EXPEDITORS INTERNATIONAL OF WASHINGTON INC
Form 10-Q
November 07, 2013

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, 2013

OR

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

For the transition period from to

Commission File 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 5, 2013, the number of shares outstanding of the issuer's Common Stock was 205,580,335.

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, 2013	December 31, 2012
Current Assets:		
Cash and cash equivalents	$1,310,330	$1,260,842
Short-term investments	99,828	139
Accounts receivable, less allowance for doubtful accounts of $10,187 at September 30, 2013 and $9,383 at December 31, 2012	1,027,572	1,031,376
Deferred Federal and state income taxes	12,670	12,102
Other	47,811	53,140
Total current assets	2,498,211	2,357,599
Property and equipment, less accumulated depreciation and amortization of $337,154 at September 30, 2013 and $325,595 at December 31, 2012	562,125	556,204
Goodwill	7,927	7,927
Other assets, net	30,300	32,395
Total assets	$3,098,563	$2,954,125
Current Liabilities:		
Accounts payable	656,674	641,593
Accrued expenses, primarily salaries and related costs	183,130	178,995
Federal, state and foreign income taxes	24,175	21,970
Total current liabilities	863,979	842,558
Deferred Federal and state income taxes	53,854	78,997
Commitments and contingencies		
Shareholders’ Equity:		
Preferred stock, none issued	—	—
Common stock, par value $.01 per share. Issued and outstanding 205,455,991 shares at September 30, 2013 and 206,392,013 shares at December 31, 2012	2,055	2,064
Additional paid-in capital	2,443	1,283
Retained earnings	2,181,317	2,018,618
Accumulated other comprehensive (loss) income	(6,236)	5,734
Total shareholders’ equity	2,179,579	2,027,699
Noncontrolling interest	1,151	4,871
Total equity	2,180,730	2,032,570
Total liabilities and equity	$3,098,563	$2,954,125

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,	
	2013	2012	2013	2012
Revenues:				
Airfreight services	$628,116	$622,678	$1,891,459	$1,900,131
Ocean freight and ocean services	525,193	549,250	1,462,679	1,502,584
Customs brokerage and other services	381,780	359,736	1,091,889	1,045,271
Total revenues	1,535,089	1,531,664	4,446,027	4,447,986
Operating Expenses:				
Airfreight services	466,699	471,947	1,414,634	1,437,301
Ocean freight and ocean services	409,649	432,518	1,135,299	1,177,919
Customs brokerage and other services	176,716	162,061	499,684	467,406
Salaries and related costs	261,613	252,899	765,599	748,956
Rent and occupancy costs	21,851	21,304	65,640	63,333
Depreciation and amortization	12,629	10,030	35,581	29,245
Selling and promotion	8,306	7,847	23,891	25,370
Other	31,313	27,959	87,289	95,683
Total operating expenses	1,388,776	1,386,565	4,027,617	4,045,213
Operating income	146,313	145,099	418,410	402,773
Other Income (Expense):				
Interest income	2,967	2,831	9,280	9,241
Other, net	1,212	1,050	7,068	4,987
Other income, net	4,179	3,881	16,348	14,228
Earnings before income taxes	150,492	148,980	434,758	417,001
Income tax expense	57,763	60,253	168,756	167,531
Net earnings	92,729	88,727	266,002	249,470
Less net earnings attributable to the noncontrolling interest	329	237	972	318
Net earnings attributable to shareholders	$92,400	$88,490	$265,030	$249,152
Diluted earnings attributable to shareholders per share	$.45	$.42	$1.28	$1.17
Basic earnings attributable to shareholders per share	$.45	$.42	$1.28	$1.18
Dividends declared and paid per common share	$—	$—	$.30	$.28
Weighted average diluted shares outstanding	207,368,792	211,397,602	207,351,569	212,916,309
Weighted average basic shares outstanding	206,516,194	210,135,763	206,478,746	211,314,850

