JEFFERIES GROUP INC /DE/
Form 10-K
March 01, 2007

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

Form 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.**

For the fiscal year ended December 31, 2006

OR

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

For the transition period from _______________ to _______________

Commission File Number: 1-14947

JEFFERIES GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-4719745**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

520 Madison Avenue, 12th Floor New York, New York	**10022**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (212) 284-2550

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	Name of each exchange on which registered**:**
Common Stock, $.0001 par value	**New York Stock Exchange**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. þ

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No þ

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant s most recently completed second fiscal quarter. $3,392,154,283 as of June 30, 2006.

Indicate the number of shares outstanding of the registrant s class of common stock, as of the latest practicable date. 123,745,551 shares as of the close of business February 15, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

Information from the Registrant s Definitive Proxy Statement with respect to the 2007 Annual Meeting of Stockholders to be held on May 21, 2007 to be filed with the SEC is incorporated by reference into Part III of this Form 10-K.

LOCATION OF EXHIBIT INDEX

The index of exhibits is contained in Part IV herein on page 85.

JEFFERIES GROUP, INC.
2006 FORM 10-K ANNUAL REPORT
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PART I

Item 1. Business.

Introduction

Jefferies Group, Inc. and its subsidiaries (we , us or our) operate as a full-service global investment bank and institutional securities firm focused on growth and middle-market companies and their investors. We offer these companies capital raising, merger and acquisition, restructuring and other financial advisory services, and provide investors fundamental research and trade execution in equity, equity-linked, high yield and investment grade fixed income securities, as well as commodities and derivatives. We also provide asset management services and products to institutions and other investors.

Our principal operating subsidiary, Jefferies & Company, Inc. (Jefferies), was founded in 1962. Since 2000, we have pursued a strategy of continuing growth and diversification, whereby we have sought to increase our market share in each of the markets we serve and the products and services we offer, while at the same time expanding the breadth of our activities in an effort to mitigate the cyclical nature of the financial markets in which we operate. Our growth plan has been achieved through internal growth supported by the ongoing addition of experienced personnel in targeted areas, as well as the acquisition from time to time of complementary businesses. More recently, we have increased our global focus on serving companies and investors in Europe, the Middle East, Latin America and Asia.

As of December 31, 2006, we had 2,254 employees. We maintain offices throughout the world and have our executive offices located at 520 Madison Avenue, New York, New York 10022. Our telephone number is (212) 284-2550 and our Internet address is www.jefferies.com.

We make available free of charge on our Internet website the following documents and reports, including amendments (the reports are made available as soon as reasonably practicable after such materials are filed with or furnished to the SEC pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934):

- Code of Ethics;
- Reportable waivers, if any, from our Code of Ethics by our executive officers;
- Board of Directors Corporate Governance Guidelines;
- Charter of the Audit Committee of the Board of Directors;
- Charter of the Corporate Governance and Nominating Committee of the Board of Directors;
- Charter of the Compensation Committee of the Board of Directors;
- Annual reports on Form 10-K;
- Quarterly reports on Form 10-Q;
- Current reports on Form 8-K; and
- Beneficial ownership reports on Forms 3, 4 and 5.

Shareholders may also obtain free of charge a printed copy of any of these documents or reports by sending a request to Investor Relations, Jefferies & Company, Inc., 520 Madison Avenue, 12th Floor, New York, NY 10022, by calling 203-708-5975 or by sending an email to info@jefferies.com.

Business Segments

We currently operate in two business segments, Capital Markets and Asset Management. Our Capital Markets reportable segment includes our traditional securities and investment banking activities. The Capital Markets reportable segment is managed as a single operating segment that provides the research, sales, trading and investment banking effort for various fixed income, equity and advisory products and services. The Capital Markets segment comprises many divisions, with extensive interactions among each. In addition, we voluntarily choose to disclose our Asset Management segment, even though it is currently an immaterial non-reportable segment as defined by FASB 131, *Disclosures about Segments of an Enterprise and Related Information*. The Asset Management segment is primarily comprised of operating activities related to our asset management businesses including Victoria Falls CLO, Summit Lake CLO, Diamond Lake CLO, Jefferies RTS Fund, Jefferies Paragon Fund and Jefferies Buckeye Fund. This segment does not include activity associated with our high yield or international asset management as they are managed by the respective desk managers and included as an integrated component of the Capital Markets reportable segment.

Financial information regarding our reportable business segments as of December 31, 2006, December 31, 2005, and December 31, 2004 is set forth in note 18 of the Notes to Consolidated Financial Statements, titled Segment Reporting and is incorporated herein by reference.

Jefferies Businesses

Capital Markets

Our Capital Markets activity includes our securities execution activities, including sales, trading and research in equity, equity derivatives, convertible, high yield and investment grade fixed income securities, and prime brokerage, and our investment banking activities which include capital market transactions, mergers and acquisitions and other advisory transactions. In addition, our Capital Markets activities include securities lending and commodity-related trading. We are primarily focused on serving corporations and institutional investors.

Investment Banking

Our Investment Banking Division offers our clients, primarily growing and mid-sized companies, a full range of financial advisory services, as well as debt, equity, and convertible capital raising services.

Underwriting

Equity and Equity-Linked Financing We offer expertise in direct placements, private equity, private placements, initial public offerings, and follow-on offerings of equity and equity-linked convertible securities.

Leveraged Finance We offer a full range of debt financing for growing and middle market companies and sponsors. We focus on structuring and distributing public and private debt in leveraged finance transactions, including leveraged buy-outs, acquisitions, growth capital financings, recapitalizations, and Chapter 11 exit financings. We specialize in high yield debt, fixed- and floating-rate senior and subordinated debt. Our joint venture loan finance company, Jefferies Finance, has the ability to commit capital for transactions that range between $50 million and $500 million.

Advisory Services

Mergers & Acquisitions We advise buyers and sellers on sales, divestitures, acquisitions, mergers, tender offers, joint ventures, strategic alliances and takeover defenses. With extensive experience facilitating and financing acquisitions and recapitalizations, we execute both buy-side and sell-side mandates. We provide dedicated senior banker focus to clients throughout the merger and acquisition (M&A) process, which leverages our industry knowledge, extensive relationships, and capital markets and restructuring expertise.

Restructuring & Recapitalization - We specialize in exchange offers, consent solicitations, capital raising, recapitalization, restructuring and distressed M&A activity. We provide advice and support in the structuring, valuation and placement of securities issued in recapitalizations and restructurings. We represent issuers, bondholders and creditors, as well as buyers and sellers of assets.

Fund Placement - Helix Associates, our fund placement group, is a leading placement agent serving private equity fund sponsors and sophisticated investors throughout North America, Europe, the Middle East, Japan and Australia.

Our over 430 investment banking professionals operate throughout the United States, Europe and Asia, and are organized into industry, product and geographic coverage groups in order to maximize our extensive network of relationships and deep product and industry knowledge in particular areas. Industry coverage groups include Jefferies Quarterdeck for Aerospace and Defense, CleanTech, Jefferies Randall & Dewey for Energy, Financial & Business Services, Gaming and Leisure, Healthcare, Industrial, Media & Communications, Private Equity and Venture Capital Sponsors, Retail & Consumer, Jefferies Broadview for Technology, and Transportation, Oil Service & Infrastructure. The division has experienced substantial growth over the last five years both organically and through acquisitions.

Equities

Our Equities Division consists of equity research, sales and trading, electronic execution services, equity derivatives, securities lending and prime brokerage.

Equity Sales and Trading

Our equity research, sales and trading unit is one of the primary foundations of our platform. We have an over forty-year history in equity trading and one of the largest, most experienced institutional sales forces on Wall Street, providing a major source of liquidity for institutional investors. Our equity sales representatives connect a network of more than 2,000 institutional investors around the globe and excel at providing seamless execution with a focus on minimal market impact. We specialize in listed block trades, NASDAQ market making, bulletin board trading, capital markets/origination, risk arbitrage, statistical arbitrage, special situations, pair trades, relative value, and portfolio and electronic trading, as well as American Depository Receipts and Ordinary Shares. We consistently rank highly versus our peers as a trader of equity securities and are often the number one trader of the stocks in which we make a market.

Our clients include domestic and international investors such as investment advisors, banks, mutual funds, insurance companies, hedge funds, and pension and profit sharing plans. These investors normally purchase and sell securities in block transactions, the execution of which requires focused marketing and trading expertise. We are one of the leading firms in the execution of equity block transactions and believe that our institutional customers are attracted by the quality of our execution (measured by volume, timing and price) and our competitive commission rates, which are negotiated on the basis of market conditions, the size of the particular transaction and other factors. We have a small, but growing Private Client Services group that focuses on serving smaller institutions, family offices and high net worth individuals.

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Execution

Through our Jefferies Execution subsidiary, we provide agency-only execution services for stocks and options listed on the NYSE, AMEX, and all other major exchanges, as well as OTC. In 2006, the firm traded over 25 billion shares utilizing its execution platform which includes floor brokerage, electronic connectivity, direct access and listed options trading. Jefferies Execution is one of the largest execution services providers on the New York Stock Exchange. In addition, we offer a suite of quantitative and algorithmic trading solutions as well as access to liquidity in order to access the global markets. We leverage our portfolio management systems, analysis and benchmark auto-trading strategies to deliver our execution services to our institutional customers.

Research

Encompassed within equity sales and trading is research and research sales. We have built and expanded our research platform over the last ten years and now employ over 130 equity and convertible research professionals covering over 950 companies worldwide, and nearly 70 dedicated equity research sales professionals. We provide long- and short-term investment ideas, utilizing the latest technologies to deliver a product that is differentiated and tailored to customers. Our analysts use a variety of quantitative and qualitative tools, integrating field analysis, proprietary channel checks and ongoing dialogue with the managements of the companies they cover.

Equity Derivatives

We offer equity derivatives for investors seeking to manage risk and optimize returns within the equities market. Our experienced professionals have deep expertise in listed and over-the-counter transactions and products. We focus on serving the diverse needs of our institutional, corporate and private client base across multiple product lines, offering listed options, ETFs and OTC options and swaps.

Securities Lending

In connection with both our trading and brokerage activities, we borrow securities to cover short sales and to complete transactions in which customers have failed to deliver securities by the required settlement date, and lend securities to other brokers and dealers for similar purposes. In addition, we have an active matched book business whereby we borrow securities from one party and lend them to another party. When we borrow securities, we provide cash to the lender as collateral, which is reflected in our financial statements as receivable from brokers and dealers. We earn interest revenues on this cash collateral. Similarly, when we lend securities to another party, that party provides cash to us as collateral, which is reflected in our financial statements as payable to brokers and dealers. We incur interest expense on the cash collateral received from the party borrowing the securities. A substantial portion of our interest revenues and interest expenses results from our matched book activities. The initial collateral advanced or received approximates or is greater than, the fair value of the securities borrowed or loaned. We monitor the fair value of the securities borrowed and loaned on a daily basis and request additional collateral or return excess collateral, as appropriate. In 2006, we expanded our securities lending focus internationally, with additional professionals in London and New York.

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Prime Brokerage

We offer prime brokerage services to hedge funds, money managers, and registered investment advisors. Our clients receive an integrated, one-firm, service-based approach by receiving securities lending, competitive financing and technology support and access to our research and capital markets platform. In 2006, we enhanced our prime brokerage unit and expanded our overall commitment to being a significant provider of prime brokerage services.

Fixed Income and Commodities

Our Fixed Income and Commodities division consists of our high yield department, convertibles department, investment grade fixed income department, research and our commodity trading group.

