YUM BRANDS INC
Form 10-Q
April 29, 2013

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

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FORM 10-Q

(Mark One)

[ ] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended March 23, 2013

OR

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

For the transition period from ____________ to _________________

Commission file number 1-13163

____

YUM! BRANDS, INC.
(Exact name of registrant as specified in its charter)

North Carolina (State or other jurisdiction of incorporation or organization)	13-3951308 (I.R.S. Employer Identification No.)
1441 Gardiner Lane, Louisville, Kentucky (Address of principal executive offices)	40213 (Zip Code)

Registrant's telephone number, including area code: (502) 874-8300

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 [ü] No [ ]

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

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. (Check one): Large accelerated filer: [ü] Accelerated filer: [ ]

Non-accelerated filer: [ ] 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 [ ] No [ü]

The number of shares outstanding of the Registrant’s Common Stock as of April 23, 2013 was 449,837,985 shares.

YUM! BRANDS, INC.

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions, except per share data)

	Quarter ended	
Revenues	3/23/2013	3/24/2012
Company sales	$2,099	$2,344
Franchise and license fees and income	436	399
Total revenues	2,535	2,743
Costs and Expenses, Net		
Company restaurant expenses		
Food and paper	680	767
Payroll and employee benefits	490	513
Occupancy and other operating expenses	596	624
Company restaurant expenses	1,766	1,904
General and administrative expenses	273	272
Franchise and license expenses	30	26
Closures and impairment (income) expenses	4	1
Refranchising (gain) loss	(17)	(26)
Other (income) expense	(8)	(79)
Total costs and expenses, net	2,048	2,098
Operating Profit	487	645
Interest expense, net	31	37
Income Before Income Taxes	456	608
Income tax provision	120	147
Net Income – including noncontrolling interests	336	461
Net Income (loss) – noncontrolling interests	(1)	3
Net Income – YUM! Brands, Inc.	$337	$458
Basic Earnings Per Common Share	$0.74	$0.99
Diluted Earnings Per Common Share	$0.72	$0.96
Dividends Declared Per Common Share	$0.335	$0.285

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	Quarter ended 3/23/2013	Quarter ended 3/24/2012
Net Income - including noncontrolling interests	$ 336	$ 461
Other comprehensive income, net of tax		
Translation adjustments and gains (losses) from intra-entity transactions of a long-term investment nature	(5)	13
Tax (expense) benefit	7	(2)
Reclassification of currency translation adjustments into Net Income	—	3
Tax expense (benefit)	—	—
Net unrealized losses arising during the year on pension and post-retirement plans	(8)	—
Tax (expense) benefit	1	—
Reclassification of pension and post-retirement losses to Net Income	25	15
Tax expense (benefit)	(9)	(6)
Net unrealized gain (loss) on derivative instruments	1	(1)
Tax (expense) benefit	—	—
Other comprehensive income, net of tax	12	22
Comprehensive Income - including noncontrolling interests	348	483
Comprehensive Income (loss) - noncontrolling interests	(1)	3
Comprehensive Income - YUM! Brands, Inc.	$ 349	$ 480

See accompanying Notes to Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	Quarter ended	
	3/23/2013	3/24/2012
Cash Flows – Operating Activities		
Net Income – including noncontrolling interests	$336	$461
Depreciation and amortization	130	127
Closures and impairment (income) expenses	4	1
Refranchising (gain) loss	(17)	(26)
Contributions to defined benefit pension plans	(1)	(8)
Gain upon acquisition of Little Sheep	—	(74)
Deferred income taxes	(6)	(4)
Equity income from investments in unconsolidated affiliates	(7)	(13)
Excess tax benefits from share-based compensation	(11)	(28)
Share-based compensation expense	9	11
Changes in accounts and notes receivable	9	29
Changes in inventories	26	27
Changes in prepaid expenses and other current assets	(8)	(15)
Changes in accounts payable and other current liabilities	(81)	(124)
Changes in income taxes payable	18	70
Other, net	—	39
Net Cash Provided by Operating Activities	401	473
Cash Flows – Investing Activities		
Capital spending	(237)	(173)
Proceeds from refranchising of restaurants	81	102
Acquisitions	—	(540)
Changes in restricted cash	—	300
Increase in short-term investments	—	(79)
Other, net	3	(1)
Net Cash Used in Investing Activities	(153)	(391)
Cash Flows – Financing Activities		
Repayments of long-term debt	(1)	(3)
Short-term borrowings, more than three months, net	9	—
Repurchase shares of Common Stock	(98)	(78)
Excess tax benefits from share-based compensation	11	28
Employee stock option proceeds	5	16
Dividends paid on Common Stock	(151)	(131)
Other, net	(34)	(20)
Net Cash Used in Financing Activities	(259)	(188)
Effect of Exchange Rates on Cash and Cash Equivalents	(3)	7
Net Decrease in Cash and Cash Equivalents	(14)	(99)
Cash and Cash Equivalents - Beginning of Period	776	1,198
Cash and Cash Equivalents - End of Period	$762	$1,099

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS
YUM! BRANDS, INC. AND SUBSIDIARIES
(in millions)

	(Unaudited) 3/23/2013	12/29/2012
ASSETS		
Current Assets		
Cash and cash equivalents	$762	$776
Accounts and notes receivable, net	368	301
Inventories	288	313
Prepaid expenses and other current assets	227	272
Deferred income taxes	133	127
Advertising cooperative assets, restricted	120	136
Total Current Assets	1,898	1,925
Property, plant and equipment, net	4,258	4,250
Goodwill	1,026	1,034
Intangible assets, net	693	690
Investments in unconsolidated affiliates	31	72
Other assets	571	575
Deferred income taxes	468	467
Total Assets	$8,945	$9,013
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and other current liabilities	$1,866	$2,036
Income taxes payable	82	97
Short-term borrowings	21	10
Advertising cooperative liabilities	120	136
Total Current Liabilities	2,089	2,279
Long-term debt	2,924	2,932
Other liabilities and deferred credits	1,515	1,490
Total Liabilities	6,528	6,701
Redeemable noncontrolling interest	59	59
Shareholders' Equity		
Common Stock, no par value, 750 shares authorized; 450 and 451 shares issued in 2013 and 2012, respectively	—	—
Retained earnings	2,413	2,286
Accumulated other comprehensive income (loss)	(120)	(132)
Total Shareholders' Equity – YUM! Brands, Inc.	2,293	2,154
Noncontrolling interests	65	99
Total Shareholders' Equity	2,358	2,253
Total Liabilities, Redeemable Noncontrolling Interest and Shareholders' Equity	$8,945	$9,013

See accompanying Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Tabular amounts in millions, except per share data)

Note 1 - Financial Statement Presentation

We have prepared our accompanying unaudited Condensed Consolidated Financial Statements ("Financial Statements") in accordance with the rules and regulations of the Securities and Exchange Commission ("SEC") for interim financial information. Accordingly, they do not include all of the information and footnotes required by Generally Accepted Accounting Principles in the United States ("GAAP") for complete financial statements. Therefore, we suggest that the accompanying Financial Statements be read in conjunction with the Consolidated Financial Statements included in our annual report on Form 10-K for the fiscal year ended December 29, 2012 ("2012 Form 10-K"). Except as disclosed herein, there has been no material change in the information disclosed in our Consolidated Financial Statements included in the 2012 Form 10-K.

YUM! Brands, Inc. and Subsidiaries (collectively referred to herein as "YUM" or the "Company") comprises primarily the worldwide operations of KFC, Pizza Hut and Taco Bell (collectively the "Concepts"). References to YUM throughout these Notes to our Financial Statements are made using the first person notations of "we," "us" or "our."

YUM's business consists of four reporting segments: YUM Restaurants China ("China" or "China Division"), YUM Restaurants International ("YRI" or "International Division"), United States ("U.S." or "U.S. Division") and YUM Restaurants India ("India" or "India Division"). The China Division includes mainland China, and the India Division includes India, Bangladesh, Mauritius, Nepal and Sri Lanka. YRI includes the remainder of our international operations.

Our fiscal year ends on the last Saturday in December and, as a result, a 53rd week is added every five or six years. The first three quarters of each fiscal year consist of 12 weeks and the fourth quarter consists of 16 weeks in fiscal years with 52 weeks and 17 weeks in fiscal years with 53 weeks. Our subsidiaries operate on similar fiscal calendars except that China, India and certain other international subsidiaries operate on a monthly calendar, and thus never have a 53rd week, with two months in the first quarter, three months in the second and third quarters and four months in the fourth quarter. YRI closes one period earlier to facilitate consolidated reporting. During the quarter ended March 23, 2013 we eliminated the period lag that we previously used to facilitate the reporting of our India Division's results. Accordingly, the India Division results for the first quarter of 2013 include the months of January and February 2013. Due to the immateriality of the India Division's results we did not restate the prior year operating results for the elimination of this period lag and therefore the results for the first quarter of 2012 continue to include the months of December 2011 and January 2012.

Our preparation of the accompanying Financial Statements in conformity with GAAP requires us to make estimates and assumptions that affect reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Financial Statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

In our opinion, the accompanying Financial Statements include all normal and recurring adjustments considered necessary to present fairly, when read in conjunction with our 2012 Form 10-K, our financial position as of March 23, 2013, and the results of our operations, comprehensive income and cash flows for the quarters ended March 23, 2013 and March 24, 2012. Our results of operations, comprehensive income and cash flows for these interim periods are not necessarily indicative of the results to be expected for the full year.

Our significant interim accounting policies include the recognition of certain advertising and marketing costs, generally in proportion to revenue, and the recognition of income taxes using an estimated annual effective tax rate.

We have reclassified certain items in the Financial Statements for the prior period to be comparable with the classification for the quarter ended March 23, 2013. These reclassifications had no effect on previously reported Net Income - YUM! Brands, Inc.

Note 2 - Earnings Per Common Share ("EPS")

	Quarter ended	
	3/23/2013	3/24/2012
Net Income – YUM! Brands, Inc.	$337	$458
Weighted-average common shares outstanding (for basic calculation)	455	465
Effect of dilutive share-based employee compensation	10	13
Weighted-average common and dilutive potential common shares outstanding (for diluted calculation)	465	478
Basic EPS	$0.74	$0.99
Diluted EPS	$0.72	$0.96
Unexercised employee stock options and stock appreciation rights (in millions) excluded from the diluted EPS computation(a)	4.5	1.9

(a) These unexercised employee stock options and stock appreciation rights were not included in the computation of diluted EPS because to do so would have been antidilutive for the periods presented.

Note 3 - Shareholders' Equity

Under the authority of our Board of Directors, we repurchased shares of our Common Stock during the quarters ended March 23, 2013 and March 24, 2012, as indicated below. All amounts exclude applicable transaction fees.

		Shares Repurchased (thousands)			Dollar Value of Shares Repurchased			Remaining Dollar Value of Shares that may be Repurchased
Authorization Date	Authorization Expiration Date	2013		2012	2013		2012	2013
January 2011	June 2012	—		1,219	$—		$78	$—
November 2012	May 2014	1,198		—	78		—	875
Total		1,198	(a)	1,219	$78	(a)	$78	$875

(a) Amount excludes the effect of $20 million in share repurchases (0.3 million shares) with trade dates prior to the 2012 fiscal year end but cash settlement dates subsequent to the 2012 fiscal year end.

Changes in accumulated other comprehensive income ("OCI") are presented below.

	Translation Adjustments and Gains (Losses) From Intra-Entity Transactions of a Long-Term Nature	Pension and Post-Retirement Benefit Plan Losses (a)	Net Unrealized Loss on Derivative Instruments	Total
Balance at December 29, 2012, net of tax	$166	$(286)	$(12)	$(132)
Amounts classified into OCI, net of tax	2	(7)	1	(4)
Amounts reclassified from accumulated OCI, net of tax	—	16	—	16
OCI, net of tax	2	9	1	12
Balance at March 23, 2013, net of tax	$168	$(277)	$(11)	$(120)

(a) Amounts reclassified from accumulated OCI for pension and post-retirement benefit plan losses include amortization of net losses of $15 million, settlement charges of $10 million and the related income tax benefit of $9 million. See Note 10 Pension Benefits for further information.

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Note 4 - Items Affecting Comparability of Net Income and/or Cash Flows

Little Sheep Acquisition

On February 1, 2012 we acquired an additional 66% interest in Little Sheep Group Limited ("Little Sheep") for $540 million, net of cash acquired of $44 million, increasing our ownership to 93%. The acquisition was driven by our strategy to build leading brands across China in every significant category. Prior to our acquisition of this additional interest, our 27% interest in Little Sheep was accounted for under the equity method of accounting. As a result of the acquisition we obtained voting control of Little Sheep, and thus we began consolidating Little Sheep upon acquisition. As required by GAAP, we remeasured our previously held 27% ownership in Little Sheep, which had a recorded value of $107 million at the date of acquisition, at fair value based on Little Sheep's traded share price immediately prior to our offer to purchase the business and recognized a non-cash gain of $74 million. This gain, which resulted in no related income tax expense, was recorded in Other (income) expense on our Condensed Consolidated Statement of Income during the quarter ended March 24, 2012 and was not allocated to any segment for performance reporting purposes.

Under the equity method of accounting, we previously reported our 27% share of the net income of Little Sheep as Other (income) expense in the Condensed Consolidated Statements of Income. Since we began consolidating, we have reported the results of operations for Little Sheep in the appropriate line items of our Condensed Consolidated Statement of Income. We no longer report Other (income) expense as we did under the equity method of accounting. Net income attributable to our partner's ownership percentage is recorded as Net Income (loss) - noncontrolling interest. Little Sheep reports on a one month lag, and as a result, their consolidated results are included in the China Division from the beginning of the quarter ended June 16, 2012. The consolidation of Little Sheep increased China Division revenues and Operating Profit each by 4% for the quarter ended March 23, 2013.

Refranchising (Gain) Loss

The Refranchising (gain) loss by reportable segment is presented below. We do not allocate such gains and losses to our segments for performance reporting purposes.

	Quarter ended			
	3/23/2013		3/24/2012	
China	$—		$(2	)
YRI[(a)]	—		21	
U.S.[(b)]	(17	)	(45	)
India	—		—	
Worldwide	$(17	)	$(26	)

(a) During the fourth quarter of 2012, we refranchised our remaining 331 Company-owned Pizza Hut dine-in restaurants in the United Kingdom ("UK"). During the quarter ended March 24, 2012 we recorded a loss of $21 million and a $4 million related income tax benefit due to the then planned refranchising of these restaurants.

(b) In the quarters ended March 23, 2013 and March 24, 2012, U.S. Refranchising (gain) loss primarily relates to gains on the sales of Taco Bell restaurants.

Store Closure and Impairment Activity

Store closure (income) costs and Store impairment charges by reportable segment are presented below.

	Quarter ended March 23, 2013				
	China	YRI	U.S.	India	Worldwide
Store closure (income) costs [(a)]	$(1)	$—	$1	$—	$—
Store impairment charges	3	—	—	1	4
Closure and impairment (income) expenses	$2	$—	$1	$1	$4

	Quarter ended March 24, 2012				
	China	YRI	U.S.	India	Worldwide
Store closure (income) costs [(a)]	$—	$—	$(1)	$—	$(1)
Store impairment charges	1	1	—	—	2
Closure and impairment (income) expenses	$1	$1	$(1)	$—	$1

(a) Store closure (income) costs include the net gain or loss on sales of real estate on which we formerly operated a Company restaurant that was closed, lease reserves established when we cease using a property under an operating lease and subsequent adjustments to those reserves and other facility-related expenses from previously closed stores.

