

WERNER ENTERPRISES INC

Form 10-Q

August 03, 2018

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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 June 30, 2018

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

Commission File Number: 0-14690

WERNER ENTERPRISES, INC.  
(Exact name of registrant as specified in its charter)

NEBRASKA 47-0648386  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

14507 FRONTIER ROAD  
POST OFFICE BOX 45308 68145-0308  
OMAHA, NEBRASKA  
(Address of principal executive offices) (Zip Code)  
(402) 895-6640  
(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, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 31, 2018, 71,636,735 shares of the registrant's common stock, par value \$0.01 per share, were outstanding.

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PART I

FINANCIAL INFORMATION

Cautionary Note Regarding Forward-Looking Statements:

This Quarterly Report on Form 10-Q contains historical information and forward-looking statements based on information currently available to our management. The forward-looking statements in this report, including those made in Item 2 (Management’s Discussion and Analysis of Financial Condition and Results of Operations) of Part I, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, as amended. These safe harbor provisions encourage reporting companies to provide prospective information to investors. Forward-looking statements can be identified by the use of certain words, such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “plan,” “project” and other similar terms and language. We believe the forward-looking statements are reasonable based on currently available information. However, forward-looking statements involve risks, uncertainties and assumptions, whether known or unknown, that could cause our actual results, business, financial condition and cash flows to differ materially from those anticipated in the forward-looking statements. A discussion of important factors relating to forward-looking statements is included in Item 1A (Risk Factors) of Part I of our Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”). Readers should not unduly rely on the forward-looking statements included in this Form 10-Q because such statements speak only to the date they were made. Unless otherwise required by applicable securities laws, we undertake no obligation or duty to update or revise any forward-looking statements contained herein to reflect subsequent events or circumstances or the occurrence of unanticipated events.

Item 1. Financial Statements.

The interim consolidated financial statements contained herein reflect all adjustments which, in the opinion of management, are necessary for a fair statement of the financial condition, results of operations and cash flows for the periods presented. The interim consolidated financial statements have been prepared in accordance with the U.S. Securities and Exchange Commission (“SEC”) instructions to Form 10-Q and were also prepared without audit. The interim consolidated financial statements do not include all information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements; although in management’s opinion, the disclosures are adequate so that the information presented is not misleading. Operating results for the three-month and six-month periods ended June 30, 2018, are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. In the opinion of management, the information set forth in the accompanying consolidated condensed balance sheets is fairly stated in all material respects in relation to the consolidated balance sheets from which it has been derived. These interim consolidated financial statements and notes thereto should be read in conjunction with the consolidated financial statements and accompanying notes contained in our 2017 Form 10-K.

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CONSOLIDATED STATEMENTS OF INCOME

| (In thousands, except per share amounts)    | Three Months Ended |           | Six Months Ended |             |
|---|--------------------|-----------|------------------|-------------|
|   | June 30,<br>2018   | 2017      | June 30,<br>2018 | 2017        |
|   | (Unaudited)        |           |                  |             |
| Operating revenues                          | \$619,130          | \$519,508 | \$1,181,814      | \$1,020,729 |
| Operating expenses:                         |                    |           |                  |             |
| Salaries, wages and benefits                | 196,115            | 169,543   | 378,909          | 330,382     |
| Fuel  | 65,665             | 45,129    | 124,697          | 90,285      |
| Supplies and maintenance                    | 45,681             | 40,058    | 91,420           | 78,290      |
| Taxes and licenses                          | 22,651             | 21,638    | 45,144           | 42,424      |
| Insurance and claims                        | 30,689             | 19,827    | 51,847           | 39,667      |
| Depreciation                                | 56,551             | 53,705    | 112,057          | 109,041     |
| Rent and purchased transportation           | 151,433            | 124,634   | 287,355          | 251,059     |
| Communications and utilities                | 3,928              | 3,887     | 8,035            | 7,959       |
| Other                                       | (4,366)            | ) 4,174   | (3,548)          | ) 8,737     |
| Total operating expenses                    | 568,347            | 482,595   | 1,095,916        | 957,844     |
| Operating income                            | 50,783             | 36,913    | 85,898           | 62,885      |
| Other expense (income):                     |                    |           |                  |             |
| Interest expense                            | 490                | 624       | 972              | 1,400       |
| Interest income                             | (693)              | ) (876)   | ) (1,433)        | ) (1,790)   |
| Other                                       | 78                 | 152       | 131              | 205         |
| Total other income                          | (125)              | ) (100)   | ) (330)          | ) (185)     |
| Income before income taxes                  | 50,908             | 37,013    | 86,228           | 63,070      |
| Income taxes                                | 12,644             | 13,794    | 20,157           | 23,832      |
| Net income                                  | \$38,264           | \$23,219  | \$66,071         | \$39,238    |
| Earnings per share:                         |                    |           |                  |             |
| Basic                                       | \$0.53             | \$0.32    | \$0.91           | \$0.54      |
| Diluted                                     | \$0.53             | \$0.32    | \$0.91           | \$0.54      |
| Dividends declared per share                | \$0.090            | \$0.070   | \$0.160          | \$0.130     |
| Weighted-average common shares outstanding: |                    |           |                  |             |
| Basic                                       | 72,144             | 72,227    | 72,289           | 72,209      |
| Diluted                                     | 72,376             | 72,492    | 72,522           | 72,469      |

See Notes to Consolidated Financial Statements (Unaudited).

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WERNER ENTERPRISES, INC.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

|   | Three Months      |          | Six Months Ended |          |
|---|-------------------|----------|------------------|----------|
|   | Ended<br>June 30, |          | June 30,         |          |
| (In thousands)  | 2018              | 2017     | 2018             | 2017     |
|   | (Unaudited)       |          |                  |          |
| Net income  | \$38,264          | \$23,219 | \$66,071         | \$39,238 |
| Other comprehensive income (loss):                          |                   |          |                  |          |
| Foreign currency translation adjustments                    | (2,537 )          | 1,385    | (212 )           | 3,832    |
| Change in fair value of interest rate swap                  | 94                | 20       | 372              | 234      |
| Other comprehensive income (loss)                           | (2,443 )          | 1,405    | 160              | 4,066    |
| Comprehensive income  | \$35,821          | \$24,624 | \$66,231         | \$43,304 |
| See Notes to Consolidated Financial Statements (Unaudited). |                   |          |                  |          |

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CONSOLIDATED CONDENSED BALANCE SHEETS

| (In thousands, except share amounts)  | June 30,<br>2018<br>(Unaudited) | December 31,<br>2017 |
|---|---------------------------------|----------------------|
| <b>ASSETS</b>   |                                 |                      |
| Current assets:   |                                 |                      |
| Cash and cash equivalents   | \$9,924                         | \$ 13,626            |
| Accounts receivable, trade, less allowance of \$8,548 and \$8,250, respectively   | 333,134                         | 304,174              |
| Other receivables   | 19,784                          | 26,491               |
| Inventories and supplies  | 11,596                          | 11,694               |
| Prepaid taxes, licenses and permits   | 7,698                           | 15,972               |
| Other current assets  | 31,831                          | 28,272               |
| Total current assets  | 413,967                         | 400,229              |
| Property and equipment  | 2,187,896                       | 2,114,337            |
| Less – accumulated depreciation   | 773,280                         | 767,474              |
| Property and equipment, net   | 1,414,616                       | 1,346,863            |
| Other non-current assets  | 142,671                         | 60,899               |
| Total assets  | \$1,971,254                     | \$ 1,807,991         |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                      |
| Current liabilities:  |                                 |                      |
| Checks issued in excess of cash balances  | \$13,697                        | \$ 21,539            |
| Accounts payable  | 91,916                          | 73,802               |
| Insurance and claims accruals   | 64,978                          | 79,674               |
| Accrued payroll   | 35,995                          | 32,520               |
| Other current liabilities   | 21,631                          | 24,642               |
| Total current liabilities   | 228,217                         | 232,177              |
| Long-term debt, net of current portion  | 95,000                          | 75,000               |
| Other long-term liabilities   | 11,945                          | 12,575               |
| Insurance and claims accruals, net of current portion   | 202,039                         | 108,270              |
| Deferred income taxes   | 212,492                         | 195,187              |
| Commitments and contingencies   |                                 |                      |
| Stockholders' equity:   |                                 |                      |
| Common stock, \$0.01 par value, 200,000,000 shares authorized; 80,533,536 shares issued; 71,831,485 and 72,409,222 shares outstanding, respectively | 805                             | 805                  |
| Paid-in capital   | 104,799                         | 102,563              |
| Retained earnings   | 1,324,416                       | 1,267,871            |
| Accumulated other comprehensive loss  | (15,675 )                       | (15,835 )            |
| Treasury stock, at cost; 8,702,051 and 8,124,314 shares, respectively   | (192,784 )                      | (170,622 )           |
| Total stockholders' equity  | 1,221,561                       | 1,184,782            |
| Total liabilities and stockholders' equity  | \$1,971,254                     | \$ 1,807,991         |
| See Notes to Consolidated Financial Statements (Unaudited).   |                                 |                      |

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CONSOLIDATED STATEMENTS OF CASH FLOWS

| (In thousands)  | Six Months Ended |           |
|---|------------------|-----------|
|   | 2018             | 2017      |
|   | (Unaudited)      |           |
| Cash flows from operating activities:   |                  |           |
| Net income  | \$66,071         | \$39,238  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |           |
| Depreciation  | 112,057          | 109,041   |
| Deferred income taxes   | 16,269           | 6,252     |
| Gain on disposal of property and equipment  | (11,346 )        | (3,854 )  |
| Non-cash equity compensation  | 3,389            | 2,031     |
| Insurance and claims accruals, net of current portion                             | 14,081           | (3,265 )  |
| Other   | (2,795 )         | (8,206 )  |
| Changes in certain working capital items:   |                  |           |
| Accounts receivable, net  | (28,960 )        | 10,970    |
| Other current assets  | 3,791            | 24,209    |
| Accounts payable  | 10,745           | 1,759     |
| Other current liabilities   | (851 )           | 318       |
| Net cash provided by operating activities   | 182,451          | 178,493   |
| Cash flows from investing activities:   |                  |           |
| Additions to property and equipment   | (256,202)        | (126,051) |
| Proceeds from sales of property and equipment                                     | 81,367           | 60,076    |
| Issuance of notes receivable  | (3,300 )         | —         |
| Decrease in notes receivable  | 11,727           | 11,490    |
| Net cash used in investing activities   | (166,408)        | (54,485 ) |
| Cash flows from financing activities:   |                  |           |
| Repayments of short-term debt   | —                | (45,000 ) |
| Repayments of long-term debt  | —                | (60,000 ) |
| Proceeds from issuance of long-term debt  | 20,000           | —         |
| Change in net checks issued in excess of cash balances                            | (7,842 )         | —         |
| Dividends on common stock   | (10,140 )        | (8,663 )  |
| Repurchases of common stock   | (22,884 )        | —         |
| Tax withholding related to net share settlements of restricted stock awards       | (679 )           | (360 )    |
| Stock options exercised   | 248              | 988       |
| Net cash used in financing activities   | (21,297 )        | (113,035) |
| Effect of exchange rate fluctuations on cash                                      | 47               | 707       |
| Net increase in cash, cash equivalents and restricted cash                        | (5,207 )         | 11,680    |
| Cash, cash equivalents and restricted cash, beginning of period                   | 15,131           | 17,477    |
| Cash, cash equivalents and restricted cash, end of period <sup>(1)</sup>          | \$9,924          | \$29,157  |
| Supplemental disclosures of cash flow information:                                |                  |           |
| Interest paid   | \$972            | \$1,512   |
| Income taxes paid   | 5,463            | 4,468     |
| Supplemental schedule of non-cash investing activities:                           |                  |           |
| Notes receivable issued upon sale of property and equipment                       | \$3,816          | \$2,599   |
| Change in fair value of interest rate swap  | 372              | 234       |
| Property and equipment acquired included in accounts payable                      | 7,697            | 4,214     |
| Property and equipment disposed included in other receivables                     | 265              | 103       |



(1) The following table provides a reconciliation of cash, cash equivalents and restricted cash to amounts reported within the Consolidated Condensed Balance Sheets

Reconciliation of cash, cash equivalents and restricted cash:

|  |         |          |
|--|---------|----------|
| Cash and cash equivalents                        | \$9,924 | \$22,610 |
| Restricted cash included in Other current assets | —       | 6,547    |
| Total cash, cash equivalents and restricted cash | \$9,924 | \$29,157 |

See Notes to Consolidated Financial Statements (Unaudited).

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WERNER ENTERPRISES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) Accounting Policies

New Accounting Pronouncements Adopted

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “Revenue from Contracts with Customers,” which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The Company adopted ASU 2014-09 and related amendments, which is also known as Accounting Standards Codification (“ASC”) Topic 606, as of January 1, 2018 using the modified retrospective transition method. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis. See Note 2 - Revenue for additional adoption information, the updated accounting policy for revenue recognition, and disclosures required by ASC Topic 606.

In August 2016, the FASB issued ASU No. 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments,” which addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The Company adopted ASU No. 2016-15 as of January 1, 2018. Upon adoption, this update had no effect on our consolidated financial position, results of operations or cash flows.

In November 2016, the FASB issued ASU No. 2016-18, “Statement of Cash Flows (Topic 230): Restricted Cash,” which requires an entity to include in its cash and cash-equivalent balances in the statement of cash flows those amounts that are deemed to be restricted cash and restricted cash equivalents. The Company adopted ASU No. 2016-18 as of January 1, 2018, using the required retrospective adoption method. The adoption of this standard impacted the consolidated statements of cash flows by increasing beginning and ending cash to include the restricted balance of our like-kind exchange account and removing from operating activities the change in such balance, which resulted in a \$6.0 million increase to cash flow from operations for the six months ended June 30, 2017.

In May 2017, the FASB issued ASU No. 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting,” which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The Company adopted ASU No. 2017-09 as of January 1, 2018 on a prospective basis. Upon adoption, this update had no effect on our consolidated financial position, results of operations or cash flows.

Accounting Standards Updates Not Yet Effective

In February 2016, the FASB issued ASU No. 2016-02, “Leases,” to increase transparency and comparability by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The provisions of this update and additional guidance in subsequent ASUs are effective for fiscal years beginning after December 15, 2018. We are evaluating the impact of adopting ASU No. 2016-02 on our consolidated financial position, results of operations and cash flows.

In August 2017, the FASB issued ASU No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,” with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity’s risk management activities in its financial statements. The provisions of this update are effective for fiscal years beginning after December 15, 2018. We are evaluating the impact of adopting ASU No. 2017-12 on our financial position, results of operations and cash flows.

In February 2018, the FASB issued ASU No. 2018-02, “Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Comprehensive Income,” which allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The provisions of this update are effective for fiscal years beginning after December

15, 2018. We are evaluating the impact of adopting ASU No. 2018-02 on our financial position, results of operations and cash flows.

In June 2018, the FASB issued ASU No. 2018-07, “Compensation - Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting,” with the objective of simplifying several aspects of the accounting for nonemployee share-based payment transactions resulting from expanding the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The provisions of this update are effective for fiscal years beginning after December 15, 2018. Although we are evaluating the impact of adopting ASU No. 2018-07 on our financial position, results of operations and cash flows, we currently do not expect a material effect upon adoption because we do not have any nonemployee share-based payment transactions.

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## (2) Revenue

## Adoption of ASC Topic 606, “Revenue from Contracts with Customers”

On January 1, 2018, the Company adopted ASC Topic 606 using the modified retrospective method. Results for periods beginning January 1, 2018 and later are presented under ASC Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with the Company’s historical accounting policy for revenue recognition.

We recorded a \$2.0 million net increase to the opening balance of retained earnings as of January 1, 2018, for the cumulative impact of adopting the new guidance. The impact primarily related to the change in accounting for shipments in transit as of December 31, 2017. ASC Topic 606 requires us to recognize revenue and related direct costs over time as the shipment is being delivered. Prior to adopting the new guidance, we recognized revenue and related direct costs when the shipment was delivered.

Under the modified retrospective method of adoption, we are required to disclose the impact to our financial statements had we continued to follow our accounting policies under the previous revenue recognition guidance. Had we continued to recognize revenues and direct costs upon delivery, our operating revenues and operating expenses for the three months ended June 30, 2018 would have been lower by approximately \$0.7 million and \$0.3 million, respectively, and for the six months ended June 30, 2018 would have been lower by approximately \$1.0 million and \$0.4 million, respectively. Additionally, under ASC Topic 606, we recorded a \$3.9 million and \$7.1 million reduction of revenues for the three and six months ended June 30, 2018, respectively, related to our driver training schools that would have been reported as bad debt expense prior to the new standard.

## Revenue Recognition

Revenues are recognized over time as control of the promised services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those services.

The following table presents our revenues disaggregated by revenue source (in thousands):

|                                   | Three Months Ended |           | Six Months Ended |             |
|-----------------------------------|--------------------|-----------|------------------|-------------|
|                                   | June 30,           |           | June 30,         |             |
|                                   | 2018               | 2017      | 2018             | 2017        |
| Truckload Transportation Services | \$470,277          | \$403,502 | \$901,833        | \$788,505   |
| Werner Logistics                  | 134,012            | 100,804   | 251,432          | 200,657     |
| Inter-segment eliminations        | (212 )             | (449 )    | (670 )           | (616 )      |
| Transportation services           | 604,077            | 503,857   | 1,152,595        | 988,546     |
| Other revenues                    | 15,053             | 15,651    | 29,219           | 32,183      |
| Total revenues                    | \$619,130          | \$519,508 | \$1,181,814      | \$1,020,729 |

The following table presents our revenues disaggregated by geographic areas in which we conduct business (in thousands). Operating revenues for foreign countries include revenues for (i) shipments with an origin or destination in that country and (ii) other services provided in that country. If both the origin and destination are in a foreign country, the revenues are attributed to the country of origin.

|                | Three Months Ended |           | Six Months Ended |             |
|----------------|--------------------|-----------|------------------|-------------|
|                | June 30,           |           | June 30,         |             |
|                | 2018               | 2017      | 2018             | 2017        |
| United States  | \$540,284          | \$452,361 | \$1,028,305      | \$887,056   |
| Mexico         | 59,741             | 51,077    | 116,151          | 101,316     |
| Other          | 19,105             | 16,070    | 37,358           | 32,357      |
| Total revenues | \$619,130          | \$519,508 | \$1,181,814      | \$1,020,729 |

#### Transportation Services

We generate nearly all of our revenues by transporting truckload freight shipments for our customers. Transportation services are carried out by our Truckload Transportation Services (“Truckload”) segment and our Werner Logistics (“Logistics”) segment. The Truckload segment utilizes company-owned and independent contractor trucks to deliver shipments, while the Logistics segment uses third-party capacity providers.

The Company generates revenue from billings for transportation services under contracts with customers, generally on a rate per mile or per shipment, based on origin and destination of the shipment. The Company’s performance obligation arises when it

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receives a shipment order to transport a customer's freight and is satisfied upon delivery of the shipment. The transaction price may be defined in a transportation services agreement or negotiated with the customer prior to accepting the shipment order. A customer may submit several shipment orders for transportation services at various times throughout a service agreement term, but each shipment represents a distinct service that is a separately identified performance obligation. The Company often provides additional or ancillary services as part of the shipment (such as loading/unloading and stops in transit) which are not distinct or are not material in the context of the contract; therefore the revenue for these services is recognized with the freight transaction price. The average transit time to complete a shipment is approximately 3 days. Invoices for transportation services are typically generated soon after shipment delivery and, while payment terms and conditions vary by customer, are generally due within 30 days after the invoice date.

The Consolidated Statements of Income reflect recognition of transportation revenues (including fuel surcharge revenues) and related direct costs over time as the shipment is being delivered. The Company uses distance shipped (for the Truckload segment) and transit time (for the Logistics segment) to measure progress and the amount of revenue recognized over time, as the customer simultaneously receives and consumes the benefit. Determining a measure of progress requires us to make judgments that affect the timing of revenue recognized. The Company has determined that the methods described provide a faithful depiction of the transfer of services to the customer.

For shipments where a third-party capacity provider (including independent contractors under contract with us) is utilized to provide some or all of the service, we evaluate whether we are the principal (i.e., report revenues on a gross basis) or agent (i.e., report revenues on a net basis). Generally, we report such revenues on a gross basis, that is, we recognize both revenues for the service we bill to the customer and rent and purchased transportation expense for transportation costs we pay to the third-party provider. Where we are the principal, we control the transportation service before it is provided to our customers, which is supported by us being primarily responsible for fulfilling the shipment obligation to the customer and having a level of discretion in establishing pricing with the customer.

During the first half of 2018, revenue recognized from performance obligations related to prior periods (for example, due to changes in transaction price) was not material.

### Other Revenues

Other revenues include revenues from our driver training schools, transportation-related activities such as third-party equipment maintenance and equipment leasing, and other business activities. These revenues are generally recognized over time and accounted for 2% of our total revenue in the first half of 2018. Revenues from our driver training schools require us to make judgments regarding price concessions in determining the amount of revenue to recognize.

### Contract Balances and Accounts Receivable

A receivable is an unconditional right to consideration and is recognized when shipments have been completed and the related performance obligation has been fully satisfied. At June 30, 2018 and December 31, 2017, the accounts receivable, net, balance was \$333.1 million and \$304.2 million, respectively. Contract assets represent a conditional right to consideration in exchange for goods or services, and are transferred to receivables when the rights become unconditional. At June 30, 2018, the balance of contract assets was \$8.8 million, and the balance was \$7.8 million at January 1, 2018, after adopting ASC Topic 606. The Company has recognized contract assets within the other current assets financial statement caption on the balance sheet. These are considered current assets as they will be settled in less than 12 months.

Contract liabilities represent advance consideration received from customers, and are recognized as revenue over time as the related performance obligation is satisfied. At June 30, 2018 and December 31, 2017, the balance of contract liabilities was \$2.4 million and \$2.1 million, respectively. The amount of revenue recognized in the first half of 2018 that was included in the December 31, 2017 contract liability balance was \$2.1 million. The Company has recognized

contract liabilities within the accounts payable and other current liabilities financial statement captions on the balance sheet. These are considered current liabilities as they will be settled in less than 12 months.

#### Performance Obligations

We have elected to apply the practical expedient in ASC Topic 606 to not disclose the value of remaining performance obligations for contracts with an original expected length of one year or less. Remaining performance obligations represent the transaction price allocated to future reporting periods for freight shipments started but not completed at the reporting date that we expect to recognize as revenue in the period subsequent to the reporting date; transit times generally average approximately 3 days.

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## (3) Credit Facilities

As of June 30, 2018, we had unsecured committed credit facilities with three banks as well as a term commitment with one of these banks. We had with Wells Fargo Bank, N.A., a \$100.0 million credit facility which will expire on July 12, 2020, and a \$75.0 million term commitment with principal due and payable on September 15, 2019. We had an unsecured line of credit of \$75.0 million with U.S. Bank, N.A., which will expire on July 13, 2020. We also had a \$75.0 million credit facility with BMO Harris Bank, N.A., which will expire on March 5, 2020. Borrowings under these credit facilities and term note bear variable interest based on the London Interbank Offered Rate (“LIBOR”).

As of June 30, 2018, and December 31, 2017, our outstanding debt totaled \$95.0 million and \$75.0 million, respectively. We had \$75.0 million outstanding under the term commitment at a variable rate of 2.67% as of June 30, 2018, which is effectively fixed at 2.5% with an interest rate swap agreement, and we had an additional \$20.0 million outstanding under the credit facilities at a weighted average interest rate of 2.70%. The \$325.0 million of borrowing capacity under our credit facilities at June 30, 2018, is further reduced by \$28.8 million in stand-by letters of credit under which we are obligated. Subsequent to the end of the quarter, in July 2018, we borrowed an additional \$20.0 million. Each of the debt agreements includes, among other things, financial covenants requiring us (i) not to exceed a maximum ratio of total debt to total capitalization and/or (ii) not to exceed a maximum ratio of total funded debt to earnings before interest, income taxes, depreciation and amortization (as such terms are defined in each credit facility). At June 30, 2018, we were in compliance with these covenants.

At June 30, 2018, the aggregate future maturities of long-term debt by year are as follows (in thousands):

|       |          |
|-------|----------|
| 2018  | \$—      |
| 2019  | 75,000   |
| 2020  | 20,000   |
| 2021  | —        |
| 2022  | —        |
| Total | \$95,000 |

The carrying amounts of our long-term debt approximate fair value due to the duration of the notes and the variable interest rates.

