AVIS BUDGET GROUP, INC.
Form 10-Q
November 01, 2013
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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 September 30, 2013

OR

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

For the transition period from _____ to _____

Commission File No. 001-10308

Avis Budget Group, Inc.
(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	o	Smaller reporting company	¨

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

The number of shares outstanding of the issuer's common stock was 107,211,461 shares as of October 28, 2013.

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FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q may be considered “forward-looking statements” as that term is defined in the Private Securities Litigation Reform Act of 1995. The forward-looking statements contained herein are subject to known and unknown risks, uncertainties, assumptions and other factors that may cause our actual results, performance or achievements to be materially different from those expressed or implied by any such forward-looking statements. Forward-looking statements include information concerning our future financial performance, business strategy, projected plans and objectives. These statements may be identified by the fact that they do not relate to historical or current facts and may use words such as “believes,” “expects,” “anticipates,” “will,” “should,” “could,” “may,” “would,” “intends,” “projects,” “estimates,” “plans,” and similar words, expressions or phrases. 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;
- a change in our fleet costs as a result of a change in the cost of new vehicles, disruption in the supply of new vehicles, and/or a change in the price at which we dispose of used vehicles either in the used vehicle market or under repurchase or guaranteed depreciation programs;
- risks relating to our March 2013 acquisition of Zipcar, Inc. (“Zipcar”), including our ability to realize the synergies contemplated by the transaction and our ability to promptly and efficiently integrate the businesses of Zipcar and Avis Budget Group, Inc.;
- the results of operations or financial condition of the manufacturers of our cars, which could impact their ability to perform their payment obligations under the agreements we have with them, including repurchase and/or guaranteed depreciation arrangements, and/or their willingness or ability to make cars available to us or the rental car industry as a whole on commercially reasonable terms or at all;
- a change in travel demand, including changes in airline passenger traffic;
- any change in economic conditions generally, particularly during our peak season or in key market segments;
- our ability to continue to achieve and maintain cost savings and successfully implement our business strategies;
- our ability to obtain financing for our global operations, including the funding of our vehicle fleet through the issuance of asset-backed securities and use of the global lending markets;
- an occurrence or threat of terrorism, pandemic disease, natural disasters or military conflict in the locations in which we operate;
- our dependence on third-party distribution channels, third-party suppliers of other services and co-marketing arrangements with third parties;
- our ability to utilize derivative instruments, and the impact of derivative instruments we currently utilize, which can be affected by fluctuations in interest rates, gasoline prices and exchange rates, changes in government regulations and other factors;
- our ability to accurately estimate our future results;

- any major disruptions in our communication networks or information systems;
- our exposure to uninsured claims in excess of historical levels;
- our failure or inability to comply with laws, regulations or contractual obligations or any changes in laws, regulations or contractual obligations, including with respect to personally identifiable information and taxes;
- any impact on us from the actions of our licensees, dealers and independent contractors;

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- any substantial changes in the cost or supply of fuel, vehicle parts, energy, labor or other resources on which we depend to operate our business;

- risks related to our indebtedness, including our substantial outstanding debt obligations and our ability to incur substantially more debt;

- our ability to meet the financial and other covenants contained in the agreements governing our indebtedness;

- the terms of agreements among us and our former real estate, hospitality and travel distribution businesses following the separation of those businesses from us in 2006, particularly with respect to the allocation of assets and liabilities, including contingent liabilities and guarantees, the ability of each of the separated companies to perform its obligations, including indemnification obligations, under these agreements, and the right of our former real estate business to control the process for resolving disputes related to contingent liabilities and assets;

- risks associated with litigation or governmental or regulatory inquiries or investigations involving our Company;

- risks related to tax obligations and the effect of future changes in accounting standards;

- risks related to our October 2011 acquisition of Avis Europe plc (“Avis Europe”), including our ability to realize the synergies contemplated by the transaction;

- risks related to completed or future acquisitions or investments that we may pursue, including any incurrence of incremental indebtedness to help fund such transactions and our ability to promptly and effectively integrate any acquired businesses; and

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

We operate in a continuously changing business environment and new risk factors emerge from time to time. New risk factors, factors beyond our control, or changes in the impact of identified risk factors may cause actual results to differ materially from those set forth in any forward-looking statements. Accordingly, forward-looking statements should not be relied upon as a prediction of actual results. Moreover, we do not assume responsibility for the accuracy and completeness of those statements. Other factors and assumptions not identified above, including those discussed in “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, “Risk Factors” and other portions of our 2012 Annual Report on Form 10-K, may contain forward-looking statements and involve uncertainties that could cause actual results to differ materially from those projected in the forward-looking statements. Such statements are based upon assumptions and known risks and uncertainties.

