AVIS BUDGET GROUP, INC.
Form 10-Q
August 08, 2007
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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 quarterly period ended June 30, 2007

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 No. 1-10308

Avis Budget Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**06-0918165**
(State or other jurisdiction	*(I.R.S. Employer*
of incorporation or organization)	*Identification Number)*
6 Sylvan Way	
Parsippany, NJ	**07054**
(Address of principal executive offices)	*(Zip Code)*

(973) 496-4700

(Registrant s telephone number, including area code)

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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

The number of shares outstanding of the issuer s common stock was 103,769,313 shares as of July 31, 2007.

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FORWARD-LOOKING STATEMENTS

The forward-looking statements contained herein are subject to known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. These forward-looking statements are based on various facts and were derived utilizing numerous important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements. Forward-looking statements include the information concerning our future financial performance, business strategy, projected plans and objectives. Statements preceded by, followed by or that otherwise include the words believes , expects , anticipates , intends , projects , estimates , plans , may increase , may fluctuate and similar expressions or future or conditional verbs such as will , should , would , may are generally forward-looking in nature and not historical facts. You should understand that the following important factors and assumptions could affect our future results and could cause actual results to differ materially from those expressed in such forward-looking statements:

- the high level of competition in the vehicle rental industry and the impact such competition may have on pricing and rental volume;
- an increase in the cost of new vehicles;
- a decrease in our ability to acquire or dispose of cars generally through repurchase or guaranteed depreciation programs and/or dispose of vehicles through sales of vehicles in the used car market;
- a decline in the results of operations or financial condition of the manufacturers of our cars;
- a downturn in airline passenger traffic in the United States or in the other international locations in which we operate;
- an occurrence or threat of terrorism, pandemic disease, natural disasters or military conflict in the markets in which we operate;
- our dependence on third-party distribution channels;
- a disruption or decline in rental activity, particularly during our peak season or in key market segments;
- a disruption in our ability to obtain financing for our operations, including the funding of our vehicle fleet via the asset-backed securities and lending market;
- a significant increase in interest rates or in borrowing costs;
- our failure to increase or decrease appropriately the size of our fleet due to the seasonal nature of our business;
- our ability to accurately estimate our future results;

our ability to implement our strategy for growth;

a major disruption in our communication or centralized information networks;

our failure or inability to comply with regulations or any changes in regulations;

our failure or inability to make the changes necessary to operate effectively now that we operate independently from the former real estate, hospitality and travel distribution businesses following the separation of those businesses from us during third quarter 2006, when we were known as Cendant Corporation;

other business, economic, competitive, governmental, regulatory, political or technological factors affecting our operations, pricing or services;

risks inherent in the restructuring of the operations of Budget Truck Rental;

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- risks inherent in the separation and related transactions, including risks related to our April 2006 borrowings, and costs of the separation; and

- the terms of agreements among the separated companies, including the allocations of assets and liabilities, including contingent liabilities and guarantees, commercial arrangements and the performance of each of the separated companies obligations under these agreements.

Other factors and assumptions not identified above, including those described under Risk Factors set forth in Item 1A of our 2006 Annual Report on Form 10-K were also involved in the derivation of these forward-looking statements, and the failure of such other assumptions to be realized, as well as other factors, may also cause actual results to differ materially from those projected. Most of these factors are difficult to predict accurately and are generally beyond our control.

You should consider the areas of risk described above, as well as those described under Risk Factors set forth in Item 1A of our 2006 Annual Report on Form 10-K, in connection with any forward-looking statements that may be made by us and our businesses generally. Except for our ongoing obligations to disclose material information under the federal securities laws, we undertake no obligation to release any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events unless required by law. For any forward-looking statements contained in any document, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Avis Budget Group, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS

(In millions, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006 Restated	2007	2006 Restated
Revenues				
Vehicle rental	$ 1,175	$ 1,150	$ 2,252	$ 2,215
Other	341	304	629	576
Net revenues	1,516	1,454	2,881	2,791
Expenses				
Operating	785	729	1,496	1,425
Vehicle depreciation and lease charges, net	402	364	764	694
Selling, general and administrative	168	240	327	446
Vehicle interest, net	71	75	142	166
Non-vehicle related depreciation and amortization	20	28	43	55
Interest expense related to corporate debt, net	32	97	65	157
Separation costs, net	3	31	(3)	56
Total expenses	1,481	1,564	2,834	2,999
Income (loss) before income taxes	35	(110)	47	(208)
Provision (benefit) from income taxes	12	(46)	12	(78)
Income (loss) from continuing operations	23	(64)	35	(130)
Income from discontinued operations, net of tax		317		532
Gain (loss) on disposal of discontinued operations, net of tax	1	(1,307)	1	(1,322)
Income (loss) before cumulative effect of accounting changes	24	(1,054)	36	(920)
Cumulative effect of accounting changes, net of tax				(64)
Net income (loss)	$ 24	$ (1,054)	$ 36	$ (984)
Earnings per share				
Basic				
Income (loss) from continuing operations	$ 0.22	$ (0.64)	$ 0.34	$ (1.30)
Net income (loss)	0.23	(10.52)	0.35	(9.80)

Diluted				
Income (loss) from continuing operations	$ 0.22	$ (0.64)	$ 0.34	$ (1.30)
Net income (loss)	0.23	(10.52)	0.35	(9.80)

See Notes to Consolidated Condensed Financial Statements.

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Avis Budget Group, Inc.

CONSOLIDATED CONDENSED BALANCE SHEETS

(In millions, except share data)

(Unaudited)

	June 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 227	$ 172
Receivables, net	436	363
Deferred income taxes	6	7
Other current assets	540	1,264
Total current assets	1,209	1,806
Property and equipment, net	497	486
Deferred income taxes	169	226
Goodwill	2,194	2,193
Other intangibles, net	745	739
Other non-current assets	728	121
Total assets exclusive of assets under vehicle programs	5,542	5,571
Assets under vehicle programs:		
Program cash	18	14
Vehicles, net	9,299	7,049
Receivables from vehicle manufacturers and other	142	276
Investment in Avis Budget Rental Car Funding (AESOP), LLC related party	375	361
	9,834	7,700
Total assets	$ 15,376	$ 13,271
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable and other current liabilities	$ 1,110	$ 1,855
Current portion of long-term debt	11	29
Total current liabilities	1,121	1,884
Long-term debt	1,792	1,813
Other non-current liabilities	959	452
Total liabilities exclusive of liabilities under vehicle programs	3,872	4,149
Liabilities under vehicle programs:		
Debt	1,043	759
Debt due to Avis Budget Rental Car Funding (AESOP), LLC related party	6,321	4,511

Deferred income taxes	1,311	1,206
Other	299	203
	8,974	6,679
Commitments and contingencies (Note 12)		
Stockholders equity:		
Preferred stock, $.01 par value authorized 1 million shares; none issued and outstanding		
Common stock, $.01 par value authorized 250 million shares; issued 136,810,549 and 135,498,121 shares	1	1
Additional paid-in capital	9,327	9,664
Retained earnings (accumulated deficit)	(568)	(586)
Accumulated other comprehensive income	117	68
Treasury stock, at cost 32,605,466 and 34,306,694 shares	(6,347)	(6,704)
Total stockholders equity	2,530	2,443
Total liabilities and stockholders equity	$ 15,376	$ 13,271

See Notes to Consolidated Condensed Financial Statements.

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Avis Budget Group, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(In millions)

(Unaudited)

	Six Months Ended June 30,	
	2007	**2006 Restated**
Operating Activities		
Net income (loss)	$ 36	$ (984)
Adjustments to arrive at income (loss) from continuing operations	(1)	854
Income (loss) from continuing operations	35	(130)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by (used in) operating activities exclusive of vehicle programs:		
Non-vehicle related depreciation and amortization	43	55
Net change in assets and liabilities, excluding the impact of acquisitions and dispositions:		
Receivables	(14)	
Income taxes and deferred income taxes	12	(309)
Accounts payable and other current liabilities	(53)	(37)
Other, net	(11)	(92)
Net cash provided by (used in) continuing operating activities exclusive of vehicle programs	12	(513)
Vehicle programs:		
Vehicle depreciation	759	663
	759	663
Net cash provided by continuing operating activities	771	150
Investing Activities		
Property and equipment additions	(51)	(46)
Net assets acquired, net of cash acquired, and acquisition-related payments	(1)	(113)
Proceeds received on asset sales	8	10
Proceeds from sale of investment	106	
Payments made to Realogy and Wyndham, net	(88)	
Proceeds from dispositions of businesses, net of transaction-related payments	(1)	(28)
Other, net	(8)	6
Net cash used in investing activities exclusive of vehicle programs	(35)	(171)
Vehicle programs:		
Increase in program cash	(4)	(49)
Investment in vehicles	(6,480)	(6,936)
Payments received on investment in vehicles	3,752	5,404

Other, net		(6)
	(2,732)	(1,587)
Net cash used in investing activities	(2,767)	(1,758)

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Avis Budget Group, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Continued)

(In millions)

	Six Months Ended June 30, 2007	Six Months Ended June 30, 2006 Restated
Financing Activities		
Proceeds from borrowings		1,875
Principal payments on borrowings	(39)	
Net short-term borrowings		192
Issuances of common stock	39	36
Repurchases of common stock		(243)
Payment of dividends		(113)
Other, net		(25)
Net cash provided by financing activities exclusive of vehicle programs		1,722
Vehicle programs:		
Proceeds from borrowings	6,287	6,441
Principal payments on borrowings	(4,362)	(7,322)
Net change in short-term borrowings	129	104
Other, net	(6)	(22)
	2,048	(799)
Net cash provided by financing activities	2,048	923
Effect of changes in exchange rates on cash and cash equivalents	3	(1)
Cash provided by (used in) discontinued operations		
Operating activities		1,059
Investing activities		(526)
Financing activities		(282)
Effect of exchange rate changes		10
Cash provided by discontinued operations		261
Net increase (decrease) in cash and cash equivalents	55	(425)
Cash and cash equivalents, beginning of period	172	546
Cash and cash equivalents, end of period	$ 227	$ 121

See Notes to Consolidated Condensed Financial Statements.

