

EXPEDITORS INTERNATIONAL OF WASHINGTON INC
Form 10-Q
November 07, 2012

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, 2012

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 1, 2012, the number of shares outstanding of the issuer's Common Stock was 208,981,760.

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, 2012 | December 31, 2011 |
|--|-----------------------|----------------------|
| Current Assets: | | |
| Cash and cash equivalents | \$1,367,642 | \$1,294,356 |
| Accounts receivable, less allowance for doubtful accounts of \$9,167 at September 30, 2012 and \$10,381 at December 31, 2011 | 1,015,350 | 934,752 |
| Deferred Federal and state income taxes | 10,955 | 10,415 |
| Other | 46,048 | 47,360 |
| Total current assets | 2,439,995 | 2,286,883 |
| Property and equipment, less accumulated depreciation and amortization of \$317,896 at September 30, 2012 and \$296,481 at December 31, 2011 | 551,610 | 538,806 |
| Goodwill and other intangibles, net | 9,774 | 10,557 |
| Other assets, net | 30,808 | 30,581 |
| Total assets | \$3,032,187 | \$2,866,827 |
| Current Liabilities: | | |
| Accounts payable | 667,395 | 606,628 |
| Accrued expenses, primarily salaries and related costs | 174,862 | 169,445 |
| Federal, state and foreign income taxes | 23,943 | 20,072 |
| Total current liabilities | 866,200 | 796,145 |
| Deferred Federal and state income taxes | 70,288 | 60,613 |
| Commitments and contingencies | | |
| Shareholders' Equity: | | |
| Preferred stock, none issued | — | — |
| Common stock, par value \$.01 per share. Issued and outstanding 208,950,205 shares at September 30, 2012 and 212,003,662 shares at December 31, 2011 | 2,090 | 2,120 |
| Additional paid-in capital | 118 | 13,260 |
| Retained earnings | 2,082,542 | 1,991,222 |
| Accumulated other comprehensive income (loss) | 5,267 | (2,964) |
| Total shareholders' equity | 2,090,017 | 2,003,638 |
| Noncontrolling interest | 5,682 | 6,431 |
| Total equity | 2,095,699 | 2,010,069 |
| Total liabilities and equity | \$3,032,187 | \$2,866,827 |

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, | |
|---|-------------------------------------|-------------|------------------------------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| Revenues: | | | | |
| Airfreight services | \$622,678 | \$736,946 | \$1,900,131 | \$2,187,730 |
| Ocean freight and ocean services | 549,250 | 510,521 | 1,502,584 | 1,437,493 |
| Customs brokerage and other services | 359,736 | 358,901 | 1,045,271 | 1,023,361 |
| Total revenues | 1,531,664 | 1,606,368 | 4,447,986 | 4,648,584 |
| Operating Expenses: | | | | |
| Airfreight consolidation | 471,947 | 558,047 | 1,437,301 | 1,658,963 |
| Ocean freight consolidation | 432,518 | 392,249 | 1,177,919 | 1,109,603 |
| Customs brokerage and other services | 162,061 | 162,226 | 467,406 | 459,696 |
| Salaries and related costs | 252,899 | 258,512 | 748,956 | 745,441 |
| Rent and occupancy costs | 21,304 | 21,352 | 63,333 | 64,087 |
| Depreciation and amortization | 10,030 | 9,199 | 29,245 | 27,630 |
| Selling and promotion | 7,847 | 9,342 | 25,370 | 28,527 |
| Other | 27,959 | 31,683 | 95,683 | 91,374 |
| Total operating expenses | 1,386,565 | 1,442,610 | 4,045,213 | 4,185,321 |
| Operating income | 145,099 | 163,758 | 402,773 | 463,263 |
| Other Income (Expense): | | | | |
| Interest income | 2,831 | 2,888 | 9,241 | 7,520 |
| Interest expense | (182) |) (279) |) (1,024) |) (722) |
| Other, net | 1,232 | 10,792 | 6,011 | 12,766 |
| Other income, net | 3,881 | 13,401 | 14,228 | 19,564 |
| Earnings before income taxes | 148,980 | 177,159 | 417,001 | 482,827 |
| Income tax expense | 60,253 | 70,283 | 167,531 | 189,724 |
| Net earnings | 88,727 | 106,876 | 249,470 | 293,103 |
| Less net earnings attributable to the noncontrolling interest | 237 | 272 | 318 | 267 |
| Net earnings attributable to shareholders | \$88,490 | \$106,604 | \$249,152 | \$292,836 |
| Diluted earnings attributable to shareholders per share | \$.42 | \$.50 | \$1.17 | \$1.36 |
| Basic earnings attributable to shareholders per share | \$.42 | \$.50 | \$1.18 | \$1.38 |
| Dividends declared and paid per common share | \$— | \$— | \$.28 | \$.25 |
| Weighted average diluted shares outstanding | 211,397,602 | 214,717,451 | 212,916,309 | 215,376,675 |
| Weighted average basic shares outstanding | 210,135,763 | 212,256,119 | 211,314,850 | 212,160,994 |

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, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Net earnings | \$88,727 | \$106,876 | \$249,470 | \$293,103 |
| Other comprehensive income (loss), net of tax: | | | | |
| Foreign currency translation adjustments, net of tax of \$5,622 and \$13,476 for the three months ended September 30, 2012 and 2011, and \$4,864 and \$5,621 for the nine months ended September 30, 2012 and 2011 | 8,982 | (24,707) |) 7,691 | (10,514) |
| Reclassification adjustments for foreign currency realized losses, net of tax of \$350 for the three and nine months ended September 30, 2012 and \$391 for the three and nine months ended September 30, 2011 | 650 | 618 | 650 | 618 |
| Other comprehensive income (loss) | 9,632 | (24,089) |) 8,341 | (9,896) |
| Comprehensive income | 98,359 | 82,787 | 257,811 | 283,207 |
| Less comprehensive income (loss) attributable to the noncontrolling interest | 257 | 59 | 428 | (87) |
| Comprehensive income attributable to shareholders | \$98,102 | \$82,728 | \$257,383 | \$283,294 |