Although we believe that our assumptions are reasonable, any or all of our forward-looking statements may prove to be inaccurate and we can make no guarantees about our future performance. Should unknown risks or uncertainties materialize or underlying assumptions prove inaccurate, actual results could differ materially from past results and/or those anticipated, estimated or projected. Except to the extent of our obligations 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. 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 COMPREHENSIVE INCOME
(In millions, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues				
Vehicle rental	$1,734	$1,582	$4,388	$4,084
Other	661	588	1,699	1,575
Net revenues	2,395	2,170	6,087	5,659
Expenses				
Operating	1,142	1,036	3,080	2,882
Vehicle depreciation and lease charges, net	524	436	1,387	1,088
Selling, general and administrative	274	244	771	696
Vehicle interest, net	72	77	195	231
Non-vehicle related depreciation and amortization	39	30	109	92
Interest expense related to corporate debt, net:				
Interest expense	57	67	170	208
Early extinguishment of debt	—	2	131	52
Transaction-related costs	10	11	37	21
Restructuring expense	14	7	39	26
Impairment	33	—	33	—
Total expenses	2,165	1,910	5,952	5,296
Income before income taxes	230	260	135	363
Provision for (benefit from) income taxes	112	(20)	91	27
Net income	$118	$280	$44	$336
Comprehensive income	$178	$308	$44	$361
Earnings per share				
Basic	$1.09	$2.62	$0.41	$3.16
Diluted	$1.02	$2.38	$0.39	$2.77

See Notes to Consolidated Condensed Financial Statements (Unaudited).

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Avis Budget Group, Inc.
CONSOLIDATED CONDENSED BALANCE SHEETS
(In millions, except share data)
(Unaudited)

	September 30, 2013	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$589	$606
Receivables, net	681	553
Deferred income taxes	163	146
Other current assets	575	405
Total current assets	2,008	1,710
Property and equipment, net	570	529
Deferred income taxes	1,351	1,454
Goodwill	689	375
Other intangibles, net	928	731
Other non-current assets	375	320
Total assets exclusive of assets under vehicle programs	5,921	5,119
Assets under vehicle programs:		
Program cash	210	24
Vehicles, net	10,805	9,274
Receivables from vehicle manufacturers and other	506	439
Investment in Avis Budget Rental Car Funding (AESOP) LLC—related party	362	362
	11,883	10,099
Total assets	$17,804	$15,218
Liabilities and stockholders’ equity		
Current liabilities:		
Accounts payable and other current liabilities	$1,680	$1,421
Short-term debt and current portion of long-term debt	181	57
Total current liabilities	1,861	1,478
Long-term debt	3,203	2,848
Other non-current liabilities	878	871
Total liabilities exclusive of liabilities under vehicle programs	5,942	5,197
Liabilities under vehicle programs:		
Debt	2,508	1,603
Debt due to Avis Budget Rental Car Funding (AESOP) LLC—related party	6,128	5,203
Deferred income taxes	2,190	2,163
Other	232	295
	11,058	9,264
Commitments and contingencies (Note 13)		
Stockholders’ equity:		
	—	—

Preferred stock, $0.01 par value—authorized 10 million shares; none issued and outstanding		
Common stock, $0.01 par value—authorized 250 million shares; issued 137,081,056 and 137,081,056 shares	1	1
Additional paid-in capital	7,909	8,211
Accumulated deficit	(2,332)	(2,376)
Accumulated other comprehensive income	110	110
Treasury stock, at cost—29,384,273 and 30,027,146 shares	(4,884)	(5,189)
Total stockholders' equity	804	757
Total liabilities and stockholders' equity	$17,804	$15,218

See Notes to Consolidated Condensed Financial Statements (Unaudited).