Note 5 - Recently Adopted Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update No. 2013-2, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (ASU 2013-2), that requires an organization to present the effects on the line items of net income of significant amounts reclassified out of Accumulated OCI, but only if the item reclassified is required under U.S. GAAP to be reclassified to net income in its entirety in the same reporting period. ASU 2013-2 is effective for fiscal years beginning after December 15, 2012. All necessary disclosures have been complied with in these Financial Statements.

Note 6 - Other (Income) Expense

	Quarter ended	
	3/23/2013	3/24/2012
Equity income from investments in unconsolidated affiliates	$(7)	$(13)
Gain upon acquisition of Little Sheep	—	(74)
Foreign exchange net (gain) loss and other[(a)]	(1)	8
Other (income) expense	$(8)	$(79)

(a) The quarter ended March 24, 2012 includes $6 million of deal costs related to the acquisition of Little Sheep that were allocated to the China Division for performance reporting purposes.

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Note 7 - Supplemental Balance Sheet Information

Receivables

The Company’s receivables are primarily generated as a result of ongoing business relationships with our franchisees and licensees as a result of royalty and lease agreements. Trade receivables consisting of royalties from franchisees and licensees are generally due within 30 days of the period in which the corresponding sales occur and are classified as Accounts and notes receivable on our Condensed Consolidated Balance Sheets.

	3/23/2013	12/29/2012
Accounts and notes receivable	$380	$313
Allowance for doubtful accounts	(12)	(12)
Accounts and notes receivable, net	$368	$301

Property, Plant and Equipment

	3/23/2013	12/29/2012
Property, plant and equipment, gross	$7,428	$7,389
Accumulated depreciation and amortization	(3,170)	(3,139)
Property, plant and equipment, net	$4,258	$4,250

Assets held for sale at March 23, 2013 and December 29, 2012 total $17 million and $56 million, respectively, and are included in Prepaid expenses and other current assets in our Condensed Consolidated Balance Sheets.

Noncontrolling Interests

A reconciliation of the beginning and ending carrying amount of the equity attributable to noncontrolling interests is as follows:

Noncontrolling interests as of December 29, 2012	$99
Net Income (loss) – noncontrolling interests	(1)
Acquisition of Little Sheep store-level non-controlling interests	(15)
Dividends declared	(18)
Noncontrolling interests as of March 23, 2013	$65

Note 8 - Income Taxes

	Quarter ended	
	3/23/2013	3/24/2012
Income taxes	$120	$147
Effective tax rate	26.4%	24.1%

Our effective tax rate was lower than the expected U.S. federal statutory rate of 35% primarily due to the majority of our income being earned outside of the U.S. where tax rates are generally lower than the U.S. rate.

Our effective tax rate for the quarter ended March 23, 2013 was higher than the prior year primarily due to lapping the impact of the $74 million gain recognized upon our acquisition of additional interest in Little Sheep, which resulted in no related tax expense.

On June 23, 2010, the Company received a Revenue Agent Report (RAR) from the Internal Revenue Service (the "IRS") relating to its examination of our U.S. federal income tax returns for fiscal years 2004 through 2006. The IRS has proposed an adjustment to increase the taxable value of rights to intangibles used outside the U.S. that YUM transferred to certain of its foreign subsidiaries. The proposed adjustment would result in approximately $700 million of additional taxes plus net interest to date of approximately $230 million for fiscal years 2004-2006. On January 9, 2013, the Company received an RAR from the IRS for fiscal years 2007 and 2008. As expected, the IRS proposed an adjustment similar to their proposal for 2004-2006 that would result in approximately $270 million of additional taxes plus net interest to date of approximately $35 million for fiscal years 2007 and 2008. Furthermore, the Company expects the IRS to make similar claims for years subsequent to fiscal 2008. The potential additional taxes for 2009 through 2012, computed on a similar basis to the 2004-2008 additional taxes, would be approximately $130 million plus net interest to date of approximately $5 million.

We believe that the Company has properly reported taxable income and paid taxes in accordance with applicable laws and that the proposed adjustments are inconsistent with applicable income tax laws, Treasury Regulations and relevant case law. We intend to defend our position vigorously and have filed a protest with the IRS. As the final resolution of the proposed adjustments remains uncertain, the Company will continue to provide for its position in this matter based on the tax benefit that we believe is the largest amount that is more likely than not to be realized upon settlement of this issue. There can be no assurance that payments due upon final resolution of this issue will not exceed our currently recorded reserve and such payments could have a material, adverse effect on our financial position. Additionally, if increases to our reserves are deemed necessary due to future developments related to this issue, such increases could have a material, adverse effect on our results of operations as they are recorded. The Company does not expect resolution of this matter within twelve months and cannot predict with certainty the timing of such resolution.

Note 9 - Reportable Operating Segments

We identify our operating segments based on management responsibility. The China Division includes mainland China and the India Division includes India, Bangladesh, Mauritius, Nepal and Sri Lanka. YRI includes the remainder of our international operations. We consider our KFC-U.S., Pizza Hut-U.S. and Taco Bell-U.S. operating segments to be similar and therefore have aggregated them into a single reportable operating segment.

The following tables summarize Revenues and Operating Profit for each of our reportable operating segments:

	Quarter ended	
Revenues	3/23/2013	3/24/2012
China	$1,151	$1,218
YRI	669	708
U.S.	695	800
India	20	17
	$2,535	$2,743

	Quarter ended	
Operating Profit (loss)	3/23/2013	3/24/2012
China[a]	$154	$256
YRI	199	168
United States	165	158
India	(2)	1
Unallocated Occupancy and other[b][e]	—	4
Unallocated and General and administrative expenses[e]	(46)	(42)
Unallocated Other income (expense)[c][e]	—	74
Unallocated Refranchising gain (loss)[d][e]	17	26
Operating Profit	$487	$645
Interest expense, net	(31)	(37)
Income Before Income Taxes	$456	$608

(a) Includes equity income from investments in unconsolidated affiliates of $7 million and $13 million for the quarters ended March 23, 2013 and March 24, 2012, respectively.

(b) Amounts represent depreciation reduction recognized as a result of our decisions to refranchise Company operated Pizza Hut dine-in restaurants in the UK (see Note 4) and Company operated KFC restaurants in the U.S.

(c) Represents gain upon acquisition of Little Sheep of $74 million for the quarter ended March 24, 2012. See Note 4.

(d) Includes U.S. refranchising gains of $17 million and $45 million for the quarters ended March 23, 2013 and March 24, 2012, respectively, and a loss of $21 million related to the planned refranchising of our Pizza Hut UK dine-in business for the quarter ended March 24, 2012. See Note 4.

(e) Amounts have not been allocated to any segment for performance reporting purposes.

Note 10 - Pension Benefits

We sponsor noncontributory defined benefit pension plans covering certain full-time salaried and hourly U.S. employees. The most significant of these plans, the YUM Retirement Plan (the "Plan"), is funded while benefits from the other U.S. plan are paid by the Company as incurred. During 2001, the plans covering our U.S. salaried employees were amended such that any salaried employee hired or rehired by YUM after September 30, 2001 is not eligible to participate in those plans. We also sponsor various defined benefit pension plans covering certain of our non-U.S. employees, the most significant of which are in the UK. During the quarter ended March 23, 2013, one of our UK plans was frozen such that existing participants can no longer earn future service credits. Our other UK plan was previously frozen to future service credits in 2011.

The components of net periodic benefit cost associated with our U.S. pension plans and significant international pension plans are as follows:

	U.S. Pension Plans Quarter ended		International Pension Plans Quarter ended	
	3/23/2013	3/24/2012	3/23/2013	3/24/2012
Service cost	$5	$6	$—	$—
Interest cost	13	15	2	2
Expected return on plan assets	(14)	(16)	(3)	(2)
Amortization of net loss	14	15	1	—
Net periodic benefit cost	$18	$20	$—	$—
Additional loss (gain) recognized due to:				
Settlement [(a)]	$10	$—	$—	$—
Curtailment [(b)]	$—	$—	$(5)	$—

(a) Loss is a result of settlement transactions from a non-funded plan which exceeded the sum of annual service and interest costs for that plan. The loss was recorded in unallocated General and administrative expenses.

(b) Gain is a result of terminating future service benefits for all participants in one of our UK plans. The gain was recorded in YRI's General and administrative expenses.

We made no contributions to the Plan during the quarter ended March 23, 2013. While we are not required to make any contributions to the Plan in 2013, we may choose to make additional discretionary contributions as part of our overall capital structure strategy. We do not anticipate making any significant contributions to any plan outside of the U.S. in 2013.

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Note 11 - Derivative Instruments

The Company is exposed to certain market risks relating to its ongoing business operations. The primary market risks managed by using derivative instruments are interest rate risk and cash flow volatility arising from foreign currency fluctuations.

We enter into interest rate swaps with the objective of reducing our exposure to interest rate risk and lowering interest expense for a portion of our fixed-rate debt. At March 23, 2013, our interest rate derivative instruments outstanding had notional amounts of $300 million and have been designated as fair value hedges of a portion of our debt. These fair value hedges meet the shortcut method requirements and no ineffectiveness has been recorded.

We enter into foreign currency forward contracts with the objective of reducing our exposure to cash flow volatility arising from foreign currency fluctuations associated with certain foreign currency denominated intercompany short-term receivables and payables. The notional amount, maturity date, and currency of these contracts match those of the underlying receivables or payables. For those foreign currency exchange forward contracts that we have designated as cash flow hedges, we measure ineffectiveness by comparing the cumulative change in the fair value of the forward contract with the cumulative change in the fair value of the hedged item. At March 23, 2013, foreign currency forward contracts outstanding had a total notional amount of $533 million.

The fair values of derivatives designated as hedging instruments as of March 23, 2013 and December 29, 2012 were:

	3/23/2013	12/29/2012	Condensed Consolidated Balance Sheet Location
Interest Rate Swaps - Asset	$22	$24	Other assets
Foreign Currency Forwards - Asset	2	—	Prepaid expenses and other current assets
Foreign Currency Forwards - Liability	(5)	(5)	Accounts payable and other current liabilities
Total	$19	$19	

The unrealized gains associated with our interest rate swaps that hedge the interest rate risk for a portion of our debt have been reported as an addition of $20 million to Long-term debt at March 23, 2013 and as an addition of $22 million to Long-term debt at December 29, 2012. During the quarters ended March 23, 2013 and March 24, 2012, Interest expense, net was reduced by $2 million and $4 million, respectively, for recognized gains on interest rate swaps.

Changes in fair value of derivative instruments:

	Quarter	
	3/23/2013	3/24/2012
Beginning of Year Balance	$19	$34
Changes in fair value recognized into OCI	2	(5)
Changes in fair value recognized into income	(1)	2
Cash receipts	(1)	(7)
Ending Balance	$19	$24

For our foreign currency forward contracts the following effective portions of gains and losses were recognized into Accumulated OCI and reclassified into income from Accumulated OCI in the quarters ended March 23, 2013 and March 24, 2012:

	Quarter ended	
	3/23/2013	3/24/2012
Gains (losses) recognized into Accumulated OCI, net of tax	$1	$(4)
Gains (losses) reclassified from Accumulated OCI into income, net of tax	$—	$(3)

The gains/losses reclassified from Accumulated OCI into income were recognized as Other income (expense) in our Condensed Consolidated Statement of Income, largely offsetting foreign currency transaction losses/gains recorded when the related intercompany receivables and payables were adjusted for foreign currency fluctuations. Changes in fair values of the foreign currency forwards recognized directly in our results of operations either from ineffectiveness or exclusion from effectiveness testing were insignificant in the quarters ended March 23, 2013 and March 24, 2012.

Additionally, we had a net deferred loss of $11 million, net of tax, as of March 23, 2013 within Accumulated OCI due primarily to treasury locks and forward-starting interest rate swaps that were cash settled in prior years. The majority of this loss arose from the 2007 settlement of forward starting interest rate swaps entered into prior to the issuance of our Senior Unsecured Notes due in 2037, and is being recognized in interest expense through 2037 consistent with interest payments made on the related Senior Unsecured Notes. In the quarters ended March 23, 2013 and March 24, 2012, an insignificant amount was reclassified from Accumulated OCI to Interest expense, net as a result of these previously settled cash flow hedges.

As a result of the use of derivative instruments, the Company is exposed to risk that the counterparties will fail to meet their contractual obligations. To mitigate counterparty credit risk, we only enter into contracts with carefully selected major financial institutions based upon their credit ratings and other factors, and continually assess the creditworthiness of counterparties. At March 23, 2013, all of the counterparties to our interest rate swaps and foreign currency forwards had investment grade ratings according to the three major ratings agencies. To date, all counterparties have performed in accordance with their contractual obligations.

Note 12 - Fair Value Disclosures

Recurring Fair Value Measurements

The following table presents the fair values for those assets and liabilities measured at fair value on a recurring basis and the level within the fair value hierarchy in which the measurements fall. No transfers among the levels within the fair value hierarchy occurred during the quarter ended March 23, 2013.

	Fair Value Level	3/23/2013	12/29/2012
Foreign Currency Forwards, net	2	$(3)	$(5)
Interest Rate Swaps, net	2	22	24
Other Investments	1	18	17
Total		$37	$36

The fair value of the Company’s foreign currency forwards and interest rate swaps were determined based on the present value of expected future cash flows considering the risks involved, including nonperformance risk, and using discount rates appropriate for the duration based upon observable inputs. The other investments include investments in mutual funds, which are used to offset fluctuations in deferred compensation liabilities where employees have chosen to invest in phantom shares of a Stock Index Fund or Bond Index Fund. The other investments are classified as trading securities in Other assets in our Condensed Consolidated Balance Sheets and their fair value was determined based on the closing market prices of the respective mutual funds as of March 23, 2013 and December 29, 2012.

At March 23, 2013 the carrying values of cash and cash equivalents, short-term investments, accounts receivable and accounts payable approximated their fair values because of the short-term nature of these instruments. The fair value of notes receivable net of allowances and lease guarantees less subsequent amortization approximates their carrying value. The Company’s debt obligations, excluding capital leases, were estimated to have a fair value of $3.2 billion (Level 2), compared to their carrying value of $2.8 billion. We estimated the fair value of debt using market quotes and calculations based on market rates.

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Non-Recurring Fair Value Measurements

(Gains) losses recognized from all non-recurring fair value measurements during the quarters ended March 23, 2013 and March 24, 2012:

	Quarter ended	
	March 23, 2013	March 24, 2012
Pizza Hut UK refranchising impairment (Level 2) [(a)]	$—	$20
Little Sheep acquisition gain (Level 2) [(a)]	—	(74)
Total	$—	$(54)

(a) See Note 4 for further discussions of the Pizza Hut UK dine-in refranchising and the acquisition of Little Sheep.