High Yield

We are a recognized leader in high yield trading and financing, with a team of more than 50 professionals encompassing integrated sales, trading, research and capital markets capabilities in the U.S. and London. We are a top trader in the secondary high yield and distressed markets, trading in more than 1,500 cusip / issues with over 600 institutions globally in 2006. Our high yield professionals have long term relationships with institutional high yield, distressed, and levered debt investor bases with focus on secondary trading and new issues.

In January 2000, we created three broker-dealer entities that employ a trading and investment strategy substantially similar to that historically employed by the Jefferies High Yield division. Although we often refer to these three broker-dealer entities as funds, they are registered with the SEC as broker-dealers. Two of these funds, the Jefferies Partners Opportunity Fund and the Jefferies Opportunity Fund II, are principally capitalized with equity contributions from institutional and high net worth investors. The third fund, Jefferies Employees Opportunity Fund (and collectively with the two Jefferies Partners Opportunity Funds, referred to as the High Yield Funds), is principally capitalized with equity investments from our employees and is therefore consolidated into our consolidated financial statements. Our senior management (including our Chief Executive Officer and Chief Financial Officer) and certain of our employees have direct investments in these funds on terms identical to other fund participants. We have a 18% aggregate interest in these funds, senior management has a 3% interest and all employees (exclusive of senior management) have a 5% interest. The High Yield division and each of the funds share gains or losses on trading and investment activities of the High Yield division on the basis of a pre-established sharing arrangement related to the amount of capital each has committed. The sharing arrangement is modified from time to time to reflect changes in the respective amounts of committed capital. As of December 31, 2006, on a combined basis, the High Yield division had in excess of $1,024.8 million of combined *pari passu* capital available (including unfunded commitments and availability under the fund revolving credit facility) to deploy and execute the division s investment and trading strategy. The High Yield Funds are managed by Richard Handler, our Chief Executive Officer.

On January 15, 2007, the manager of the Funds along with a majority of the Funds member interests elected to extend the term of the High Yield Funds until January 18, 2008; thereafter, the High Yield Funds can be further extended for up to two successive one-year terms subject to approval by a majority of the member interests and the manager. We anticipate that we may establish a successor entity to these Funds during 2007. Additional information is set forth in note 25 of the Notes to Consolidated Financial Statements, titled Subsequent Events.

Convertibles

We commit dedicated personnel in the U.S., London, Tokyo, and Zurich to serve the geographically diverse global convertible markets. We offer expertise in the sales, trading and analysis of U.S. domestic and international convertible bonds, convertible preferred shares, closed-end funds, warrants and structured products, with a focus on minimizing transaction costs and maximizing liquidity. Globally, we trade in more than 750 issues and maintain active relationships with more than 450 institutional and corporate clients.

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Investment Grade Fixed Income

We provide fixed income transaction execution for institutions acting as principal, through a combination of professional sales and trading coverage, and a technology platform that enables true on-line real-time trading. The division has more than 80 professionals who are active traders of corporate bonds, U.S. government agency securities, mortgage-backed securities, municipal bonds and emerging markets debt. We serve more than 2,000 mid-sized institutional clients and trade in more than 3,800 individual issues.

Research

We have expanded our research platform over the last few years and have over 15 fixed income research professionals covering over 380 companies worldwide and have 11 dedicated fixed income sales professionals. Our fixed income research supports our investment banking and sales and trading activities. We provide long- and short-term investment ideas, utilizing the latest technologies to deliver a product that is differentiated and tailored to each customer. Our analysts use a variety of quantitative and qualitative tools, integrating field analysis, proprietary channel checks and ongoing dialogue with the managements of the companies they cover.

Commodities

Our commodities group, Jefferies Financial Products, LLC (JFP), offers swaps, options and other derivatives typically linked to various commodity indexes and is a significant provider of liquidity in exchange-traded commodity index contracts. JFP s team of experienced professionals provide innovative financial products and commodity index expertise to pension funds, mutual funds, sovereigns, foundations, endowments and other institutional investors seeking exposure to commodities as an asset class. In 2005, JFP worked with Reuters to modify the benchmark CRB Index, now renamed the Reuters Jefferies CRB Index. In addition, JFP offers proprietary commodity indexes, such as the Jefferies Commodity Performance Index, which are designed to outperform standard benchmark indexes.

Asset Management

We provide investment management services and products to various private investment funds through Jefferies Asset Management (JAM). JAM is registered as an investment adviser with the SEC. Our private fund products consist of long-short equity funds that focus on specific strategies.

Our Asset Management business is primarily comprised of operating activities related to our private investment funds including Victoria Falls CLO, Summit Lake CLO, Diamond Lake CLO, Jefferies RTS Fund, Jefferies Paragon Fund and Jefferies Buckeye Fund.

In Europe, we offer investment solutions for long-only strategies in global convertible bonds to pension funds, insurance companies and private banking clients in Switzerland, France and Germany. These funds are not registered under federal or state securities laws, are made available only to certain sophisticated investors and are not offered or sold to the general public.

Our Sources of Revenues

Commissions

A substantial portion of our revenues is derived from customer commissions and commission equivalents. We charge fees for assisting our domestic and international clients with purchasing and selling equity, debt and convertible securities as well as ADRs, options, preferred stocks, financial futures and other similar products.

Principal Transactions

In the regular course of our business, we take securities positions as a market maker to facilitate customer transactions and for proprietary risk trading. Trading profits or losses and changes in market prices of our proprietary investments are also recorded as principal transaction revenues.

Investment Banking

Investment banking revenues are generated by fees from capital markets activities which include debt, equity, and convertible underwriting and placement services and fees from financial advisory activities including M&A and restructuring services.

Interest

We derive a substantial portion of our interest revenues in connection with our securities borrowed / securities lending activity. We also earn interest on our securities portfolio, on our operating and segregated balances, on our margin lending activity and on certain of our investments, including our investment in short-term bond funds.

Competition

As a global investment bank and securities firm, all aspects of our business are intensely competitive. We compete directly with numerous domestic and international competitors, including firms included on the AMEX Securities Broker/Dealer Index and with other brokers and dealers, investment banking firms, investment advisors, mutual funds, hedge funds and commercial banks. Many of our competitors have substantially greater capital and resources than we do and offer a broader range of financial products. In addition to competition from firms currently in the securities business, there has been increasing competition from others offering financial services. These developments and others have resulted, and may continue to result, in significant additional competition for us. We believe that the principal factors affecting competition involve market focus, reputation, the abilities of professional personnel, the relative price of the service and products being offered and the quality of service.

Regulation

The securities industry in the United States is subject to extensive regulation under both federal and state laws. The Securities and Exchange Commission is the federal agency responsible for the administration of federal securities laws. In addition, self-regulatory organizations, principally NASD and the securities exchanges, are actively involved in the regulation of broker-dealers. These self-regulatory organizations conduct periodic examinations of member broker-dealers in accordance with rules they have adopted and amended from time to time, subject to approval by the SEC. Securities firms are also subject to regulation by foreign regulatory bodies, state securities commissions and state attorneys general in those jurisdictions and states in which they do business.

Broker-dealers are subject to regulations which cover all aspects of the securities business, including sales methods, trade practices among broker-dealers, use and safekeeping of customers funds and securities, capital structure of securities firms, anti-money laundering, record-keeping and the conduct of directors, officers and employees. Additional legislation, changes in rules promulgated by the SEC and self-regulatory organizations, or changes in the interpretation or enforcement of existing laws and rules, may directly affect the mode of operation and profitability of broker-dealers. Broker-dealers that engage in commodities and futures transactions are also subject to regulation by the Commodity Futures Trading Commission (CFTC) and the National Futures Association (NFA). The SEC, self-regulatory organizations, state securities commissions, state attorneys general, the CFTC and the NFA may conduct administrative proceedings which can result in censure, fine, suspension, expulsion of a broker-dealer, its officers or employees, or revocation of broker-dealer licenses. The principal purpose of regulation and discipline of broker-dealers is the protection of customers and the securities markets, rather than protection of creditors and stockholders of broker-dealers.

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As registered broker-dealers, Jefferies and Jefferies Execution are required by law to belong to the Securities Investor Protection Corporation (SIPC). In the event of a member s insolvency, the SIPC fund provides protection for customer accounts up to $500,000 per customer, with a limitation of $100,000 on claims for cash balances. We carry an excess policy that provides additional protection for securities of up to $24.5 million per customer with an aggregate limit of $100 million.

Net Capital Requirements. U.S. registered broker-dealers doing business with the public are subject to the SEC s Uniform Net Capital Rule (the Rule), which specifies minimum net capital requirements. Jefferies Group, Inc. is not a registered broker-dealer and is therefore not subject to the Rule; however, its United States broker-dealer subsidiaries are registered and are subject to the Rule.

The Rule provides that a broker-dealer doing business with the public shall not permit its aggregate indebtedness to exceed 15 times its adjusted net capital (the basic method) or, alternatively, that it not permit its adjusted net capital to be less than 2% of its aggregate debit balances (primarily receivables from customers and broker-dealers) computed in accordance with such Rule (the alternative method). Jefferies and Jefferies Execution use the alternative method of calculation.

Compliance with applicable net capital rules could limit operations of Jefferies, such as underwriting and trading activities, that require the use of significant amounts of capital, and may also restrict loans, advances, dividends and other payments by Jefferies or Jefferies Execution to us.

As of December 31, 2006, Jefferies , and Jefferies Execution s net capital and excess net capital were as follows (in thousands of dollars):

	Net Capital	Excess Net Capital
Jefferies	$ 191,830	$ 174,597
Jefferies Execution	21,477	21,227

NYSE Regulations. Our common stock is listed on the New York Stock Exchange. As a listed company, we are required to comply with the NYSE s rules and regulations, including rules pertaining to corporate governance matters. As required by the NYSE on an annual basis, in 2006 our Chief Executive Officer, Richard Handler, certified to the NYSE that he was not aware of any violation by us of the NYSE s corporate governance listing standards.

Regulation Outside the United States. We are an active participant in the international fixed income and equity markets. Many of our principal subsidiaries that participate in these markets are subject to comprehensive regulations in the United States and elsewhere that include some form of capital adequacy rules and other customer protection rules. We provide investment services in and from the United Kingdom under the regulation of the Financial Services Authority.

Business Risks

As a global investment bank and securities firm, risk is an inherent part of our businesses. Capital markets, by their nature, are prone to uncertainty and subject participants to a variety of risks. We have developed policies and procedures designed to identify, measure and monitor each of the risks involved in our trading, brokerage and investment banking activities on a global basis. Our principal risks are market, credit, operational, legal and compliance and new business risks. Risk management is considered to be of paramount importance to our day-to-day operations. Consequently, we devote significant resources (including investments in personnel and technology) to the measurement, analysis and management of risk.

We seek to reduce risk through the diversification of our businesses, counterparties and activities. We accomplish this objective by monitoring the usage of capital to each of our businesses, establishing trading limits and setting credit limits for individual counterparties. We seek to achieve adequate returns from each of our businesses commensurate with the risks assumed. Nonetheless, the effectiveness of our policies and procedures for managing risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have an adverse effect on our results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in our earnings, increases in our credit exposure to customers and counterparties and increases in general systemic risk. If any of our strategies used to hedge or otherwise mitigate exposures to the various types of risks described above are not effective, we could incur losses. Additionally, business continuity plans have been developed and are periodically tested for critical processes and systems, and controls have been implemented to provide oversight of the activities.

Margin Risk

Customers transactions are executed on either a cash or margin basis. In a margin transaction, we extend credit to the customer, collateralized by securities and cash in the customer s account, for a portion of the purchase price, and receive income from interest charged on such extensions of credit. In permitting a customer to purchase securities on margin, we are subject to the risk that a market decline could reduce the value of its collateral below the amount of the customer s indebtedness and that the customer might otherwise be unable to repay the indebtedness.

