Echo Global Logistics, Inc.
Form 10-Q
November 01, 2013
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2013

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 001-34470

ECHO GLOBAL LOGISTICS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	20-5001120 (I.R.S. Employer Identification No.)

600 West Chicago Avenue
Suite 725
Chicago, Illinois 60654
Phone: (800) 354-7993
(Address (including zip code) and telephone number (including area code) of registrant's principal executive offices)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes: x No: o

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

Indicate by check mark whether the Registrant is an a large accelerated filer, an accelerated filer, or non-accelerated filer. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer: o Accelerated filer: x Non-accelerated filer: o Smaller reporting company o

(Do not check if a smaller
reporting company)

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

As of October 31, 2013, the Registrant had 23,468,507 shares of Common Stock, par value $0.0001 per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Echo Global Logistics, Inc.
Consolidated Statements of Income
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
REVENUE	$234,842,526	$192,737,761	$662,870,833	$546,537,567
COSTS AND EXPENSES:				
Transportation costs	194,259,277	156,145,239	544,176,331	442,475,163
Selling, general, and administrative expenses	30,810,112	30,468,339	92,097,832	82,815,184
Depreciation and amortization	2,660,755	2,264,608	7,868,534	6,480,261
INCOME FROM OPERATIONS	7,112,382	3,859,575	18,728,136	14,766,959
Interest income	—	—	—	2,850
Interest expense	(185)	(1,736)	(1,357)	(8,290)
Other expense	(75,143)	(120,121)	(274,917)	(354,391)
OTHER EXPENSE, NET	(75,328)	(121,857)	(276,274)	(359,831)
INCOME BEFORE PROVISION FOR INCOME TAXES	7,037,054	3,737,718	18,451,862	14,407,128
INCOME TAX EXPENSE	(2,674,729)	(1,451,412)	(6,990,288)	(5,406,198)
NET INCOME	$4,362,325	$2,286,306	$11,461,574	$9,000,930
Basic net income per share	$0.19	$0.10	$0.50	$0.40
Diluted net income per share	$0.19	$0.10	$0.49	$0.39

See accompanying notes.

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Echo Global Logistics, Inc.
Consolidated Balance Sheets

	September 30, 2013 (Unaudited)	December 31, 2012
Assets		
Current assets:		
Cash and cash equivalents	$53,340,621	$41,780,984
Accounts receivable, net of allowance for doubtful accounts of $2,427,744 and $2,745,419 at September 30, 2013 and December 31, 2012, respectively	114,819,705	96,623,553
Income taxes receivable	—	703,590
Prepaid expenses	233,708	2,491,955
Deferred income taxes	1,291,321	—
Other current assets	116,592	139,419
Total current assets	169,801,947	141,739,501
Property and equipment, net	15,351,597	13,491,006
Intangible assets:		
Goodwill	51,650,060	51,073,903
Intangible assets, net of accumulated amortization of $10,539,365 and $8,749,057 at September 30, 2013 and December 31, 2012, respectively	11,228,614	13,018,922
Other assets	230,253	159,732
Total assets	$248,262,471	$219,483,064
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	$71,762,231	$58,889,437
Current maturities of capital lease obligations	—	24,086
Due to seller-short term	4,543,455	5,070,612
Accrued expenses	7,576,570	7,004,033
Income tax payable	772,445	—
Deferred income taxes	—	13,602
Total current liabilities	84,654,701	71,001,770
Due to seller-long term	4,535,490	5,593,639
Deferred income taxes	3,260,118	1,902,245
Total liabilities	92,450,309	78,497,654
Stockholders' equity:		
Common stock, par value $0.0001 per share, 100,000,000 shares authorized, 22,896,849 and 22,694,836 shares were issued and outstanding at September 30, 2013 and December 31, 2012, respectively	2,290	2,270
Additional paid-in capital	106,154,974	102,789,816
Retained earnings	49,654,898	38,193,324
Total stockholders' equity	155,812,162	140,985,410
Total liabilities and stockholders' equity	$248,262,471	$219,483,064

See accompanying notes.