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, | |
| | 2012 | 2011 | 2012 | 2011 |
| Operating Activities: | | | | |
| Net earnings | \$88,727 | \$106,876 | \$249,470 | \$293,103 |
| Adjustments to reconcile net earnings to net cash from operating activities: | | | | |
| Provision for losses on accounts receivable | 463 | (629) | (392) | 1,161 |
| Deferred income tax expense (benefit) | 4,588 | (9,328) | 4,330 | (9,663) |
| Excess tax benefits from stock plans | (59) | (537) | (4,291) | (5,068) |
| Stock compensation expense | 11,320 | 12,738 | 32,846 | 33,446 |
| Depreciation and amortization | 10,030 | 9,199 | 29,245 | 27,630 |
| Gain on sale of assets | (13) | (3) | (143) | (54) |
| Other | 1,273 | 1,210 | 1,826 | 1,828 |
| Changes in operating assets and liabilities: | | | | |
| Increase in accounts receivable | (23,520) | (4,312) | (73,812) | (11,802) |
| Increase in other current assets | (7,195) | (8,344) | (3,629) | (5,863) |
| (Decrease) increase in accounts payable and accrued expenses | (23,267) | (24,070) | 60,966 | 14,060 |
| Increase in income taxes payable, net | 6,819 | 10,505 | 12,961 | 10,417 |
| Net cash from operating activities | 69,166 | 93,305 | 309,377 | 349,195 |
| Investing Activities: | | | | |
| Purchase of property and equipment | (10,170) | (20,619) | (37,072) | (58,854) |
| Proceeds from sale of property and equipment | 41 | 24 | 294 | 109 |
| Other, net | (32) | (632) | 192 | (2,676) |
| Net cash from investing activities | (10,161) | (21,227) | (36,586) | (61,421) |
| Financing Activities: | | | | |
| Proceeds from issuance of common stock | 24,599 | 30,966 | 45,001 | 54,591 |
| Repurchases of common stock | (87,227) | (43,298) | (193,493) | (108,572) |
| Excess tax benefits from stock plans | 59 | 537 | 4,291 | 5,068 |
| Dividends paid | — | — | (59,358) | (53,014) |
| Distributions to noncontrolling interest | (1,177) | (822) | (1,177) | (822) |
| Net cash from financing activities | (63,746) | (12,617) | (204,736) | (102,749) |
| Effect of exchange rate changes on cash and cash equivalents | 8,136 | (24,477) | 5,231 | (8,676) |
| Increase in cash and cash equivalents | 3,395 | 34,984 | 73,286 | 176,349 |
| Cash and cash equivalents at beginning of period | 1,364,247 | 1,225,830 | 1,294,356 | 1,084,465 |
| Cash and cash equivalents at end of period | \$1,367,642 | \$1,260,814 | \$1,367,642 | \$1,260,814 |
| Interest and Taxes Paid: | | | | |
| Interest | \$27 | \$48 | \$447 | \$65 |
| Income taxes | 50,911 | 65,856 | 155,006 | 183,167 |

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, 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 footnote 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 28, 2012. Certain 2011 amounts have been reclassified to conform with the 2012 presentation. All dollar amounts in the notes are presented in thousands except for share data. All significant intercompany accounts and transactions have been eliminated in consolidation.

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 \$9,167 as of September 30, 2012 and \$10,381 as of December 31, 2011. 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 freight related exposure which the Company has self-insured, accrual of various tax liabilities, accrual of loss contingencies and calculations of share-based compensation expense. Actual results could differ from those estimates.

D. Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-No. 05 “Presentation of Comprehensive Income”, which amends Accounting Standards Codification (ASC) Topic 220-“Comprehensive Income”. This update is intended to increase the prominence of items reported in other comprehensive income by giving the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The Company adopted the provisions of ASU 2011-No. 05, as amended by ASU 2011-No. 12, beginning in the first quarter of 2012. Accordingly, condensed consolidated statements of comprehensive income were included consecutive to the condensed consolidated statements of earnings. The adoption only had a presentation impact on the Company's consolidated financial statements.

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 2, 2012, the shareholders approved the 2012 Stock Option

Plan ("2012 Plan"), which made available 3,000,000 shares of the Company's common stock for purchase upon exercise of options granted under the 2012 Plan. The Company's annual grant of option awards generally takes place during the second quarter of each fiscal year. For the nine months ended September 30, 2012 and 2011, 2,822,990 and 2,998,390 options were granted,

respectively. 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 773,661 and 663,386 shares were issued in the three and nine-month periods ended September 30, 2012 and 2011, respectively.

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, | | | |
|--|---------------------------------|---|-------------|---|
| | 2012 | | 2011 | |
| Dividend yield | 1.30 - 1.35% | | .97 - .98% | |
| Volatility - stock option plans | 38 - 39% | | 38 - 40% | |
| Volatility - stock purchase rights plans | 34 | % | 26 | % |
| Risk free interest rates | .19 - 1.43% | | .19 - 2.84% | |
| Expected life (years) - stock option plans | 5.79 - 7.26 | | 5.50 - 7.11 | |
| Expected life (years) - stock purchase rights plans | 1 | | 1 | |
| Weighted average fair value of stock options granted during the period | \$13.53 | | \$19.35 | |
| Weighted average fair value of stock purchase rights granted during the period | \$9.70 | | \$11.70 | |

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

| | Three months ended | | Nine months ended | |
|----------------------------|--------------------|----------|-------------------|----------|
| | September 30, | | September 30, | |
| | 2012 | 2011 | 2012 | 2011 |
| Stock compensation expense | \$11,320 | \$12,738 | \$32,846 | \$33,446 |
| Recognized tax benefit | \$996 | \$40 | \$1,371 | \$117 |

