

EXPEDITORS INTERNATIONAL OF WASHINGTON INC
Form 10-Q
November 06, 2014

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

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: 0-13468

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization) 91-1069248
(IRS Employer
Identification Number)

1015 Third Avenue, 12thFloor, Seattle, Washington 98104
(Address of principal executive offices) (Zip Code)
(206) 674-3400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 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 Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) 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

At November 3, 2014, the number of shares outstanding of the issuer's Common Stock was 193,030,610.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In thousands, except share data)

(Unaudited)

	September 30, 2014	December 31, 2013
Current Assets:		
Cash and cash equivalents	\$990,480	\$1,247,652
Short-term investments	40,317	26,337
Accounts receivable, less allowance for doubtful accounts of \$7,248 at September 30, 2014 and \$8,695 at December 31, 2013	1,183,167	1,073,500
Deferred Federal and state income taxes	20,782	18,396
Other	83,226	49,384
Total current assets	2,317,972	2,415,269
Property and equipment, less accumulated depreciation and amortization of \$369,575 at September 30, 2014 and \$348,282 at December 31, 2013	545,366	563,064
Goodwill	7,927	7,927
Other assets, net	54,788	28,552
Total assets	\$2,926,053	\$3,014,812
Current Liabilities:		
Accounts payable	746,193	648,156
Accrued expenses, primarily salaries and related costs	194,546	200,301
Federal, state and foreign income taxes	22,059	21,743
Total current liabilities	962,798	870,200
Deferred Federal and state income taxes	59,325	58,281
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock, none issued	—	—
Common stock, par value \$0.01 per share. Issued and outstanding 193,019,604 shares at September 30, 2014 and 202,553,220 shares at December 31, 2013	1,930	2,025
Additional paid-in capital	1,055	1,647
Retained earnings	1,920,166	2,087,376
Accumulated other comprehensive loss	(21,778)	(6,265)
Total shareholders' equity	1,901,373	2,084,783
Noncontrolling interest	2,557	1,548
Total equity	1,903,930	2,086,331
Total liabilities and equity	\$2,926,053	\$3,014,812
See accompanying notes to condensed consolidated financial statements.		

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings

(In thousands, except share data)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Revenues:				
Airfreight services	\$686,434	\$628,116	\$2,000,829	\$1,891,459
Ocean freight and ocean services	600,483	525,193	1,606,145	1,462,679
Customs brokerage and other services	418,188	384,657	1,188,917	1,100,260
Total revenues	1,705,105	1,537,966	4,795,891	4,454,398
Operating Expenses:				
Airfreight services	516,969	466,699	1,503,064	1,414,634
Ocean freight and ocean services	475,460	409,649	1,266,551	1,135,299
Customs brokerage and other services	199,420	176,716	563,720	499,684
Salaries and related costs	272,548	261,613	789,257	765,599
Rent and occupancy costs	26,396	24,542	76,959	73,447
Depreciation and amortization	12,741	12,629	37,540	35,581
Selling and promotion	9,240	8,306	26,704	23,891
Other	33,200	31,499	95,319	87,853
Total operating expenses	1,545,974	1,391,653	4,359,114	4,035,988
Operating income	159,131	146,313	436,777	418,410
Other Income (Expense):				
Interest income	2,793	2,967	8,254	9,280
Other, net	2,336	1,212	5,245	7,068
Other income, net	5,129	4,179	13,499	16,348
Earnings before income taxes	164,260	150,492	450,276	434,758
Income tax expense	61,463	57,763	171,556	168,756
Net earnings	102,797	92,729	278,720	266,002
Less net earnings attributable to the noncontrolling interest	416	329	1,213	972
Net earnings attributable to shareholders	\$102,381	\$92,400	\$277,507	\$265,030
Diluted earnings attributable to shareholders per share	\$0.53	\$0.45	\$1.40	\$1.28
Basic earnings attributable to shareholders per share	\$0.53	\$0.45	\$1.41	\$1.28
Dividends declared and paid per common share	\$—	\$—	\$0.32	\$0.30
Weighted average diluted shares outstanding	195,001,267	207,368,792	197,953,810	207,351,569
Weighted average basic shares outstanding	194,419,071	206,516,194	197,305,251	206,478,746

See accompanying notes to condensed consolidated financial statements.

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income

(In thousands)

(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Net earnings	\$102,797	\$92,729	\$278,720	\$266,002
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments, net of tax of \$9,954 and \$4,859 for the three months ended September 30, 2014 and 2013, and \$8,560 and \$6,557 for the nine months ended September 30, 2014 and 2013	(18,351)	8,751	(15,743)	(12,275)
Reclassification adjustment for foreign currency realized losses, net of tax of \$61 for the nine months ended September 30, 2014	—	—	111	—
Other comprehensive (loss) income	(18,351)	8,751	(15,632)	(12,275)
Comprehensive income	84,446	101,480	263,088	253,727
Less comprehensive income attributable to the noncontrolling interest	234	211	1,094	667
Comprehensive income attributable to shareholders	\$84,212	\$101,269	\$261,994	\$253,060

See accompanying notes to condensed consolidated financial statements.