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Avis Budget Group, Inc.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unless otherwise noted, all amounts are in millions, except per share amounts)

1. Basis of Presentation and Recently Issued Accounting Pronouncements

Basis of Presentation

Avis Budget Group, Inc. provides car and truck rentals and ancillary services to businesses and consumers in the United States and internationally. The accompanying unaudited Consolidated Condensed Financial Statements include the accounts and transactions of Avis Budget Group, Inc. and its subsidiaries (Avis Budget), as well as entities in which Avis Budget directly or indirectly has a controlling financial interest (collectively, the Company) and have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (SEC) for interim financial reporting.

The Company operates in the following business segments:

Domestic Car Rental provides car rentals and ancillary products and services in the United States.

International Car Rental provides car rentals and ancillary products and services primarily in Canada, Argentina, Australia, New Zealand, Puerto Rico and the U.S. Virgin Islands.

Truck Rental provides truck rentals and related services to consumers and light commercial users in the United States.

In presenting the Consolidated Condensed Financial Statements in accordance with accounting principals generally accepted in the United States (U.S. GAAP), management makes estimates and assumptions that affect the amounts reported and related disclosures. Estimates, by their nature, are based on judgments and available information. Accordingly, actual results could differ from those estimates. In management s opinion, the Consolidated Condensed Financial Statements contain all normal recurring adjustments necessary for a fair presentation of interim results reported. The results of operations reported for interim periods are not necessarily indicative of the results of operations for the entire year or any subsequent interim period. These financial statements should be read in conjunction with the Company s 2006 Annual Report on Form 10-K filed on March 1, 2007.

Vehicle Programs. The Company presents separately the financial data of its vehicle programs. These programs are distinct from the Company s other activities since the assets under vehicle programs are generally funded through the issuance of debt, asset-backed funding or other similar arrangements which are collateralized by such assets. The income generated by these assets is used, in part, to repay the principal and interest associated with the debt. Cash inflows and outflows relating to the generation or acquisition of such assets and the principal debt repayment or financing of such assets are classified as activities of the Company s vehicle programs. The Company believes it is appropriate to segregate the financial data of its vehicle programs because, ultimately, the source of repayment of such debt is the realization of such assets.

Discontinued Operations. In connection with the separation of Cendant into four independent companies, the Company completed the spin-offs of Realogy Corporation (Realogy) and Wyndham Worldwide Corporation (Wyndham) on July 31, 2006 and completed the sale of Travelport, Inc. (Travelport) on August 23, 2006. Pursuant to Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS No. 144), the account balances and activities of Realogy, Wyndham and Travelport have been segregated and reported as discontinued operations for the three and six months ended June 30, 2006. Summarized financial data for the aforementioned businesses are provided in Note 2 Discontinued Operations.

Separation. During the three and six months ended June 30, 2007, the Company incurred costs (credits) of $3 million and $(3) million, respectively, in connection with the separation of Cendant into four independent companies. Such costs consisted primarily of professional and consulting fees and the six months ended June 30, 2007 amount includes a $14 million credit for tax-related receivables from Realogy and Wyndham recognized in connection with the adoption of the Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48), discussed below. For the three and six months ended June 30, 2006, the Company incurred costs of $31 million and $56 million, respectively, in connection with the separation. Such costs were primarily related to the accelerated vesting of stock-based compensation awards, severance and retention and professional and consulting fees.

Restatement. In 2006, the Company restated second quarter 2006 income (loss) from disposal of discontinued operations for an error in the determination of the impairment charge related to the sale of Travelport. The effect of this correction was to recognize an additional loss of $300 million on the sale of Travelport in the second quarter 2006. This restatement was disclosed in the Company s September 30, 2006 Quarterly Report on Form 10-Q, filed on November 21, 2006.

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The following table presents certain of the Company s previously reported income statement and cash flow data and revisions to such data resulting from the restatement and corresponding amounts currently reported.

	As Previously Reported as Cendant	Effect of Discontinued Operations	Effect of Restatement	As Restated
For the three months ended June 30, 2006:				
Consolidated condensed statement of operations				
Gain (loss) on disposal of discontinued operations, net of tax	$ (981)	(26)	(300)	$ (1,307)
Net income (loss)	(754)		(300)	(1,054)
Per share information (*)				
Basic:				
Gain (loss) on disposal of discontinued operations	(9.79)	(0.26)	(3.00)	(13.05)
Net income (loss)	(7.52)		(3.00)	(10.52)
For the six months ended June 30, 2006:				
Consolidated condensed statement of operations				
Gain (loss) on disposal of discontinued operations, net of tax	$ (981)	(41)	(300)	$ (1,322)
Income (loss) before cumulative effect of accounting changes	(620)		(300)	(920)
Net income (loss)	(684)		(300)	(984)
Per share information (*)				
Basic:				
Gain (loss) on disposal of discontinued operations	(9.78)	(0.40)	(2.99)	(13.17)
Net income (loss)	(6.81)		(2.99)	(9.80)
Consolidated condensed statement of cash flow				
Adjustments to arrive at income (loss) from continuing operations	939	(385)	300	854

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(*) Adjusted for the 1-for-10 reverse stock split which became effective September 5, 2006.

This restatement did not affect the Company s income from continuing operations. There was a corresponding decrease of $300 million to the assets of discontinued operations on the Company s balance sheet at June 30, 2006.

Changes in Accounting Policies during 2007

Accounting for Uncertainty in Income Taxes. In June 2006, the FASB issued FIN 48, which is an interpretation of SFAS No. 109, Accounting for Income Taxes. FIN 48 prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. For those benefits to be recognized, a tax position must be more-likely-than-not to be sustained upon examination by taxing authorities. The amount recognized is measured as the largest amount of benefit that is greater than 50 percent likely of being realized upon ultimate settlement. The Company adopted the provisions of FIN 48 effective January 1, 2007, as required, and recorded an after tax charge to stockholders equity of $18 million, which represents the recognition of $10 million of accrued interest and an increase of $8 million in the liability for unrecognized tax benefits. The Company has been indemnified by Realogy and Wyndham for additional tax related liabilities of $14 million recognized as a result of the adoption of FIN 48. Accordingly, the Company recorded a $14 million credit, within the separation costs, net line item on the accompanying Consolidated Condensed Statement of Operations for first quarter 2007, reflecting the recognition of receivables from Wyndham and Realogy for such tax related matters. At June 30, 2007, certain income tax payable balances have been classified as long term liabilities and certain receivables from Realogy and Wyndham have been classified as non-current assets (see Note 8 Other Current Assets and Note 9 Accounts Payable and Other Current Liabilities).

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Including the impact of the adoption of FIN 48 discussed above, the Company s unrecognized tax benefits totaled $559 million and were reclassified to long-term income taxes payable as of January 1, 2007. If recognized, substantially all would affect the annual effective income tax rate. In connection with the Company s adoption of FIN 48, the Company reduced alternative minimum tax credit and net operating loss carryforwards in the amount of $94 million and $60 million, respectively.

During the six months ended June 30, 2007, the Company s unrecognized tax benefits did not significantly change. As of June 30, 2007, the unrecognized tax benefits in the long-term income taxes payable were $404 million. The Company does not anticipate that total unrecognized tax benefits will significantly change due to the settlement of audits or the expiration of statute of limitations within twelve months.

Including the impact of the adoption of FIN 48 discussed above, the Company s accrual for the payment of potential interest associated with uncertain tax positions was $26 million as of January 1, 2007. During the six months ended June 30, 2007, the Company recorded additional liabilities of $12 million for the payment of interest, which had minimal impact on the Company s results of operations as the Company is substantially indemnified for such liabilities and recognized corresponding receivables from Realogy and Wyndham. The Company recognizes potential interest related to unrecognized tax benefits within interest expense related to corporate debt, net on the accompanying Consolidated Condensed Statements of Operations. Penalties incurred during the six months ended June 30, 2007, were not significant and recognized as a component of income taxes.

Recently Issued Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115, (SFAS No. 159). SFAS No. 159 permits a company to irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on a contract-by-contract basis, with changes in fair value recognized in earnings. The Company will adopt SFAS No. 159 on January 1, 2008, as required, and is currently evaluating the impact of such adoption on its financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements (SFAS No. 157) which defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 157 on January 1, 2008, as required, and is currently evaluating the impact of such adoption on its financial statements.

2. Discontinued Operations

The $1 million gain on disposal of discontinued operations, net of tax in the three and six months ended June 30, 2007 represents reserve adjustments related to the disposition of certain discontinued operations.

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Summarized statement of operations data for discontinued operations for the three and six months ended June 30, 2006 is as follows:

Three Months Ended June 30, 2006

	Wright Express[(a)]	Marketing Services Division[(b)]	Realogy[(c)]	Wyndham[(c)]
Net revenues	$	$	$ 1,904	$ 899
Income before income taxes	$	$	$ 277	$ 127
Provision for income taxes			108	44
Income from discontinued operations, net of tax	$	$	$ 169	$ 83
Gain (loss) on disposal of discontinued operations	$ 9	$ (8)	$ (9)	$ (8)
Provision (benefit) from income taxes	3	(2)	(2)	(2)
Gain (loss) on disposal of discontinued operations, net of tax	$ 6	$ (6)	$ (7)	$ (6)

	Travelport[(d)]	Total
Net revenues	$ 687	$ 3,490
Income before income taxes	$ 80	$ 484
Provision for income taxes	15	167
Income from discontinued operations, net of tax	$ 65	$ 317
Gain (loss) on disposal of discontinued operations	$ (1,321)	$ (1,337)
Provision (benefit) from income taxes	(27)	(30)
Gain (loss) on disposal of discontinued operations, net of tax	$ (1,294)	$ (1,307)

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(a) Represents payments received from Wright Express in connection with a tax receivable agreement pursuant to which Wright Express is obligated to make payments to the Company over a 15 year term. Pursuant to the Separation Agreement, the Company began to distribute all such payments received from Wright Express to Realogy and Wyndham following the separation.

(b) Represents payments in connection with a guarantee obligation made to the Company s former Marketing Services division.

(c) Loss on disposal of discontinued operations represents costs incurred by Realogy and Wyndham in connection with their separation from Cendant, which was completed on July 31, 2006.

(d) Loss on disposal of discontinued operations includes a $1.3 billion impairment charge reflecting the difference between Travelport s carrying value and its estimated fair value.