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 per share:

| (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 |
| 2012 | | | |
| Basic earnings attributable to shareholders | \$88,490 | 210,135,763 | \$.42 |
| Effect of dilutive potential common shares | — | 1,261,839 | — |
| Diluted earnings attributable to shareholders | \$88,490 | 211,397,602 | \$.42 |
| 2011 | | | |
| Basic earnings attributable to shareholders | \$106,604 | 212,256,119 | \$.50 |
| Effect of dilutive potential common shares | — | 2,461,332 | — |
| Diluted earnings attributable to shareholders | \$106,604 | 214,717,451 | \$.50 |

| (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 |
| 2012 | | | |
| Basic earnings attributable to shareholders | \$249,152 | 211,314,850 | \$ 1.18 |
| Effect of dilutive potential common shares | — | 1,601,459 | — |
| Diluted earnings attributable to shareholders | \$249,152 | 212,916,309 | \$ 1.17 |
| 2011 | | | |
| Basic earnings attributable to shareholders | \$292,836 | 212,160,994 | \$ 1.38 |
| Effect of dilutive potential common shares | — | 3,215,681 | — |
| Diluted earnings attributable to shareholders | \$292,836 | 215,376,675 | \$ 1.36 |

The following 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, | |
|--------|-------------------------------------|-----------|------------------------------------|-----------|
| | 2012 | 2011 | 2012 | 2011 |
| Shares | 15,265,732 | 8,550,014 | 15,211,875 | 7,281,935 |

Note 4. Components of Equity

The components of equity for the nine months ended September 30, 2012 and 2011 are as follows:

| | Shareholders' equity | Noncontrolling interest | Total equity |
|---|-------------------------|----------------------------|-----------------|
| Balance at December 31, 2011 | \$2,003,638 | 6,431 | 2,010,069 |
| Exercise of stock options | 21,610 | — | 21,610 |
| Issuance of shares under stock purchase plan | 23,391 | — | 23,391 |
| Shares repurchased under provisions of stock repurchase plans | (193,493) | — | (193,493) |
| Stock compensation expense | 32,846 | — | 32,846 |
| Tax benefits from stock plans, net | 4,000 | — | 4,000 |
| Net earnings | 249,152 | 318 | 249,470 |
| Other comprehensive income | 8,231 | 110 | 8,341 |
| Dividends paid (\$.28 per share) | (59,358) | — | (59,358) |
| Distributions to noncontrolling interest | — | (1,177) | (1,177) |
| Balance at September 30, 2012 | \$2,090,017 | 5,682 | 2,095,699 |
| Balance at December 31, 2010 | \$1,740,906 | 7,248 | 1,748,154 |
| Exercise of stock options | 30,367 | — | 30,367 |
| Issuance of shares under stock purchase plan | 24,224 | — | 24,224 |
| Shares repurchased under provisions of stock repurchase plans | (108,572) | — | (108,572) |
| Stock compensation expense | 33,446 | — | 33,446 |
| Tax benefits from stock plans, net | 5,068 | — | 5,068 |
| Net earnings | 292,836 | 267 | 293,103 |
| Other comprehensive loss | (9,542) | (354) | (9,896) |
| Dividends paid (\$.25 per share) | (53,014) | — | (53,014) |
| Distributions to noncontrolling interest | — | (822) | (822) |
| Balance at September 30, 2011 | \$1,955,719 | 6,339 | 1,962,058 |

On May 2, 2012, the Board of Directors declared a semi-annual cash dividend of \$0.28 per share payable on June 15, 2012 to shareholders of record as of June 1, 2012. On May 4, 2011, the Board of Directors declared a semi-annual cash dividend of \$.25 per share payable on June 15, 2011 to shareholders of record as of June 1, 2011.

Subsequent to the end of the quarter, on November 5, 2012, the Board of Directors declared a semi-annual cash dividend of \$.28 per share payable on December 17, 2012 to shareholders of record as of December 3, 2012.

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. Cash and cash equivalents consist of the following:

| | September 30, 2012 | | December 31, 2011 | |
|---------------------------------|--------------------|------------|-------------------|------------|
| | Cost | Fair Value | Cost | Fair Value |
| Cash and Cash Equivalents: | | | | |
| Cash and overnight deposits | \$546,142 | \$546,142 | \$445,586 | \$445,586 |
| Corporate commercial paper | 769,317 | 769,624 | 791,729 | 791,902 |
| Time deposits | 52,183 | 52,183 | 57,041 | 57,041 |
| Total cash and cash equivalents | 1,367,642 | 1,367,949 | 1,294,356 | 1,294,529 |

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

Note 6. Contingencies

On October 10, 2007, the U. S. Department of Justice (DOJ) issued a subpoena ordering the Company to produce certain information and records relating to an investigation of alleged anti-competitive behavior amongst air cargo freight forwarders. In a letter dated October 17, 2012, the DOJ confirmed that the Company is no longer a subject of this investigation.

On April 19, 2012, the Company received and has responded to a federal grand jury subpoena from the DOJ requiring the production of documents related to the export or re-export by unaffiliated third-parties to end users in a US-embargoed country of products and/or services produced by a U.S. manufacturer. In a related matter, the Company has also responded to an administrative subpoena from the Commerce Department's Bureau of Industry and Security (BIS) requiring the production of documents pertaining to the export or re-export of US-origin goods to the same embargoed country. If it is determined that the Company or one of its subsidiaries, directly or indirectly, facilitated the export or re-export of these specified products and/or services, the Company may incur fines and/or penalties which management does not expect would have a material impact on the Company's results of operations and cash flows.