Note 13 - Guarantees, Commitments and Contingencies

Lease Guarantees

As a result of (a) assigning our interest in obligations under real estate leases as a condition to the refranchising of certain Company restaurants; (b) contributing certain Company restaurants to unconsolidated affiliates; and (c) guaranteeing certain other leases, we are frequently contingently liable on lease agreements. These leases have varying terms, the latest of which expires in 2066. As of March 23, 2013, the potential amount of undiscounted payments we could be required to make in the event of non-payment by the primary lessees was approximately $750 million. The present value of these potential payments discounted at our pre-tax cost of debt at March 23, 2013 was approximately $675 million. Our franchisees are the primary lessees under the vast majority of these leases. We generally have cross-default provisions with these franchisees that would put them in default of their franchise agreement in the event of non-payment under the lease. We believe these cross-default provisions significantly reduce the risk that we will be required to make payments under these leases. Accordingly, the liability recorded for our probable exposure under such leases at March 23, 2013 was not material.

Franchise Loan Pool and Equipment Guarantees

We have agreed to provide financial support, if required, to a variable interest entity that operates a franchisee lending program used primarily to assist franchisees in the development of new restaurants in the U.S. and, to a lesser extent, in connection with the Company's refranchising programs. We have provided guarantees of $37 million in support of the franchisee loan program at March 23, 2013. Loans outstanding under the loan pool totaled $53 million at March 23, 2013 with an additional $27 million available for lending at March 23, 2013. We have determined that we are not required to consolidate this entity as we share the power to direct this entity's lending activity with other parties.

In addition to the guarantee program described above, YUM has provided guarantees of $54 million on behalf of franchisees for several financing programs related to specific initiatives. The total loans outstanding under these financing programs were approximately $70 million at March 23, 2013.

Insurance Programs

We are self-insured for a substantial portion of our current and prior years' loss exposures including workers' compensation, employment practices liability, general liability, automobile liability, product liability and property losses (collectively, "property and casualty losses"). To mitigate the cost of our exposures for certain property and casualty losses, we self-insure the risks of loss up to defined maximum per occurrence retentions on a line-by-line basis. The Company then purchases insurance coverage, up to a certain limit, for losses that exceed the self-insurance per occurrence retention. The insurers' maximum aggregate loss limits are significantly above our actuarially-determined probable losses; therefore, we believe the likelihood of losses exceeding the insurers' maximum aggregate loss limits is remote. As of March 23, 2013 and December 29, 2012, we had liabilities recorded for self-insured property and casualty losses of $137 million and $142 million, respectively.

In the U.S. and in certain other countries, we are also self-insured for healthcare claims and for long-term disability claims for eligible participating employees subject to certain deductibles and limitations. We have accounted for our retained liabilities for property and casualty losses, healthcare and long-term disability claims, including both reported and incurred but not reported claims, based on information provided by independent actuaries.

Due to the inherent volatility of actuarially-determined property and casualty loss estimates, it is reasonably possible that we could experience changes in estimated losses which could be material to our growth in quarterly and annual Net Income. We believe that we have recorded reserves for property and casualty losses at a level which has substantially mitigated the potential negative impact of adverse developments and/or volatility.

Legal Proceedings

We are subject to various claims and contingencies related to lawsuits, real estate, environmental and other matters arising in the normal course of business. An accrual is recorded with respect to claims or contingencies for which a loss is determined to be probable and reasonably estimable.

Beginning on January 24, 2013 four purported class actions were filed in the United States District Court for the Central District of California against the Company and certain of its executive officers. The complaints allege claims under sections 10(b) and 20(a) of the Securities Exchange Act of 1934 against defendants on behalf of a purported class of all persons who purchased or otherwise acquired the Company's publicly traded securities between October 9, 2012 and January 7, 2013, inclusive (the “class period”). Plaintiffs allege that during the class period, defendants purportedly made materially false and misleading statements concerning the Company's current and future business and financial condition, thereby inflating the prices at which the Company's securities traded. The complaints seek damages in an undefined amount. On March 25, 2013, two prospective lead plaintiffs filed motions seeking consolidation of the four actions, appointment as lead plaintiff, and approval of their selection of counsel. In addition, on March 26, 2013, the Company filed a motion to transfer venue to the United States District Court for the Western District of Kentucky. These motions are currently pending before the court. The Company denies liability and intends to vigorously defend against all claims in these complaints. A reasonable estimate of the amount of any possible loss or range of loss cannot be made at this time.

On January 24, 2013, a purported shareholder of the Company submitted a letter demanding that the board of directors initiate an investigation of alleged breaches of fiduciary duties by directors, officers and employees of the Company. The breaches of fiduciary duties are alleged to have arisen as a result of, among other alleged misconduct, the failure to implement proper controls in connection with the Company's purchases of poultry from suppliers to the Company's China operations. Since that time, several similar additional letters by other purported shareholders have been submitted to the Company. Those letters have been referred to a committee of the Board of Directors for consideration.

On February 8, 2013, another purported shareholder of the Company filed a derivative action in the United States District Court for the Central District of California against various officers and directors of the Company asserting breaches of fiduciary duty in connection with an alleged scheme to mislead investors about the Company's growth prospects in China. The shareholder plaintiff did not first submit a demand on the board of directors of the Company to bring this action as required under North Carolina law, and on February 13, 2013 the shareholder plaintiff requested voluntary dismissal of the complaint. The parties are awaiting the court's approval of this request. Following the request for voluntary dismissal, the shareholder also submitted a letter similar to the letters described in the previous paragraph.

Taco Bell was named as a defendant in a number of putative class action suits filed in 2007, 2008, 2009 and 2010 alleging violations of California labor laws including unpaid overtime, failure to timely pay wages on termination, failure to pay accrued vacation wages, failure to pay minimum wage, denial of meal and rest breaks, improper wage statements, unpaid business expenses, wrongful termination, discrimination, conversion and unfair or unlawful business practices in violation of California Business & Professions Code §17200. Some plaintiffs also seek penalties for alleged violations of California's Labor Code under California's Private Attorneys General Act as well as statutory “waiting time” penalties and allege violations of California's Unfair Business Practices Act. Plaintiffs seek to represent a California state-wide class of hourly employees.

On May 19, 2009 the court granted Taco Bell's motion to consolidate these matters, and the consolidated case is styled In Re Taco Bell Wage and Hour Actions. The In Re Taco Bell Wage and Hour Actions plaintiffs filed a consolidated complaint in June 2009, and in March 2010 the court approved the parties' stipulation to dismiss the Company from the action. Plaintiffs filed their motion for class certification on the vacation and final pay claims in December 2010, and on September 26, 2011 the court issued its order denying the certification of the vacation and final pay claims. Plaintiffs then sought to certify four separate meal and rest break classes. On January 2, 2013, the District Court rejected three of the proposed classes but granted certification with respect to the late meal break class.

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. A reasonable estimate of the amount of any possible loss or range of loss cannot be made at this time.

On September 28, 2009, a putative class action styled Marisela Rosales v. Taco Bell Corp. was filed in Orange County Superior Court. The plaintiff, a former Taco Bell crew member, alleges that Taco Bell failed to timely pay her final wages upon termination and seeks restitution and late payment penalties on behalf of herself and similarly situated employees. This case appears to be duplicative of the In Re Taco Bell Wage and Hour Actions case described above. Taco Bell filed a motion to dismiss, stay or transfer the case to the same district court as the In Re Taco Bell Wage and Hour Actions case. The state court granted Taco Bell's motion to stay the Rosales case on May 28, 2010. After the September 2011 denial of class certification in the In Re Taco Bell Wage and Hour Actions, the court granted plaintiff leave to amend her lawsuit, which plaintiff filed and served on January 4, 2012. Taco Bell filed its responsive pleading on February 8, 2012, and plaintiff has since filed two additional amended complaints. Taco Bell has answered the Third Amended Complaint and commenced discovery.

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. A reasonable estimate of the amount of any possible loss or range of loss cannot be made at this time.

On December 17, 2002, Taco Bell was named as the defendant in a class action lawsuit filed in the United States District Court for the Northern District of California styled Moeller, et al. v. Taco Bell Corp. On August 4, 2003, plaintiffs filed an amended complaint alleging, among other things, that Taco Bell has discriminated against the class of people who use wheelchairs or scooters for mobility by failing to make its approximately 200 Company-owned restaurants in California accessible to the class. Plaintiffs contend that queue rails and other architectural and structural elements of the Taco Bell restaurants relating to the path of travel and use of the facilities by persons with mobility-related disabilities do not comply with the U.S. Americans with Disabilities Act (the “ADA”), the Unruh Civil Rights Act (the “Unruh Act”), and the California Disabled Persons Act (the “CDPA”). Plaintiffs have requested: (a) an injunction from the District Court ordering Taco Bell to comply with the ADA and its implementing regulations; (b) that the District Court declare Taco Bell in violation of the ADA, the Unruh Act, and the CDPA; and (c) monetary relief under the Unruh Act or CDPA. Plaintiffs, on behalf of the class, are seeking the minimum statutory damages per offense of either $4,000 under the Unruh Act or $1,000 under the CDPA for each aggrieved member of the class. Plaintiffs contend that there may be in excess of 100,000 individuals in the class. In February 2004, the District Court granted plaintiffs' motion for class certification. The class included claims for injunctive relief and minimum statutory damages.

In May 2007, a hearing was held on plaintiffs' Motion for Partial Summary Judgment seeking judicial declaration that Taco Bell was in violation of accessibility laws as to three specific issues: indoor seating, queue rails and door opening force. In August 2007, the court granted plaintiffs' motion in part with regard to dining room seating. In addition, the court granted plaintiffs' motion in part with regard to door opening force at some restaurants (but not all) and denied the motion with regard to queue lines.

On December 16, 2009, the court denied Taco Bell's motion for summary judgment on the ADA claims and ordered plaintiffs to select one restaurant to be the subject of a trial. The trial for the exemplar restaurant began on June 6, 2011, and on October 5, 2011 the court issued Findings of Fact and Conclusions of Law ruling that plaintiffs established that classwide injunctive relief was warranted with regard to maintaining compliance as to corporate Taco Bell restaurants in California. The court declined to order injunctive relief at the time, however, citing the pendency of Taco Bell's motions to decertify both the injunctive and damages class. The court also found that twelve specific items at the exemplar store were once out of compliance with applicable state and/or federal accessibility standards.

Taco Bell filed a motion to decertify the class in August 2011, and in July 2012, the court granted Taco Bell's motion to decertify the previously certified state law damages class but denied Taco Bell's motion to decertify the ADA injunctive relief class. On September 13, 2012, the court set a discovery and briefing schedule concerning the trials of the four individual plaintiffs' state law damages claims, which the court stated will be tried before holding further proceedings regarding the possible issuance of an injunction. On September 17, 2012, the court issued an order modifying its October 2011 Findings of Facts and Conclusions of Law deleting the statement that an injunction was warranted. Plaintiffs appealed that order. Briefing is complete, and a hearing has been scheduled for June 13, 2013.

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. Further, Taco Bell intends to vigorously oppose plaintiffs' appeal. Taco Bell has taken steps to address potential architectural and structural compliance issues at the restaurants in accordance with applicable state and federal disability access laws. The costs associated with addressing these issues have not significantly impacted our results of operations. We have provided for a reasonable estimate of the possible loss relating to this lawsuit. However, in view of the inherent uncertainties of litigation, there can be no assurance that this lawsuit will not result in losses in excess of those currently provided for in our Financial Statements. A reasonable estimate of the amount of any possible loss or range of loss in excess of that currently provided for in our Financial Statements cannot be made at this time.

On July 9, 2009, a putative class action styled Mark Smith v. Pizza Hut, Inc. was filed in the United States District Court for the District of Colorado. The complaint alleged that Pizza Hut did not properly reimburse its delivery drivers for various automobile costs, uniforms costs, and other job-related expenses and seeks to represent a class of delivery drivers nationwide under the Fair Labor Standards Act (FLSA) and Colorado state law. On January 4, 2010, plaintiffs filed a motion for conditional certification of a nationwide class of current and former Pizza Hut, Inc. delivery drivers. However, on March 11, 2010, the court granted Pizza Hut's pending motion to dismiss for failure to state a claim, with leave to amend. On March 31, 2010, plaintiffs filed an amended complaint, which dropped the uniform claims but, in addition to the federal FLSA claims, asserted state-law class action claims under the laws of sixteen different states. Pizza Hut filed a motion to dismiss the amended complaint, and plaintiffs sought leave to amend their complaint a second time. On August 9, 2010, the court granted plaintiffs' motion to amend. Pizza Hut filed another motion to dismiss the Second Amended Complaint. On July 15, 2011, the Court granted Pizza Hut's motion with respect to plaintiffs' state law claims but allowed the FLSA claims to go forward. Plaintiffs filed their Motion for Conditional Certification on August 31, 2011, and the Court granted plaintiffs' motion April 21, 2012. The opt-in period closed on August 23, 2012, and the parties are working to finalize the list of opt-ins. The final number has yet to be determined but is expected to be approximately 6,000.

Pizza Hut denies liability and intends to vigorously defend against all claims in this lawsuit. A reasonable estimate of the amount of any possible loss or range of loss cannot be made at this time.

On August 6, 2010, a putative class action styled Jacquelyn Whittington v. Yum Brands, Inc., Taco Bell of America, Inc. and Taco Bell Corp. was filed in the United States District Court for the District of Colorado. The plaintiff seeks to represent a nationwide class, with the exception of California, of salaried assistant managers who were allegedly misclassified and did not receive compensation for all hours worked and did not receive overtime pay after 40 hours worked in a week. The plaintiff also purports to represent a separate class of Colorado assistant managers under Colorado state law, which provides for daily overtime after 12 hours worked in a day. The Company has been dismissed from the case without prejudice. Taco Bell filed its answer on September 20, 2010, and the parties commenced class discovery, which is currently on-going. On September 16, 2011, plaintiffs filed their motion for conditional certification under the FLSA. The court heard plaintiffs' motion for conditional certification under the FLSA on January 10, 2012, granted conditional certification and ordered the notice of the opt-in class be sent to the putative class members. Approximately 488 individuals submitted opt-in forms. The court granted Taco Bell's request for written and deposition discovery of the class. After further discovery, Taco Bell plans to seek decertification of the class. The plaintiffs are no longer pursuing their alleged Colorado state law claims.

Taco Bell denies liability and intends to vigorously defend against all claims in this lawsuit. We have provided for a reasonable estimate of the possible loss relating to this lawsuit. However, in view of the inherent uncertainties of litigation, there can be no assurance that this lawsuit will not result in losses in excess of those currently provided for in our Financial Statements. A reasonable estimate of the amount of any possible loss or range of loss in excess of that currently provided for in our Financial Statements cannot be made at this time.
On July 27, 2012, a putative class action lawsuit, styled Agustine Castillo v. Taco Bell of America, LLC and Taco Bell Corp., was filed in the United States District Court for the Eastern District of New York. The plaintiff seeks to represent a nationwide class of salaried assistant general managers who were allegedly misclassified and did not receive compensation for all hours worked and did not receive overtime pay after 40 hours worked in a week. The plaintiff also seeks to represent a statewide class of salaried assistant general managers who allegedly did not receive compensation for all hours worked. The plaintiff's counsel in this action is the same as plaintiffs' counsel in the Whittington lawsuit. On January 4, 2013, Taco Bell filed a motion to dismiss or stay the action. On March 18, 2013, the court granted Taco Bell's motion to dismiss as to the putative class. Thereafter, the three individually-named plaintiffs dismissed their individual actions, and the matter is finally closed.