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,	
	2013	2012	2013	2012
Net earnings	$92,729	$88,727	$266,002	$249,470
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments, net of tax of $4,859 and $4,922 for the three months ended September 30, 2013 and 2012, and $6,557 and $4,164 for the nine months ended September 30, 2013 and 2012	8,751	8,982	(12,275)	7,691
Reclassification adjustments for foreign currency realized losses, net of tax of $350 for the three and nine months ended September 30, 2012	—	650	—	650
Other comprehensive income (loss)	8,751	9,632	(12,275)	8,341
Comprehensive income	101,480	98,359	253,727	257,811
Less comprehensive income attributable to the noncontrolling interest	211	257	667	428
Comprehensive income attributable to shareholders	$101,269	$98,102	$253,060	$257,383

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, 2013	Three months ended September 30, 2012	Nine months ended September 30, 2013	Nine months ended September 30, 2012
Operating Activities:				
Net earnings	$92,729	$88,727	$266,002	$249,470
Adjustments to reconcile net earnings to net cash from operating activities:				
Provision for losses (recoveries) on accounts receivable	1,496	463	2,537	(392)
Deferred income tax (benefit) expense	(33,185)	4,588	(20,245)	4,330
Excess tax benefits from stock plans	—	(59)	(1,683)	(4,291)
Stock compensation expense	11,015	11,320	33,060	32,846
Depreciation and amortization	12,629	10,030	35,581	29,245
Other	187	1,260	636	1,683
Changes in operating assets and liabilities:				
Increase in accounts receivable	(5,115)	(23,520)	(14,482)	(73,812)
Increase in other current assets	(4,702)	(7,195)	(5,278)	(3,629)
(Decrease) increase in accounts payable and accrued expenses	(8,875)	(23,267)	34,815	60,966
Increase in income taxes payable, net	30,114	6,819	14,640	12,961
Net cash from operating activities	96,293	69,166	345,583	309,377
Investing Activities:				
(Increase) decrease in short-term investments, net	(9,925)	113	(99,690)	211
Purchase of property and equipment	(15,482)	(10,170)	(42,691)	(37,072)
Other, net	306	(104)	1,126	275
Net cash from investing activities	(25,101)	(10,161)	(141,255)	(36,586)
Financing Activities:				
Proceeds from issuance of common stock	33,615	24,599	52,092	45,001
Repurchases of common stock	(85,925)	(87,227)	(125,206)	(193,493)
Excess tax benefits from stock plans	—	59	1,683	4,291
Dividends paid	—	—	(61,899)	(59,358)
Purchase of noncontrolling interest	—	—	(7,730)	—
Distributions to noncontrolling interest	(1,161)	(1,177)	(1,161)	(1,177)
Net cash from financing activities	(53,471)	(63,746)	(142,221)	(204,736)
Effect of exchange rate changes on cash and cash equivalents	6,500	8,136	(12,619)	5,231
Increase in cash and cash equivalents	24,221	3,395	49,488	73,286
Cash and cash equivalents at beginning of period	1,286,109	1,364,247	1,260,842	1,294,356
Cash and cash equivalents at end of period	$1,310,330	$1,367,642	$1,310,330	$1,367,642
Taxes Paid:				
Income taxes	$147,248	$50,911	$174,199	$155,006

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 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, 2013.

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 2013 presentation.

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 $10,187 as of September 30, 2013 and $9,383 as of December 31, 2012. 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 calculation of share-based compensation expense. Actual results could differ from those estimates.