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Avis Budget Group, Inc.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2013	2012
Operating activities		
Net income	$44	$336
Adjustments to reconcile net income to net cash provided by operating activities:		
Vehicle depreciation	1,295	1,100
Gain on sale of vehicles, net	(10)	(107)
Non-vehicle related depreciation and amortization	109	92
Amortization of debt financing fees	33	43
Impairment	33	—
Net change in assets and liabilities, excluding the impact of acquisitions and dispositions:		
Receivables	(150)	(146)
Income taxes and deferred income taxes	61	(12)
Accounts payable and other current liabilities	22	28
Other, net	306	190
Net cash provided by operating activities	1,743	1,524
Investing activities		
Property and equipment additions	(92)	(82)
Proceeds received on asset sales	13	16
Net assets acquired, net of cash acquired	(531)	(5)
Other, net	37	(25)
Net cash used in investing activities exclusive of vehicle programs	(573)	(96)
Vehicle programs:		
Increase in program cash	(173)	(90)
Investment in vehicles	(8,865)	(8,962)
Proceeds received on disposition of vehicles	6,393	6,136
	(2,645)	(2,916)
Net cash used in investing activities	(3,218)	(3,012)

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Avis Budget Group, Inc.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Continued)
(In millions)
(Unaudited)

	Nine Months Ended September 30, 2013	2012
Financing activities		
Proceeds from long-term borrowings	2,725	654
Payments on long-term borrowings	(2,344)	(907)
Net change in short-term borrowings	(32)	1
Purchases of warrants	(30)	(26)
Proceeds from sale of call options	41	38
Repurchases of common stock	(21)	—
Debt financing fees	(36)	(11)
Other, net	2	1
Net cash provided by (used in) financing activities exclusive of vehicle programs	305	(250)
Vehicle programs:		
Proceeds from borrowings	10,266	9,238
Payments on borrowings	(9,079)	(7,467)
Debt financing fees	(26)	(18)
	1,161	1,753
Net cash provided by financing activities	1,466	1,503
Effect of changes in exchange rates on cash and cash equivalents	(8)	5
Net (decrease) increase in cash and cash equivalents	(17)	20
Cash and cash equivalents, beginning of period	606	534
Cash and cash equivalents, end of period	$589	$554

See Notes to Consolidated Condensed Financial Statements (Unaudited).

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Avis Budget Group, Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS (Unaudited)
(Unless otherwise noted, all dollar amounts in tables 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 worldwide. 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 for interim financial reporting.

The Company operates the following business segments:

- North America—provides car rentals in the United States and vehicle rentals in Canada, as well as ancillary products and services, and operates the Company's Zipcar car sharing business.

- International—provides, and licenses the Company's brands to third parties for, vehicle rentals and ancillary products and services primarily in Europe, the Middle East, Asia, Africa, South America, Central America, the Caribbean, Australia and New Zealand.

- Truck Rental—provides truck rentals and ancillary products and services to consumers and commercial users in the United States.

In presenting the Consolidated Condensed Financial Statements in accordance with accounting principles generally accepted in the United States of America ("GAAP"), management makes estimates and assumptions that affect the amounts reported and related disclosures. Estimates, by their nature, are based on judgment and available information. Accordingly, actual results could differ from those estimates. In management's opinion, the Consolidated Condensed Financial Statements contain all 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 2012 Annual Report on Form 10-K and Form 10-K/A.

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 that is 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 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.

Transaction-related Costs. The Company completed the acquisition of Zipcar on March 14, 2013 and the acquisition of Payless Car Rental ("Payless") on July 15, 2013. During the three and nine months ended September 30, 2013, transaction-related costs primarily include expenses related to the integration of Avis Europe's operations with those of the Company and costs related to the acquisition and integration of Zipcar and Payless. In the three and nine months ended September 30, 2012, transaction-related costs primarily included expenses related to the integration of Avis Europe's operations with the Company's.

Currency Transactions. The Company records the gain or loss of foreign-currency transactions on certain intercompany loans and gain or loss on intercompany loan hedges within interest expense related to corporate debt, net. During the three and nine months ended September 30, 2013, the Company recorded losses of $1 million and $8 million, respectively, on such items. In the three and nine months ended September 30, 2012, the Company recorded losses of $3 million and $12 million, respectively, on such items.

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Adoption of New Accounting Standards

On January 1, 2013, as a result of the issuance of a new accounting pronouncement, the Company adopted, as required, Accounting Standards Update No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," which requires companies to disclose additional information about amounts reclassified out of accumulated other comprehensive income by component. The adoption of this pronouncement resulted in incremental disclosure about activity and amounts reclassified out of accumulated other comprehensive income.