Six Months Ended June 30, 2006

	Wright Express[(a)]	Marketing Services Division[(b)]	Realogy[(c)]	Wyndham[(c)]
Net revenues	$	$	$ 3,329	$ 1,714

Income before income taxes	$	$	$ 368	$ 288
Provision for income taxes			140	106
Income from discontinued operations, net of tax	$	$	$ 228	$ 182
Gain (loss) on disposal of discontinued operations	$ 9	$ (10)	$ (14)	$ (15)
Provision (benefit) from income taxes	3	(4)	(2)	(3)
Gain (loss) on disposal of discontinued operations, net of tax	$ 6	$ (6)	$ (12)	$ (12)

	Travelport[d]	**Total**
Net revenues	$ 1,327	$ 6,370
Income before income taxes	$ 136	$ 792
Provision for income taxes	14	260
Income from discontinued operations, net of tax	$ 122	$ 532
Gain (loss) on disposal of discontinued operations	$ (1,327)	$ (1,357)
Provision (benefit) from income taxes	(29)	(35)
Gain (loss) on disposal of discontinued operations, net of tax	$ (1,298)	$ (1,322)

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(a) Represents payments received from Wright Express in connection with a tax receivable agreement pursuant to which Wright Express is obligated to make payments to the Company over a 15 year term. Pursuant to the Separation Agreement, the Company began to distribute all such payments received from Wright Express to Realogy and Wyndham following the separation.

(b) Represents payments in connection with a guarantee obligation made to the Company s former Marketing Services division.

(c) Loss on disposal of discontinued operations represents costs incurred by Realogy and Wyndham in connection with their separation from Cendant, which was completed on July 31, 2006.

(d) Loss on disposal of discontinued operations includes a $1.3 billion impairment charge reflecting the difference between Travelport s carrying value and its estimated fair value.

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3. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (EPS):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Income (loss) from continuing operations	$ 23	$ (64)	$ 35	$ (130)
Income from discontinued operations, net of tax		317		532
Gain (loss) on disposal of discontinued operations, net of tax	1	(1,307)	1	(1,322)
Cumulative effect of accounting changes, net of tax				(64)
Net income (loss)	$ 24	$ (1,054)	$ 36	$ (984)
Basic weighted average shares outstanding [(a)]	103.4	100.1	102.5	100.4
Stock options, warrants and restricted stock units [(b)]	1.4		1.2	
Diluted weighted average shares outstanding [(a)]	104.8	100.1	103.7	100.4
Earnings per share:				
Basic				
Income (loss) from continuing operations	$ 0.22	$ (0.64)	$ 0.34	$ (1.30)
Income from discontinued operations		3.17		5.30
Gain (loss) on disposal of discontinued operations	0.01	(13.05)	0.01	(13.17)
Cumulative effect of accounting changes				(0.63)
Net income (loss)	$ 0.23	$ (10.52)	$ 0.35	$ (9.80)
Diluted				
Income (loss) from continuing operations	$ 0.22	$ (0.64)	$ 0.34	$ (1.30)
Income from discontinued operations		3.17		5.30
Gain (loss) on disposal of discontinued operations	0.01	(13.05)	0.01	(13.17)
Cumulative effect of accounting changes				(0.63)
Net income (loss)	$ 0.23	$ (10.52)	$ 0.35	$ (9.80)

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(a) Because the Company incurred a loss from continuing operations in 2006, all outstanding stock options, restricted stock units and warrants are anti-dilutive. Accordingly, basic and diluted weighted average shares outstanding are equal for such period.

(b) Excludes restricted stock units for which performance-based vesting criteria have not been achieved.

The following table summarizes the Company s outstanding common stock equivalents that were anti-dilutive and

therefore excluded from the computation of diluted EPS:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Options [(a)]	3.0	12.0	4.6	12.0
Warrants	0.2	0.2	0.2	0.2

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(a) The weighted average exercise price for anti-dilutive options for the three and six months ended June 30, 2007 was $39.32 and $35.25, respectively. At June 30, 2006, all outstanding stock options were anti-dilutive, as the Company incurred a loss from continuing operations.

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4. Intangible Assets

As of June 30, 2007 and December 31, 2006, intangible assets consisted of:

	As of June 30, 2007			As of December 31, 2006		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized Intangible Assets						
Franchise agreements	$ 75	$ 17	$ 58	$ 75	$ 16	$ 59
Customer lists	19	6	13	19	6	13
Other	2	1	1	2	1	1
	$ 96	$ 24	$ 72	$ 96	$ 23	$ 73
Unamortized Intangible Assets						
Goodwill	$ 2,194			$ 2,193		
Trademarks	$ 673			$ 666		

Amortization expense relating to all intangible assets was less than $1 million during both second quarter 2007 and 2006.

For the six month periods ended June 30, 2007 and 2006, amortization expense was less than $2 million.

Based on the Company s amortizable intangible assets at June 30, 2007, the Company expects amortization expense of approximately $1 million for the remainder of 2007 and approximately $3 million for each of the five fiscal years thereafter.

5. Restructuring Charges

During fourth quarter 2006, the Company recorded $10 million of restructuring charges, of which $8 million was incurred in connection with current restructuring initiatives within the Company s Truck Rental and Domestic Car Rental operations and $2 million represented a revision to an estimated charge recorded in connection with restructuring actions undertaken in first quarter 2005. The remaining liability relating to the 2005 actions was $3 million at June 30, 2007 and primarily relates to obligations under terminated leases.

2006 Restructuring

During fourth quarter 2006, the Company committed to various strategic initiatives targeted principally at reducing costs, enhancing organizational efficiency and consolidating and rationalizing existing processes and facilities within its Budget Truck Rental and Domestic Car Rental operations. The more significant areas of cost reduction include the closure of the Budget Truck Rental headquarters and other facilities and reductions in staff.

The initial recognition of the restructuring charge and the corresponding utilization for the 2006 Truck Rental and Domestic Car Rental operations restructuring initiative are summarized by category from inception as follows:

	Personnel Related [(a)]	Facility Related [(b)]	Total
Initial charge	$ 4	$ 4	$ 8

Cash payments				(1)		(1)
Balance at December 31, 2006		4		3		7
Cash payments		(4)		(2)		(6)
Balance at June 30, 2007	$		$	1	$	1

-

(a) The initial charge primarily represents severance benefits resulting from reductions in staff. Prior to December 31, 2006, the Company formally communicated the termination of employment to approximately 180 employees, representing a wide range of employee groups. As of June 30, 2007, the Company had terminated substantially all of these employees.

(b) The initial charge principally represents costs incurred in connection with facility closures and lease obligations resulting from the closure of the Truck Rental headquarters, consolidation of Truck Rental operations and the closure of other facilities within the Company s Domestic Car Rental operations.

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6. Vehicle Rental Activities

The components of the Company s vehicles, net within assets under vehicle programs are as follows:

	As of June 30, 2007	As of December 31, 2006
Rental vehicles	$ 10,305	$ 7,738
Less: Accumulated depreciation	(1,124)	(993)
	9,181	6,745
Vehicles held for sale	118	304
	$ 9,299	$ 7,049

The components of vehicle depreciation and lease charges, net are summarized below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Depreciation expense	$ 407	$ 346	$ 759	$ 663
Lease charges	12	12	26	29
(Gain) loss on sales of vehicles, net	(17)	6	(21)	2
	$ 402	$ 364	$ 764	$ 694

During the three and six months ended June 30, 2007, vehicle interest, net on the accompanying Consolidated Condensed Statements of Operations excludes $35 million and $71 million, respectively, of interest expense related to the fixed and floating rate borrowings of the Company s Avis Budget Car Rental, LLC (Avis Budget Car Rental) subsidiary. Such interest is recorded within interest expense related to corporate debt, net on the accompanying Consolidated Condensed Statements of Operations.

7. Income Taxes

The Company s effective tax rate from continuing operations for the six months ended June 30, 2007 is a provision of 25.5%. Such rate differs from the Federal statutory rate of 35.0% primarily due to an increase in the receivables due from Realogy and Wyndham in connection with the adoption of FIN 48 with a corresponding credit to the separation costs which is not subject to income taxes; and a decrease for changes in New York State and Canadian tax law.

8. Other Current Assets

Other current assets consisted of:

	As of	As of

	June 30, 2007	December 31, 2006
Receivables from Realogy [(a)]	$ 137	$ 572
Receivables from Wyndham [(a)]	106	393
Prepaid expenses	145	144
Other	152	155
	$ 540	$ 1,264

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(a) Represents amounts due for certain contingent and other corporate liabilities assumed by Realogy and Wyndham in connection with the separation and services performed under the Transition Services Agreement. These amounts are due from Realogy and Wyndham on demand upon the Company s settlement of the related liability. At June 30, 2007 and December 31, 2006, there are corresponding liabilities recorded within accounts payable and other current liabilities. In connection with the Company s adoption of FIN 48, receivables from Realogy and Wyndham related to income taxes were classified as non-current assets. At June 30, 2007, receivables related to tax items included in non-current assets were $623 million.

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9. Accounts Payable and Other Current Liabilities

Accounts payable and other current liabilities consisted of:

	As of June 30, 2007	As of December 31, 2006
Income taxes payable [a]	$	$ 520
Accounts payable	209	223
Accrued payroll and related	180	244
Accrued disposition costs	141	152
Public liability and property damage insurance liabilities [b]	117	116
Accrued legal settlements	36	71
Other	427	529
	$ 1,110	$ 1,855

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(a) Income taxes payable have been classified as long-term liabilities as of January 1, 2007, in connection with the adoption of FIN 48. At June 30, 2007, the non-current liability related to long-term income taxes payable was $404 million.

(b) The non-current liability related to public liability and property damage insurance was $266 million and $260 million at June 30, 2007 and December 31, 2006, respectively.

10. Long-term Debt and Borrowing Arrangements

Long-term debt consisted of:

	Maturity Date	As of June 30, 2007	As of December 31, 2006
Floating rate term loan	April 2012	$ 800	$ 838
Floating rate notes	May 2014	250	250
7 5/8% notes	May 2014	375	375
7 3/4% notes	May 2016	375	375
		1,800	1,838
Other		3	4
Total long-term debt		1,803	1,842
Less: Current portion [a]		11	29
Long-term debt		$ 1,792	$ 1,813

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(a) Primarily represents borrowings under the Company s floating rate term loan as of June 30, 2007 and December 31, 2006.