## (4) Income Taxes

We accrued interest expense of \$30 thousand and \$48 thousand during the three-month periods ended June 30, 2018 and June 30, 2017, respectively, and \$53 thousand and \$103 thousand during the six-month periods ended June 30, 2018 and June 30, 2017, respectively, excluding the reversal of accrued interest related to adjustments for the remeasurement of uncertain tax positions. Our total gross liability for unrecognized tax benefits at June 30, 2018, is \$2.6 million. If recognized, \$2.1 million of unrecognized tax benefits would impact our effective tax rate. Interest of \$0.4 million has been reflected as a component of the total liability. We expect no significant increases or decreases for uncertain tax positions during the next twelve months.

The Tax Cuts and Jobs Act of 2017 (the “Tax Act”) was enacted on December 22, 2017, and lowered the federal corporate income tax rate to 21% from 35% effective January 1, 2018. The Company recognized the provisional tax impact related to the revaluation of deferred income tax assets and liabilities in accordance with SEC Staff Accounting Bulletin No. 118 and included the amount in its consolidated financial statements for the year ended December 31, 2017. The ultimate impact may differ from the provisional amount due to, among other things, additional analysis, change in interpretations and assumptions the Company has made, and additional regulatory guidance that may be issued. During the three and six months ended June 30, 2018, we did not make any adjustments to the provisional amounts recorded as of December 31, 2017. The accounting is expected to be completed when the Company’s 2017 income tax returns are filed later in 2018.



We file U.S. federal income tax returns, as well as income tax returns in various states and several foreign jurisdictions. The years 2014 through 2017 are open for examination by the Internal Revenue Service (“IRS”), and various years are open for examination by state and foreign tax authorities. State and foreign jurisdictional statutes of limitations generally range from three to four years.

(5) Commitments and Contingencies

As of June 30, 2018, we have committed to property and equipment purchases of approximately \$236.8 million.

We are involved in certain claims and pending litigation, including those described herein, arising in the ordinary course of business. The majority of these claims relate to bodily injury, property damage, cargo and workers’ compensation incurred in the transportation of freight, as well as certain class action litigation related to personnel and employment matters. We accrue for the uninsured portion of contingent losses from these and other pending claims when it is both probable that a liability has been incurred and

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the amount of the loss can be reasonably estimated. Based on the knowledge of the facts, management believes the resolution of claims and pending litigation, taking into account existing reserves, will not have a material adverse effect on our consolidated financial statements. Moreover, the results of complex legal proceedings are difficult to predict, and our view of these matters may change in the future as the litigation and related events unfold.

On May 17, 2018, in Harris County District Court in Houston, Texas, a jury rendered an adverse verdict against Werner Enterprises, Inc. (the “Company”) in a lawsuit arising from an accident between a Werner tractor-trailer and a passenger vehicle. The accident happened on December 30, 2014, near Odessa, Texas. A Werner driver was westbound on Interstate 20. A pickup truck, driven by Zaragoza Salinas, was eastbound on Interstate 20. The Salinas pickup lost control in the eastbound lanes, traveled into and through the grassy interstate median, and directly into the path of the Werner unit. The pickup had spun prior to impact, so that the bed of the pickup first struck the front of the Werner tractor.

As a result of the accident, four passengers in the pickup sustained varying injuries. Tragically, a 7 year-old boy died, and his 12 year-old sister suffered catastrophic brain injuries. The children’s mother and their 14 year-old brother were also injured.

Werner’s driver did not receive a citation, and the investigating officers placed no blame on the Werner driver. The Werner driver was traveling well below the posted speed limit, did not lose control of his tractor-trailer, and even brought the unit to a controlled stop after the impact.

Despite these facts, the jury awarded a gross verdict of approximately \$89.7 million to the family. The jury did not award any punitive damages. The jury verdict form contained varying answers regarding apportionment of fault to Mr. Salinas, Werner, and Werner’s driver. On July 30, 2018, the court entered the final judgment, with Werner liable for the entire \$89.7 million verdict.

The Company has premium-based liability insurance to cover the potential outcome from this jury verdict. Under the Company’s insurance policies in effect on the date of this accident, the Company’s maximum liability for this accident is \$10.0 million (plus pre-judgment and post-judgment interest) with premium-based coverage that exceeds the jury verdict amount. As a result of this jury verdict, the Company accrued \$11.3 million of pre-tax insurance and claims expense (including interest of \$1.3 million) in its financial statements during second quarter 2018. Under the terms of the Company’s insurance policies, the Company is the primary obligor of the verdict awarded to the family, and as such, the Company has recorded a \$79.7 million receivable from its third-party insurance providers in other non-current assets and a corresponding liability of the same amount in the long-term portion of insurance and claims accruals in the unaudited consolidated condensed balance sheets as of June 30, 2018, and such amounts are treated as non-cash operating activities in the unaudited consolidated statement of cash flows for the six months ended June 30, 2018.

The Company will be pursuing an appeal of this verdict. No assurances can be given regarding the outcome of any such appeal.

We are involved in class action litigation in the U.S. District Court for the District of Nebraska, in which the plaintiffs allege that we owe drivers for unpaid wages under the Fair Labor Standards Act (FLSA) and the Nebraska Wage Payment and Collection Act and that we failed to pay minimum wage per hour for drivers in our student driver training program, related to short break time and sleeper berth time. The period covered by this class action suit is August 2008 through March 2014. The case was tried to a jury in May 2017, resulting in a verdict of \$0.8 million in plaintiffs’ favor on the short break matter and a verdict in our favor on the sleeper berth matter. As a result of various post-trial motions, the court has awarded \$0.5 million to the plaintiffs for attorney fees and costs. As of June 30, 2018, we had accrued for the jury’s award, attorney fees and costs in the short break matter and had not accrued for the

sleeper berth matter. Plaintiffs have appealed the post-verdict amounts awarded by the trial court for fees, costs and liquidated damages.

We are also involved in certain class action litigation in which the plaintiffs allege claims for failure to provide meal and rest breaks, unpaid wages, unauthorized deductions and other items. Based on the knowledge of the facts, management does not currently believe the outcome of these class actions is likely to have a material adverse effect on our financial position or results of operations. However, the final disposition of these matters and the impact of such final dispositions cannot be determined at this time.

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## (6) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of common shares outstanding plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include outstanding stock options and restricted stock awards. There are no differences in the numerators of our computations of basic and diluted earnings per share for any period presented. The computation of basic and diluted earnings per share is shown below (in thousands, except per share amounts).

|   | Three Months |          | Six Months |          |
|---|--------------|----------|------------|----------|
|   | Ended        |          | Ended      |          |
|   | June 30,     |          | June 30,   |          |
|   | 2018         | 2017     | 2018       | 2017     |
| Net income  | \$38,264     | \$23,219 | \$66,071   | \$39,238 |
| Weighted average common shares outstanding          | 72,144       | 72,227   | 72,289     | 72,209   |
| Dilutive effect of stock-based awards               | 232          | 265      | 233        | 260      |
| Shares used in computing diluted earnings per share | 72,376       | 72,492   | 72,522     | 72,469   |
| Basic earnings per share                            | \$0.53       | \$0.32   | \$0.91     | \$0.54   |
| Diluted earnings per share                          | \$0.53       | \$0.32   | \$0.91     | \$0.54   |

There were no options to purchase shares of common stock that were outstanding during the periods indicated above that were excluded from the computation of diluted earnings per share because the option purchase price was greater than the average market price of the common shares during the period. Performance awards are excluded from the calculation of dilutive potential common shares until the threshold performance conditions have been satisfied.

## (7) Equity Compensation

The Werner Enterprises, Inc. Amended and Restated Equity Plan (the "Equity Plan"), approved by the Company's shareholders, provides for grants to employees and non-employee directors of the Company in the form of nonqualified stock options, restricted stock and units ("restricted awards"), performance awards, and stock appreciation rights. The Board of Directors or the Compensation Committee of our Board of Directors determines the terms of each award, including the type, recipients, number of shares subject to and vesting conditions of each award. No awards of stock appreciation rights have been issued under the Equity Plan to date. The maximum number of shares of common stock that may be awarded under the Equity Plan is 20,000,000 shares. The maximum aggregate number of shares that may be awarded to any one person in any one calendar year under the Equity Plan is 500,000. As of June 30, 2018, there were 7,081,217 shares available for granting additional awards.

Equity compensation expense is included in salaries, wages and benefits within the Consolidated Statements of Income. As of June 30, 2018, the total unrecognized compensation cost related to non-vested equity compensation awards was approximately \$12.0 million and is expected to be recognized over a weighted average period of 2.2 years. The following table summarizes the equity compensation expense and related income tax benefit recognized in the Consolidated Statements of Income (in thousands):

|                                  | Three Months |      | Six Months |      |
|----------------------------------|--------------|------|------------|------|
|                                  | Ended        |      | Ended      |      |
|                                  | June 30,     |      | June 30,   |      |
|                                  | 2018         | 2017 | 2018       | 2017 |
| Stock options:                   |              |      |            |      |
| Pre-tax compensation expense     | \$—          | \$1  | \$—        | \$3  |
| Tax benefit                      | —            | —    | —          | 1    |
| Stock option expense, net of tax | \$—          | \$1  | \$—        | \$2  |

Restricted awards:

|                                      |         |       |         |         |
|--------------------------------------|---------|-------|---------|---------|
| Pre-tax compensation expense         | \$1,127 | \$866 | \$2,063 | \$1,499 |
| Tax benefit                          | 287     | 340   | 526     | 585     |
| Restricted stock expense, net of tax | \$840   | \$526 | \$1,537 | \$914   |

Performance awards:

|                                       |       |       |         |       |
|---------------------------------------|-------|-------|---------|-------|
| Pre-tax compensation expense          | \$842 | \$306 | \$1,327 | \$589 |
| Tax benefit                           | 214   | 120   | 338     | 230   |
| Performance award expense, net of tax | \$628 | \$186 | \$989   | \$359 |

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We do not have a formal policy for issuing shares upon an exercise of stock options or vesting of restricted and performance awards. Such shares are generally issued from treasury stock. From time to time, we repurchase shares of our common stock, the timing and amount of which depends on market and other factors. Historically, the shares acquired from such repurchases have provided us with sufficient quantities of stock to issue for equity compensation. Based on current treasury stock levels, we do not expect to repurchase additional shares specifically for equity compensation during 2018.

## Stock Options

Stock options are granted at prices equal to the market value of the common stock on the date the option award is granted. Option awards currently outstanding become exercisable in installments from 24 to 72 months after the date of grant. The options are exercisable over a period not to exceed ten years, one day from the date of grant. The following table summarizes stock option activity for the six months ended June 30, 2018:

|                                    | Number of<br>Options<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price (\$) | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(Years) | Aggregate<br>Intrinsic Value<br>(in thousands) |
|------------------------------------|--|---|--|--|
| Outstanding at beginning of period | 33                                     | \$ 19.69                                      |  |  |
| Granted                            | —                                      | —   |  |  |
| Exercised                          | (12 )                                  | 20.68   |  |  |
| Forfeited                          | —                                      | —   |  |  |
| Expired                            | —                                      | —   |  |  |
| Outstanding at end of period       | 21                                     | 19.12   | 1.49   | \$ 385   |
| Exercisable at end of period       | 21                                     | 19.12   | 1.49   | \$ 385   |

We did not grant any stock options during the six-month periods ended June 30, 2018 and June 30, 2017. The fair value of stock option grants is estimated using a Black-Scholes valuation model. The total intrinsic value of stock options exercised was \$235 thousand and \$636 thousand for the six-month periods ended June 30, 2018 and June 30, 2017, respectively.

## Restricted Awards

Restricted stock entitles the holder to shares of common stock when the award vests. Restricted stock units entitle the holder to a combination of cash or stock equal to the value of common stock when the unit vests. The value of these shares may fluctuate according to market conditions and other factors. Restricted awards currently outstanding vest over periods ranging from 12 to 60 months from the grant date of the award. The restricted awards do not confer any voting or dividend rights to recipients until such shares vest and do not have any post-vesting sales restrictions. The following table summarizes restricted award activity for the six months ended June 30, 2018:

|                                  | Number of<br>Restricted<br>Awards (in<br>thousands) | Weighted<br>Average Grant<br>Date Fair<br>Value (\$) |
|----------------------------------|---|--|
| Nonvested at beginning of period | 273   | \$ 27.69   |
| Granted                          | 124   | 37.43  |
| Vested                           | (21 )   | 26.74  |
| Forfeited                        | (4 )  | 28.72  |
| Nonvested at end of period       | 372   | 30.98  |

We estimate the fair value of restricted awards based upon the market price of the underlying common stock on the date of grant, reduced by the present value of estimated future dividends because the awards are not entitled to receive dividends prior to vesting. Our estimate of future dividends is based on the most recent quarterly dividend rate at the time of grant, adjusted for any known future changes in the dividend rate. Cash settled restricted stock units are recorded as a liability within the Consolidated Balance Sheets and are adjusted to fair value each reporting period.

The total fair value of previously granted restricted awards vested during the six-month period ended June 30, 2018 was \$778 thousand, and for the six-month period ended June 30, 2017 was \$107 thousand. We withheld shares based on the closing stock price on the vesting date to settle the employees' statutory obligation for the applicable income and other employment taxes. The shares withheld to satisfy the tax withholding obligations are recorded as treasury stock.

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## Performance Awards

Performance awards entitle the recipient to shares of common stock upon attainment of performance objectives as pre-established by the Compensation Committee. If the performance objectives are achieved, performance awards currently outstanding vest, subject to continued employment, over periods ranging from 12 to 60 months from the grant date of the award. The performance awards do not confer any voting or dividend rights to recipients until such shares vest and do not have any post-vesting sales restrictions. The following table summarizes performance award activity for the six months ended June 30, 2018:

|                                  | Number of<br>Performance<br>Awards (in<br>thousands) | Weighted<br>Average Grant<br>Date Fair<br>Value (\$) |
|----------------------------------|--|--|
| Nonvested at beginning of period | 158  | \$ 27.20   |
| Granted                          | 84   | 37.48  |
| Vested                           | (35 )  | 27.07  |
| Forfeited                        | —  | —  |
| Nonvested at end of period       | 207  | 30.31  |

The 2018 performance awards are earned based upon the level of attainment by the Company of specified performance objectives related to cumulative diluted earnings per share for the two-year period from January 1, 2018 to December 31, 2019. Shares earned based on cumulative diluted earnings per share may be capped based on absolute total shareholder return during the three-year period ended December 31, 2020. The 2018 performance awards will vest in one installment on the third anniversary from the grant date.

We estimate the fair value of performance awards based upon the market price of the underlying common stock on the date of grant, reduced by the present value of estimated future dividends because the awards are not entitled to receive dividends prior to vesting. Our estimate of future dividends is based on the most recent quarterly dividend rate at the time of grant, adjusted for any known future changes in the dividend rate.

The vesting date fair value of performance awards that vested during the six-month periods ended June 30, 2018 and June 30, 2017 was \$1.3 million and \$1.0 million, respectively. We withhold shares based on the closing stock price on the vesting date to settle the employees' statutory obligation for the applicable income and other employment taxes. The shares withheld to satisfy the tax withholding obligations are recorded as treasury stock.

## (8) Segment Information

We have two reportable segments – Truckload Transportation Services (“Truckload”) and Werner Logistics.

The Truckload segment consists of three operating units, Dedicated, One-Way Truckload and Temperature Controlled. These units are aggregated because they have similar economic characteristics and meet the other aggregation criteria described in the accounting guidance for segment reporting. Dedicated provides truckload services dedicated to a specific customer, generally for a retail distribution center or manufacturing facility, utilizing either dry van or specialized trailers. One-Way Truckload is comprised of the following operating fleets: (i) the medium-to-long-haul van (“Van”) fleet transports a variety of consumer nondurable products and other commodities in truckload quantities over irregular routes using dry van trailers; (ii) the expedited (“Expedited”) fleet provides time-sensitive truckload services utilizing driver teams; and (iii) the regional short-haul (“Regional”) fleet provides comparable truckload van service within geographic regions across the United States. Temperature Controlled provides truckload services for temperature sensitive products over irregular routes utilizing temperature-controlled trailers. Revenues for the Truckload segment include a small amount of non-trucking revenues which consist primarily of the intra-Mexico portion of cross-border shipments delivered to or from Mexico where we utilize a



third-party capacity provider.

The Werner Logistics segment generates the majority of our non-trucking revenues through five operating units that provide non-trucking services to our customers. These five Werner Logistics operating units are as follows: (i) truck brokerage (“Brokerage”) uses contracted carriers to complete customer shipments; (ii) freight management (“Freight Management”) offers a full range of single-source logistics management services and solutions; (iii) the intermodal (“Intermodal”) unit offers rail transportation through alliances with rail and drayage providers as an alternative to truck transportation; (iv) Werner Global Logistics international (“WGL”) provides complete management of global shipments from origin to destination using a combination of air, ocean, truck and rail transportation modes; and (v) Werner Final Mile (“Final Mile”) offers home and business deliveries of large or heavy items using two associates operating a liftgate straight truck.

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We generate other revenues from our driver training schools, transportation-related activities such as third-party equipment maintenance and equipment leasing, and other business activities. None of these operations meets the quantitative reporting thresholds. As a result, these operations are grouped in "Other" in the table below. "Corporate" includes revenues and expenses that are incidental to our activities and are not attributable to any of our operating segments, including gains and losses on sales of assets not attributable to our operating segments. We do not prepare separate balance sheets by segment and, as a result, assets are not separately identifiable by segment. Inter-segment eliminations in the table below represent transactions between reporting segments that are eliminated in consolidation.

The following table summarizes our segment information (in thousands):

|                                   | Three Months Ended |           | Six Months Ended |             |
|-----------------------------------|--------------------|-----------|------------------|-------------|
|                                   | June 30,           |           | June 30,         |             |
|                                   | 2018               | 2017      | 2018             | 2017        |
| Revenues                          |                    |           |                  |             |
| Truckload Transportation Services | \$470,277          | \$403,502 | \$901,833        | \$788,505   |
| Werner Logistics                  | 134,012            | 100,804   | 251,432          | 200,657     |
| Other                             | 14,422             | 15,127    | 27,681           | 31,237      |
| Corporate                         | 631                | 524       | 1,538            | 946         |
| Subtotal                          | 619,342            | 519,957   | 1,182,484        | 1,021,345   |
| Inter-segment eliminations        | (212 )             | (449 )    | (670 )           | (616 )      |
| Total                             | \$619,130          | \$519,508 | \$1,181,814      | \$1,020,729 |
| Operating Income                  |                    |           |                  |             |
| Truckload Transportation Services | \$43,432           | \$36,036  | \$76,854         | \$59,502    |
| Werner Logistics                  | 5,602              | 2,285     | 8,359            | 5,334       |
| Other                             | 243                | (541 )    | (143 )           | (396 )      |
| Corporate                         | 1,506              | (867 )    | 828              | (1,555 )    |
| Total                             | \$50,783           | \$36,913  | \$85,898         | \$62,885    |

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

Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A") summarizes the financial statements from management's perspective with respect to our financial condition, results of operations, liquidity and other factors that may affect actual results. The MD&A is organized in the following sections:

Overview

Results of Operations

Liquidity and Capital Resources

Contractual Obligations and Commercial Commitments

Regulations

Critical Accounting Policies and Estimates

The MD&A should be read in conjunction with our 2017 Form 10-K.

#### Overview:

We have two reportable segments, Truckload Transportation Services ("Truckload") and Werner Logistics, and we operate in the truckload and logistics sectors of the transportation industry. In the truckload sector, we focus on transporting consumer nondurable products that generally ship more consistently throughout the year. In the logistics sector, besides managing transportation requirements for individual customers, we provide additional sources of truck capacity, alternative modes of transportation, a global delivery network and systems analysis to optimize transportation needs. Our success depends on our ability to efficiently and effectively manage our resources in the delivery of truckload transportation and logistics services to our customers. Resource requirements vary with customer demand, which may be subject to seasonal or general economic conditions. Our ability to adapt to changes in customer transportation requirements is essential to efficiently deploy resources and make capital investments in tractors and trailers (with respect to our Truckload segment) or obtain qualified third-party capacity at a reasonable price (with respect to our Werner Logistics segment). Although our business volume is not highly concentrated, we may also be affected by our customers' financial failures or loss of customer business.

Revenues for our Truckload segment operating units (Dedicated, One-Way Truckload and Temperature Controlled) are typically generated on a per-mile basis and also include revenues such as stop charges, loading and unloading charges, equipment detention charges and equipment repositioning charges. To mitigate our risk to fuel price increases, we recover from our customers additional fuel surcharges that generally recoup a majority of the increased fuel costs; however, we cannot assure that current recovery levels will continue in future periods. Because fuel surcharge revenues fluctuate in response to changes in fuel costs, we identify them separately and exclude them from the statistical calculations to provide a more meaningful comparison between periods. The key statistics used to evaluate trucking revenues, net of fuel surcharge, are (i) average revenues per tractor per week, (ii) average percentage of empty miles (miles without trailer cargo), (iii) average trip length (in loaded miles) and (iv) average number of tractors in service. General economic conditions, seasonal trucking industry freight patterns and industry capacity are important factors that impact these statistics. Our Truckload segment also generates a small amount of revenues categorized as non-trucking revenues, which consist primarily of the intra-Mexico portion of cross-border shipments delivered to or from Mexico where the Truckload segment utilizes a third-party capacity provider. We exclude such revenues from the statistical calculations.

Our most significant resource requirements are company drivers, independent contractors, tractors and trailers. Independent contractors supply their own tractors and drivers and are responsible for their operating expenses. Our financial results are affected by company driver and independent contractor availability and the markets for new and used revenue equipment. We are self-insured for a significant portion of bodily injury, property damage and cargo claims; workers' compensation claims; and associate health claims (supplemented by premium-based insurance coverage above certain dollar levels). For that reason, our financial results may also be affected by driver safety, medical costs, weather, legal and regulatory environments and insurance coverage costs to protect against catastrophic losses.

The operating ratio is a common industry measure used to evaluate our profitability and that of our Truckload segment operating fleets. The operating ratio consists of operating expenses expressed as a percentage of operating revenues. The most significant variable expenses that impact the Truckload segment are driver salaries and benefits, fuel, fuel taxes (included in taxes and licenses expense), payments to independent contractors (included in rent and purchased transportation expense), supplies and maintenance and insurance and claims. As discussed further in the comparison of operating results for second quarter 2018 to second quarter 2017, several industry-wide issues have caused, and could continue to cause, costs to increase in future periods. These issues include shortages of drivers or independent contractors, changing fuel prices, higher new truck and trailer purchase prices and compliance with new or proposed regulations. Our main fixed costs include depreciation expense for tractors and trailers and equipment licensing fees (included in taxes and licenses expense). The Truckload segment requires substantial cash expenditures for tractor and trailer purchases. We fund these purchases with net cash from operations and financing available under our existing credit facilities, as management deems necessary.

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We provide non-trucking services primarily through the five operating units within our Werner Logistics segment (Brokerage, Freight Management, Intermodal, WGL and Final Mile). Unlike our Truckload segment, the Werner Logistics segment is less asset-intensive and is instead dependent upon qualified associates, information systems and qualified third-party capacity providers. The largest expense item related to the Werner Logistics segment is the cost of purchased transportation we pay to third-party capacity providers. This expense item is recorded as rent and purchased transportation expense. Other operating expenses consist primarily of salaries, wages and benefits. We evaluate the Werner Logistics segment's financial performance by reviewing the gross margin percentage (revenues less rent and purchased transportation expenses expressed as a percentage of revenues) and the operating income percentage. The gross margin percentage can be impacted by the rates charged to customers and the costs of securing third-party capacity. We have a mix of contracted long-term rates and variable rates for the cost of third-party capacity, and we cannot assure that our operating results will not be adversely impacted in the future if our ability to obtain qualified third-party capacity providers changes or the rates of such providers increase.