In addition to monitoring the creditworthiness of our customers, we also consider the trading liquidity and volatility of the securities we accept as collateral for margin loans. Trading liquidity and volatility may be dependent, in part, upon the market in which the security is traded, the number of outstanding shares of the issuer, events affecting the issuer and/or securities markets in general, and whether or not there are any legal restrictions on the sale of the securities. Certain types of securities have historical trading patterns, which may assist us in making this evaluation. Historical trading patterns, however, may not be good indicators over relatively short time periods or in markets which are affected by unusual or unexpected developments. We consider all of these factors at the time we agree to extend credit to customers and continue to review extensions of credit on an ongoing basis.

The majority of our margin loans are made to United States citizens or to corporations which are domiciled in the United States. We may extend credit to investors or corporations who are citizens of foreign countries or who may reside outside the United States. We believe that should such foreign investors default upon their loans and should the collateral for those loans be insufficient to satisfy the investors obligations, it may be more difficult to collect such investors outstanding indebtedness than would be the case if investors were citizens or residents of the United States.

Although we attempt to minimize the risk associated with the extension of credit in margin accounts, there is no assurance that the assumptions on which we base our decisions will be correct or that we are in a position to predict factors or events which will have an adverse impact on any individual customer or issuer, or the securities markets in general.

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Underwriting Risk

Investment banking activity involves both economic and regulatory risks. An underwriter may incur losses if it is unable to sell the securities it is committed to purchase or if it is forced to liquidate its commitments at less than the agreed upon purchase price. In addition, under the federal securities laws and other laws and court decisions with respect to underwriters liability and limitations on indemnification of underwriters by issuers, an underwriter is subject to substantial potential liability for material misstatements or omissions in prospectuses and other communications with respect to underwritten offerings. Further, underwriting commitments constitute a charge against net capital and our underwriting commitments may be limited by the requirement that our broker-dealers must, at all times, be in compliance with the Uniform Net Capital Rule 15c3-1 of the Securities Exchange Act of 1934. We intend to continue to pursue opportunities for our corporate customers, which may require us to finance and/or underwrite the issuance of securities. Under circumstances where we are required to act as an underwriter or to take a position in the securities of our customers, we may assume greater risk than would normally be assumed in our normal trading activity.

Item 1A. Risk Factors

Factors Affecting Our Business

The following factors describe some of the assumptions, risks, uncertainties and other factors that could adversely affect our business or that could otherwise result in changes that differ materially from our expectations. In addition to the factors mentioned in this report, we are also affected by changes in general economic and business conditions, acts of war, terrorism and natural disasters.

Changing conditions in financial markets and the economy could result in decreased revenues.

As an investment banking and securities firm, changes in the financial markets or economic conditions in the United States and elsewhere in the world could adversely affect our business in many ways, including the following:

- A market downturn could lead to a decline in the volume of transactions executed for customers and, therefore, to a decline in the revenues we receive from commissions and spreads.

- Unfavorable financial or economic conditions could likely reduce the number and size of transactions in which we provide underwriting, financial advisory and other services. Our investment banking revenues, in the form of financial advisory and underwriting or placement fees, are directly related to the number and size of the transactions in which we participate and could therefore be adversely affected by unfavorable financial or economic conditions.

- Adverse changes in the market could lead to a reduction in revenues from principal transactions and commissions.

- Adverse changes in the market could also lead to a reduction in revenues from asset management fees and investment income from managed funds and losses from managed funds. Continued increases in our asset management business, especially increases in the amount of our investments in managed funds, would make us more susceptible to adverse changes in the market.

Our principal trading and investments expose us to risk of loss.

A significant portion of our revenues is derived from trading in which we act as principal. Although a significant portion of our principal trading is riskless principal in nature, we may incur trading losses relating to the purchase, sale or short sale of high yield, international, convertible, and equity securities and futures and commodities for our own account and from other program or principal trading. Additionally, we have made substantial investments of our capital in debt securities, equity securities and commodities, including investments managed by us and investments managed by third parties. In any period, we may experience losses as a result of price declines, lack of trading volume, and illiquidity. From time to time, we may engage in a large block trade in a single security or maintain large position concentrations in a single security, securities of a single issuer, or securities of issuers engaged in a specific industry. In general, because our inventory is marked to market on a daily basis, any downward price movement in these securities could result in a reduction of our revenues and profits. In addition, we may engage in hedging transactions that if not successful, could result in losses.

Increased competition may adversely affect our revenues and profitability.

All aspects of our business are intensely competitive. We compete directly with numerous other brokers and dealers, investment banking firms and banks. In addition to competition from firms currently in the securities business, there has been increasing competition from others offering financial services, including automated trading and other services based on technological innovations. We believe that the principal factors affecting competition involve market focus, reputation, the abilities of professional personnel, the ability to execute the transaction, relative price of the service and products being offered and the quality of service. Increased competition or an adverse change in our competitive position could lead to a reduction of business and therefore a reduction of revenues and profits. Competition also extends to the hiring and retention of highly skilled employees. A competitor may be successful in hiring away an employee or group of employees, which may result in our losing business formerly serviced by such employee or employees. Competition can also raise our costs of hiring and retaining the key employees we need to effectively execute our business plan.

Operational risks may disrupt our business, result in regulatory action against us or limit our growth.

Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across numerous and diverse markets in many currencies, and the transactions we process have become increasingly complex. If any of our financial, accounting or other data processing systems do not operate properly or are disabled or if there are other shortcomings or failures in our internal processes, people or systems, we could suffer an impairment to our liquidity, financial loss, a disruption of our businesses, liability to clients, regulatory intervention or reputational damage. These systems may fail to operate properly or become disabled as a result of events that are wholly or partially beyond our control, including a disruption of electrical or communications services or our inability to occupy one or more of our buildings. The inability of our systems to accommodate an increasing volume of transactions could also constrain our ability to expand our businesses.

We also face the risk of operational failure or termination of any of the clearing agents, exchanges, clearing houses or other financial intermediaries we use to facilitate our securities transactions. Any such failure or termination could adversely affect our ability to effect transactions and manage our exposure to risk.

In addition, despite the contingency plans we have in place, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which they are located. This may include a disruption involving electrical, communications, transportation or other services used by us or third parties with which we conduct business.

Our operations rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software and networks may be vulnerable to unauthorized access, computer viruses or other malicious code, and other events that could have a security impact. If one or more of such events occur, this potentially could jeopardize our or our clients or counterparties confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, our clients , our counterparties or third parties operations. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us.

Asset management revenue is subject to variability based on market and economic factors and the amount of assets under management.

Asset management revenue includes revenues we receive from management, administrative and performance fees from funds managed by us, revenues from asset management and performance fees we receive from third-party managed funds, and investment income from our investments in these funds. These revenues are dependent upon the amount of assets under management and the performance of the funds. If these funds do not perform as well as our asset management clients expect, our clients may withdraw their assets from these funds, which would reduce our revenues. Some of our revenues from management, administrative and performance fees are derived from our own investments in these funds. We experience significant fluctuations in our quarterly operating results due to the nature of our asset management business and therefore may fail to meet revenue expectations.

We face numerous risks and uncertainties as we expand our business.

We expect the growth of our business to come primarily from internal expansion and through acquisitions and strategic partnering. As we expand our business, there can be no assurance that our financial controls, the level and knowledge of our personnel, our operational abilities, our legal and compliance controls and our other corporate support systems will be adequate to manage our business and our growth. The ineffectiveness of any of these controls or systems could adversely affect our business and prospects. In addition, as we acquire new businesses, we face numerous risks and uncertainties integrating their controls and systems into ours, including financial controls, accounting and data processing systems, management controls and other operations. A failure to integrate these systems and controls, and even an inefficient integration of these systems and controls, could adversely affect our business and prospects.

Our business depends on our ability to maintain adequate levels of personnel.

We have made substantial increases in personnel. If a significant number of our key personnel leave, or if our business volume increases significantly over current volume, we could be compelled to hire additional personnel. At that time, there could be a shortage of qualified and, in some cases, licensed personnel whom we could hire. This could hinder our ability to expand or cause a backlog in our ability to conduct our business, including the handling of investment banking transactions and the processing of brokerage orders, all of which could harm our business, financial condition and operating results.

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Extensive regulation of our business limits our activities, and, if we violate these regulations, we may be subject to significant penalties.

The securities industry in the United States is subject to extensive regulation under both federal and state laws. The SEC is the federal agency responsible for the administration of federal securities laws. In addition, self-regulatory organizations, principally NASD and the securities exchanges, are actively involved in the regulation of broker-dealers. Securities firms are also subject to regulation by regulatory bodies, state securities commissions and state attorneys general in those foreign jurisdictions and states in which they do business. Broker-dealers are subject to regulations which cover all aspects of the securities business, including sales methods, trade practices among broker-dealers, use and safekeeping of customers funds and securities, capital structure of securities firms, anti-money laundering, record-keeping and the conduct of directors, officers and employees. Broker-dealers that engage in commodities and futures transactions are also subject to regulation by the CFTC and the NFA. The SEC, self-regulatory organizations, state securities commissions, state attorneys general, the CFTC and the NFA may conduct administrative proceedings which can result in censure, fine, suspension, expulsion of a broker-dealer or its officers or employees, or revocation of broker-dealer licenses. Additional legislation, changes in rules or changes in the interpretation or enforcement of existing laws and rules, may directly affect our mode of operation and our profitability. Continued efforts by market regulators to increase transparency and reduce the transaction costs for investors, such as decimalization and NASD s Trade Reporting and Compliance Engine, or TRACE, has affected and could continue to affect our trading revenue.

Our business is substantially dependent on our Chief Executive Officer.

Our future success depends to a significant degree on the skills, experience and efforts of Richard Handler, our Chief Executive Officer. We do not have an employment agreement with Mr. Handler which provides for his continued employment. The loss of his services could compromise our ability to effectively operate our business. In addition, in the event that Mr. Handler ceases to actively manage the three funds that invest on a *pari passu* basis with our High Yield Division, investors in those funds would have the right to withdraw from the funds. Although we have substantial key man life insurance covering Mr. Handler, the proceeds from the policy may not be sufficient to offset any loss in business.

Legal liability may harm our business.

Many aspects of our business involve substantial risks of liability, and in the normal course of business, we have been named as a defendant or co-defendant in lawsuits involving primarily claims for damages. The risks associated with potential legal liabilities often may be difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time. Private Client Services involves an aspect of the business that has historically had more risk of litigation than our institutional business. Additionally, the expansion of our business, including increases in the number and size of investment banking transactions and our expansion into new areas, imposes greater risks of liability. In addition, unauthorized or illegal acts of our employees could result in substantial liability to us. Substantial legal liability could have a material adverse financial effect or cause us significant reputational harm, which in turn could seriously harm our business and our prospects.

Our business is subject to significant credit risk.