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Echo Global Logistics, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ended September 30,	
	2013	2012
Operating activities		
Net income	$11,461,574	$9,000,930
Adjustments to reconcile net income to net cash provided by operating activities:		
Deferred income taxes	13,040	(1,292,800)
Noncash stock compensation expense	2,636,317	2,139,513
Increase (decrease) in contingent consideration due to seller	444,694	(443,520)
Depreciation and amortization	7,868,534	6,480,261
Acquisition related impairment loss	—	2,490,612
Change in assets, net of acquisitions:		
Accounts receivable	(16,112,563)	(11,339,153)
Taxes receivable	1,476,035	1,386,639
Prepaid expenses and other assets	2,228,690	2,293,511
Change in liabilities, net of acquisitions:		
Accounts payable	11,153,355	629,156
Accrued expenses and other	572,329	1,700,556
Net cash provided by operating activities	21,742,005	13,045,705
Investing activities		
Purchases of property and equipment	(6,938,817)	(6,833,816)
Payments for acquisitions, net of cash acquired	(1,958,236)	(3,601,483)
Net cash used in investing activities	(8,897,053)	(10,435,299)
Financing activities		
Principal payments on capital lease obligations	(24,086)	(155,849)
Tax benefit of stock options exercised	455,553	360,443
Payment of contingent consideration	(2,030,000)	(2,882,500)
Issuance of shares, net of issuance costs	1,121,200	1,420,560
Employee tax withholdings related to net share settlements of equity-based awards	(807,982)	(192,736)
Net cash used in financing activities	(1,285,315)	(1,450,082)
Increase in cash and cash equivalents	11,559,637	1,160,324
Cash and cash equivalents, beginning of period	41,780,984	47,007,309
Cash and cash equivalents, end of period	$53,340,621	$48,167,633
Supplemental disclosure of cash flow information		
Cash paid during the period for interest	$1,357	$8,290
Cash paid during the period for income taxes	5,031,472	5,092,160
Non-cash financing activity		
Vesting of restricted shares	—	37,850
Due to seller	—	631,914

See accompanying notes.

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Echo Global Logistics, Inc.
Consolidated Statement of Stockholders' Equity
Nine Months Ended September 30, 2013
(Unaudited)

	Common Stock		Additional		
	Shares	Amount	Paid-In Capital	Retained Earnings	Total
Balance at December 31, 2012	22,694,836	$2,270	$102,789,816	$38,193,324	$140,985,410
Share compensation expense	—	—	2,636,317	—	2,636,317
Exercise of stock options	112,110	11	1,121,189	—	1,121,200
Common stock issued for vested restricted stock	132,436	13	(13)	—	—
Common shares withheld and retired to satisfy employee tax withholding obligations upon vesting of restricted stock	(42,533)	(4)	(807,978)	—	(807,982)
Tax benefit from exercise of stock options	—	—	415,643	—	415,643
Net income	—	—	—	11,461,574	11,461,574
Balance at September 30, 2013	22,896,849	$2,290	$106,154,974	$49,654,898	$155,812,162

See accompanying notes.

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Echo Global Logistics, Inc. and Subsidiaries
Notes to Unaudited Consolidated Financial Statements
Nine Months Ended September 30, 2013 and 2012

1. Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements include the accounts of Echo Global Logistics, Inc. and its subsidiaries (the "Company"). All significant intercompany accounts and transactions have been eliminated in the consolidation. The consolidated statements of income include the results of entities or assets acquired from the effective date of the acquisition for accounting purposes.

The preparation of the consolidated financial statements is in conformity with the rules and regulations of the Securities and Exchange Commission ("SEC") and accounting principles generally accepted in the United States ("U.S. GAAP") for interim financial information. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules or regulations. In the opinion of management, the accompanying unaudited financial statements reflect all adjustments considered necessary for a fair presentation of the results for the period and those adjustments are of a normal recurring nature. The operating results for the nine month period ended September 30, 2013 are not necessarily indicative of the results expected for the full year of 2013. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's most recent audited financial statements.

Preparation of Financial Statements and Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results can differ from those estimates.

Fair Value of Financial Instruments

The carrying values of the Company's financial investments, which consist of cash and cash equivalents, accounts receivable, accounts payable and capital lease obligations, approximate their fair values due to their short term nature. The fair value of the contingent consideration obligation is determined based on the likelihood of contingent earn-out payments.

2. New Accounting Pronouncements

In February 2013, the Financial Accounting Standards Board ("FASB") issued an update to the authoritative guidance which requires disclosure information about the amounts reclassified out of accumulated other comprehensive income. This update does not apply to the Company since there are no items of other comprehensive income in any period presented.

In July 2013, the FASB issued authoritative guidance under Accounting Standard Update ("ASU") 2013-11, which provides guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss (“NOL”) carryforward, a similar tax loss, or a tax credit carryforward exists. ASU 2013-11 requires entities to present an unrecognized tax benefit as a reduction of a deferred tax asset for a NOL or tax credit carryforward whenever the

NOL or tax credit carryforward would be available to reduce the additional taxable income or tax due if the tax position is disallowed. This accounting standard update requires entities to assess whether to net the unrecognized tax benefit with a deferred tax asset as of the reporting date. ASU 2013-11 will be effective for the Company's first quarter of fiscal 2014. The Company is currently evaluating the impact of this accounting standard update on its consolidated financial statements.