Committed Credit Facilities and Available Funding Arrangements

At June 30, 2007, the committed credit facilities available to the Company and/or its subsidiaries at the corporate or Avis Budget Car Rental level were as follows:

	Total Capacity	Net of tax
Total reclassifications for the quarter	$ 4	Net of tax

Accumulated other comprehensive income (loss) as of March 30, 2013 and December 29, 2012 consisted of the following:

(millions)	**March 30, 2013**	December 29, 2012
Foreign currency translation adjustments	**$ (845)**	$ (817)
Cash flow hedges unrealized net gain (loss)	**5**	(3)
Postretirement and postemployment benefits:		
Net experience loss	**(27)**	(29)
Prior service cost	**(80)**	(82)
Total accumulated other comprehensive income (loss)	**$ (947)**	$ (931)

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Note 5 Debt

The following table presents the components of notes payable at March 30, 2013 and December 29, 2012:

(millions)	**March 30, 2013** Principal amount	**March 30, 2013** Effective interest rate	December 29, 2012 Principal amount	December 29, 2012 Effective interest rate
U.S. commercial paper	**$534**	**0.26%**	$853	0.26%
Europe commercial paper	**253**	**0.15**	159	0.18
Bank borrowings	**51**		53	
Total	**$838**		$1,065	

In the first quarter of 2013, the Company terminated interest rate swaps with notional amounts totaling $250 million, which were designated as fair value hedges of its 3.25% fixed rate U.S. Dollar Notes due 2018. The interest rate swaps effectively converted the interest rate on the Notes from fixed to variable and the unrealized gain upon termination of $12 million will be amortized to interest expense over the remaining term of the notes.

In February 2013, the Company issued $250 million of floating rate U.S. Dollar Notes bearing interest at LIBOR plus 0.23% due February 2015 and $400 million of ten-year 2.75% U.S. Dollar Notes, resulting in aggregate net proceeds after debt discount and commissions of $645 million. The proceeds from these Notes were used for general corporate purposes, including, together with cash on hand, the repayment of $749 million aggregate principal amount of the Company s 4.25% U.S. Dollar Notes that matured on March 6, 2013. The Notes contain customary covenants that limit the ability of the Company and its restricted subsidiaries (as defined) to incur certain liens or enter into certain sale and lease-back transactions, as well as a change of control provision.

In March 2013, the Company entered into interest rate swaps with notional amounts totaling $650 million, which effectively converted a portion of the associated U.S. Dollar Notes from fixed rate to floating rate obligations. The effective interest rates on debt obligations resulting from the Company s interest rate swaps as of March 30, 2013 were as follows: 1) seven-year 4.45% U.S. Dollar Notes due 2016 3.27%; 2) five-year 1.875% U.S. Dollar Notes due 2016 1.17%; 3) ten-year 4.15% U.S. Dollar Notes due 2019 2.76%; 4) five-year 1.75% U.S. Dollar Notes due 2017 1.51% 5) ten-year 4.00% U.S. Dollar Notes due 2020 2.88%. These derivative instruments were designated as fair value hedges.

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Note 6 Stock compensation

The Company uses various equity-based compensation programs to provide long-term performance incentives for its global workforce. Currently, these incentives consist principally of stock options, and to a lesser extent, executive performance shares, restricted stock units and restricted stock grants. The Company also sponsors a discounted stock purchase plan in the United States and matching-grant programs in several international locations. Additionally, the Company awards restricted stock to its outside directors. The interim information below should be read in conjunction with the disclosures included within the stock compensation footnote of the Company s 2012 Annual Report on Form 10-K.

The Company classifies pre-tax stock compensation expense in SGA expense principally within its corporate operations. For the periods presented, compensation expense for all types of equity-based programs and the related income tax benefit recognized were as follows:

(millions)	Quarter ended March 30, 2013	Quarter ended March 31, 2012
Pre-tax compensation expense	**$9**	$12
Related income tax benefit	**$3**	$ 4

As of March 30, 2013, total stock-based compensation cost related to non-vested awards not yet recognized was $75 million and the weighted-average period over which this amount is expected to be recognized was 2 years.

Stock options

During the quarters ended March 30, 2013 and March 31, 2012, the Company granted non-qualified stock options to eligible employees as presented in the following activity tables. Terms of these grants and the Company s methods for determining grant-date fair value of the awards were consistent with that described within the stock compensation footnote in the Company s 2012 Annual Report on Form 10-K.

Quarter ended March 30, 2013:

Employee and director stock options	Shares (millions)	Weighted-average exercise price	Weighted-average remaining contractual term (yrs.)	Aggregate intrinsic value (millions)
Outstanding, beginning of period	**25**	**$50**		
Granted	**6**	**60**		
Exercised	**(5)**	**47**		
Forfeitures and expirations				
Outstanding, end of period	**26**	**$53**	**7.5**	**$271**
Exercisable, end of period	**13**	**$50**	**5.9**	**$187**

Quarter ended March 31, 2012:

	Weighted-	Weighted-average	Aggregate

Employee and director stock options	Shares (millions)	average exercise price	remaining contractual term (yrs.)	intrinsic value (millions)
Outstanding, beginning of period	24	$48		
Granted	6	53		
Exercised	(1)	42		
Forfeitures and expirations	(1)	53		
Outstanding, end of period	28	$49	6.9	$123
Exercisable, end of period	18	$47	5.5	$115

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The weighted-average fair value of options granted was $5.92 per share and $5.23 per share for the quarters ended March 30, 2013 and March 31, 2012, respectively. The fair value was estimated using the following assumptions:

	Weighted-average expected volatility	Weighted-average expected term (years)	Weighted-average risk-free interest rate	Dividend yield
Grants within the quarter ended March 30, 2013:	15%	7.44	1.49%	2.90%
Grants within the quarter ended March 31, 2012:	16%	7.53	1.60%	3.30%

The total intrinsic value of options exercised was $58 million and $8 million for the quarters ended March 30, 2013 and March 31, 2012, respectively.

Performance shares

In the first quarter of 2013, the Company granted performance shares to a limited number of senior executive-level employees, which entitle these employees to receive a specified number of shares of the Company s common stock on the vesting date, provided cumulative three-year operating profit and internal net sales growth targets are achieved.

The 2013 target grant currently corresponds to approximately 244,000 shares, with a grant-date fair value of $54 per share. The actual number of shares issued on the vesting date could range from 0 to 200% of target, depending on actual performance achieved. Based on the market price of the Company s common stock at March 30, 2013, the maximum future value that could be awarded to employees on the vesting date for all outstanding performance share awards was as follows:

(millions)	**March 30, 2013**
2011 Award	**$17**
2012 Award	**$29**
2013 Award	**$31**

The 2010 performance share award, payable in stock, was settled at 40% of target in February 2013 for a total dollar equivalent of $4 million.

Note 7 Employee benefits

The Company sponsors a number of U.S. and foreign pension, other nonpension postretirement and postemployment plans to provide various benefits for its employees. These plans are described within the footnotes to the Consolidated Financial Statements included in the Company s 2012 Annual Report on Form 10-K. During the fourth quarter of 2012 the Company changed its policy for recognizing expense for its pension and postretirement benefit plans. Components of Company plan benefit expense for the periods presented are included in the tables below. All amounts have been adjusted to reflect the new policy.

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Pension

(millions)	Quarter ended **March 30, 2013**	March 31, 2012
Service cost	**$ 34**	$ 28
Interest cost	**50**	51
Expected return on plan assets	**(90)**	(86)
Amortization of unrecognized prior service cost	**4**	4
Total pension expense	**$ (2)**	$ (3)

Other nonpension postretirement

(millions)	Quarter ended **March 30, 2013**	March 31, 2012
Service cost	**$ 9**	$ 6
Interest cost	**12**	13
Expected return on plan assets	**(22)**	(21)
Amortization of unrecognized prior service cost (credit)	**(1)**	
Total postretirement benefit expense	**$ (2)**	$ (2)

Postemployment

(millions)	Quarter ended **March 30, 2013**	March 31, 2012
Service cost	**$ 2**	$ 2
Interest cost	**1**	1
Recognized net loss	**2**	1
Total postemployment benefit expense	**$ 5**	$ 4

Company contributions to employee benefit plans are summarized as follows:

(millions)	**Pension**	**Nonpension postretirement**	**Total**
Quarter ended:			
March 30, 2013	$ 27	$ 4	$ 31
March 31, 2012	$ 21	$ 4	$ 25
Full year:			
Fiscal year 2013 (projected)	$ 45	$ 17	$ 62
Fiscal year 2012 (actual)	$ 38	$ 13	$ 51

Plan funding strategies may be modified in response to management s evaluation of tax deductibility, market conditions, and competing investment alternatives.

Note 8 Income taxes

The consolidated effective tax rate for the quarter ended March 30, 2013 of 28% was lower than the prior year s rate of 31%. The effective rate for the first quarter of 2013 benefited from research and development related tax legislation.

As of March 30, 2013, the Company classified $15 million related to uncertain tax positions as a net current liability, representing several income tax positions under examination in various jurisdictions. Management s estimate of reasonably possible changes in unrecognized tax benefits during the next twelve months consists of the current liability balance, expected to be settled within one year, offset by $9 million of projected additions. Management is currently unaware of any issues under review that could result in significant additional payments, accruals or other material deviation in this estimate.

Following is a reconciliation of the Company s total gross unrecognized tax benefits for the year-to-date period ended March 30, 2013; $59 million of this total represents the amount that, if recognized, would affect the Company s effective income tax rate in future periods.

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(millions)	
December 29, 2012	**$80**
Tax positions related to current year:	
Additions	**2**
Reductions	
Tax positions related to prior years:	
Additions	**5**
Reductions	**(1)**
Settlements	**(5)**
March 30, 2013	**$81**

For the current quarter, the Company recognized an increase of $1 million of tax-related interest and penalties and a settlement that decreased tax-related interest and penalties by $4 million, resulting in an accrual of $17 million at March 30, 2013.

Note 9 Derivative instruments and fair value measurements

The Company is exposed to certain market risks such as changes in interest rates, foreign currency exchange rates, and commodity prices, which exist as a part of its ongoing business operations. Management uses derivative financial and commodity instruments, including futures, options, and swaps, where appropriate, to manage these risks. Instruments used as hedges must be effective at reducing the risk associated with the exposure being hedged.

The Company designates derivatives as cash flow hedges, fair value hedges, net investment hedges, and uses other contracts to reduce volatility in interest rates, foreign currency and commodities. As a matter of policy, the Company does not engage in trading or speculative hedging transactions.