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Operating Activities:				
Net earnings	\$102,797	\$92,729	\$278,720	\$266,002
Adjustments to reconcile net earnings to net cash from operating activities:				
Provision for losses (recoveries) on accounts receivable	564	1,496	(55	) 2,537
Deferred income tax (benefit) expense	(2,085	) (33,185	) 8,000	(20,245
Excess tax benefits from stock plans	(47	) —	(1,031	) (1,683
Stock compensation expense	10,049	11,015	32,220	33,060
Depreciation and amortization	12,741	12,629	37,540	35,581
Other	139	187	345	636
Changes in operating assets and liabilities:				
Increase in accounts receivable	(58,984	) (5,115	) (131,374	) (14,482
Increase (decrease) in accounts payable and accrued expenses	23,113	(8,875	) 114,036	34,815
Increase (decrease) in income taxes payable, net	2,050	30,114	(27,115	) 14,640
Increase in other current assets	(3,646	) (4,702	) (5,852	) (5,278
Net cash from operating activities	86,691	96,293	305,434	345,583
Investing Activities:				
Purchase of short-term investments	(40,275	) (9,991	) (136,706	) (99,890
Proceeds from maturities of short-term investments	86,107	66	122,726	200
Purchase of property and equipment	(8,255	) (15,482	) (26,650	) (42,691
Escrow deposit for land acquisition	—	—	(27,101) —
Other, net	370	306	504	1,126
Net cash from investing activities	37,947	(25,101	) (67,227	) (141,255
Financing Activities:				
Proceeds from issuance of common stock	28,452	33,615	58,469	52,092
Repurchases of common stock	(117,044	) (85,925	) (475,160	) (125,206
Excess tax benefits from stock plans	47	—	1,031	1,683
Dividends paid	—	—	(62,807	) (61,899
Purchase of noncontrolling interest	—	—	—	(7,730
Distributions to noncontrolling interest	—	(1,161	) (85	) (1,161
Net cash from financing activities	(88,545	) (53,471	) (478,552	) (142,221
Effect of exchange rate changes on cash and cash equivalents	(16,174	) 6,500	(16,827	) (12,619
Increase (decrease) in cash and cash equivalents	19,919	24,221	(257,172	) 49,488
Cash and cash equivalents at beginning of period	970,561	1,286,109	1,247,652	1,260,842
Cash and cash equivalents at end of period	\$990,480	\$1,310,330	\$990,480	\$1,310,330
Taxes Paid:				
Income taxes	\$61,899	\$62,053	\$195,358	\$174,199

See accompanying notes to condensed consolidated financial statements.

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(In thousands, except share data)

(Unaudited)

Note 1. Summary of Significant Accounting Policies

A. Basis of Presentation

Expeditors International of Washington, Inc. (“the Company”) is a non-asset based provider of global logistics services operating through a worldwide network of offices and exclusive or non-exclusive agents. The Company’s customers include retailing and wholesaling, electronics, industrial and manufacturing companies around the world.

The condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. As a result, certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) have been condensed or omitted. The Company believes that the disclosures made are adequate to make the information presented not misleading. The condensed consolidated financial statements reflect all adjustments, consisting of normal recurring items, which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's Form 10-K as filed with the Securities and Exchange Commission on February 27, 2014.

All significant intercompany accounts and transactions have been eliminated in consolidation. All dollar amounts in the notes are presented in thousands except for share data. Certain prior year amounts have been reclassified to conform to the 2014 presentation. The reclassifications include presenting rental income of \$2,877 and \$8,371 for the three and nine months ended September 30, 2013, respectively, in customs brokerage and other services revenues while it was historically recorded in rent and occupancy costs and other operating expenses.

B. Accounts Receivable

The Company maintains an allowance for doubtful accounts, which is reviewed at least monthly for estimated losses resulting from the inability of its customers to make required payments for services and advances. Additional allowances may be necessary in the future if the ability of its customers to pay deteriorates. The Company has recorded an allowance for doubtful accounts in the amounts of \$7,248 as of September 30, 2014 and \$8,695 as of December 31, 2013. Additions and write-offs have not been significant in the periods presented.

C. Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. The Company uses estimates primarily in the following areas: accounts receivable valuation, accrual of costs related to ancillary services the Company provides, accrual of insurance liabilities for the portion of the related exposure which the Company has self-insured, accrual of various tax liabilities, accrual of loss contingencies and calculation of share-based compensation expense. Actual results could differ from those estimates.

D. Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 (Topic 606) “Revenue from Contracts with Customers”. This update, which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605 - “Revenue Recognition” and most industry-specific guidance throughout the industry topics of the FASB ASC, substantially converges revenue recognition guidance between U.S. GAAP and International Financial Reporting Standards (IFRS), providing a single, comprehensive framework for recognizing revenue. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. The Company is currently evaluating the impact of adopting ASU 2014-09 on its consolidated financial statements and related disclosures.

Note 2. Share-Based Compensation

The Company provides compensation benefits by granting stock options and employee stock purchase rights to its employees and restricted shares to its directors. On May 7, 2014, the shareholders approved the 2014 Stock Option Plan, which made available 2,750,000 shares of the Company's common stock for purchase upon exercise of options granted. The Company has historically granted the majority of its options during the second quarter of each fiscal year. For the nine months ended September 30, 2014 and 2013, 2,289,600 and 2,279,700 options were granted, respectively. On May 7, 2014, the shareholders approved an amendment to the Company's 2002 Employee Stock Purchase Plan to increase the Company's common stock available for purchase under that plan by 3,000,000 shares. The grant of employee stock purchase rights and the issuance of shares under the employee stock purchase plan are made in the third quarter of each fiscal year and 671,775 and 800,461 were issued in the nine-month periods ended September 30, 2014 and 2013. On May 7, 2014, shareholders also approved the 2014 Directors' restricted stock plan, which made available 250,000 shares of common stock for issuance to independent directors. On May 20, 2014, 30,702 fully vested shares were granted to independent directors.

The Company recognizes stock compensation expense based on an estimate of the fair value of awards granted to employees and directors under the Company's stock option, director restricted stock and employee stock purchase rights plans. The expense, adjusted for expected forfeitures, is recognized on a straight-line basis over the stock awards' vesting period. The forfeiture assumption used to calculate compensation expense is primarily based on historical pre-vesting employee forfeiture patterns.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	Nine months ended September 30,	
	2014	2013
Dividend yield	1.50 - 1.51%	1.50 - 1.53%
Volatility - stock option plans	36 %	38 %
Volatility - stock purchase rights plans	20 %	21 %
Risk free interest rates	0.11 - 2.27%	0.12 - 1.40%
Expected life (years) - stock option plans	6.52 - 7.43	5.91 - 7.43
Expected life (years) - stock purchase rights plans	1	1
Weighted average fair value of stock options granted during the period	\$14.08	\$11.17
Weighted average fair value of stock purchase rights granted during the period	\$9.60	\$9.43

Total stock compensation expense and the total related tax benefit recognized are as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2014	2013	2014	2013
Stock compensation expense	\$10,049	\$11,015	\$32,220	\$33,060
Recognized tax benefit	\$988	\$943	\$3,115	\$2,492

Note 3. Basic and Diluted Earnings per Share

The following table reconciles the numerator and the denominator of the basic and diluted per share computations for earnings attributable to shareholders:

(Amounts in thousands, except share and per share amounts)	Three months ended September 30,		
	Net earnings attributable to shareholders	Weighted average shares	Earnings per share
2014			
Basic earnings attributable to shareholders	\$102,381	194,419,071	\$ 0.53
Effect of dilutive potential common shares	—	582,196	—
Diluted earnings attributable to shareholders	\$102,381	195,001,267	\$ 0.53
2013			
Basic earnings attributable to shareholders	\$92,400	206,516,194	\$ 0.45
Effect of dilutive potential common shares	—	852,598	—
Diluted earnings attributable to shareholders	\$92,400	207,368,792	\$ 0.45

(Amounts in thousands, except share and per share amounts)	Nine months ended September 30,		
	Net earnings attributable to shareholders	Weighted average shares	Earnings per share
2014			
Basic earnings attributable to shareholders	\$277,507	197,305,251	\$ 1.41
Effect of dilutive potential common shares	—	648,559	—
Diluted earnings attributable to shareholders	\$277,507	197,953,810	\$ 1.40
2013			
Basic earnings attributable to shareholders	\$265,030	206,478,746	\$ 1.28
Effect of dilutive potential common shares	—	872,823	—
Diluted earnings attributable to shareholders	\$265,030	207,351,569	\$ 1.28

The following potential common shares have been excluded from the computation of diluted earnings per share because the effect would have been antidilutive:

Shares	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
	16,576,091	15,314,114	16,601,433	17,165,060

Note 4. Components of Equity

The components of equity for the nine months ended September 30, 2014 and 2013 are as follows:

	Shareholders' equity	Noncontrolling interest	Total equity
Balance at December 31, 2013	\$2,084,783	1,548	2,086,331
Exercise of stock options	34,669	—	34,669
Issuance of shares under stock purchase plan	23,800	—	23,800
Shares repurchased under provisions of stock repurchase plans	(475,160) —	