We are engaged in various other legal proceedings and have certain unresolved claims pending, the ultimate liability for which, if any, cannot be determined at this time. However, based upon consultation with legal counsel, we are of the opinion that such proceedings and claims are not expected to have a material adverse effect, individually or in the aggregate, on our Financial Statements.

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

Introduction and Overview

The following Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited Condensed Consolidated Financial Statements ("Financial Statements"), the Cautionary Note Regarding Forward-Looking Statements and our annual report on Form 10-K for the fiscal year ended December 29, 2012 ("2012 Form 10-K"). Throughout the MD&A, YUM! Brands, Inc. ("YUM" or the "Company") makes reference to certain performance measures as described below.

- The Company provides the percentage changes excluding the impact of foreign currency translation ("FX" or "Forex"). These amounts are derived by translating current year results at prior year average exchange rates. We believe the elimination of the foreign currency translation impact provides better year-to-year comparability without the distortion of foreign currency fluctuations.
- System sales growth includes the results of all restaurants regardless of ownership, including Company-owned, franchise, unconsolidated affiliate and license restaurants that operate our concepts, except for non-company-owned restaurants for which we do not receive a sales-based royalty. Sales of franchise, unconsolidated affiliate and license restaurants generate ongoing franchise and license fees for the Company (typically at a rate of 4% to 6% of sales). Franchise, unconsolidated affiliate and license restaurant sales are not included in Company sales on the Condensed Consolidated Statements of Income; however, the franchise and license fees are included in the Company's revenues. We believe system sales growth is useful to investors as a significant indicator of the overall strength of our business as it incorporates all of our revenue drivers, Company and franchise same-store sales as well as net unit development.
- Same-store sales is the estimated growth in system sales of all restaurants that have been open and in the YUM system one year or more.
- Company restaurant profit is defined as Company sales less expenses incurred directly by our Company restaurants in generating Company sales. Company restaurant margin as a percentage of sales is defined as Company restaurant profit divided by Company sales.
- Operating margin is defined as Operating Profit divided by Total revenues.

All Note references herein refer to the accompanying Notes to the Financial Statements. Tabular amounts are displayed in millions of U.S. dollars except per share and unit count amounts, or as otherwise specifically identified. Percentages may not recompute due to rounding.

Description of Business

YUM is the world's largest quick-service restaurant ("QSR") company in terms of system restaurants, with over 39,000 restaurants in more than 130 countries and territories operating primarily under the KFC, Pizza Hut or Taco Bell brands. The Company's primary restaurant brands – KFC, Pizza Hut and Taco Bell – are the global leaders in the quick-service chicken, pizza and Mexican-style food categories, respectively. Of the over 39,000 restaurants, 75% are operated by franchisees and unconsolidated affiliates, 20% are operated by the Company and 5% are operated by licensees.

YUM's business consists of four reporting segments: YUM China ("China" or "China Division"), YUM Restaurants International ("YRI" or "International Division"), United States ("U.S." or "U.S. Division") and YUM Restaurants India ("India" or "India Division"). The China Division includes mainland China and the India Division includes India, Bangladesh, Mauritius, Nepal and Sri Lanka. YRI includes the remainder of our international operations. The China Division, YRI and Taco Bell-U.S. now represent approximately 85% of the Company's segment operating profits.

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Strategies

The Company continues to focus on four key strategies:

Build Leading Brands in China in Every Significant Category – The Company has developed the KFC and Pizza Hut brands into the leading quick service and casual dining restaurant brands, respectively, in mainland China. Additionally, the Company owns and operates the distribution system for its restaurants in China which we believe provides a significant competitive advantage. Given this strong competitive position, a growing economy and a population of 1.3 billion in mainland China, the Company is rapidly adding KFC and Pizza Hut Casual Dining restaurants and testing the additional restaurant concepts of Pizza Hut Home Service (pizza delivery) and East Dawning (Chinese food). Additionally, on February 1, 2012 we acquired an additional 66% interest in Little Sheep Group Ltd. ("Little Sheep"), a leading casual dining concept in China. This acquisition brought our total ownership to approximately 93% of the business. Our ongoing earnings growth model in China includes double-digit percentage unit growth, mid-teen system sales growth, mid-single digit same-store sales growth and moderate leverage of our General and Administrative (“G&A”) infrastructure, which we expect to drive Operating Profit growth of 15%.

Drive Aggressive International Expansion and Build Strong Brands Everywhere – Outside the U.S. and China the Company and its franchisees opened over 1,000 new restaurants in 2012, representing 13 straight years of opening over 700 restaurants, and the Company is one of the leading international retail developers in terms of units opened. The Company expects to continue to experience strong growth by building out existing markets and growing in new markets including India, France, Germany, Russia and across Africa. The International Division’s Operating Profit has experienced a 10-year compound annual growth rate of 12%. Our ongoing earnings growth model for YRI includes Operating Profit growth of 10% driven by 3-4% unit growth, system sales growth of 6%, at least 2-3% same-store sales growth, margin improvement and leverage of our G&A infrastructure.

Dramatically Improve U.S. Brand Positions, Consistency and Returns – The Company continues to focus on improving its U.S. position through differentiated products and marketing and an improved customer experience. The Company also strives to provide industry-leading new product innovation which adds sales layers and expands day parts. We continue to evaluate our returns and ownership positions with an earn-the-right-to-own philosophy on Company-owned restaurants. Our ongoing earnings growth model for the U.S. calls for Operating Profit growth of 5% driven by same-store sales growth of at least 2%, margin improvement and leverage of our G&A infrastructure.

Drive Industry-Leading, Long-Term Shareholder and Franchisee Value – The Company is focused on delivering high returns and returning substantial cash flows to its shareholders via dividends and share repurchases. The Company has one of the highest returns on invested capital in the QSR industry. The Company’s dividend and share repurchase programs have returned over $2.8 billion and $7.8 billion to shareholders, respectively, since 2004. The Company targets an annual dividend payout ratio of 35% to 40% of net income and has increased the quarterly dividend at a double-digit percentage rate each year since first initiating a dividend in 2004. Shares are repurchased opportunistically as part of our regular capital structure decisions.

The ongoing earnings growth rates referenced above represent our average annual targets for the next several years. Consistent with these ongoing earnings growth rates, in December 2012 we indicated our expectation of at least 10% EPS growth for 2013. We have subsequently lowered our 2013 full year expectations. See the China Poultry Supply Situation and Avian Flu section within the Significant Known Events, Trends or Uncertainties Impacting or Expected to Impact Comparisons of Reported or Future Results section of this MD&A for further discussion.

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Quarter Ended March 23, 2013 Highlights

China Division sales and profits were significantly impacted by adverse publicity from the poultry supply situation that occurred in late December 2012.

Worldwide system sales grew 1%, prior to foreign currency translation, including 4% at Yum! Restaurants International (YRI) and 2% in the U.S. System sales declined 9% in China.

Same-store sales declined 20% in China. Same-store sales grew 1% at YRI and 2% in the U.S.

Total international development was 380 new restaurants; 88% of this development occurred in emerging markets.

Worldwide restaurant margin declined 2.7 percentage points to 15.9%, including a decline of 7.0 percentage points in China. Restaurant margin increased 1.4 percentage points at YRI and 2.4 percentage points in the U.S.

Worldwide operating profit declined 14%, prior to foreign currency translation, including a 41% decline in China. Operating profit grew 19% at YRI and 5% in the U.S.

Worldwide effective tax rate, prior to Special Items, decreased to 26.0% from 27.5%. The decrease in the tax rate positively impacted EPS growth by 2 percentage points.

All preceding comparisons are versus the same period a year ago and exclude the impact of Special Items. See the Significant Known Events, Trends or Uncertainties Impacting or Expected to Impact Comparisons of Reported or Future Results section of this MD&A for a description of Special Items.

Results of Operations

	Quarter ended		
	3/23/2013	3/24/2012	% B/(W)
Company sales	$2,099	$2,344	(10)
Franchise and license fees and income	436	399	9
Total revenues	$2,535	$2,743	(8)
Company restaurant profit	$333	$440	(24)
% of Company sales	15.9 %	18.8 %	(2.9) ppts.
Operating Profit	$487	$645	(25)
Interest expense, net	31	37	16
Income tax provision	120	147	18
Net Income – including noncontrolling interests	$336	$461	

0.4%

% of net revenue 4.9% 4.3% 5.0% 4.5%

Selling and marketing expense decreased for the three months ended October 27, 2012 by $2.1 million, compared to the three months ended October 29, 2011. The decrease primarily reflects lower expenses for contractor services and other professional services as we continue to tightly manage this spending.

Selling and marketing expense increased for the nine months ended October 27, 2012 by $0.5 million, compared to the nine months ended October 29, 2011. The increase was primarily attributable to increased trade show and marketing communication activities, which were partially offset by lower expenses for contractor and other professional services.

We currently expect that selling and marketing expense for the three months ending February 2, 2013 will be higher than the level of expense reported for the three months ended October 27, 2012. This is driven primarily by the additional week in our quarter ending February 2, 2013, due to the timing of our fiscal calendar.

General and Administrative

	Three Months Ended			Nine Months Ended		
	October 27, 2012	October 29, 2011	% Change	October 27, 2012	October 29, 2011	% Change
	(in thousands, except percentage)					
General and administrative	$ 24,514	$ 29,021	(15.5)%	$ 75,937	$ 77,436	(1.9)%
% of net revenue	3.1%	3.0%		3.2%	2.9%	

General and administrative expense for the three and nine months ended October 27, 2012 decreased by $4.5 million and $1.5 million, respectively, compared to the three and nine months ended October 29, 2011. These decreases were due primarily to lower share-based compensation expense combined with lower legal expenses as legal expenses in the comparable period included certain legal settlements.

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We currently expect that general and administrative expense for the three months ending February 2, 2013 will be higher than the level of expense reported for the three months ended October 27, 2012. This is driven primarily by the additional week in our quarter ending February 2, 2013, due to the timing of our fiscal calendar.

Amortization and Write-Off of Acquired Intangible Assets

	Three Months Ended			Nine Months Ended		
	October 27, 2012	October 29, 2011	% Change	October 27, 2012	October 29, 2011	% Change
	(in thousands, except percentage)					
Amortization and write-off of acquired intangible assets	$ 13,054	$ 11,155	17.0%	$ 40,432	$ 36,634	10.4%
% of net revenue	1.7%	1.2%		1.7%	1.4%	

Amortization and write-off of acquired intangible assets for the three and nine months ended October 27, 2012 increased by $1.9 million and $3.8 million, respectively, as compared to the three and nine months ended October 29, 2011. These increases were primarily due to the intangible assets acquired in the fourth quarter of fiscal 2012 from a small acquisition. Also, amortization and write-off of acquired intangible assets for the nine months ended October 27, 2012 included a $0.8 million write-off of in-process research and development related to an abandoned project. These increases were partially offset by certain intangible assets acquired in earlier acquisitions that became fully amortized.

Interest and Other Income, Net

	Three Months Ended			Nine Months Ended		
	October 27, 2012	October 29, 2011	% Change	October 27, 2012	October 29, 2011	% Change
	(in thousands, except percentage)					
Interest and other income, net	$ 2,387	$ 7,729	(69.1)%	$ 9,308	$ 9,575	(2.8)%
% of net revenue	0.3%	0.9%		0.4%	0.3%	

Interest and other income, net, decreased for the three months ended October 27, 2012, compared to the three months ended October 29, 2011 primarily due to the impact of the relative weakening of the U.S. dollar on our foreign currency denominated tax liabilities. This was partially offset by lower interest income in the three and nine months ended October 27, 2012 from lower average cash and investment balances, as well as a lower rate of return.

Interest and other income, net, decreased slightly for the nine months ended October 27, 2012, compared to the nine months ended October 29, 2011 primarily due to lower interest income from lower average cash and investment balances, as well as lower rate of return.

Provision for Income Taxes

	Three Months Ended			Nine Months Ended		
	October 27, 2012	October 29, 2011	% Change	October 27, 2012	October 29, 2011	% Change
	(in thousands, except percentage)					
Provision for income taxes	$ 368	$ 3,994	(90.8)%	$ 3,920	$ 9,340	(58.0)%
% of net revenue	%	0.5%		0.2%	0.3%	

The income tax provision for the three and nine months ended October 27, 2012 included the current income tax liability of $5.9 million and $14.5 million, respectively, which was primarily offset by net reductions in unrecognized tax benefits of $5.5 million in the three months ended October 27, 2012 and $11.5 million in the nine months ended October 27, 2012. These net reductions in unrecognized tax benefits primarily arose from the expiration of statute of limitations and from the settlement of audits in non-U.S. jurisdictions less increases in current unrecognized tax benefit estimates.

The income tax provision for the three and nine months ended October 29, 2011 included the current income tax liability of $5.9 million and $14.2 million, respectively, which was partially offset by a net reduction in unrecognized tax benefits of $2.8 million in the three months ended October 29, 2011 and $6.2 million in the nine months ended October 29, 2011 primarily due to the expiration of the statute of limitations in non-U.S. jurisdictions less increases in current unrecognized tax benefit estimates.

During the next 12 months, it is reasonably possible that the amount of unrecognized tax benefits could decrease due to a potential settlement with tax authorities and/or the expiration of applicable statutes of limitations. However, the amount cannot be reasonably estimated as we will have negotiations with various tax authorities throughout the year.

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Liquidity and Capital Resources

Our principal source of liquidity as of October 27, 2012 consisted of approximately $2.0 billion of cash, cash equivalents and short-term investments. We believe that our existing cash, cash equivalents and short term investments, together with cash generated from operations and from the issuance of common shares through our employee stock option and purchase plans, will be sufficient to cover our working capital needs, capital expenditures, investment requirements, commitments, repurchases of our common shares and payment of quarterly dividends for at least the next 12 months. To the extent that our existing cash, cash equivalents and short-term investments and cash generated by operations are insufficient to fund our future activities, we may need to raise additional funds through public or private debt or equity financing. We may enter into additional acquisitions of businesses, assets, products, technologies or other strategic arrangements in the future, which could also require us to seek debt or equity financing. If we elect to raise additional funds, we may not be able to obtain such funds on a timely basis or on acceptable terms, if at all. If we raise additional funds by issuing additional equity or convertible debt securities, the ownership percentages of existing shareholders would be reduced. In addition, the equity or debt securities that we issue may have rights, preferences or privileges senior to our common shares.

Net Cash Provided by Operating Activities

Net cash provided by operating activities was $524.4 million for the nine months ended October 27, 2012. The cash inflows from operations for the nine months ended October 27, 2012 were due to $458.8 million of net income adjusted for non-cash items and positive working capital changes of $65.6 million. The increase in working capital for the nine months ended October 27, 2012 was primarily driven by a decrease in accounts receivable and inventories due to lower shipments on lower sales combined with a decrease in prepaid expenses and other assets. This positive impact on working capital was partially offset by a decrease in accounts payable caused by lower spending as production activity declined in the latter part of the third quarter of fiscal 2013.