Total notional amounts of the Company s derivative instruments as of March 30, 2013 and December 29, 2012 were as follows:

(millions)	**March 30, 2013**	December 29, 2012
Foreign currency exchange contracts	**$ 583**	$ 570
Interest rate contracts	**2,550**	2,150
Commodity contracts	**362**	320
Total	**$3,495**	$ 3,040

Following is a description of each category in the fair value hierarchy and the financial assets and liabilities of the Company that were included in each category at March 30, 2013 and December 29, 2012, measured on a recurring basis.

Level 1 Financial assets and liabilities whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market. For the Company, level 1 financial assets and liabilities consist primarily of commodity derivative contracts.

Level 2 Financial assets and liabilities whose values are based on quoted prices in markets that are not active or model inputs that are observable either directly or indirectly for substantially the full term of the asset or liability. For the Company, level 2 financial assets and liabilities consist of interest rate swaps and over-the-counter commodity and currency contracts.

The Company s calculation of the fair value of interest rate swaps is derived from a discounted cash flow analysis based on the terms of the contract and the interest rate curve. Over-the-counter commodity derivatives are valued using an income approach based on the commodity index prices less the contract rate multiplied by the notional amount. Foreign currency contracts are valued using an income approach based on forward rates less the contract rate multiplied by the notional amount. The Company s calculation of the fair value of level 2 financial assets and liabilities takes into consideration the risk of nonperformance, including counterparty credit risk.

Level 3 Financial assets and liabilities whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the asset or liability. The Company did not have any level 3 financial assets or liabilities as of March 30, 2013 or

December 29, 2012.

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The following table presents assets and liabilities that were measured at fair value in the Consolidated Balance Sheet on a recurring basis as of March 30, 2013 and December 29, 2012:

Derivatives designated as hedging instruments

	March 30, 2013			December 29, 2012		
(millions)	**Level 1**	**Level 2**	**Total**	Level 1	Level 2	Total
Assets:						
Foreign currency exchange contracts:						
Other prepaid assets	**$**	**$ 13**	**$ 13**	$	$ 4	$ 4
Interest rate contracts (a):						
Other assets		**48**	**48**		64	64
Total assets	**$**	**$ 61**	**$ 61**	$	$ 68	$ 68
Liabilities:						
Foreign currency exchange contracts:						
Other current liabilities	**$**	**$ (5)**	**$ (5)**	$	$ (3)	$(3)
Commodity contracts:						
Other current liabilities		**(9)**	**(9)**		(11)	(11)
Other liabilities		**(25)**	**(25)**		(27)	(27)
Total liabilities	**$**	**$(39)**	**$(39)**	$	$(41)	$(41)

(a) The fair value of the related hedged portion of the Company s long-term debt, a level 2 liability, was $2.8 billion as of March 30, 2013 and $2.3 billion as of December 29, 2012.

Derivatives not designated as hedging instruments

	March 30, 2013			December 29, 2012		
(millions)	**Level 1**	**Level 2**	**Total**	Level 1	Level 2	Total
Assets:						
Commodity contracts:						
Other prepaid assets	**$ 1**	**$**	**$ 1**	$ 5	$	$ 5
Total assets	**$ 1**	**$**	**$ 1**	$ 5	$	$ 5
Liabilities:						
Foreign currency exchange contracts:						
Other current liabilities	**$**	**$ (1)**	**$ (1)**	$	$	$
Commodity contracts:						
Other current liabilities	**(16)**		**(16)**	(3)		(3)
Total liabilities	**$ (16)**	**$ (1)**	**$(17)**	$ (3)	$	$ (3)

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The effect of derivative instruments on the Consolidated Statements of Income and Comprehensive Income for the quarters ended March 30, 2013 and March 31, 2012 was as follows:

Derivatives in fair value hedging relationships

(millions)	Location of gain (loss) recognized in income	Gain (loss) recognized in income (a)	
		Mar. 30, 2013	Mar. 31, 2012
Foreign currency exchange contracts	Other income (expense), net	**$ 3**	$ 15
Interest rate contracts	Interest expense	**1**	1
Total		$ 4	$ 16

(a) Includes the ineffective portion and amount excluded from effectiveness testing.

Derivatives in cash flow hedging relationships

(millions)	Gain (loss) recognized in AOCI		Location of gain (loss) reclassified from AOCI	Gain (loss) reclassified from AOCI into income		Location of gain(loss) recognized in income (a)	Gain (loss) recognized in income (a)	
	Mar. 30, 2013	Mar. 31, 2012		**Mar. 30, 2013**	Mar. 31, 2012		**Mar. 30, 2013**	Mar. 31, 2012
Foreign currency exchange contracts	**$ 9**	$ (2)	COGS	**$ 2**	$	Other income (expense), net	**$**	$
Foreign currency exchange contracts	**1**		SGA expense			Other income (expense), net		
Interest rate contracts			Interest expense	**1**	1	N/A		
Commodity contracts	**1**	(6)	COGS	**(3)**	(5)	Other income (expense), net		
Total	**$ 11**	$ (8)		**$**	$ (4)		**$**	$

(a) Includes the ineffective portion and amount excluded from effectiveness testing.

Derivatives in net investment hedging relationships

(millions)	Gain (loss) recognized in AOCI	
	Mar. 30, 2013	Mar. 31, 2012
Foreign currency exchange contracts	**$**	$ (6)
Total	**$**	$ (6)

Derivatives not designated as hedging instruments

(millions)	Location of gain (loss) recognized in income	Gain (loss) recognized in income	
		Mar. 30, 2013	Mar. 31, 2012
Interest rate contracts	Interest expense	**$**	$ 26
Commodity contracts	COGS	**(16)**	
Total		**$ (16)**	$ 26

During the next 12 months, the Company expects $2 million of net deferred gains reported in AOCI at March 30, 2013 to be reclassified to income, assuming market rates remain constant through contract maturities.

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Certain of the Company s derivative instruments contain provisions requiring the Company to post collateral on those derivative instruments that are in a liability position if the Company s credit rating is at or below BB+ (S&P), or Ba1 (Moody s). The fair value of all derivative instruments with credit-risk-related contingent features in a liability position on March 30, 2013 was $19 million. If the credit-risk-related contingent features were triggered as of March 30, 2013, the Company would be required to post collateral of $19 million. In addition, certain derivative instruments contain provisions that would be triggered in the event the Company defaults on its debt agreements. There were no collateral posting requirements as of March 30, 2013 triggered by credit-risk-related contingent features.

Financial instruments

The carrying values of the Company s short-term items, including cash, cash equivalents, accounts receivable, accounts payable and notes payable approximate fair value. The fair value of the Company s long-term debt, which are level 2 liabilities, is calculated based on broker quotes and was as follows at March 30, 2013:

(millions)	Fair Value	Carrying Value
Current maturities of long-term debt	$ 1	$ 1
Long-term debt	7,449	6,717
Total	$ 7,450	$ 6,718

Counterparty credit risk concentration

The Company is exposed to credit loss in the event of nonperformance by counterparties on derivative financial and commodity contracts. Management believes a concentration of credit risk with respect to derivative counterparties is limited due to the credit ratings and use of master netting and reciprocal collateralization agreements with the counterparties and the use of exchange-traded commodity contracts.

Master netting agreements apply in situations where the Company executes multiple contracts with the same counterparty. Certain counterparties represent a concentration of credit risk to the Company. If those counterparties fail to perform according to the terms of derivative contracts, this would result in a loss to the Company of $38 million as of March 30, 2013.

For certain derivative contracts, reciprocal collateralization agreements with counterparties call for the posting of collateral in the form of cash, treasury securities or letters of credit if a fair value loss position to the Company or its counterparties exceeds a certain amount. There were no collateral balance requirements at March 30, 2013.

Management believes concentrations of credit risk with respect to accounts receivable is limited due to the generally high credit quality of the Company s major customers, as well as the large number and geographic dispersion of smaller customers. However, the Company conducts a disproportionate amount of business with a small number of large multinational grocery retailers, with the five largest accounts encompassing approximately 25% of consolidated trade receivables at March 30, 2013.

Note 10 Reportable segments

Kellogg Company is the world s leading producer of cereal, second largest producer of cookies and crackers, and a leading producer of savory snacks and frozen foods. Additional product offerings include toaster pastries, cereal bars, fruit-flavored snacks and veggie foods. Kellogg products are manufactured and marketed globally. Principal markets for these products include the United States and United Kingdom.

The Company currently manages its operations through eight operating segments that are based on product category or geographic location. These operating segments are evaluated for similarity with regards to economic characteristics, products, production processes, types or classes of customers, distribution methods and regulatory environments to determine if they can be aggregated into reportable segments. Beginning in the first quarter of 2013, the Kashi operating segment, which was formerly aggregated with the U.S. Morning Foods operating segment and reported as U.S. Morning Foods and Kashi, was eliminated due to a reorganization of the business. Kashi operating segment results of prior periods were recast between U.S. Morning Foods and U.S. Snacks to conform to the current presentation. The reportable segments are discussed in greater detail below.

The U.S. Morning Foods operating segment includes cereal, toaster pastries, health and wellness bars, and beverages generally marketed under the Kellogg s name.

U.S. Snacks represents the U.S. snacks business which includes products such as cookies, crackers, cereal bars, savory snacks and fruit-flavored snacks.

U.S. Specialty primarily represents the food service, convenience and Girl Scouts businesses. The food service business is mostly non-commercial, servicing institutions such as schools and hospitals.

North America Other represents the U.S. Frozen and Canada operating segments. As these operating segments are not considered economically similar enough to aggregate with other operating segments and are immaterial for separate disclosure, they have been grouped together as a single reportable segment.

The three remaining reportable segments are based on geographic location Europe which consists principally of European countries; Latin America which is comprised of Central and South America and includes Mexico; and Asia Pacific which is comprised of South Africa, Australia and other Asian and Pacific markets.

The measurement of reportable segment results is based on segment operating profit which is generally consistent with the presentation of operating profit in the Consolidated Statement of Income. Intercompany transactions between operating segments were insignificant in all periods presented. Segment operating profit excludes unrealized gains and losses on certain commodity hedging activities, certain components of our postemployment benefit plans, and general corporate expenses. Once realized, the gains and losses on certain commodity hedging activities are recognized within the segment results in the same period in which the underlying transaction being economically hedged is included in earnings. We exclude certain components of our postemployment benefit plans from segment operating profit because we centrally manage postemployment benefit plan funding decisions as well as the determination of discount rate, expected rate of return on plan assets and other actuarial assumptions. We also manage market-based impacts to these benefit plans centrally. Therefore we allocate only the service cost and amortization of prior service cost components of our pension and nonpension postretirement plan expense to segment operating profit.