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Echo Global Logistics, Inc. and Subsidiaries
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Nine Months Ended September 30, 2013 and 2012

3. Acquisitions

2013 Acquisitions

Open Mile, Inc.

Effective March 11, 2013, the Company acquired Open Mile, Inc. ("Open Mile"), a truckload transportation brokerage with offices in Boston, Massachusetts, and the results of Open Mile have been included in the unaudited consolidated financial statements since that date. The Company agreed to purchase the assets and assume certain liabilities of Open Mile for $2,025,000 in cash. There is no contingent consideration associated with the purchase of Open Mile. As a result of the acquisition, the Company recorded $579,972 of goodwill, which is approximately the amount of goodwill deductible for U.S. income tax purposes. Pro forma results of the acquisition were not presented as they are not material to the financial statements.

4. Fair Value Measurement

The Company applies ASC Topic 820 "Fair Value Measurements and Disclosures" ("ASC Topic 820") for its financial assets and financial liabilities. The guidance requires disclosures about assets and liabilities measured at fair value. The Company's financial assets primarily consist of financial liabilities primarily related to contingent earn-out payments of $9,078,945. The potential earn-out payments and performance measures are defined in the individual purchase agreement for each acquisition. EBITDA is the performance target defined and measured to determine the earn-out payment due, if any, after each defined measurement period.

ASC Topic 820 includes a fair value hierarchy that is intended to increase consistency and comparability in fair value measurements and related disclosures. The fair value hierarchy is based on observable or unobservable inputs to valuation techniques that are used to measure fair value. Observable inputs reflect assumptions market participants would use in pricing an asset or liability based on market data obtained from independent sources while unobservable inputs reflect a reporting entity's pricing based upon its own market assumptions. The fair value hierarchy consists of the following three levels:

- Level 1: Inputs are quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs are quoted prices for similar assets or liabilities in an active market, quoted prices for identical or similar assets or liabilities in markets that are not active, and inputs other than quoted prices that are observable and market-corroborated inputs, which are derived principally from or corroborated by observable market data.
- Level 3: Inputs that are derived from valuation techniques in which one or more significant inputs or value drivers are unobservable.

The significant inputs used to derive the fair value of the contingent consideration obligation include financial forecasts of future operating results, the probability of reaching the forecast and an appropriate discount rate for each contingent liability. The probability of paying the contingent consideration ranges from 5% to 55%, with discount rates used in determining the fair value of the contingent consideration ranging between 6% and 15%. Historical results of the respective acquisitions serve as the basis for the financial forecasts used in the valuation. Quantitative factors are also considered in these forecasts, including acquisition synergies, growth and sales potential and potential operational efficiencies gained. Changes to the significant inputs used in determining the fair value of the contingent consideration could result in a change in the fair value of the contingent consideration. However, the correlation and inverse relationship between higher projected financial results to the discount rate applied and probability of meeting the financial targets mitigates the effect of any changes to the unobservable inputs.

The following table sets forth the Company's financial liabilities measured at fair value on a recurring basis and the basis of measurement at September 30, 2013 and December 31, 2012:

	Fair Value Measurements as of September 30, 2013			
	Total	Level 1	Level 2	Level 3
Liabilities:				
Contingent consideration obligation	$(9,078,945)	$—	$—	$(9,078,945)

	Fair Value Measurements as of December 31, 2012			
	Total	Level 1	Level 2	Level 3
Liabilities:				
Contingent consideration obligation	$(10,664,251)	$—	$—	$(10,664,251)

The following table provides a reconciliation of the beginning and ending balances for the liabilities measured at fair value using significant unobservable inputs (Level 3):

	Due to Seller
Balance at December 31, 2012	$(10,664,251)
Change in fair value	(444,694)
Payment of contingent consideration	2,030,000
Balance at September 30, 2013	$(9,078,945)

For the nine month period ended September 30, 2013, the Company recorded an adjustment to each of the ten remaining contingent consideration obligations related to our acquisitions. The adjustments were the result of adjusting for the time value of money and using revised forecasts and updated fair value measurements that adjusted the Company's estimated earn-out payments related to the purchases of these businesses.

For the nine month periods ended September 30, 2013 and 2012, the Company recognized a charge of $444,694 and a benefit of $443,520, respectively, in selling, general, and administrative expenses in the consolidated statement of income due to the change in fair value measurements using a level three valuation technique.