Net cash provided by operating activities was $702.1 million for the nine months ended October 29, 2011. The cash inflows from operations in the nine months ended October 29, 2011 were primarily due to $740.6 million of net income adjusted for non-cash items, offset by a negative effect from changes in working capital.

Net Cash Provided by and (Used in) Investing Activities

Net cash provided by investing activities was $45.9 million for the nine months ended October 27, 2012 compared to net cash used in investing activities of $593.9 million for the nine months ended October 29, 2011. For the nine months ended October 27, 2012, net cash provided by investing activities was primarily generated from the sale and maturities of marketable securities of $1.3 billion less purchases of marketable securities of $1.2 billion. The net cash inflow from marketable securities for the nine months ended October 27, 2012 was partially offset by the purchase of $49.1 million of property and equipment and $10.7 million of IP licenses.

For the nine months ended October 29, 2011, net cash used in investing activities was primarily due to net purchases of marketable securities of $499.7 million. In addition, we paid $62.3 million for the purchase of property and equipment, $18.8 million for acquisitions and $9.6 million for technology licenses.

Net Cash Used in Financing Activities

Net cash used in financing activities was $687.0 million for the nine months ended October 27, 2012 compared to net cash used in financing activities of $1.1 billion for the nine months ended October 29, 2011. For the nine months ended October 27, 2012, net cash used in financing activities was primarily attributable to repurchases under our share repurchase program of 57.3 million of its common shares in the open market for $676.5 million and the payment of our quarterly dividends of $67.0 million. The cash outflow was partially offset by net proceeds of $56.4 million from the issuance of our common shares under our share-based plans less the minimum tax withholding paid on behalf of employees for net share settlements. For the nine months ended October 29, 2011, net cash used in financing activities was primarily attributable to repurchases under our share repurchase program of 74.3 million of its common shares in the open market for $1.2 billion. The cash outflow was partially offset net proceeds of $50.4 million from the issuance of common shares under our share-based plans less the minimum tax withholding paid on behalf of employees for net share settlements.

Subsequent to the end of the quarter through November 21, 2012, we repurchased an additional 1.5 million of our common shares for $11.5 million at an average price per share of $7.68.

Off-Balance Sheet Arrangements

As of October 27, 2012, we did not have any material off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of SEC Regulation S-K.

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Contractual Obligations

We presented our contractual obligations at January 28, 2012 in our Annual Report on Form 10-K for the fiscal year then ended. There has been no material changes outside the ordinary course of business in those obligations during nine months ended October 27, 2012.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

Interest Rate Risk. Our interest rate risk relates primarily to our fixed income short-term investment portfolio as we did not have any outstanding debt as of October 27, 2012. We maintain an investment policy that requires minimum credit ratings, diversification of credit risk and limits the long-term interest rate risk by requiring maturities of generally less than five years. We invest our excess cash primarily in highly liquid debt instruments of the U.S. government and its agencies, time deposits, money market mutual funds, and corporate debt securities. These investments are classified as available-for-sale and, consequently, are recorded on our balance sheets at fair market value with their related unrealized gain or loss reflected as a component of accumulated other comprehensive income in shareholders equity. Investments in both fixed rate and floating rate interest earning securities carry a degree of interest rate risk. Fixed rate securities may have their fair market value adversely impacted due to a rise in interest rates, while floating rate securities may produce less income than predicted if interest rates fall.

To provide an assessment of the interest rate risk associated with our investment portfolio, we performed a sensitivity analysis to determine the impact that an adverse change in interest rates would have on the value of the investment portfolio. Based on investment positions as of October 27, 2012, a hypothetical 100 basis point increase in interest rates across all maturities would result in a $14.9 million decline in the fair market value of the portfolio. Due to our positive cash flow from operations, the relatively short-term nature of our investment portfolio and our ability to hold investments to maturity, such change in fair market value would likely not have resulted in any cash flow impact.

As of October 27, 2012, our investment portfolio included $19.5 million in par value of auction rate securities. Beginning in February 2008, liquidity issues in the global credit markets resulted in a failure of auction rate securities, as the amount of securities submitted for sale in those auctions exceeded the amount of bids. To estimate the fair value of the auction rate securities, we use a discounted cash flow model based on estimated timing and amount of future interest and principal payments. In developing the cash flow model, we consider the credit quality and liquidity of the underlying securities and related issuer, the collateralization of underlying security investments and other considerations. As of October 27, 2012, the fair value of auction rate securities was $1.4 million less than par value and recorded in long-term investments.

Based on our balance of approximately $2.0 billion in cash, cash equivalents and short-term investments, and the fact that we continue to generate positive cash flow on a quarterly basis, we do not anticipate having to sell these securities below par value and do not have the intent to sell these auction rate securities until recovery. Since we consider the impairment to be temporary, we recorded the unrealized loss to accumulated other comprehensive income, a component of shareholders equity.

Investment Risk. We invest in equity instruments of privately held companies for strategic purposes. We account for these investments under the cost method when we do not have the ability to exercise significant influence or control over the operations of these companies and under the equity method when we have the ability to exercise significant influence, but do not have control. Carrying value of these equity investments was $11.4 million at October 27, 2012, and was included in other non-current assets in our balance sheets. We monitor these investments for impairment and make appropriate reductions in carrying value when an impairment is deemed to be other-than-temporary.

Commodity Price Risk. We are subject to risk from fluctuating market prices of certain commodity raw materials, particularly gold, that are incorporated into our end products. Supplies for such commodities may from time-to-time become restricted, or general market factors and conditions may affect the pricing of such commodities. Over the past few years, the price of gold increased significantly and certain of our supply chain partners assessed surcharges to compensate for the rising commodity prices. We are currently restructuring certain manufacturing processes to use copper instead of gold in our products. While we continue to attempt to mitigate the risk of similar increases in commodities-related costs, there can be no assurance that we will be able to successfully safeguard against potential short-term and long-term commodities price fluctuations. We do not enter into formal hedging arrangements to mitigate against commodity risk.

Foreign Currency Exchange Risk. Substantially all of our sales and the majority of our expenses are denominated in U.S. dollars. Since we operate in many countries, we pay certain payroll and other operating expenses in local currencies and these expenses may be higher or lower in U.S. dollar terms. Furthermore, our operation in Israel represents a large portion of our total foreign currency exposure. We may also hold certain assets and liabilities, including potential tax liabilities in local currency on our balance sheet. These tax liabilities would be settled in local currency. Therefore, foreign exchange gains and losses from remeasuring the tax liabilities are recorded to interest and other income,

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net. The related effects of foreign exchange fluctuations on local currency expenses are recorded to operating expenses. Significant fluctuations in exchange rates in countries where we incur expenses or record assets or liabilities in local currency could affect our business and operating results in the future. There is also a risk that our customers may be negatively impacted in their ability to purchase our products priced in U.S. dollars when there has been significant volatility in foreign currency exchange rates.

We engage in hedging transactions to help mitigate some of the volatility to forecasted cash flows due to changes in foreign exchange rates, and in particular hedge a portion of the forecasted Israeli shekel expenses. We enter into certain short-term forward exchange contracts, typically less than 12 months in duration, to hedge exposures for expenses and purchases denominated in foreign currencies when the currency exposure is significant and there is a high certainty of the underlying cash flow. We do not enter into derivative financial instruments for trading or speculative purposes. We may choose not to hedge certain foreign exchange exposures due to immateriality, offsetting exposures, prohibitive economic cost of hedging a particular currency, and limited availability of appropriate hedging instruments. To the extent our foreign currency hedges are effective, the results of the hedge activities offset the underlying expense within the operating expense. De-designated hedges or hedges deemed ineffective are recorded in interest and other income, net. We do not hedge our tax liabilities denominated in local currency on our balance sheet as the timing of these tax liabilities becoming cash flows is not deemed to be certain.

To provide an assessment of the foreign currency exchange risk associated with our foreign currency exposures within operating expense, we performed a sensitivity analysis to determine the impact that an adverse change in exchange rates would have on our financial statements. If the U.S. dollar weakened by 10%, our operating expense could increase by 3.4%. We expect our hedges of foreign currency exposures to be highly effective and offset a significant portion of the short-term impact of changes in exchange rates.

Item 4. ***Controls and Procedures***

Management s Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and our Interim Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act). Our disclosure controls and procedures are designed to ensure that information required to be disclosed is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission (SEC) and that such information is accumulated and communicated to management, including the Chief Executive Officer and Interim Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based on this evaluation, our Chief Executive Officer and Interim Chief Financial Officer concluded that, as of October 27, 2012, our disclosure controls and procedures were effective to provide reasonable assurance.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended October 27, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Limitation on Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. Control systems can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies and procedures may deteriorate. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

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PART II. OTHER INFORMATION

Item 1. ***Legal Proceedings***

The information under the caption Contingencies as set forth in Note 9 Commitments and Contingencies of our notes to unaudited condensed consolidated financial statements, included in Part I, Item 1, is incorporated herein by reference. For additional discussion of certain risks associated with legal proceedings, see Part II, Item 1A, Risk Factors, immediately below.

Item 1A. Risk Factors

Before deciding to purchase, hold or sell our common shares, you should carefully consider the risks described below in addition to the other cautionary statements and risks described elsewhere and the other information contained in this Quarterly Report on Form 10-Q and in our other filings with the SEC, including our Annual Report on Form 10-K for the year ended January 28, 2012 and subsequent reports on Forms 10-Q and 8-K. Many of these risks and uncertainties are beyond our control, including business cycles and seasonal trends of the computing, semiconductor and related industries.

Our financial condition and results of operations may vary from quarter to quarter, which may cause the price of our common shares to decline.

Our quarterly results of operations have fluctuated in the past and could do so in the future. Because our results of operations are difficult to predict, you should not rely on quarterly comparisons of our results of operations as an indication of our future performance.

Fluctuations in our results of operations may be due to a number of factors, including, but not limited to, those listed below and those identified throughout this Risk Factors section:

- changes in general economic and political conditions and specific conditions in the markets we address, including the continuing volatility in the technology sector and semiconductor industry;
- the highly competitive nature of the end markets we serve, and specifically within the semiconductor industry;
- any current and future litigation that could result in substantial costs and a diversion of management s attention and resources that are needed to successfully maintain and grow our business;
- our dependence on a few customers for a significant portion of our revenue;
- our ability to maintain a competitive cost structure for our manufacturing and assembly and test processes, including the impact of changing commodity prices such as the price of gold;
- failure to qualify our products or our suppliers manufacturing lines;
- cancellations, rescheduling or deferrals of significant customer orders or shipments, as well as the ability of our customers to manage inventory;

our ability to develop and introduce new and enhanced products in a timely and effective manner, as well as our ability to anticipate and adapt to changes in technology;

gain or loss of a key customer or design win;

seasonality in sales of consumer devices in which our products are incorporated;

failure to protect our intellectual property;

impact of a significant natural disaster, including earthquakes, floods and tsunamis; and

our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel.

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Due to fluctuations in our quarterly results of operations and other factors, the price at which our common shares will trade is likely to continue to be highly volatile. Accordingly, you may not be able to resell your common shares at or above the price you paid. In future periods, our stock price could decline if, amongst other factors, our revenues or operating results are below our estimates or the estimates or expectations of public market analysts and investors. As a result of stock price volatility, we may be subject to securities class action litigation. Any litigation could result in substantial costs and a diversion of management s attention and resources that are needed to successfully maintain and grow our business.

We operate in the intensely competitive markets, and our failure to compete effectively would harm our results of operations.

The semiconductor industry and specifically the mobile and wireless communications markets are extremely competitive, and we expect competition to intensify as current competitors expand their product offerings and new competitors enter the market. We currently compete with a number of large domestic and international companies in the business of designing integrated circuits and related applications, some of which have greater financial, technical and management resources than us. We expect competition to continue to increase as industry standards continue to evolve and become better known, and others realize the market potential of wired and wireless products and services. For example, we expect to continue seeing increased competition in the TD-SCDMA smartphone market in China. As competition in the markets in which we operate continues to increase, our revenues and gross margins may decline. For example, competitors with greater financial resources may be able to offer lower prices than us, or they may offer additional products, services or other incentives that we may not be able to match. In addition, many of our competitors operate and maintain their own fabrication facilities and have longer operating histories, greater name recognition, larger customer bases, and greater sales, marketing and distribution resources than we do. Furthermore, our current and potential competitors in the mobile and wireless markets have established or may establish financial and strategic relationships among themselves or with existing or potential customers or other third parties to increase the ability of their products to address the needs of customers. Accordingly, new competitors or alliances among these competitors may acquire significant market share, which would harm our business. While we continue to pursue similar strategic relationships, and currently have significant financial and technical resources, we cannot assure you that we will be able to continue to compete successfully against existing or new competitors, which would harm our results of operations.

In addition, the semiconductor providers competing in the mobile and wireless communication markets have recently experienced consolidation. For example, Broadcom Corporation acquired NetLogic Microsystems in February 2011 and Texas Instruments Incorporated acquired National Semiconductor in September 2011. Consolidation among our competitors could lead to a changing competitive landscape, capabilities and market share, which could harm our results of operations.

A significant portion of our business is dependent on the HDD industry, which is highly cyclical, experiences rapid technological change, is subject to industry consolidation and is facing increased competition from alternative technologies.

The HDD industry is intensely competitive, and the technology changes rapidly. This industry has historically been cyclical, with periods of increased demand and rapid growth followed by periods of oversupply and subsequent contraction. These cycles may affect us because some of our customers are participants in this industry.

HDD manufacturers tend to order more components than they may need during growth periods, and sharply reduce orders for components during periods of contraction. Rapid technological changes in the HDD industry often result in shifts in market share among the industry s participants. If the HDD manufacturers using our products do not retain or increase their market share, our sales may decrease.

In addition, the HDD industry has experienced consolidation over the past several years. For example, during fiscal 2010, Toshiba acquired the HDD operations of Fujitsu. In December 2011, Seagate completed the acquisition of Samsung s HDD unit. In March 2012, Western Digital completed the acquisition of Hitachi s HDD unit. Consolidation among our customers could lead to changing demand for our products, replacement of our products by the merged entity with those of our competitors and cancellation of orders, each of which could harm our results of operations. On the other hand, this could lead to increased opportunities for our products within the combined company if we can leverage our technology and customer relationships.

Furthermore, future changes in the nature of information storage products could reduce demand for traditional HDDs. For example, products using alternative technologies, such as solid-state flash drives and other storage technologies could become a source of competition to manufacturers of HDDs. Although we offer SSD controllers, leveraging our technology in hard drives, we cannot ensure we will be able to maintain significant market share if demand for traditional HDDs decreases.

Our business, financial condition and results of operations may be adversely impacted by global economic conditions, which may cause a decline in the market price of our common shares.

We operate in the semiconductor industry, which is cyclical and subject to rapid change and evolving industry standards. From time to time, this industry has experienced significant demand downturns. These downturns are characterized by decreases in product demand, excess

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customer inventories and sometimes accelerated erosion of prices, including as a result of volatile global economic conditions. These factors could cause substantial fluctuations in our net revenue, gross margin, cash flows and results of operations. In addition, during these downturns some competitors may become more aggressive in their pricing practices, which would adversely impact our gross margin. Any downturns in the current environment may be severe and prolonged, and any failure of the markets in which we operate to fully recover from downturns could seriously impact our revenue and harm our business, financial condition and results of operations. The semiconductor industry is also subject to periodic increases in demand and supply constraints, which may affect our ability to ship products. Accordingly, our results of operations may vary significantly as a result of the general conditions in the semiconductor industry, which could cause fluctuations in our stock price.