	Quarter ended	
(millions)	**March 30, 2013**	March 31, 2012
Net sales		
U.S. Morning Foods	**$ 911**	$ 897
U.S. Snacks	**901**	786
U.S. Specialty	**379**	348
North America Other	**403**	368
Europe	**692**	538
Latin America	**308**	270
Asia Pacific	**267**	233
Consolidated	**$ 3,861**	$ 3,440
Operating profit		
U.S. Morning Foods	**$ 163**	$ 153
U.S. Snacks	**106**	123
U.S. Specialty	**78**	71
North America Other	**75**	70
Europe	**71**	70
Latin America	**48**	51
Asia Pacific	**21**	33
Total Reportable Segments	**562**	571
Corporate	**(59)**	(44)
Consolidated	**$ 503**	$ 527

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KELLOGG COMPANY

PART I FINANCIAL INFORMATION

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Results of operations

Overview

For more than 100 years, consumers have counted on Kellogg for great-tasting, high-quality and nutritious foods. Kellogg is the world s leading producer of cereal, second largest producer of cookies and crackers, and a leading producer of savory snacks and frozen foods. Additional product offerings include toaster pastries, cereal bars, fruit-flavored snacks and veggie foods. Kellogg products are manufactured and marketed globally.

We manage our operations through eight operating segments that are based on product category or geographic location. These operating segments are evaluated for similarity with regards to economic characteristics, products, production processes, types or classes of customers, distribution methods and regulatory environments to determine if they can be aggregated into reportable segments. We report results of operations in the following reportable segments: U.S. Morning Foods; U.S. Snacks; U.S. Specialty; North America Other; Europe; Latin America; and Asia Pacific.

We manage our Company for sustainable performance defined by our long-term annual growth targets. These targets are 3 to 4% for internal net sales, mid-single-digit (4 to 6%) for underlying internal operating profit, and high-single-digit (7 to 9%) for currency-neutral underlying diluted net earnings per share.

Internal net sales and internal operating profit growth of our reportable segments exclude the impact of foreign currency translation and, if applicable, acquisitions, dispositions and integration costs associated with the acquisition of the *Pringles*® business (Pringles). In addition to these items, internal operating profit growth also includes the benefit of allocating a portion of costs related to our support functions that are now being leveraged to provide support to the Pringles business.

Comparability of certain financial measures is impacted significantly by the mark-to-market adjustments that are recorded for pensions and commodity derivative contracts. To provide increased transparency and assist in understanding our underlying operating performance we use non-GAAP financial measures within the MD&A that exclude the impact of mark-to-market adjustments. These non-GAAP financial measures include underlying gross margin, underlying gross profit, underlying SGA%, underlying operating margin, underlying operating profit, underlying internal operating profit growth, underlying income taxes, underlying net income attributable to Kellogg Company, underlying basic earnings per share (EPS), underlying diluted EPS, and underlying diluted EPS growth. Underlying internal operating profit growth excludes the impact of foreign currency translation, mark-to-market adjustments, and, if applicable, acquisitions, dispositions, and integration costs associated with the acquisition of the Pringles business.

For the quarter ended March 30, 2013, our reported net sales, which includes the impact of the operating results of the Pringles business and integration costs related to the acquisition of Pringles, increased by 12% and internal net sales increased by 2%. We experienced growth for the quarter in each of our geographic regions: North America, Europe, Latin America and Asia Pacific. Operating environments in Europe continued to be difficult, although we are seeing continued improvement in sales trends for the segment with year-over-year sales growth in our two largest markets, the UK and France. Reported operating profit, which includes the impact of mark-to-market accounting, the operating results of the Pringles business, and integration costs related to the acquisition of Pringles, declined by 4%. Underlying internal operating profit declined by 6% due to increased cost pressures, soft internal net sales performance in U.S. Snacks, and the impact of charges related to the closure of a plant in Australia.

During the current quarter, the Venezuelan government announced a 46.5% devaluation of the official exchange rate. As a result of this devaluation, we have realized an unfavorable impact to EPS of $.03. Including this impact, diluted EPS for the quarter of $.85 was down 13% compared to the prior year EPS of $.98. Underlying EPS of $.95 was down 12% compared to prior year EPS of $1.08, in line with our expectations.

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Reconciliation of certain non-GAAP Financial Measures

Consolidated results (dollars in millions, except per share data)		Quarter ended March 30, 2013	Quarter ended March 31, 2012
Net sales		$ 3,861	$ 3,440
Net sales growth:	As reported	12.2%	(1.3)%
	Acquisitions (a)	11.0	
	Dispositions (b)	(0.1)	(0.3)
	Integration impact (c)	(0.1)	
	Foreign currency impact	(0.8)	(0.9)
	Internal (d)	**2.2%**	**(0.1)%**
Reported operating profit		$ 503	$ 527
Mark-to-market (e)		(54)	(50)
Underlying operating profit (f)		$ 557	$ 577
Operating profit growth:			
	As reported	(4.5)%	(14.4)%
	Acquisitions (a)	7.9	
	Dispositions (b)	(0.3)	0.4
	Integration impact (c)	(3.8)	
	Foreign currency impact	(1.4)	(0.6)
	Internal operating profit growth (d)	**(6.9)%**	**(14.2)%**
	Mark-to-market (e)	(1.1)%	(9.1)%
	Underlying internal (f)	**(5.8)%**	**(5.1)%**
Reported income taxes		$ 124	$ 156
Mark-to-market (e)		(17)	(15)
Underlying income taxes (f)		**$ 141**	**$ 171**
Reported net income attributable to Kellogg Company		$ 311	$ 351
Mark-to-market (e)		(37)	(35)
Underlying net income attributable to Kellogg Company (f)		**$ 348**	**$ 386**
Reported basic EPS		$ 0.86	$ 0.98
Mark-to-market (e)		(0.10)	(0.10)
Underlying basic EPS (f)		$ 0.96	$ 1.08
Underlying basic EPS growth (f)		**(11.1)%**	**%**
Reported diluted EPS		$ 0.85	$ 0.98

Mark-to-market (e)	(0.10)	(0.10)
Underlying diluted EPS (f)	**$** 0.95	$ 1.08
Underlying diluted EPS growth (f)	**(12.0)%**	**0.9%**

(a) Impact of results for the quarter ended March 30, 2013 from the acquisition of Pringles.

(b) Impact of results for the quarter ended March 30, 2013 and March 31, 2012 from the divestiture of Navigable Foods.

(c) Quarter ended March 30, 2013 includes integration costs associated with the Pringles acquisition.

(d) Internal net sales and operating profit growth for 2013 excludes the impact of acquisitions, divestitures, integration costs, and currency. Internal net sales and operating profit growth for 2012 excludes the impact of divestitures and currency. Internal net sales and operating profit growth are a non-GAAP financial measure further discussed and reconciled to the directly comparable measure in accordance with U.S. GAAP in the net sales and operating profit section.

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(e) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations but discount rates fell almost 100 basis points for pension plans resulting in a net loss. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the current quarter. In 2011, asset returns were lower than expected and discount rates declined. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

(f) Underlying operating profit, underlying internal operating profit growth, underlying income taxes, underlying net income attributable to Kellogg Company, underlying basic EPS, underlying basic EPS growth, underlying diluted EPS, and underlying diluted EPS growth are non-GAAP measures that exclude the impact of mark-to-market adjustments for pension plans and commodity contracts. Underlying internal operating profit growth excludes the impact of foreign currency translation, mark-to-market adjustments, and, if applicable, acquisitions, dispositions, and transaction and integration costs associated with the acquisition of Pringles. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance. These non-GAAP measures are reconciled to the directly comparable measures in accordance with U.S. GAAP within this table.

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Net sales and operating profit

The following table provides an analysis of net sales and operating profit performance for the first quarter of 2013 versus 2012:

(dollars in millions)	U.S. Morning Foods	U.S. Snacks	U.S. Specialty	North America Other	Europe	Latin America	Asia Pacific
2013 net sales	**$ 911**	**$ 901**	**$ 379**	**$ 403**	**$ 692**	**$ 308**	**$ 267**
2012 net sales	**$ 897**	**$ 786**	**$ 348**	**$ 368**	**$ 538**	**$ 270**	**$ 233**
% change 2013 vs. 2012:							
Internal business (a)	**1.6%**	**(1.7)%**	**3.4%**	**7.4 %**	**2.6 %**	**7.4 %**	**.3%**
Acquisitions (b)	%	16.3%	5.3%	3.2%	27.3%	8.6%	20.8%
Dispositions (c)	%	%	%	%	%	%	(1.7)%
Integration (d)	%	%	%	(.2)%	%	%	(.4)%
Foreign currency impact	%	%	%	(.6)%	(1.2)%	(2.3)%	(4.3)%
Total change	**1.6%**	**14.6%**	**8.7%**	**9.8%**	**28.7%**	**13.7%**	**14.7%**

(dollars in millions)	U.S. Morning Foods	U.S. Snacks	U.S. Specialty	North America Other	Europe	Latin America	Asia Pacific
2013 operating profit	**$ 163**	**$ 106**	**$ 78**	**$ 75**	**$ 71**	**$ 48**	**$ 21**
2012 operating profit	**$ 153**	**$ 123**	**$ 71**	**$ 70**	**$ 70**	**$ 51**	**$ 33**
% change 2013 vs. 2012:							
Internal business (a)	**5.9%**	**(25.6)%**	**6.4%**	**4.5%**	**.1%**	**(5.6)%**	**(30.6)%**
Acquisitions (b)	%	15.3%	4.6%	3.9%	14.2%	6.2%	15.2%
Dispositions (c)	%	%	%	%	%	%	(4.7)%
Integration (d)	%	(3.0)%	%	(1.2)%	(11.1)%	(.3)%	(14.2)%
Foreign currency impact	%	%	%	(.7)%	(2.0)%	(7.6)%	(1.7)%
Total change	**5.9%**	**(13.3)%**	**11.0%**	**6.5%**	**1.2%**	**(7.3)%**	**(36.0)%**

(a) Internal net sales and operating profit growth for 2013 exclude the impact of acquisitions, divestitures, integration costs and the impact of currency. Internal net sales and operating profit growth are non-GAAP financial measures which are reconciled to the directly comparable measures in accordance with U.S. GAAP within these tables.