The Company is involved in claims, lawsuits, government investigations and other legal matters which arise in the ordinary course of business and are subject to inherent uncertainties. Currently, in management's opinion, none of these matters are expected to have a significant effect on the Company's operations or financial position. As of September 30, 2012, 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 loss, 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, 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 are 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, 2012: | | | | | | | | |
| Revenues from unaffiliated customers | \$ 383,830 | 50,208 | 20,815 | 804,855 | 198,124 | 73,832 | — | 1,531,664 |
| Transfers between geographic areas | 24,423 | 2,677 | 4,140 | 10,676 | 9,624 | 4,507 | (56,047) | — |
| Total revenues | \$ 408,253 | 52,885 | 24,955 | 815,531 | 207,748 | 78,339 | (56,047) | 1,531,664 |
| Net revenues | \$ 187,737 | 23,412 | 13,978 | 146,992 | 69,841 | 23,178 | — | 465,138 |
| Operating income | \$ 56,096 | 6,886 | 4,239 | 59,620 | 13,312 | 4,946 | — | 145,099 |
| Identifiable assets at quarter end | \$ 1,570,615 | 102,020 | 58,687 | 714,982 | 423,488 | 162,225 | 170 | 3,032,187 |
| Capital expenditures | \$ 5,681 | 222 | 405 | 1,934 | 1,476 | 452 | — | 10,170 |
| Depreciation and amortization | \$ 5,942 | 188 | 220 | 1,691 | 1,555 | 434 | — | 10,030 |
| Equity | \$ 1,281,250 | 58,471 | 33,444 | 499,590 | 158,939 | 96,621 | (32,616) | 2,095,699 |
| Three months ended September 30, 2011: | | | | | | | | |
| Revenues from unaffiliated customers | \$ 388,736 | 49,341 | 21,353 | 839,069 | 229,776 | 78,093 | — | 1,606,368 |
| Transfers between geographic areas | 27,161 | 2,989 | 5,025 | 10,500 | 10,727 | 4,596 | (60,998) | — |
| Total revenues | \$ 415,897 | 52,330 | 26,378 | 849,569 | 240,503 | 82,689 | (60,998) | 1,606,368 |
| Net revenues | \$ 189,381 | 23,783 | 15,035 | 162,785 | 77,768 | 25,094 | — | 493,846 |
| Operating income | \$ 57,564 | 7,345 | 4,846 | 69,001 | 18,616 | 6,386 | — | 163,758 |
| Identifiable assets at quarter end | \$ 1,509,393 | 87,554 | 52,058 | 667,421 | 414,991 | 149,253 | 2,499 | 2,883,169 |
| Capital expenditures | \$ 7,435 | 315 | 162 | 7,201 | 4,981 | 525 | — | 20,619 |
| Depreciation and amortization | \$ 4,904 | 250 | 240 | 1,822 | 1,488 | 495 | — | 9,199 |
| Equity | \$ 1,242,594 | 49,134 | 27,258 | 435,466 | 146,652 | 92,668 | (31,714) | 1,962,058 |

| (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, 2012: | | | | | | | | |
| Revenues from unaffiliated customers | \$ 1,140,258 | 149,964 | 61,450 | 2,273,783 | 606,696 | 215,835 | — | 4,447,986 |
| Transfers between geographic areas | 69,135 | 7,608 | 14,010 | 32,686 | 28,694 | 13,828 | (165,961) | — |
| Total revenues | \$ 1,209,393 | 157,572 | 75,460 | 2,306,469 | 635,390 | 229,663 | (165,961) | 4,447,986 |
| Net revenues | \$ 551,503 | 70,769 | 43,537 | 414,714 | 212,871 | 71,966 | — | 1,365,360 |
| Operating income | \$ 150,814 | 21,340 | 13,119 | 158,626 | 40,510 | 18,364 | — | 402,773 |
| Identifiable assets at quarter end | \$ 1,570,615 | 102,020 | 58,687 | 714,982 | 423,488 | 162,225 | 170 | 3,032,187 |
| Capital expenditures | \$ 20,676 | 551 | 1,060 | 9,823 | 3,529 | 1,433 | — | 37,072 |
| Depreciation and amortization | \$ 17,320 | 556 | 644 | 4,960 | 4,389 | 1,376 | — | 29,245 |
| Equity | \$ 1,281,250 | 58,471 | 33,444 | 499,590 | 158,939 | 96,621 | (32,616) | 2,095,699 |
| Nine months ended September 30, 2011: | | | | | | | | |
| Revenues from unaffiliated customers | \$ 1,156,647 | 141,004 | 62,822 | 2,383,549 | 673,111 | 231,451 | — | 4,648,584 |
| Transfers between geographic areas | 77,099 | 8,454 | 15,866 | 29,853 | 32,789 | 13,305 | (177,366) | — |
| Total revenues | \$ 1,233,746 | 149,458 | 78,688 | 2,413,402 | 705,900 | 244,756 | (177,366) | 4,648,584 |
| Net revenues | \$ 548,918 | 66,065 | 45,295 | 454,889 | 230,521 | 74,634 | — | 1,420,322 |
| Operating income | \$ 169,050 | 18,895 | 14,095 | 189,981 | 53,200 | 18,042 | — | 463,263 |
| Identifiable assets at quarter end | \$ 1,509,393 | 87,554 | 52,058 | 667,421 | 414,991 | 149,253 | 2,499 | 2,883,169 |
| Capital expenditures | \$ 14,815 | 923 | 462 | 16,535 | 24,568 | 1,551 | — | 58,854 |
| Depreciation and amortization | \$ 14,815 | 830 | 773 | 5,638 | 4,014 | 1,560 | — | 27,630 |
| Equity | \$ 1,242,594 | 49,134 | 27,258 | 435,466 | 146,652 | 92,668 | (31,714) | 1,962,058 |

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 "Executive Summary," "Critical Accounting Estimates," "Results of Operations," "Currency and Other Risk Factors" and "Liquidity and Capital Resources" contain forward-looking statements. Words such as "expects," "goals," "plans," "believes," "continues," "may," "will," and variations 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. In addition to risk factors identified elsewhere in this report, attention should be given to the factors identified and discussed in the report on Form 10-K filed on February 28, 2012.