## Results of Operations:

The following table sets forth the Consolidated Statements of Income in dollars and as a percentage of total operating revenues and the percentage increase or decrease in the dollar amounts of those items compared to the prior year.

|                                   | Three Months Ended (3ME) |         |           |         | Six Months Ended (6ME) |         |             |         | Percentage Change |          |    |
|-----------------------------------|--------------------------|---------|-----------|---------|------------------------|---------|-------------|---------|-------------------|----------|----|
|                                   | June 30, 2018            |         | 2017      |         | June 30, 2018          |         | 2017        |         | in Dollar Amounts | 3ME      |    |
| (Amounts in thousands)            | \$                       | %       | \$        | %       | \$                     | %       | \$          | %       | %                 | %        | %  |
| Operating revenues                | \$619,130                | 100.0 % | \$519,508 | 100.0 % | \$1,181,814            | 100.0 % | \$1,020,729 | 100.0 % | 19.2 %            | 15.8 %   | %  |
| Operating expenses:               |                          |         |           |         |                        |         |             |         |                   |          |    |
| Salaries, wages and benefits      | 196,115                  | 31.7 %  | 169,543   | 32.6 %  | 378,909                | 32.1 %  | 330,382     | 32.3 %  | 15.7 %            | 14.7 %   | %  |
| Fuel                              | 65,665                   | 10.6 %  | 45,129    | 8.7 %   | 124,697                | 10.5 %  | 90,285      | 8.8 %   | 45.5 %            | 38.1 %   | %  |
| Supplies and maintenance          | 45,681                   | 7.4 %   | 40,058    | 7.7 %   | 91,420                 | 7.7 %   | 78,290      | 7.7 %   | 14.0 %            | 16.8 %   | %  |
| Taxes and licenses                | 22,651                   | 3.7 %   | 21,638    | 4.2 %   | 45,144                 | 3.8 %   | 42,424      | 4.2 %   | 4.7 %             | 6.4 %    | %  |
| Insurance and claims              | 30,689                   | 4.9 %   | 19,827    | 3.8 %   | 51,847                 | 4.4 %   | 39,667      | 3.9 %   | 54.8 %            | 30.7 %   | %  |
| Depreciation                      | 56,551                   | 9.1 %   | 53,705    | 10.3 %  | 112,057                | 9.5 %   | 109,041     | 10.7 %  | 5.3 %             | 2.8 %    | %  |
| Rent and purchased transportation | 151,433                  | 24.5 %  | 124,634   | 24.0 %  | 287,355                | 24.3 %  | 251,059     | 24.6 %  | 21.5 %            | 14.5 %   | %  |
| Communications and utilities      | 3,928                    | 0.6 %   | 3,887     | 0.8 %   | 8,035                  | 0.7 %   | 7,959       | 0.8 %   | 1.1 %             | 1.0 %    | %  |
| Other                             | (4,366)                  | (0.7)%  | 4,174     | 0.8 %   | (3,548)                | (0.3)%  | 8,737       | 0.8 %   | (204.6)%          | (140.6)% | %  |
| Total operating expenses          | 568,347                  | 91.8 %  | 482,595   | 92.9 %  | 1,095,916              | 92.7 %  | 957,844     | 93.8 %  | 17.8 %            | 14.4 %   | %  |
| Operating income                  | 50,783                   | 8.2 %   | 36,913    | 7.1 %   | 85,898                 | 7.3 %   | 62,885      | 6.2 %   | 37.6 %            | 36.6 %   | %  |
|                                   | (125)                    | )—      | (100)     | )—      | (330)                  | )—      | (185)       | )—      | (25.0)            | (78.4)   | )% |

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Total other  
expense  
(income)

|                               |          |     |   |          |     |   |        |     |   |          |     |   |       |    |        |    |
|-------------------------------|----------|-----|---|----------|-----|---|--------|-----|---|----------|-----|---|-------|----|--------|----|
| Income before<br>income taxes | 50,908   | 8.2 | % | 37,013   | 7.1 | % | 86,228 | 7.3 | % | 63,070   | 6.2 | % | 37.5  | %  | 36.7   | %  |
| Income taxes                  | 12,644   | 2.0 | % | 13,794   | 2.6 | % | 20,157 | 1.7 | % | 23,832   | 2.4 | % | (8.3) | %) | (15.4) | %) |
| Net income                    | \$38,264 | 6.2 | % | \$23,219 | 4.5 | % | 66,071 | 5.6 | % | \$39,238 | 3.8 | % | 64.8  | %  | 68.4   | %  |

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The following tables set forth the operating revenues, operating expenses and operating income for the Truckload segment, as well as certain statistical data regarding our Truckload segment operations for the periods indicated.

|  | Three Months Ended |       |            |       | Six Months Ended |       |         |       |
|--|--------------------|-------|------------|-------|------------------|-------|---------|-------|
|  | June 30,<br>2018   |       | 2017       |       | June 30,<br>2018 |       | 2017    |       |
| Truckload Transportation Services (amounts in thousands) | \$                 | %     | \$         | %     | \$               | %     | \$      | %     |
| Trucking revenues, net of fuel surcharge                 | \$ 395,094         |       | \$ 347,433 |       | 759,282          |       | 677,922 |       |
| Trucking fuel surcharge revenues                         | 68,042             |       | 49,496     |       | 128,792          |       | 97,477  |       |
| Non-trucking and other operating revenues                | 7,141              |       | 6,573      |       | 13,759           |       | 13,106  |       |
| Operating revenues                                       | 470,277            | 100.0 | 403,502    | 100.0 | 901,833          | 100.0 | 788,505 | 100.0 |
| Operating expenses                                       | 426,845            | 90.8  | 367,466    | 91.1  | 824,979          | 91.5  | 729,003 | 92.5  |
| Operating income   | \$43,432           | 9.2   | \$36,036   | 8.9   | 76,854           | 8.5   | 59,502  | 7.5   |

|  | Three Months Ended |         |             | Six Months Ended |         |             |             |
|--|--------------------|---------|-------------|------------------|---------|-------------|-------------|
|  | June 30,<br>2018   |         | 2017        | June 30,<br>2018 |         | 2017        | %<br>Change |
| Truckload Transportation Services                              | 2018               | 2017    | %<br>Change | 2018             | 2017    | %<br>Change |             |
| Operating ratio, net of fuel surcharge revenues <sup>(1)</sup> | 89.2 %             | 89.8 %  |             | 90.1 %           | 91.4 %  |             |             |
| Average revenues per tractor per week <sup>(2)</sup>           | \$4,027            | \$3,676 | 9.5 %       | \$3,900          | \$3,604 | 8.2 %       |             |
| Average completed trip length in miles (loaded)                | 447                | 470     | (4.9 )%     | 448              | 469     | (4.5 )%     |             |
| Average percentage of empty miles <sup>(3)</sup>               | 12.36 %            | 12.30 % | 0.5 %       | 12.46 %          | 12.34 % | 1.0 %       |             |
| Average tractors in service                                    | 7,548              | 7,270   | 3.8 %       | 7,488            | 7,235   | 3.5 %       |             |
| Total trailers (at quarter end)                                | 22,870             | 22,020  |             | 22,870           | 22,020  |             |             |
| Total tractors (at quarter end):                               |                    |         |             |                  |         |             |             |
| Company  | 7,075              | 6,615   |             | 7,075            | 6,615   |             |             |
| Independent contractor   | 625                | 700     |             | 625              | 700     |             |             |
| Total tractors   | 7,700              | 7,315   |             | 7,700            | 7,315   |             |             |

Calculated as if fuel surcharge revenues are excluded from total revenues and instead reported as a reduction of

(1) operating expenses, which provides a more consistent basis for comparing results of operations from period to period.

(2) Net of fuel surcharge revenues.

(3) "Empty" refers to miles without trailer cargo.

The following tables set forth the Werner Logistics segment's revenues, rent and purchased transportation expense, gross margin, other operating expenses (primarily salaries, wages and benefits expense) and operating income, as well as certain statistical data regarding the Werner Logistics segment.

|   | Three Months Ended |       |            |       | Six Months Ended |       |            |       |
|---|--------------------|-------|------------|-------|------------------|-------|------------|-------|
|   | June 30,<br>2018   |       | 2017       |       | June 30,<br>2018 |       | 2017       |       |
| Werner Logistics (amounts in thousands)   | \$                 | %     | \$         | %     | \$               | %     | \$         | %     |
| Operating revenues                        | \$ 134,012         | 100.0 | \$ 100,804 | 100.0 | \$ 251,432       | 100.0 | \$ 200,657 | 100.0 |
| Rent and purchased transportation expense | 112,918            | 84.3  | 85,453     | 84.8  | 213,194          | 84.8  | 169,770    | 84.6  |
| Gross margin                              | 21,094             | 15.7  | 15,351     | 15.2  | 38,238           | 15.2  | 30,887     | 15.4  |
| Other operating expenses                  | 15,492             | 11.5  | 13,066     | 12.9  | 29,879           | 11.9  | 25,553     | 12.7  |
| Operating income                          | \$5,602            | 4.2   | \$2,285    | 2.3   | 8,359            | 3.3   | 5,334      | 2.7   |

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|                                 | Three<br>Months<br>Ended<br>June 30, |       |             | Six Months<br>Ended<br>June 30, |       |             |
|---------------------------------|--------------------------------------|-------|-------------|---------------------------------|-------|-------------|
| Werner Logistics                | 2018                                 | 2017  | %<br>Change | 2018                            | 2017  | %<br>Change |
| Average tractors in service     | 40                                   | 48    | (16.7)%     | 42                              | 55    | (23.6)%     |
| Total trailers (at quarter end) | 1,620                                | 1,840 | (12.0)%     | 1,620                           | 1,840 | (12.0)%     |
| Total tractors (at quarter end) | 43                                   | 48    | (10.4)%     | 43                              | 48    | (10.4)%     |

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Three Months Ended June 30, 2018 Compared to Three Months Ended June 30, 2017

Operating Revenues

Operating revenues increased 19.2% for the three months ended June 30, 2018, compared to the same period of the prior year. When comparing second quarter 2018 to second quarter 2017, Truckload segment revenues increased \$66.8 million or 16.5%, and Werner Logistics revenues increased \$33.2 million or 32.9%.

Second quarter 2018 freight demand in our One-Way Truckload fleet was much stronger than normal. Demand was consistently strong each month of second quarter 2018 and was broad-based geographically. Freight volumes in July 2018 continued to be strong, one of the top two months of July in the last 10 years.

Trucking revenues, net of fuel surcharge, increased 13.7% in second quarter 2018 compared to second quarter 2017 due to a 9.5% increase in average revenues per tractor per week and a 3.8% increase in average tractors in service. Our average revenues per total mile, net of fuel surcharge, increased by 13.3% in second quarter 2018 compared to second quarter 2017 and average miles per truck decreased by 3.3%. The increase in average revenues per total mile was due primarily to higher contractual rates, more freight choices with higher rates, support for customer surge business, lane mix changes with higher rates and growth in our Dedicated business. We currently expect average revenues per total mile to increase between 9% and 12% for the full year 2018 compared to 2017. The growth in our Dedicated fleet of 565 trucks year over year is responsible for the decrease in average miles per truck as this business typically has shorter miles per trip at a higher rate per mile. Changing industry dynamics are occurring as customers shift freight away from one-way fleets to shorter length of haul dedicated fleets, which result in the need for more trucks to haul the same amount of freight. Our total miles increased 0.4% in second quarter 2018 compared to second quarter 2017, despite a 3.8% growth in average trucks in service.

The average number of tractors in service in the Truckload segment increased 3.8% to 7,548 in second quarter 2018 from 7,270 in second quarter 2017. We ended second quarter 2018 with 7,700 trucks in the Truckload segment, a year-over-year increase of 385 trucks compared to the end of second quarter 2017, and a sequential increase of 315 trucks compared to the end of first quarter 2018. We cannot predict whether future driver shortages, if any, will adversely affect our ability to maintain our fleet size. If such a driver shortage were to occur, it could result in a fleet size reduction, and our results of operations could be adversely affected.

Trucking fuel surcharge revenues increased 37.5% to \$68.0 million in second quarter 2018 from \$49.5 million in second quarter 2017 due to higher average fuel prices in the 2018 quarter. These revenues represent collections from customers for the increase in fuel and fuel-related expenses, including the fuel component of our independent contractor cost (recorded as rent and purchased transportation expense) and fuel taxes (recorded in taxes and licenses expense), when diesel fuel prices rise. Conversely, when fuel prices decrease, fuel surcharge revenues decrease. To lessen the effect of fluctuating fuel prices on our margins, we collect fuel surcharge revenues from our customers for the cost of diesel fuel and taxes in excess of specified base fuel price levels according to terms in our customer contracts. Fuel surcharge rates generally adjust weekly based on an independent U.S. Department of Energy fuel price survey which is released every Monday. Our fuel surcharge programs are designed to (i) recoup higher fuel costs from customers when fuel prices rise and (ii) provide customers with the benefit of lower fuel costs when fuel prices decline. These programs generally enable us to recover a majority, but not all, of the fuel price increases. The remaining portion is generally not recoverable because it results from empty and out-of-route miles (which are not billable to customers) and truck idle time. Fuel prices that change rapidly in short time periods also impact our recovery because the surcharge rate in most programs only changes once per week.

Werner Logistics revenues are generated by its five operating units and exclude revenues for full truckload shipments transferred to the Truckload segment, which are recorded as trucking revenues by the Truckload segment. Werner Logistics also recorded revenue and brokered freight expense of \$0.2 million in second quarter 2018 and \$0.4 million in second quarter 2017 for Intermodal drayage movements performed by the Truckload segment (also recorded as

trucking revenue by the Truckload segment), and these transactions between reporting segments are eliminated in consolidation. In second quarter 2018, Werner Logistics revenues increased \$33.2 million or 32.9%, and operating income dollars increased \$3.3 million or 145.2%, compared to second quarter 2017. The Werner Logistics gross margin percentage in second quarter 2018 of 15.7% increased from 15.2% in second quarter 2017. The Werner Logistics operating income percentage in second quarter 2018 of 4.2% increased from second quarter 2017 of 2.3%.

In second quarter 2018, all of the Werner Logistics service offerings achieved revenue growth year over year, with the largest being 51% in our truck brokerage solution which is also our largest offering in terms of total revenues. The Werner Logistics operating income percentage improved sequentially the last four quarters, from 1.3% in third quarter 2017 to 1.8% in fourth quarter 2017 to 2.3% in first quarter 2018 to 4.2% in second quarter 2018. We continue to see strong customer acceptance of the value of the Werner Logistics portfolio of service offerings, particularly as the market strengthens and shippers tend to consolidate their logistics business with the stability of larger asset-backed logistics providers.

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We generate other revenues from our driver training schools, transportation-related activities such as third-party equipment maintenance and equipment leasing, and other business activities. On January 1, 2018, we adopted the new revenue recognition accounting standard using the modified retrospective transition method, under which comparative information is not required to be restated. Under the new standard, we recorded a \$3.9 million reduction of revenues in second quarter 2018 related to our driver training schools that would have been reported as bad debt expense prior to the new standard, with no impact to operating income.

### Operating Expenses

Our operating ratio (operating expenses expressed as a percentage of operating revenues) was 91.8% for the three months ended June 30, 2018, compared to 92.9% for the three months ended June 30, 2017. Expense items that impacted the overall operating ratio are described on the following pages. The tables on pages 18 and 19 show the Consolidated Statements of Income in dollars and as a percentage of total operating revenues and the percentage increase or decrease in the dollar amounts of those items compared to the same quarter of the prior year, as well as the operating ratios, operating margins, and certain statistical information for our two reportable segments, Truckload and Werner Logistics.

Salaries, wages and benefits increased \$26.6 million or 15.7% in second quarter 2018 compared to second quarter 2017 and decreased 0.9% as a percentage of operating revenues to 31.7%. The higher dollar amount of salaries, wages and benefits expense in the 2018 second quarter was due primarily to higher driver and student pay rates, approximately 5 million more company truck miles, and higher non-driver pay, all of which also resulted in a higher amount of payroll taxes and other payroll-related fringe benefits. When evaluated on a per-mile basis, driver salaries, wages and benefits also increased, which we primarily attribute to 12% higher driver pay per company truck mile in second quarter 2018 compared to second quarter 2017. Non-driver salaries, wages and benefits in the non-trucking Werner Logistics segment increased 21.4% compared to the previously noted revenue increase of 32.9%.

We renewed our workers' compensation insurance coverage for the policy year beginning April 1, 2018. Our coverage levels are the same as the prior policy year. We continue to maintain a self-insurance retention of \$1.0 million per claim. Our workers' compensation insurance premium rate for the policy year beginning April 2018 is 10% lower than the rate for the previous policy year.

The driver recruiting market is increasingly difficult. Several ongoing market factors persisted including a declining number of, and increased competition for, driver training school graduates, an historically low national unemployment rate, aging truck driver demographics and increased truck safety regulations including the regulation changes for electronic logging devices. We continue to take significant actions to strengthen our driver recruiting and retention to make Werner a preferred choice for the best drivers, including raising driver pay, maintaining a new truck and trailer fleet, purchasing best-in-class safety and training features for all new trucks, investing in our driver training school network and collaborating with customers to improve or eliminate unproductive freight. These efforts continue to have positive results on our driver turnover, achieving the lowest second quarter driver turnover percentage in 20 years. We are unable to predict whether we will experience future driver shortages. If such a shortage were to occur and additional driver pay rate increases became necessary to attract and retain drivers, our results of operations would be negatively impacted to the extent that we could not obtain corresponding freight rate increases.

Fuel increased \$20.5 million or 45.5% in second quarter 2018 compared to second quarter 2017 and increased 1.9% as a percentage of operating revenues due to higher average diesel fuel prices and 5 million more company truck miles. Average diesel fuel prices were 65 cents per gallon higher in second quarter 2018 than in second quarter 2017 and were 19 cents per gallon higher than in first quarter 2018.

We continue to employ measures to improve our fuel mpg such as (i) limiting truck engine idle time, (ii) optimizing the speed, weight and specifications of our equipment and (iii) implementing mpg-enhancing equipment changes to

our fleet including new trucks with U.S. Environmental Protection Agency (the “EPA”) 2010 compliant engines, more aerodynamic truck features, idle reduction systems, trailer tire inflation systems, trailer skirts and automated manual transmissions to reduce our fuel gallons purchased. However, fuel savings from mpg improvement is offset by higher depreciation expense and the additional cost of diesel exhaust fluid (required in tractors with engines that meet the 2010 EPA emission standards). Although our fuel management programs require significant capital investment and research and development, we intend to continue these and other environmentally conscious initiatives, including our active participation as an EPA SmartWay Transport Partner. The SmartWay Transport Partnership is a national voluntary program developed by the EPA and freight industry representatives to reduce greenhouse gases and air pollution and promote cleaner, more efficient ground freight transportation.

For July 2018, the average diesel fuel price per gallon was approximately 65 cents higher than the average diesel fuel price per gallon in July 2017 and approximately 49 cents higher than in third quarter 2017.

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Shortages of fuel, increases in fuel prices and petroleum product rationing can have a materially adverse effect on our operations and profitability. We are unable to predict whether fuel price levels will increase or decrease in the future or the extent to which fuel surcharges will be collected from customers. As of June 30, 2018, we had no derivative financial instruments to reduce our exposure to fuel price fluctuations.

Supplies and maintenance increased \$5.6 million or 14.0% in second quarter 2018 compared to second quarter 2017 and decreased 0.3% as a percentage of operating revenues. The higher dollar amount of maintenance expense was due primarily to higher company truck miles driven in second quarter 2018 compared to second quarter 2017 and increased tractor maintenance costs in the 2018 quarter. We also incurred higher driver recruiting and other driver-related costs in the 2018 quarter.

Insurance and claims increased \$10.9 million or 54.8% in second quarter 2018 compared to second quarter 2017 and increased 1.1% as a percentage of operating revenues. In second quarter 2018, we accrued \$11.3 million (12 cents per diluted share) of pre-tax insurance and claims expense (including pre-judgment interest of \$1.3 million) related to a previously disclosed excess adverse jury verdict rendered on May 17, 2018, in a lawsuit arising from a December 2014 accident (see Note 5 in the Notes to Consolidated Financial Statements (Unaudited) set forth in Part I of this report). Under our insurance policies in effect on the date of this accident, our maximum liability for this accident is \$10.0 million (plus pre-judgment and post-judgment interest) with premium-based insurance coverage that exceeds the jury verdict amount. The Company is appealing this verdict. The majority of our insurance and claims expense results from our claim experience and claim development under our self-insurance program; the remainder results from insurance premiums for claims in excess of our self-insured limits.

We renewed our liability insurance policies on August 1, 2018 and continued to be responsible for the first \$3.0 million per claim with an annual \$6.0 million aggregate for claims between \$3.0 million and \$5.0 million. We also have an additional \$5.0 million deductible per claim for each claim between \$5.0 million and \$10.0 million. As a result, we are responsible for the first \$10.0 million per claim, until we meet the \$6.0 million aggregate for claims between \$3.0 million and \$5.0 million. For the policy year that ended July 31, 2017, we were responsible for the first \$2.0 million per claim with an annual \$8.0 million aggregate for claims between \$2.0 million and \$5.0 million and an annual aggregate of \$5.0 million for claims between \$5.0 million and \$10.0 million. We maintain liability insurance coverage with insurance carriers substantially in excess of the \$10.0 million per claim. Our liability insurance premiums for the policy year that began August 1, 2018 are similar to premiums for the previous policy year on a per-mile basis.

Depreciation expense increased \$2.8 million or 5.3% in second quarter 2018 compared to second quarter 2017 and decreased 1.2% as a percentage of operating revenues. The higher cost of new equipment, larger company truck and trailer fleet size, and information technology and communications infrastructure upgrades resulted in higher depreciation expense in second quarter 2018. In second quarter 2017, we recognized higher expense from reducing the estimated life of certain trucks in fourth quarter 2016 to more rapidly depreciate the trucks to their residual values. This change resulted in additional depreciation expense in second quarter 2017 of \$0.7 million but had no effect on second quarter 2018 as the trucks were sold in 2017.

We are continuing to invest in newer trucks and trailers in 2018 to improve our driver experience, raise operational efficiency and more effectively manage our maintenance, safety and fuel costs. The average age of our truck fleet remains low by industry standards and was 1.9 years as of June 30, 2018.

Rent and purchased transportation expense increased \$26.8 million or 21.5% in second quarter 2018 compared to second quarter 2017 and increased 0.5% as a percentage of operating revenues. Rent and purchased transportation expense consists mostly of payments to third-party capacity providers in the Werner Logistics segment and other non-trucking operations and payments to independent contractors in the Truckload segment. The payments to

third-party capacity providers generally vary depending on changes in the volume of services generated by the Werner Logistics segment. Werner Logistics rent and purchased transportation expense increased \$27.5 million, and as a percentage of Werner Logistics revenues decreased to 84.3% in second quarter 2018 from 84.8% in second quarter 2017.

Rent and purchased transportation expense for the Truckload segment decreased \$1.0 million in second quarter 2018 compared to second quarter 2017. This decrease is due primarily to lower payments to independent contractors during second quarter 2018 compared to second quarter 2017 resulting from a 15.7% decrease in independent contractor miles, or approximately 4 million fewer miles, driven in second quarter 2018. This decrease was partially offset by higher average fuel reimbursement per mile in the 2018 quarter and an increase to the per-mile settlement rate for certain owner operators in June 2018. Independent contractor miles as a percentage of total miles were 10.3% in second quarter 2018 compared to 12.3% in second quarter 2017. Because independent contractors supply their own tractors and drivers and are responsible for their operating expenses, the decrease in independent contractor miles as a percentage of total miles shifted costs from the rent and purchased transportation category to other expense categories, including (i) salaries, wages and benefits, (ii) fuel, (iii) depreciation, (iv) supplies and maintenance and (v) taxes and licenses.

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Challenging operating conditions continue to make independent contractor recruitment and retention difficult. Such conditions include inflationary cost increases that are the responsibility of independent contractors and a shortage of financing available to independent contractors for equipment purchases. Historically we have been able to add company tractors and recruit additional company drivers to offset any decrease in the number of independent contractors. If a shortage of independent contractors and company drivers were to occur, further increases in per-mile settlement rates (for independent contractors) and driver pay rates (for company drivers) may become necessary to attract and retain these drivers. This could negatively affect our results of operations to the extent that we would not be able to obtain corresponding freight rate increases.

