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)

x 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

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

For the transition period from to

Commission File 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, 12th Floor, Seattle, Washington (Address of principal executive offices)	98104 (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 x No o

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

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

Large accelerated filer x		Accelerated filer	o
Non-accelerated filer o	(Do not check if a smaller reporting company)	Smaller reporting company	o

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

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 September 30,		Nine months ended 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.

6

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 September 30,		Nine months ended 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:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Shares	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)	—	(475,160)
Stock compensation expense	32,220	—	32,220
Tax benefits from stock plans, net	1,031	—	1,031
Net earnings	277,507	1,213	278,720
Other comprehensive loss	(15,513)	(119)	(15,632)
Dividends paid ($0.32 per share)	(62,807)	—	(62,807)
Purchase of noncontrolling interest	843	—	843
Distributions to noncontrolling interest	—	(85)	(85)
Balance at September 30, 2014	$1,901,373	2,557	1,903,930
Balance at December 31, 2012	$2,027,699	4,871	2,032,570
Exercise of stock options	28,115	—	28,115
Issuance of shares under stock purchase plan	23,977	—	23,977
Shares repurchased under provisions of stock repurchase plans	(125,206)	—	(125,206)
Stock compensation expense	33,060	—	33,060
Tax benefits from stock plans, net	1,280	—	1,280
Net earnings	265,030	972	266,002
Other comprehensive loss	(11,970)	(305)	(12,275)
Dividends paid ($0.30 per share)	(61,899)	—	(61,899)
Purchase of noncontrolling interest	(507)	(3,226)	(3,733)
Distributions to noncontrolling interest	—	(1,161)	(1,161)
Balance at September 30, 2013	$2,179,579	1,151	2,180,730

The Company has a Non-Discretionary Stock Repurchase Plan to repurchase shares from the proceeds of stock option exercises and employee stock purchases. During the nine months ended September 30, 2014, 1,364,974 shares were repurchased at an average price of $42.73 per share. The Company also has a Discretionary Stock Repurchase Plan that was amended by the Board of Directors on February 24, 2014 to authorize management to reduce issued and outstanding stock to 190 million shares of common stock. During the nine months ended September 30, 2014, 10,057,648 shares were repurchased at an average price of $41.44 per share.

Accumulated other comprehensive loss consisted entirely of foreign currency translation adjustments, net of related income tax effects, for all the periods presented.

On May 7, 2014, the Board of Directors declared a semi-annual cash dividend of $0.32 per share payable on June 16, 2014 to shareholders of record as of June 2, 2014. On May 1, 2013, the Board of Directors declared a semi-annual cash dividend of $0.30 per share payable on June 17, 2013 to shareholders of record as of June 3, 2013.

Subsequent to the end of the third quarter, on November 4, 2014, the Board of Directors declared a semi-annual dividend of $0.32 per share payable on December 15, 2014 to shareholders of record as of December 1, 2014.

Note 5. Fair Value of Financial Instruments

The Company's financial instruments, other than cash, consist primarily of cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses. The carrying value of these financial instruments approximates their fair value. Cash equivalents consist of highly liquid investments with a maturity of three months or less at date of purchase. Short-term investments have a maturity of greater than three months at date of purchase.

Cash, cash equivalents and short-term investments consist of the following:

	September 30, 2014		December 31, 2013	
	Cost	Fair Value	Cost	Fair Value
Cash and Cash Equivalents:				
Cash and overnight deposits	$616,092	616,092	590,317	590,317
Corporate commercial paper	336,405	336,455	629,923	629,990
Time deposits	37,983	37,983	27,412	27,412
Total cash and cash equivalents	990,480	990,530	1,247,652	1,247,719
Short-Term Investments:				
Corporate commercial paper	40,296	40,317	26,296	26,321
Time deposits	21	21	41	41
Total short-term investments	40,317	40,338	26,337	26,362
Total	$1,030,797	1,030,868	1,273,989	1,274,081

The fair value of corporate commercial paper is based on the use of market interest rates for identical or similar assets (Level 2 fair value measurement).

Note 6. Contingencies

The Company is involved in claims, lawsuits, government investigations and other legal matters that arise in the ordinary course of business and are subject to inherent uncertainties. Currently, in management's opinion and based upon advice from legal advisors, none of these matters are expected to have a significant effect on the Company's operations or financial position. As of September 30, 2014, the amounts accrued for these claims, lawsuits, government investigations and other legal matters are not significant to the Company's operations or financial position. At this time the Company is unable to estimate any additional loss or range of reasonably possible losses, if any, beyond the amounts recorded, that might result from the resolution of these matters.

Note 7. Business Segment Information

The Company is organized functionally in geographic operating segments. Accordingly, management focuses its attention on revenues, net revenues[1], operating income, identifiable assets, capital expenditures, depreciation and amortization and equity generated in each of these geographical areas when evaluating the effectiveness of geographic management. The Company charges its subsidiaries and affiliates for services rendered in the United States on a cost recovery basis. Transactions among the Company's various offices are conducted using the same arms-length pricing methodologies the Company uses when its offices transact business with independent agents.

Financial information regarding the Company's operations by geographic area is as follows:

(in thousands)	UNITED STATES	OTHER NORTH AMERICA	LATIN AMERICA	ASIA PACIFIC	EUROPE and AFRICA	MIDDLE EAST and INDIA	ELIMI-NATIONS	CONSOLI-DATED
Three months ended September 30, 2014:								
Revenues from unaffiliated customers	$438,882	55,209	22,962	850,855	253,683	83,514	—	1,705,105
Transfers between geographic areas	24,847	2,867	5,194	12,965	9,492	5,427	(60,792)	—
Total revenues	$463,729	58,076	28,156	863,820	263,175	88,941	(60,792)	1,705,105
Net revenues[1]	$215,320	27,323	16,792	149,069	79,007	25,745	—	513,256
Operating income	$68,972	7,779	4,890	57,409	14,413	5,668	—	159,131
Identifiable assets at period end	$1,333,124	113,621	53,939	733,776	506,442	173,455	11,696	2,926,053
Capital expenditures	$3,171	361	369	2,942	1,042	370	—	8,255
Depreciation and amortization	$8,369	303	226	2,030	1,389	424	—	12,741
Equity	$1,074,837	75,848	34,218	454,982	199,751	97,476	(33,182)	1,903,930
Three months ended September 30, 2013:								
Revenues from unaffiliated customers	$396,764	52,962	22,136	777,845	212,507	75,752	—	1,537,966
Transfers between geographic areas	22,065	2,911	5,643	12,081	9,358	4,473	(56,531)	—
Total revenues	$418,829	55,873	27,779	789,926	221,865	80,225	(56,531)	1,537,966
Net revenues[1]	$199,107	26,255	15,627	147,477	70,949	25,487	—	484,902
Operating income	$55,627	8,524	5,317	57,975	11,894	6,976	—	146,313
Identifiable assets at period end	$1,694,366	102,713	52,785	663,584	438,711	142,843	3,561	3,098,563
Capital expenditures	$12,463	639	147	1,250	703	280	—	15,482
Depreciation and amortization	$7,608	211	210	2,343	1,534	723	—	12,629
Equity	$1,423,598	63,351	30,637	439,719	181,134	75,444	(33,153)	2,180,730

(in thousands)	UNITED STATES	OTHER NORTH AMERICA	LATIN AMERICA	ASIA PACIFIC	EUROPE and AFRICA	MIDDLE EAST and INDIA	ELIMI-NATIONS	CONSOLI-DATED
Nine months ended September 30, 2014:								
Revenues from unaffiliated customers	$1,256,075	162,136	65,594	2,346,073	725,833	240,180	—	4,795,891
Transfers between geographic areas	67,266	7,829	15,965	37,367	27,917	15,527	(171,871)	—
Total revenues	$1,323,341	169,965	81,559	2,383,440	753,750	255,707	(171,871)	4,795,891
Net revenues[1]	$607,508	79,017	48,797	420,788	230,702	75,744	—	1,462,556
Operating income	$180,650	23,155	14,425	161,686	39,698	17,163	—	436,777
Identifiable assets at period end	$1,333,124	113,621	53,939	733,776	506,442	173,455	11,696	2,926,053
Capital expenditures	$12,646	1,047	841	7,975	3,156	985	—	26,650
Depreciation and amortization	$24,100	879	665	6,246	4,352	1,298	—	37,540
Equity	$1,074,837	75,848	34,218	454,982	199,751	97,476	(33,182)	1,903,930
Nine months ended September 30, 2013:								
Revenues from unaffiliated customers	$1,166,633	161,317	63,421	2,221,264	621,040	220,723	—	4,454,398
Transfers between geographic areas	65,308	7,971	16,133	34,316	27,427	13,359	(164,514)	—
Total revenues	$1,231,941	169,288	79,554	2,255,580	648,467	234,082	(164,514)	4,454,398
Net revenues[1]	$572,959	75,476	45,560	424,466	212,631	73,689	—	1,404,781
Operating income	$161,290	23,023	14,007	165,640	35,433	19,017	—	418,410
Identifiable assets at period end	$1,694,366	102,713	52,785	663,584	438,711	142,843	3,561	3,098,563
Capital expenditures	$22,196	1,534	551	14,858	2,464	1,088	—	42,691
Depreciation and amortization	$21,641	615	680	6,314	4,713	1,618	—	35,581
Equity	$1,423,598	63,351	30,637	439,719	181,134	75,444	(33,153)	2,180,730

[1]Net revenues are a non-GAAP measure calculated as revenues less directly related operations expenses attributable to the Company's principal services. The Company's management believes that net revenues are a better measure than total revenues when evaluating the Company's operating segment performance since total revenues earned as a freight consolidator include the carriers' charges for carrying the shipment, whereas revenues earned in other capacities include primarily the commissions and fees earned by the Company. Net revenue is one of the Company's primary operational and financial measures and demonstrates the Company's ability to concentrate and leverage purchasing power through effective consolidation of shipments from customers utilizing a variety of transportation carriers and optimal routings.

The following table presents the calculation of consolidated net revenues:

	Three months ended September 30,		Nine months ended September 30,	
	2014	2013	2014	2013
Total revenues	$1,705,105	$1,537,966	$4,795,891	$4,454,398

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
Net revenues	$513,256	$484,902	$1,462,556	$1,404,781

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

SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS UNDER PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995; CERTAIN CAUTIONARY STATEMENTS

Certain portions of this report on Form 10-Q including the sections entitled “Overview,” "Strategy and Culture," "International Trade and Competition," "Seasonality," “Critical Accounting Estimates,” “Results of Operations,” “Currency and Other Risk Factors” and “Liquidity and Capital Resources” contain forward-looking statements. Words such as "will likely result", "are expected to", "will continue", "is anticipated", "estimate", "project", "plan", "believe", "probable", "reasonably possible", "may", "could", "should", "intends", "foreseeable future" and variations of such words and similar expressions are intended to identify such forward-looking statements. In addition, any statements that refer to projections of future financial performance, our anticipated growth and trends in the Company's businesses, and other characterizations of future events or circumstances are forward-looking statements. These statements must be considered in connection with the discussion of the important factors that could cause actual results to differ materially from the forward-looking statements. Attention should be given to the factors identified and discussed in the Company's annual report on Form 10-K filed on February 27, 2014.

Overview

Expeditors International of Washington, Inc. is a global logistics company. The Company's services include air and ocean freight consolidation and forwarding, customs brokerage, warehousing and distribution, purchase order management, vendor consolidation, time-definite transportation services, cargo insurance and other logistics solutions. The Company does not compete for overnight courier or small parcel business. As a non-asset based carrier, the Company does not own or operate transportation assets.

The Company derives its revenues from three principal sources: 1) airfreight services, 2) ocean freight and ocean services, and 3) customs brokerage and other services. These are the revenue categories presented in the financial statements.