EXECUTIVE SUMMARY

Expeditors International of Washington, Inc. is engaged in the business of global logistics management, including international freight forwarding and consolidation, for both air and ocean freight. The Company acts as a customs broker in all domestic offices, and in many of its international offices. The Company also provides additional services for its customers including value-added distribution, purchase order management, vendor consolidation, domestic time definite services and other logistics solutions. The Company does not compete for overnight courier or small parcel business. The Company does not own or operate aircraft or steamships.

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, nor can the Company predict 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 or 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. Absent of any meaningful improvement in economic conditions, the Company expects similar trends to continue in the near term.

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.

As a non-asset based carrier, the Company does not own transportation assets. Rather, the Company generates the major portion of its air and ocean freight revenues by purchasing transportation services from direct (asset-based) carriers and reselling those services to its customers. The difference between the rate billed to customers (the sell rate) and the rate paid to the carrier or service provider (the buy rate) is termed "net revenue" or "yield." By consolidating shipments from multiple customers and concentrating its buying power, the Company is able to negotiate favorable buy rates from the direct carriers and service providers, while at the same time offering lower sell rates than customers would otherwise be able to negotiate themselves.

Customs brokerage and other services involves providing services at destination, such as helping customers clear shipments through customs by preparing required documentation, calculating and providing for payment of duties and other taxes on behalf of the customers as well as arranging for any required inspections by governmental agencies, and arranging for delivery. This is a complicated function requiring technical knowledge of customs rules and regulations

in the multitude of countries in which the Company has offices.

The Company's ability to provide services to its customers is highly dependent on good working relationships with a variety of entities including airlines, ocean steamship lines, and governmental agencies. The significance of maintaining acceptable working relationships with governmental agencies and asset-based carriers involved in global trade has gained increased importance as a result of ongoing concern over terrorism. As each carrier labors to comply with additional governmental regulations implementing security policies and procedures, inherent conflicts emerge which can and do affect

global trade. A good reputation helps to develop practical working understandings that will assist in meeting security requirements while minimizing potential international trade obstacles. The Company considers its current working relationships with these entities to be satisfactory. However, the airline and ocean steamship line industries have incurred significant losses in recent years as a result of the global economic downturn and many carriers are highly leveraged with debt. This situation has required the Company to be increasingly selective in which carriers to utilize. Further changes in the financial stability, operating capabilities and capacity of asset-based carriers, space allotments available from carriers, governmental regulation or deregulation efforts, “modernization” of the regulations governing customs brokerage, and/or changes in governmental quota restrictions or trade accords could affect the Company’s business in unpredictable ways.

Historically, the Company’s operating results have been subject to a seasonal trend when measured on a quarterly basis. The first quarter has traditionally been the weakest and the third and fourth quarters have traditionally been the strongest. This pattern is the result of, or is influenced by, numerous factors including weather patterns, national holidays, consumer demand, 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. The Company cannot accurately forecast many of these factors nor can the Company estimate accurately the relative influence of any particular factor and, as a result, there can be no assurance that historical patterns, if any, will continue in future periods.

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 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 operates in 63 countries throughout the world in the competitive global logistics industry and Company activities are tied directly to the global economy. 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;
- 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 is required, 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 our 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, these losses must be made up from 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 our control. Consequently, management spends the majority of its time focused on creating an environment where employees can learn and develop while also improving systems and taking preventative action to reduce exposure to negative events and risks. 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 our focus is on building and maintaining a global corporate culture of well-trained employees and managers that are prepared to identify and react to subtle changes as they develop and thereby help the Company adapt and thrive as major trends emerge.

Critical Accounting Estimates

Management believes that the nature of the Company's business is such that there are few complex challenges in accounting for operations. While judgments and estimates are a necessary component of any system of accounting, the Company's use of estimates is limited primarily to 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 freight related exposure which the Company has self-insured;
- accrual of various tax liabilities;
- accrual of loss contingencies; and
- calculation of share-based compensation expense.

These estimates, other than the accrual of loss contingencies and calculation of share-based compensation expense, are not highly uncertain and have not historically been subject to significant change. Management believes that the methods utilized in all of these areas are non-aggressive in approach and consistent in application. Management believes that there are limited, if any, alternative accounting principles or methods which could be applied to the Company's transactions. While the use of estimates means that actual future results may be different from those contemplated by the estimates, the Company believes that alternative principles and methods used for making such estimates would not produce materially different results than those reported.

The outcomes of government investigations, legal proceedings and claims brought against the Company are subject to significant uncertainty. An estimated loss from a contingency such as a government investigation, legal proceeding or claim is accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a loss contingency is required if there is at least a reasonable possibility that a significant loss has been incurred. In determining whether a loss should be accrued, management evaluates several factors, including advice from outside legal counsel, in order to estimate the degree of probability of an unfavorable outcome and make a reasonable estimate of the amount of loss or range of reasonably possible loss. Changes in these factors could have a material impact on the Company's results of operations and operating cash flows for any particular quarter or year.

As described in Note 2 in the condensed consolidated financial statements in this quarterly report, the Company accounts for share-based compensation based on an estimate of the fair value of options granted to employees under the Company's stock option and stock purchase rights plans. This expense, as adjusted for expected forfeitures, is recorded on a straight-line basis over the option vesting period.

Determining the appropriate option pricing model to use to estimate stock compensation expense requires judgment. Any option pricing model requires assumptions that are subjective and these assumptions also require judgment. Examples include assumptions about long-term stock price volatility, employee exercise patterns, pre-vesting option forfeitures, post-vesting option terminations, and future interest rates and dividend yields. The Company uses the Black-Scholes model for estimating the fair value of stock options.