Other operating expenses decreased \$8.5 million in second quarter 2018 compared to second quarter 2017 and decreased 1.5% as a percentage of operating revenues. Gains on sales of assets (primarily used trucks and trailers) are reflected as a reduction of other operating expenses and are reported net of sales-related expenses (which include costs to prepare the equipment for sale). Gains on sales of assets were \$8.6 million in second quarter 2018, which included a gain on the sale of real estate of \$3.5 million (four cents per diluted share) compared to \$2.5 million in second quarter 2017. In second quarter 2018, we sold more trucks and fewer trailers than in second quarter 2017. We realized higher average gains per truck and higher average gains per trailer in second quarter 2018 compared to second quarter 2017. The used truck pricing market for our used trucks has improved in recent months, while we continue to make progress increasing the number of our late-model trucks sold via our retail network. Other operating expenses, primarily the provision for doubtful accounts related to the driver training schools, declined by \$2.4 million in second quarter 2018 compared to second quarter 2017. Under the new revenue recognition accounting standard effective January 1, 2018, we recorded a \$3.9 million reduction of revenues in second quarter 2018 related to our driver training schools that would have been reported as bad debt expense prior to the new standard.

**Other Expense (Income)**

Other expense (income) remained flat from second quarter 2017 to second quarter 2018 and also remained flat as a percentage of operating revenues. Interest expense decreased in second quarter 2018 when compared to second quarter 2017 due to lower average outstanding debt in the 2018 quarter. This decrease in interest expense was nearly offset by lower interest income due primarily to lower average outstanding notes receivable.

**Income Taxes**

Our effective income tax rate (income taxes expressed as a percentage of income before income taxes) was 24.8% in second quarter 2018 and 37.3% in second quarter 2017. The 24.8% income tax rate in second quarter 2018 is attributed primarily to the 14% lower federal income tax rate related to the enactment of the Tax Cuts and Jobs Act of 2017 and the benefit of discrete state income tax items. We expect our effective income tax rate to be in the range of 25% to 26% going forward.

**Six Months Ended June 30, 2018 Compared to Six Months Ended June 30, 2017****Operating Revenues**

Operating revenues increased 15.8% for the six months ended June 30, 2018, compared to the same period of the prior year. In the Truckload segment, trucking revenues, net of fuel surcharge, increased 12.0% in the 2018 year-to-date period compared to the 2017 year-to-date period due primarily to an 8.2% increase in average revenues per tractor per week and a 3.5% increase in the average number of tractors in service. Average revenues per total mile, net of fuel surcharge, increased 11.7% in the first six months of 2018 compared to the same period in 2017, and average monthly miles per tractor decreased by 3.1%. Truckload segment fuel surcharge revenues for the six months ended June 30, 2018 increased \$31.3 million or 32.1% when compared to the six months ended June 30, 2017 due to higher average fuel prices in the 2018 period. Werner Logistics revenues increased to \$251.4 million in the first six months of 2018 compared to \$200.7 million in the same 2017 period.

**Operating Expenses**

Our operating ratio (operating expenses expressed as a percentage of operating revenues) was 92.7% for the six months ended June 30, 2018, compared to 93.8% for the six months ended June 30, 2017. Expense items that impacted the overall operating ratio are described on the following pages. The tables on pages 18 and 19 show the Consolidated Statements of Income in dollars and as a percentage of total operating revenues and the percentage increase or decrease in the dollar amounts of those items compared to the same period of the prior year, as well as the operating ratios, operating margins, and certain statistical information for our two reportable segments, Truckload and Werner Logistics.

Salaries, wages and benefits increased \$48.5 million or 14.7% in the first six months of 2018 compared to the first six months of 2017 and decreased as a percentage of operating revenues to 32.1%. The higher dollar amount of salaries, wages and benefits expense was due primarily to higher driver and student pay rates, approximately 10 million more company truck miles, higher non-driver pay, higher payroll taxes and payroll-related fringe benefits, and increases in higher-cost medical claims, prescription



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drugs and other health insurance costs in the 2018 period. When evaluated on a per-company-truck-mile basis, driver salaries increased by about 10%. Non-driver salaries, wages and benefits in the non-trucking Werner Logistics segment increased 19.9% compared to 25.3% higher revenues.

Fuel increased \$34.4 million or 38.1% in the first six months of 2018 compared to the same period in 2017 and increased 1.7% as a percentage of operating revenues due primarily to higher average diesel fuel prices in 2018 and increased company truck miles. Average diesel fuel prices were 52 cents per gallon higher in the first six months of 2018 than in the same 2017 period.

Supplies and maintenance increased \$13.1 million or 16.8% in the first six months of 2018 compared to the same period in 2017 and remained flat as a percentage of operating revenues due primarily to higher company truck miles driven in the first six months of 2018 compared to the first six months of 2017 and higher equipment maintenance costs for towing, road calls, jump starts and other weather-related maintenance due to more severe winter weather conditions in first quarter 2018 compared to first quarter 2017. We also incurred higher driver recruiting and other driver-related costs in the 2018 period.

Insurance and claims expense increased \$12.2 million or 30.7% in the first six months of 2018 compared to the same period in 2017 and decreased 0.5% as a percentage of operating revenues. The higher expense in the 2018 year-to-date period was due primarily to the aforementioned \$11.3 million accrual related to the adverse jury verdict.

Depreciation expense increased \$3.0 million or 2.8% in the first six months of 2018 compared to the same 2017 period and decreased 1.2% as a percentage of operating revenues due primarily to the higher cost of new equipment, larger company truck and trailer fleet size, and information technology and communications infrastructure upgrades. In the first six months of 2017, we recognized higher expense from reducing the estimated life of certain trucks in fourth quarter 2016 to more rapidly depreciate the trucks to their residual values. This change resulted in additional depreciation expense of \$3.3 million in the 2017 period but had no effect on 2018 as the trucks were sold in 2017.

Rent and purchased transportation expense increased \$36.3 million or 14.5% in the first six months of 2018 compared to the same 2017 period and decreased 0.3% as a percentage of operating revenues. Rent and purchased transportation for the Truckload segment decreased \$7.3 million in the first six months of 2018 compared to the same 2017 period. This decrease is due primarily to 17.5% fewer independent contractor miles driven in the first six months of 2018 compared to the same period in 2017. Independent contractor miles as a percentage of total miles were 10.4% and 12.7% in the first six months of 2018 and 2017, respectively. Werner Logistics rent and purchased transportation expense increased \$43.4 million and as a percentage of Werner Logistics revenues increased to 84.8% in the 2018 period from 84.6% in the 2017 period.

Other operating expenses decreased \$12.3 million in the first six months of 2018 compared to the same period in 2017 and decreased 1.1% as a percentage of operating revenues. Gains on sales of assets (primarily used trucks and trailers) increased to \$11.3 million, which included a \$3.5 million gain on the sale of real estate, in the six months ended June 30, 2018 from \$3.9 million in the six months ended June 30, 2017. In the 2018 year-to-date period, we sold more trucks and fewer trailers and realized higher average gains per truck and trailer when compared to same period of 2017. Provision for doubtful accounts related to our driver schools was lower in the 2018 period, resulting from adopting the new revenue recognition standard in 2018 under which we record a \$7.1 million reduction of revenues that would have been reported as bad debt expense prior to the new standard.

**Other Expense (Income)**

Other expense (income) decreased \$0.1 million in the first six months of 2018 compared to the same 2017 period and remained flat as a percentage of operating revenues. Interest expense was lower in the 2018 period due to lower average outstanding debt. Interest income decreased due to lower average outstanding notes receivable in the first six months of 2018 compared to the first six months of 2017.

**Income Taxes**

Our effective income tax rate (income taxes expressed as a percentage of income before income taxes) decreased to 23.4% for the first six months of 2018 from 37.8% for the first six months of 2017. The 23.4% income tax rate in the year-to-date 2018 period is attributed primarily to the 14% lower federal income tax rate related to the enactment of the Tax Cuts and Jobs Act of 2017 and the benefit of discrete federal and state income tax items.

Liquidity and Capital Resources:

During the six months ended June 30, 2018, we generated cash flow from operations of \$182.5 million, a 2% or \$4.0 million increase in cash flows compared to the same six-month period a year ago. We were able to make net capital expenditures, pay dividends and repurchase company stock with the net cash provided by operating activities and existing cash balances, supplemented by borrowings under our credit facilities.

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Net cash used in investing activities increased to \$166.4 million for the six-month period ended June 30, 2018 from \$54.5 million for the six-month period ended June 30, 2017. Net property additions (primarily revenue equipment) were \$174.8 million for the six-month period ended June 30, 2018, compared to \$66.0 million during the same period of 2017. As of June 30, 2018, we were committed to property and equipment purchases of approximately \$236.8 million. We currently estimate net capital expenditures (primarily revenue equipment) in 2018 to be in the range of \$325 million to \$375 million, compared to net capital expenditures in 2017 of \$198.8 million. The 2018 range allows for increased investment in our tractor and trailer fleet as a result of the changes to federal income tax laws. We intend to fund these net capital expenditures through cash flow from operations and financing available under our existing credit facilities, if necessary.

Net financing activities used \$21.3 million during the six months ended June 30, 2018, and used \$113.0 million during the same period in 2017. We borrowed \$20.0 million of long-term debt during the six months ended June 30, 2018, bringing our outstanding debt at June 30, 2018 to \$95.0 million. In the same 2017 period, we repaid short-term and long-term debt of \$105.0 million. We paid dividends of \$10.1 million in the six-month period ended June 30, 2018 and \$8.7 million in the six-month period ended June 30, 2017. We increased our quarterly dividend rate by \$0.01 per share, or 17%, beginning with the quarterly dividend paid in July 2017. Financing activities for the six months ended June 30, 2018, also included common stock repurchases of 627,652 shares at a cost of \$22.9 million. No repurchases were made in the six months ended June 30, 2017. From time to time, the Company has repurchased, and may continue to repurchase, shares of the Company's common stock. The timing and amount of such purchases depend upon stock market conditions and other factors. As of June 30, 2018, the Company had purchased 3,914,943 shares pursuant to our current Board of Directors repurchase authorization and had 4,085,057 shares remaining available for repurchase.

Management believes our financial position at June 30, 2018 is strong. As of June 30, 2018, we had \$9.9 million of cash and cash equivalents and over \$1.2 billion of stockholders' equity. Cash is invested primarily in government portfolio money market funds. As of June 30, 2018, we had a total of \$325.0 million of credit pursuant to three credit facilities (see Note 3 in the Notes to Consolidated Financial Statements under Item 1 of Part I of this Form 10-Q), of which we had borrowed \$95.0 million. The remaining \$230.0 million of credit available under these facilities at June 30, 2018 is reduced by the \$28.8 million in stand-by letters of credit under which we are obligated. These stand-by letters of credit are primarily required as security for insurance policies. Based on our strong financial position, management does not foresee any significant barriers to obtaining sufficient financing, if necessary.

### Contractual Obligations and Commercial Commitments:

Item 7 of Part II of our 2017 Form 10-K includes our disclosure of contractual obligations and commercial commitments as of December 31, 2017. There were no material changes in the nature of these items during the six-months ended June 30, 2018. See the Notes to Consolidated Financial Statements (Unaudited) under Item I of Part I of this Form 10-Q.

### Regulations:

Item 1 of Part I of our 2017 Form 10-K includes a discussion of pending proposed regulations that may have an effect on our operations if they become adopted and effective as proposed. There have been no material changes in the status of these proposed regulations previously disclosed in the 2017 Form 10-K.

### Critical Accounting Policies and Estimates:

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the (i) reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and (ii) reported amounts of revenues and expenses during the reporting period. We evaluate these estimates on an ongoing basis as events and circumstances change, utilizing historical experience, consultation with

experts and other methods considered reasonable in the particular circumstances. Actual results could differ from those estimates and may significantly impact our results of operations from period to period. It is also possible that materially different amounts would be reported if we used different estimates or assumptions.

Information regarding our Critical Accounting Policies and Estimates can be found in our 2017 Form 10-K. The most critical accounting policies and estimates that require us to make significant judgments and estimates and affect our financial statements include the following:

- Depreciation and impairment of tractors and trailers.
- Estimates of accrued liabilities for insurance and claims for liability and physical damage losses and workers' compensation.
- Accounting for income taxes.

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There have been no material changes to these critical accounting policies and estimates from those discussed in our 2017 Form 10-K.

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

We are exposed to market risk from changes in commodity prices, foreign currency exchange rates and interest rates.

#### Commodity Price Risk

The price and availability of diesel fuel are subject to fluctuations attributed to changes in the level of global oil production, refining capacity, seasonality, weather and other market factors. Historically, we have recovered a majority, but not all, of fuel price increases from customers in the form of fuel surcharges. We implemented customer fuel surcharge programs with most of our customers to offset much of the higher fuel cost per gallon. However, we do not recover all of the fuel cost increase through these surcharge programs. We cannot predict the extent to which fuel prices will increase or decrease in the future or the extent to which fuel surcharges could be collected. As of June 30, 2018, we had no derivative financial instruments to reduce our exposure to fuel price fluctuations.

#### Foreign Currency Exchange Rate Risk

We conduct business in several foreign countries, including Mexico, Canada, China and Australia. To date, most foreign revenues are denominated in U.S. Dollars, and we receive payment for foreign freight services primarily in U.S. Dollars to reduce direct foreign currency risk. Assets and liabilities maintained by a foreign subsidiary company in the local currency are subject to foreign exchange gains or losses. Foreign currency translation gains and losses primarily relate to changes in the value of revenue equipment owned by a subsidiary in Mexico, whose functional currency is the Peso. Foreign currency translation losses were \$2.5 million for second quarter 2018 and gains were \$1.4 million for second quarter 2017. These were recorded in accumulated other comprehensive loss within stockholders' equity in the Consolidated Balance Sheets.

#### Interest Rate Risk

We manage interest rate exposure through a mix of variable rate debt and interest rate swap agreements. We had \$75 million of debt outstanding at June 30, 2018, for which the interest rate is effectively fixed at 2.5% through September 2019 with an interest rate swap agreement to reduce our exposure to interest rate increases. We had \$20 million of variable rate debt outstanding at June 30, 2018. Interest rates on the variable rate debt and our unused credit facilities are based on the LIBOR (see Contractual Obligations and Commercial Commitments). Assuming this level of borrowing, a hypothetical one-percentage point increase in the LIBOR interest rate would increase our annual interest expense by \$200,000.

### Item 4. Controls and Procedures.

As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"). Our disclosure controls and procedures are designed to provide reasonable assurance of achieving the desired control objectives. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective at a reasonable assurance level in enabling us to record, process, summarize and report information required to be included in our periodic filings with the SEC within the required time period and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Management, under the supervision of and with the participation of our Chief Executive Officer and Chief Financial Officer, concluded that no changes in our internal control over financial reporting occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over

financial reporting.

We have confidence in our internal controls and procedures. Nevertheless, our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that the internal controls or disclosure procedures and 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 that resource constraints exist, and the benefits of controls must be evaluated relative to their costs. Because of the inherent limitations in all internal control systems, no evaluation of controls can provide absolute assurance that all control issues, misstatements and instances of fraud, if any, have been prevented or detected.

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OTHER INFORMATION

## Item 1. Legal Proceedings.

Information regarding the May 17, 2018 adverse jury verdict in Harris County District Court in Houston, Texas, is incorporated by reference from Note 5 in our Notes to Consolidated Financial Statements (Unaudited) set forth in Part I of this report.

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

On October 15, 2007, we announced that on October 11, 2007 our Board of Directors approved an increase in the number of shares of our common stock that the Company is authorized to repurchase. Under this authorization, the Company is permitted to repurchase an additional 8,000,000 shares. As of June 30, 2018, the Company had purchased 3,914,943 shares pursuant to this authorization and had 4,085,057 shares remaining available for repurchase. The Company may purchase shares from time to time depending on market, economic and other factors. The authorization will continue unless withdrawn by the Board of Directors.

The following table summarizes our stock repurchases during second quarter 2018 made pursuant to this authorization. The Company did not purchase any shares during second quarter 2018 other than pursuant to this authorization. All stock repurchases were made by the Company or on its behalf and not by any “affiliated purchaser,” as defined by Rule 10b-18 of the Exchange Act.

## Issuer Purchases of Equity Securities

| Period           | Total<br>Number of<br>Shares<br>(or Units)<br>Purchased | Average<br>Price<br>Paid per<br>Share<br>(or<br>Unit) | Total<br>Number of<br>Shares<br>(or Units)<br>Purchased<br>as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number (or<br>Approximate<br>Dollar<br>Value) of<br>Shares (or<br>Units) that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|------------------|---|---|---|--|
| April 1-30, 2018 | 153,426   | \$ 34.91  | 153,426   | 4,559,283  |
| May 1-31, 2018   | 192,163   | \$ 34.98  | 192,163   | 4,367,120  |
| June 1-30, 2018  | 282,063   | \$ 38.31  | 282,063   | 4,085,057  |
| Total            | 627,652   | \$ 36.46  | 627,652   | 4,085,057  |

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Item 6. Exhibits.

| Exhibit No. | Exhibit  | Incorporated by Reference to:  |
|-------------|--|--|
| 3(i)        | <u>Restated Articles of Incorporation of Werner Enterprises, Inc.</u>  | <u>Exhibit 3(i) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007</u>   |
| 3(ii)       | <u>Revised and Restated By-Laws of Werner Enterprises, Inc.</u>  | <u>Exhibit 3.1 to the Company's Current Report on Form 8-K dated May 10, 2016</u>  |
| 11          | <u>Statement Re: Computation of Per Share Earnings</u>   | <u>See Note 6 (Earnings Per Share) in the Notes to Consolidated Financial Statements (Unaudited) under Item 1 of Part I of this Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018</u>   |
| 31.1        | <u>Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 (Section 302 of the Sarbanes-Oxley Act of 2002)</u> | <u>Filed herewith</u>  |
| 31.2        | <u>Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 (Section 302 of the Sarbanes-Oxley Act of 2002)</u> | 2.5.2 If a grantee's employment terminates for any reason other than death or dismissal for cause, the grantee may exercise any outstanding option or stock appreciation right on the following terms and conditions: (a) exercise may be made only to the extent that the grantee was entitled to exercise the award on the date of employment termination; and (b) exercise must occur within 90 days after employment terminates, except that this 90 day period shall be increased to one year if the termination is by reason of disability, but in no event after the expiration date of the award as set forth in the Plan Agreement. In the case of an incentive stock option, the term disability |



for purposes of the preceding sentence shall have the meaning given to it by section 422(c)(6) of the Code.

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2.5.3 If a grantee dies while employed by the Company or any subsidiary, or after employment termination but during the period in which the grantee's awards are exercisable pursuant to Section 2.5.2, any outstanding option or stock appreciation right shall be exercisable on the following terms and conditions: (a) exercise may be made only to the extent that the grantee was entitled to exercise the award on the date of death; and (b) exercise must occur by the earlier of the first anniversary of the grantee's death or the expiration date of the award. Any such exercise of an award following a grantee's death shall be made only by the grantee's executor or administrator, unless the grantee's will specifically disposes of such award, in which case such exercise shall be made only by the recipient of such specific disposition. If a grantee's personal representative or the recipient of a specific disposition under the grantee's will shall be entitled to exercise any award pursuant to the preceding sentence, such representative or recipient shall be bound by all the terms and conditions of the Plan and the applicable Plan Agreement which would have applied to the grantee including, without limitation, the provisions of Sections 3.3 and 3.7 hereof.

## **2.6 Grant of Restricted Stock**

2.6.1 The Committee may grant restricted shares of Stock to such key persons, in such amounts, and subject to such terms and conditions as the Committee shall determine in its discretion, subject to the provisions of the Plan.

Restricted stock awards may be made independently of or in connection with any other award under the Plan. A grantee of a restricted stock award shall have no rights with respect to such award unless such grantee accepts the award within such period as the Committee shall specify by executing a Plan Agreement in such form as the Committee shall determine and, if the Committee shall so require, makes payment to the Company by certified or official bank check (or the equivalent thereof acceptable to the Company) in such amount as the Committee may determine.

2.6.2 Promptly after a grantee accepts a restricted stock award, the Company shall issue in the grantee's name a certificate or certificates for the shares of the Common Stock covered by the award. Upon the issuance of such certificate(s), the grantee shall have the rights of a stockholder with respect to the restricted stock, subject to the nontransferability restrictions and Company repurchase rights described in Sections 2.6.4 and 2.6.5 and to such other restrictions and conditions as the Committee in its discretion may include in the applicable Plan Agreement.

2.6.3 Unless the Committee shall otherwise determine, any certificate issued evidencing shares of restricted stock shall remain in the possession of the Company until such shares are free of any restrictions specified in the applicable Plan Agreement.

2.6.4 Shares of restricted stock may not be sold, assigned, transferred, pledged or otherwise encumbered or disposed of except as specifically provided in this Plan or the applicable Plan Agreement. The Committee at the time of grant shall specify the date or dates (which may depend upon or be related to the attainment of performance goals and other conditions) on which the nontransferability of the restricted stock shall lapse. Unless the applicable Plan Agreement provides otherwise, additional shares of Stock or other property distributed to the grantee in respect of shares of restricted stock, as dividends or otherwise, shall be subject to the same restrictions applicable to such restricted stock.

2.6.5 During the 120 days following termination of the grantee's employment for any reason, the Company shall have the right to require the return of any shares to which restrictions on transferability apply, in exchange for which the Company shall repay to the grantee (or the grantee's estate) any amount paid by the grantee for such shares.

## **2.7 Grant of Restricted Stock Units**

2.7.1 The Committee may grant awards of restricted stock units to such key persons, in such amounts, and subject to such terms and conditions as the Committee shall determine in its discretion, subject to the provisions of the Plan.

Restricted stock units may be awarded independently of or in connection with any other award under the Plan.

2.7.2 At the time of grant, the Committee shall specify the date or dates on which the restricted stock units shall become fully vested and nonforfeitable, and may specify such conditions to vesting as it deems appropriate. In the event of the termination of the grantee's employment by the Company and its subsidiaries for any reason, restricted stock units that have not become nonforfeitable shall be forfeited and

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cancelled. The Committee at any time may accelerate vesting dates and otherwise waive or amend any conditions of an award of restricted stock units.

2.7.3 At the time of grant, the Committee shall specify the maturity date applicable to each grant of restricted stock units, which may be determined at the election of the grantee. Such date may be later than the vesting date or dates of the award. On the maturity date, the Company shall transfer to the grantee one unrestricted, fully transferable share of the Common Stock for each restricted stock unit scheduled to be paid out on such date and not previously forfeited. The Committee shall specify the purchase price, if any, to be paid by the grantee to the Company for such shares of the Common Stock.

## **2.8 Other Stock-Based Awards**

The Committee may grant other types of stock-based awards (including the grant of unrestricted shares) to such key persons, in such amounts and subject to such terms and conditions, as the Committee shall in its discretion determine, subject to the provisions of the Plan. Such awards may entail the transfer of actual shares of the Common Stock to Plan participants, or payment in cash or otherwise of amounts based on the value of shares of the Common Stock.

# **ARTICLE III MISCELLANEOUS**

## **3.1 Amendment of the Plan; Modification of Awards**

3.1.1 The Board may from time to time suspend, discontinue, revise or amend the Plan in any respect whatsoever, except that no such amendment shall materially impair any rights or materially increase any obligations under any award theretofore made under the Plan without the consent of the grantee (or, after the grantee's death, the person having the right to exercise the award). For purposes of this Section 3.1, any action of the Board or the Committee that alters or affects the tax treatment of any award shall not be considered to materially impair any rights of any grantee.

3.1.2 Stockholder approval of any amendment shall be obtained to the extent necessary to comply with section 422 of the Code (relating to incentive stock options) or other applicable law or regulation.

3.1.3 The Committee may amend any outstanding Plan Agreement, including, without limitation, by amendment which would accelerate the time or times at which the award becomes unrestricted or may be exercised, or waive or amend any goals, restrictions or conditions set forth in the Agreement. However, any such amendment (other than an amendment pursuant to Section 3.7.2, relating to change in control) that materially impairs the rights or materially increases the obligations of a grantee under an outstanding award shall be made only with the consent of the grantee (or, upon the grantee's death, the person having the right to exercise the award).

## **3.2 Tax Withholding**

3.2.1 As a condition to the receipt of any shares of the Common Stock pursuant to any award or the lifting of restrictions on any award, or in connection with any other event that gives rise to a federal or other governmental tax withholding obligation on the part of the Company relating to an award (including, without limitation, FICA tax), the Company shall be entitled to require that the grantee remit to the Company an amount sufficient in the opinion of the

Company to satisfy such withholding obligation.