The Company generates the major portion of its air and ocean freight revenues by purchasing transportation services on a wholesale basis from direct (asset-based) carriers and reselling those services to its customers on a retail basis. The difference between the rate billed to customers (the sell rate) and the rate paid to the carrier (the buy rate) is termed “net revenue” (a non-GAAP measure), “yield” or “margin.” By consolidating shipments from multiple customers and concentrating its buying power, the Company is able to negotiate favorable buy rates from the direct carriers, while at the same time offering lower sell rates than customers would otherwise be able to negotiate themselves. The most significant drivers of changes in gross revenues and related transportation expenses are volume, sell rates and buy rates. Volume has a similar effect on the change in both gross revenues and related transportation expenses in each of the Company's three primary sources of revenue.

In most cases the Company acts as an indirect carrier. When acting as an indirect carrier, the Company will issue a House Airway Bill (HAWB) or a House Ocean Bill of Lading (HOBL) to customers as the contract of carriage. In turn, when the freight is physically tendered to a direct carrier, the Company receives a contract of carriage known as a Master Airway Bill for airfreight shipments and a Master Ocean Bill of Lading for ocean shipments. In these transactions, the Company is the primary obligor and is required to compensate direct carriers for services performed regardless of whether customers accept the service, has latitude in establishing price, has discretion in selecting the direct carrier and has credit risk. Therefore, the Company is the principal in these transactions and reports revenue and the related expenses on a gross basis.

For revenues earned in other capacities, for instance, when the Company does not issue a HAWB or a HOBL or otherwise acts solely as an agent for the shipper, only the commissions and fees earned for such services are included in revenues. In these transactions, the Company is not a principal and reports only commissions and fees earned in revenue.

Customs brokerage and other services involves providing services at destination, such as helping customers clear shipments through customs by preparing and filing required documentation, calculating and providing for payment of duties and other taxes on behalf of customers as well as arranging for any required inspections by governmental agencies, and arranging for delivery. These are complicated functions requiring technical knowledge of customs rules and regulations in the multitude of countries in which the Company has offices.

The Company is managed along three geographic areas of responsibility: Americas; Asia Pacific; and Europe, Africa, Near/Middle East and Indian Subcontinent (EMAIR). Each area is divided into sub-regions which are composed of operating units with individual profit and loss responsibility. The Company’s business involves shipments between operating units and typically touches more than one geographic area. The nature of the international logistics business necessitates a high degree of communication and cooperation among operating units. Because of this inter-relationship between operating units, it is very difficult to examine any one geographic area and draw meaningful conclusions as to its contribution to the Company’s overall success on a stand-alone basis.

The Company’s operating units share revenue using the same arms-length pricing methodologies the Company uses when its offices transact business with independent agents. The Company charges its subsidiaries and affiliates for services rendered in the United States on a cost recovery basis. The Company’s strategy closely links compensation with operating unit profitability. Individual success is closely linked to cooperation with other operating units within the network.

The mix of services varies by segment based primarily on the import or export orientation of local operations in each region. In accordance with the Company's revenue recognition policy (see Note 1. E. to the consolidated financial statements in the Company's annual report on Form 10-K filed on February 27, 2014), almost all freight revenues and related expenses are recorded at origin and shipment profits are split between origin and destination offices by recording a commission fee or profit share revenue at destination and a corresponding commission or profit share expense as a component of origin consolidation costs. The Asia Pacific segment is the Company's largest export oriented region and accounted for 49% of revenues and 37% of operating income for the nine months ended September 30, 2014. Asia Pacific's operating income as a percentage of revenue is lower than other segments due to the largely export nature of operations in that region.

Strategy and Culture

The Company has pursued a strategy emphasizing organic growth supplemented by certain strategic acquisitions. From the inception of the Company, management has believed that the elements required for a successful global service organization can only be assured through recruiting, training, and ultimately retaining superior personnel. The Company’s greatest challenge is now and always has been perpetuating a consistent global corporate culture which demands:

- Total dedication, first and foremost, to providing superior customer service;
- Compliance with Company policies and government regulations;
- Aggressive marketing of all of the Company’s service offerings;
- Ongoing development of key employees and management personnel via formal and informal means;
- Creation of unlimited advancement opportunities for employees dedicated to hard work, personal growth and continuous improvement;
- Individual commitment to the identification and mentoring of successors for every key position so that when inevitable change occurs, a qualified and well-trained internal candidate is ready to step forward; and
- Continuous identification, design and implementation of system solutions, both technological and otherwise, to meet and exceed the needs of our customers while simultaneously delivering tools to make the Company's employees more efficient and more effective.

The Company reinforces these values with a compensation system that rewards employees for profitably managing the things they can control. This compensation system has been in place since the Company became a publicly traded entity. There is no limit to how much a key manager can be compensated for success. The Company believes in a “real world” environment in every operating unit where individuals are not sheltered from the profit implications of their decisions. If these decisions result in operating losses, current management must make up these losses with future operating profits, in the aggregate, before any cash incentive compensation can be earned. At the same time, the Company insists on continued focus on such things as accounts receivable collection, cash flow management and credit soundness in an attempt to insulate managers from the sort of catastrophic errors that might end a career.

Any failure to perpetuate this unique culture on a self-sustained basis throughout the Company provides a greater threat to the Company’s continued success than any external force, which would be largely beyond its control. The Company strongly believes that it is nearly impossible to predict events that, in the aggregate, could have a positive or a negative impact on future operations. As a result, management's focus is on building and maintaining a global corporate culture and an environment where well-trained employees and managers are prepared to identify and react to changes as they develop and thereby help the Company adapt and thrive as major trends emerge.

The Company’s ability to provide services to its customers is highly dependent on good working relationships with a variety of entities including airlines, steamship lines, ground transportation providers and governmental agencies. The significance of maintaining acceptable working relationships with these entities has gained increased importance as a result of ongoing concern over terrorism and increased governmental regulation and oversight of international trade. A good reputation helps to develop practical working understandings that will assist in meeting security requirements while minimizing potential international trade obstacles, especially as governments promulgate new regulations and increase oversight and enforcement of new and existing laws. The Company considers its current working relationships with these entities to be satisfactory. The airline and ocean steamship line industries have incurred significant losses in recent years and many carriers are highly leveraged with debt. This situation has required the Company to be increasingly selective in determining which carriers to utilize. Further changes in the financial stability, operating capabilities and capacity of asset-based carriers, space allotments available from carriers, governmental regulations, and/or trade accords could adversely affect the Company's business in unpredictable ways.