In the normal course of our businesses, we are involved in the execution, settlement and financing of various customer and principal securities and commodities transactions. These activities are transacted on a cash, margin or delivery-versus-payment basis and are subject to the risk of counterparty or customer nonperformance. Although transactions are generally collateralized by the underlying security or other securities, we still face the risks associated with changes in the market value of the collateral through settlement date or during the time when margin is extended. We may also incur credit risk in our derivative transactions to the extent such transactions result in uncollateralized credit exposure to our counterparties. We seek to control the risk associated with these transactions by establishing and monitoring credit limits and by monitoring collateral and transaction levels daily. We may require counterparties to deposit additional collateral or return collateral pledged. In the case of aged securities failed to receive, we may, under industry regulations, purchase the underlying securities in the market and seek reimbursement for any losses from the counterparty.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

We maintain offices throughout the world including New York, Atlanta, Boston, Calgary, Chicago, Dallas, Dubai, Houston, Jersey City, London, Los Angeles, Nashville, Richmond, Silicon Valley, Paris, San Francisco, Short Hills, Singapore, Shanghai, Stamford, Tokyo, Washington, D.C. and Zurich. In addition, we maintain back-up facilities with redundant technologies in Dallas. We lease all of our office space which management believes is adequate for our business. For information concerning leasehold improvements and rental expense, see notes 1, 6 and 13 of the Notes to Consolidated Financial Statements.

Item 3. Legal Proceedings.

Many aspects of our business involve substantial risks of legal liability. In the normal course of business, we have been named as defendants or co-defendants in lawsuits involving primarily claims for damages. We are also involved in a number of judicial and regulatory matters arising out of the conduct of our business. Our management, based on currently available information, does not believe that any matter will have a material adverse effect on our financial condition, although, depending on our results for a particular period, an adverse determination could be material for a particular period.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock trades on the NYSE under the symbol JEF. On April 18, 2006, we declared a 2-for-1 split of all outstanding shares of our common stock, payable May 15, 2006 to stockholders of record as of April 28, 2006. The stock split was effected as a stock dividend of one share for each one share outstanding on the record date. All share, share price and per share information has been restated to retroactively reflect the effect of the two-for-one stock split.

The following table sets forth for the periods indicated the range of high and low sales prices per share of our common stock as reported by the NYSE.

	High	Low
2006		
Fourth Quarter	$ 31.76	$ 26.41
Third Quarter	30.50	21.45
Second Quarter	34.80	24.73
First Quarter	29.58	22.38
2005		
Fourth Quarter	$ 23.94	$ 19.30
Third Quarter	21.78	18.57
Second Quarter	19.50	16.78
First Quarter	20.38	18.13

There were approximately 750 holders of record of our common stock at February 12, 2007.

In 1988, we instituted a policy of paying regular quarterly cash dividends. There are no restrictions on our present ability to pay dividends on our common stock, other than the applicable provisions of the Delaware General Corporation Law.

During the first quarter of 2005, we announced a 20% increase in our quarterly dividend to $0.06 per share and then in the fourth quarter of 2005, we announced an additional 25% increase in our quarterly dividend to $0.075 per share. In the second quarter of 2006, we announced a 67% increase in our quarterly dividend to $0.125 per share.

Dividends per share of common stock (declared and paid):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006	$ .075	$ .125	$ .125	$ .125
2005	$ .060	$ .060	$ .060	$ .075

Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased (1)	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2)	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 October 31, 2006	11,127	29.97	10,000	5,939,000
November 1 November 30, 2006	68,421	29.57		5,939,000
December 1 December 31, 2006	168,075	29.61		5,939,000

Total	247,623	29.62	10,000	5,939,000

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(1) We repurchased an aggregate of 237,623 shares during the fourth quarter other than as part of a publicly announced plan or program. We repurchased these securities in connection with our equity compensation plans which allow participants to use shares to pay the exercise price of options exercised and to use shares to satisfy tax liabilities arising from the exercise of options or the vesting of restricted stock. This number does not include unvested shares forfeited back to us pursuant to the terms of our equity compensation plans.

(2) On July 26, 2005, we issued a press release announcing the authorization by our Board of Directors to repurchase, from time to time, up to an aggregate of 3,000,000 shares of our common stock. After giving effect to the 2-for-1 stock split effected as a stock dividend on May 15, 2006, this authorization increased to 6,000,000 shares.

Shareholder Return Performance Presentation

Set forth below is a line graph comparing the yearly change in the cumulative total shareholder return on our common stock against the cumulative total return of the Standard & Poor s 500, and the Financial Service Analytics Brokerage (FSA Composite) Indices for the period of five fiscal years, commencing January 1, 2002 (based on prices at December 31, 2001), and ending December 31, 2006.

	2001	2002	2003	2004	2005	2006
Jefferies Group Inc.	100	136	136	215	264	298
FSA Composite	100	78	115	128	155	203
S&P500	100	78	100	111	117	135

* Normalized so that the value of our common stock and each index was $100 on December 31, 2001.

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Item 6. Selected Financial Data.

The selected data presented below as of and for each of the years in the five-year period ended December 31, 2006, are derived from the consolidated financial statements of Jefferies Group, Inc. and its subsidiaries, which financial statements have been audited by KPMG LLP, our independent registered public accounting firm. The data should be read in connection with the consolidated financial statements including the related notes contained on pages 48 through 83. On July 14, 2003, we declared a 2-for-1 split of all outstanding shares of common stock, payable August 15, 2003 to stockholders of record as of July 31, 2003. On April 18, 2006, we declared a 2-for-1 split of all outstanding shares of common stock, payable May 15, 2006 to stockholders of record as of April 28, 2006. The stock splits were effected as a stock dividend of one share for each one share outstanding on the record date. All share, share price and per share information has been restated to retroactively reflect the effect of the two-for-one stock splits. Certain reclassifications have been made to the prior period amounts to conform to the current period s presentation.

	Year Ended December 31,				
	2006	2005	2004	2003	2002
	(In Thousands, Except Per Share Amounts)				
Earnings Statement Data					
Revenues:					
Commissions	$ 280,681	$ 246,943	$ 258,838	$ 250,191	$ 268,984
Principal transactions	468,002	349,489	358,213	301,299	227,664
Investment banking	540,596	495,014	352,804	229,608	139,828
Asset management fees and investment income from managed funds	109,550	82,052	81,184	32,769	19,643
Interest	528,882	304,053	134,450	102,403	92,027
Other	35,497	20,322	13,150	10,446	6,630
Total revenues	1,963,208	1,497,873	1,198,639	926,716	754,776
Interest expense	505,606	293,173	140,394	97,102	80,087
Revenues, net of interest expense	1,457,602	1,204,700	1,058,245	829,614	674,689

Non-interest expenses:

$
57,318

$
87,066

Other comprehensive loss:

Foreign currency translation adjustments	(1,023)	(2,044)	(3,009)	(3,578)
Change in fair value of interest rate swap	388	(605)	(517)	(368)
Other comprehensive loss	(635)	(2,649)	(3,526)	(3,946)
Comprehensive income	$ 18,285	$ 29,427	$ 53,792	$ 83,120

See Notes to Consolidated Financial Statements (Unaudited).

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WERNER ENTERPRISES, INC.
CONSOLIDATED CONDENSED BALANCE SHEETS

(In thousands, except share amounts)	September 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,736	$ 31,833
Accounts receivable, trade, less allowance of $9,080 and $10,298, respectively	252,512	251,023
Other receivables	13,536	17,241
Inventories and supplies	14,446	16,415
Prepaid taxes, licenses and permits	6,949	15,657
Income taxes receivable	13,110	20,052
Other current assets	63,568	27,281
Total current assets	377,857	379,502
Property and equipment	2,011,888	1,908,600
Less – accumulated depreciation	728,503	754,130
Property and equipment, net	1,283,385	1,154,470
Other non-current assets	65,137	51,675
Total assets	$ 1,726,379	$ 1,585,647
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Checks issued in excess of cash balances	$ 2,665	$ —
Accounts payable	72,735	70,643
Insurance and claims accruals	71,056	64,106
Accrued payroll	29,608	25,233
Other current liabilities	18,249	23,720
Total current liabilities	194,313	183,702
Long-term debt, net of current portion	150,000	75,000
Other long-term liabilities	18,275	19,832
Insurance and claims accruals, net of current portion	114,125	125,195
Deferred income taxes	271,206	246,264
Commitments and contingencies		
Stockholders' equity:		
Common stock, $0.01 par value, 200,000,000 shares authorized; 80,533,536 shares issued; 72,061,210 and 71,998,750 shares outstanding, respectively	805	805
Paid-in capital	103,648	102,734
Retained earnings	1,067,315	1,022,966
Accumulated other comprehensive loss	(16,589)	(13,063)
Treasury stock, at cost; 8,472,326 and 8,534,786 shares, respectively	(176,719)	(177,788)
Total stockholders' equity	978,460	935,654
Total liabilities and stockholders' equity	$ 1,726,379	$ 1,585,647

See Notes to Consolidated Financial Statements (Unaudited).

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WERNER ENTERPRISES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)	Nine Months Ended September 30, 2016	2015
	(Unaudited)	
Cash flows from operating activities:		
Net income	$57,318	$87,066
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	152,849	143,065
Deferred income taxes	23,773	(3,417)
Gain on disposal of property and equipment	(13,250)	(18,880)
Non-cash equity compensation	2,325	3,607
Insurance and claims accruals, net of current portion	(11,070)	6,450
Other	(8,500)	5,288
Changes in certain working capital items:		
Accounts receivable, net	(1,489)	15,849
Other current assets	(11,647)	29,546
Accounts payable	1,898	10,163
Other current liabilities	8,968	4,035
Net cash provided by operating activities	201,175	282,772
Cash flows from investing activities:		
Additions to property and equipment	(388,386)	(337,475)
Proceeds from sales of property and equipment	94,372	86,366
Decrease in notes receivable	14,007	11,956
Net cash used in investing activities	(280,007)	(239,153)
Cash flows from financing activities:		
Repayments of short-term debt	(20,000)	—
Proceeds from issuance of short-term debt	20,000	—
Repayments of long-term debt	(40,000)	—
Proceeds from issuance of long-term debt	115,000	—
Change in net checks issued in excess of cash balances	2,665	—
Dividends on common stock	(12,966)	(10,801)
Repurchases of common stock	—	(6,438)
Tax withholding related to net share settlements of restricted stock awards	(623)	(461)
Stock options exercised	298	846
Excess tax benefits from equity compensation	(17)	219
Payment of notes payable	(3,117)	(3,117)
Net cash provided by (used in) financing activities	61,240	(19,752)
Effect of exchange rate fluctuations on cash	(505)	(550)
Net increase (decrease) in cash and cash equivalents	(18,097)	23,317
Cash and cash equivalents, beginning of period	31,833	22,604
Cash and cash equivalents, end of period	$13,736	$45,921
Supplemental disclosures of cash flow information:		
Interest paid	$1,838	$1,578
Income taxes paid	4,257	34,201
Supplemental schedule of non-cash investing activities:		
Notes receivable issued upon sale of property and equipment	$22,952	$21,792

Change in fair value of interest rate swap	(517)	(368)
Property and equipment acquired included in accounts payable	821	10,513
Property and equipment disposed included in other receivables	259	—

See Notes to Consolidated Financial Statements (Unaudited).

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WERNER ENTERPRISES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(1) Accounting Policies

Presentation of Deferred Taxes
In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-17, which requires presentation of deferred tax assets and liabilities as non-current in the balance sheet, which simplifies the current guidance. Effective January 1, 2016, we early-adopted the guidance and retrospectively adjusted the December 31, 2015 presentation by reclassifying $28.0 million of current deferred tax assets into the non-current liability "Deferred income taxes."

(2) Credit Facilities
As of September 30, 2016, 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 September 30, 2016, and December 31, 2015, our outstanding debt totaled $150.0 million and $75.0 million, respectively. We had $75.0 million outstanding under the term commitment at a variable rate of 1.12% as of September 30, 2016, which is effectively fixed at 2.5% with an interest rate swap agreement, and we had an additional $75.0 million outstanding under the credit facilities at a weighted average interest rate of 1.08%. The $325.0 million of borrowing capacity under our credit facilities at September 30, 2016, is further reduced by $25.8 million in stand-by letters of credit under which we are obligated. 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 September 30, 2016, we were in compliance with these covenants.