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 1, 2013, the shareholders approved the 2013 Stock Option Plan ("2013 Plan"), which made available 3,000,000 shares of the Company's common stock for purchase upon exercise of options granted under the 2013 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, 2013 and 2012, 2,779,700 and 2,822,990 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 800,461 and 773,661 shares were issued in the three-month periods ended September 30, 2013 and 2012, 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,			
	2013		2012	
Dividend yield	1.50 - 1.53%		1.30 - 1.35%	
Volatility - stock option plans	38	%	38 - 39%	
Volatility - stock purchase rights plans	21	%	34	%
Risk free interest rates	.12 - 1.40%		.19 - 1.43%	
Expected life (years) - stock option plans	5.91 - 7.43		5.79 - 7.26	
Expected life (years) - stock purchase rights plans	1		1	
Weighted average fair value of stock options granted during the period	$11.17		$13.53	
Weighted average fair value of stock purchase rights granted during the period	$9.43		$9.70	

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Stock compensation expense	$11,015	$11,320	$33,060	$32,846
Recognized tax benefit	$943	$996	$2,492	$1,371

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
2013			
Basic earnings attributable to shareholders	$92,400	206,516,194	$ .45
Effect of dilutive potential common shares	—	852,598	—
Diluted earnings attributable to shareholders	$92,400	207,368,792	$ .45
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

(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
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
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

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,	
	2013	2012	2013	2012
Shares	15,314,114	15,265,732	17,165,060	15,211,875

Note 4. Components of Equity

The components of equity for the nine months ended September 30, 2013 and 2012 are as follows:

	Shareholders' equity	Noncontrolling interest	Total equity
Balance at December 31, 2012	$2,027,699	4,871	2,032,570
Exercise of stock options	28,115	—	28,115
Issuance of shares under stock purchase plan	23,977	—	23,977
Shares repurchased under provisions of stock repurchase plans	(125,206)	—	(125,206)
Stock compensation expense	33,060	—	33,060
Tax benefits from stock plans, net	1,280	—	1,280
Net earnings	265,030	972	266,002
Other comprehensive loss	(11,970)	(305)	(12,275)
Dividends paid ($.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
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

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

On May 1, 2013, the Board of Directors declared a semi-annual cash dividend of $.30 per share payable on June 17, 2013 to shareholders of record as of June 3, 2013. On May 2, 2012, the Board of Directors declared a semi-annual cash dividend of $.28 per share payable on June 15, 2012 to shareholders of record as of June 1, 2012.

Subsequent to the end of the third quarter, on November 4, 2013, the Board of Directors declared a semi-annual cash dividend of $.30 per share payable on December 16, 2013 to shareholders of record as of December 2, 2013.

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, 2013		December 31, 2012	
	Cost	Fair Value	Cost	Fair Value
Cash and Cash Equivalents:				
Cash and overnight deposits	$548,504	$548,504	$458,169	$458,169
Corporate commercial paper	728,375	728,562	642,884	642,886
Time deposits	33,451	33,451	159,789	159,789
Total cash and cash equivalents	$1,310,330	$1,310,517	$1,260,842	$1,260,844
Short-Term Investments:				
Corporate commercial paper	99,796	99,911	—	—
Time deposits	32	32	139	139
Total short-term investments	$99,828	$99,943	$139	$139
Total	$1,410,158	$1,410,460	$1,260,981	$1,260,983

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

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, 2013, 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, 2013:								
Revenues from unaffiliated customers	$394,046	52,962	22,136	777,711	212,482	75,752	—	1,535,089
Transfers between geographic areas	22,065	2,911	5,643	12,081	9,358	4,473	(56,531)	—
Total revenues	$416,111	55,873	27,779	789,792	221,840	80,225	(56,531)	1,535,089
Net revenues[1]	$196,389	26,255	15,627	147,343	70,924	25,487	—	482,025
Operating income	$55,627	8,524	5,317	57,975	11,894	6,976	—	146,313
Identifiable assets at quarter 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
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[1]	$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

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(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, 2013:								
Revenues from unaffiliated customers	$1,158,569	161,317	63,421	2,221,033	620,964	220,723	—	4,446,027
Transfers between geographic areas	65,308	7,971	16,133	34,316	27,427	13,359	(164,514)	—
Total revenues	$1,223,877	169,288	79,554	2,255,349	648,391	234,082	(164,514)	4,446,027
Net revenues[1]	$564,895	75,476	45,560	424,235	212,555	73,689	—	1,396,410
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
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[1]	$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 period 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