The Company is currently conducting a comprehensive strategic assessment of its market positions and organizational structures. The primary purpose of the strategic assessment is to focus management's expertise to create an environment where the Company will be both unified and confident in allocating its resources in areas that maximize the total returns to its stakeholders. The Company's strategic assessment has resulted in the following four basic, broad key strategic initiatives:

- Ensure every operating unit's base-line growth strategies for the air, ocean and customs services both defend existing market share and grow at the rate of that unit's (i.e. district or region) relevant market growth rate. Transcon and Distribution services are expected to maintain current growth rates.
- Align and integrate European-Asian Pacific interests and European-North Americas interest to the same degree Asian Pacific and Americas interests have historically been aligned. This alignment is expected to result in additional growth in these markets beyond the base-line growth expectations, referenced above.
- Leverage our long and deeply entrenched presence in various Asian export markets, and the reputation we have with strategic carriers servicing those markets, to create a stronger Asian import presence while concentrating and enhancing export capabilities in key strategic lanes, particularly into and out of China and Southeast Asia. This is expected to create additional product growth opportunities in these markets.
- Expand market share growth and position in North America, traditionally the Company's most strategic market.

International Trade and Competition

The Company operates in 62 countries in the competitive global logistics industry and Company activities are closely tied to the global economy. International trade is influenced by many factors, including economic and political conditions in the United States and abroad, currency exchange rates, and laws and policies relating to tariffs, trade restrictions, foreign investments and taxation. Periodically, governments consider a variety of changes to current tariffs and trade restrictions and accords. The Company cannot predict which, if any, of these proposals may be adopted, or the effects the adoption of any such proposal will have on the Company's business. Doing business in foreign locations also subjects the Company to a variety of risks and considerations not normally encountered by domestic enterprises. In addition to being influenced by governmental policies concerning international trade, the Company's business may also be affected by political developments and changes in government personnel or policies, as well as economic turbulence, political unrest and security concerns in the nations in which it does business and the future impact that these events may have on international trade and oil prices.

The global logistics services industry is intensely competitive and is expected to remain so for the foreseeable future. Consistent with continuing uncertainty in global economic conditions, concerns over volatile fuel costs, rising costs in general, political unrest and fluctuating currency exchange rates, the Company's pricing and terms continue to be pressured by customers, carriers and service providers which has resulted in a compression of the Company's unitary margins. We expect these competitive conditions to continue.

The Company cannot predict what impact ongoing uncertainties in the global economy may have on its operating results, freight volumes, pricing, changes in consumer demand, carrier stability and capacity, customers' abilities to pay or on changes in competitors' behavior.

Seasonality

Historically, the Company's operating results have been subject to seasonal trends with the first quarter being the weakest and the third and fourth quarters being the strongest. This pattern has been the result of, or influenced by, numerous factors including weather patterns, national holidays, consumer demand, new product launches, economic conditions and a myriad of other similar and subtle forces. In addition, this historical quarterly trend has been influenced by the growth and diversification of the Company's international network and service offerings.

A significant portion of the Company's revenues are derived from customers in retail industries whose shipping patterns are tied closely to consumer demand, and from customers in industries whose shipping patterns are dependent upon just-in-time production schedules. Therefore, the timing of the Company's revenues are, to a large degree, impacted by factors out of the Company's control, such as a sudden change in consumer demand for retail goods, product launches and/or manufacturing production delays. Additionally, many customers ship a significant portion of their goods at or near the end of a quarter, and therefore, the Company may not learn of a shortfall in revenues until late in a quarter.

To the extent that a shortfall in revenues or earnings was not expected by securities analysts, any such shortfall from levels predicted by securities analysts could have an immediate and adverse effect on the trading price of the Company's stock. The Company cannot accurately forecast many of these factors or estimate accurately the relative influence of any particular factor and, as a result, there can be no assurance that historical patterns will continue in future periods.

Critical Accounting Estimates

The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States requires that the Company make estimates and judgments. The Company bases its estimates on historical experience and on assumptions that it believes are reasonable. The Company's critical accounting estimates are discussed in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of the Company's annual report on Form 10-K for the year ended December 31, 2013, filed on February 27, 2014. There have been no material changes to the critical accounting estimates previously disclosed in that report.

Results of Operations

The following table shows the total net revenues (a non-GAAP measure calculated as revenues less directly related operations expenses attributable to the Company's principal services) and the Company's expenses for the three and nine-month periods ended September 30, 2014 and 2013, expressed as percentages of net revenues. Management believes that net revenues are a better measure than total revenues when analyzing and discussing management's effectiveness in managing the Company's principal services since total revenues earned by the Company as a freight consolidator include the carriers' charges to the Company for carrying the shipment, whereas revenues earned by the Company in its other capacities include primarily the commissions and fees actually earned by the Company. Net revenue is one of the Company's primary operational and financial measures that demonstrates the ability of the Company to manage sell rates to customers with its ability to concentrate and leverage its purchasing power through effective consolidation of shipments from multiple customers utilizing a variety of transportation carriers and optimal routings. Using net revenue also provides a commonality for comparison among various services.

The table and the accompanying discussion and analysis should be read in conjunction with the condensed consolidated financial statements and related notes thereto which appear elsewhere in this quarterly report.