3.2.2 If the event giving rise to the withholding obligation is a transfer of shares of the Common Stock, then, unless otherwise specified in the applicable Plan Agreement, the grantee may satisfy the withholding obligation imposed under Section 3.2.1 by electing to have the Company withhold shares of the Common Stock having a Fair Market Value equal to the amount of tax to be withheld. For this purpose, Fair Market Value shall be determined as of the date on which the amount of tax to be withheld is determined (and any fractional share amount shall be settled in cash).

### **3.3 Restrictions**

3.3.1 If the Committee shall at any time determine that any consent (as hereinafter defined) is necessary or desirable as a condition of, or in connection with, the granting of any award under the Plan, the issuance or purchase of shares or other rights thereunder, or the taking of any other action thereunder (each such action

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being hereinafter referred to as a plan action ), then such plan action shall not be taken, in whole or in part, unless and until such consent shall have been effected or obtained to the full satisfaction of the Committee.

3.3.2 The term consent as used herein with respect to any plan action means (a) any and all listings, registrations or qualifications in respect thereof upon any securities exchange or under any federal, state or local law, rule or regulation, (b) any and all written agreements and representations by the grantee with respect to the disposition of shares, or with respect to any other matter, which the Committee shall deem necessary or desirable to comply with the terms of any such listing, registration or qualification or to obtain an exemption from the requirement that any such listing, qualification or registration be made and (c) any and all consents, clearances and approvals in respect of a plan action by any governmental or other regulatory bodies.

### **3.4 Non-assignability**

Except to the extent otherwise provided in the applicable Plan Agreement, no award or right granted to any person under the Plan shall be assignable or transferable other than by will or by the laws of descent and distribution, and all such awards and rights shall be exercisable during the life of the grantee only by the grantee or the grantee's legal representative.

### **3.5 Notification of Election Under Code Section 83(b)**

If any grantee shall, in connection with the acquisition of shares of the Common Stock under the Plan, make the election permitted under section 83(b) of the Code (that is, an election to include in gross income in the year of transfer the amounts specified in section 83(b)), such grantee shall notify the Company of such election within 10 days of filing notice of the election with the Internal Revenue Service, in addition to any filing and notification required pursuant to regulations issued under the authority of Code section 83(b).

### **3.6 Notification Upon Disqualifying Disposition**

If any grantee shall make any disposition of shares of the Common Stock issued pursuant to the exercise of an incentive stock option under the circumstances described in section 421(b) of the Code (relating to certain disqualifying dispositions), such grantee shall notify the Company of such disposition within 10 days thereof.

### **3.7 Adjustment Upon Changes in Stock**

3.7.1 Shares Available for Grants. In the event of any change in the number of shares of Stock outstanding by reason of any stock dividend or split, reverse stock split, recapitalization, merger, consolidation, combination or exchange of shares or similar corporate change, the maximum number of shares of the Common Stock with respect to which the Committee may grant awards under Article II hereof, as described in Section 1.5.1, and the individual annual limit described in Section 1.5.2, shall be appropriately adjusted by the Committee. In the event of any change in the number of shares of the Common Stock outstanding by reason of any other event or transaction, the Committee may, but need not, make such adjustments in the number and class of shares of the Common Stock with respect to which awards: (i) may be granted under Article II hereof and (ii) granted to any one employee of the Company or a subsidiary during any one calendar year, in each case as the Committee may deem appropriate, unless such adjustment would cause any award that would otherwise qualify as performance based compensation with respect to a 162(m) covered employee (as defined in Section 162 of the Code), to cease to so qualify.

3.7.2 Outstanding Restricted Stock and Restricted Stock Units. Unless the Committee in its absolute discretion otherwise determines, any securities or other property (including dividends paid in cash) received by a grantee with respect to a share of restricted stock, the issue date with respect to which occurs prior to such event, but which has not vested as of the date of such event, as a result of any dividend, stock split, reverse stock split, recapitalization, merger, consolidation, combination, exchange of shares or otherwise will not vest until such share of restricted stock vests, and shall be promptly deposited with the Company or otherwise treated as was the certificate for the underlying share of restricted stock, pursuant to Section 2.6.3 hereof.

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The Committee may, in its absolute discretion, adjust any grant of shares of restricted stock, the issue date with respect to which has not occurred as of the date of the occurrence of any of the following events, or any grant of restricted stock units, to reflect any dividend, stock split, reverse stock split, recapitalization, merger, consolidation, combination, exchange of shares or similar corporate change as the Committee may deem appropriate to prevent the enlargement or dilution of rights of grantees.

3.7.3 Outstanding Options and Stock Appreciation Rights Increase or Decrease in Issued Shares Without Consideration. Subject to any required action by the stockholders of the Company, in the event of any increase or decrease in the number of issued shares of Stock resulting from a subdivision or consolidation of shares of Stock or the payment of a stock dividend (but only on the shares of Stock), or any other increase or decrease in the number of such shares effected without receipt of consideration by the Company, the Committee shall proportionally adjust the number of shares of the Common Stock subject to each outstanding option and stock appreciation right, and the exercise price-per-share of the Common Stock of each such option and stock appreciation right.

3.7.4 Outstanding Options and Stock Appreciation Rights Certain Mergers. Subject to any required action by the stockholders of the Company, in the event that the Company shall be the surviving corporation in any merger or consolidation (except a merger or consolidation as a result of which the holders of shares of Stock receive securities of another corporation), each option and stock appreciation right outstanding on the date of such merger or consolidation shall pertain to and apply to the securities which a holder of the number of shares of the Common Stock subject to such option or stock appreciation right would have received in such merger or consolidation.

3.7.5 Outstanding Options and Stock Appreciation Rights Certain Other Transactions. In the event of (i) a dissolution or liquidation of the Company, (ii) a sale of all or substantially all of the Company's assets, (iii) a merger or consolidation involving the Company in which the Company is not the surviving corporation or (iv) a merger or consolidation involving the Company in which the Company is the surviving corporation but the holders of shares of the Common Stock receive securities of another corporation and/or other property, including cash, the Committee shall, in its absolute discretion, have the power to:

cancel, effective immediately prior to the occurrence of such event, each option and stock appreciation right outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the grantee to whom such option or stock appreciation right was granted an amount in cash, for (i) each share of the Common Stock subject to such option or stock appreciation right, respectively, equal to the excess of (x) the value, as determined by the Committee in its absolute discretion, of the property (including cash) received by the holder of a share of the Common Stock as a result of such event over (y) the exercise price of such option or stock appreciation right;

cancel, effective immediately prior to the occurrence of such event, each option and stock appreciation right outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such (ii) cancellation, pay to the grantee to whom such option or stock appreciation right was granted, for each share of the Common Stock subject to such option or stock appreciation right, respectively, the property (including cash) received by the holder of a share of the Common Stock as a result of such event; or

provide for the exchange of each option and stock appreciation right outstanding immediately prior to such event (whether or not then exercisable) for an option on or stock appreciation right with respect to, as appropriate, some or all of the property which a holder of the number of shares of the Common Stock subject to such option or stock appreciation right would have received and, incident thereto, make an equitable adjustment as determined by the (iii) Committee in its absolute discretion in the exercise price of the option or stock appreciation right, or the number of shares or amount of property subject to the option or stock appreciation right or, if appropriate, provide for a cash payment to the grantee to whom such option or stock appreciation right was granted in partial consideration for the exchange of the option or stock appreciation right.





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3.7.6 Outstanding Options and Stock Appreciation Rights – Other Changes. In the event of any change in the capitalization of the Company or a corporate change other than those specifically referred to in Sections 3.7.3, 3.7.4 or 3.7.5 hereof, the Committee may, in its absolute discretion, make such adjustments in the number and class of shares subject to options and stock appreciation rights outstanding on the date on which such change occurs and in the per-share exercise price of each such option and stock appreciation right as the Committee may consider appropriate to prevent dilution or enlargement of rights. In addition, if and to the extent the Committee determines it is appropriate, the Committee may elect to cancel each option and stock appreciation right outstanding immediately prior to such event (whether or not then exercisable), and, in full consideration of such cancellation, pay to the grantee to whom such option or stock appreciation right was granted an amount in cash, for each share of the Common Stock subject to such option or stock appreciation right, respectively, equal to the excess of (i) the Fair Market Value of the Common Stock on the date of such cancellation over (ii) the exercise price of such option or stock appreciation right.

3.7.7 No Other Rights. Except as expressly provided in the Plan, no grantee shall have any rights by reason of any subdivision or consolidation of shares of stock of any class, the payment of any dividend, any increase or decrease in the number of shares of stock of any class or any dissolution, liquidation, merger or consolidation of the Company or any other corporation. Except as expressly provided in the Plan, no issuance by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number of shares of the Common Stock subject to an award or the exercise price of any option or stock appreciation right. Except as otherwise provided in Section 3.7, no adjustment shall be made for dividends, distributions or other rights (whether ordinary or extraordinary, and whether in cash, securities or other property) for which the record date is prior to the date such stock certificate is issued.

## **3.8 Right of Discharge Reserved**

Nothing in the Plan or in any Plan Agreement shall confer upon any grantee the right to continue in the employ of the Company or affect any right which the Company may have to terminate such employment.

## **3.9 Nature of Payments**

3.9.1 Any and all grants of awards and issuances of shares of the Common Stock under the Plan shall be in consideration of services performed for the Company by the grantee.

3.9.2 All such grants and issuances shall constitute a special incentive payment to the grantee and shall not be taken into account in computing the amount of salary or compensation of the grantee for the purpose of determining any benefits under any pension, retirement, profit-sharing, bonus, life insurance or other benefit plan of the Company or under any agreement between the Company and the grantee, unless such plan or agreement specifically provides otherwise.

## **3.10 Non-Uniform Determinations**

The Committee's determinations under the Plan need not be uniform and may be made by it selectively among persons who receive, or are eligible to receive, awards under the Plan (whether or not such persons are similarly situated).

Without limiting the generality of the foregoing, the Committee shall be entitled, among other things, to make non-uniform and selective determinations, and to enter into non-uniform and selective Plan agreements, as to (a) the persons to receive awards under the Plan, (b) the terms and provisions of awards under the Plan, and (c) the treatment of leaves of absence pursuant to Section 1.6.4.

### **3.11 Other Payments or Awards**

Nothing contained in the Plan shall be deemed in any way to limit or restrict the Company from making any award or payment to any person under any other plan, arrangement or understanding, whether now existing or hereafter in effect.

### **3.12 Section Headings**

The section headings contained herein are for the purpose of convenience only and are not intended to define or limit the contents of the sections.

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**3.13 Effective Date and Term of Plan**

3.13.1 The Plan was adopted by the Board on September 27, 2010, subject to approval by the Company's stockholders. The Plan was amended on June 1, 2016, subject to approval by the Company's stockholders to increase the number of shares of the Common Stock which may be transferred pursuant to awards granted under the Plan by 2,000,000 to 10,000,000. All awards under the Plan prior to such stockholder approval are subject in their entirety to such approval.

If such approval is not obtained prior to the first anniversary of the date of adoption of the Plan, the Plan and all awards thereunder shall terminate on that date.

3.13.2 Unless sooner terminated by the Board, the Plan will terminate on the close of business on September 27, 2020, ten years from the original effective date. All awards made under the Plan prior to its termination shall remain in effect until such awards have been satisfied or terminated in accordance with the terms and provisions of the Plan and the applicable Plan Agreements.

**3.14 Governing Law**

All rights and obligations under the Plan shall be construed and interpreted in accordance with the laws of the State of Nevada, without giving effect to principles of conflict of laws.

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APPENDIX B

**PLAN OF CONVERSION  
OF  
SYNTHETIC BIOLOGICS, INC., A NEVADA  
CORPORATION  
INTO  
SYNTHETIC BIOLOGICS, INC., A DELAWARE  
CORPORATION**

THIS PLAN OF CONVERSION, dated as of [ ], 2016 (including all of the Exhibits attached hereto, this Plan ), is hereby adopted by Synthetic Biologics, Inc., a Nevada corporation, in order to set forth the terms, conditions and procedures governing the conversion of Synthetic Biologics, Inc. from a Nevada corporation to a Delaware corporation pursuant to Section 265 of the General Corporation Law of the State of Delaware, as amended (the DGCL ), and Section 92A.120 of the Nevada Revised Statutes, as amended (the NRS ).

**RECITALS**

WHEREAS, Synthetic Biologics, Inc. is a corporation organized and existing under the laws of the State of Nevada (the Converting Entity );

WHEREAS, the Board of Directors of the Converting Entity has determined that it would be advisable and in the best interests of the Converting Entity and its stockholders for the Converting Entity to convert from a Nevada corporation to a Delaware corporation pursuant to Section 265 of the DGCL and Sections 92A.120 and 92A.250 of the NRS;

WHEREAS, the form, terms and provisions of this Plan have been authorized, approved and adopted by the Board of Directors of the Converting Entity;

WHEREAS, the Board of Directors of the Converting Entity has submitted this Plan to the stockholders of the Converting Entity for approval; and

WHEREAS, this Plan has been authorized, approved and adopted by the holders of a majority of the voting power of the stockholders of the Converting Entity.

NOW, THEREFORE, the Converting Entity hereby adopts this Plan as follows:

**PLAN OF CONVERSION**

1. Conversion; Effect of Conversion.

(a) Upon the Effective Time (as defined in Section 3 below), the Converting Entity shall be converted from a Nevada

corporation to a Delaware corporation pursuant to Section 265 of the DGCL and Sections 92A.120 and 92A.250 of the NRS (the Conversion ) and the Converting Entity, as converted to a Delaware corporation (the Converted Entity ), shall thereafter be subject to all of the provisions of the DGCL, except that notwithstanding Section 106 of the DGCL, the existence of the Converted Entity shall be deemed to have commenced on the date the Converting Entity commenced its existence in the State of Nevada.

Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, the Converted Entity shall, for all purposes of the laws of the State of Delaware, be deemed to be the same entity as the Converting Entity existing immediately prior to the Effective Time. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, for all purposes of the laws of the State of Delaware, all of the rights, privileges and powers of the Converting Entity existing immediately prior to the Effective Time, and all property, real, personal and mixed, and (b) all debts due to the Converting Entity existing immediately prior to the Effective Time, as well as all other things and causes of action belonging to the Converting Entity existing immediately prior to the Effective Time, shall remain vested in the Converted Entity and shall be the property of the Converted Entity and the title to any real property vested by deed or otherwise in the Converting Entity existing immediately prior to the Effective Time shall not revert or be in any way impaired by reason of the Conversion; but all rights of creditors and all liens upon any property of the

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Converting Entity existing immediately prior to the Effective Time shall be preserved unimpaired, and all debts, liabilities and duties of the Converting Entity existing immediately prior to the Effective Time shall remain attached to the Converted Entity upon the Effective Time, and may be enforced against the Converted Entity to the same extent as if said debts, liabilities and duties had originally been incurred or contracted by the Converted Entity in its capacity as a corporation of the State of Delaware. The rights, privileges, powers and interests in property of the Converting Entity existing immediately prior to the Effective Time, as well as the debts, liabilities and duties of the Converting Entity existing immediately prior to the Effective Time, shall not be deemed, as a consequence of the Conversion, to have been transferred to the Converted Entity upon the Effective Time for any purpose of the laws of the State of Delaware.

(c) The Conversion shall not be deemed to affect any obligations or liabilities of the Converting Entity incurred prior to the Conversion or the personal liability of any person incurred prior to the Conversion.

(d) Upon the Effective Time, the name of the Converted Entity shall remain unchanged and continue to be Synthetic Biologics, Inc.

The Converting Entity intends for the Conversion to constitute a tax-free reorganization qualifying under Section (e) 368(a) of the Internal Revenue Code of 1986, as amended. This Plan is adopted as a plan of reorganization within the meaning of Treasury Regulations Sections 1.368-1(c) and 1.368-2(g).

2. Filings. As promptly as practicable following the adoption of this Plan by the Board of Directors and the stockholders of the Converting Entity, the Converting Entity shall cause the Conversion to be effective by: executing and filing (or causing the execution and filing of) Articles of Conversion pursuant to Section 92A.205 of (a) the NRS, substantially in the form of Exhibit A hereto (the Nevada Articles of Conversion ), with the Secretary of State of the State of Nevada;

executing and filing (or causing the execution and filing of) a Certificate of Conversion pursuant to Sections 103 (b) and 265 of the DGCL, substantially in the form of Exhibit B hereto (the Delaware Certificate of Conversion ), with the Secretary of State of the State of Delaware; and

executing and filing (or causing the execution and filing of) a Certificate of Incorporation of the Converted Entity, (c) substantially in the form of Exhibit C hereto (the Delaware Certificate of Incorporation ), with the Secretary of State of the State of Delaware.

Effective Time. The Conversion shall become effective upon the last to occur of the filing of the Nevada Articles of Conversion, the Delaware Certificate of Conversion and the Delaware Certificate of Incorporation (the time of the effectiveness of the Conversion, the Effective Time ).

4. Effect of Conversion.

Effect on Common Stock. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, each share of Common Stock, \$0.001 par value per share, of (a) the Converting Entity (Converting Entity Common Stock ) that is issued and outstanding immediately prior to the Effective Time shall convert into one validly issued, fully paid and nonassessable share of Common Stock, \$0.001 par value per share, of the Converted Entity (Converted Entity Common Stock ).

Effect on Preferred Stock. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, each share of Preferred Stock, \$0.001 par value per share, of (b) the Converting Entity (Converting Entity Preferred Stock ) that is issued and outstanding immediately prior to the Effective Time (if any) shall convert into one validly issued, fully paid and nonassessable share of Preferred Stock, \$0.001 par value per share, of the Converted Entity Preferred Stock.

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(c) Effect on Outstanding Stock Options. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, each option to acquire shares of Converting Entity Common Stock outstanding immediately prior to the Effective Time shall convert into an equivalent option to acquire, upon the same terms and conditions (including the vesting schedule and exercise price per share applicable to each such option) as were in effect immediately prior to the Effective Time, the same number of shares of Converted Entity Common Stock.

(d) Effect on Outstanding Warrants or Other Rights. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, each warrant or other right to acquire shares of Converting Entity Common Stock outstanding immediately prior to the Effective Time shall convert into an equivalent warrant or other right to acquire, upon the same terms and conditions (including the vesting schedule and exercise price per share applicable to each such warrant or other right) as were in effect immediately prior to the Effective Time, the same number of shares of Converted Entity Common Stock.

(e) Effect on Stock Certificates. All of the outstanding certificates representing shares of Converting Entity Common Stock immediately prior to the Effective Time shall be deemed for all purposes to continue to evidence ownership of and to represent the same number of shares of Converted Entity Common Stock.

(f) Effect on Employee Benefit, Equity Incentive or Other Similar Plans. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, each employee benefit plan, equity incentive plan or other similar plan to which the Converting Entity is a party shall continue to be a plan of the Converted Entity. To the extent that any such plan provides for the issuance of Converting Entity Common Stock, upon the Effective Time, such plan shall be deemed to provide for the issuance of Converted Entity Common Stock.

(g) Effect of Conversion on Directors and Officers. Upon the Effective Time, by virtue of the Conversion and without any further action on the part of the Converting Entity or its stockholders, the members of the Board of Directors and the officers of the Converting Entity holding their respective offices in the Converting Entity existing immediately prior to the Effective Time shall continue in their respective offices as members of the Board of Directors and officers, respectively, of the Converted Entity.

5. Further Assurances. If, at any time after the Effective Time, the Converted Entity shall determine or be advised that any deeds, bills of sale, assignments, agreements, documents or assurances or any other acts or things are necessary, desirable or proper, consistent with the terms of this Plan, (a) to vest, perfect or confirm, of record or otherwise, in the Converted Entity its right, title or interest in, to or under any of the rights, privileges, immunities, powers, purposes, franchises, properties or assets of the Converting Entity existing immediately prior to the Effective Time, or (b) to otherwise carry out the purposes of this Plan, the Converted Entity and its officers and directors (or their designees), are hereby authorized to solicit in the name of the Converted Entity any third-party consents or other documents required to be delivered by any third party, to execute and deliver, in the name and on behalf of the Converted Entity, all such deeds, bills of sale, assignments, agreements, documents and assurances and do, in the name and on behalf of the Converted Entity, all such other acts and things necessary, desirable or proper to vest, perfect or confirm its right, title or interest in, to or under any of the rights, privileges, immunities, powers, purposes, franchises, properties or assets of the Converting Entity existing immediately prior to the Effective Time and otherwise to carry out the purposes of this Plan.

6. Delaware Bylaws. Upon the Effective Time, the bylaws of the Converted Entity shall be the Bylaws of Synthetic Biologics, Inc., substantially in the form of Exhibit D hereto.

7. Delaware Indemnification Agreements. As promptly as practicable following the Effective Time, the Converted Entity shall enter into an Indemnification Agreement substantially in the form of Exhibit E hereto with each member of the Board of Directors of the Converted Entity and each executive officer of the Converted Entity.

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Copy of Plan of Conversion. After the Conversion, a copy of this Plan will be kept on file at the offices of the 8. Converted Entity, and any stockholder of the Converted Entity (or former stockholder of the Converting Entity) may request a copy of this Plan at no charge at any time.

Termination. At any time prior to the Effective Time, this Plan may be terminated and the transactions contemplated hereby may be abandoned by action of the Board of Directors of the Converting Entity if, in the 9. opinion of the Board of Directors of the Converting Entity, such action would be in the best interests of the Converting Entity and its stockholders. In the event of termination of this Plan, this Plan shall become void and of no further force or effect.

Third-Party Beneficiaries. This Plan shall not confer any rights or remedies upon any person other than as 10. expressly provided herein.

Severability. Whenever possible, each provision of this Plan will be interpreted in such manner as to be effective and valid under applicable law, but if any provision of this Plan is held to be prohibited by or invalid under 11. applicable law, such provision will be ineffective only to the extent of such prohibition or invalidity, without invalidating the remainder of this Plan.

*[Remainder of page intentionally left blank]*

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**IN WITNESS WHEREOF**, the undersigned hereby causes this Plan to be duly executed as of the date hereof.

**SYNTHETIC BIOLOGICS, INC.,  
a Nevada corporation**

By:

Name: Jeffrey Riley

Title: Chief Executive Officer

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APPENDIX C

STATE OF NEVADA ARTICLES OF CONVERSION

**ROSS MILLER**  
**Secretary of State**  
**204 North Carson Street, Suite 1**  
**Carson City, Nevada 89701-4520**  
**(775) 684-5708**  
**Website: www.nvsos.gov**

Articles of Conversion  
(PURSUANT TO NRS 92A.205)

**Articles of Conversion**  
**(Pursuant to NRS 92A.205)**

1. **Name and jurisdiction of organization of constituent entity and resulting entity:**  
**Name of constituent entity: Synthetic Biologics, Inc. (Nevada)**

Jurisdiction: Nevada

Entity type: Corporation

**Name of resulting entity: Synthetic Biologics, Inc. (Delaware)**

Jurisdiction: Delaware

Entity type: Corporation

2. **A plan of conversion has been adopted by the constituent entity in compliance with the law of the jurisdiction governing the constituent entity.**

3.

**Location of plan of conversion: (check one)**

ü

**The entire plan of conversion is attached to these articles.**

- 0 **The complete executed plan of conversion is on file at the registered office or principal place of business of the resulting entity.**

- 0 **The complete executed plan of conversion for the resulting domestic limited partnership is on file at the records office required by NRS 88.330.**

4. **Forwarding address where copies of process may be sent by the Secretary of State of Nevada (if a foreign entity is the resulting entity in the conversion):**

Synthetic Biologics, Inc.  
9605 Medical Center Drive, Suite 270  
Rockville, MD 20850

**5. Effective date and time of filing: (optional) (must not be later than 90 days after the certificate is filed)**  
**Date:** **Time:**

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**6. Signatures must be signed by:**

1. If constituent entity is a Nevada entity: an officer of each Nevada corporation; all general partners of each Nevada limited partnership or limited-liability limited partnership; a manager of each Nevada limited-liability company with managers or one member if there are no managers; a trustee of each Nevada business trust; a managing partner of a Nevada limited-liability partnership (a.k.a. general partnership governed by NRS chapter 87).
2. If constituent entity is a foreign entity: must be signed by the constituent entity in the manner provided by the law governing it.