[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,	
	2013	2012	2013	2012
Total revenues	$1,535,089	$1,531,664	$4,446,027	$4,447,986

Expenses:				
Airfreight services	466,699	471,947	1,414,634	1,437,301
Ocean freight and ocean services	409,649	432,518	1,135,299	1,177,919
Customs brokerage and other services	176,716	162,061	499,684	467,406
Net revenues	$482,025	$465,138	$1,396,410	$1,365,360

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 “expects,” “goals,” “plans,” “believes,” “estimates,” “continues,” “may,” “will,” and variations of such words and similar expre 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, 2013.

Overview

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 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, such as aircraft or steamships.

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 our 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, is obligated 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 an HAWB or an 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 the 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 look at 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, 2013), 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 50% of revenues and 40% of operating income for the nine months ended September 30, 2013. 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 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.

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, 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, 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.

International Trade and Competition

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. 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 resulted in a compression of the Company's 2012 margins. In the quarter ended September 30, 2013, the Company's ocean freight consolidation net revenue per container decreased 16%, as compared with the third quarter of 2012, primarily related to exports out of China.

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 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, 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 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, if any, 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, 2012, filed on February 27, 2013. There have been no material changes to the critical accounting estimates previously disclosed in that report.

Results of Operations

The following table shows the calculation of consolidated 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, 2013 and 2012, 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 includes 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 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,			
	2013		2012		2013		2012	
	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	$628,116		$622,678		$1,891,459		$1,900,131	
Expenses	466,699		471,947		1,414,634		1,437,301	
Net revenues	161,417	33 %	150,731	32 %	476,825	34 %	462,830	34 %
Ocean freight services and ocean services:								
Revenues	525,193		549,250		1,462,679		1,502,584	
Expenses	409,649		432,518		1,135,299		1,177,919	
Net revenues	115,544	24	116,732	25	327,380	24	324,665	24
Customs brokerage and other services:								
Revenues	381,780		359,736		1,091,889		1,045,271	
Expenses	176,716		162,061		499,684		467,406	
Net revenues	205,064	43	197,675	43	592,205	42	577,865	42
Total net revenues	482,025	100	465,138	100	1,396,410	100	1,365,360	100
Overhead expenses:								
Salaries and related costs	261,613	54	252,899	54	765,599	55	748,956	55
Other	74,099	16	67,140	15	212,401	15	213,631	16
Total overhead expenses	335,712	70	320,039	69	978,000	70	962,587	71
Operating income	146,313	30	145,099	31	418,410	30	402,773	29
Other income, net	4,179	1	3,881	1	16,348	1	14,228	1
Earnings before income taxes	150,492	31	148,980	32	434,758	31	417,001	30
Income tax expense	57,763	12	60,253	13	168,756	12	167,531	12
Net earnings	92,729	19	88,727	19	266,002	19	249,470	18
Less net earnings attributable to the	329	—	237	—	972	—	318	—

noncontrolling interest											
Net earnings attributable to shareholders	$92,400	19	%	$88,490	19	%	$265,030	19	%	$249,152	18	%

Airfreight services:

Airfreight services revenues increased 1% for the three-month period ended September 30, 2013, as compared with the same period for 2012, due to a 3% increase in tonnage that was partially offset by the Company lowering sell rates to reflect soft market conditions primarily caused by higher available capacity relative to demand. Airfreight services expenses decreased 1% for the three-month period ended September 30, 2013, as compared with the same period for 2012, as the increase in tonnage was more than offset by improved buy rates and effective carrier utilization.

Airfreight services revenues decreased slightly and related expenses declined 2% for the nine-month period ended September 30, 2013, as compared with the same period for 2012, as a 3% increase in tonnage was offset by lower sell and buy rates for the market conditions described above.