	Three months ended September 30,				Nine months ended September 30,			
	2014		2013		2014		2013	
	Amount	Percent of net revenues	Amount	Percent of net revenues	Amount	Percent of net revenues	Amount	Percent of net revenues
(in thousands)								
Airfreight services:								
Revenues	$686,434		$628,116		$2,000,829		$1,891,459	
Expenses	516,969		466,699		1,503,064		1,414,634	
Net revenues	169,465	33 %	161,417	33 %	497,765	34 %	476,825	34 %
Ocean freight services and ocean services:								
Revenues	600,483		525,193		1,606,145		1,462,679	
Expenses	475,460		409,649		1,266,551		1,135,299	
Net revenues	125,023	24	115,544	24	339,594	23	327,380	23
Customs brokerage and other services:								
Revenues	418,188		384,657		1,188,917		1,100,260	
Expenses	199,420		176,716		563,720		499,684	
Net revenues	218,768	43	207,941	43	625,197	43	600,576	43
Total net revenues	513,256	100	484,902	100	1,462,556	100	1,404,781	100
Overhead expenses:								

Salaries and related costs	272,548	53		261,613	54		789,257	54		765,599	54	
Other	81,577	16		76,976	16		236,522	16		220,772	16	
Total overhead expenses	354,125	69		338,589	70		1,025,779	70		986,371	70	
Operating income	159,131	31		146,313	30		436,777	30		418,410	30	
Other income, net	5,129	1		4,179	1		13,499	1		16,348	1	
Earnings before income taxes	164,260	32		150,492	31		450,276	31		434,758	31	
Income tax expense	61,463	12		57,763	12		171,556	12		168,756	12	
Net earnings	102,797	20		92,729	19		278,720	19		266,002	19	
Less net earnings attributable to the noncontrolling interest	416	—		329	—		1,213	—		972	—	
Net earnings attributable to shareholders	$102,381	20	%	$92,400	19	%	$277,507	19	%	$265,030	19	%

Airfreight services:

Airfreight services revenues increased 9% in the third quarter of 2014, as compared with the same period for 2013, due to a 12% increase in tonnage that was partially offset by lower sell rates in response to competitive market conditions in North America and Asia Pacific. Airfreight services expenses increased 11% in the third quarter of 2014 as the increase in tonnage was slightly offset by negotiating lower buy rates with carriers, primarily on exports from North America and Asia Pacific.

Airfreight service revenues increased 6% during the nine-month period ended September 30, 2014, as compared with the same period for 2013, due to an 8% increase in tonnage that was partially offset by lower sell rates in response to competitive market conditions in North America and Asia Pacific. Airfreight services expenses also increased 6% for the nine-month period ended September 30, 2014 as the increase in tonnage was slightly offset by negotiating lower buy rates with carriers, primarily on exports from North America.

Airfreight services net revenues increased 5% for the three-month period ended September 30, 2014, as compared with the same period for 2013. This increase was primarily due to a 12% improvement in airfreight tonnage, partially offset by a 7% decrease in net revenue per kilo. North America export tonnage grew by 14% but net revenues increased by only 9% as the reduction in average sell rates to customers exceeded the reduction in average buy rates negotiated with carriers. Europe net revenues increased 27% primarily due to a 31% growth in export tonnage as a result of new customers. Asia Pacific net revenues decreased 5%. This was primarily the result of lower average sell rates in response to competitive market conditions, which resulted in a 14% reduction in net revenue per kilo and more than offset a 9% growth in export tonnage.

Airfreight services net revenues increased 4% for the nine-month period ended September 30, 2014, as compared with the same period for 2013. This was primarily due to an 8% improvement in airfreight tonnage, partially offset by a 5% decrease in net revenue per kilo. For the same reasons described above, North America export tonnage grew by 12% but net revenues increased by only 7%, Europe net revenues increased 19% primarily due to a 20% growth in export tonnage, and Asia Pacific net revenues decreased 4%, while export tonnage rose 4%.

The global airfreight market continues to be affected by overcapacity and the timing of new product launches. Customers remain focused on improving supply-chain efficiency by utilizing deferred airfreight or ocean freight whenever possible. The Company expects these trends to continue in conjunction with carriers' efforts to manage available capacity, however, this could be affected by new product launches during periods that have historically experienced higher demands. These factors result in a higher degree of volatility in buy and sell rates and volumes.

Ocean freight services and ocean services:

Ocean freight and ocean services revenues increased 14% for the three-month period ended September 30, 2014, as compared with the same period for 2013, due primarily to an 11% increase in container volume and higher average sell rates to customers commensurate with increased carrier buy rates. Ocean freight and ocean services expenses increased 16% for the three-month period ended September 30, 2014, due primarily to increased volume and higher average buy rates. Container volume is measured in terms of forty-foot container equivalent units (FEUs).

Ocean freight and ocean services revenues increased 10% for the nine-month period ended September 30, 2014, as compared with the same period for 2013. Container volume increased 11% as the Company lowered sell rates,

principally in the first half of 2014, to maintain its existing customer base and grow market share. Ocean freight and ocean services expenses increased 12% for the nine-month period ended September 30, 2014, primarily resulting from higher volumes and higher costs in ocean freight consolidation.
Ocean freight and ocean services net revenues increased 8% and 4% for the three and nine-month periods ended September 30, 2014, as compared with the same periods for 2013. Ocean freight and ocean services net revenues are comprised of three basic services: ocean freight consolidation, direct ocean forwarding and order management. The largest component is ocean freight consolidation, which represented 45% and 44% of ocean freight net revenue for the three and nine-month periods ended September 30, 2014 and 44% and 46%, respectively, for the same periods ended in 2013.
Ocean freight consolidation net revenues increased 10% for the three-month period ended September 30, 2014, as compared with the same period in 2013. This increase was due primarily to an 11% growth in volume while net revenue per container remained constant. Average market prices improved during the third quarter as overall market demand increased due to seasonality. Ocean freight consolidation net revenues remained flat for the nine-month period ended September 30, 2014. The 11% increase in volume was offset by the effect of reducing sell rates, principally in the first half of 2014. This resulted in an 11% decrease in net revenue per container, primarily in North America and Asia Pacific.
Direct ocean freight forwarding net revenues increased 5% and 6%, respectively, for the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013, as a result of higher volumes principally in North America, Asia Pacific and Europe. Order management net revenues increased 9% for both the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013, mostly due to higher volumes with new and existing customers, primarily in North America. The overall margins in order management declined due to higher costs, primarily in Asia Pacific.
North America ocean freight and ocean services net revenues increased 11% and 5%, respectively, for the three and nine-month periods ended September 30, 2014, primarily due to an increase in ocean freight consolidation in the third quarter and growth in order management services for both the quarter and nine-month periods. Asia Pacific increased 8% in the third quarter due principally to ocean freight consolidation and direct ocean forwarding. Asia Pacific increased 2% during the nine month-period, primarily due to an increase in direct ocean forwarding. Europe ocean freight and ocean services net revenues increased 1% and 3% for the three and nine-month periods, primarily due to an increase in direct ocean forwarding.
Customs brokerage and other services:
Customs brokerage and other services revenues increased 9% and 8%, respectively, for the three and nine-month periods ended September 30, 2014, as compared with the same periods for 2013, as a result of increased volumes from existing and new customers. Customs brokerage and other services expenses increased 13% for both the three and nine-month periods ended September 30, 2014, due to higher costs associated with import and delivery services.
Customs brokerage and other services net revenues increased 5% and 4%, respectively, for the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013, primarily due to higher volumes from existing and new customers in North America. The margin percentage declined primarily as a result of higher import services costs and lower yields in domestic time-definite transportation services.
North America, Asia Pacific and Europe net revenues increased 6%, 4% and 5%, respectively, in the third quarter of 2014, as compared with the same period in 2013, primarily as a result of higher volumes from existing and new customers. North America, Asia Pacific and Europe net revenues increased 6%, 1% and 3%, respectively, in the nine-month period ended September 30, 2014, for the reasons described above.
Overhead expenses:
Salaries and related costs increased 4% and 3%, respectively, for the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013, primarily as a result of an increase in the number of employees in North America and Europe and higher average base salaries.
Historically, the relatively consistent relationship between salaries and net revenues is the result of a compensation philosophy that has been maintained since the inception of the Company: offer a modest base salary and the opportunity to share in a fixed and determinable percentage of the operating profit of the business unit controlled by each key employee. Using this compensation model, changes in individual incentive compensation will occur in proportion to changes in Company operating income, creating a direct alignment between corporate performance and