We cannot predict the timing, strength or duration of any economic slowdown or subsequent global economic recovery in the semiconductor industry. If the economy or markets in which we operate deteriorate from current levels, our business, financial condition and results of operations will likely be materially and adversely affected. Additionally, the combination of our lengthy sales cycle coupled with challenging macroeconomic conditions could adversely impact our results of operations.

We may become involved with costly and lengthy litigation involving our patents and other intellectual property, which could subject us to liability, require us to indemnify our customers, require us to obtain or renew licenses, stop selling our products or force us to redesign our products.

Litigation involving patents and other intellectual property is widespread in the high-technology industry and is particularly prevalent in the semiconductor industry, where a number of companies and other entities aggressively bring numerous infringement claims to assert their patent portfolios. The amount of damages alleged in intellectual property infringement claims can often be very significant. For example, on November 26, 2012, we went to trial with Carnegie Mellon University (CMU) as described in more detail in Note 9 of the notes to our unaudited condensed consolidated financial statements. CMU has alleged past damages in the amount of approximately $1.2 billion through July 2012. If we receive a significant adverse judgment in any litigation matter, our results of operations and financial position will be adversely affected.

From time to time our subsidiaries and customers receive, and may continue to receive in the future, notices that allege claims of infringement, misappropriation or misuse of the intellectual property rights of third parties. In addition to standards-based infringement claims, infringement claims have also been directed against us and our subsidiaries proprietary technologies, particularly those related to storage technology, microprocessors and other circuit components. We have also had certain patent licenses with third parties that have not been renewed, and if we cannot successfully renew these licenses, our subsidiaries and customers could face claims of infringement. These claims could result in litigation and/or claims for indemnification, which, in turn, could subject us to significant liability for damages, attorney s fees and costs. Any potential intellectual property litigation also could force us to do one or more of the following:

- stop selling, offering for sale, making, having made or exporting products or using technology that contains the allegedly infringing intellectual property;

- limit or restrict the type of work that employees involved in such litigation may perform for us;

- pay substantial damages and/or license fees and/or royalties to the party claiming infringement that could adversely impact our liquidity or operating results;

- attempt to obtain or renew licenses to the relevant intellectual property, which licenses may not be available on reasonable terms or at all; and

- attempt to redesign those products that contain the allegedly infringing intellectual property.

We may also be required to indemnify some customers under our contracts if a third party alleges, or a court finds, that our products have infringed upon the proprietary rights of other parties. From time to time, we have agreed to indemnify select customers for claims made against our products, where such claims allege infringement of third party intellectual property rights, including, but not limited to, patents, registered trademarks and/or copyrights. If we are required to make a significant payment under any of our indemnification obligations, our result of operations may be harmed.

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We have been named as a party to several lawsuits and we may be named in additional litigation in the future, all of which could result in an unfavorable outcome and have a material adverse effect on our business, financial condition, results of operations, cash flows, and the trading price for our securities.

We have been named as a party to several lawsuits and we may be named in additional litigation in the future. Please see Note 9 Commitments and Contingencies of our notes to the unaudited condensed consolidated financial statements set forth in Part I, Item 1 of this Quarterly Report on Form 10-Q for a more detailed description of a number of the litigation matters we are currently engaged in. Under certain circumstances, we have contractual and other legal obligations to indemnify and to incur legal expenses on behalf of current and former directors and officers for these lawsuits. In addition, due to the high volatility of our stock price, we may be vulnerable to securities class action litigation. In addition, as a result of a prior SEC settlement, we forfeited for three years our ability to invoke the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995. Because we could not benefit from the statutory safe harbor from June 2008 through June 2011, it may be more difficult for us to defend against any future claims based on any forward-looking statements issued during that timeframe.

The ultimate outcome of any litigation could have a material adverse effect on our business and the trading price for our securities. Litigation may be time-consuming, expensive, and disruptive to normal business operations, and the outcome of litigation is difficult to predict. The defense of these lawsuits may result in significant expenditures and the continued diversion of our management s time and attention from the operation of our business, which could impede our business. In the event we were to receive an unfavorable outcome in any lawsuit, our business, financial condition, results of operations, cash flows and the trading price of our securities may be materially and adversely affected.

We rely on independent foundries and subcontractors for the manufacture, assembly and testing of our integrated circuit products, and the failure of any of these third party vendors to deliver products or otherwise perform as requested could damage our relationships with our customers, decrease our sales and limit our ability to grow our business.

We do not have our own manufacturing or assembly facilities and have very limited in-house testing facilities. Therefore, we currently rely on several third party foundries to produce our integrated circuit products. We also currently rely on several third party assembly and test subcontractors to assemble, package and test our products. This exposes us to a variety of risks, including the following:

Regional Concentration:

Substantially all of our products are manufactured by third party foundries located in Taiwan. Our other sources for manufacturing are located in the U.S., China and Singapore. In addition, substantially all of our third party assembly and testing facilities are located in Singapore, Taiwan, Malaysia and the Philippines. Because of the geographic concentration of these third party foundries, as well as our assembly and test subcontractors, we are exposed to the risk that their operations may be disrupted by regional disasters or by political changes. For example, the risk of an earthquake in Taiwan and elsewhere in the Pacific Rim region is significant due to the proximity of major earthquake fault lines to the facilities of our foundries and assembly and test subcontractors. Taiwan has experienced significant earthquakes in the past and may be subject to additional earthquakes that could disrupt manufacturing operations. In the event of a significant natural disaster or a quarantine or closure that affects our manufacturers in the Pacific Rim, our revenues, cost of goods sold and results of operations would be negatively impacted. In addition, if we were unable to quickly identify alternate manufacturing facilities, we could experience significant delays in product shipments, which could harm our results of operations.

No Guarantee of Capacity or Supply:

The ability of each foundry to provide us with semiconductor devices is limited by its available capacity and existing obligations. In addition, when demand is strong, availability of foundry capacity may be constrained, and with limited exceptions, our vendors are not obligated to perform services or supply products to us for any specific period, in any specific quantities, or at any specific price, except as may be provided in a particular purchase order. For example, in recent years, we experienced some supply shortages due to the difficulties encountered by the foundries in rapidly increasing their production capacities after the recovery from the severe economic down turn from fiscal 2009 to fiscal 2012 due to a rapid increase in demand. Although we have entered into contractual commitments to supply specified levels of products to some of our customers, we may not have sufficient levels of production capacity with all of our foundries. In addition, foundry capacity may not be available when we need it or at reasonable prices. We place our orders on the basis of our customers purchase orders or our forecast of customer demand, and the foundries can allocate capacity to the production of other companies products and reduce deliveries to us on short notice. It is possible that foundry customers that are larger and better financed than we are or that have long-term agreements with our main foundries may induce our foundries to reallocate capacity to those customers. This reallocation could impair our ability to secure the supply of components that we need. Moreover, if any of our third party foundry suppliers are unable to secure necessary raw materials from their suppliers, lose benefits under material agreements, experience power outages, lack sufficient capacity to manufacture our products, encounter financial difficulties or suffer any other disruption or reduction in efficiency, we may encounter supply delays or disruptions, which could harm our business or results of operations.

Despite our strategy to move to a dual source, most of our products are not manufactured at more than one foundry at any given time, and our products typically are designed to be manufactured in a specific process at only one of these foundries. Accordingly, if one of our foundries is unable to provide us with components as needed, it may be difficult for us to transition the manufacture of our products to other foundries, and we could experience significant delays in securing sufficient supplies of those components. This could result in a material decline in revenues, net income and cash flow.

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In order to secure sufficient foundry capacity when demand is high and mitigate the risks described in the foregoing paragraph, we may enter into various arrangements with suppliers that could be costly and harm our results of operations, such as non-refundable deposits with or loans to foundries in exchange for capacity commitments, and contracts that commit us to purchase specified quantities of integrated circuits over extended periods. We may not be able to make any such arrangement in a timely fashion or at all, and any arrangements may be costly, reduce our financial flexibility, and not be on terms favorable to us. Moreover, if we are able to secure foundry capacity, we may be obligated to use all of that capacity or incur penalties. These penalties may be expensive and could harm our financial results.

We are also subject to risk from fluctuating market prices of certain commodity raw materials, particularly gold, that are incorporated into our end products or used by our suppliers to manufacture our end products. Supplies for such commodities may from time-to-time become restricted, or general market factors and conditions may affect pricing of such commodities. Over the past few years, the price of gold increased significantly and certain of our supply chain partners assessed surcharges to compensate for the resultant increase in manufacturing costs. As a result, our gross margins have been adversely affected by significant increases in the price of gold. We are currently restructuring certain manufacturing processes to use copper instead of gold in our products. In transitioning from gold to copper, because the capacity of either wafer producers or assemblers can be limited from time to time, we may be unable to satisfy the demand of our customers, or may have to accept price increases or other compensation arrangements that increase our operating expenses and erode our gross margins. Our results may also be materially affected adversely if we fail to execute successfully or if we experience resistance from our customer base in the transition from gold to copper.

Uncertain Yields and Quality:

The fabrication of integrated circuits is a complex and technically demanding process. Our foundries have from time to time experienced manufacturing defects and reduced manufacturing yields. Changes in manufacturing processes or the inadvertent use of defective or contaminated materials by our foundries could result in lower than anticipated manufacturing yields or unacceptable performance. Many of these problems are difficult to detect at an early stage of the manufacturing process and may be time consuming and expensive to correct. Poor yields from our foundries, or defects, integration issues or other performance problems in our products could cause us significant customer relations and business reputation problems, harm our financial results and result in financial or other damages to our customers. Our customers could also seek damages from us for their losses. A product liability claim brought against us, even if unsuccessful, would likely be time consuming and costly to defend. In addition, defects in our existing or new products could result in significant warranty, support and repair costs, and divert the attention of our engineering personnel from our product development efforts.

To the extent that we rely on outside suppliers to manufacture or assemble and test our products, we may have a reduced ability to control directly product delivery schedules and quality assurance. This lack of control may result in product shortages or quality assurance problems that could delay shipments of products or increase manufacturing, assembly, testing or other costs.

Our sales are concentrated in a few customers, and if we lose or experience a significant reduction in sales to any of these key customers, or if any of these key customers experience a significant decline in market share, our revenues may decrease substantially.

We receive a significant amount of our revenues from a limited number of customers. Net revenue from our three largest customers represented 43% of our net revenue in the nine months ended October 27, 2012. Sales to our largest customers have fluctuated significantly from period to period and year to year primarily due to the timing and number of design wins with each customer, natural disasters that may divert a customer s operations, as well as the continued diversification of our customer base as we expand into new markets, and will likely continue to fluctuate in the future. The loss of any of our large customers or a significant reduction in sales we make to them would likely harm our financial condition and results of operations. Our operating results in the foreseeable future will continue to depend on sales to a relatively small number of customers, as well as the ability of these customers to sell products that incorporate our products. In the future, these customers may decide not to purchase our products at all, purchase fewer products than they did in the past, or alter their purchasing patterns in some other way, particularly because:

- a significant portion of our sales are made on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with relatively short notice to us;

- our customers may purchase integrated circuits from our competitors;

our customers may discontinue sales or lose market share in the markets for which they purchase our products;

our customers may develop their own solutions; or

our customers may be subject to severe business disruptions.

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If we are unable to develop and introduce new and enhanced products that achieve market acceptance in a timely and cost-effective manner, our results of operations and competitive position will be harmed.

Our future success will depend on our ability, in a timely and cost-effective manner, to develop and introduce new products and enhancements to our existing products. We sell products in markets that are characterized by rapid technological change, evolving industry standards, frequent new product introductions, short product life cycles and increasing demand for higher levels of integration and smaller process geometries. In addition, the development of new silicon devices is highly complex, and due to supply chain cross-dependencies and other issues, we may experience delays in completing the development, production and introduction of our new products. Our past sales and profitability have resulted, to a large extent, from our ability to anticipate changes in technology and industry standards and to develop and introduce new and enhanced products incorporating the new standards and technologies. Our ability to adapt to these changes and to anticipate future standards, and the rate of adoption and acceptance of those standards, will be a significant factor in maintaining or improving our competitive position and prospects for growth. If new industry standards emerge that we do not properly anticipate, our products or our customers products could become unmarketable or obsolete, and we could lose market share. We may also have to incur substantial unanticipated costs to comply with these new standards. In addition, our target markets continue to undergo rapid growth and consolidation. A significant slowdown in any of these markets could materially and adversely affect our business, financial condition and results of operations. Our success will also depend on the ability of our customers to develop new products and enhance existing products for the markets they serve and to introduce and promote those products successfully. Even if new and enhanced products are introduced to the market, we and our customers may not be able to achieve market acceptance of them in a timely manner.

In addition, our long-standing relationships with some of our larger customers may also deter other potential customers who compete with these customers from buying our products. To attract new customers or retain existing customers, we may offer certain customers certain price concessions, which could cause our average selling prices and gross margins to decline.

Our gross margin and results of operations may be adversely affected in the future by a number of factors, including decreases in average selling prices of products over time and shifts in our product mix.

The products we develop and sell are primarily used for high volume applications. As a result, the prices of those products have historically decreased rapidly. In addition, more recently introduced products tend to have higher associated costs because of initial overall development and production ramp. Therefore, over time, we may not be able to maintain or improve our gross margins. Our financial results could suffer if we are unable to offset any reductions in our average selling prices by other cost reductions through efficiencies, introduction of higher margin products and other means.

Moreover, because of the wide price differences across the markets we serve, the mix and types of performance capabilities of our products sold may affect the average selling prices of our products and have a substantial impact on our revenue and gross margin. We may enter new markets in which a significant amount of competition exists, and this may require us to sell our products with lower gross margins than our established businesses. Fluctuations in the mix and types of our products may also affect the extent to which we are able to recover the fixed costs and investments associated with a particular product, and as a result can harm our financial results.

Additionally, because we do not operate our own manufacturing, assembly or testing facilities, we may not be able to reduce our costs as rapidly as companies that operate their own facilities, and our costs may even increase, which could also reduce our gross margins. In the past, we have reduced the average selling prices of our products in anticipation of future competitive pricing pressures, new product introductions by us or by our competitors and other factors. We expect that we will continue to have to reduce prices in the future.

We are subject to order and shipment uncertainties, and if we are unable to accurately predict customer demand, we may hold excess or obsolete inventory, which would reduce our gross margin; conversely, we may have insufficient inventory, which would result in lost revenue opportunities and potentially in loss of market share and damaged customer relationships.