Airfreight services net revenues increased 7% for the three-month period ended September 30, 2013, as compared with the same period for 2012. The increase in global airfreight services net revenues was primarily due to a 3% increase in airfreight tonnage and a 4% increase in net revenue per kilo. North America, Asia Pacific and Europe airfreight services net revenues increased 9%, 4% and 6%, respectively, as air export tonnage increased 3%, 1% and 5%, respectively.

Airfreight services net revenues increased 3% for the nine-month period ended September 30, 2013, as compared with the same period for 2012. The increase in global airfreight services net revenues was principally due to a 3% increase in airfreight tonnage. North America, Asia Pacific and Europe airfreight services net revenues increased 2%, 4% and 2%, respectively, in the nine months ended September 30, 2013 as compared with the same periods in 2012, while airfreight export tonnage for North America, Asia Pacific and Europe increased 1%, 4% and 3%, respectively.

The global airfreight market continues to be affected by the decrease in size and weight of high technology consumer products 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 both rates and volumes.

Ocean freight services and ocean services:

Ocean freight and ocean services revenues decreased 4% and 3%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods for 2012, primarily driven by lower sell rates to customers, reflecting increased carrier capacity that outpaced overall market demand. Ocean freight and ocean services expenses decreased 5% and 4%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods for 2012, primarily due to reduced buy rates from carriers as a result of the market conditions referenced above. The decreases in sell and buy rates were partially offset by an increase in container volumes of 9% and 3%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods for 2012. Container volume is measured in terms of forty-foot container equivalent units (FEUs).

Container volumes increased 9% for the three-month period ended September 30, 2013, as compared with the same period for 2012, while ocean freight and ocean services net revenues decreased 1%, primarily resulting from pricing reductions needed to both maintain and gain market share. Ocean freight and ocean services net revenues increased 1% for the nine-month period ended September 30, 2013, as compared with the same period for 2012, primarily resulting from additional services and volumes with new and existing customers utilizing order management services.

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 44% and 46% of ocean freight net revenue for the three and nine-month periods ended September 30, 2013, respectively, and 47% for the same periods ended in 2012.

Ocean freight consolidation net revenues decreased 8% for the three-month period ended September 30, 2013, as compared with the same period in 2012, primarily due to a 16% decrease in net revenue per container, partially offset by a 9% increase in container volume. During the third quarter of 2013, ocean carriers attempted on several occasions to impose general price increases. Ultimately, these efforts were unsuccessful and market ocean rates continued to fall throughout the quarter in the face of ongoing capacity issues. In order to maintain and grow market share, the Company reacted to these market trends by temporarily absorbing carrier cost increases, when the Company anticipated such cost increases would be temporary and could not be sustained by the carriers. The Company also implemented rate reductions with its customers where needed to reflect market conditions, mostly on exports from China. Ocean freight consolidation net revenues decreased 1% for the nine-month period ended September 30, 2013, as compared with the same period in 2012, primarily due to a 5% decrease in net revenue per container, partially offset by a 3% increase in container volume.

Direct ocean freight forwarding net revenues increased 1% and remained constant, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods in 2012. Order management net revenues increased 9% and 6%, respectively, for the three and nine-month periods ended September 30, 2013 as compared with the same periods in 2012, mostly due to additional services and volumes with new and existing customers.

North America and Europe ocean freight and ocean services net revenues increased 3% and 1%, respectively, while Asia Pacific decreased 6% in the third quarter of 2013, as compared with the same period in 2012. North America ocean freight and ocean services net revenues increased 3%, while Europe remained flat and Asia Pacific decreased 2% in the nine-month period ended September 30, 2013, as compared with the same period in 2012. The decreases in net revenues in Asia Pacific are due to the Company implementing sell rate reductions to customers in the third quarter, which on average outpaced buy rate reductions negotiated with carriers, and was partially offset by an 11% increase in container volumes.