(b) Impact of results for the quarter ended March 30, 2013 from the acquisition of Pringles.

(c) Impact of results for the quarter ended March 30, 2013 from the divestiture of Navigable Foods.

(d) Includes impact of integration costs associated with the Pringles acquisition.

Internal net sales for U.S. Morning Foods increased 2% as a result of increased volume and flat pricing/mix. This segment consists of cereal, toaster pastries, health and wellness bars, and beverages. Cereal category growth has been slightly lower than anticipated. Despite this category performance, *Special K*®, *Mini-Wheats*®, and *Frosted Flakes*® all posted increased consumption and share gains during the quarter. Toaster pastries internal net sales increased behind solid consumption growth and share gains. Beverages internal net sales increased due to solid results from innovations and expanded distribution.

Internal net sales in U.S. Snacks declined 2% as a result of unfavorable pricing/mix and decreased volume. This segment consists of cookies, crackers, cereal bars, fruit-flavored snacks, and Pringles. The sales performance was the result of growth in bars behind *Special K Pastry Crisps*® and *Nutri-grain Fruit Crunch*® innovations being more than offset by declines in sales across the crackers and cookies categories due to strong growth comparisons from the prior year and timing of current-year innovations and promotions.

Internal net sales in U.S. Specialty increased by 3% as a result of favorable pricing/mix and increased volume. Sales growth was due to continued strong innovation.

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Internal net sales in North America Other (U.S. Frozen and Canada) increased by 7% due to favorable pricing/mix and increased volume. Sales growth was driven by strong U.S. Frozen business growth resulting from increased brand-building support behind innovation activity and distribution gains. Sales in the Canada business were up slightly as a result of innovation activity partially offset by competitive pressures.

Europe s internal net sales increased 3% as a result of improved volume and pricing/mix. During the quarter, we grew sales in the UK (volume and pricing/mix) and France (volume partially offset by pricing/mix), our two largest markets. These favorable results were offset by declines in Southern Europe due to the continued difficult operating environment. Latin America s internal net sales growth was 7% due to improved pricing/mix, and flat volume across most markets. Internal net sales in Asia Pacific was flat as a result of increased volume which was offset by unfavorable pricing/mix. Underlying consumption growth in Latin America and Asia Pacific exceeded our reported sales results due to timing/shifts in trade inventory.

Internal operating profit in U.S. Morning Foods improved by 6% due to sales growth and favorable timing of overhead and brand-building investments. U.S. Snacks was unfavorable 26% due to reduced sales and the impact of inflation. U.S. Specialty improved by 6% as a result of sales growth and favorable input costs. North America Other improved by 5% as a result of sales growth which was partially offset by the impact of inflation and investments in supply chain to launch innovation. Europe was flat due to sales growth and favorable timing of brand-building investment being offset by the impact of inflation. Latin America declined by 6% due to sales growth being offset by the impact of inflation and unfavorable timing of overhead and brand-building investments. Asia Pacific declined by 31% primarily due to charges related to the closure of a plant in Australia.

Corporate expense	**Quarter ended**	
(dollars in millions)	**March 30, 2013**	March 31, 2012
Operating profit	$ (59)	$ (44)

Corporate expense is primarily the result of mark-to-market adjustments for our pension plans and commodity contracts. These adjustments were ($54) and ($50) in the first quarter of 2013 and 2012 respectively. The variance in corporate expense for the quarter is primarily due to Pringles integration and overhead costs that were not recognized in the prior year as a result of our May 31, 2012 acquisition. The remaining variance primarily consists of unfavorable timing of overhead investments.

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Margin performance

Margin performance for the first quarter of 2013 versus 2012 is as follows:

	2013	2012	*Change vs. prior year (pts.)*
Reported gross margin (a)	**36.1%**	39.3%	**(3.2)**
Mark-to-market (COGS) (b)	**(1.4)%**	(1.5)%	**.1**
Underlying gross margin (c)	**37.5%**	40.8%	**(3.3)**
Reported SGA%	**(23.1)%**	(24.0)%	**.9**
Mark-to-market (SGA) (b)	**%**	%	
Underlying SGA% (c)	**(23.1)%**	(24.0)%	**.9**
Reported operating margin	**13.0%**	15.3%	**(2.3)**
Mark-to-market (b)	**(1.4)%**	(1.5)%	**.1**
Underlying operating margin (c)	**14.4%**	16.8%	**(2.4)**

(a) Reported gross margin as a percentage of net sales. Gross margin is equal to net sales less cost of goods sold.

(b) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations but discount rates fell almost 100 basis points for pension plans resulting in a net loss. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the current quarter. In 2011, asset returns were lower than expected and discount rates declined. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

(c) Underlying gross margin, underlying SGA%, and underlying operating margin are non-GAAP measures that exclude the impact of pension and commodity mark-to-market adjustments. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance.

Underlying gross margin, which excludes the impact of mark-to-market adjustments, declined by 330 basis points due to the impact of inflation, net of cost savings, and the lower margin structure of the Pringles business. Underlying SG&A%, which excludes the impact of mark-to-market adjustments, improved by 90 basis points as a result of favorable overhead leverage and synergies resulting from the Pringles acquisition, as well as timing of brand-building investment that increased at a rate lower than sales growth. This favorability was partially offset by integration costs related to the Pringles acquisition.

Our underlying gross profit, underlying SG&A, and underlying operating profit measures are reconciled to the most comparable GAAP measure as follows:

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(dollars in millions)	**2013**	2012
Reported gross profit (a)	**$ 1,393**	$ 1,353
Mark-to-market (COGS) (b)	**(54)**	(50)
Underlying gross profit (c)	**$ 1,447**	$ 1,403
Reported SGA	**$ 890**	$ 826
Mark-to-market (SGA) (b)		
Underlying SGA (c)	**$ 890**	$ 826
Reported operating profit	**$ 503**	$ 527
Mark-to-market (b)	**(54)**	(50)
Underlying operating profit (c)	**$ 557**	$ 577

(a) Gross profit is equal to net sales less cost of goods sold.

(b) Includes mark-to-market adjustments for pension plans and commodity contracts as reflected in cost of goods sold. Actuarial gains/losses for pension plans are recognized in the year they occur. In 2012, asset returns exceeded expectations but discount rates fell almost 100 basis points for pension plans resulting in a net loss. A portion of the 2012 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2012. This amount has been recorded in earnings in the current quarter. In 2011, asset returns were lower than expected and discount rates declined. A portion of the 2011 pension mark-to-market adjustment was capitalized as an inventoriable cost at the end of 2011. This amount was recorded in earnings in the first quarter of 2012. Mark-to-market adjustments for commodities reflect the changes in the fair value of contracts for the difference between contract and market prices for the underlying commodities. The resulting gains/losses are recognized in the quarter they occur.

(c) Underlying gross profit, underlying SGA, and underlying operating profit are non-GAAP measures that exclude the impact of pension and commodity mark-to-market adjustments. We believe the use of such non-GAAP measures provides increased transparency and assists in understanding our underlying operating performance.

For the full year, we expect underlying gross margin to remain under pressure and decline approximately 50 basis points compared to 2012 including the full-year impact of Pringles.

Foreign currency translation

The reporting currency for our financial statements is the U.S. dollar. Certain of our assets, liabilities, expenses and revenues are denominated in currencies other than the U.S. dollar, primarily in the euro, British pound, Mexican peso, Australian dollar and Canadian dollar. To prepare our consolidated financial statements, we must translate those assets, liabilities, expenses and revenues into U.S. dollars at the applicable exchange rates. As a result, increases and decreases in the value of the U.S. dollar against these other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. This could have a significant impact on our results if such increase or decrease in the value of the U.S. dollar is substantial.

Interest expense

For the quarter ended March 30, 2013, interest expense was $60 million as compared to $33 million for the quarter ended March 31, 2012. Current quarter interest expense was higher than the prior year due to a $26 million pre-tax gain recognized during the first quarter of 2012 on interest rate derivatives associated with the acquisition of Pringles.

For the full year 2013, we expect gross interest expense to be approximately $230-240 million, compared to 2012 s full year interest expense of $261 million.

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Income taxes

The consolidated effective income tax rate was 28% for the quarter ended March 30, 2013, as compared to 31% for the comparable quarter of 2012. Refer to Note 8 of the Consolidated Financial Statements for further discussion.

For the full year 2013, we currently expect the consolidated effective income tax rate to be approximately 30%. Fluctuations in foreign currency exchange rates could impact the expected effective income tax rate as it is dependent upon U.S. dollar earnings of foreign subsidiaries doing business in various countries with differing statutory rates. Additionally, the rate could be impacted if pending uncertain tax matters, including tax positions that could be affected by planning initiatives, are resolved more or less favorably than we currently expect.

Liquidity and capital resources

Our principal source of liquidity is operating cash flows supplemented by borrowings for major acquisitions and other significant transactions. Our cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating and investing needs.

The following table sets forth a summary of our cash flows:

	Quarter ended	
(millions)	**March 30, 2013**	March 31, 2012
Net cash provided by (used in):		
Operating activities	**$ 338**	$ 340
Investing activities	**(102)**	(57)
Financing activities	**(260)**	(355)
Effect of exchange rates on cash and cash equivalents	**(5)**	16
Net increase (decrease) in cash and cash equivalents	**$ (29)**	$ (56)

Operating activities

The principal source of our operating cash flow is net earnings, meaning cash receipts from the sale of our products, net of costs to manufacture and market our products.

Net cash provided by our operating activities for the first quarter of 2013, amounted to $338 million, a decrease of $2 million over the same period in 2012. The quarter over quarter decrease compared to the prior year is primarily due to improved performance on trade receivables, inventories and accounts payable, which was more than offset by unfavorable impacts in accrued income taxes and accrued advertising and promotion.

Our cash conversion cycle (defined as days of inventory and trade receivables outstanding less days of trade payables outstanding, based on a trailing 12 month average) is relatively short, equating to approximately 29 days, 27 days and 30 days for the 12 month periods ended March 30, 2013, March 31, 2012 and December 29, 2012, respectively. Compared with the 12 month period ended March 31, 2012, the unfavorable impact on the 2013 cash conversion cycle resulted from higher days of inventory and lower days of payables. This was primarily due to increased inventory levels to support new product innovations and to maintain appropriate levels of service while investing in our supply chain infrastructure.

