve against certain net deferred tax assets in several jurisdictions, including the United States. A valuation allowance is established when it is more likely than not that some portion or all of the deferred tax assets will not be realized. The Company assesses the likelihood that its deferred tax assets will be recovered from estimated future taxable income and available tax planning strategies and determines in certain cases that adjustments to the valuation allowances are appropriate. In making these assessments, all available evidence is considered including the current economic climate, as well as reasonable tax planning strategies. The Company believes it is more likely than not that the Company will realize its deferred tax assets, net of any applicable valuation allowances, in future years.

10. DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company has significant manufacturing operations in the United States, France, Germany, Finland and Brazil, and it purchases a portion of its tractors, combines and components from third-party foreign suppliers, primarily in various European countries and in Japan. The Company also sells products in over 150 countries throughout the world. The Company's most significant transactional foreign currency exposures are the Euro, Brazilian real and the Canadian dollar in relation to the United States dollar, and the Euro in relation to the British pound.

The Company attempts to manage its transactional foreign exchange exposure by hedging foreign currency cash flow forecasts and commitments arising from the anticipated settlement of receivables and payables and from future purchases and sales. Where naturally offsetting currency positions do not occur, the Company hedges certain, but not all, of its exposures through the use of foreign currency contracts. The Company's translation exposure resulting from translating the financial statements of foreign subsidiaries into United States dollars may be partially hedged from time to time. The Company's most significant translation exposures are the Euro, the British pound and the Brazilian real in relation to the United States dollar and the Swiss franc in relation to the Euro. When practical, the translation impact is reduced by financing local operations with local borrowings.

The Company uses floating rate and fixed rate debt to finance its operations. The floating rate debt obligations expose the Company to variability in interest payments due to changes in the EURIBOR and LIBOR benchmark interest rates. The Company believes it is prudent to limit the variability of a portion of its interest payments, and to meet that objective, the Company periodically enters into interest rate swaps to manage the interest rate risk associated with the Company's borrowings. The Company designates interest rate contracts used to convert the interest rate exposure on a portion of the Company's debt portfolio from a floating rate to a fixed rate as cash flow hedges, while those contracts

converting the Company's interest rate exposure from a fixed rate to a floating rate are designated as fair value hedges.

To protect the value of the Company's investment in foreign operations against adverse changes in foreign currency exchange rates, the Company from time to time, may hedge a portion of the Company's net investment in the foreign subsidiaries by using a cross currency swap. The component of the gains and losses on the Company's net investment in the designated foreign operations driven by changes in foreign exchange rates are economically offset by movements in the fair value of the cross currency swap contracts.

The Company's senior management establishes the Company's foreign currency and interest rate risk management policies. These policies are reviewed periodically by the Finance Committee of the Company's Board of Directors. The policies

Table of Contents

allow for the use of derivative instruments to hedge exposures to movements in foreign currency and interest rates. The Company's policies prohibit the use of derivative instruments for speculative purposes.

All derivatives are recognized on the Company's Condensed Consolidated Balance Sheets at fair value. On the date the derivative contract is entered into, the Company designates the derivative as either (1) a cash flow hedge of a forecasted transaction, (2) a fair value hedge of a recognized liability, (3) a hedge of a net investment in a foreign operation, or (4) a non-designated derivative instrument.

The Company formally documents all relationships between hedging instruments and hedged items, as well as the risk management objectives and strategy for undertaking various hedge transactions. The Company formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flow of hedged items or the net investment hedges in foreign operations. When it is determined that a derivative is no longer highly effective as a hedge, hedge accounting is discontinued on a prospective basis.

The Company categorizes its derivative assets and liabilities into one of three levels based on the assumptions used in valuing the asset or liability. See Note 14 for a discussion of the fair value hierarchy as per the guidance in ASC 820. The Company's valuation techniques are designed to maximize the use of observable inputs and minimize the use of unobservable inputs.

Counterparty Risk

The Company regularly monitors the counterparty risk and credit ratings of all the counterparties to the derivative instruments. The Company believes that its exposures are appropriately diversified across counterparties and that these counterparties are creditworthy financial institutions. If the Company perceives any risk with a counterparty, then the Company will cease to do business with that counterparty. There have been no negative impacts to the Company from any non-performance of any counterparties.

Derivative Tr