At September 30, 2016, the aggregate future maturities of long-term debt by year are as follows (in thousands):

Year	Amount
2016	$—
2017	—
2018	—
2019	75,000
2020	75,000
Total	$ 150,000

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

(3) Income Taxes
We accrued interest expense of $58 thousand and $52 thousand during the three-month periods ended September 30, 2016, and September 30, 2015, respectively, and $185 thousand and $176 thousand during the nine-month periods ended September 30, 2016, and September 30, 2015, 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 September 30, 2016, is $6.2 million. If recognized, $4.0 million of unrecognized tax benefits would impact our effective tax rate. Interest of $1.0 million has been reflected as a component of the total liability. We expect no other

significant increases or decreases for uncertain tax positions during the next twelve months.

We file U.S. federal income tax returns, as well as income tax returns in various states and several foreign jurisdictions. The years 2011 and 2013 through 2015 are open for examination by the Internal Revenue Service (“IRS”), and various years are open for examination by state and foreign tax authorities. The IRS is currently performing an audit of our amended 2011 federal income tax return. State and foreign jurisdictional statutes of limitations generally range from three to four years.

(4) Commitments and Contingencies
As of September 30, 2016, we have committed to property and equipment purchases of approximately $133.3 million.

We are involved in certain claims and pending litigation 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 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.

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 dates back to 2008 through March 2014. In August 2015, the court denied our motion for summary judgment and granted the plaintiff's motion for summary judgment, ruling in plaintiff's favor on both theories of liability (short breaks and sleeper berth time). During second quarter 2016, the court issued two rulings, the first of which dismissed the plaintiff's claims under the Nebraska Wage Payment and Collection Act (but not the FLSA) and the second of which granted our motion to strike plaintiff's untimely damages calculations. As a result, we reduced our accrual in second quarter 2016, and we had a $1.2 million estimated liability at September 30, 2016 related to the short break matter. Based on the knowledge of the facts related to the sleeper berth matter, management does not currently believe a loss is probable, thus we have not accrued for the sleeper berth matter. We are currently unable to determine the possible loss or range of loss. We intend to vigorously defend the merits of these claims and to appeal any adverse verdict in this case.

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 the litigation 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.

(5) 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 Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net income	$18,920	$32,076	$57,318	$87,066

Weighted average common shares outstanding	72,058	71,890	72,043	71,967
Dilutive effect of stock-based awards	348	588	321	579
Shares used in computing diluted earnings per share	72,406	72,478	72,364	72,546
Basic earnings per share	$0.26	$0.45	$0.80	$1.21
Diluted earnings per share	$0.26	$0.44	$0.79	$1.20

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.

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(6) 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 stock and units ("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 September 30, 2016, there were 7,417,846 shares available for granting additional awards.

Equity compensation expense is included in salaries, wages and benefits within the Consolidated Statements of Income. As of September 30, 2016, the total unrecognized compensation cost related to non-vested equity compensation awards was approximately $6.6 million and is expected to be recognized over a weighted average period of 2.3 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 Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Stock options:				
Pre-tax compensation expense	$5	$17	$14	$51
Tax benefit	2	7	6	20
Stock option expense, net of tax	$3	$10	$8	$31
Restricted awards:				
Pre-tax compensation expense	$813	$(92)	$1,743	$1,949
Tax benefit	317	(36)	680	770
Restricted award expense, net of tax	$496	$(56)	$1,063	$1,179
Performance awards:				
Pre-tax compensation expense	$517	$(60)	$628	$1,648
Tax benefit	202	(24)	245	651
Performance award expense, net of tax	$315	$(36)	$383	$997

During the nine-month period ended September 30, 2016, we recorded a $1.8 million reduction in compensation expense and a $0.7 million reduction of tax benefit resulting from a change in forfeiture estimates for certain restricted and performance awards, most of which relate to a previously disclosed executive retirement that occurred in February 2016. During the three-month and nine-month periods ended September 30, 2015, we recorded a $2.0 million reduction of compensation expense and a $0.8 million reduction of tax benefit resulting from our change in forfeiture estimates for certain restricted and performance awards primarily due to a previously disclosed executive resignation.

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 2016.

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.

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The following table summarizes stock option activity for the nine months ended September 30, 2016:

	Number of Options (in thousands)	Weighted Average Exercise Price ($)	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at beginning of period	192	$ 18.29		
Granted	—	—		
Exercised	(15)	18.78		
Forfeited	(2)	22.28		
Expired	—	—		
Outstanding at end of period	175	18.21	2.15	$ 884
Exercisable at end of period	166	18.00	1.99	$ 876

We did not grant any stock options during the three-month and nine-month periods ended September 30, 2016 and September 30, 2015. The fair value of stock option grants is estimated using a Black-Scholes valuation model. The total intrinsic value of stock options exercised was $95 thousand and $0.7 million for the nine-month periods ended September 30, 2016 and September 30, 2015, 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 84 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 nine months ended September 30, 2016:

	Number of Restricted Awards (in thousands)	Weighted Average Grant Date Fair Value ($)
Nonvested at beginning of period	445	$ 24.32
Granted	—	—
Vested	(10)	22.96
Forfeited	(46)	21.51
Nonvested at end of period	389	24.69

We did not grant any restricted awards during the three-month and nine-month periods ended September 30, 2016 and September 30, 2015. 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 three-month periods ended September 30, 2016 and September 30, 2015 was $0.2 million and for the nine-month periods ended September 30, 2016 and September 30, 2015 was $0.3 million. We withheld shares based on the closing stock price on the vesting date to settle the employees' minimum statutory obligation for the applicable income and other employment taxes. Total cash remitted for the employees' tax obligations to the relevant taxing authorities is reflected as a financing activity within the Consolidated Statements of Cash Flows, and the shares withheld to satisfy the minimum 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 nine months ended September 30, 2016:

	Number of Performance Awards (in thousands)	Weighted Average Grant Date Fair Value ($)
Nonvested at beginning of period	258	$ 27.23
Granted	110	26.53
Vested	(60)	27.11
Forfeited	(75)	27.45
Nonvested at end of period	233	26.86

We did not grant any performance awards during the three-month periods ended September 30, 2016 and September 30, 2015, and granted performance awards (in thousands) totaling 110 shares and 202 shares during the nine-month periods ended September 30, 2016 and September 30, 2015, respectively, including additional shares earned as a result of attaining performance objectives at higher than the target level. Performance awards are earned based upon the level of attainment by the Company of specified performance objectives related to earnings per share for the fiscal year, as established by the Compensation Committee. The number of shares which are ultimately earned for the 2016 awards will range from 0 percent to 123 percent of the target number based on the level of attainment of the performance objectives and ranged from 0 percent to 132 percent for the 2015 awards. 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 present value of estimated future dividends was calculated using the following assumptions:

	Nine Months Ended September 30,	
	2016	2015
Dividends per share (quarterly amounts)	$0.06	$0.05
Risk-free interest rate	1.5 %	1.6 %

During the nine-month period ended September 30, 2016, the Compensation Committee determined that the 2015 fiscal year performance objectives were achieved at a level above the target level and 165,500 shares of common stock were earned (excluding those shares forfeited prior to the end of the performance period), subject to time-based vesting over a five-year period. The vesting date fair value of performance awards that vested during the nine-month periods ended September 30, 2016 and September 30, 2015 was $1.6 million and $1.1 million, respectively. We withhold shares based on the closing stock price on the vesting date to settle the employees' minimum statutory obligation for the applicable income and other employment taxes. Total cash remitted for employees' tax obligations to the relevant taxing authorities is reflected as a financing activity within the Consolidated Statements of Cash Flows, and the shares withheld to satisfy the minimum tax withholding obligations are recorded as treasury stock.

(7) Segment Information
We have two reportable segments – Truckload Transportation Services ("Truckload") and Werner Logistics (formerly Value Added Services).

The Truckload segment consists of two operating units, One-Way Truckload and Specialized Services, that are aggregated because they have similar economic characteristics and meet the other aggregation criteria described in the accounting guidance for segment reporting. 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

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regional short-haul ("Regional") fleet provides comparable truckload van service within geographic regions across the United States. Specialized Services (primarily Dedicated) provides truckload services dedicated to a specific customer, generally for a retail distribution center or manufacturing facility, including services for products requiring specialized trailers such as flatbed or temperature-controlled trailers. Revenues for the Truckload segment include a small amount of non-trucking revenues which consist primarily of the portion of 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 four operating units that provide non-trucking services to our customers. These four 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; and (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.

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 September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues				
Truckload Transportation Services	$384,312	$417,861	$1,136,478	$1,225,439
Werner Logistics	109,459	102,149	310,001	296,459
Other	14,804	14,087	43,148	41,996
Corporate	313	634	1,300	1,880
Subtotal	508,888	534,731	1,490,927	1,565,774
Inter-segment eliminations	(212)	(283)	(768)	(1,028)
Total	$508,676	$534,448	$1,490,159	$1,564,746
Operating Income				
Truckload Transportation Services	$19,846	$48,747	$74,971	$131,901
Werner Logistics	4,894	5,021	16,502	12,474
Other	(1,191)	(1,354)	(4,964)	(2,038)
Corporate	5,525	386	4,605	858
Total	$29,074	$52,800	$91,114	$143,195

(8) Derivative Financial Instrument

In the normal course of business we are subject to risk from adverse fluctuations in foreign exchange and interest rates and commodity prices. We manage our risks for interest rate changes through use of an interest rate swap. At September 30, 2016, we had one interest rate swap outstanding, which matures in September 2019, with a notional value of $75.0 million and a pre-tax fair value loss of $2.4 million. The counterparty to this contract is a major

financial institution. We are exposed to credit loss in the event of non-performance by the counterparty. We do not use derivative instruments for trading or speculative purposes and have no derivative financial instruments to reduce our exposure to fuel price fluctuations.

Our objective in managing exposure to interest rate risk is to limit the impact on earnings and cash flow. The extent to which we use such instruments is dependent on our access to these contracts in the financial markets and our success using other methods.

Our outstanding derivative financial instrument is recognized as an other long-term liability in the Consolidated Balance Sheets at fair value. The interest rate swap is accounted for as a cash flow hedging instrument. At inception, we formally designated and documented the financial instrument as a hedge of a specific underlying exposure, the risk management objective, and the manner in which effectiveness of the hedge will be assessed. We formally assess, both at inception and at each reporting period thereafter, whether the derivative financial instrument is effective in offsetting changes in cash flows of the related underlying exposure. All changes in fair value of outstanding derivatives in cash flow hedges, except any ineffective portion, are recorded in other comprehensive income until earnings are impacted by the hedged transaction. Classification of the gain or loss in the Consolidated Statements of Income upon release from comprehensive income is the same as that of the underlying exposure. Any ineffective portion of the change in fair value of the instruments is recognized immediately in earnings.

We will discontinue the use of hedge accounting prospectively when (i) the derivative instrument is no longer effective in offsetting changes in fair value or cash flows of the underlying hedged item; (ii) the derivative instrument expires, is sold, terminated or exercised; or (iii) designating the derivative instrument as a hedge is no longer appropriate.

Should we discontinue hedge accounting because it is no longer probable that an anticipated transaction will occur in the originally expected period, or within an additional two-month period thereafter, changes to fair value accumulated in other comprehensive income would be recognized immediately in earnings.