Customs brokerage and other services:

Customs brokerage and other services revenues increased 6% and 4%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods for 2012, as a result of increased volumes from existing and new customers. Customs brokerage and other services expenses increased 9% and 7%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods for 2012 as a result of increased volume, higher buy rates and other costs in domestic time definite transportation services.

Customs brokerage and other services net revenues increased 4% and 2%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods in 2012, primarily due to higher volumes from existing and new customers. The margin percentage declined primarily as a result of domestic time definite transportation services. Customers continue to seek out customs brokers with sophisticated computerized capabilities critical to an overall logistics management program, including rapid responses to changes in the regulatory and security environment.

North America and Asia Pacific customs brokerage and other services net revenues increased 5% and 4%, respectively, in the third quarter of 2013 and 3% and 4%, respectively for the nine-month period ended September 30, 2013, as compared with the same periods in 2012, primarily as a result of higher volumes. These increases were partially offset by declines in Europe of 1% and 2%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods in 2012, related to the ongoing economic challenges in Europe.

Overhead expenses:

Salaries and related costs increased 3% and 2%, respectively, for the three and nine-month periods ended September 30, 2013, as compared with the same periods in 2012, primarily as a result of increases in base salaries and higher field and executive management bonuses earned as a result of increases in operating income.

Salaries and related costs and stock-based compensation expense as a percentage of net revenues are as follows:

	Three months ended September 30,				Nine months ended September 30,			
	2013		2012		2013		2012	
Salaries and related costs	$261,613		$252,899		$765,599		$748,956	
As a % of net revenues	54.3	%	54.4	%	54.8	%	54.9	%
Stock compensation expense	$11,015		$11,320					

The denominator for diluted net income per common share for fiscal years 2008, 2007 and 2006 exclude 3,758, 1,136 and 932 employee options, respectively, due to their anti-dilutive effects.

11. Employee benefit plans

The Company provides a 401(k) retirement plan covering all employees who qualify as to age, length of service, and hours employed. In fiscal 2008, 2007, and 2006, the plan was funded through employee contributions and a Company match of 40% up to 3% of eligible compensation. For fiscal years 2008, 2007 and 2006, the Company match was $437, $408 and $300, respectively.

On January 1, 2009, the Company established a non-qualified deferred compensation plan for highly compensated employees whose contributions are limited under qualified defined contribution plans. Amounts contributed and deferred under the plan are credited or charged with the performance of investment options offered under the plan as elected by the participants. In the event of bankruptcy, the assets of this plan are available to satisfy the claims of general creditors. The liability for compensation deferred under the Company s plan was insignificant at January 31, 2009, and is included in accrued liabilities. Total expense recorded under this plan was also insignificant during fiscal 2008, and is included in selling, general and administrative expenses. The Company manages the risk of changes in the fair value of the liability for deferred compensation by electing to match its liability under the plan with investment vehicles that offset a substantial portion of its exposure. The cash value of the investment vehicles was insignificant at January 31, 2009, and is included in cash and cash equivalents. Both the asset and the liability are carried at fair value.

12. Related-party transactions

During fiscal 1997, 1998, and 2001, certain officers of the Company were issued shares of Series V, IV, and I Preferred Stock, respectively, in exchange for promissory notes. These notes bear interest at a rate of 6.85% per annum and were due and payable at the earlier of 90 days after termination of employment or various dates through November 4, 2007, subject to certain exceptions. These notes were fully repaid in fiscal 2007.

During fiscal 2006, an officer of the Company exercised stock options in exchange for a promissory note for $4,094. The note bears interest at a rate of 5.06% per annum and was due at the earlier of an initial public offering of the Company s common stock or five years from issuance date. The note was paid in full on June 29, 2007.

