OWENS ILLINOIS INC /DE/
Form 10-Q
October 31, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended

September 30, 2018

or

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

For the transition period from to

Commission file number 1-9576

OWENS-ILLINOIS, INC.

(Exact name of registrant as specified in its charter)

Delaware	22-2781933
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

One Michael Owens Way, Perrysburg, Ohio	43551
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (567) 336-5000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer	Non-accelerated filer
Smaller reporting company	Emerging growth 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.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of common stock, par value $.01, of Owens-Illinois, Inc. outstanding as of September 30, 2018 was 158,698,663.

Part I — FINANCIAL INFORMATION

Item 1. Financial Statements.

The Condensed Consolidated Financial Statements of Owens-Illinois, Inc. (the "Company") presented herein are unaudited but, in the opinion of management, reflect all adjustments necessary to present fairly such information for the periods and at the dates indicated. All adjustments are of a normal recurring nature. Because the following unaudited condensed consolidated financial statements have been prepared in accordance with Article 10 of Regulation S-X, they do not contain all information and footnotes normally contained in annual consolidated financial statements; accordingly, they should be read in conjunction with the Consolidated Financial Statements and notes thereto appearing in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED RESULTS OF OPERATIONS

(Dollars in millions, except per share amounts)
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net sales	$ 1,734	$ 1,791	$ 5,242	$ 5,157
Cost of goods sold	(1,410)	(1,438)	(4,253)	(4,143)
Gross profit	324	353	989	1,014
Selling and administrative expense	(115)	(120)	(367)	(362)
Research, development and engineering expense	(17)	(15)	(50)	(46)
Interest expense, net	(63)	(63)	(199)	(204)
Equity earnings	19	22	57	55
Other income (expense), net	20	(5)	(49)	(61)
Earnings from continuing operations before income taxes	168	172	381	396
Provision for income taxes	(41)	(37)	(95)	(65)
Earnings from continuing operations	127	135	286	331
Loss from discontinued operations		(2)	(1)	(2)
Net earnings	127	133	285	329
Net earnings attributable to noncontrolling interests	(7)	(7)	(18)	(15)
Net earnings attributable to the Company	$ 120	$ 126	$ 267	$ 314
Amounts attributable to the Company:				
Earnings from continuing operations	$ 120	$ 128	$ 268	$ 316
Loss from discontinued operations		(2)	(1)	(2)
Net earnings	$ 120	$ 126	$ 267	$ 314
Basic earnings per share:				
Earnings from continuing operations	$ 0.75	$ 0.78	$ 1.67	$ 1.94
Loss from discontinued operations		(0.01)	(0.01)	(0.01)
Net earnings	$ 0.75	$ 0.77	$ 1.66	$ 1.93
Weighted averages shares outstanding (thousands)	159,032	162,866	160,936	162,658
Diluted earnings per share:				
Earnings from continuing operations	$ 0.75	$ 0.77	$ 1.65	$ 1.92
Loss from discontinued operations		(0.01)	(0.01)	(0.01)
Net earnings	$ 0.75	$ 0.76	$ 1.64	$ 1.91

Weighted average diluted shares outstanding (thousands)	161,035	164,993	162,977	164,440

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED COMPREHENSIVE INCOME

(Dollars in millions)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net earnings	$ 127	$ 133	$ 285	$ 329
Other comprehensive income (loss):				
Foreign currency translation adjustments	32	10	(110)	212
Pension and other postretirement benefit adjustments, net of tax	15	10	51	25
Change in fair value of derivative instruments, net of tax	(1)		(7)	(10)
Other comprehensive income (loss)	46	20	(66)	227
Total comprehensive income	173	153	219	556
Comprehensive income (loss) attributable to noncontrolling interests	1	(8)		(8)
Comprehensive income attributable to the Company	$ 174	$ 145	$ 219	$ 548

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in millions)

(Unaudited)