2. Restructuring Activities

During fourth quarter 2012, the Company initiated a strategic restructuring initiative to better position the business of its Truck Rental segment, in which it will close certain rental locations and decrease the size of the rental fleet, which the Company believes will increase fleet utilization and reduce costs. During the nine months ended September 30, 2013, as part of this process, the Company recorded restructuring expense of $19 million. The Company expects further restructuring expenses of approximately $3 million to be incurred, through the completion of this initiative, in 2013.

In 2011, the Company implemented a restructuring initiative to identify synergies across the Company, enhance organizational efficiencies and consolidate and rationalize processes and facilities. During the nine months ended September 30, 2013, as part of this process, the Company formally communicated the termination of employment to approximately 370 employees and recorded $20 million of expense in connection with these initiatives. These expenses primarily represent severance, outplacement services and other costs associated with employee terminations. As of September 30, 2013, the Company has terminated approximately 300 of these employees. The Company expects further restructuring expenses of approximately $18 million to be incurred in 2013.

The following tables summarize the changes to our restructuring-related liabilities and identify the amounts recorded within the Company's reportable segments, and by category, for restructuring expenses and corresponding payments and utilizations:

	North America	International	Truck Rental	Total
Balance as of January 1, 2013	$1	$12	$—	$13
Restructuring expense	6	14	19	39
Cash payment/utilization	(4)	(17)	(19)	(40)
Balance as of September 30, 2013	$3	$9	$—	$12

	Personnel Related	Facility Related	Other [(a)]	Total
Balance as of January 1, 2013	$12	$1	$—	$13
Restructuring expense	18	2	19	39
Cash payment/utilization	(19)	(2)	(19)	(40)
Balance as of September 30, 2013	$11	$1	$—	$12

(a) Includes expenses related to the disposition of vehicles.

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3. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share (“EPS”) (shares in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Net income for basic EPS	$118	$280	$44	$336
Convertible note interest, net of tax	1	1	1	4
Net income for diluted EPS	$119	$281	$45	$340
Basic weighted average shares outstanding	108.3	106.8	108.1	106.5
Options, warrants and non-vested stock [(a)]	3.3	2.3	3.3	2.2
Convertible debt	4.6	8.9	5.5	14.0
Diluted weighted average shares outstanding	116.2	118.0	116.9	122.7
Earnings per share:				
Basic	$1.09	$2.62	$0.41	$3.16
Diluted	$1.02	$2.38	$0.39	$2.77

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(a) For the three and nine months ended September 30, 2013, the number of anti-dilutive securities which were excluded from the computation of diluted earnings per share was not significant. For the three and nine months ended September 30, 2012, 0.2 million outstanding options and 8.9 million warrants have an anti-dilutive effect and therefore are excluded from the computation of diluted weighted average shares outstanding.

4. Acquisitions

Zipcar

On March 14, 2013, the Company completed the acquisition of the entire issued share capital of Zipcar, the leading car sharing company, for $473 million, net of acquired cash. The acquisition increased the Company’s growth potential and its ability to better serve a greater variety of customer transportation needs.

The excess of the purchase price over preliminary fair value of net assets acquired was allocated to goodwill, which was assigned to the Company’s North America segment. The goodwill is not expected to be deductible for tax purposes. The fair value of the assets acquired and liabilities assumed has not yet been finalized and is therefore subject to change. In connection with this acquisition, $188 million was recorded in identifiable intangible assets (consisting of $112 million related to trademarks and $76 million related to customer relationships) and $275 million was recorded in goodwill. The trademark assets are indefinite-lived and the customer relationship intangibles will be amortized over an estimated life of 8 years.

Brazilian licensee

On August 12, 2013, the Company acquired a 50% ownership stake in its Brazilian licensee for $53 million. Approximately $11 million of the total consideration was paid in the third quarter of 2013 and the remainder is expected to be paid by the end of first quarter 2014. The Company’s investment significantly increases its presence in the Brazilian car rental market.

The Company's investment in its Brazilian licensee was recorded as an equity investment within Other non-current assets, and the Company's share of the Brazilian licensee's operating results is reported within Operating expenses. In conjunction with the acquisition, the Company agreed to the payment of contingent consideration of up to $13 million based on the Brazilian licensee's future financial performance. The fair value of the contingent consideration was estimated by utilizing a Monte Carlo simulation technique, based on a range of possible future results, and no value was attributed to the contingent consideration at the acquisition date. At September 30, 2013, the Company's investment totaled approximately $20 million, which is net of an impairment charge of $33 million ($33 million, net of tax). The impairment charge was recorded at the time of the investment based on a combination of observable and unobservable fair value inputs (Level 3), specifically a combination of the Income approach discounted cash flow method and the Market approach-public company market multiple method.