shareholder interests. Bonuses to management for the nine-month period ended September 30, 2014 were up 1% as compared with the same period for 2013, primarily as a result of a 4% increase in operating income. The Company’s management incentive compensation programs have always been incentive-based and performance driven and there is no built-in bias that favors or enriches management in a manner inconsistent with overall corporate performance. Salaries and related costs as a percentage of net revenues decreased 1% and remained constant, respectively, for the three and nine-month periods ended September 30, 2014 as compared with the same periods for 2013.
Because the Company’s management incentive compensation programs are also cumulative, no management bonuses can be paid unless the relevant business unit is, from inception, cumulatively profitable. Any operating losses must have been offset in their entirety by operating profits before current management is eligible for a bonus. Since the most significant portion of management compensation comes from the incentive bonus programs, the Company believes that this cumulative feature is a disincentive to excessive risk taking by its managers. Due to the nature of the Company’s services, it has a short operating cycle. The outcome of any higher risk transactions, such as overriding established credit limits, would be known in a relatively short time frame. Management believes that when the potential and certain impact on the bonus is fully considered in light of this short operating cycle, the potential for short term gains that could be generated by engaging in risky business practices is sufficiently mitigated to discourage excessive and inappropriate risk taking. Management believes that both the stability and the long term growth in revenues, net revenues and net earnings are a result of the incentives inherent in the Company’s compensation program.
Other overhead expenses increased 6% and 7%, respectively, for the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013. The increase in expenses in the third quarter of 2014 is primarily due to higher costs related to investments in software and systems and increased building, maintenance and warehousing costs, partially offset by lower bad debt expense and reduced legal costs and claims.
The increase in expenses in the first nine months of 2014 is primarily due to (i) consulting fees and costs associated with the Company's strategic assessment and organizational changes; (ii) higher costs related to investments in software and systems; (iii) increased building, maintenance and warehousing costs; (iv) higher travel costs partially offset by a recovery of bad debt expense and reduced legal costs. Other overhead expenses remained constant as a percentage of net revenues for the three and nine-month periods ended September 30, 2014, as compared with the same periods in 2013.
Income tax expense:
The Company pays income taxes in the United States and other jurisdictions. The Company’s consolidated effective income tax rate was 37.4% and 38.1% for the three and nine-month periods ended September 30, 2014 and 38.4% and 38.8%, for the same periods in 2013. The decreases in the effective tax rates over the prior periods are principally the result of an increasingly higher proportion of the Company's total outstanding stock options being non-qualified grants. The tax benefit associated with non-qualified stock option grants is recorded when the related compensation expense is recognized while the tax benefits for incentive stock options and employee stock purchase plan shares cannot be anticipated and are recognized if and when a disqualifying disposition event occurs.

Currency and Other Risk Factors
The nature of the Company's worldwide operations necessitates the Company dealing with a multitude of currencies other than the U.S. dollar. This results in the Company being exposed to the inherent risks of volatile international currency markets and governmental interference. Some of the countries where the Company maintains offices and/or agency relationships have strict currency control regulations which influence the Company's ability to hedge foreign currency exposure. The Company tries to compensate for these exposures by accelerating international currency settlements among its offices or agents. The Company may enter into foreign currency hedging transactions where there are regulatory or commercial limitations on the Company's ability to move money freely around the world or the short-term financial outlook in any country is such that hedging is the most time-sensitive way to mitigate short-term exchange losses. Any such hedging activity during the three and nine months ended September 30, 2014 and 2013 was insignificant. The Company had no foreign currency derivatives outstanding at September 30, 2014 and December 31, 2013. During the three and nine months ended September 30, 2014, net foreign currency gains were approximately $2 million and net foreign currency losses were less than $1 million, respectively. For the same periods of 2013, net foreign currency losses were less than $1 million.

International air and ocean freight forwarding and customs brokerage are intensively competitive and are expected to remain so for the foreseeable future. There are a large number of entities competing in the international logistics industry, many of which have significantly more resources than the Company; however, the Company’s primary competition is confined to a relatively small number of companies within this group. The industry continues to experience consolidations into larger firms striving for stronger and more complete multinational and multi-service networks. However, regional and local brokers and forwarders remain a competitive force.