**Name of constituent entity:** Synthetic Biologics, Inc. (Nevada)

| <b>Signature /s/ Jeffrey Riley</b> | <b>Title Chief Executive Officer</b> | <b>Date</b> |
|------------------------------------|--------------------------------------|-------------|
|------------------------------------|--------------------------------------|-------------|

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APPENDIX D

**STATE OF DELAWARE  
CERTIFICATE OF CONVERSION  
FROM A NON-DELAWARE CORPORATION  
TO A DELAWARE CORPORATION  
PURSUANT TO SECTION 265 OF THE  
DELAWARE GENERAL CORPORATION LAW**

FIRST: The jurisdiction where the Non-Delaware Corporation is currently incorporated is Nevada.

SECOND: The jurisdiction immediately prior to filing this Certificate is Nevada.

THIRD: The Non-Delaware Corporation's predecessor, Sheffield Pharmaceuticals, Inc., was incorporated in 1986, and in 2006 engaged in a reverse merger with Pipex Therapeutics, Inc., a publicly-traded Delaware corporation formed in 2001. After the merger, it changed its name to Pipex Pharmaceuticals, Inc., and in October 2008 changed its name to Adeona Pharmaceuticals, Inc. On October 15, 2009, the corporation engaged in a merger with a wholly owned subsidiary for the purpose of reincorporating in the State of Nevada. On February 15, 2012, the Non-Delaware Corporation changed its name to Synthetic Biologics, Inc.

FOURTH: The name of the Non-Delaware Corporation immediately prior to filing this Certificate is Synthetic Biologics, Inc.

FIFTH: The name of the Corporation as set forth in the Certificate of Incorporation is Synthetic Biologics, Inc.

IN WITNESS WHEREOF, the undersigned being duly authorized to sign on behalf of the converting Non-Delaware Corporation has executed this Certificate on the      day of      , A.D. 2016.

**SYNTHETIC BIOLOGICS, INC.,  
a Nevada corporation**

By:

Name: Jeffrey Riley  
Title: Chief Executive Officer

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APPENDIX E

**CERTIFICATE OF INCORPORATION**  
**OF**  
**SYNTHETIC BIOLOGICS, INC.**

The undersigned, a natural person (the Sole Incorporator ), for the purpose of organizing a corporation to conduct the business and promote the purposes hereinafter stated, under the provisions and subject to the requirements of the laws of the State of Delaware hereby certifies that:

**I.**

The name of this corporation is Synthetic Biologics, Inc.

**II.**

The registered office of the corporation in the State of Delaware shall be established and maintained at the office of The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801, County of New Castle, and The Corporation Trust Company shall be the registered agent of the Corporation in charge thereof.

**III.**

The purpose of this corporation is to engage in any lawful act or activity for which a corporation may be organized under the Delaware General Corporation Law (  *DGCL*  ).

**IV.**

**A.** This corporation is authorized to issue two classes of stock to be designated, respectively,  *Common Stock*  and  *Preferred Stock* . The total number of shares which the corporation is authorized to issue is Two Hundred Sixty Million (260,000,000) shares. Two Hundred Fifty Million (250,000,000) shares shall be Common Stock, each having a par value of one-tenth of one cent (\$0.001). Ten Million (10,000,000) shares shall be Preferred Stock, each having a par value of one-tenth of one cent (\$0.001).

**B.** The Preferred Stock may be issued from time to time in one or more series. The Board of Directors is hereby expressly authorized to provide for the issue of all of any of the shares of the Preferred Stock in one or more series, and to fix the number of shares and to determine or alter for each such series, such voting powers, full or limited, or no voting powers, and such designation, preferences, and relative, participating, optional, or other rights and such qualifications, limitations, or restrictions thereof, as shall be stated and expressed in the resolution or resolutions

adopted by the Board of Directors providing for the issuance of such shares and as may be permitted by the DGCL.

The Board of Directors is also expressly authorized to increase or decrease the number of shares of any series subsequent to the issuance of shares of that series, but not below the number of shares of such series then outstanding.

In case the number of shares of any series shall be decreased in accordance with the foregoing sentence, the shares constituting such decrease shall resume the status that they had prior to the adoption of the resolution originally fixing

the number of shares of such series. The number of authorized shares of Preferred Stock may be increased or decreased (but not below the number of shares thereof then outstanding) by the affirmative vote of the holders of a majority of the voting power of the stock of the corporation entitled to vote thereon, without a separate vote of the holders of the Preferred Stock, or of any series thereof, unless a vote of any such holders is required pursuant to the terms of any certificate of designation filed with respect to any series of Preferred Stock.

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**V.**

For the management of the business and for the conduct of the affairs of the corporation, and in further definition, limitation and regulation of the powers of the corporation, of its directors and of its stockholders or any class thereof, as the case may be, it is further provided that:

**A.**

1. The management of the business and the conduct of the affairs of the corporation shall be vested in its Board of Directors. The number of directors which shall constitute the Board of Directors shall be fixed exclusively by resolutions adopted by a majority of the authorized number of directors constituting the Board of Directors.

**2. Board of Directors**

Subject to the rights of the holders of any series of Preferred Stock to elect additional directors under specified circumstances, directors shall be elected at each annual meeting of stockholders for a term of one year. Each director shall serve until his successor is duly elected and qualified or until his earlier death, resignation or removal. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

**3. Removal of Directors**

The Board of Directors or any individual director may be removed from office at any time (a) with cause by the affirmative vote of the holders of a majority of the voting power of all the then-outstanding shares of capital stock of the corporation, entitled to vote at an election of directors; or (b) without cause by the affirmative vote of the holders of a majority of the voting power of all the then-outstanding shares of the capital stock of the corporation entitled to vote generally at an election of directors.

**4. Vacancies.** Subject to any limitations imposed by applicable law and subject to the rights of the holders of any series of Preferred Stock, any vacancies on the Board of Directors resulting from death, resignation, disqualification, removal or other causes and any newly created directorships resulting from any increase in the number of directors, shall, unless the Board of Directors determines by resolution that any such vacancies or newly created directorships shall be filled by the stockholders and except as otherwise provided by applicable law, be filled only by the affirmative vote of a majority of the directors then in office, even though less than a quorum of the Board of Directors, and not by the stockholders. Any director elected in accordance with the preceding sentence shall hold office for the remainder of the full term of the director for which the vacancy was created or occurred and until such director's successor shall have been elected and qualified.

**B.**

**1. Bylaw Amendments.** The Board of Directors is expressly empowered to adopt, amend or repeal the Bylaws of the corporation. Any adoption, amendment or repeal of the Bylaws of the corporation by the Board of Directors shall require the approval of a majority of the authorized number of directors. The stockholders shall also have power to adopt, amend or repeal the Bylaws of the corporation; *provided, however*, that, in addition to any vote of the holders of any class or series of stock of the corporation required by law or by this Certificate of Incorporation, such action by stockholders shall require the affirmative vote of the holders of at least sixty-six and two-thirds (66 2/3%) of the voting power of all of the then-outstanding shares of the capital stock of the corporation entitled to vote generally in

the election of directors, voting together as a single class.

**2.** The directors of the corporation need not be elected by written ballot unless the Bylaws so provide.

**3.** No action shall be taken by the stockholders of the corporation except at an annual or special meeting of stockholders called in accordance with the Bylaws. Advance notice of stockholder nominations for the election of directors and of business to be brought by stockholders before any meeting of the stockholders of the corporation shall be given in the manner provided in the Bylaws of the corporation.

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**VI.**

**A.** The liability of the directors for monetary damages shall be eliminated to the fullest extent under applicable law.

**B.** To the fullest extent permitted by applicable law, the Company is authorized to provide indemnification of (and advancement of expenses to) directors, officers and agents of the Company (and any other persons to which applicable law permits the Company to provide indemnification) through Bylaw provisions, agreements with such agents or other persons, vote of stockholders or disinterested directors or otherwise in excess of the indemnification and advancement otherwise permitted by such applicable law. If applicable law is amended after approval by the stockholders of this Article VI to authorize corporate action further eliminating or limiting the personal liability of directors, then the liability of a director to the company shall be eliminated or limited to the fullest extent permitted by applicable law as so amended.

**C.** Any repeal or modification of this Article VI shall only be prospective and shall not affect the rights or protections or increase the liability of any director under this Article VI in effect at the time of the alleged occurrence of any act or omission to act giving rise to liability or indemnification.

**VII.**

**A.** Unless the corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall, to the fullest extent permitted by law, be the sole and exclusive forum for (1) any derivative action or proceeding brought on behalf of the corporation; (2) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the corporation to the corporation or the corporation's stockholders; (3) any action asserting a claim against the corporation or any director or officer or other employee of the corporation arising pursuant to any provision of the DGCL, the corporation's Amended and Restated Certificate of Incorporation or the Bylaws of the corporation; or (4) any action asserting a claim against the corporation or any director or officer or other employee of the corporation governed by the internal affairs doctrine.

**VIII.**

The corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, except as provided in paragraph B. of this Article VIII, and all rights conferred upon the stockholders herein are granted subject to this reservation.

**IX.**

The name and the mailing address of the Sole Incorporator is as follows:

Name  
[Your Name]

**Mailing Address**  
Cooley LLP

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**In Witness Whereof**, this Certificate has been subscribed this      day of      , 2016 by the undersigned who affirms that the statements made herein are true and correct.

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**[Your Name]**  
Sole Incorporator

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APPENDIX F

**BYLAWS**

**OF**

**SYNTHETIC BIOLOGICS, INC.**

**(A DELAWARE CORPORATION)**

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## ARTICLE I

### OFFICES

**Section 1. Registered Office.** The registered office of the corporation in the State of Delaware shall be established and maintained at the office of The Corporation Trust Company, 1209 Orange Street, Wilmington, Delaware 19801, County of New Castle, and The Corporation Trust Company shall be the registered agent of the Corporation in charge thereof.

**Section 2. Other Offices.** The corporation shall also have and maintain an office or principal place of business at such place as may be fixed by the Board of Directors, and may also have offices at such other places, both within and without the State of Delaware as the Board of Directors may from time to time determine or the business of the corporation may require.

## ARTICLE II

### CORPORATE SEAL

**Section 3. Corporate Seal.** The Board of Directors may adopt a corporate seal. The corporate seal shall consist of a die bearing the name of the corporation and the inscription, Corporate Seal-Delaware. Said seal may be used by causing it or a facsimile thereof to be impressed or affixed or reproduced or otherwise.

## ARTICLE III

### STOCKHOLDERS MEETINGS

**Section 4. Place Of Meetings.** Meetings of the stockholders of the corporation may be held at such place, either within or without the State of Delaware, as may be determined from time to time by the Board of Directors. The Board of Directors may, in its sole discretion, determine that the meeting shall not be held at any place, but may instead be held solely by means of remote communication as provided under the Delaware General Corporation Law ( DGCL ).

#### **Section 5. Annual Meetings.**

(a) The annual meeting of the stockholders of the corporation, for the purpose of election of directors and for such other business as may properly come before it, shall be held on such date and at such time as may be designated from time to time by the Board of Directors. Nominations of persons for election to the Board of Directors of the corporation and the proposal of business to be considered by the stockholders may be made at an annual meeting of stockholders: (i) pursuant to the corporation's notice of meeting of stockholders (with respect to business other than nominations); (ii) brought specifically by or at the direction of the Board of Directors; or (iii) by any stockholder of

the corporation who was a stockholder of record at the time of giving the stockholder's notice provided for in Section 5(b) below, who is entitled to vote at the meeting and who complied with the notice procedures set forth in Section 5. For the avoidance of doubt, clause (iii) above shall be the exclusive means for a stockholder to make nominations and submit other business (other than matters properly included in the corporation's notice of meeting of stockholders and proxy statement under Rule 14a-8 under the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder (the "1934 Act")) before an annual meeting of stockholders.

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**(b)** At an annual meeting of the stockholders, only such business shall be conducted as is a proper matter for stockholder action under Delaware law and as shall have been properly brought before the meeting.

**(i)** For nominations for the election to the Board of Directors to be properly brought before an annual meeting by a stockholder pursuant to clause (iii) of Section 5(a) of these Bylaws, the stockholder must deliver written notice to the Secretary at the principal executive offices of the corporation on a timely basis as set forth in Section 5(b)(iii) and must update and supplement such written notice on a timely basis as set forth in Section 5(c). Such stockholder's notice shall set forth: (A) as to each nominee such stockholder proposes to nominate at the meeting: (1) the name, age, business address and residence address of such nominee; (2) the principal occupation or employment of such nominee; (3) the class and number of shares of each class of capital stock of the corporation which are owned of record and beneficially by such nominee; (4) the date or dates on which such shares were acquired and the investment intent of such acquisition; (5) with respect to each nominee for election or re-election to the Board of Directors, include a completed and signed questionnaire, representation and agreement required by Section 5(e) of these Bylaws; and (6) such other information concerning such nominee as would be required to be disclosed in a proxy statement soliciting proxies for the election of such nominee as a director in an election contest (even if an election contest is not involved), or that is otherwise required to be disclosed pursuant to Section 14 of the 1934 Act and the rules and regulations promulgated thereunder (including such person's written consent to being named as a nominee and to serving as a director if elected); and (B) the information required by Section 5(b)(iv). The corporation may require any proposed nominee to furnish such other information as it may reasonably require to determine the eligibility of such proposed nominee to serve as an independent director of the corporation or that could be material to a reasonable stockholder's understanding of the independence, or lack thereof, of such proposed nominee.

**(ii)** Other than proposals sought to be included in the corporation's proxy materials pursuant to Rule 14(a)-8 under the 1934 Act, for business other than nominations for the election to the Board of Directors to be properly brought before an annual meeting by a stockholder pursuant to clause (iii) of Section 5(a) of these Bylaws, the stockholder must deliver written notice to the Secretary at the principal executive offices of the corporation on a timely basis as set forth in Section 5(b)(iii), and must update and supplement such written notice on a timely basis as set forth in Section 5(c). Such stockholder's notice shall set forth: (A) as to each matter such stockholder proposes to bring before the meeting, a brief description of the business desired to be brought before the meeting, the reasons for conducting such business at the meeting, and any material interest (including any anticipated benefit of such business to any Proponent (as defined below) other than solely as a result of its ownership of the corporation's capital stock, that is material to any Proponent individually, or to the Proponents in the aggregate) in such business of any Proponent; and (B) the information required by Section 5(b)(iv).

**(iii)** To be timely, the written notice required by Section 5(b)(i) or 5(b)(ii) must be received by the Secretary at the principal executive offices of the corporation not later than the close of business on the ninetieth (90<sup>th</sup>) day nor earlier than the close of business on the one hundred twentieth (120<sup>th</sup>) day prior to the first anniversary of the preceding year's annual meeting; *provided, however*, that, subject to the last sentence of this Section 5(b)(iii), in the event that the date of the annual meeting is advanced more than thirty (30) days prior to or delayed by more than thirty (30) days after the anniversary of the preceding year's annual meeting, notice by the stockholder to be timely must be so received not earlier than the close of business on the one hundred twentieth (120<sup>th</sup>) day prior to such annual meeting and not later than the close of business on the later of the ninetieth (90<sup>th</sup>) day prior to such annual meeting or the tenth (10<sup>th</sup>) day following the day on which public announcement of the date of such meeting is first made. In no event shall an adjournment or a postponement of an annual meeting for which notice has been given, or the public announcement thereof has been made, commence a new time period for the giving of a stockholder's notice as described above.



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(iv) The written notice required by Section 5(b)(i) or 5(b)(ii) shall also set forth, as of the date of the notice and as to the stockholder giving the notice and the beneficial owner, if any, on whose behalf the nomination or proposal is made (each, a Proponent and collectively, the Proponents ): (A) the name and address of each Proponent, as they appear on the corporation's books; (B) the class, series and number of shares of the corporation that are owned beneficially and of record by each Proponent; (C) a description of any agreement, arrangement or understanding (whether oral or in writing) with respect to such nomination or proposal between or among any Proponent and any of its affiliates or associates, and any others (including their names) acting in concert, or otherwise under the agreement, arrangement or understanding, with any of the foregoing; (D) a representation that the Proponents are holders of record or beneficial owners, as the case may be, of shares of the corporation entitled to vote at the meeting and intend to appear in person or by proxy at the meeting to nominate the person or persons specified in the notice (with respect to a notice under Section 5(b)(i)) or to propose the business that is specified in the notice (with respect to a notice under Section 5(b)(ii)); (E) a representation as to whether the Proponents intend to deliver a proxy statement and form of proxy to holders of a sufficient number of holders of the corporation's voting shares to elect such nominee or nominees (with respect to a notice under Section 5(b)(i)) or to carry such proposal (with respect to a notice under Section 5(b)(ii)); (F) to the extent known by any Proponent, the name and address of any other stockholder supporting the proposal on the date of such stockholder's notice; and (G) a description of all Derivative Transactions (as defined below) by each Proponent during the previous twelve (12) month period, including the date of the transactions and the class, series and number of securities involved in, and the material economic terms of, such Derivative Transactions.

For purposes of Sections 5 and 6, a Derivative Transaction means any agreement, arrangement, interest or understanding entered into by, or on behalf or for the benefit of, any Proponent or any of its affiliates or associates, whether record or beneficial:

(w) the value of which is derived in whole or in part from the value of any class or series of shares or other securities of the corporation,

(x) which otherwise provides any direct or indirect opportunity to gain or share in any gain derived from a change in the value of securities of the corporation,

(y) the effect or intent of which is to mitigate loss, manage risk or benefit of security value or price changes, or

(z) which provides the right to vote or increase or decrease the voting power of, such Proponent, or any of its affiliates or associates, with respect to any securities of the corporation,

which agreement, arrangement, interest or understanding may include, without limitation, any option, warrant, debt position, note, bond, convertible security, swap, stock appreciation right, short position, profit interest, hedge, right to dividends, voting agreement, performance-related fee or arrangement to borrow or lend shares (whether or not subject to payment, settlement, exercise or conversion in any such class or series), and any proportionate interest of such Proponent in the securities of the corporation held by any general or limited partnership, or any limited liability company, of which such Proponent is, directly or indirectly, a general partner or managing member.

(c) A stockholder providing written notice required by Section 5(b)(i) or (ii) shall update and supplement such notice in writing, if necessary, so that the information provided or required to be provided in such notice is true and correct in all material respects as of (i) the record date for the meeting and (ii) the date that is five (5) business days prior to the meeting and, in the event of any adjournment or postponement thereof, five (5) business days prior to such adjourned or postponed meeting. In the case of an update and supplement pursuant to clause (i) of this Section 5(c), such update and supplement shall be received by the Secretary at the principal executive offices of the corporation not later than five (5) business days after the record date for the meeting. In the case of an update and supplement pursuant to clause

(ii) of this Section 5(c), such update and supplement shall be received by the Secretary at the principal executive offices of the corporation not later than two (2) business days

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prior to the date for the meeting, and, in the event of any adjournment or postponement thereof, two (2) business days prior to such adjourned or postponed meeting.

**(d)** Notwithstanding anything in Section 5(b)(iii) to the contrary, in the event that the number of directors of the Board of Directors of the corporation is increased and there is no public announcement of the appointment of a director, or, if no appointment was made, of the vacancy, made by the corporation at least ten (10) days before the last day a stockholder may deliver a notice of nomination in accordance with Section 5(b)(iii), a stockholder's notice required by this Section 5 and which complies with the requirements in Section 5(b)(i), other than the timing requirements in Section 5(b)(iii), shall also be considered timely, but only with respect to nominees for any new positions created by such increase, if it shall be received by the Secretary at the principal executive offices of the corporation not later than the close of business on the tenth (10<sup>th</sup>) day following the day on which such public announcement is first made by the corporation.

**(e)** To be eligible to be a nominee for election or re-election as a director of the corporation pursuant to a nomination under clause (iii) of Section 5(a), such proposed nominee or a person on such proposed nominee's behalf must deliver (in accordance with the time periods prescribed for delivery of notice under Section 5(b)(iii) or 5(d), as applicable) to the Secretary at the principal executive offices of the corporation a written questionnaire with respect to the background and qualification of such proposed nominee and the background of any other person or entity on whose behalf the nomination is being made (which questionnaire shall be provided by the Secretary upon written request) and a written representation and agreement (in the form provided by the Secretary upon written request) that such person (i) is not and will not become a party to (A) any agreement, arrangement or understanding with, and has not given any commitment or assurance to, any person or entity as to how such person, if elected as a director of the corporation, will act or vote on any issue or question (a Voting Commitment) that has not been disclosed to the corporation in the questionnaire or (B) any Voting Commitment that could limit or interfere with such person's ability to comply, if elected as a director of the corporation, with such person's fiduciary duties under applicable law; (ii) is not and will not become a party to any agreement, arrangement or understanding with any person or entity other than the corporation with respect to any direct or indirect compensation, reimbursement or indemnification in connection with service or action as a director of the corporation that has not been disclosed therein; and (iii) in such person's individual capacity and on behalf of any person or entity on whose behalf the nomination is being made, would be in compliance, if elected as a director of the corporation, and will comply with, all applicable publicly disclosed corporate governance, conflict of interest, confidentiality and stock ownership and trading policies and guidelines of the corporation.

**(f)** A person shall not be eligible for election or re-election as a director unless the person is nominated either in accordance with clause (ii) of Section 5(a), or in accordance with clause (iii) of Section 5(a). Except as otherwise required by law, the chairman of the meeting shall have the power and duty to determine whether a nomination or any business proposed to be brought before the meeting was made, or proposed, as the case may be, in accordance with the procedures set forth in these Bylaws and, if any proposed nomination or business is not in compliance with these Bylaws, or the Proponent does not act in accordance with the representations in Sections 5(b)(iv)(D) and 5(b)(iv)(E), to declare that such proposal or nomination shall not be presented for stockholder action at the meeting and shall be disregarded, notwithstanding that proxies in respect of such nominations or such business may have been solicited or received.

**(g)** Notwithstanding the foregoing provisions of this Section 5, in order to include information with respect to a stockholder proposal in the proxy statement and form of proxy for a stockholders' meeting, a stockholder must also comply with all applicable requirements of the 1934 Act and the rules and regulations thereunder. Nothing in these Bylaws shall be deemed to affect any rights of stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the 1934 Act; *provided, however*, that any references in these Bylaws to the

1934 Act or the rules and regulations thereunder are not intended to and shall not limit the requirements applicable to proposals and/or nominations to be considered pursuant to Section 5(a)(iii) of these Bylaws.

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(h) For purposes of Sections 5 and 6,

(i) public announcement shall mean disclosure in a press release reported by the Dow Jones News Service, Associated Press or comparable national news service or in a document publicly filed by the corporation with the Securities and Exchange Commission pursuant to Section 13, 14 or 15(d) of the 1934 Act; and

(ii) affiliates and associates shall have the meanings set forth in Rule 405 under the Securities Act of 1933, as amended (the 1933 Act ).

**Section 6. Special Meetings.**

(a) Special meetings of the stockholders of the corporation may be called, for any purpose as is a proper matter for stockholder action under Delaware law, by (i) the Chairman of the Board of Directors; (ii) the Chief Executive Officer; or (iii) the Board of Directors pursuant to a resolution adopted by a majority of the total number of authorized directors (whether or not there exist any vacancies in previously authorized directorships at the time any such resolution is presented to the Board of Directors for adoption).

(b) The Board of Directors shall determine the time and place, if any, of such special meeting. Upon determination of the time and place, if any, of the meeting, the Secretary shall cause a notice of meeting to be given to the stockholders entitled to vote, in accordance with the provisions of Section 7 of these Bylaws. No business may be transacted at such special meeting otherwise than specified in the notice of meeting.

(c) Nominations of persons for election to the Board of Directors may be made at a special meeting of stockholders at which directors are to be elected (i) by or at the direction of the Board of Directors or (ii) by any stockholder of the corporation who is a stockholder of record at the time of giving notice provided for in this paragraph, who shall be entitled to vote at the meeting and who delivers written notice to the Secretary of the corporation setting forth the information required by Section 5(b)(i). In the event the corporation calls a special meeting of stockholders for the purpose of electing one or more directors to the Board of Directors, any such stockholder of record may nominate a person or persons (as the case may be), for election to such position(s) as specified in the corporation's notice of meeting, if written notice setting forth the information required by Section 5(b)(i) of these Bylaws shall be received by the Secretary at the principal executive offices of the corporation not later than the close of business on the later of the ninetieth (90<sup>th</sup>) day prior to such meeting or the tenth (10<sup>th</sup>) day following the day on which public announcement is first made of the date of the special meeting and of the nominees proposed by the Board of Directors to be elected at such meeting. The stockholder shall also update and supplement such information as required under Section 5(c). In no event shall an adjournment or a postponement of a special meeting for which notice has been given, or the public announcement thereof has been made, commence a new time period for the giving of a stockholder's notice as described above.

