

The Company periodically uses interest rate swaps to effectively convert a portion of floating-rate debt, including forecasted debt issuances, into fixed-rate debt. The agreements are intended to reduce the impact of interest rate changes on future interest expense.

To protect against the reduction in value of forecasted foreign currency cash flows (such as royalties denominated in foreign currencies), the Company uses foreign currency forwards to hedge a portion of anticipated exposures. When the U.S. dollar strengthens against foreign currencies, the decline in value of future foreign denominated royalties is offset by gains in the fair value of the foreign currency forwards. Conversely, when the U.S. dollar weakens, the increase in the value of future foreign denominated royalties is offset by losses in the fair value of the foreign currency forwards. The hedges cover the next 18 months for certain exposures and are denominated in various currencies. As of December 31, 2017, the Company had derivatives outstanding with an equivalent notional amount of \$761.7 million that were used to hedge a portion of forecasted foreign currency denominated royalties.

The Company recorded after tax adjustments to the cash flow hedging component of AOCI in shareholders' equity. The Company recorded a decrease of \$39.4 million for the year ended December 31, 2017 and an increase of \$2.9 million for the year ended December 31, 2016. Based on interest rates and foreign exchange rates at December 31, 2017, there is \$16.5 million in after-tax cumulative cash flow hedging losses, which is not expected to have a significant effect on earnings over the next 12 months.

Net Investment Hedges

The Company primarily uses foreign currency denominated debt (third party and intercompany) to hedge its investments in certain foreign subsidiaries and affiliates. Realized and unrealized translation adjustments from these hedges are included in the foreign currency translation component of AOCI, as well as the offset translation adjustments on the underlying net assets of foreign subsidiaries and affiliates. The cumulative translation gains or losses will remain in AOCI until the foreign subsidiaries and affiliates are liquidated or sold. As of December 31, 2017, \$11.9 billion of third party foreign currency denominated debt and \$3.6 billion of intercompany foreign currency denominated debt were designated to hedge investments in certain foreign subsidiaries and affiliates.

Derivatives in Hedging Relationships	Gain (Loss) Recognized in AOCI (Effective Portion)	
	2017	2016
Foreign currency denominated debt	\$ (1,599.7)	\$ 654.9
Foreign currency derivatives	(8.9)	9.9
	<u>\$ (1,608.6)</u>	<u>\$ 664.8</u>

Undesignated Derivatives

The Company enters into certain derivatives that are not designated for hedge accounting, therefore the changes in the fair value of these derivatives are recognized immediately in earnings together with the gain or loss from the hedged balance sheet position. As an example, the Company enters into equity derivative contracts, including total return swaps, to hedge market-driven changes in certain of its supplemental benefit plan liabilities. Changes in the fair value of these derivatives are recorded in Selling, general & administrative expenses together with the changes in the supplemental benefit plan liabilities. In addition, the Company uses foreign currency forwards to mitigate the change in fair value of certain foreign currency denominated assets and liabilities. The changes in the fair value of these derivatives are recognized in Nonoperating (income) expense, net,

along with the currency gain or loss from the hedged balance sheet position.

Derivatives Not Designated for Hedge Accounting	Gain (Loss) Recognized in Earnings	
	2017	2016
Foreign currency	\$ (24.2)	\$ 4.3
Equity	92.7	26.0
	<u>\$ 68.5</u>	<u>\$ 30.3</u>

Credit Risk

The Company is exposed to credit-related losses in the event of non-performance by the counterparties to its hedging instruments. The counterparties to these agreements consist of a diverse group of financial institutions and market participants. The Company continually monitors its positions and the credit ratings of its counterparties and adjusts positions as appropriate. The Company did not have significant exposure to any individual counterparty at December 31, 2017, and has master agreements that contain netting arrangements. For financial reporting purposes, the Company presents gross derivative balances in the financial statements and supplementary data, even for counterparties subject to netting arrangements. Some of these agreements also require each party to post collateral if credit ratings fall below, or aggregate exposures exceed, certain contractual limits. At December 31, 2017, the Company was required to post an immaterial amount of collateral due to negative fair value of certain derivative positions. The Company's counterparties were not required to post collateral on any derivative position, other than on hedges of certain of the Company's supplemental benefit plan liabilities where the counterparties were required to post collateral on their liability positions.

INCOME TAXES

Income Tax Uncertainties

The Company, like other multi-national companies, is regularly audited by federal, state and foreign tax authorities, and tax assessments may arise several years after tax returns have been filed. Accordingly, tax liabilities are recorded when, in management's judgment, a tax position does not meet the more likely than not threshold for recognition. For tax positions that meet the more likely than not threshold, a tax liability may still be recorded depending on management's assessment of how the tax position will ultimately be settled.

The Company records interest and penalties on unrecognized tax benefits in the provision for income taxes.

Accounting for Global Intangible Low-Taxed Income ("GILTI")

The Tax Act requires a U.S. shareholder of a foreign corporation to include GILTI in taxable income. The accounting policy of the Company is to record any tax on GILTI in the provision for income taxes in the year it is incurred.