Management believes that the assumptions used are appropriate based upon the Company's historical and currently expected future experience. Looking to future events, management has been strongly influenced by historical patterns which may not be valid predictors of future developments and any future deviation may be material. The fair value of an option is more significantly impacted by changes in the expected volatility and expected life assumptions. The pre-vesting forfeitures assumption is ultimately adjusted to the actual forfeiture rate. Therefore, changes in the forfeitures assumption would not impact the total amount of expense ultimately recognized over the vesting period. Different forfeitures assumptions would only impact the timing of expense recognition over the vesting period. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances.

Results of Operations

The following table shows the consolidated net revenues (revenues less transportation expenses) attributable to the Company's principal services and the Company's expenses for the three and nine-month periods ended September 30, 2012 and 2011, expressed as percentages of net revenues. Management believes that net revenues are a better measure than total revenues of the relative importance of 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 only the commissions and fees actually earned by the Company. 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, | | |
|---|----------------------------------|-------------------------|------------|---------------------------------|------------|-------------------------|
| | 2012 | 2011 | 2011 | 2012 | 2011 | 2011 |
| | Amount | Percent of net revenues | Amount | Percent of net revenues | Amount | Percent of net revenues |
| (Amounts in thousands) | | | | | | |
| Net Revenues: | | | | | | |
| Airfreight services | \$ 150,731 | 32 % | \$ 178,899 | 36 % | \$ 462,830 | 34 % |
| Ocean freight and ocean services | 116,732 | 25 | 118,272 | 24 | 324,665 | 24 |
| Customs brokerage and other services | 197,675 | 43 | 196,675 | 40 | 577,865 | 42 |
| Net revenues | 465,138 | 100 | 493,846 | 100 | 1,365,360 | 100 |
| Overhead Expenses: | | | | | | |
| Salaries and related costs | 252,899 | 54 | 258,512 | 52 | 748,956 | 55 |
| Other | 67,140 | 15 | 71,576 | 15 | 213,631 | 16 |
| Total overhead expenses | 320,039 | 69 | 330,088 | 67 | 962,587 | 71 |
| Operating income | 145,099 | 31 | 163,758 | 33 | 402,773 | 29 |
| Other income, net | 3,881 | 1 | 13,401 | 3 | 14,228 | 1 |
| Earnings before income taxes | 148,980 | 32 | 177,159 | 36 | 417,001 | 30 |
| Income tax expense | 60,253 | 13 | 70,283 | 14 | 167,531 | 12 |
| Net earnings | 88,727 | 19 | 106,876 | 22 | 249,470 | 18 |
| Less net earnings attributable to the noncontrolling interest | 237 | — | 272 | — | 318 | — |
| Net earnings attributable to shareholders | \$ 88,490 | 19 % | \$ 106,604 | 22 % | \$ 249,152 | 18 % |

Airfreight services net revenues decreased 16% for the three-month period ended September 30, 2012, as compared with the same period for 2011. The decrease in global airfreight services net revenues was primarily due to a 9% decrease in airfreight tonnage and a 7% decrease in net revenue per kilo. North America, Asia Pacific and Europe airfreight services net revenues decreased 11%, 17% and 22%, respectively, in the third quarter of 2012 as compared with the same period in 2011, while airfreight export tonnage for North America, Asia Pacific and Europe decreased 13%, 7% and 12%, respectively.

Airfreight services net revenues decreased 12% for the nine-month period ended September 30, 2012, as compared with the same period for 2011. The decrease in global airfreight services net revenues was primarily due to a 9% decrease in airfreight tonnage and a 3% decrease in net revenue per kilo. North America, Asia Pacific and Europe airfreight services net revenues decreased 8%, 16% and 16%, respectively, in the nine months ended September 30, 2012 as compared with the same period in 2011, while airfreight export tonnage for North America, Asia Pacific and

Europe decreased 14%, 6% and 9%, respectively.

The decline in airfreight tonnage for the three and nine months ended September 30, 2012 can be attributed to an overall decrease in the global airfreight market and a lower level of customer specific infrastructure and project related tonnage than experienced during the same period in 2011. Net revenue per kilo was lower in both the three and nine-month periods compared to the same periods in 2011, as carriers reduced overall available capacity to manage market pricing. Absent of any meaningful improvements in the uncertainties related to global economic conditions, the Company expects similar trends to continue in the near term.

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 of the Company's ocean freight net revenue is derived from ocean freight consolidation which represented 47% of ocean freight net revenue for both the three and nine-month periods ended September 30, 2012, and 49% and 50% for the same periods ended September 30, 2011, respectively.

Ocean freight and ocean services net revenues decreased 1% for the three-month period ended September 30, 2012, as compared with the same period for 2011. Europe ocean freight net revenues increased 2% while North America and Asia Pacific decreased 1% and 3%, respectively, in the third quarter of 2012, as compared with the same period in 2011. Ocean freight consolidation net revenue decreased 6% for the three-month period ended September 30, 2012, as compared with the same period for 2011, due to a 2% decrease in net revenue per container and a 4% decrease in container volume as measured in terms of forty-foot container equivalent units (FEUs).

Ocean freight and ocean services net revenues decreased 1% for the nine-month period ended September 30, 2012, as compared with the same period for 2011. North America ocean freight net revenues increased 1% while Asia Pacific and Europe decreased by 4% and 1%, respectively, in the nine-month period ended September 30, 2012, as compared with the same period in 2011. Ocean freight consolidation net revenue decreased 7% for the nine-month period ended September 30, 2012, as compared with the same period for 2011, due to a 6% decrease in net revenue per container and a 1% decrease in container volume as measured in terms of FEUs. The decreases in net revenues per container were primarily due to the timing of significant increases in buy rates implemented by carriers, requirements to provide notice of these increases to customers and the Company's ability to implement commensurate increases in its sell rates. Carrier reductions in available capacity and its associated impact on pricing also affected this timing. We expect carriers will continue to manage overall available capacity in an attempt to maintain rates and improve their operating results.