(d) Notwithstanding the foregoing provisions of this Section 6, a stockholder must also comply with all applicable requirements of the 1934 Act and the rules and regulations thereunder with respect to matters set forth in this Section 6. Nothing in these Bylaws shall be deemed to affect any rights of stockholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the 1934 Act; *provided, however*, that any references in these Bylaws to the 1934 Act or the rules and regulations thereunder are not intended to and shall not limit the requirements applicable to nominations for the election to the Board of Directors to be considered pursuant to Section 6(c) of these Bylaws.

**Section 7. Notice Of Meetings.** Except as otherwise provided by law, notice, given in writing or by electronic transmission, of each meeting of stockholders shall be given not less than ten (10) nor more than sixty (60) days

before the date of the meeting to each stockholder entitled to vote at such meeting, such notice to specify the place, if any, date and hour, in the case of special meetings, the purpose or purposes of the meeting, and the means of remote communications, if any, by which stockholders and proxy holders may be deemed to be present in person and vote at any such meeting. If mailed, notice is given when deposited in the United States mail, postage prepaid, directed to the stockholder at such stockholder's address as it appears on

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the records of the corporation. Notice of the time, place, if any, and purpose of any meeting of stockholders may be waived in writing, signed by the person entitled to notice thereof, or by electronic transmission by such person, either before or after such meeting, and will be waived by any stockholder by his attendance thereat in person, by remote communication, if applicable, or by proxy, except when the stockholder attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Any stockholder so waiving notice of such meeting shall be bound by the proceedings of any such meeting in all respects as if due notice thereof had been given.

**Section 8. Quorum.** At all meetings of stockholders, except where otherwise provided by statute or by the Certificate of Incorporation, or by these Bylaws, the presence, in person, by remote communication, if applicable, or by proxy duly authorized, of the holders of a majority of the outstanding shares of stock entitled to vote shall constitute a quorum for the transaction of business. In the absence of a quorum, any meeting of stockholders may be adjourned, from time to time, either by the chairman of the meeting or by vote of the holders of a majority of the shares represented thereat, but no other business shall be transacted at such meeting. The stockholders present at a duly called or convened meeting, at which a quorum is present, may continue to transact business until adjournment, notwithstanding the withdrawal of enough stockholders to leave less than a quorum. Except as otherwise provided by statute or by applicable stock exchange rules, or by the Certificate of Incorporation or these Bylaws, in all matters other than the election of directors, the affirmative vote of the majority of shares present in person, by remote communication, if applicable, or represented by proxy at the meeting and entitled to vote generally on the subject matter shall be the act of the stockholders. Except as otherwise provided by statute, the Certificate of Incorporation or these Bylaws, directors shall be elected by a plurality of the votes of the shares present in person, by remote communication, if applicable, or represented by proxy at the meeting and entitled to vote generally on the election of directors. Where a separate vote by a class or classes or series is required, except where otherwise provided by the statute or by the Certificate of Incorporation or these Bylaws, a majority of the outstanding shares of such class or classes or series, present in person, by remote communication, if applicable, or represented by proxy duly authorized, shall constitute a quorum entitled to take action with respect to that vote on that matter. Except where otherwise provided by statute or by the Certificate of Incorporation or these Bylaws, the affirmative vote of the majority (plurality, in the case of the election of directors) of shares of such class or classes or series present in person, by remote communication, if applicable, or represented by proxy at the meeting shall be the act of such class or classes or series.

**Section 9. Adjournment And Notice Of Adjourned Meetings.** Any meeting of stockholders, whether annual or special, may be adjourned from time to time either by the chairman of the meeting or by the vote of a majority of the shares present in person, by remote communication, if applicable, or represented by proxy at the meeting. When a meeting is adjourned to another time or place, if any, notice need not be given of the adjourned meeting if the time and place, if any, thereof are announced at the meeting at which the adjournment is taken. At the adjourned meeting, the corporation may transact any business which might have been transacted at the original meeting. If the adjournment is for more than thirty (30) days or if after the adjournment a new record date is fixed for the adjourned meeting, a notice of the adjourned meeting shall be given to each stockholder of record entitled to vote at the meeting.

**Section 10. Voting Rights.** For the purpose of determining those stockholders entitled to vote at any meeting of the stockholders, except as otherwise provided by law, only persons in whose names shares stand on the stock records of the corporation on the record date, as provided in Section 12 of these Bylaws, shall be entitled to vote at any meeting of stockholders. Every person entitled to vote shall have the right to do so either in person, by remote communication, if applicable, or by an agent or agents authorized by a proxy granted in accordance with Delaware law. An agent so appointed need not be a stockholder. No proxy shall be voted after three (3) years from its date of creation unless the proxy provides for a longer period.



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**Section 11. Joint Owners Of Stock.** If shares or other securities having voting power stand of record in the names of two (2) or more persons, whether fiduciaries, members of a partnership, joint tenants, tenants in common, tenants by the entirety, or otherwise, or if two (2) or more persons have the same fiduciary relationship respecting the same shares, unless the Secretary is given written notice to the contrary and is furnished with a copy of the instrument or order appointing them or creating the relationship wherein it is so provided, their acts with respect to voting shall have the following effect: (a) if only one (1) votes, his act binds all; (b) if more than one (1) votes, the act of the majority so voting binds all; (c) if more than one (1) votes, but the vote is evenly split on any particular matter, each faction may vote the securities in question proportionally, or may apply to the Delaware Court of Chancery for relief as provided in the DGCL, Section 217(b). If the instrument filed with the Secretary shows that any such tenancy is held in unequal interests, a majority or even-split for the purpose of subsection (c) shall be a majority or even-split in interest.

**Section 12. List Of Stockholders.** The Secretary shall prepare and make, at least ten (10) days before every meeting of stockholders, a complete list of the stockholders entitled to vote at said meeting, arranged in alphabetical order, showing the address of each stockholder and the number of shares registered in the name of each stockholder. Such list shall be open to the examination of any stockholder, for any purpose germane to the meeting, (a) on a reasonably accessible electronic network, provided that the information required to gain access to such list is provided with the notice of the meeting, or (b) during ordinary business hours, at the principal place of business of the corporation. In the event that the corporation determines to make the list available on an electronic network, the corporation may take reasonable steps to ensure that such information is available only to stockholders of the corporation. The list shall be open to examination of any stockholder during the time of the meeting as provided by law.

**Section 13. Action Without Meeting.**

No action shall be taken by the stockholders except at an annual or special meeting of stockholders called in accordance with these Bylaws, and no action shall be taken by the stockholders by written consent or by electronic transmission.

**Section 14. Organization.**

(a) At every meeting of stockholders, the Chairman of the Board of Directors, or, if a Chairman has not been appointed or is absent, the President, or, if the President is absent, a chairman of the meeting chosen by a majority in interest of the stockholders entitled to vote, present in person or by proxy, shall act as chairman. The Secretary, or, in his or her absence, an Assistant Secretary directed to do so by the President, shall act as secretary of the meeting.

(b) The Board of Directors of the corporation shall be entitled to make such rules or regulations for the conduct of meetings of stockholders as it shall deem necessary, appropriate or convenient. Subject to such rules and regulations of the Board of Directors, if any, the chairman of the meeting shall have the right and authority to prescribe such rules, regulations and procedures and to do all such acts as, in the judgment of such chairman, are necessary, appropriate or convenient for the proper conduct of the meeting, including, without limitation, establishing an agenda or order of business for the meeting, rules and procedures for maintaining order at the meeting and the safety of those present, limitations on participation in such meeting to stockholders of record of the corporation and their duly authorized and constituted proxies and such other persons as the chairman shall permit, restrictions on entry to the meeting after the time fixed for the commencement thereof, limitations on the time allotted to questions or comments by participants and regulation of the opening and closing of the polls for balloting on matters which are to be voted on by ballot. The date and time of the opening and closing of the polls for each matter upon which the stockholders will vote at the meeting shall be announced at the meeting. Unless and to the extent determined by the Board of Directors or the chairman of the meeting, meetings of stockholders shall not be required to be held in accordance with rules of parliamentary procedure.



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## ARTICLE IV

### DIRECTORS

**Section 15. Number And Term Of Office.** The authorized number of directors of the corporation shall be fixed in accordance with the Certificate of Incorporation. Directors need not be stockholders unless so required by the Certificate of Incorporation. If for any cause, the directors shall not have been elected at an annual meeting, they may be elected as soon thereafter as convenient at a special meeting of the stockholders called for that purpose in the manner provided in these Bylaws.

**Section 16. Powers.** The business and affairs of the corporation shall be managed by or under the direction of the Board of Directors, except as may be otherwise provided by statute or by the Certificate of Incorporation.

**Section 17. Election of Directors.** Subject to the rights of the holders of any series of Preferred Stock to elect additional directors under specified circumstances, directors shall be elected at each annual meeting of stockholders to serve until the next annual meeting of stockholders. Each director shall serve until his successor is duly elected and qualified or until his death, resignation or removal. No stockholder entitled to vote at an election for directors may cumulate votes to which such stockholder is entitled. No decrease in the number of directors constituting the Board of Directors shall shorten the term of any incumbent director.

**Section 18. Vacancies.** Unless otherwise provided in the Certificate of Incorporation, and subject to the rights of the holders of any series of Preferred Stock, any vacancies on the Board of Directors resulting from death, resignation, disqualification, removal or other causes and any newly created directorships resulting from any increase in the number of directors shall, unless the Board of Directors determines by resolution that any such vacancies or newly created directorships shall be filled by stockholders, be filled only by the affirmative vote of a majority of the directors then in office, even though less than a quorum of the Board of Directors, or by a sole remaining director, and not by the stockholders, *provided, however*, that whenever the holders of any class or classes of stock or series thereof are entitled to elect one or more directors by the provisions of the Certificate of Incorporation, vacancies and newly created directorships of such class or classes or series shall, unless the Board of Directors determines by resolution that any such vacancies or newly created directorships shall be filled by stockholders, be filled by a majority of the directors elected by such class or classes or series thereof then in office, or by a sole remaining director so elected, and not by the stockholders. Any director elected in accordance with the preceding sentence shall hold office for the remainder of the full term of the director for which the vacancy was created or occurred and until such director's successor shall have been elected and qualified. A vacancy in the Board of Directors shall be deemed to exist under this Bylaw in the case of the death, removal or resignation of any director.

**Section 19. Resignation.** Any director may resign at any time by delivering his or her notice in writing or by electronic transmission to the Secretary, such resignation to specify whether it will be effective at a particular time. If no such specification is made, it shall be deemed effective at the time of delivery to the Secretary. When one or more directors shall resign from the Board of Directors, effective at a future date, a majority of the directors then in office, including those who have so resigned, shall have power to fill such vacancy or vacancies, the vote thereon to take effect when such resignation or resignations shall become effective, and each Director so chosen shall hold office for the unexpired portion of the term of the Director whose place shall be vacated and until his successor shall have been duly elected and qualified.

**Section 20. Removal.** The Board of Directors or any individual director may be removed from office at any time (a) with cause by the affirmative vote of the holders of a majority of the voting power of all the then-outstanding shares of capital stock of the corporation, entitled to vote generally at an election of directors; or (b) without cause by the affirmative vote of the holders of a majority of the voting power of all the then-outstanding shares of the capital stock of the corporation entitled to vote generally at an election of directors.

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**Section 21. Meetings.**

**(a) Regular Meetings.** Unless otherwise restricted by the Certificate of Incorporation, regular meetings of the Board of Directors may be held at any time or date and at any place within or without the State of Delaware which has been designated by the Board of Directors and publicized among all directors, either orally or in writing, by telephone, including a voice-messaging system or other system designed to record and communicate messages, facsimile, telegraph or telex, or by electronic mail or other electronic means. No further notice shall be required for regular meetings of the Board of Directors.

**(b) Special Meetings.** Unless otherwise restricted by the Certificate of Incorporation, special meetings of the Board of Directors may be held at any time and place within or without the State of Delaware whenever called by a majority of the authorized number of Directors, the Chairman of the Board, or the Chief Executive Officer.

**(c) Meetings by Electronic Communications Equipment.** Any member of the Board of Directors, or of any committee thereof, may participate in a meeting by means of conference telephone or other communications equipment by means of which all persons participating in the meeting can hear each other, and participation in a meeting by such means shall constitute presence in person at such meeting.

**(d) Notice of Special Meetings.** Notice of the time and place of all special meetings of the Board of Directors shall be orally or in writing, by telephone, including a voice messaging system or other system or technology designed to record and communicate messages, facsimile, telegraph or telex, or by electronic mail or other electronic means, during normal business hours, at least twenty-four (24) hours before the date and time of the meeting. If notice is sent by US mail, it shall be sent by first class mail, charges prepaid, at least three (3) days before the date of the meeting. Notice of any meeting may be waived in writing, or by electronic transmission, at any time before or after the meeting and will be waived by any director by attendance thereat, except when the director attends the meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

**(e) Waiver of Notice.** The transaction of all business at any meeting of the Board of Directors, or any committee thereof, however called or noticed, or wherever held, shall be as valid as though it had been transacted at a meeting duly held after regular call and notice, if a quorum be present and if, either before or after the meeting, each of the directors not present who did not receive notice shall sign a written waiver of notice or shall waive notice by electronic transmission. All such waivers shall be filed with the corporate records or made a part of the minutes of the meeting.

**Section 22. Quorum And Voting.**

**(a)** Unless the Certificate of Incorporation requires a greater number, and except with respect to questions related to indemnification arising under these Bylaws for which a quorum shall be one-third of the exact number of directors fixed from time to time, a quorum of the Board of Directors shall consist of a majority of the exact number of directors fixed from time to time by the Board of Directors in accordance with the Certificate of Incorporation; *provided, however,* at any meeting whether a quorum be present or otherwise, a majority of the directors present may adjourn from time to time until the time fixed for the next regular meeting of the Board of Directors, without notice other than by announcement at the meeting.

**(b)** At each meeting of the Board of Directors at which a quorum is present, all questions and business shall be determined by the affirmative vote of a majority of the directors present, unless a different vote be required by law, the Certificate of Incorporation or these Bylaws.

**Section 23. Action Without Meeting.** Unless otherwise restricted by the Certificate of Incorporation or these Bylaws, any action required or permitted to be taken at any meeting of the Board of Directors or of any committee thereof may be taken without a meeting, if all members of the Board of Directors or committee, as the case may be, consent thereto in writing or by electronic transmission, and such writing or writings or transmission or transmissions are filed with the minutes of proceedings of the Board of Directors or

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committee. Such filing shall be in paper form if the minutes are maintained in paper form and shall be in electronic form if the minutes are maintained in electronic form.

**Section 24. Fees And Compensation.** Directors shall be entitled to such compensation for their services as may be approved by the Board of Directors, including, if so approved, by resolution of the Board of Directors, a fixed sum and expenses of attendance, if any, for attendance at each regular or special meeting of the Board of Directors and at any meeting of a committee of the Board of Directors. Nothing herein contained shall be construed to preclude any director from serving the corporation in any other capacity as an officer, agent, employee, or otherwise and receiving compensation therefor.

**Section 25. Committees.**

**(a) Executive Committee.** The Board of Directors may appoint an Executive Committee to consist of one (1) or more members of the Board of Directors. The Executive Committee, to the extent permitted by law and provided in the resolution of the Board of Directors shall have and may exercise all the powers and authority of the Board of Directors in the management of the business and affairs of the corporation, and may authorize the seal of the corporation to be affixed to all papers which may require it; but no such committee shall have the power or authority in reference to (i) approving or adopting, or recommending to the stockholders, any action or matter (other than the election or removal of directors) expressly required by the DGCL to be submitted to stockholders for approval, or (ii) adopting, amending or repealing any Bylaw of the corporation.

**(b) Other Committees.** The Board of Directors may, from time to time, appoint such other committees as may be permitted by law. Such other committees appointed by the Board of Directors shall consist of one (1) or more members of the Board of Directors and shall have such powers and perform such duties as may be prescribed by the resolution or resolutions creating such committees, but in no event shall any such committee have the powers denied to the Executive Committee in these Bylaws.

**(c) Term.** The Board of Directors, subject to any requirements of any outstanding series of Preferred Stock and the provisions of subsections (a) or (b) of this Section 25, may at any time increase or decrease the number of members of a committee or terminate the existence of a committee. The membership of a committee member shall terminate on the date of his death or voluntary resignation from the committee or from the Board of Directors. The Board of Directors may at any time for any reason remove any individual committee member and the Board of Directors may fill any committee vacancy created by death, resignation, removal or increase in the number of members of the committee. The Board of Directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee, and, in addition, in the absence or disqualification of any member of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the Board of Directors to act at the meeting in the place of any such absent or disqualified member.

**(d) Meetings.** Unless the Board of Directors shall otherwise provide, regular meetings of the Executive Committee or any other committee appointed pursuant to this Section 25 shall be held at such times and places as are determined by the Board of Directors, or by any such committee, and when notice thereof has been given to each member of such committee, no further notice of such regular meetings need be given thereafter. Special meetings of any such committee may be held at any place which has been determined from time to time by such committee, and may be called by any director who is a member of such committee, upon notice to the members of such committee of the time and place of such special meeting given in the manner provided for the giving of notice to members of the Board of Directors of the time and place of special meetings of the Board of Directors. Notice of any special meeting of any committee may be waived in writing or by electronic transmission at any time before or after the meeting and will be

waived by any director by attendance thereat, except when the director attends such special meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. Unless otherwise provided by the Board of Directors in the resolutions authorizing the creation of the committee, a

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majority of the authorized number of members of any such committee shall constitute a quorum for the transaction of business, and the act of a majority of those present at any meeting at which a quorum is present shall be the act of such committee.

**Section 26. Lead Independent Director.** The Chairman of the Board of Directors, or if the Chairman is not an independent director, one of the independent directors, may be designated by the Board of Directors as lead independent director to serve until replaced by the Board of Directors ( Lead Independent Director ). The Lead Independent Director will: with the Chairman of the Board of Directors, establish the agenda for regular Board meetings and serve as chairman of Board of Directors meetings in the absence of the Chairman of the Board of Directors; establish the agenda for meetings of the independent directors; coordinate with the committee chairs regarding meeting agendas and informational requirements; preside over meetings of the independent directors; preside over any portions of meetings of the Board of Directors at which the evaluation or compensation of the Chief Executive Officer is presented or discussed; preside over any portions of meetings of the Board of Directors at which the performance of the Board of Directors is presented or discussed; and perform such other duties as may be established or delegated by the Chairman of the Board of Directors.

**Section 27. Chairman.** The Chairman of the Board of Directors, when present, shall preside at all meetings of the stockholders and the Board of Directors. The Chairman of the Board of Directors shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers, as the Board of Directors shall designate from time to time.

**Section 28. Organization.** At every meeting of the directors, the Chairman of the Board of Directors, or, if a Chairman has not been appointed or is absent, the Lead Independent Director (if any), or if the Lead Independent Director is absent, the Chief Executive Officer (if a director), or, if a Chief Executive Officer is absent, the President (if a director), or if the President is absent, the most senior Vice President (if a director), or, in the absence of any such person, a chairman of the meeting chosen by a majority of the directors present, shall preside over the meeting. The Secretary, or in his absence, any Assistant Secretary or other officer or director directed to do so by the President, shall act as secretary of the meeting.

## ARTICLE V

### OFFICERS

**Section 29. Officers Designated.** The officers of the corporation shall include, if and when designated by the Board of Directors, the Chairman of the Board of Directors, the Chief Executive Officer, the President, one or more Vice Presidents, the Secretary, the Chief Financial Officer and the Treasurer. The Board of Directors may also appoint one or more Assistant Secretaries and Assistant Treasurers and such other officers and agents with such powers and duties as it shall deem necessary. The Board of Directors may assign such additional titles to one or more of the officers as it shall deem appropriate. Any one person may hold any number of offices of the corporation at any one time unless specifically prohibited therefrom by law. The salaries and other compensation of the officers of the corporation shall be fixed by or in the manner designated by the Board of Directors.

**Section 30. Tenure And Duties Of Officers.**

**(a) General.** All officers shall hold office at the pleasure of the Board of Directors and until their successors shall have been duly elected and qualified, unless sooner removed. Any officer elected or appointed by the Board of Directors may be removed at any time by the Board of Directors. If the office of any officer becomes vacant for any reason, the vacancy may be filled by the Board of Directors.

**(b) Duties of Chief Executive Officer.** The Chief Executive Officer shall preside at all meetings of the stockholders, unless the Chairman of the Board of Directors or the Lead Independent Director (if any) has been appointed and is present. Unless an officer has been appointed Chief Executive Officer of the corporation, the President shall be the chief executive officer of the corporation and shall, subject to the control of the Board of Directors, have general supervision, direction and control of the business and officers of the corporation. To the extent that a Chief Executive Officer has been appointed and no President has been appointed, all references in these Bylaws to the President shall be deemed references

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to the Chief Executive Officer. The Chief Executive Officer shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers, as the Board of Directors shall designate from time to time.

**(c) Duties of President.** The President shall preside at all meetings of the stockholders, unless the Chairman of the Board of Directors, the Lead Independent Director, or the Chief Executive Officer has been appointed and is present. Unless another officer has been appointed Chief Executive Officer of the corporation, the President shall be the chief executive officer of the corporation and shall, subject to the control of the Board of Directors, have general supervision, direction and control of the business and officers of the corporation. The President shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers, as the Board of Directors shall designate from time to time.

**(d) Duties of Vice Presidents.** The Vice Presidents may assume and perform the duties of the President in the absence or disability of the President or whenever the office of President is vacant. The Vice Presidents shall perform other duties commonly incident to their office and shall also perform such other duties and have such other powers as the Board of Directors or the Chief Executive Officer, or, if the Chief Executive Officer has not been appointed or is absent, the President shall designate from time to time.

**(e) Duties of Secretary.** The Secretary shall attend all meetings of the stockholders and of the Board of Directors and shall record all acts and proceedings thereof in the minute book of the corporation. The Secretary shall give notice in conformity with these Bylaws of all meetings of the stockholders and of all meetings of the Board of Directors and any committee thereof requiring notice. The Secretary shall perform all other duties provided for in these Bylaws and other duties commonly incident to the office and shall also perform such other duties and have such other powers, as the Board of Directors shall designate from time to time. The President may direct any Assistant Secretary or other officer to assume and perform the duties of the Secretary in the absence or disability of the Secretary, and each Assistant Secretary shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time.

**(f) Duties of Chief Financial Officer.** The Chief Financial Officer shall keep or cause to be kept the books of account of the corporation in a thorough and proper manner and shall render statements of the financial affairs of the corporation in such form and as often as required by the Board of Directors or the President. The Chief Financial Officer, subject to the order of the Board of Directors, shall have the custody of all funds and securities of the corporation. The Chief Financial Officer shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time. To the extent that a Chief Financial Officer has been appointed and no Treasurer has been appointed, all references in these Bylaws to the Treasurer shall be deemed references to the Chief Financial Officer. The President may direct the Treasurer, if any, or any Assistant Treasurer, or the Controller or any Assistant Controller to assume and perform the duties of the Chief Financial Officer in the absence or disability of the Chief Financial Officer, and each Treasurer and Assistant Treasurer and each Controller and Assistant Controller shall perform other duties commonly incident to the office and shall also perform such other duties and have such other powers as the Board of Directors or the President shall designate from time to time.

**(g) Duties of Treasurer.** Unless another officer has been appointed Chief Financial Officer of the corporation, the Treasurer shall be the chief financial officer of the corporation and shall keep or cause to be kept the books of account of the corporation in a thorough and proper manner and shall render statements of the financial affairs of the corporation in such form and as often as required by the Board of Directors or the President, and, subject to the order of the Board of Directors, shall have the custody of all funds and securities of the corporation. The Treasurer shall perform other duties commonly incident to the office and shall also perform such other duties and have such other

powers as the Board of Directors or the President shall designate from time to time.