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Payless Car Rental

On July 15, 2013, the Company completed the acquisition of Payless for $50 million in cash. The acquisition provides the Company with a meaningful position in the deep-value segment of the car rental industry.

The excess of the purchase price over preliminary fair value of net assets acquired was allocated to goodwill, which was assigned to the Company’s North America segment. The goodwill is not expected to be deductible for tax purposes. The fair value of the assets acquired and liabilities assumed has not yet been finalized and is therefore subject to change. In connection with this acquisition, $23 million was recorded in identifiable intangible assets (consisting of $16 million related to trademarks and $7 million related to license agreements) and $27 million was recorded in goodwill. The trademark assets are indefinite-lived and the license agreements will be amortized over an estimated life of 15 years.

Apex Car Rentals

In October 2012, the Company completed the acquisition of the assets of Apex Car Rentals (“Apex”), a leading deep-value car rental company in New Zealand and Australia, operating a fleet of approximately 4,000 rental vehicles. In conjunction with the acquisition, the Company paid $63 million in cash (including the acquisition of fleet) and agreed to the payment of contingent consideration with an estimated acquisition date fair value of $9 million. The contingent consideration consists of a maximum of $26 million in additional payments that are contingent on Apex’ future financial performance, and the fair value of the contingent consideration at the acquisition date was estimated by utilizing a Monte Carlo simulation technique, based on a range of possible future results. The allocation of the purchase price of Apex principally includes vehicles of $33 million, trademarks of $21 million and goodwill of $16 million, which were allocated to the Company’s International segment. The goodwill is not expected to be deductible for tax purposes.

5. Other Current Assets

Other current assets consisted of:

	As of September 30, 2013	As of December 31, 2012
Sales and use taxes	$223	$108
Prepaid expenses	200	174
Other	152	123
Other current assets	$575	$405

6. Intangible Assets

Intangible assets consisted of:

	As of September 30, 2013			As of December 31, 2012		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized Intangible Assets						
License agreements [a]	$269	$49	$220	$257	$39	$218
Customer relationships [b]	165	30	135	86	19	67
Other	2	1	1	2	1	1

Total	$436	$80	$356	$345	$59	$286
Unamortized Intangible Assets						
Goodwill [a][b]	$689			$375		
Trademarks [a][b]	$572			$445		

[a] The increases in carrying amounts primarily relate to the acquisition of Payless.
[b] The increases in carrying amounts primarily relate to the acquisition of Zipcar.

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Amortization expense relating to all intangible assets was approximately $7 million and $4 million during third quarter 2013 and 2012, respectively. For the nine months ended September 30, 2013 and 2012, amortization expense was approximately $20 million and $15 million, respectively. Based on the Company's amortizable assets at September 30, 2013, the Company expects amortization expense of approximately $7 million for the remainder of 2013 and approximately $29 million for each of the five fiscal years thereafter.

7. Financial Instruments

The fair value of the Company's financial instruments is generally determined by reference to market values resulting from trading on a national securities exchange or in an over-the-counter market. In some cases where quoted market prices are not available, prices are derived by considering the yield of the benchmark security that was issued to initially price the instruments and adjusting this rate by the credit spread that market participants would demand for the instruments as of the measurement date. The carrying amounts of cash and cash equivalents; receivables, net; program cash and accounts payable and other current liabilities approximate fair value due to the short-term maturities of these assets and liabilities.

Debt Instruments

The carrying amounts and estimated fair values of debt instruments were as follows:

	As of September 30, 2013		As of December 31, 2012	
	Carrying Amount	Estimated Fair Value [(a)]	Carrying Amount	Estimated Fair Value [(a)]
Corporate debt				
Short-term debt and current portion of long-term debt	$181	$181	$57	$58
Long-term debt, excluding convertible debt	3,128	3,192	2,720	2,903
Convertible debt	75	135	128	171
Debt under vehicle programs				
Vehicle-backed debt due to Avis Budget Rental Car Funding (AESOP) LLC	$6,128	$6,231	$5,203	$5,391
Vehicle-backed debt	2,502	2,510	1,599	1,613
Interest rate swaps and interest rate contracts [(b)]	6	6	4	4

(a) The fair value measurements are based on significant observable inputs (Level 2).
(b) Derivatives in a liability position.