The primary competitive factors in the international logistics industry continue to be price and quality of service, including reliability, responsiveness, expertise, convenience, and scope of operations. The Company emphasizes quality customer service and believes that its prices are competitive with those of others in the industry. Customers regularly solicit bids from competitors in order to improve service, pricing and contractual terms such as seeking longer payment terms, higher or unlimited liability limits and performance penalties. Increased competition and competitors' acceptance of such expanded contractual terms could result in reduced revenues, reduced margins, higher operating costs or loss of market share, any of which would damage the Company's results of operations and financial condition.

Larger customers utilize more sophisticated and efficient procedures for the management of their logistics supply chains by embracing strategies such as just-in-time inventory management. The Company believes that this trend has resulted in customers using fewer service providers with greater technological capacity and more consistent global coverage. Accordingly, sophisticated computerized customer service capabilities and a stable worldwide network have become significant factors in attracting and retaining customers. Developing and maintaining these systems and a worldwide network has added a considerable indirect cost to the services provided to customers. Smaller and middle-tier competitors, in general, do not have the resources available to develop customized systems and a worldwide network.

Liquidity and Capital Resources

The Company’s principal source of liquidity is cash and cash equivalents, short-term investments and cash generated from operating activities. Net cash provided by operating activities for the three and nine months ended September 30, 2014, was approximately $87 million and $305 million, respectively, as compared with $96 million and $346 million for the same periods in 2013. The decreases of $9 million and $41 million for the three and nine-month periods ended September 30, 2014 are primarily due to net growth in accounts receivable, accounts payable, accrued expenses and income taxes payable. At September 30, 2014, working capital was $1,355 million, including cash and cash equivalents and short-term investments of $1,031 million. The Company had no long-term debt at September 30, 2014. Management believes that the Company’s current cash position and operating cash flows will be sufficient to meet its capital and liquidity requirements for at least the next 12 months and thereafter for the foreseeable future, including meeting any contingent liabilities related to standby letters of credit and other obligations.

As a customs broker, the Company makes significant cash advances for a select group of its credit-worthy customers. These cash advances are for customer obligations such as the payment of duties and taxes to governmental authorities in various countries throughout the world. Cash advances are a “pass through” and are not recorded as a component of revenue and expense. The billings of such advances to customers are accounted for as a direct increase in accounts receivable from the customer and a corresponding increase in accounts payable to governmental customs authorities. As a result of these “pass through” billings, the conventional Days Sales Outstanding or DSO calculation does not directly measure collection efficiency. For customers that meet certain criteria, the Company has agreed to extend payment terms beyond its customary terms. Management believes that the Company has effective credit control procedures, and historically has experienced relatively insignificant collection problems.

The Company’s business is subject to seasonal fluctuations. Cash flow fluctuates as a result of this seasonality. Historically, the first quarter shows an excess of customer collections over customer billings. This results in positive cash flow. The increased activity associated with peak season (typically commencing late second or early third quarter and continuing well into the fourth quarter) causes an excess of customer billings over customer collections. This cyclical growth in customer receivables consumes available cash.

Cash provided from investing activities for the third quarter of 2014 was $38 million and cash used was $67 million for the nine months ended September 30, 2014, as compared with cash used of $25 million and $141 million for the same periods in 2013. The Company received net proceeds from short-term investments of $46 million and made a net investment of $14 million for the three and nine-month periods ended September 30, 2014, respectively, as compared with net short-term investments of $10 million and $100 million, respectively, for the same periods in 2013. The Company had capital expenditures of $8 million and $27 million, respectively, for the three and nine-month periods ended September 30, 2014, as compared with capital expenditures of $15 million and $43 million, for the same periods in 2013. Capital expenditures in the three and nine months ended September 30, 2014 related primarily to investments in technology, office furniture and equipment and building and leasehold improvements. The Company does have need, on occasion, to purchase buildings to house staff and to facilitate the staging of customers' freight. During the second quarter of 2014, the Company deposited $27 million in an escrow account for an expected land acquisition. Total capital expenditures in 2014 are estimated to be approximately $40 million. This includes routine capital expenditures plus additional real estate development.

Cash used in financing activities during the three and nine months ended September 30, 2014, was $89 million and $479 million as compared with $53 million and $142 million for the same periods in 2013. The Company uses the proceeds from stock option exercises, employee stock purchases and available cash to repurchase the Company's common stock on the open market to limit the growth in issued and outstanding shares. Also, during the three and nine months ended September 30, 2014, the Company used cash to repurchase an additional 2.0 million and 9.6 million shares of common stock to reduce the number of total outstanding shares. During the nine months ended September 30, 2014 and 2013, the Company paid dividends of $0.32 and $0.30 per share, respectively.

The Company follows established guidelines relating to credit quality, diversification and maturities of its investments to preserve principal and maintain liquidity. Historically, the Company's investment portfolio has not been adversely impacted by the disruption in the credit markets. However, there can be no assurance that the Company's investment portfolio will not be adversely affected in the future.

At September 30, 2014, the Company was contingently liable for $75 million from standby letters of credit and guarantees. The standby letters of credit and guarantees relate to obligations of the Company's foreign subsidiaries for credit extended in the ordinary course of business by direct carriers, primarily airlines, and for duty and tax deferrals available from governmental entities responsible for customs and value-added-tax (VAT) taxation. The total underlying amounts due and payable for transportation and governmental excises are properly recorded as obligations in the books of the respective foreign subsidiaries, and there would be no need to record additional expense in the unlikely event the parent company is required to perform.

The Company's foreign subsidiaries regularly remit dividends to the U.S. parent company after evaluating their working capital requirements and needs to finance local capital expenditures. In some cases, the Company's ability to repatriate funds from foreign operations may be subject to foreign exchange controls. At September 30, 2014, cash and cash equivalent balances of $655 million were held by the Company's non-United States subsidiaries, of which $46 million was held in banks in the United States. Earnings of the Company's foreign subsidiaries are not considered to be indefinitely reinvested outside of the United States and, accordingly, a deferred tax liability has been accrued for all undistributed earnings, net of foreign related tax credits that are available to be repatriated.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to market risks in the ordinary course of its business. These risks are primarily related to foreign exchange risk and changes in short-term interest rates. The potential impact of the Company's exposure to these risks is presented below:

Foreign Exchange Risk

The Company conducts business in many different countries and currencies. The Company's business often results in billings issued in a country and currency which differs from that where the expenses related to the service are incurred. In the ordinary course of business, the Company creates numerous intercompany transactions and may have receivables, payables and currencies that are not denominated in the local functional currency. This brings foreign exchange risk to the Company's earnings. The principal foreign exchange risks to which the Company is exposed are in Chinese Yuan, Euro, Mexican Peso and Canadian Dollar.