Our pension and other postretirement benefit plan contributions amounted to $31 million and $25 million for the first quarter of 2013 and 2012, respectively. For the full year 2013, we currently expect that our contributions to pension and other postretirement plans will total approximately $60 million. Plan funding strategies may be modified in response to our evaluation of tax deductibility, market conditions and competing investment alternatives.

We measure cash flow as net cash provided by operating activities reduced by expenditures for property additions. We use this non-GAAP financial measure of cash flow to focus management and investors on the amount of cash available for debt repayment, dividend distributions, acquisition opportunities, and share repurchases. Our cash flow metric is reconciled to the most comparable GAAP measure, as follows:

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(millions)	Quarter period ended March 30, 2013	March 31, 2012	*Change versus prior year*
Net cash provided by operating activities	**$ 338**	$ 340	**(.6)%**
Additions to properties	**(102)**	(63)	
Cash flow	**$ 236**	$ 277	**(14.8)%**

For the full-year 2013, we are projecting cash flow (as defined) to be approximately $1.1 billion to $1.2 billion.

Investing activities

Our net cash used in investing activities for the first quarter of 2013 amounted to $102 million compared to $57 million in the same period of 2012. The year-over-year increase was primarily attributable to the timing of capital expenditures in 2013. For the full-year 2013, we project capital spending of approximately 4% of net sales.

Financing activities

Our net cash used in financing activities for the first quarter of 2013 amounted to $260 million compared to $355 million in the same period of 2012. The cash used in financing activities was primarily a result of payment of notes payable, long-term debt and dividends, partially offset by the issuance of long-term debt and common stock.

In February 2013, we issued long-term debt for net proceeds of approximately $645 million and in March 2013, retired $749 million of long-term debt at maturity.

In April 2010, our board of directors approved a $2.5 billion, three-year share repurchase program for 2010 through 2012. As of March 31, 2012, total purchases under the repurchase authorization amounted to 37 million shares totaling $1.9 billion, with $63 million repurchased in 2012. In December 2012, our board of directors approved a $300 million share repurchase program for 2013. As of March 30, 2013, total purchases under the December 2012 repurchase authorization amounted to 1 million shares totaling $44 million. In April 2013, the board of directors approved a $1 billion share repurchase program expiring in April 2014. This authorization supersedes the existing authorization and is intended to allow us to repurchase shares to offset the impact of proceeds from the exercise of options through the end of 2013, and to begin our 2014 purchase plan. Actual repurchases could be different from our current expectations, as influenced by factors such as the impact of changes in our stock price and other competing priorities.

We paid cash dividends of $160 million in the first quarter of 2013, compared to $153 million during the same period in 2012. In April 2013, the board of directors declared a dividend of $.44 per common share, payable on June 17, 2013 to shareholders of record at the close of business on June 3, 2013. In addition, the board of directors announced plans to increase the quarterly dividend by 4.5 percent to $.46 per common share beginning with the third quarter of 2013. The dividend is consistent with our current plan to maintain our dividend pay-out between 40% and 50% of reported net income.

We are in compliance with all debt covenants. We continue to believe that we will be able to meet our interest and principal repayment obligations and maintain our debt covenants for the foreseeable future. We expect our access to public debt and commercial paper markets, along with operating cash flows, will be adequate to meet future operating, investing and financing needs, including the pursuit of selected acquisitions.

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Forward-looking statements

This Report contains forward-looking statements with projections concerning, among other things, the integration of the *Pringles*® business, our strategy, financial principles, and plans; initiatives, improvements and growth; sales, gross margins, advertising, promotion, merchandising, brand building, operating profit, and earnings per share; innovation; investments; capital expenditures; asset write-offs and expenditures and costs related to productivity or efficiency initiatives; the impact of accounting changes and significant accounting estimates; our ability to meet interest and debt principal repayment obligations; minimum contractual obligations; future common stock repurchases or debt reduction; effective income tax rate; cash flow and core working capital improvements; interest expense; commodity, and energy prices; and employee benefit plan costs and funding. Forward-looking statements include predictions of future results or activities and may contain the words expects, believes, will, can, anticipates, projects, should, estimates, implies, or words or phrases of similar meaning. For example, fo statements are found in Item 1 and in several sections of Management s Discussion and Analysis. Our actual results or activities may differ materially from these predictions. Our future results could be affected by a variety of factors, including:

the ability to realize the anticipated benefits and synergies from the Pringles acquisition in the amounts and at the times expected;

the impact of competitive conditions;

the effectiveness of pricing, advertising, and promotional programs;

the success of innovation, renovation and new product introductions;

the recoverability of the carrying value of goodwill and other intangibles;

the success of productivity improvements and business transitions;

commodity and energy prices;

labor costs;

disruptions or inefficiencies in supply chain;

the availability of and interest rates on short-term and long-term financing;

actual market performance of benefit plan trust investments;

the levels of spending on systems initiatives, properties, business opportunities, integration of acquired businesses, and other general and administrative costs;

changes in consumer behavior and preferences;

the effect of U.S. and foreign economic conditions on items such as interest rates, statutory tax rates, currency conversion and availability;

legal and regulatory factors including changes in food safety, advertising and labeling laws and regulations;

the ultimate impact of product recalls;

business disruption or other losses from natural disasters, war, terrorist acts, or political unrest; and,

the risks and uncertainties described herein under Part II, Item 1A.

Forward-looking statements speak only as of the date they were made, and we undertake no obligation to publicly update them.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

Our Company is exposed to certain market risks, which exist as a part of our ongoing business operations. We use derivative financial and commodity instruments, where appropriate, to manage these risks. Refer to Note 9 within Notes to Consolidated Financial Statements for further information on our derivative financial and commodity instruments.

Refer to disclosures contained within Item 7A of our 2012 Annual Report on Form 10-K. Other than changes noted here, there have been no material changes in the Company s market risk as of March 30, 2013.

During the quarter ended March 30, 2013 we terminated interest rate swaps with notional amounts totaling $250 million which were previously designated as fair value hedges of certain U.S. Dollar Notes. Additionally during the quarter ended March 30, 2013 we entered into new interest rate swaps with notional amounts totaling $650 million that are designated as fair value hedges of certain U.S. Dollar Notes. Refer to Note 5 within Notes to Consolidated Financial Statements.

The total notional amount of interest rate swaps at March 30, 2013 was $2.6 billion, representing a net settlement receivable of $48 million. The total notional amount of interest rate swaps at December 29, 2012 was $2.2 billion, representing a settlement receivable of $64 million. Assuming average variable rate debt levels during the year, a one percentage point increase in interest rates would have increased annual interest expense by approximately $34 million at March 30, 2013 and $24 million at year-end December 29, 2012.

Venezuela was designated as a highly inflationary economy as of the beginning of our 2010 fiscal year. Gains and losses resulting from the translation of the financial statements of subsidiaries operating in highly inflationary economies are recorded in earnings. In February 2013, the Venezuelan government announced a 46.5% devaluation of the official exchange rate. Additionally, the Transaction System for Foreign Currency Denominated Securities (SITME) was eliminated. Accordingly, in 2013 we began using the official exchange rate to translate our Venezuelan subsidiary s financial statements to U.S. dollar. During the first quarter of 2013 we recognized a $12 million foreign currency translation loss as a result of the devaluation of the official Venezuelan exchange rate.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure under Rules 13a-15(e) and 15d-15(e). Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurance of achieving the desired control objectives.

As of March 30, 2013, we carried out an evaluation under the supervision and with the participation of our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. We acquired Pringles during the second quarter of 2012, which represented approximately 18% of our total assets as of March 30, 2013. As the acquisition occurred during the second quarter of 2012, the scope of our assessment of the effectiveness of disclosure controls and procedures does not include Pringles. This exclusion is in accordance with the SEC s general guidance that an assessment of a recently acquired business may be omitted from our scope for 12 months following the acquisition. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

During the first quarter of 2012, we initiated the implementation of an upgrade to our existing enterprise resource planning (ERP) system within North America. This implementation has resulted in the modification of certain business processes and internal controls impacting financial reporting. During the implementation, which is expected to continue into 2014, we have taken the necessary steps to monitor and maintain appropriate internal controls impacting financial reporting. It is anticipated that, upon completion, implementation of this new ERP will enhance internal controls due to increased automation and further integration of related processes.

There have been no other changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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KELLOGG COMPANY

PART II OTHER INFORMATION

Item 1A. Risk Factors

There have been no material changes in our risk factors from those disclosed in Part I, Item 1A to our Annual Report on Form 10-K for the fiscal year ended December 29, 2012. The risk factors disclosed under those Reports in addition to the other information set forth in this Report, could materially affect our business, financial condition, or results. Additional risks and uncertainties not currently known to us or that we deem to be immaterial could also materially adversely affect our business, financial condition, or results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Issuer Purchases of Equity Securities

(millions, except per share data)

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Month #1:				
12/30/12-1/26/13				$ 300
Month #2:				
1/27/13-2/23/13	0.7	59.07	0.7	$ 260
Month #3:				
2/24/13-3/30/13		59.26		$ 256
Total	0.7	59.09	0.7	

In December 2012, our board of directors approved a share repurchase program authorizing us to repurchase shares of our common stock amounting to $300 million during 2013. As of April 26, 2013, the board of directors has approved a new authorization to repurchase up to $1 billion in shares through April 2014. This authorization supersedes the existing authorization and is intended to allow us to repurchase shares to offset the impact of proceeds from the exercise of options through the end of 2013, and to begin our 2014 purchase plan.

Item 6. Exhibits

(a) Exhibits:

31.1 Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant

31.2 Rule 13a-14(e)/15d-14(a) Certification from Ronald L. Dissinger

32.1	Section 1350 Certification from John A. Bryant
32.2	Section 1350 Certification from Ronald L. Dissinger
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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KELLOGG COMPANY

SIGNATURES

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

KELLOGG COMPANY

/s/ R. L. Dissinger
R. L. Dissinger
Principal Financial Officer;

Senior Vice President and Chief Financial Officer

/s/ M. A. Dangel
M. A. Dangel
Principal Accounting Officer;

Vice President Corporate Controller

Date: May 7, 2013

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EXHIBIT INDEX

Exhibit No.	Description	Electronic (E) Paper (P) Incorp. By Ref. (IBRF)
31.1	Rule 13a-14(e)/15d-14(a) Certification from John A. Bryant	E
31.2	Rule 13a-14(e)/15d-14(a) Certification from Ronald L. Dissinger	E
32.1	Section 1350 Certification from John A. Bryant	E
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101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	E
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	E
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	E