	September 30, 2018	December 31, 2017	September 30, 2017
Assets			
Current assets:			
Cash and cash equivalents	$ 440	$ 492	$ 339
Trade receivables, net of allowance of $35 million, $34 million, and $36 million at September 30, 2018, December 31, 2017 and September 30, 2017	992	663	1,028
Inventories	973	1,036	1,046
Prepaid expenses and other current assets	259	229	254
Total current assets	2,664	2,420	2,667
Property, plant and equipment, net	3,044	3,131	3,036
Goodwill	2,549	2,590	2,621
Intangibles, net	422	439	473
Other assets	1,261	1,176	1,202
Total assets	$ 9,940	$ 9,756	$ 9,999
Liabilities and Share Owners' Equity			
Current liabilities:			
Accounts payable	$ 1,048	$ 1,324	$ 1,087
Short-term loans and long-term debt due within one year	152	162	243
Current portion of asbestos-related liabilities	100	100	115
Other liabilities	604	579	617
Other liabilities - discontinued operations	115	115	115
Total current liabilities	2,019	2,280	2,177
Long-term debt	5,487	5,121	5,378
Asbestos-related liabilities	442	482	528
Other long-term liabilities	925	946	977
Share owners' equity	1,067	927	939
Total liabilities and share owners' equity	$ 9,940	$ 9,756	$ 9,999

See accompanying notes.

OWENS-ILLINOIS, INC.

CONDENSED CONSOLIDATED CASH FLOWS

(Dollars in millions)

(Unaudited)

	Nine months ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net earnings	$ 285	$ 329
Loss from discontinued operations	1	2
Non-cash charges		
Depreciation and amortization	384	372
Pension expense	25	22
Restructuring, asset impairment and related charges	70	48
Cash payments		
Pension contributions	(26)	(28)
Asbestos-related payments	(40)	(49)
Cash paid for restructuring activities	(21)	(30)
Change in components of working capital	(545)	(601)
Other, net (a)	(34)	(26)
Cash provided by continuing operating activities	99	39
Cash utilized in discontinued operating activities	(1)	(2)
Total cash provided by operating activities	98	37
Cash flows from investing activities:		
Cash payments for property, plant and equipment	(383)	(292)
Acquisitions, net of cash acquired	(48)	(37)
Net cash proceeds on disposal of assets	10	14
Cash utilized in continuing investing activities	(421)	(315)
Cash provided by discontinued investing activities		115
Total cash utilized in investing activities	(421)	(200)
Cash flows from financing activities:		
Changes in borrowings, net	413	23
Issuance of common stock and other	1	(5)
Treasury shares repurchased	(107)	
Payment of finance fees	(13)	(23)
Distributions to noncontrolling interests	(9)	(9)
Cash provided by (utilized in) financing activities	285	(14)
Effect of exchange rate fluctuations on cash	(14)	24
Change in cash	(52)	(153)
Cash at beginning of period	492	492
Cash at end of period	$ 440	$ 339

(a) Other, net includes other non-cash charges plus other changes in non-current assets and liabilities.

See accompanying notes.

OWENS-ILLINOIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Tabular data dollars in millions, except per share amounts

1. Segment Information

The Company has three reportable segments and three operating segments based on its geographic locations: Americas, Europe, and Asia Pacific. These three segments are aligned with the Company's internal approach to managing, reporting, and evaluating performance of its global glass operations. As previously disclosed, to better leverage its scale and presence across a larger geography and market, the Company completed the consolidation of the former North America and Latin America segments into one segment, named the Americas, effective January 1, 2018. The consolidation resulted in the leadership roles of the former North America and Latin America segments being combined into one position, President of the Americas, reporting to the Company's chief operating decision maker ("CODM"), who is the Company's Chief Executive Officer. Beginning January 1, 2018, the CODM reviews the operating results at the Americas level to make resource allocation decisions and to assess performance. The consolidation also resulted in the elimination of duplicative costs as certain functions of the former North America and Latin America segments were combined to simplify the management of the new Americas segment. For example, the Company consolidated its business shared service centers in North America and Latin America into one Americas shared service center.

Certain assets and activities not directly related to one of the regions or to glass manufacturing are reported with Retained corporate costs and other. These include licensing, equipment manufacturing, global engineering, and certain equity investments. Retained corporate costs and other also includes certain headquarters administrative and facilities costs and certain incentive compensation and other benefit plan costs that are global in nature and are not allocable to the reportable segments.