FASB ASC 815-10 requires companies to recognize the derivative instrument as an asset or a liability at fair value in the statement of financial position. Fair value of the derivative instrument is required to be measured under the FASB’s Fair Value Measurements and Disclosures guidance, which establishes a hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity’s own assumptions about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy). Level 1 inputs use quoted prices (unadjusted) in active markets for identical assets or liabilities that we have the ability to access. Level 2 inputs are inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs for the asset or liability, which are typically based on an entity’s own assumptions, as there is little, if any, related market activity. The fair value of our interest rate swap is based on Level 2 inputs.

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
- Accounting Standards

The MD&A should be read in conjunction with our 2015 Form 10-K.

Overview:
We have two reportable segments, Truckload Transportation Services ("Truckload") and Werner Logistics (formerly Value Added Services or "VAS"), 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 in certain customers or goods, we may also be affected by our customers' financial failures or loss of customer business.

Revenues for our Truckload segment operating units (One-Way Truckload and Specialized Services) 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, related to 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 third quarter 2016 to third quarter 2015, 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

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and trailer purchases. We fund these purchases with net cash from operations and financing available under our existing credit facilities, as management deems necessary.

We provide non-trucking services primarily through the four operating units within our Werner Logistics segment (Brokerage, Freight Management, Intermodal and Werner Global Logistics international). 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) September 30,				Nine Months Ended (9ME) September 30,				Percentage Change in Dollar Amounts	
	2016		2015		2016		2015		3ME	9ME
(Amounts in thousands)	$	%	$	%	$	%	$	%	%	%
Operating revenues	$508,676	100.0	$534,448	100.0	$1,490,159	100.0	$1,564,746	100.0	(4.8)%	(4.8)%
Operating expenses:										
Salaries, wages and benefits	162,862	32.0	167,301	31.3	479,298	32.2	479,142	30.6	(2.7)%	—%
Fuel	40,638	8.0	50,855	9.5	112,034	7.5	160,996	10.3	(20.1)%	(30.4)%
Supplies and maintenance	41,027	8.1	50,283	9.4	130,559	8.8	144,328	9.2	(18.4)%	(9.5)%
Taxes and licenses	21,540	4.2	22,616	4.2	64,353	4.3	66,459	4.3	(4.8)%	(3.2)%
Insurance and claims	19,106	3.8	17,372	3.3	59,384	4.0	60,034	3.8	10.0%	(1.1)%
Depreciation	51,781	10.2	49,081	9.2	152,849	10.3	143,065	9.1	5.5%	6.8%
Rent and purchased transportation	133,876	26.3	122,006	22.8	379,155	25.4	360,706	23.1	9.7%	5.1%
Communications and utilities	4,206	0.8	3,786	0.7	12,110	0.8	11,301	0.7	11.1%	7.2%
Other	4,566	0.9	(1,652)	(0.3)	9,303	0.6	(4,480)	(0.3)	376.4%	307.7%
Total operating expenses	479,602	94.3	481,648	90.1	1,399,045	93.9	1,421,551	90.8	(0.4)%	(1.6)%
Operating income	29,074	5.7	52,800	9.9	91,114	6.1	143,195	9.2	(44.9)%	(36.4)%
Total other expense (income)	(260)	(0.1)	(217)	—	(1,167)	(0.1)	(262)	—	(19.8)%	(345.4)%
	29,334	5.8	53,017	9.9	92,281	6.2	143,457	9.2	(44.7)%	(35.7)%

Income before income taxes										
Income taxes	10,414	2.1	20,941	3.9	34,963	2.4	56,391	3.6	(50.3)%	(38.0)%
Net income	$18,920	3.7	$32,076	6.0	$57,318	3.8	$87,066	5.6	(41.0)%	(34.2)%

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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 September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
Truckload Transportation Services (amounts in thousands)	$	%	$	%	$	%	$	%
Trucking revenues, net of fuel surcharge	$336,673		$360,124		$1,008,738		$1,042,309	
Trucking fuel surcharge revenues	41,994		52,428		111,018		167,175	
Non-trucking and other operating revenues	5,645		5,309		16,722		15,955	
Operating revenues	384,312	100.0	417,861	100.0	1,136,478	100.0	1,225,439	100.0
Operating expenses	364,466	94.8	369,114	88.3	1,061,507	93.4	1,093,538	89.2
Operating income	$19,846	5.2	$48,747	11.7	$74,971	6.6	$131,901	10.8

	Three Months Ended September 30,			Nine Months Ended September 30,		
Truckload Transportation Services	2016	2015	% Change	2016	2015	% Change
Operating ratio, net of fuel surcharge revenues [1]	94.2 %	86.7 %		92.7 %	87.5 %	
Average revenues per tractor per week [2]	$3,589	$3,767	(4.7)%	$3,547	$3,710	(4.4)%
Average trip length in miles (loaded)	468	483	(3.1)%	466	480	(2.9)%
Average percentage of empty miles [3]	12.55 %	12.53 %	0.2 %	13.08 %	12.30 %	6.3 %
Average tractors in service	7,216	7,355	(1.9)%	7,291	7,205	1.2 %
Total trailers (at quarter end)	22,655	22,495		22,655	22,495	
Total tractors (at quarter end):						
Company	6,355	6,710		6,355	6,710	
Independent contractor	820	705		820	705	
Total tractors	7,175	7,415		7,175	7,415	

(1) Calculated as if fuel surcharge revenues are excluded from total revenues and instead reported as a reduction of 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 September 30,				Nine Months Ended September 30,			
	2016		2015		2016		2015	
Werner Logistics (amounts in thousands)	$	%	$	%	$	%	$	%
Operating revenues	$109,459	100.0	$102,149	100.0	$310,001	100.0	$296,459	100.0
Rent and purchased transportation expense	91,695	83.8	86,085	84.3	255,954	82.6	251,406	84.8
Gross margin	17,764	16.2	16,064	15.7	54,047	17.4	45,053	15.2

Other operating expenses	12,870	11.7	11,043	10.8	37,545	12.1	32,579	11.0
Operating income	$4,894	4.5	$5,021	4.9	$16,502	5.3	$12,474	4.2

	Three Months Ended September 30,			Nine Months Ended September 30,		
Werner Logistics	2016	2015	% Change	2016	2015	% Change
Average tractors in service	75	60	25.0 %	71	54	31.5 %
Total trailers (at quarter end)	1,590	1,405	13.2 %	1,590	1,405	13.2 %
Total tractors (at quarter end)	86	70	22.9 %	86	70	22.9 %

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Three Months Ended September 30, 2016 Compared to Three Months Ended September 30, 2015

Operating Revenues

Operating revenues decreased 4.8% for the three months ended September 30, 2016, compared to the same period of the prior year. When comparing third quarter 2016 to third quarter 2015, Truckload segment revenues decreased $33.5 million or 8.0%, and Werner Logistics revenues increased $7.3 million or 7.2%.

Trucking revenues, net of fuel surcharge, decreased 6.5% in third quarter 2016 compared to third quarter 2015 due to a 4.7% decrease in average revenues per tractor per week, net of fuel surcharge, and a 1.9% decrease in the average number of tractors in service. Our average miles per truck declined by 3.5% in third quarter 2016 compared to third quarter 2015, and average revenues per total mile, net of fuel surcharge, declined by 1.2%.

Third quarter 2016 freight demand showed gradual improvement from the weak second quarter 2016 freight market. We believe part of this improvement was industry specific and part was Company specific. During June 2016, to take advantage of the strengthening Dedicated market, we moved 150 trucks from One-Way Truckload into Dedicated, lessening the need to find freight for their trucks in the more challenged One-Way market. In September 2016, we moved an additional 100 trucks from One-Way Truckload into Dedicated. Freight volumes and transactional (non-contract) spot market pricing in the One-Way Truckload market improved in third quarter 2016 from the lower levels in second quarter 2016. We reduced our spot market exposure from elevated levels in second quarter 2016 to more typical levels in third quarter 2016. We experienced better than normal freight volume trends in our One-Way Truckload business in July followed by stable and steady freight trends in August and September. Freight demand in October 2016 was consistent with normal seasonal trends.

During third quarter 2016, we experienced gradual freight improvement which began to validate our pricing strategy. The contractual rate market became more challenging in second quarter 2016, particularly in One-Way Truckload. An excess supply of industry trucks relative to sluggish freight demand created a market in which customers pushed harder for contractual rate decreases. We chose to exit from certain contractual business that would have required significant contractual rate decreases for the next year, since we believed that this pricing was not sustainable and that freight market conditions would begin to show improvement. While we avoided mid-single digit percentage or higher contractual rate decreases in second quarter 2016, market conditions and competition necessitated agreeing to flat to slightly lower contractual rates which became effective in third quarter 2016.

The average number of tractors in service in the Truckload segment decreased 1.9% to 7,216 in third quarter 2016 from 7,355 in third quarter 2015. We ended third quarter 2016 with 7,175 trucks in the Truckload segment, a year-over-year reduction of 240 trucks compared to the end of third quarter 2015, and a sequential decrease of 80 trucks compared to the end of second quarter 2016. We reduced our average trucks in service by 90 trucks from second quarter 2016 to third quarter 2016 in response to the freight market conditions. We are not growing our truck fleet until we see meaningful improvement in the freight and rate markets. We cannot predict whether future driver shortages, if any, will adversely affect our ability to maintain our fleet size. If such a driver market 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 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. These revenues decreased 19.9% to $42.0 million in third quarter 2016 from $52.4 million in third quarter 2015 due to lower average fuel prices in the 2016 quarter. 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 four 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 third quarter 2016 and $0.3 million in third quarter 2015 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 third quarter 2016, Werner Logistics revenues increased $7.3 million or 7.2%, and operating income dollars decreased $0.1 million or 2.5%, compared to third quarter 2015. The Werner Logistics gross margin percentage in third quarter 2016 of 16.2% improved year over year compared to the gross margin percentage

of 15.7% in third quarter 2015. The Werner Logistics operating income percentage in third quarter 2016 of 4.5% declined from third quarter 2015 of 4.9%.

In third quarter 2016, Werner Logistics continued to see strong growth in our truck brokerage and intermodal solutions despite the sluggish logistics freight market. We believe this is a vote of confidence from our customers regarding the value of the Werner Enterprises portfolio of service offerings. We increased our Werner Logistics inside sales team by 25% year over year to facilitate growth and continue to invest in our regional office network. During third quarter 2016, we opened a new office in Omaha and renovated or expanded offices in Dallas, Atlanta and Chicago to support this continued growth. We remain confident that the depth and breadth of our portfolio strategy positions us very well for the changing regulatory environment in 2017.

Operating Expenses

Our operating ratio (operating expenses expressed as a percentage of operating revenues) was 94.3% for the three months ended September 30, 2016, compared to 90.1% for the three months ended September 30, 2015. Expense items that impacted the overall operating ratio are described on the following pages. The tables on pages 16 and 17 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 decreased $4.4 million or 2.7% in third quarter 2016 compared to third quarter 2015 but increased 0.7% as a percentage of operating revenues to 32.0%. The lower dollar amount of salaries, wages and benefits expense in the 2016 third quarter was due primarily to fewer company trucks and miles, partially offset by higher driver mileage pay rates (including a pay increase effective January 1, 2016, for approximately 20% of our company drivers, as well as prior driver pay increases in multiple Dedicated fleets). Additionally, in third quarter 2015, we accrued a total of $3.9 million of expense related to a class action suit involving an employment related claim and separation agreement for an executive resignation. When evaluated on a per-mile basis, driver salaries, wages and benefits increased, which we primarily attribute to 8% higher driver pay in third quarter 2016 compared to third quarter 2015. Non-driver salaries, wages and benefits in the non-trucking Werner Logistics segment increased 22.8%.