We typically sell products pursuant to purchase orders rather than long-term purchase commitments. Customers can generally cancel or defer purchase orders on short notice without incurring a significant penalty. Due to their inability to predict demand or other reasons, some of our customers may accumulate excess inventories and, as a consequence, defer purchase of our products. We cannot accurately predict what or how many products our customers will need in the future. Anticipating demand is difficult because our customers face unpredictable demand for their own products and are increasingly focused more on cash preservation and tighter inventory management. In addition, as an increasing number of our chips are being incorporated into consumer products, we anticipate greater fluctuations in demand for our products, which makes it more difficult to forecast customer demand. We place orders with our suppliers based on forecasts of customer demand and, in some instances, may establish buffer inventories to accommodate anticipated demand. Our forecasts are based on multiple assumptions, each of which may introduce error into our estimates. For example, our ability to accurately forecast customer demand may be impaired by the delays inherent in our lengthy sales cycle. The sales cycle for many of our products is long and requires us to invest significant resources

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with each potential customer without any assurance of sales to that customer. Our sales cycle typically begins with an extended evaluation and test period, also known as qualification, during which our products undergo rigorous reliability testing by our customers. Qualification is typically followed by an extended development period by our customers and an additional three to nine month period before a customer commences volume production of equipment incorporating our products. This lengthy sales cycle creates the risk that our customers will decide to cancel or change product plans for products incorporating our integrated circuits prior to completion, which makes it even more difficult to forecast customer demand.

Our products are incorporated into complex devices and systems, which may create supply chain cross-dependencies. For example, in fiscal 2012, many areas of Thailand sustained massive damage from flooding, which disrupted the global supply chain for HDDs. Due to cross dependencies, any supply chain disruptions could negatively impact the demand for our products in the short term. We have a limited ability to predict the timing of a supply chain correction. In addition, the market share of our customers could be adversely impacted on a long-term basis due to any continued supply chain disruption, which could negatively affect our results of operations.

If we overestimate customer demand, our excess or obsolete inventory may increase significantly, which would reduce our gross margin and adversely affect our financial results. Conversely, if we underestimate customer demand or if insufficient manufacturing capacity is available, we would miss revenue opportunities and potentially lose market share and damage our customer relationships. In addition, any future significant cancellations or deferrals of product orders or the return of previously sold products could materially and adversely affect our profit margins, increase product obsolescence and restrict our ability to fund our operations.

We are exposed to potential impairment charges on certain assets.

We had approximately $2.0 billion of goodwill and $101.9 million of intangible assets on our balance sheet as of October 27, 2012. Under U.S. GAAP, we are required to review our intangible assets including goodwill for impairment whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. We perform an annual assessment of goodwill at the beginning of our fiscal fourth quarter and we also assess the impairment of goodwill on an interim basis whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. We have only one reporting unit, and the fair value of the reporting unit is determined by taking our market capitalization as determined through quoted market prices and adjusted for a control premium and other relevant factors. If our fair value declines to below our carrying value, we could incur significant goodwill impairment charges.

During the three months ended October 27, 2012, we experienced a continued decline in our stock price which caused a substantial reduction in the reporting unit s excess fair value over its net book value. Although we determined the fair value of our company was in excess of our carrying value, and therefore there was no impairment of goodwill as of October 27, 2012, if our stock price declines further and erodes our total market capitalization, we may be required to record an impairment charge in the future that could be material to our operating results.

In addition, from time to time, we have made investments in private companies. If the companies that we invest in are unable to execute their plans and succeed in their respective markets, we may not benefit from such investments, and we could potentially lose the amounts we invest. We evaluate our investment portfolio on a regular basis to determine if impairments have occurred. If the operations of any businesses that we have acquired declines significantly, we could incur significant intangible asset impairment charges. Impairment charges could have a material impact on our results of operations in any period.

If we fail to appropriately scale our operations in response to changes in demand for our existing products or to the demand for new products requested by our customers, our business and profitability could be materially and adversely affected.

To achieve our business objectives, it may be necessary from time to time for us to expand or contract our operations. In the future, we may not be able to scale our workforce and operations in a sufficiently timely manner to respond effectively to changes in demand for our existing products or to the demand for new products requested by our customers. In that event, we may be unable to meet competitive challenges or exploit potential market opportunities, and our current or future business could be materially and adversely affected. Conversely, if we expand our operations and workforce too rapidly in anticipation of increased demand for our products, and such demand does not materialize at the pace at which we expected, the rate of increase in our costs and operating expenses may exceed the rate of increase in our revenue, which would adversely affect our results of operations. In addition, if such demand does not materialize at the pace which we expect, we may be required to scale down our business through expense and headcount reductions as well as facility consolidations or closures that could result in restructuring charges that would materially and adversely affect our results of operations. For example, in order to reduce expenses in the challenging economic environment that began during the second half of fiscal 2009, in late fiscal 2009 and early in fiscal 2010, we implemented certain cost reduction measures to reduce operating expenses. Since that time we have hired a significant numbers of employees primarily in the research and development area. Because many of our expenses are fixed in the short-term or are incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any decrease in customer demand. If customer demand does not increase as anticipated, our profitability could be adversely affected due to our higher expense levels.

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Our past growth has placed, and any future long-term growth is expected to continue to place, a significant strain on our management personnel, systems and resources. To implement our current business and product plans, we will need to continue to expand, train, manage and motivate our workforce. All of these endeavors will require substantial management effort. Although we have an enterprise resource planning system to help us improve our planning and management processes, we anticipate that we will also need to continue to implement and improve a variety of new and upgraded operational and financial systems, as well as additional procedures and other internal management systems. These systems can be time consuming and expensive to implement, increase management responsibilities and divert management attention. If we are unable to effectively manage our expanding operations, we may be unable to scale our business quickly enough to meet competitive challenges or exploit potential market opportunities, or conversely, we may scale our business too quickly and the rate of increase in our costs and expenses may exceed the rate of increase in our revenue, either of which would materially and adversely affect our results of operations.

Costs related to defective products could have a material adverse effect on us.

We have experienced, from time to time, hardware and software defects and bugs associated with the introduction of our highly complex products. We cannot assure you that, despite our testing procedures, errors will not be found in new products or releases after commencement of commercial shipments in the future, which could result in loss of or delay in market acceptance of our products, material recall and replacement costs, delay in revenue recognition or loss of revenues, writing down the inventory of defective products, the diversion of the attention of our engineering personnel from product development efforts, our having to defend against litigation related to defective products or related property damage or personal injury, and damage to our reputation in the industry that could adversely affect our relationships with our customers. In addition, we may have difficulty identifying the end customers of the defective products in the field. As a result, we could incur substantial costs to implement modifications to correct defects. Any of these problems could materially adversely affect our results of operations.

We may experience difficulties in transitioning to smaller geometry process technologies or in achieving higher levels of design integration, which may result in reduced manufacturing yields, delays in product deliveries and increased expenses.

In order to remain competitive, we expect to continue to transition our semiconductor products to increasingly smaller line width geometries. This transition requires us to modify the manufacturing processes for our products and to redesign some products. We periodically evaluate the benefits, on a product-by-product basis, of migrating to smaller geometry process technologies to reduce our costs. In the past, we have experienced some difficulties in shifting to smaller geometry process technologies or new manufacturing processes, which resulted in reduced manufacturing yields, delays in product deliveries and increased expenses. We may face similar difficulties, delays and expenses as we continue to transition our products to smaller geometry processes. We are dependent on our relationships with our foundry subcontractors to transition to smaller geometry processes successfully. We cannot assure you that the foundries that we use will be able to effectively manage the transition or that we will be able to maintain our existing foundry relationships or develop new ones. If we or any of our foundry subcontractors experience significant delays in this transition or fail to efficiently implement this transition, we could experience reduced manufacturing yields, delays in product deliveries and increased expenses, all of which could harm our relationships with our customers and our results of operations. As smaller geometry processes become more prevalent, we expect to continue to integrate greater levels of functionality, as well as customer and third party intellectual property, into our products. However, we may not be able to achieve higher levels of design integration or deliver new integrated products on a timely basis, if at all. Moreover, even if we are able to achieve higher levels of design integration, such integration may have a short-term adverse impact on our results of operations, as we may reduce our revenue by integrating the functionality of multiple chips into a single chip.

As a result of our global operations, we face additional risks, which may harm our results of operations, because a majority of our products and our customers   products are manufactured and sold outside of the United States.

A substantial portion of our business is conducted outside of the United States and, as a result, we are subject to foreign business, political and economic risks. All of our products are manufactured outside of the United States. Our current qualified integrated circuit foundries are located in the same region within Taiwan, and our primary assembly and test subcontractors are located in the Pacific Rim region. In addition, many of our customers are located outside of the United States, primarily in Asia, which further exposes us to foreign risks. Sales to customers located in Asia represented approximately 90% of our net revenue in nine months ended October 27, 2012, 89% of our net revenue in fiscal 2012 and 81% of our net revenue in fiscal 2011.

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We also have substantial operations outside of the U.S. These operations are directly influenced by the political and economic conditions of the region in which they are located, and with respect to Israel, possible military hostilities that could affect our operations there. For example, current hostilities in Israel could cause substantial political unrest in the region, which could lead to a potential economic downturn in Israel. We anticipate that our manufacturing, assembly, testing and sales outside of the United States will continue to account for a substantial portion of our operations and revenue in future periods. Accordingly, we are subject to risks associated with international operations, including:

political, social and economic instability, including wars, terrorism, political unrest, boycotts, curtailment of trade and other business restrictions;

compliance with domestic and foreign export and import regulations, and difficulties in obtaining and complying with domestic and foreign export, import and other governmental approvals, permits and licenses;

local laws and practices that favor local companies, including business practices that we are prohibited from engaging in by the Foreign Corrupt Practices Act and other anti-corruption laws and regulations;

difficulties in staffing and managing foreign operations;

natural disasters, including earthquakes, tsunamis and floods;

trade restrictions or higher tariffs;

transportation delays;

difficulties of managing distributors;

less effective protection of intellectual property than is afforded to us in the United States or other developed countries;

inadequate local infrastructure; and

exposure to local banking, currency control and other financial-related risks.

As a result of having global operations, the sudden disruption of the supply chain and/or the manufacture of our customer s products caused by events outside of our control could impact our results of operations by impairing our ability to timely and efficiently deliver our products. During fiscal 2012, the earthquake and tsunami that affected Japan disrupted the global supply chain for certain components important to our products and the flooding in Thailand affected the supply chain and manufacturing of the products for a number of our customers.

Moreover, the international nature of our business subjects us to risk associated with the fluctuation of the U.S. dollar versus foreign currencies. Decreases in the value of the U.S. dollar versus currencies in jurisdictions where we have large fixed costs or our third party manufacturers have significant cost will increase the cost of such operations, which could harm our results of operations. For example, we have large fixed costs in Israel, which will become greater if the U.S. dollar declines in value versus the Israeli shekel. On the other hand, substantially all of our sales have been denominated in U.S. dollars.

We depend on key personnel to manage our business, and if we are unable to retain our current personnel and hire additional personnel, our ability to develop and successfully market our products could be harmed.

We believe our future success will depend in large part upon our ability to attract and retain highly skilled managerial, engineering, sales and marketing personnel. The loss of key employees or the inability to attract qualified personnel, including hardware and software engineers and sales and marketing personnel could delay the development and introduction of and harm our ability to sell our products. We typically do not enter into employment agreements with any of our key technical personnel, and their knowledge of our business and industry would be extremely difficult to replace.

The competition for qualified technical personnel with significant experience in the design, development, manufacturing, marketing and sales of integrated circuits is intense. Our key technical personnel represent a significant asset and serve as the source of our technological and product innovations. We may not be successful in attracting and retaining sufficient numbers of technical personnel to develop new products or enhance existing products in a timely manner.

We have made and may continue to make acquisitions and investments, which could divert management s attention, cause ownership dilution to our shareholders, be difficult to integrate and adversely affect our results of operations and share price.

We expect to continue to make acquisitions of, and investments in, businesses that offer complementary products and technologies, augment our end market coverage, or enhance our technological capabilities. We may also enter into strategic alliances or joint ventures to

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achieve these goals. We cannot assure you that we will be able to identify suitable acquisition, investment, alliance or joint venture opportunities in the future, or that we will be able to consummate any such transactions or relationships on terms and conditions acceptable to us, or that such transactions or relationships will be successful.

Integrating newly acquired businesses or technologies typically entails many risks that could put a strain on our resources, could be costly and time consuming, and might not be successful. In addition, any acquisitions could materially harm our results of operations or liquidity as a result of either the issuance of dilutive equity securities, new debt or contingent liabilities, or payment of cash. Moreover, such acquisitions could divert our management s attention from other business concerns and also result in customer dissatisfaction. In addition, we might lose key employees of the newly acquired organizations during the acquisition process. The acquisition of another company or its products and technologies may also require us to enter into a geographic or business market in which we have little or no prior experience.

We rely on third party distributors and manufacturers representatives and the failure of these distributors and manufacturers representatives to perform as expected could reduce our future sales.

From time to time, we enter into relationships with distributors and manufacturers representatives to sell our products, and we are unable to predict the extent to which these partners will be successful in marketing and selling our products. Moreover, many of our distributors and manufacturers representatives also market and sell competing products, and may terminate their relationships with us at any time. Our future performance will also depend, in part, on our ability to attract additional distributors or manufacturers representatives that will be able to market and support our products effectively, especially in markets in which we have not previously distributed our products. If we cannot retain or attract quality distributors or manufacturers representatives, our sales and results of operations will be harmed.

Changes in financial accounting standards or practices or existing taxation rules or practices may adversely affect our financial results.

Changes in financial accounting standards or practices or changes in existing taxation rules or practices may have a significant effect on our reported results. New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation practice have occurred and may occur in the future. For example, the U.S. Congress may consider legislation affecting the taxation of foreign corporations and such legislation if enacted might adversely affect our future tax liabilities and have a material impact on our results of operations. Changes to existing rules or the questioning of current practices by regulators may adversely affect our reported financial results or the way we conduct our business or cause our stock price to decline.

Tax benefits that we receive may be terminated or reduced in the future, which would harm our results of operations and profitability.

In prior years, we have entered into agreements with the local governments in certain foreign jurisdictions where we have significant operations to provide us with favorable tax rates in those jurisdictions if certain criteria are met.

We have obtained from the Minister of Finance of Bermuda under the Exempt Undertakings Tax Protection Act 1966, as amended, an undertaking that, in the event Bermuda enacts legislation imposing tax computed on profits, income, or capital asset, gain or appreciation, then the imposition of any such taxes will not apply to us until March 31, 2035. We cannot assure that any future elected Government of Bermuda would not amend the Exempted Undertaking Tax Protection Act 1966 such that tax would be imposed in Bermuda.

The Economic Development Board of Singapore (the EDB) granted Pioneer Status to our wholly-owned subsidiary in Singapore in July 1999. This tax exemption was to expire after ten years, but the EDB in June 2006 agreed to extend the term to 15 years. As a result, we anticipate that a significant portion of the income we earn in Singapore during this period will be exempt from the Singapore income tax. We are required to meet several requirements as to investment, headcount and activities in Singapore to retain this status.

Under the Israeli Encouragement law of approved or benefited enterprise, two branches of Marvell Israel (MISL), the GTL branch and the cellular branch (formerly Marvell DSPC), are entitled to a beneficial tax program that includes reduced tax rates and exemption of certain income. The first program was approved for MISL in 1995 and the most recent was approved in 2003. Marvell DSPC has five approved programs, with the first approved in 1990 and the most recent benefited enterprise approved in 2010. The benefit period is generally 10 to 15 years and begins in the first year in which our Israeli divisions earn taxable income from the approved or benefited enterprises, provided the maximum period has not elapsed. Income from the approved or benefited enterprises is subject to reduced tax rates ranging between 0% and 10% or tax exemptions for fiscal 2008 through 2020. A new amendment to the Encouragement law, which was approved by the Israeli government in December 2011, came into effect January 1, 2012. MISL and DSPC will not apply the new amendment to the Encouragement law prior to fiscal 2023.