Net Investment Hedge

The Company has designated its 6% Euro-denominated notes issued March 2013 as a hedge of its net investment in Euro-denominated foreign operations. The Company records the effective portion of the gain or loss on this net investment hedge, net of taxes, in accumulated other comprehensive income as part of currency translation adjustments. For the three months and nine months ended September 30, 2013, the Company has recorded an $8 million loss, net of tax, in accumulated other comprehensive income. Any ineffective portion of the net investment hedge is immediately reclassified from accumulated other comprehensive income into earnings. There was no ineffectiveness during the three and nine months ended September 30, 2013 and the Company does not expect to reclassify any amounts from accumulated other comprehensive income into earnings over the next 12 months.

Derivative Instruments and Hedging Activities

The Company uses foreign exchange contracts to manage its exposure to changes in currency exchange rates associated with its foreign currency denominated receivables and forecasted royalties, forecasted earnings of foreign subsidiaries and forecasted foreign currency denominated acquisitions. The Company primarily hedges its foreign currency exposure to the Australian, Canadian and New Zealand dollars, the Euro and the British pound sterling. These forward contracts do not qualify for hedge accounting treatment; however, the fluctuations in the value of these forward contracts largely offset the impact of changes in the value of the underlying risk they economically hedge.

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The Company uses various hedging strategies including interest rate swaps and interest rate caps to create an appropriate mix of fixed and floating rate assets and liabilities. The Company uses interest rate swaps to manage the risk related to its floating rate corporate debt and its floating rate vehicle-backed debt. The Company records the effective portion of changes in the fair value of its cash flow hedges to other comprehensive income, net of tax, and subsequently reclassifies these amounts into earnings in the period during which the hedged transaction is recognized. The Company records the gains or losses related to freestanding derivatives, which are not designated as a hedge for accounting purposes, in its consolidated results of operations. The changes in fair values of hedges that are determined to be ineffective are immediately reclassified from accumulated other comprehensive income into earnings. The Company estimates that the amount of gains or losses currently recorded in accumulated other comprehensive income which will be recognized in earnings over the next 12 months is not material.

From time to time, the Company enters into derivative commodity contracts to manage its exposure to changes in the price of unleaded gasoline. Changes in the fair value of these derivatives are recorded within operating expenses.

Certain of the Company’s derivative instruments contain collateral support provisions that require the Company to post cash collateral to the extent that such derivatives are in a liability position. The aggregate fair value of such derivatives and the aggregate fair value of assets needed to settle these derivatives as of September 30, 2013 was approximately $3 million, for which the Company has posted cash collateral in the normal course of business.

As of September 30, 2013, the Company held derivative instruments with absolute notional values as follows:

	As of September 30, 2013
Interest rate caps [(a)]	$6,959
Interest rate swaps	904
Foreign exchange forward contracts	77
Foreign exchange swaps	704

(a) Represents $4.7 billion of interest rate caps sold and approximately $2.2 billion of interest rate caps purchased. These amounts exclude $2.5 billion of interest rate caps purchased by the Company’s Avis Budget Rental Car Funding (AESOP) LLC (“Avis Budget Rental Car Funding”) subsidiary.

As of September 30, 2013, the Company also had commodity contracts for the purchase of 11 million gallons of unleaded gasoline.

The Company used significant observable inputs (Level 2 inputs) to determine the fair value of its derivative assets and liabilities. Derivatives entered into by the Company are typically executed over-the-counter and are valued using various valuation techniques, as no quoted market prices exist for such instruments. The valuation technique and inputs depend on the type of derivative and the nature of the underlying exposure. The principal techniques used to value these instruments are discounted cash flows and Black-Scholes option valuation models. These models take into account a variety of factors including, where applicable, maturity, commodity prices, interest rate yield curves of the Company and counterparties, credit curves, counterparty creditworthiness and currency exchange rates. These factors are applied on a consistent basis and are based upon observable inputs.

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Fair values of derivative instruments were as follows:

	As of September 30, 2013		As of December 31, 2012	
	Fair Value, Asset Derivatives	Fair Value, Liability Derivatives	Fair Value, Asset Derivatives	Fair Value, Liability Derivatives
Derivatives designated as hedging instruments				
Interest rate swaps [(a)]	$—	$1	$—	$1