We renewed our workers' compensation insurance coverage for the policy year beginning April 1, 2016. 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 premiums for the policy year beginning April 2016 were similar to those for the previous policy year.

The driver recruiting market remains challenging. Several ongoing market factors persist including a declining number of, and increased competition for, driver training school graduates, a low national unemployment rate, aging truck driver demographics and increased truck safety regulations. We have taken many significant actions in the last year to strengthen our driver recruiting and retention to make Werner the preferred choice for the best drivers, including raising driver pay, lowering the age of our truck fleet, installing safety and training features on all new trucks and investing in our driver training schools. Our driver turnover rate continued to improve, achieving the lowest third quarter rate in 18 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 decreased $10.2 million or 20.1% in third quarter 2016 compared to third quarter 2015 and decreased 1.5% as a percentage of operating revenues due to lower average diesel fuel prices and slightly improved miles per gallon ("mpg").

Average diesel fuel prices were 17 cents per gallon lower in third quarter 2016 than in third quarter 2015, however were 2 cents per gallon higher than in second quarter 2016.

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.

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For October 2016, the average diesel fuel price per gallon was approximately 3 cents lower than the average diesel fuel price per gallon in the same period of 2015 and approximately 18 cents higher than in fourth quarter 2015.

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 September 30, 2016, we had no derivative financial instruments to reduce our exposure to fuel price fluctuations.

Supplies and maintenance decreased $9.3 million or 18.4% in third quarter 2016 compared to third quarter 2015 and decreased 1.3% as a percentage of operating revenues. Repairs and maintenance decreased due to our younger tractor and trailer fleet and fewer company driver miles driven in the 2016 quarter. The average age of our company truck fleet was 1.7 years at the end of third quarter 2016, 1.9 years at the end of third quarter 2015 and 1.7 years at the end of second quarter 2016.

Taxes and licenses decreased $1.1 million or 4.8% in third quarter 2016 compared to third quarter 2015 and remained flat as a percentage of operating revenues. The decrease was caused primarily by lower diesel fuel taxes in third quarter 2016 compared to third quarter 2015, the result of fewer company driver miles.

Insurance and claims increased $1.7 million or 10.0% in third quarter 2016 compared to third quarter 2015 and increased 0.5% as a percentage of operating revenues. The increase in third quarter 2016 compared to third quarter 2015 was primarily the result of unfavorable development on prior period large dollar claims during the 2016 quarter and higher premiums, partially offset by better experience on small dollar claims. 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, 2016 and continued to be 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 in excess of $5.0 million and less than $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, 2016 are about $3.5 million higher than premiums for the previous policy year. The market for excess trucking liability coverage is extremely difficult, as insurance carriers have either exited the market or increased premium rates due to increasing plaintiff awards in the industry.

Depreciation expense increased $2.7 million or 5.5% in third quarter 2016 compared to third quarter 2015 and increased 1.0% as a percentage of operating revenues. This increase was due primarily to the higher cost of new trucks purchased compared to the cost of used trucks that were sold over the past 12 months. In addition, the purchase of new trailers over the past 12 months to replace older used trailers which were fully depreciated also contributed to the increase in depreciation expense.

Depreciation expense has been historically affected by a series of changes to engine emissions standards imposed by the EPA that became effective in October 2002, January 2007 and January 2010, resulting in increased truck purchase costs. Trucks with 2010-standard engines have a higher purchase price than trucks manufactured to meet the 2007 standards, but the 2010-standard engines are more fuel efficient. As of September 30, 2016, nearly all company trucks had engines that comply with the 2010 emissions standards.

Rent and purchased transportation expense increased $11.9 million or 9.7% in third quarter 2016 compared to third quarter 2015 and increased 3.5% 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 $5.6 million, and as a percentage of Werner Logistics revenues decreased to 83.8% in third quarter 2016 from 84.3% in third quarter 2015. This improved gross margin percentage is a result of on-going efforts to match contractual customer consistent freight with our strategic carrier partners' capacity and then utilize the available capacity in the market to cover transactional volume.

Rent and purchased transportation for the Truckload segment increased $6.2 million in third quarter 2016 compared to third quarter 2015. This increase is due primarily to higher payments to independent contractors. In November 2015, we increased the per-mile settlement rate for certain independent contractors. Independent contractor miles as a percentage of total miles were 14.8% in third quarter 2016 compared to 11.7% in third quarter 2015. Because independent contractors supply their own tractors and drivers and are responsible for their operating expenses, the increase in independent contractor miles as a percentage of total miles also shifted costs to the rent and purchased transportation category from other expense categories, including (i) salaries, wages and benefits, (ii) fuel, (iii) depreciation, (iv) supplies and maintenance and (v) taxes and licenses.

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 occurs, 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.

Communications and utilities increased $0.4 million or 11.1% in third quarter 2016 compared to third quarter 2015 and increased 0.1% as a percentage of operating revenues. This increase is primarily due to higher communications costs and equipment tracking expenses in third quarter 2016 compared to third quarter 2015.

Other operating expenses increased $6.2 million in third quarter 2016 compared to third quarter 2015 and increased 1.2% 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 $3.1 million in third quarter 2016, which includes a $6.5 million gain from the sale of real estate and $3.4 million of losses on equipment sales, compared to $6.7 million in third quarter 2015, which included a $0.7 million gain from a real estate sale. In third quarter 2016, we sold more trucks and more trailers than in third quarter 2015. We realized average losses per truck in third quarter 2016 compared to average gains in third quarter 2015 and realized similar average gains per trailer. The used truck pricing market became increasingly more difficult in third quarter 2016 due to a higher than normal supply of used trucks in the market and low buyer demand. We expect the used truck pricing market will remain difficult for at least the near term. Other operating expenses, primarily provision for doubtful accounts related to the driver training schools and professional and consulting fees, were $7.7 million in third quarter 2016 compared to $5.0 million in third quarter 2015.

Other Expense (Income)

Other expense (income) decreased 0.1% as a percentage of operating revenues in third quarter 2016 compared to third quarter 2015 due primarily to slightly higher interest income in the 2016 quarter which was partially offset by a slight increase in interest expense third quarter 2016 compared to third quarter 2015, as we had additional borrowings under our credit facilities in the 2016 quarter.

Income Taxes

Our effective income tax rate (income taxes expressed as a percentage of income before income taxes) was 35.5% in third quarter 2016 and 39.5% in third quarter 2015. The lower income tax rate in third quarter 2016 is attributed to favorable tax adjustments for the remeasurement of uncertain tax positions.

Nine Months Ended September 30, 2016 Compared to Nine Months Ended September 30, 2015

Operating Revenues

Operating revenues decreased 4.8% for the nine months ended September 30, 2016, compared to the same period of the prior year. In the Truckload segment, trucking revenues, net of fuel surcharge, decreased 3.2% in the 2016 year-to-date period compared to the 2015 year-to-date period due primarily to a 4.4% decrease in average revenues per tractor per week, partially offset by a 1.2% increase in the average number of tractors in service. Average revenues per total mile, net of fuel surcharge, decreased 1.4% in the first nine months of 2016 compared to the same period in 2015, and average monthly miles per tractor decreased by 3.0%. Truckload segment fuel surcharge revenues for the nine months ended September 30, 2016 decreased $56.2 million or 33.6% when compared to the nine months ended September 30, 2015 due to lower average fuel prices in the 2016 period. Werner Logistics revenues increased 4.6%, from $296.5 million in the first nine months of 2015 to $310.0 million in the same 2016 period.

Operating Expenses

Our operating ratio (operating expenses expressed as a percentage of operating revenues) was 93.9% for the nine months ended September 30, 2016, compared to 90.8% for the nine months ended September 30, 2015. Expense items that impacted the overall operating ratio are described on the following pages. The tables on pages 16 and 17 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 remained flat in the first nine months of 2016 compared to the first nine months of 2015 and increased 1.6% as a percentage of operating revenues to 32.2% due primarily to higher driver salaries, partially offset by lower workers' compensation expense and student driver salaries. When evaluated on a per-mile basis, driver salaries, wages and benefits increased

as well, which is attributable to higher driver pay. Non-driver salaries, wages and benefits in the non-trucking Werner Logistics segment increased 19.2%.

Fuel decreased $49.0 million or 30.4% in the first nine months of 2016 compared to the same period in 2015 and decreased 2.8% as a percentage of operating revenues due primarily to lower average diesel fuel prices in 2016 and improved mpg. Average diesel fuel prices were 44 cents per gallon lower in the first nine months of 2016 than in the same 2015 period.

Supplies and maintenance decreased $13.8 million or 9.5% in the first nine months of 2016 compared to the same period in 2015 and decreased 0.4% as a percentage of operating revenues. Repairs and maintenance decreased due to our younger tractor and trailer fleet and fewer company driver miles driven in the year-to-date 2016 period.

Taxes and licenses decreased $2.1 million or 3.2% in the first nine months of 2016 compared to the same 2015 period and remained flat as a percentage of operating revenues. Diesel fuel taxes were lower as a result of fewer company driver miles in the year-to-date 2016 period.

Insurance and claims decreased $0.7 million or 1.1% in the first nine months of 2016 compared to the same period in 2015 and increased 0.2% as a percentage of operating revenues due primarily to lower costs related to large dollar liability claims in the 2016 period.

Depreciation expense increased $9.8 million or 6.8% in the first nine months of 2016 compared to the same 2015 period and increased 1.2% as a percentage of operating revenues due primarily to the higher cost of new trucks purchased compared to the cost of used trucks that were sold over the past 12 months. The purchase of new trailers over the past 12 months to replace older used trailers which were fully depreciated also contributed to the increase in depreciation expense.

Rent and purchased transportation expense increased $18.4 million or 5.1% in the first nine months of 2016 compared to the same 2015 period and increased 2.3% as a percentage of operating revenues. Rent and purchased transportation for the Truckload segment increased $14.2 million in the first nine months of 2016 compared to the same 2015 period. This increase is due primarily to higher payments to independent contractors in the first nine months of 2016 compared to the same period in 2015 because of rate increases for certain independent contractors in fourth quarter 2015 and higher independent contractor miles in the first nine months of 2016 compared to the same period in 2015. Independent contractor miles as a percentage of total miles were 14.4% and 11.7% in the first nine months of 2016 and 2015, respectively. Werner Logistics rent and purchased transportation expense increased $4.5 million and as a percentage of Werner Logistics revenues decreased to 82.6% in the 2016 period from 84.8% in the 2015 period. The Werner Logistics gross margin percentage improved as a result of on-going efforts to match contractual customer consistent freight with our strategic carrier partners' capacity and then utilize the available capacity in the market to cover the transactional volume.

Communications and utilities increased $0.8 million or 7.2% in the first nine months of 2016 compared to the same 2015 period and increased 0.1% as a percentage of operating revenues. This increase is primarily due to higher communications costs and equipment tracking expenses in the 2016 year-to-date period compared to the 2015 year-to-date period.

Other operating expenses increased $13.8 million in the first nine months of 2016 compared to the same period in 2015 and increased 0.9% as a percentage of operating revenues. Gains on sales of assets (primarily used trucks and trailers) decreased to $13.3 million in the nine months ended September 30, 2016, including $10.5 million from sales of real estate, from $18.9 million in the nine months ended September 30, 2015. In the 2016 year-to-date period, we sold fewer trucks and more trailers and realized average losses per truck and higher average gains per trailer sold. Provision for doubtful accounts related to our driver schools was also higher in the 2016 period.