The Company's measure of profit for its reportable segments is segment operating profit, which is a non-GAAP financial measure that consists of consolidated earnings from continuing operations before interest income, interest expense, and provision for income taxes and excludes amounts related to certain items that management considers not representative of ongoing operations as well as certain retained corporate costs. The Company's management uses segment operating profit, in combination with net sales and selected cash flow information, to evaluate performance and to allocate resources. Segment operating profit for reportable segments includes an allocation of some corporate expenses based on both a percentage of sales and direct billings based on the costs of specific services provided.

Financial information for the three and nine months ended September 30, 2018 and 2017 regarding the Company's reportable segments is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Net sales:				
Americas	$ 939	$ 963	$ 2,777	$ 2,774
Europe	613	624	1,930	1,813
Asia Pacific	165	188	491	516
Reportable segment totals	1,717	1,775	5,198	5,103
Other	17	16	44	54

Net sales	$ 1,734	$ 1,791	$ 5,242	$ 5,157

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	Three months ended September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Segment operating profit:				
Americas	$ 158	$ 159	$ 458	$ 459
Europe	87	81	260	220
Asia Pacific	10	20	16	51
Reportable segment totals	255	260	734	730
Items excluded from segment operating profit:				
Retained corporate costs and other	(24)	(25)	(81)	(81)
Restructuring, asset impairment and other			(73)	(49)
Interest expense, net	(63)	(63)	(199)	(204)
Earnings from continuing operations before income taxes	$ 168	$ 172	$ 381	$ 396

Financial information regarding the Company's total assets is as follows:

	September 30, 2018	December 31, 2017	September 30, 2017
Total assets:			
Americas	$ 5,455	$ 5,411	$ 5,598
Europe	3,220	3,133	3,140
Asia Pacific	999	1,001	1,046
Reportable segment totals	9,674	9,545	9,784
Other	266	211	215
Consolidated totals	$ 9,940	$ 9,756	$ 9,999

2. Revenue

On January 1, 2018, the Company adopted accounting standard ASC 606, Revenue from Contracts with Customers, and selected the modified retrospective transition method. The adoption of this new standard did not impact the Company's consolidated results of operations or balance sheet and there was no cumulative effect of initially applying this new revenue standard to the opening balance of retained earnings.

Revenue is recognized when obligations under the terms of the Company's contracts and related purchase orders with its customers are satisfied. This occurs with the transfer of control of glass containers, which primarily takes place when products are shipped from the Company's manufacturing or warehousing facilities to the customer. Revenue is measured as the amount of consideration the Company expects to receive in exchange for transferring goods, which includes estimated provisions for rebates, discounts, returns and allowances. Sales, value added, and other taxes the Company collects concurrent with revenue-producing activities are excluded from revenue. The Company's payment terms are based on customary business practices and can vary by customer type. The term between invoicing and when payment is due is not significant. Also, the Company elected to account for shipping and handling costs as a fulfillment cost at the time of shipment.

For the three and nine months ended September 30, 2018, the Company had no material bad debt expense and there were no material contract assets, contract liabilities or deferred contract costs recorded on the Condensed Consolidated Balance Sheet. For the three and nine months ended September 30, 2018, revenue recognized from prior periods (for example, due to changes in transaction price) was not material.

The following table for three months ended September 30, 2018 disaggregates the Company's revenue by customer end use:

	Three months ended September 30, 2018			
	Americas	Europe	Asia Pacific	Total
Alcoholic beverages (beer, wine, spirits)	$ 582	$ 419	$ 121	$ 1,122
Food and other	209	127	24	360
Non-alcoholic beverages	148	67	20	235
Reportable segment totals	$ 939	$ 613	$ 165	$ 1,717
Other				17
Net sales				$ 1,734

The following table for nine months ended September 30, 2018 disaggregates the Company's revenue by customer end use:

	Nine months ended September 30, 2018			
	Americas	Europe	Asia Pacific	Total
Alcoholic beverages (beer, wine, spirits)	$ 1,743	$ 1,383	$ 361	$ 3,487
Food and other	594	351	72	1,017
Non-alcoholic beverages	440	196	58	694
Reportable segment totals	$ 2,777	$ 1,930	$ 491	$ 5,198
Other				44
Net sales				$ 5,242