Ulta Salon, Cosmetics & Fragrance, Inc.
Notes to Consolidated Financial Statements (Continued)

13. Valuation and qualifying accounts

Description	Balance at Beginning of Period	Charged to Costs and Expenses	Deductions	Balance at end of Period
Fiscal 2008				
Allowance for doubtful accounts	$ 309	$ 209	$ (222)(a)	$ 296
Shrink reserve	1,745	3,785	(3,525)	2,005
Inventory lower of cost or market reserve	1,801	1,840	(1,277)	2,364
Fiscal 2007				
Allowance for doubtful accounts	422	298	(411)(a)	309
Shrink reserve	1,005	3,620	(2,880)	1,745
Inventory lower of cost or market reserve	701	1,561	(461)	1,801
Fiscal 2006				
Allowance for doubtful accounts	224	338	(140)(a)	422
Shrink reserve	722	2,003	(1,720)	1,005
Inventory lower of cost or market reserve	758	359	(416)	701

(a) Represents writeoff of uncollectible accounts.

Ulta Salon, Cosmetics & Fragrance, Inc.
Notes to Consolidated Financial Statements (Continued)

14. Selected quarterly financial data (unaudited)

The following tables set forth the Company s unaudited quarterly results of operations for each of the quarters in fiscal 2008 and fiscal 2007. The Company uses a 13 week fiscal quarter ending on the last Saturday of the quarter.

	Fiscal Quarter							
	2008				2007			
	First	Second	Third	Fourth	First	Second	Third	Fourth
Net sales	$ 239,298	$ 249,111	$ 254,843	$ 341,394	$ 194,113	$ 200,449	$ 208,235	$ 309,344
Cost of sales	165,377	175,965	175,368	240,002	134,600	141,417	140,156	212,322
Gross profit	73,921	73,146	79,475	101,392	59,513	59,032	68,079	97,022
Selling, general and administrative expenses	62,065	61,889	65,176	78,192	47,982	51,188	55,609	70,388
Pre-opening expenses	3,772	4,050	4,693	1,796	1,656	2,914	4,494	2,694
Operating income	8,084	7,207	9,606	21,404	9,875	4,930	7,976	23,940
Interest expense	915	1,016	1,124	888	996	1,162	1,307	1,077
Income before income taxes	7,169	6,191	8,482	20,516	8,879	3,768	6,669	22,863
Income tax expense	2,894	2,503	3,465	8,228	3,560	1,562	2,463	9,259
Net income	$ 4,275	$ 3,688	$ 5,017	$ 12,288	$ 5,319	$ 2,206	$ 4,206	$ 13,604
Net income per common share:								
Basic	$ 0.08	$ 0.06	$ 0.09	$ 0.21	$ 0.22	$ (0.23)	$ 0.06	$ 0.24
Diluted	$ 0.07	$ 0.06	$ 0.09	$ 0.21	$ 0.10	$ (0.23)	$ 0.05	$ 0.23

Due to preferred stock dividends prior to the initial public offering, changes in stock prices during the year and timing of issuance of shares, the sum of fiscal 2007 quarterly net income per common share will not equal the fiscal 2007 annual net income per common share.