For the nine month period ended September 30, 2013, the Company paid $2,030,000 in contingent earn-out payments. The Company paid the former owners of Lubenow Logistics LLC ("Lubenow"), Freight Management Inc. ("FMI"), Freight Lanes International Inc. ("FLI") and Advantage Transport, Inc. ("Advantage"), $280,000, $520,000, $305,000 and $925,000, respectively, as the EBITDA targets set forth in the purchase agreement had been met. For the nine month period ended September 30, 2012, the Company paid $2,882,500 in contingent earn-out payments. The Company paid the former owners of Resource Group Associates ("RGA"), Distribution Services Inc. ("DSI"), Nationwide Traffic Services, LLC ("Nationwide"), Lubenow, FMI and Advantage $200,000, $520,000, $437,500, $280,000, $520,000 and $925,000, respectively, as the EBITDA targets set forth in the purchase agreement had been met.

5. Intangible Assets

The following is a roll-forward of goodwill from December 31, 2012 to September 30, 2013:

Balance as of December 31, 2012	$51,073,903
Adjustment to goodwill related to prior acquisitions	(3,815)
Goodwill acquired related to the purchase of Open Mile	579,972
Balance as of September 30, 2013	$51,650,060

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The following is a summary of amortizable intangible assets as of September 30, 2013 and December 31, 2012:

	September 30, 2013	December 31, 2012	Weighted-Average Life
Customer relationships	$21,438,979	$21,438,979	8.6 years
Noncompete agreements	139,000	139,000	2.9 years
Trade names	190,000	190,000	3.0 years
	21,767,979	21,767,979	8.5 years
Less accumulated amortization	(10,539,365)	(8,749,057)	
Intangible assets, net	$11,228,614	$13,018,922	

Amortization expense related to intangible assets was $1,790,308 and $1,457,316 for the nine months ended September 30, 2013 and 2012, respectively.

The estimated amortization expense for the next five years and thereafter is as follows:

Remainder of 2013	$581,368
2014	2,033,737
2015	1,784,218
2016	1,432,832
2017	1,160,975
Thereafter	4,235,484
	$11,228,614

6. Accrued Expenses

The components of accrued expenses at September 30, 2013 and December 31, 2012 are as follows:

	September 30, 2013	December 31, 2012
Accrued compensation	$1,867,102	$2,258,566
Accrued rebates	2,463,771	1,902,436
Deferred rent	1,825,994	1,153,376
Other	1,419,703	1,689,655
Total accrued expenses	$7,576,570	$7,004,033

7. Income Taxes

The following table shows the Company's effective income tax rate for the three and nine months ended September 30, 2013 and 2012:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Income before provision for income taxes	$7,037,054	$3,737,718	$18,451,862	$14,407,128
Income tax expense	(2,674,729)	(1,451,412)	(6,990,288)	(5,406,198)
Effective tax rate	38.0%	38.8%	37.9%	37.5%

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8. Earnings Per Share

Basic earnings per common share is calculated by dividing net income available to common stockholders by the weighted average number of common shares outstanding. Diluted earnings per share is calculated by dividing net income by the weighted average shares outstanding plus share equivalents that would arise from the exercise of stock options and the vesting of restricted stock. There were no employee stock options excluded from the calculation of diluted earnings per share for the nine month periods ended September 30, 2013 and 2012. The computation of basic and diluted earnings per common share for the three and nine month periods ended September 30, 2013 and 2012 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Numerator:				
Net income	$4,362,325	$2,286,306	$11,461,574	$9,000,930
Denominator:				
Denominator for basic earnings per share-weighted-average shares	22,888,907	22,383,168	22,847,574	22,272,952
Effect of dilutive securities:				
Employee stock options	572,050	512,106	504,820	548,994
Denominator for dilutive earnings per share	23,460,957	22,895,274	23,352,394	22,821,946
Basic net income per common share	$0.19	$0.10	$0.50	$0.40
Diluted net income per common share	$0.19	$0.10	$0.49	$0.39

9. Stock-Based Compensation Plans

Using the Black-Scholes-Merton option valuation model and the assumptions listed below, the Company recorded $769,727 and $2,636,317 in compensation expense related to stock-based compensation, with corresponding tax benefits of $300,194 and $1,028,164 for the three and nine month periods ended September 30, 2013, respectively. For the three and nine month periods ended September 30, 2012, the Company recorded $600,710 and $2,139,513 in compensation expense with corresponding tax benefits of $234,277 and $834,410, respectively. For the nine month period ended September 30, 2013, the Company granted 3,000 stock options to one employee. During the nine month period ended September 30, 2012, the Company did not grant any stock options. The Company granted 125,863 and 454,487 shares of restricted stock to various employees during the nine month periods ended September 30, 2013 and September 30, 2012, respectively. In 2013, the Company initiated a performance stock incentive plan for certain executives that is based on specific financial performance measurements. The Company granted 34,328 shares of performance stock during the nine