3. Inventories

Major classes of inventory at September 30, 2018, December 31, 2017 and September 30, 2017 are as follows:

	September 30, 2018	December 31, 2017	September 30, 2017
Finished goods	$ 808	$ 873	$ 875
Raw materials	119	122	129
Operating supplies	46	41	42
	$ 973	$ 1,036	$ 1,046

4. Derivative Instruments

The Company has certain derivative assets and liabilities which consist of natural gas forwards, foreign exchange option and forward contracts, interest rate swaps and cross currency swaps. The valuation of these instruments is determined using widely accepted valuation techniques, including discounted cash flow analysis on the expected cash flows of each derivative an income approach to value most of these contracts. Natural gas forward rates and foreign exchange rates are the significant inputs into the valuation models. The Company also evaluates counterparty risk in determining fair values. This analysis reflects the contractual terms of the derivatives, including the period to maturity, and uses observable market-based inputs, including interest rate curves and implied volatilities. The fair values of interest rate swaps are determined using the market standard methodology of netting the discounted future fixed cash receipts (or payments) and the discounted expected variable cash payments (or receipts). The variable cash payments (or receipts) are based on an expectation of future interest rates (forward curves) derived from observable market interest rate curves. These inputs are observable in active markets over the terms of the instruments the Company holds, and accordingly, the Company classifies its derivative assets and liabilities as Level 2 in the hierarchy.

Commodity Forward Contracts Designated as Cash Flow Hedges

In several regions, the Company enters into commodity forward contracts related to forecasted natural gas requirements, the objectives of which are to limit the effects of fluctuations in the future market price paid for natural gas and the related volatility in cash flows. In the Americas, some customer contracts contain provisions that pass the price of natural gas to the customer, which the customer has the option of fixing for a specified period of time. To limit the effects of fluctuations in cash flows resulting from these customer contracts, the Company enters into commodity forward contracts related to forecasted natural gas requirements. In Asia Pacific, the Company implemented a hedging program that included the execution of commodity forward contracts for certain contracted natural gas requirements. In total, the Company had entered into commodity forward contracts covering approximately 7,600,000 MM BTUs at September 30, 2018, 8,800,000 MM BTUs at December 31, 2017 and 9,300,000 MM BTUs at September 30, 2017, respectively.

The Company accounts for the above forward contracts as cash flow hedges and recognizes them on the Condensed Consolidated Balance Sheet at fair value. The effective portion of changes in the fair value of a derivative that is designated as, and meets the required criteria for, a cash flow hedge is recorded in the Accumulated Other Comprehensive Income component of share owners' equity ("OCI") and reclassified into earnings in the same period or periods during which the underlying hedged item affects earnings. An unrecognized loss of $8 million at September 30, 2018, an unrecognized gain of $3 million at December 31, 2017 and an unrecognized loss of less than $1 million at September 30, 2017 related to the commodity forward contracts was included in Accumulated OCI, and will be reclassified into earnings in the period when the commodity forward contracts expire. Any material portion of the change in the fair value of a derivative designated as a cash flow hedge that is deemed to be ineffective is recognized in current earnings. The ineffectiveness related to these natural gas hedges for the three and nine months ended September 30, 2018 and 2017 was not material.

The effect of the commodity forward contracts on the results of operations for the three months ended September 30, 2018 and September 30, 2017 is as follows:

Amount of Gain (Loss) Recognized in OCI on Commodity Forward Contracts (Effective Portion)		Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (reported in cost of goods sold) (Effective Portion)	
2018	2017	2018	2017
$ 1	$ (1)	$ —	$ —

The effect of the commodity forward contracts on the results of operations for the nine months ended September 30, 2018 and September 30, 2017 is as follows:

Amount of Gain Recognized in OCI on Commodity Forward Contracts (Effective Portion)		Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (reported in cost of goods sold) (Effective Portion)	
2018	2017	2018	2017
$ 6	$ 3	$ (1)	$ —

Foreign Exchange Derivative Contracts and not Designated as Hedging Instruments

The Company may enter into short-term forward exchange or option agreements to purchase foreign currencies at set rates in the future. These agreements are used to limit exposure to fluctuations in foreign currency exchange rates for significant planned purchases of fixed assets or commodities that are denominated in currencies other than the subsidiaries' functional currency. The Company may also use foreign exchange agreements to offset the foreign currency risk for receivables and payables, including intercompany receivables, payables, and loans, not denominated in, or indexed to, their functional currencies. The Company records these short-term foreign exchange agreements on the balance sheet at fair value and changes in the fair value are recognized in current earnings.