Exhibits

Exhibit Number	Description of Document
3.1	Amended and Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Company s Registration Statement on Form S-1 (file No. 333-144405) filed with the Securities and Exchange Commission on August 17, 2007).
3.2	Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to the Company s Registration Statement on Form S-1 (file No. 333-144405) filed with the Securities and Exchange Commission on August 17, 2007).
4.1	Specimen Common Stock Certificate (incorporated by reference to Exhibit 4.1 to the Company s Registration Statement on Form S-1 (file No. 333-144405) filed with the Securities and Exchange Commission on October 11, 2007).
4.2	Third Amended and Restated Registration Rights Agreement between Ulta Salon, Cosmetics & Fragrance, Inc. and the stockholders party thereto (incorporated by reference to Exhibit 4.2 to the Company s Registration Statement on Form S-1 (file No. 333-144405) filed with the Securities and Exchange Commission on August 17, 2007).
4.3	Stockholder Rights Agreement (incorporated by reference to Exhibit 4.4 to the Company s Registration Statement on Form S-1 (file No. 333-144405) filed with the Securities and Exchange Commission on August 17, 2007).
10.12(a)	Second Amendment to Lease, dated February 20, 2008, by and between Bolingbrook Investors, LLC and Ulta Salon, Cosmetics and Fragrance, Inc. (incorporated by reference to Exhibit 10.1 to the Company s Quarterly Report on Form 10-Q (file No. 001-33764) filed with the Securities and Exchange Commission on June 17, 2008)
10.13(a)*	Second Amendment to Lease, dated March 17, 2008, by and between Southwest Valley Partners, LLC and Ulta Salon, Cosmetics and Fragrance, Inc. (incorporated by reference to Exhibit 10.2 to the Company s Quarterly Report on Form 10-Q (file No. 001-33764) filed with the Securities and Exchange Commission on June 17, 2008)
10.14(a)	First Amendment to Third Amended and Restated Loan and Security Agreement, dated as of August 15, 2008 (incorporated by reference to Exhibit 10.15 to the Company s Current Report on Form 8-K (file No. 001-33764) filed with the Securities and Exchange Commission on August 20, 2008).
10.15*	Acceptance Letter and Commencement Date Agreement, dated March 24, 2008, by and between Southwest Valley Partners, LLC and Ulta Salon, Cosmetics and Fragrance, Inc. (incorporated by reference to Exhibit 10.3 to the Company s Quarterly Report on Form 10-Q (file No. 001-33764) filed with the Securities and Exchange Commission on June 17, 2008)
10.16	Employment Agreement, dated as of June 16, 2008, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Lyn Kirby. (incorporated by reference to Exhibit 10.4 to the Company s Quarterly Report on Form 10-Q (file No. 001-33764) filed with the Securities and Exchange Commission on June 17, 2008)
10.16(a)	Amendment to Option Agreement with Grant Date March 24, 2008, by and between Ulta Salon, Cosmetics & Fragrance, Inc. and Lyn Kirby
10.17	Ulta Salon, Cosmetics & Fragrance, Inc. Nonqualified Deferred Compensation Plan
23.1	Consent of Independent Registered Public Accounting Firm
31.1	

	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Confidential treatment has been requested with respect to certain portions of this Exhibit pursuant to Rule 24b-2 under the Securities Exchange Act. Omitted portions have been filed separately with the Securities and Exchange Commission.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Chicago, State of Illinois, on April 2, 2009.

ULTA SALON, COSMETICS & FRAGRANCE, INC.

By: /s/ Gregg R. Bodnar

Gregg R. Bodnar
Chief Financial Officer and Assistant Secretary

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated:

Signatures	Title	Date
/s/ Lynelle P. Kirby Lynelle P. Kirby	President, Chief Executive Officer and Director (Principal Executive Officer)	April 2, 2009
/s/ Gregg R. Bodnar Gregg R. Bodnar	Chief Financial Officer and Assistant Secretary (Principal Financial and Accounting Officer)	April 2, 2009
/s/ Hervé J.F. Defforey Hervé J.F. Defforey	Director	April 2, 2009
/s/ Robert F. DiRomualdo Robert F. DiRomualdo	Director	April 2, 2009
/s/ Dennis K. Eck Dennis K. Eck	Chairman of the Board of Directors	April 2, 2009
/s/ Gerald R. Gallagher Gerald R. Gallagher	Director	April 2, 2009
/s/ Charles Heilbronn Charles Heilbronn	Director	April 2, 2009

/s/ Steven E. Lebow	Director	April 2, 2009
Steven E. Lebow		
/s/ Charles J. Philippin	Director	April 2, 2009
Charles J. Philippin		
/s/ Yves Sisteron	Director	April 2, 2009
Yves Sisteron		

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