During fiscal 2007, our Switzerland subsidiary received a ten-year Federal and Cantonal tax holiday on revenues from research and design and wafer supply trading activities that will expire in 2016. In fiscal 2011, we met the requirements of the initial five year period and we will receive the ongoing tax holiday benefits provided that we continue to meet the ongoing requirements.

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If any of our tax agreements in any of these foreign jurisdictions were terminated, our results of our operations and profitability would be harmed.

We may be unable to protect our intellectual property, which would negatively affect our ability to compete.

We believe one of our key competitive advantages results from our collection of proprietary technologies that we have developed and acquired since our inception. If we fail to protect these intellectual property rights, competitors could sell products based on technology that we have developed that could harm our competitive position and decrease our revenues. We believe that the protection of our intellectual property rights is and will continue to be important to the success of our business. We rely on a combination of patent, copyright, trademark and trade secret laws, as well as nondisclosure agreements and other methods, to protect our proprietary technologies. We also enter into confidentiality or license agreements with our employees, consultants and business partners, and control access to and distribution of our documentation and other proprietary information. We have been issued several U.S. and foreign patents and have a number of pending U.S. and foreign patent applications. However, a patent may not be issued as a result of any applications or, if issued, claims allowed may not be sufficiently broad to protect our technology. In addition, it is possible that existing or future patents may be challenged, invalidated or circumvented. Despite our efforts, unauthorized parties may attempt to copy or otherwise obtain and use our products or proprietary technology. Monitoring unauthorized use of our technology is difficult, and the steps that we have taken may not prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If our patents do not adequately protect our technology, our competitors may be able to offer products similar to ours, which would adversely impact our business and results of operations.

Certain of our software (as well as that of our customers) may be derived from so-called open source software that is generally made available to the public by its authors and/or other third parties. Open source software is often made available under licenses, which impose certain obligations on us in the event we were to distribute derivative works of the open source software. These obligations may require us to make source code for the derivative works available to the public, and/or license such derivative works under a particular type of license, rather than the forms of license customarily used to protect our intellectual property. While we believe we have complied with our obligations under the various applicable licenses for open source software, in the event that the copyright holder of any open source software were to successfully establish in court that we had not complied with the terms of a license for a particular work, we could be required to release the source code of that work to the public and/or stop distribution of that work.

We must comply with a variety of existing and future laws and regulations that could impose substantial costs on us and may adversely affect our business.

We are subject to various state, federal and international laws and regulations governing the environment, including restricting the presence of certain substances in electronic products and making producers of those products financially responsible for the collection, treatment, recycling and disposal of those products. In addition, we are also subject to various industry requirements restricting the presence of certain substances in electronic products. Although our management systems are designed to maintain compliance, we cannot assure you that we have been or will be at all times in complete compliance with such laws and regulations. If we violate or fail to comply with any of them, a range of consequences could result, including fines, import/export restrictions, sales limitations, criminal and civil liabilities or other sanctions.

We and our customers are also subject to various import and export laws and regulations. Government export regulations apply to the encryption or other features contained in some of our products. If we fail to continue to receive licenses or otherwise comply with these regulations, we may be unable to manufacture the affected products at foreign foundries or ship these products to certain customers, or we may incur penalties or fines.

There is also a regulation to improve the transparency and accountability concerning the supply of minerals coming from the conflict zones in and around the Democratic Republic of Congo. New U.S. legislation includes disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries and procedures regarding a manufacturer s efforts to prevent the sourcing of such conflict minerals. The implementation of these requirements could affect the sourcing and availability of minerals used in the manufacture of semiconductor devices. As a result, there may only be a limited pool of suppliers who provide conflict-free metals, and we cannot assure you that we will be able to obtain products in sufficient quantities or at competitive prices.

Future regulations may become more stringent or costly and our compliance costs and potential liabilities could increase, which may harm our business.

There can be no assurance that we will continue to declare cash dividends at all or in any particular amounts.

In May 2012, we announced the declaration of our first quarterly cash dividend. Future payment of a regular quarterly cash dividend on our common shares will be subject to, among other things, the best interests of our shareholders, our results of operations, cash balances and future cash requirements, financial condition, statutory requirements of Bermuda law, and other factors that the board of directors may deem relevant. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in or elimination of our dividend payments could have a negative effect on our share price.

If our internal control over financial reporting or disclosure controls and procedures are not effective, there may be errors in our financial statements that could require a restatement or our filings may not be filed on a timely basis and investors may lose confidence in our reported financial information, which could lead to a decline in our stock price.

We believe that effective internal controls are necessary for us to provide reliable financial reports and effectively prevent fraud. Any inability to provide reliable financial reports or prevent fraud could harm our business. The Sarbanes-Oxley Act of 2002 requires management and our auditors to evaluate and assess the effectiveness of our internal control over financial reporting, as of the end of each year. Our management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in each Annual Report on Form 10-K.

Our management, including our Chief Executive Officer and Interim Chief Financial Officer, does not expect that our internal control over financial reporting will prevent all error and all fraud. These inherent limitations include the realities that judgments in decision making can be faulty, breakdowns can occur because of simple errors, and errors discovered by personnel within control systems may not be properly disclosed and addressed. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. In addition, we are consistently evaluating the design and operating effectiveness of our internal controls, a process which sometimes leads to modifications in such controls. These modifications could affect the overall effectiveness or evaluation of the control system in the future by us or our independent registered public accounting firm. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Two of our officers and directors own a large percentage of our voting stock, and, together with another employee who is also a significant shareholder, are related by blood or marriage. These factors may allow the officers and directors as a group or the three related employees to influence the election of directors and the approval or disapproval of significant corporate actions.

Dr. Sehat Sutardja, our President and Chief Executive Officer, and Weili Dai, who serves as the Vice President and General Manager of Communications and Consumer Business of Marvell Semiconductor, Inc, are husband and wife, and Dr. Sehat Sutardja and Dr. Pantas Sutardja, our Vice President, Chief Technology Officer and Chief Research and Development Officer, are brothers. Together, these three individuals held approximately 19% of our outstanding common shares as of October 27, 2012. As a result, if these individuals act together, they may influence the election of our directors and the approval or disapproval of any significant corporate actions that require shareholder approval. This influence over our affairs might be adverse to the interests of other shareholders. For example, the voting power of these individuals could have the effect of delaying or preventing an acquisition of us on terms that other shareholders may desire.

Under Bermuda law, all of our officers, in exercising their powers and discharging their duties, must act honestly and in good faith with a view to our best interests and exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances. Majority shareholders do not owe fiduciary duties to minority shareholders. As a result, the minority shareholders will not have a direct claim against the majority shareholders in the event the majority shareholders take actions that damage the interests of minority shareholders.
Class actions are generally not available to shareholders under the laws of Bermuda. Derivative actions may be available in certain circumstances, which would permit a shareholder to bring an action in our name if the directors or officers are alleged to be acting beyond our corporate power, committing illegal acts or violating our Memorandum of Association or Third Amended and Restated Bye-Laws (Bye-Laws). Furthermore, consideration would be given by a Bermuda court to acts that are alleged to constitute a fraud against the minority shareholders or, for example, where an act requiring the approval of a greater percentage of the company s shareholders than those who actually approved it.

The Companies Act 1981 of Bermuda, as amended, provides that when one or more shareholders believes the affairs of a company are being conducted in a manner which is prejudicial to the interest of some of the shareholders, a Bermuda court, upon petition, may make such order as it sees fit, including an order regulating the conduct of the company s affairs in the future or ordering the purchase of the shares of any shareholders by other shareholders or by the company, and in the case of a purchase of the shares by the company, for the reduction accordingly of the company s capital or otherwise.

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We rely upon the performance of our information technology systems to process, transmit, store and protect electronic information, and the failure of any critical information technology system may result in serious harm to our reputation, business, results of operations and/or financial condition.

We are heavily dependent on our technology infrastructure and maintain and rely upon certain critical information systems for the effective operation of our business. These information technology systems include telecommunications, the Internet, our corporate intranet, various computer hardware and software applications, network communications and e-mail. These information technology systems are subject to damage or interruption from a number of potential sources including natural disasters, viruses, destructive or inadequate code, malware, power failures, cyber attacks, and other events. To the extent that these information systems are under our control, we have implemented security procedures, such as virus protection software and emergency recovery processes, to address the outlined risks. We may incur significant costs in order to implement, maintain and/or update security systems that we feel are necessary to protect our information systems. A material breach in the security of our information systems could include the theft of our intellectual property or trade secrets, negatively impact our operations, or result in the compromise of personal and confidential information of our employees, customers or suppliers. While we believe that our information technology systems are appropriately controlled and that we have processes in place to adequately mitigate these risks, security procedures for information systems cannot be guaranteed to be failsafe. To the extent that any system failure, accident or security breach results in disruptions or interruptions to our operations or the theft, loss or disclosure of, or damage to our data or confidential information, our reputation, business, results of operations and/or financial condition could be materially adversely affected. In addition, a miscalculation of the level of investment needed to ensure our technology solutions are current and up-to-date as technology advances and evolves could result in disruptions in our business should the software, hardware or maintenance of such items become out-of-date or obsolete. Furthermore, when we implement new systems and/or upgrade existing systems, there is a risk that our business may be temporarily disrupted during the period of implementation.

We are subject to the risks of owning real property.

Our buildings in Santa Clara, California; Singapore; Etoy, Switzerland; and Shanghai, China subject us to the risks of owning real property, which include:

- the possibility of environmental contamination and the costs associated with fixing any environmental problems;
- adverse changes in the value of these properties, due to interest rate changes, changes in the neighborhood in which the property is located, or other factors;
- the possible need for structural improvements in order to comply with zoning, seismic and other legal or regulatory requirements;
- the potential disruption of our business and operations arising from or connected with a relocation due to moving to or renovating the facility;
- increased cash commitments for improvements to the buildings or the property or both;
- increased operating expenses for the buildings or the property or both;
- possible disputes with tenants or other third parties related to the buildings or the property or both; and
- the risk of financial loss in excess of amounts covered by insurance, or uninsured risks, such as the loss caused by damage to the buildings as a result of earthquakes, floods and or other natural disasters.

As we carry only limited insurance coverage, any incurred liability resulting from uncovered claims could adversely affect our financial condition and results of operations.

Our insurance policies may not be adequate to fully offset losses from covered incidents, and we do not have coverage for certain losses. For example, there is very limited coverage available with respect to the services provided by our third party foundries and assembly and test subcontractors. In the event of a natural disaster (such as an earthquake or tsunami), political or military turmoil, widespread health issues or other significant disruptions to their operations, insurance may not adequately protect us from this exposure. We believe our existing insurance coverage is consistent with common practice, economic considerations and availability considerations. If our insurance coverage is insufficient to protect us against unforeseen catastrophic losses, any uncovered losses could adversely affect our financial condition and results of operations.

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We are incorporated in Bermuda, and, as a result, it may not be possible for our shareholders to enforce civil liability provisions of the securities laws of the United States. In addition, our Bye-Laws contain a waiver of claims or rights of action by our shareholders against our officers and directors, which will severely limit our shareholders right to assert a claim against our officers and directors under Bermuda law.

We are organized under the laws of Bermuda. As a result, it may not be possible for our shareholders to affect service of process within the United States upon us, or to enforce against us in United States courts judgments based on the civil liability provisions of the securities laws of the United States. There is significant doubt as to whether the courts of Bermuda would recognize or enforce judgments of United States courts obtained against us or our directors or officers based on the civil liability provisions of the securities laws of the United States or any state or hear actions brought in Bermuda against us or those persons based on those laws. The United States and Bermuda do not currently have a treaty providing for the reciprocal recognition and enforcement of judgments in civil and commercial matters. Therefore, a final judgment for the payment of money rendered by any federal or state court in the United States based on civil liability, whether or not based solely on United States federal or state securities laws, would not be automatically enforceable in Bermuda.

Our Bye-Laws contain a broad waiver by our shareholders of any claim or right of action, both individually and on our behalf, against any of our officers and directors. The waiver applies to any action taken by an officer or director, or the failure of an officer or director to take any action, in the performance of his or her duties with or for us, other than with respect to any matter involving any fraud or dishonesty on the part of the officer or director or to any matter arising under U.S. securities laws. This waiver will limit the rights of our shareholders to assert claims against our officers and directors unless the act complained of involves fraud or dishonesty. Therefore, so long as acts of business judgment do not involve fraud or dishonesty, they will not be subject to shareholder claims under Bermuda law. For example, shareholders will not have claims against officers and directors for a breach of trust, unless the breach rises to the level of fraud or dishonesty.

Our Bye-Laws contain provisions that could delay or prevent a change in corporate control, even if the change in corporate control would benefit our shareholders.

Our Bye-Laws contain change in corporate control provisions, which include:

- authorizing the issuance of preferred stock without shareholder approval; and

- requiring a vote of two-thirds of votes cast in person or by proxy to approve any change of corporate control in the event the action is not approved by at least $66^{2/3}$% of the directors holding office at the date of the Board meeting to approve the action.

These change in corporate control provisions could make it more difficult for a third party to acquire us, even if doing so would be a benefit to our shareholders.

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

There were no sales of unregistered securities during the three months ended October 27, 2012.

Issuer Purchases of Equity Securities

The following table presents details of our repurchases during the three months ended October 27, 2012 (in thousands, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximated Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs (1)
July 29 August 25, 2012				$ 598,154
August 26 September 22, 2012				$ 598,154
September 23 October 27, 2012	22,917	$ 8.86	22,917	$ 395,168
Total	22,917	$ 8.86	22,917	$ 395,168

(1) In August 2010, our board of directors initially authorized our current share repurchase program to repurchase up to $500 million of our outstanding common shares. During fiscal 2012, our board of directors authorized an additional $1.5 billion to be used to repurchase our common shares under the share repurchase program. In May 2012, we announced an additional increase of $500 million to the share repurchase program. This increases the total available under the repurchase program to $2.5 billion. We intend to effect the repurchase program in accordance with the conditions of Rule 10b-18 under the Exchange Act. The repurchase program will be subject to market conditions and other factors and does not obligate us to repurchase any dollar amount or number of our common shares. The repurchase program may be extended, modified, suspended or discontinued at any time. We may make repurchases in open market or privately negotiated transactions in order to effect our repurchases.

Item 6. ***Exhibits***

(a) The following exhibits are filed as part of this report:

31.1	Certification of Principal Executive Officer as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Principal Financial Officer as required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Principal Executive Officer as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of Principal Financial Officer as required pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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

* The certifications furnished in Exhibits 32.1 and 32.2 hereto are deemed to accompany this Form 10-Q and will not be deemed filed for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filings under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

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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.

MARVELL TECHNOLOGY GROUP LTD.

November 29, 2012	By: /s/ Brad D. Feller
Date	Brad D. Feller
	Interim Chief Financial Officer
	(Principal Financial and Accounting Officer)

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