Other Expense (Income)

Other expense (income) decreased $0.9 million in the first nine months of 2016 compared to the same 2015 period and decreased 0.1% as a percentage of operating revenues, due primarily to higher interest income. Interest expense increased slightly for the first nine months of 2016 compared to first nine months of 2015, as we had additional borrowings under our credit facilities in 2016.

Income Taxes

Our effective income tax rate (income taxes expressed as a percentage of income before income taxes) decreased to 37.9% for the first nine months of 2016 from 39.3% for the first nine months of 2015. The lower income tax rate for the first nine months of 2016 is attributed to (i) accruing for employment tax credits in 2016, which in the prior year were not enacted for 2015 until December 2015, and thus could not be accrued until fourth quarter 2015 and (ii) favorable tax adjustments for the remeasurement of uncertain tax positions.

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Liquidity and Capital Resources:
During the nine months ended September 30, 2016, we generated cash flow from operations of $201.2 million, a 29% or $81.6 million decrease in cash flows compared to the same nine-month period a year ago. The decrease in net cash provided by operating activities resulted primarily from a $61.9 million decrease from general working capital activities including accounts receivable and accounts payable and a $29.7 million decrease in net income. We were able to make net capital expenditures and pay dividends with the net cash provided by operating activities and existing cash balances, supplemented by net borrowings under our credit facilities.

Net cash used in investing activities increased to $280.0 million for the nine-month period ended September 30, 2016 from $239.2 million for the nine-month period ended September 30, 2015. Net property additions (primarily revenue equipment) were $294.0 million for the nine-month period ended September 30, 2016, compared to $251.1 million during the same period of 2015. This increase occurred as we continued to increase our capital expenditures to lower the average age of our company truck fleet. As of September 30, 2016, we were committed to property and equipment purchases of approximately $133.3 million. We currently estimate net capital expenditures (primarily revenue equipment) in 2016 to be in the range of $350 million to $400 million, compared to net capital expenditures in 2015 of $351.5 million. We intend to fund these net capital expenditures through cash flow from operations and financing available under our existing credit facilities, as management deems necessary.

Net financing activities provided $61.2 million during the nine months ended September 30, 2016, and used $19.8 million during the same period in 2015. During the nine months ended September 30, 2016, we borrowed $135.0 million of short-term and long-term debt and repaid $60.0 million of short-term and long-term debt. Our outstanding debt at September 30, 2016, was $150.0 million. We paid dividends of $13.0 million and $10.8 million in the nine-month periods ended September 30, 2016 and 2015, respectively. We increased our quarterly dividend rate by $0.01 per share, or 20%, beginning with the dividend paid in October 2015. We did not repurchase any shares of common stock during the nine months ended September 30, 2016, and we repurchased 225,000 shares at a cost of $6.4 million during the nine months ended September 30, 2015. 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 September 30, 2016, the Company had purchased 3,287,291 shares pursuant to our current Board of Directors repurchase authorization and had 4,712,709 shares remaining available for repurchase.

Management believes our financial position at September 30, 2016 is strong. As of September 30, 2016, we had $13.7 million of cash and cash equivalents and $978.5 million of stockholders' equity. Cash is invested primarily in government portfolio money market funds. As of September 30, 2016, we had a total of $325.0 million of credit pursuant to three credit facilities (see Note 2 in the Notes to Consolidated Financial Statements under Item 1 of Part I of this Form 10-Q), of which we had borrowed $150.0 million. The remaining $175.0 million of credit available under these facilities is reduced by the $25.8 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.

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Contractual Obligations and Commercial Commitments:
The following tables set forth our contractual obligations and commercial commitments as of September 30, 2016.
Payments Due by Period

(Amounts in millions)	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years	Period Unknown
Contractual Obligations						
Unrecognized tax benefits	$6.2	$ —	$ —	$ —	$ —	$ 6.2
Long-term debt including current maturities	150.0	—	—	150.0	—	—
Interest payments on debt	8.6	2.7	5.3	0.6	—	—
Property and equipment purchase commitments	133.3	133.3	—	—	—	—
Total contractual cash obligations	$298.1	$ 136.0	$ 5.3	$ 150.6	$ —	$ 6.2
Other Commercial Commitments						
Unused lines of credit	$149.2	$ —	$ —	$ 149.2	$ —	$ —
Stand-by letters of credit	25.8	25.8	—	—	—	—
Total commercial commitments	$175.0	$ 25.8	$ —	$ 149.2	$ —	$ —
Total obligations	$473.1	$ 161.8	$ 5.3	$ 299.8	$ —	$ 6.2

As of September 30, 2016, 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 September 30, 2016, we had $75.0 million outstanding under the term commitment at a variable rate of 1.12%, which is effectively fixed at 2.5% with an interest rate swap agreement, and we had an additional $75.0 million outstanding under the credit facilities at a weighted average interest rate of 1.08%. Interest payments on debt are based on the debt balance and interest rates at September 30, 2016. The borrowing capacity under these credit facilities is further reduced by the amount of stand-by letters of credit under which we are obligated. The stand-by letters of credit are primarily required for insurance policies. The unused lines of credit are available to us in the event we need financing for the replacement of our fleet or for other significant capital expenditures. Management believes our financial position is strong, and we therefore expect that we could obtain additional financing, if necessary. Property and equipment purchase commitments relate to committed equipment expenditures, primarily for revenue equipment. As of September 30, 2016, we had recorded a $6.2 million liability for unrecognized tax benefits. We expect none of it to be settled within the next twelve months and are unable to reasonably determine when the $6.2 million categorized as “period unknown” will be settled.

Regulations:
Item 1 of Part I of our 2015 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. Except as described below, there have been no material changes in the status of these proposed regulations previously disclosed in the 2015 Form 10-K.

In June 2015, the Entry-Level Driver Training Advisory Committee (“ELDTAC”), formed by the Federal Motor Carrier Safety Administration (“FMCSA”) to conduct a negotiated rulemaking to implement entry-level driver training provisions, reached a consensus and forwarded its recommendations to the FMCSA. In March 2016, the FMCSA issued a proposed rule and requested public comments due by April 6, 2016. The proposal requires Class A CDL driver-trainees to receive a minimum of 30 hours of training behind the wheel but does not specify a minimum number of classroom hours. A driver-trainee must also demonstrate proficiency in operating the vehicle prior to being issued a training certificate. The provisions would not become effective until three years after a final rule is published. This rule could materially impact the number of potential new drivers entering the industry, and we currently cannot

predict how the adoption of such rules would affect our driver recruitment and the overall driver market.

In December 2015, FMCSA issued final rules regarding the required installation and use of electronic logging devices (ELDs) by nearly all carriers to enhance the monitoring and enforcement of the driver hours of service rules. Carriers have until December 2017 to adopt and use compliant ELDs. We are the recognized industry leader for electronic logging of driver hours as we proactively adopted a paperless log system in 1996 that was subsequently approved for use by FMCSA in 1998, and we support a broad-based mandate for ELDs. In March 2016, the Owner-Operator Independent Drivers Association (OOIDA) filed a legal complaint with

the 7th Circuit Court of Appeals against FMCSA seeking to overturn the ELD mandate. OOIDA has asked the court to strike down the rule, arguing the rule is an unconstitutional violation of trucker's rights and will do little to enhance safety. The court heard oral arguments in September 2016 and on October 31, 2016, denied OOIDA's lawsuit. It is uncertain if OOIDA will appeal the decision.

Critical Accounting Policies and Estimates:
The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management 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 2015 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.

There have been no material changes to these critical accounting policies and estimates from those discussed in our 2015 Form 10-K.

Accounting Standards:
In the descriptions under "New Accounting Pronouncements Adopted" and "Accounting Standards Updates Not Yet Effective" that follow, references in quotations identify guidance and Accounting Standards Updates ("ASU") relating to the topics and subtopics (and their descriptive titles, as appropriate) of the Accounting Standards Codification™ of the Financial Accounting Standards Board ("FASB").

New Accounting Pronouncements Adopted
We did not adopt any new accounting standards during third quarter 2016.

Accounting Standards Updates Not Yet Effective
On May 28, 2014, the FASB issued 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 ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The FASB has also issued ASU No. 2016-08, 2016-10, 2016-11, and 2016-12 in 2016, with additional guidance related to revenue recognition matters. In July 2015, the FASB voted to approve a one-year deferral of the effective date of the new revenue recognition standard and to permit early adoption but no earlier than the original effective date (annual periods beginning after December 15, 2016); such decisions were documented in the FASB's ASU No. 2015-14 "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date." As a result of the deferral, the new standard (as well as ASU No. 2016-08 and 2016-10) will become effective for us beginning January 1, 2018, unless we choose to adopt early on January 1, 2017. The standard permits the use of either the retrospective or cumulative effect transition method. We are evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures and have not yet selected a transition method.

In July 2015, the FASB issued ASU No. 2015-11, "Inventory: Simplifying the Measurement of Inventory," which requires inventory to be recorded at the lower of cost and net realizable value. The provisions of this update are effective as of January 1, 2017, and are not expected to have a material effect on our consolidated financial position, results of operations or cash flows.

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 are effective for fiscal years beginning after December 15, 2018. We are evaluating the effect that ASU No. 2016-02 will have on our consolidated financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting,” to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The provisions of this update are effective for fiscal years beginning after December 15, 2016. We are evaluating the effect that ASU No. 2016-09 will have on our consolidated financial position, results of operations and cash flows.

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 provisions of this update are effective for fiscal years beginning after December 15, 2017. We are evaluating the effect that ASU No. 2016-15 will have on our consolidated cash flows.

Other ASUs not identified above and which are not effective until after September 30, 2016 are not expected to have a material effect on our consolidated financial position, results of operations or cash flows.

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 September 30, 2016, 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 $1.0 million for third quarter 2016 and $2.0 million for third quarter 2015 and 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 $75.0 million of debt outstanding at September 30, 2016, 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 $75.0 million of variable rate debt outstanding at September 30, 2016. 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 borrowings, a hypothetical one-percentage point increase in the LIBOR interest rate would increase our annual interest expense by $750,000.

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 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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PART II
OTHER INFORMATION

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 September 30, 2016, the Company had purchased 3,287,291 shares pursuant to this authorization and had 4,712,709 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.

No shares of common stock were repurchased during the third quarter 2016 by either the Company or any “affiliated purchaser,” as defined by Rule 10b-18 of the Exchange Act.

Item 6. Exhibits.

Exhibit No.	Exhibit	Incorporated by Reference to:
3(i)	Restated Articles of Incorporation of Werner Enterprises, Inc.	Exhibit 3(i) to the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2007
3(ii)	Revised and Restated By-Laws of Werner Enterprises, Inc.	Exhibit 3.1 to the Company's Current Report on Form 8-K dated May 10, 2016
11	Statement Re: Computation of Per Share Earnings	See Note 5 (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 September 30, 2016
31.1	Certification of the Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 (Section 302 of the Sarbanes-Oxley Act of 2002)	Filed herewith
31.2	Certification of the Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934 (Section 302 of the Sarbanes-Oxley Act of 2002)	Filed herewith
32.1	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)	Furnished herewith
32.2	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350 (Section 906 of the Sarbanes-Oxley Act of 2002)	Furnished herewith
101.INS	XBRL Instance Document	Filed herewith
101.SCH	XBRL Taxonomy Extension Schema Document	Filed herewith
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	Filed herewith
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	Filed herewith
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	Filed herewith
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	Filed herewith

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

WERNER ENTERPRISES, INC.

Date: November 1, 2016	By:	/s/ John J. Steele John J. Steele Executive Vice President, Treasurer and Chief Financial Officer
Date: November 1, 2016	By:	/s/ James L. Johnson James L. Johnson Executive Vice President, Chief Accounting Officer and Corporate Secretary

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