Direct ocean freight forwarding net revenues, which are primarily fee-based, increased 8% and 9%, respectively, for the three and nine-month periods ended September 30, 2012, as compared with the same periods in 2011, primarily due to an increase in market share and volume. Order management net revenues decreased 3% for the three month period ended September 30, 2012 as compared with the same periods in 2011 due to lower volumes, which partially offset the net revenue increase in the first six months of 2012.

Customs brokerage and other services net revenues increased 1% and 3%, respectively, for the three and nine-month periods ended September 30, 2012, as compared with the same periods for 2011. Higher volumes in domestic time definite services were partially offset by a decline in customs brokerage activity.

Salaries and related costs for the three-month period ended September 30, 2012, decreased 2% when compared with the same period in 2011, primarily as a result of lower bonuses earned due to lower operating income, partially offset by a 2% increase in the number of employees and higher payroll related taxes and medical costs. Salaries and related costs for the nine-month period ended September 30, 2012, increased slightly as compared with the same period in 2011 as the increase in the number of employees and higher payroll related taxes and medical costs were mostly offset by lower earned bonuses as a result of the decrease in operating income. The effects of including stock-based compensation expense in salaries and related costs are as follows:

| | Three months ended September 30, | | Nine months ended September 30, | | |
|----------------------------|----------------------------------|-----------|---------------------------------|-----------|---|
| | 2012 | 2011 | 2012 | 2011 | |
| Salaries and related costs | \$252,899 | \$258,512 | \$748,956 | \$745,441 | |
| As a % of net revenue | 54.4 | % 52.3 | % 54.9 | % 52.5 | % |
| Stock compensation expense | \$11,320 | \$12,738 | \$32,846 | \$33,446 | |
| As a % of net revenue | 2.4 | % 2.6 | % 2.4 | % 2.4 | % |

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 profits, creating a direct alignment between corporate performance and shareholder interests. However, the results in the nine-month period ended September 30, 2012 were not consistent with this historical relationship primarily due to a decrease in net revenues while the number of employees increased to support customer driven initiatives, enhance information systems and expand certain product capabilities. Bonuses to field and executive management for the nine-month period ended September 30, 2012 were down 9% and 13%, respectively, as compared with the same period for 2011, primarily as a result of a 13% decrease in operating income for the nine-month period. 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.

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 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 decreased 6% for the three months ended September 30, 2012, as compared with the same period in 2011. This decrease is due primarily to transition in certain tax jurisdictions to a value added tax system and cost reduction measures, including decreased travel and entertainment expenses. These expenses increased 1% for the nine months ended September 30, 2012 as the reductions described above were offset by the European Commission's finding against the Company for anti-competitive behavior which resulted in a fine of €4.14 million (\$5.5 million).

Other overhead expenses as a percentage of net revenues remained constant for the three months ended September 30, 2012, as compared with the same period in 2011 and also remained constant for the nine months ended September 30, 2012, as compared with the same period in 2011 when excluding the fine discussed above.

The Company is subject to formal and informal investigations or litigation from governmental authorities and others. Further, the Company periodically conducts reviews of the operations and procedures of its offices worldwide relating to compliance with applicable laws and regulations. The Company will continue to incur legal costs until these legal proceedings are concluded.

Other income, net, decreased approximately \$10 million and \$5 million, respectively, for the three and nine-month periods ended September 30, 2012, primarily as a result of foreign exchange losses in 2012 as compared to foreign exchange gains in 2011. The net foreign exchange gains in 2011 resulted primarily from U.S. dollar accounts receivable in non U.S. dollar-based subsidiaries as the U.S. dollar appreciated against other currencies at the end of the third quarter of 2011.

The Company pays income taxes in the United States and other jurisdictions, as well as other taxes which are typically included in costs of operations. The Company's consolidated effective income tax rate increased to approximately 40.4% and 40.2%, respectively, for the three and nine-month periods ended September 30, 2012, as compared to 39.7% and 39.3%, respectively, for the three and nine-month periods ended September 30, 2011, principally due to higher nondeductible expenses and a reduction in available tax deductions associated with disqualifying dispositions of incentive stock options relative to lower pre-tax earnings.

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 enters into foreign currency hedging transactions only in limited locations 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, 2012 and 2011 was insignificant. The Company had no foreign currency derivatives outstanding at September 30, 2012 and December 31, 2011. During the three and nine months ended September 30, 2012, net foreign currency losses were approximately \$427 and \$2,934, respectively. For the same periods of 2011, the Company's net foreign currency gains were approximately \$4,972 and \$4,642, respectively.

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; 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 service and believes that its prices are competitive with those of others in the industry. 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 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 and cash generated from operating activities. Net cash provided by operating activities for the three and nine months ended September 30, 2012, was approximately \$69 million and \$309 million, respectively, as compared with \$93 million and \$349 million for the same periods in 2011. The decreases of \$24 million for the three-month period ended September 30, 2012 and \$40 million for the nine-month period ended September 30, 2012 are primarily due to lower earnings and changes in working capital accounts, partially offset by an increase in deferred taxes. At September 30, 2012, working capital was \$1,574 million, including cash and cash equivalents of \$1,368 million. The Company had no long-term debt at September 30, 2012. Management believes that the Company's current cash position and operating cash flows will be sufficient to meet its capital and liquidity requirements for the foreseeable future, including meeting any contingent liabilities related to standby letters of credit and other obligations.

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.

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 to customs 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. Management believes that the Company has effective credit control procedures, and historically has experienced relatively insignificant collection problems.