Foreign exchange rate sensitivity analysis can be quantified by estimating the impact on the Company's earnings as a result of hypothetical changes in the value of the U.S. dollar, the Company's functional currency, relative to the other currencies in which the Company transacts business. All other things being equal, an average 10% weakening of the U.S. dollar, throughout the nine months ended September 30, 2014, would have had the effect of raising operating income approximately $29 million. An average 10% strengthening of the U.S. dollar, for the same period, would have the effect of reducing operating income approximately $24 million. This analysis does not take into account changes in shipping patterns based upon this hypothetical currency fluctuation. For example, a weakening in the U.S. dollar would be expected to increase exports from the United States and decrease imports into the United States over some relevant period of time, but the exact effect of this change cannot be quantified without making speculative assumptions.

The Company currently does not use derivative financial instruments to manage foreign currency risk and only enters into foreign currency hedging transactions in limited locations where regulatory or commercial limitations restrict the Company's ability to move money freely. Any such hedging activity during the three and nine months ended September 30, 2014 and 2013 was insignificant. During the three and nine months ended September 30, 2014, net foreign currency gains were approximately $2 million and net foreign currency losses were less than $1 million, respectively. For the same periods of 2013, net foreign currency losses were less than $1 million. The Company had no foreign currency derivatives outstanding at September 30, 2014 and December 31, 2013. The Company instead follows a policy of accelerating international currency settlements to manage foreign exchange risk relative to intercompany billings. As of September 30, 2014, the Company had approximately $34 million of net unsettled intercompany transactions. The majority of intercompany billings are resolved within 30 days.

Interest Rate Risk

At September 30, 2014, the Company had cash and cash equivalents and short term investments of $1,031 million, of which $415 million was invested at various short-term market interest rates. The Company had no long-term debt at September 30, 2014. A hypothetical change in the interest rate of 10 basis points at September 30, 2014 would not have a significant impact on the Company's earnings.

In management's opinion, there has been no material change in the Company's interest rate risk exposure in the third quarter of 2014.

Item 4. Controls and Procedures

Evaluation of Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of its management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report at the reasonable assurance level.

Changes in Internal Controls

There were no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

The Company's management has confidence in the Company’s internal controls and procedures. Nevertheless, the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, does not expect that the Company’s disclosure controls and procedures or the Company’s internal controls will prevent all errors or intentional fraud. An internal control system, no matter how well-conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of such internal controls are met. Further, the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all internal control systems, no evaluation of controls can provide absolute assurance that all the Company’s control issues and instances of fraud, if any, have been detected.

The Company is developing a new accounting system which it plans to implement on a worldwide basis over the next several years. This system is expected to improve the efficiency of certain financial and transactional processes and reporting. This transition will affect the processes that constitute the Company's internal control over financial reporting and will require testing for operating effectiveness.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is involved in claims, lawsuits, government investigations and other legal matters that arise in the ordinary course of business and are subject to inherent uncertainties. Currently, in management's opinion and based upon advice from legal advisors, none of these matters are expected to have a significant effect on the Company's operations or financial position. As of September 30, 2014, the amounts accrued for these claims, lawsuits, government investigations and other legal matters are not significant to the Company's operations or financial position. At this time the Company is unable to estimate any additional loss or range of reasonably possible losses, if any, beyond the amounts recorded, that might result from the resolution of these matters.

Item 1A. Risk Factors

There have been no material changes in the Company’s risk factors from those disclosed in the Company's annual report on Form 10-K filed on February 27, 2014.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
July 1-31, 2014	—	$—	—	19,220,122
August 1-31, 2014	1,823,140	41.08	1,823,140	16,702,789
September 1-30, 2014	1,000,000	42.15	1,000,000	15,746,480
Total	2,823,140	$41.46	2,823,140	15,746,480

In November 1993, the Company’s Board of Directors authorized a Non-Discretionary Stock Repurchase Plan for the purpose of repurchasing the Company’s common stock in the open market with the proceeds received from the exercise of stock options. On February 9, 2009, the Plan was amended to increase the authorization to repurchase up to 40 million shares of the Company’s common stock. This authorization has no expiration date. This plan was disclosed in the Company’s annual report on Form 10-K filed on March 31, 1995. In the third quarter of 2014, 712,992 shares of common stock were repurchased under the Non-Discretionary Stock Repurchase Plan.

On November 13, 2001, the Company’s Board of Directors announced a Discretionary Stock Repurchase Plan, which authorized the repurchase of the Company's common stock in the open market to reduce the issued and outstanding common stock to 200 million shares. On February 24, 2014, the Plan was amended to authorize management to reduce issued and outstanding stock to 190 million shares. The maximum number of shares available for repurchase under this plan will increase as the total number of outstanding shares increases. This authorization has no expiration date. In the third quarter of 2014, 2,110,148 shares of common stock were repurchased under the Discretionary Stock

Repurchase Plan. These discretionary repurchases included 110,148 shares that were made to limit the growth in the number of issued and outstanding shares resulting from stock option exercises and the exercise of employee stock purchase rights and 2,000,000 shares to reduce the number of total shares outstanding.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

(a) Not applicable.

(b) Not applicable.

Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K.

Exhibit Number	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification Pursuant to 18 U.S.C. Section 1350, As Adopted 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

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.

	EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
November 6, 2014	/s/ JEFFREY S. MUSSER Jeffrey S. Musser, President, Chief Executive Officer and Director
November 6, 2014	/s/ BRADLEY S. POWELL Bradley S. Powell, Senior Vice President and Chief Financial Officer

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES
Form 10-Q Index and Exhibits
September 30, 2014

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101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document