At September 30, 2018, December 31, 2017 and September 30, 2017, the Company had outstanding foreign exchange and option agreements denominated in various currencies covering the equivalent of approximately $410 million, $460 million and $320 million, respectively, related primarily to intercompany transactions and loans.

The effect of the foreign exchange derivative contracts on the results of operations for the three months ended September 30, 2018 and September 30, 2017 is as follows:

Location of Gain (Loss) Recognized in Income on Foreign Exchange Contracts	Amount of Gain (Loss) Recognized in Income on Foreign Exchange Contracts	
	2018	2017
Other expense, net	$ —	$ (2)

The effect of the foreign exchange derivative contracts on the results of operations for the nine months ended September 30, 2018 and September 30, 2017 is as follows:

Location of Gain (Loss) Recognized in Income on Foreign Exchange Contracts	Amount of Gain (Loss) Recognized in Income on Foreign Exchange Contracts	
	2018	2017
Other expense, net	$ (1)	$ 4

Cash Flow Hedges of Foreign Exchange Risk

The Company has variable-interest rate borrowings denominated in currencies other than the functional currency of the borrowing subsidiaries. As a result, the Company is exposed to fluctuations in the currency of the borrowing against the subsidiaries' functional currency. The Company uses derivatives to manage these exposures and designates these derivatives as cash flow hedges of foreign exchange risk. For these derivatives designated as cash flow hedges of foreign exchange risk the gain or loss on the derivative is recorded in Accumulated OCI and is subsequently reclassified into earnings in the period for which the hedged forecasted transaction affects earnings. If there is an ineffective portion of the change in fair value of the derivative it is recognized directly in earnings.

During the fourth quarter of 2017, one of the Company's Euro-functional subsidiaries entered into a series of cross-currency swaps to manage its exposure to fluctuations in the Euro-U.S. dollar exchange rate arising from a U.S. dollar denominated borrowing. These swaps involve exchanging fixed rate Euro interest payments for fixed rate U.S. dollar interest receipts, both of which will occur at the forward exchange rates in effect upon entering into the instrument. An unrecognized loss of $9 million at September 30, 2018 and an unrecognized loss of less than $1 million at December 31, 2017, related to these cross-currency swaps, were included in Accumulated OCI, and will be reclassified into earnings within the next twelve months. These instruments, in the aggregate, have a pay fixed notional amount of €263 million and a receive notional amount of $310 million. They reach final maturity in 2023. There was no ineffectiveness related to these cross-currency interest rate swaps for the three and nine months ended September 30, 2018.

During the second quarter of 2018, two of the Company's subsidiaries, a New Zealand dollar ("NZD") functional currency subsidiary and an Australian dollar ("AUD") functional currency subsidiary, entered into a series of cross-currency swaps to manage its exposure to fluctuations in the NZD-U.S. dollar exchange rate and the AUD-U.S. dollar exchange rate arising from U.S. dollar denominated borrowings. These swaps involve exchanging floating rate

U.S. dollar interest receipts for fixed rate NZD and AUD interest payments, both of which will occur at the forward exchange rates in effect upon entering into the instrument. An unrecognized loss of $3 million at September 30, 2018 related to these cross-currency swaps, was included in Accumulated OCI, and will be reclassified into earnings within the next twelve months. The NZD to U.S. dollar instruments, in the aggregate, have a pay fixed notional amount of NZD $161 million and a receive notional amount of $110 million. They reach final maturity in 2022. The AUD to U.S. dollar instruments, in the aggregate, have a pay fixed notional amount of AUD $231 million and a receive notional amount of $170 million. They reach final maturity in 2022. There was no ineffectiveness related to these cross-currency swaps for the three and nine months ended September 30, 2018.