Cash from investing activities for the three and nine months ended September 30, 2012 was \$10 million and \$37 million, respectively. The largest use of cash in investing activities is cash paid for capital expenditures. The Company does have need, on occasion, to purchase or construct buildings to house staff and to facilitate the staging of customers' freight. The Company routinely invests in technology, office furniture and equipment and leasehold improvements. In the third quarter of 2012, the Company made capital expenditures of \$10 million, as compared with \$21 million for the same period in 2011. Capital expenditures in the third quarter of 2012 related primarily to investments in technology, and office furniture and equipment. Total capital expenditures in 2012 are estimated to be approximately \$50 million. This includes normal capital expenditures as noted above plus additional real estate development.

Cash used in financing activities during the three and nine months ended September 30, 2012, was \$64 million and \$205 million, as compared with \$13 million and \$103 million for each of the same periods in 2011. The Company uses the proceeds from stock option exercises and available cash to repurchase the Company's common stock on the open market. In the third quarter of 2012, the Company continued its policy of repurchasing stock to limit growth in issued and outstanding shares as a result of stock option exercises. The increase in cash used in financing activity during the three and nine months ended September 30, 2012, as compared to the same periods in 2011, is primarily the result of this policy and additional discretionary repurchases of 1.6 million and 3.1 million shares at an average price

of \$36.71 and \$37.13, respectively. During the nine months ended September 30, 2012 and 2011, the Company paid dividends of \$.28 per share and \$.25 per share, respectively.

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

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' ability to pay or on changes in competitors' behavior.

The Company maintains international unsecured bank lines of credit. At September 30, 2012, amounts available for borrowing under international bank lines of credit totaled \$15 million. At September 30, 2012, the Company was contingently liable for \$102 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, 2012, cash and cash equivalent balances of \$650 million were held by the Company's non-United States subsidiaries, of which \$50 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 revenue 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, 2012, 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 \$23 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.

As of September 30, 2012, the Company had approximately \$1 million of net unsettled intercompany transactions. 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 nine months ended September 30, 2012 and 2011 was insignificant. During the three and nine months ended September 30, 2012, net foreign currency

losses were approximately \$427 and \$2,934. For the same periods of 2011, the Company's net foreign currency gains were approximately \$4,972 and \$4,642, respectively. The Company had no foreign currency derivatives outstanding at September 30, 2012 and December 31, 2011. The Company instead follows a policy of accelerating international currency settlements to manage foreign exchange risk relative to intercompany billings. The majority of intercompany billings are resolved within 30 days.

Interest Rate Risk

At September 30, 2012, the Company had cash and cash equivalents and short term investments of \$1,368 million of which \$822 million was invested at various short-term market interest rates. The Company had no long-term debt at September 30, 2012. A hypothetical change in the interest rate of 10 basis points at September 30, 2012 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 2012.

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 the 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 procedures and controls 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.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On October 10, 2007, the U. S. Department of Justice (DOJ) issued a subpoena ordering the Company to produce certain information and records relating to an investigation of alleged anti-competitive behavior amongst air cargo freight forwarders. In a letter dated October 17, 2012, the DOJ confirmed that the Company is no longer a subject of this investigation.

On April 19, 2012, the Company received and has responded to a federal grand jury subpoena from the DOJ requiring the production of documents related to the export or re-export by unaffiliated third-parties to end users in a US-embargoed country of products and/or services produced by a U.S. manufacturer. In a related matter, the Company has also responded to an administrative subpoena from the Commerce Department's Bureau of Industry and Security (BIS) requiring the production of documents pertaining to the export or re-export of US-origin goods to the same embargoed country. If it is determined that the Company or one of its subsidiaries, directly or indirectly, facilitated the export or re-export of these specified products and/or services, the Company may incur fines and/or penalties which management does not expect would have a material impact on the Company's results of operations and cash flows.

The Company is involved in claims, lawsuits, government investigations and other legal matters which arise in the ordinary course of business and are subject to inherent uncertainties. Currently, in management's opinion, none of these matters are expected to have a significant effect on the Company's operations or financial position. As of

September 30, 2012, 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 loss, 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 report on Form 10-K filed on February 28, 2012, except for the following:

RISK FACTOR

DISCUSSION AND POTENTIAL SIGNIFICANCE

Litigation/Investigations

As a multinational corporation, the Company is subject to formal or informal investigations or litigation from governmental authorities or others in the countries in which it does business. These investigations and other periodic investigations may require management time and could cause the Company to incur substantial legal and related costs, which may include fines and/or penalties that could have a material impact on the Company's results of operations and cash flows.

The Company may also become subject to other civil litigation arising from such investigations or litigations, including but not limited to shareholder class action lawsuits and derivative claims made on behalf of plaintiffs.

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, 2012 | — | \$— | — | 26,888,456 |
| August 1-31, 2012 | 1,804,293 | 36.69 | 1,804,293 | 26,000,346 |
| September 1-30, 2012 | 576,450 | 36.48 | 576,450 | 24,668,097 |
| Total | 2,380,743 | \$36.64 | 2,380,743 | 24,668,097 |

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 report on Form 10-K filed March 31, 1995. In the third quarter of 2012, 660,385 shares of common stock were repurchased under the Non-Discretionary Stock Repurchase Plan.

In November 2001, under a Discretionary Stock Repurchase Plan, the Company's Board of Directors authorized the repurchase of such shares as may be necessary to reduce the issued and outstanding stock to 200 million shares of common stock. 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. This plan was announced on November 13, 2001. In the third quarter of 2012, 1,720,358 shares of common stock were repurchased under the Discretionary Stock Repurchase Plan. These discretionary repurchases included 143,908 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 1,576,450 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 | Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

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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 7, 2012

/s/ PETER J. ROSE
Peter J. Rose, Chairman and Chief Executive Officer

November 7, 2012

/s/ BRADLEY S. POWELL
Bradley S. Powell, Senior Vice President and Chief Financial Officer

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.
AND SUBSIDIARIES
Form 10-Q Index and Exhibits
September 30, 2012

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