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**Section 31. Delegation Of Authority.** The Board of Directors may from time to time delegate the powers or duties of any officer to any other officer or agent, notwithstanding any provision hereof.

**Section 32. Resignations.** Any officer may resign at any time by giving notice in writing or by electronic transmission to the Board of Directors or to the President or to the Secretary. Any such resignation shall be effective when received by the person or persons to whom such notice is given, unless a later time is specified therein, in which event the resignation shall become effective at such later time. Unless otherwise specified in such notice, the acceptance of any such resignation shall not be necessary to make it effective. Any resignation shall be without prejudice to the rights, if any, of the corporation under any contract with the resigning officer.

**Section 33. Removal.** Any officer may be removed from office at any time, either with or without cause, by the affirmative vote of a majority of the directors in office at the time, or by the unanimous written consent of the directors in office at the time, or by any committee or by the Chief Executive Officer or by other superior officers upon whom such power of removal may have been conferred by the Board of Directors.

## ARTICLE VI

# EXECUTION OF CORPORATE INSTRUMENTS AND VOTING OF SECURITIES OWNED BY THE CORPORATION

**Section 34. Execution Of Corporate Instruments.** The Board of Directors may, in its discretion, determine the method and designate the signatory officer or officers, or other person or persons, to execute on behalf of the corporation any corporate instrument or document, or to sign on behalf of the corporation the corporate name without limitation, or to enter into contracts on behalf of the corporation, except where otherwise provided by law or these Bylaws, and such execution or signature shall be binding upon the corporation.

All checks and drafts drawn on banks or other depositaries on funds to the credit of the corporation or in special accounts of the corporation shall be signed by such person or persons as the Board of Directors shall authorize so to do.

Unless authorized or ratified by the Board of Directors or within the agency power of an officer, no officer, agent or employee shall have any power or authority to bind the corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or for any amount.

**Section 35. Voting Of Securities Owned By The Corporation.** All stock and other securities of other corporations owned or held by the corporation for itself, or for other parties in any capacity, shall be voted, and all proxies with respect thereto shall be executed, by the person authorized so to do by resolution of the Board of Directors, or, in the absence of such authorization, by the Chairman of the Board of Directors, the Chief Executive Officer, the President, or any Vice President.

## ARTICLE VII

### SHARES OF STOCK

**Section 36. Form And Execution Of Certificates.** The shares of the corporation shall be represented by certificates, or shall be uncertificated if so provided by resolution or resolutions of the Board of Directors. Certificates for the shares of stock, if any, shall be in such form as is consistent with the Certificate of Incorporation and applicable law. Every holder of stock represented by certificate in the corporation shall be entitled to have a certificate signed by or in the name of the corporation by the Chairman of the Board of Directors, or the President or any Vice President and by the Treasurer or Assistant Treasurer or the Secretary or Assistant Secretary, certifying the number of shares owned by him in the corporation. Any or all of the signatures on the certificate may be facsimiles. In case any officer, transfer agent, or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent, or registrar before such certificate is issued, it may be issued with the same effect as if he were such officer, transfer agent, or registrar at the date of issue.

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**Section 37. Lost Certificates.** A new certificate or certificates shall be issued in place of any certificate or certificates theretofore issued by the corporation alleged to have been lost, stolen, or destroyed, upon the making of an affidavit of that fact by the person claiming the certificate of stock to be lost, stolen, or destroyed. The corporation may require, as a condition precedent to the issuance of a new certificate or certificates, the owner of such lost, stolen, or destroyed certificate or certificates, or the owner's legal representative, to agree to indemnify the corporation in such manner as it shall require or to give the corporation a surety bond in such form and amount as it may direct as indemnity against any claim that may be made against the corporation with respect to the certificate alleged to have been lost, stolen, or destroyed.

### **Section 38. Transfers.**

(a) Transfers of record of shares of stock of the corporation shall be made only upon its books by the holders thereof, in person or by attorney duly authorized, and, in the case of stock represented by certificate, upon the surrender of a properly endorsed certificate or certificates for a like number of shares.

(b) The corporation shall have power to enter into and perform any agreement with any number of stockholders of any one or more classes of stock of the corporation to restrict the transfer of shares of stock of the corporation of any one or more classes owned by such stockholders in any manner not prohibited by the DGCL.

**Section 39. Fixing Record Dates.** In order that the corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, the Board of Directors may fix a record date, which record date shall not precede the date upon which the resolution fixing the record date is adopted by the Board of Directors, and which record date shall, subject to applicable law, not be more than sixty (60) nor less than ten (10) days before the date of such meeting. If no record date is fixed by the Board of Directors, the record date for determining stockholders entitled to notice of or to vote at a meeting of stockholders shall be at the close of business on the day next preceding the day on which notice is given, or if notice is waived, at the close of business on the day next preceding the day on which the meeting is held. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; *provided, however*, that the Board of Directors may fix a new record date for the adjourned meeting.

**Section 40. Registered Stockholders.** The corporation shall be entitled to recognize the exclusive right of a person registered on its books as the owner of shares to receive dividends, and to vote as such owner, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares on the part of any other person whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

## **ARTICLE VIII**

### **OTHER SECURITIES OF THE CORPORATION**

**Section 41. Execution Of Other Securities.** All bonds, debentures and other corporate securities of the corporation, other than stock certificates (covered in **Section 36**), may be signed by the Chairman of the Board of Directors, the President or any Vice President, or such other person as may be authorized by the Board of Directors, and the corporate seal impressed thereon or a facsimile of such seal imprinted thereon and attested by the signature of the Secretary or an Assistant Secretary, or the Chief Financial Officer or Treasurer or an Assistant Treasurer; *provided, however*, that where any such bond, debenture or other corporate security shall be authenticated by the manual

signature, or where permissible facsimile signature, of a trustee under an indenture pursuant to which such bond, debenture or other corporate security shall be issued, the signatures of the persons signing and attesting the corporate seal on such bond, debenture or other corporate security may be the imprinted facsimile of the signatures of such persons. Interest coupons appertaining to any such bond, debenture or other corporate security, authenticated by a trustee as aforesaid, shall be signed by the Treasurer or an Assistant Treasurer of the corporation or such other person as may be authorized by the Board of Directors, or bear imprinted thereon the facsimile signature of such person. In case any officer who shall have signed or attested any bond, debenture or other corporate security, or whose facsimile signature shall appear thereon or on any such interest coupon, shall have ceased to be such officer before the bond, debenture or

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other corporate security so signed or attested shall have been delivered, such bond, debenture or other corporate security nevertheless may be adopted by the corporation and issued and delivered as though the person who signed the same or whose facsimile signature shall have been used thereon had not ceased to be such officer of the corporation.

## ARTICLE IX

### DIVIDENDS

**Section 42. Declaration Of Dividends.** Dividends upon the capital stock of the corporation, subject to the provisions of the Certificate of Incorporation and applicable law, if any, may be declared by the Board of Directors pursuant to law at any regular or special meeting. Dividends may be paid in cash, in property, or in shares of the capital stock, subject to the provisions of the Certificate of Incorporation and applicable law.

**Section 43. Dividend Reserve.** Before payment of any dividend, there may be set aside out of any funds of the corporation available for dividends such sum or sums as the Board of Directors from time to time, in their absolute discretion, think proper as a reserve or reserves to meet contingencies, or for equalizing dividends, or for repairing or maintaining any property of the corporation, or for such other purpose as the Board of Directors shall think conducive to the interests of the corporation, and the Board of Directors may modify or abolish any such reserve in the manner in which it was created.

## ARTICLE X

### FISCAL YEAR

**Section 44. Fiscal Year.** The fiscal year of the corporation shall be fixed by resolution of the Board of Directors.

## ARTICLE XI

### INDEMNIFICATION

**Section 45. Indemnification of Directors, Executive Officers, Other Officers, Employees and Other Agents.**

**(a) Directors and Executive Officers.** The corporation shall indemnify its directors, executive officers (for the purposes of this Article XI, executive officers shall have the meaning defined in Rule 3b-7 promulgated under the 1934 Act) and officers to the extent not prohibited by the DGCL or any other applicable law; *provided, however*, that the corporation may modify the extent of such indemnification by individual contracts with its directors and executive officers; and, *provided, further*, that the corporation shall not be required to indemnify any director or executive officer in connection with any proceeding (or part thereof) initiated by such person unless (i) such indemnification is expressly required to be made by law, (ii) the proceeding was authorized by the Board of Directors of the corporation, (iii) such indemnification is provided by the corporation, in its sole discretion, pursuant to the powers vested in the

corporation under the DGCL or any other applicable law or (iv) such indemnification is required to be made under subsection (d).

**(b) Expenses.** The corporation shall advance to any person who was or is a party or is threatened to be made a party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director or executive officer, of the corporation, or is or was serving at the request of the corporation as a director or executive officer of another corporation, partnership, joint venture, trust or other enterprise, prior to the final disposition of the proceeding, promptly following request therefor, all expenses incurred by any director or executive officer in connection with such proceeding provided, however, that if the DGCL requires, an advancement of expenses incurred by a director or executive officer in his or her capacity as a director or executive officer (and not in any other capacity in which service was or is rendered by such indemnitee, including, without limitation, service to an employee benefit plan) shall be made only upon delivery to the corporation of an undertaking (hereinafter an undertaking ), by or on behalf of such indemnitee, to repay all amounts so advanced if it shall ultimately be determined by final judicial decision from which

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there is no further right to appeal (hereinafter a final adjudication ) that such indemnitee is not entitled to be indemnified for such expenses under this section or otherwise.

Notwithstanding the foregoing, unless otherwise determined pursuant to paragraph (e) of this section, no advance shall be made by the corporation to an officer of the corporation (except by reason of the fact that such officer is or was a director of the corporation in which event this paragraph shall not apply) in any action, suit or proceeding, whether civil, criminal, administrative or investigative, if a determination is reasonably and promptly made (i) by a majority vote of directors who were not parties to the proceeding, even if not a quorum, or (ii) by a committee of such directors designated by a majority vote of such directors, even though less than a quorum, or (iii) if there are no such directors, or such directors so direct, by independent legal counsel in a written opinion, that the facts known to the decision-making party at the time such determination is made demonstrate clearly and convincingly that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to the best interests of the corporation.

**(c) Enforcement.** Without the necessity of entering into an express contract, all rights to indemnification and advances to directors and officers under this Bylaw shall be deemed to be contractual rights and be effective to the same extent and as if provided for in a contract between the corporation and the director or officer. Any right to indemnification or advances granted by this section to a director or officer shall be enforceable by or on behalf of the person holding such right in any court of competent jurisdiction if (i) the claim for indemnification or advances is denied, in whole or in part, or (ii) no disposition of such claim is made within ninety (90) days of request therefor. To the extent permitted by law, the claimant in such enforcement action, if successful in whole or in part, shall be entitled to be paid also the expense of prosecuting the claim. In connection with any claim for indemnification, the corporation shall be entitled to raise as a defense to any such action that the claimant has not met the standards of conduct that make it permissible under the DGCL or any other applicable law for the corporation to indemnify the claimant for the amount claimed. In connection with any claim by an officer of the corporation (except in any action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that such executive officer is or was a director of the corporation) for advances, the corporation shall be entitled to raise a defense as to any such action clear and convincing evidence that such person acted in bad faith or in a manner that such person did not believe to be in or not opposed to the best interests of the corporation, or with respect to any criminal action or proceeding that such person acted without reasonable cause to believe that his conduct was lawful. Neither the failure of the corporation (including its Board of Directors, independent legal counsel or its stockholders) to have made a determination prior to the commencement of such action that indemnification of the claimant is proper in the circumstances because he has met the applicable standard of conduct set forth in the DGCL or any other applicable law, nor an actual determination by the corporation (including its Board of Directors, independent legal counsel or its stockholders) that the claimant has not met such applicable standard of conduct, shall be a defense to the action or create a presumption that claimant has not met the applicable standard of conduct. In any suit brought by a director or officer to enforce a right to indemnification or to an advancement of expenses hereunder, the burden of proving that the director or officer is not entitled to be indemnified, or to such advancement of expenses, under this section or otherwise shall be on the corporation.

**(d) Non-Exclusivity of Rights.** The rights conferred on any person by this Bylaw shall not be exclusive of any other right which such person may have or hereafter acquire under any applicable statute, provision of the Certificate of Incorporation, Bylaws, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding office. The corporation is specifically authorized to enter into individual contracts with any or all of its directors, officers, employees or agents respecting indemnification and advances, to the fullest extent not prohibited by the DGCL, or by any other applicable law.

**(e) Survival of Rights.** The rights conferred on any person by this Bylaw shall continue as to a person who has ceased to be a director or officer, employee or other agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

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**(f) Insurance.** To the fullest extent permitted by the DGCL or any other applicable law, the corporation, upon approval by the Board of Directors, may purchase insurance on behalf of any person required or permitted to be indemnified pursuant to this section.

**(g) Amendments.** Any repeal or modification of this section shall only be prospective and shall not affect the rights under this Bylaw in effect at the time of the alleged occurrence of any action or omission to act that is the cause of any proceeding against any agent of the corporation.

**(h) Saving Clause.** If this Bylaw or any portion hereof shall be invalidated on any ground by any court of competent jurisdiction, then the corporation shall nevertheless indemnify each director and officer to the full extent not prohibited by any applicable portion of this section that shall not have been invalidated, or by any other applicable law. If this section shall be invalid due to the application of the indemnification provisions of another jurisdiction, then the corporation shall indemnify each director and officer to the full extent under any other applicable law.

**(i) Certain Definitions.** For the purposes of this Bylaw, the following definitions shall apply:

**(i)** The term proceeding shall be broadly construed and shall include, without limitation, the investigation, preparation, prosecution, defense, settlement, arbitration and appeal of, and the giving of testimony in, any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative.

**(ii)** The term expenses shall be broadly construed and shall include, without limitation, court costs, attorneys fees, witness fees, fines, amounts paid in settlement or judgment and any other costs and expenses of any nature or kind incurred in connection with any proceeding.

**(iii)** The term the corporation shall include, in addition to the resulting corporation, any constituent corporation (including any constituent of a constituent) absorbed in a consolidation or merger which, if its separate existence had continued, would have had power and authority to indemnify its directors, officers, and employees or agents, so that any person who is or was a director, officer, employee or agent of such constituent corporation, or is or was serving at the request of such constituent corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise, shall stand in the same position under the provisions of this section with respect to the resulting or surviving corporation as he would have with respect to such constituent corporation if its separate existence had continued.

**(iv)** References to a director, executive officer, officer, employee, or agent of the corporation shall include, without limitation, situations where such person is serving at the request of the corporation as, respectively, a director, executive officer, officer, employee, trustee or agent of another corporation, partnership, joint venture, trust or other enterprise.

**(v)** References to other enterprises shall include employee benefit plans; references to fines shall include any excise taxes assessed on a person with respect to an employee benefit plan; and references to serving at the request of the corporation shall include any service as a director, officer, employee or agent of the corporation which imposes duties on, or involves services by, such director, officer, employee, or agent with respect to an employee benefit plan, its participants, or beneficiaries; and a person who acted in good faith and in a manner he reasonably believed to be in the interest of the participants and beneficiaries of an employee benefit plan shall be deemed to have acted in a manner not opposed to the best interests of the corporation as referred to in this section.





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## ARTICLE XII

### NOTICES

#### Section 46. Notices.

**(a) Notice To Stockholders.** Written notice to stockholders of stockholder meetings shall be given as provided in Section 7 herein. Without limiting the manner by which notice may otherwise be given effectively to stockholders under any agreement or contract with such stockholder, and except as otherwise required by law, written notice to stockholders for purposes other than stockholder meetings may be sent by US mail or nationally recognized overnight courier, or by facsimile, telegraph or telex or by electronic mail or other electronic means.

**(b) Notice To Directors.** Any notice required to be given to any director may be given by the method stated in subsection (a), as otherwise provided in these Bylaws, or by overnight delivery service, facsimile, telex or telegram, except that such notice other than one which is delivered personally shall be sent to such address as such director shall have filed in writing with the Secretary, or, in the absence of such filing, to the last known post office address of such director.

**(c) Affidavit Of Mailing.** An affidavit of mailing, executed by a duly authorized and competent employee of the corporation or its transfer agent appointed with respect to the class of stock affected, or other agent, specifying the name and address or the names and addresses of the stockholder or stockholders, or director or directors, to whom any such notice or notices was or were given, and the time and method of giving the same, shall in the absence of fraud, be prima facie evidence of the facts therein contained.

**(d) Methods of Notice.** It shall not be necessary that the same method of giving notice be employed in respect of all recipients of notice, but one permissible method may be employed in respect of any one or more, and any other permissible method or methods may be employed in respect of any other or others.

**(e) Notice To Person With Whom Communication Is Unlawful.** Whenever notice is required to be given, under any provision of law or of the Certificate of Incorporation or Bylaws of the corporation, to any person with whom communication is unlawful, the giving of such notice to such person shall not be required and there shall be no duty to apply to any governmental authority or agency for a license or permit to give such notice to such person. Any action or meeting which shall be taken or held without notice to any such person with whom communication is unlawful shall have the same force and effect as if such notice had been duly given. In the event that the action taken by the corporation is such as to require the filing of a certificate under any provision of the DGCL, the certificate shall state, if such is the fact and if notice is required, that notice was given to all persons entitled to receive notice except such persons with whom communication is unlawful.

**(f) Notice to Stockholders Sharing an Address.** Except as otherwise prohibited under DGCL, any notice given under the provisions of DGCL, the Certificate of Incorporation or the Bylaws shall be effective if given by a single written notice to stockholders who share an address if consented to by the stockholders at that address to whom such notice is given. Such consent shall have been deemed to have been given if such stockholder fails to object in writing to the corporation within sixty (60) days of having been given notice by the corporation of its intention to send the single notice. Any consent shall be revocable by the stockholder by written notice to the corporation.

## ARTICLE XIII

### AMENDMENTS

**Section 47.** Subject to the limitations set forth in **Section 45(h)** of these Bylaws or the provisions of the Certificate of Incorporation, the Board of Directors is expressly empowered to adopt, amend or repeal the Bylaws of the corporation. Any adoption, amendment or repeal of the Bylaws of the corporation by the Board of Directors shall require the approval of a majority of the authorized number of directors. The stockholders also shall have power to adopt, amend or repeal the Bylaws of the corporation; *provided, however,* that, in

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addition to any vote of the holders of any class or series of stock of the corporation required by law or by the Certificate of Incorporation, such action by stockholders shall require the affirmative vote of the holders of at least SIXTY-SIX AND TWO-THIRDS PERCENT (66- 2/3%) of the voting power of all of the then-outstanding shares of the capital stock of the corporation entitled to vote generally in the election of directors, voting together as a single class.

## ARTICLE XIV

### LOANS TO OFFICERS

**Section 48. Loans To Officers.** Except as otherwise prohibited by applicable law, the corporation may lend money to, or guarantee any obligation of, or otherwise assist any officer or other employee of the corporation or of its subsidiaries, including any officer or employee who is a director of the corporation or its subsidiaries, whenever, in the judgment of the Board of Directors, such loan, guarantee or assistance may reasonably be expected to benefit the corporation. The loan, guarantee or other assistance may be with or without interest and may be unsecured, or secured in such manner as the Board of Directors shall approve, including, without limitation, a pledge of shares of stock of the corporation. Nothing in these Bylaws shall be deemed to deny, limit or restrict the powers of guaranty or warranty of the corporation at common law or under any statute.

## ARTICLE XV

### MISCELLANEOUS

**Section 49. Forum.** Unless the corporation consents in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware shall be the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the corporation; (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the corporation to the corporation or the corporation's stockholders; (iii) any action asserting a claim against the corporation or any director or officer or other employee of the corporation arising pursuant to any provision of the DGCL, the certificate of incorporation or the Bylaws of the corporation; or (iv) any action asserting a claim against the corporation or any director or officer or other employee of the corporation governed by the internal affairs doctrine.

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**SYNTHETIC BIOLOGICS, INC.  
THIS PROXY IS SOLICITED BY THE BOARD OF  
DIRECTORS  
IN CONNECTION WITH THE 2016 ANNUAL MEETING  
OF STOCKHOLDERS  
TO BE HELD AT 9:00 A.M. (EASTERN DAYLIGHT TIME)  
ON AUGUST 25, 2016**

PROXY: JEFFREY RILEY AND STEVEN SHALLCROSS, or either of them, are hereby appointed by the undersigned as attorneys and proxies with full power of substitution, to vote at the 2016 Annual Meeting of Stockholders of Synthetic Biologics, Inc. and at any adjournment(s) or postponement(s) of that meeting.

WITH RESPECT TO ANY MATTER THAT SHOULD PROPERLY COME BEFORE THE ANNUAL MEETING OF STOCKHOLDERS THAT IS NOT SPECIFIED HEREIN, THIS PROXY, WILL BE VOTED IN THE DISCRETION OF THE PROXY HOLDER.

PLEASE SIGN AND DATE AND RETURN PROMPTLY

**IMPORTANT NOTICE REGARDING THE AVAILABILITY  
OF PROXY MATERIAL  
FOR THE 2016 ANNUAL MEETING OF  
STOCKHOLDERS  
TO BE HELD AT 9:00 A.M. (EASTERN DAYLIGHT TIME)  
ON AUGUST 25, 2016**

**THE NOTICE OF ANNUAL MEETING OF  
STOCKHOLDERS, THE PROXY STATEMENT AND OUR  
ANNUAL REPORT ON FORM 10-K FOR THE YEAR  
ENDED DECEMBER 31, 2015 ARE AVAILABLE ON  
THE INTERNET AT:  
***WWW.SYNTHETICBIOLOGICS.COM.*****

# VOTE BY INTERNET

It is fast, convenient, and your vote is immediately confirmed and posted.

## A. THE BOARD OF DIRECTORS OF SYNTHETIC BIOLOGICS, INC. RECOMMENDS THAT YOU VOTE FOR ALL NOMINEES LISTED IN PROPOSAL 1, FOR PROPOSALS 2, 3, 4, 6 and 7 FOR 3 YEARS ON PROPOSAL 5

**PROPOSAL 1.** Election of the following director nominees to serve for the following year and until his successor is elected: Nominees are: Jeffrey J. Kraws, Jeffrey Riley, Scott L. Tarriff and Jeffrey Wolf.

FOR ALL NOMINEES

WITHHOLD AUTHORITY FOR ALL NOMINEES

WITHHELD FOR THE FOLLOWING ONLY: (WRITE THE NAME(S) OF THE NOMINEE(S) IN THE SPACE BELOW)

**PROPOSAL 2.** Ratification of the selection of BDO USA, LLP as our independent registered public accounting firm for the year ending December 31, 2016.

FOR

AGAINST

ABSTAIN

**PROPOSAL 3.** Approval of an amendment to our 2010 Stock Option Plan to increase the number of shares of common stock that we will have authority to grant under the Plan from 8,000,000 to 14,000,000;

FOR

AGAINST

ABSTAIN

**PROPOSAL 4.** Approval, on an advisory basis, of the compensation of our executive officers.

FOR

AGAINST

ABSTAIN

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**PROPOSAL 5.** Recommend, on an advisory basis, the frequency of holding an advisory vote on executive compensation.

1 YEAR

2 YEARS

3 YEARS

ABSTAIN

**PROPOSAL 6.** Approval of the reincorporation of the Company from the State of Nevada to the State of Delaware.

FOR

AGAINST

ABSTAIN

**PROPOSAL 7.** Approval of the adjournment of the Annual Meeting of Stockholders, if necessary, to solicit additional proxies if there are not sufficient votes in favor of Proposal 6.

FOR

AGAINST

ABSTAIN

## B. NON-VOTING ITEMS

**Change of Address** Please print your new address below.

**Comments** Please print your comments below.

## C. AUTHORIZED SIGNATURES

**This section must be completed for your vote to be counted. Date and Sign Below**

Dated:

Signature(s) of Stockholder(s):

Title:

Please mark, date and sign exactly as your name appears on this proxy card and return in the enclosed envelope. If acting as executor, administrator, trustee, guardian, etc., you should so indicate when signing. If the signer is a

corporation, please sign the full corporate name, by a duly authorized officer. If shares are held jointly, each stockholder named should sign.

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