The effect of the cash flow hedges of foreign exchange risk on the results of operations for the three months ended September 30, 2018 is as follows:

Amount of Gain (Loss) Recognized in OCI on Cash Hedges of Foreign Exchange Risk (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (reported in Other expense, net) (Effective Portion)
$ 7	$ (9)

The effect of the cash flow hedges of foreign exchange risk on the results of operations for the nine months ended September 30, 2018 is as follows:

Amount of Gain (Loss) Recognized in OCI on Cash Hedges of Foreign Exchange Risk (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (reported in Other expense, net) (Effective Portion)
$ 8	$ 1

Interest Rate Swaps Designated as Fair Value Hedges

During 2017, the Company entered into a series of interest rate swap agreements with a total notional amount of €725 million that reach final maturity in 2024. The swaps were executed in order to maintain a capital structure containing appropriate amounts of fixed and floating-rate debt.

The Company’s fixed-to-variable interest rate swaps were accounted for as fair value hedges. The relevant terms of the swap agreements match the corresponding terms of the notes and therefore there is no hedge ineffectiveness. The Company recorded the net of the fair market values of the swaps as a long-term liability and short-term asset along with a corresponding net decrease in the carrying value of the hedged debt.

Under the swaps, the Company receives fixed rate interest amounts (equal to the interest on the corresponding hedged note) and pays interest at a six-month Euribor rate (set in arrears) plus a margin spread (see table below). The interest rate differential on each swap is recognized as an adjustment of interest expense during each six-month period over the term of the agreement.

The following selected information relates to fair value swaps at September 30, 2018:

	Amount Hedged	Receive Rate	Average Spread
Senior Notes due 2024	€ 725	3.125 %	2.6 %

Cash Flow Hedges of Interest Rate Risk

During the third quarter of 2018, the Company entered into a series of interest rate swap agreements with a total notional amount of $180 million. These interest rate swaps reach final maturity in 2020. The Company’s objectives in using interest rate derivatives are to manage its exposure to interest rate movements. To accomplish this objective, the Company uses interest rate swaps as part of its interest rate risk management strategy. Interest rate swaps designated as cash flow hedges involve the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments. These interest rate swap agreements were used to hedge the variable cash flows associated with variable-rate debt.

Under the swaps, the Company pays fixed rate interest and receives floating rate interest amounts at a one month Libor rate plus a margin spread of 1.25%. The interest rate differential on each swap is recognized as an adjustment of interest expense during each monthly period over the term of the agreement.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company’s variable-rate debt. An unrecognized gain of less than $1 million at September 30, 2018 related to these interest rate swaps, was included in Accumulated OCI, and will be reclassified into earnings within the next twelve months. For the three months ended September 30, 2018 there was a loss of less than $1 million recorded into Accumulated OCI and a gain of less than $1 million reclassified from Accumulated OCI into interest expense.

Net Investment Hedges

The Company is exposed to fluctuations in foreign exchange rates on investments it holds in non-U.S. subsidiaries. The Company uses cross currency swaps to hedge its exposure to changes in foreign exchange rates on certain of these investments. During the third quarter of 2018, the Company entered into a series of cross currency swap agreements with a pay notional amount of €154 million and a receive notional amount is $180 million that reach final maturity in 2020. These cross-currency swaps involve the receipt of USD fixed rate amounts from a counterparty in exchange for the Company making Euro fixed payments over the life of the agreement. For derivatives designated as net investment hedges, the gain or loss on the derivative is reported in Accumulated Other Comprehensive Income as part of the cumulative translation adjustment. Amounts are reclassified out of Accumulated Other Comprehensive Income into earnings when the hedged net investment is either sold or substantially liquidated. For the three months ended September 30, 2018 there was a loss of less than $1 million recorded into Accumulated OCI.

Balance Sheet Classification

The Company records the fair values of derivative financial instruments on the balance sheet as follows:
(a) receivables if the instrument has a positive fair value and maturity within one year, (b) deposits, receivables, and other assets if the instrument has a positive fair value and maturity after one year, (c) other accrued liabilities or other liabilities (current) if the instrument has a negative fair value and maturity within one year, and (d) other accrued liabilities or other liabilities if the instrument has a negative fair value and maturity after one year.

The following table shows the amount and classification (as noted above) of the Company’s derivatives at September 30, 2018, December 31, 2017 and September 30, 2017: