

RYDER SYSTEM INC
Form 10-K
February 14, 2017

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

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

For the fiscal year ended December 31, 2016

OR

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

For the transition period from _____ to _____

Commission File Number: 1-4364

RYDER SYSTEM, INC.

(Exact name of registrant as specified in its charter)

Florida

(State or other jurisdiction of incorporation or organization)

11690 N.W. 105th Street,

Miami, Florida 33178

(Address of principal executive offices, including zip code)

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

Title of each class

Ryder System, Inc. Common Stock (\$0.50 par value)

Securities registered pursuant to Section 12(g) of the Act: None

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES NO

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark 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 the 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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant computed by reference to the price at which the common equity was sold at June 30, 2016 was \$3,202,591,552. The number of shares of Ryder System, Inc. Common Stock (\$0.50 par value per share) outstanding at January 31, 2017 was 53,464,988.

Documents Incorporated by Reference into this Report Part of Form 10-K into which Document is Incorporated

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FORM 10-K ANNUAL REPORT
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PART I

ITEM 1. BUSINESS

OVERVIEW

Ryder System, Inc. (Ryder) is a global leader in transportation and supply chain management solutions. Our operating segments are aggregated into reportable business segments based upon similar economic characteristics, products, services, customers and delivery methods. We are reporting our financial performance based on three business segments: (1) Fleet Management Solutions (FMS), which provides full service leasing, commercial rental, contract maintenance, and contract-related maintenance of trucks, tractors and trailers to customers principally in the U.S., Canada and the U.K.; (2) DTS, which provides vehicles and drivers as part of a dedicated transportation solution in the U.S.; and (3) SCS, which provides comprehensive supply chain solutions including distribution and transportation services in North America and Asia. Dedicated transportation services provided as part of an integrated, multi-service, supply chain solution to SCS customers are reported in the SCS business segment.

In May of 2016, we expanded our full service lease product line to provide lease customers flexibility, choice and control in fleet management. Therefore, we have renamed the lease product to ChoiceLease. Our ChoiceLease product line is a scalable lease model, which allows customers to select the terms of their lease alongside the level of maintenance they prefer, from full service or total bumper-to-bumper coverage to on demand or pay-as-you-go maintenance. We also renamed our contract maintenance product to SelectCare. Beginning in 2017, FMS will report using these new product names. In addition, the historical Contract-Related Maintenance product will be included in SelectCare.

For financial information and other information relating to each of our business segments and about our geographic areas, see Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," of this report and Note 27, "Segment Reporting," in the Notes to Consolidated Financial Statements.

MISSION AND STRATEGY

Ryder's mission is to provide innovative fleet management and supply chain solutions that are reliable, safe and efficient, enabling our customers to deliver on their promises. We seek to deliver valuable solutions that will compel customers to outsource their fleet management and supply chain needs to us. Our strategy is to grow our fleet management and supply chain outsourcing services by targeting private fleets not currently outsourcing their fleet-related services (FMS and DTS) and key industries (SCS) with innovative solutions, operational excellence, best in class talent and information technology. This strategy is supported by:

- offering innovative products, solutions and support services that will create and strengthen customer relationships;
- delivering operational excellence through continuous productivity and process improvements;
- attracting, developing and retaining the best talent
- deploying technology that will enable growth while improving operational efficiencies.

INDUSTRY AND OPERATIONS

Fleet

Management

Solutions

Value Proposition

Through our FMS business, we provide our customers with a variety of fleet solutions that are designed to improve their competitive position. By outsourcing these services to us, our customers can focus on their core business, improve their efficiency and productivity, and lower their costs. Our FMS product offering is comprised of longer-term full service leasing as well as leasing with flexible maintenance options; shorter-term commercial truck rental; contract maintenance services; flexible maintenance services; and value-added fleet support services such as insurance, vehicle administration and fuel services. In addition, we provide our customers the ability to purchase a large selection of used trucks, tractors and trailers through our used vehicle sales program.

Market Trends

The U.S. commercial fleet market is estimated to include 8.2 million vehicles⁽¹⁾ of which 4.2 million vehicles are with privately held companies, 1.5 million vehicles⁽²⁾ are with for-hire carriers, 0.5 million vehicles are leased from banks or other financial institutions and 0.8 million vehicles are in the lease and rental market. The 4.2 million vehicles privately owned by companies provide all or a portion of the transportation services for themselves rather than outsourcing those services to third parties such as Ryder. Several trends have been increasing the need for outsourcing: increased demand for efficiency and reliability; increased complexity and cost of buying and maintaining vehicles including technology, diagnostics, and training; labor issues including a shortage of qualified truck drivers and mechanics; as well as increased regulation and enforcement of safety requirements. Because of these trends, we believe the privately held fleets and the for-hire carriers will increasingly decide to outsource. Ryder also targets customers who are already outsourcing with other providers.

Similar trends apply to outsourcing in Canada, and the Canadian commercial fleet is estimated at 500,000 vehicles, of which approximately 17,000 are in the lease and rental market⁽³⁾. In the U.K., the commercial rental and lease market is estimated at 225,000 units⁽⁴⁾. The total lease and rental market in Ryder's major markets totals over 1 million units. However, due to general trends and the trends in market sub-segments described above, combined with our success in converting owners to outsourcing, the total market potential for Ryder is significantly higher.

Over the last several years, many key trends have been reshaping the transportation industry. We strongly believe these trends increase the value of our product offering. Because of increased demand for efficiency and reliability, companies that own and manage their own fleet of vehicles have put greater emphasis on the quality of their preventive maintenance and safety programs. The maintenance and operation of commercial vehicles has become more complicated and expensive, requiring companies to spend a significant amount of time and money to keep up with new technology, diagnostics, retooling and training. Increased regulation and active enforcement efforts by federal and state governments require more stringent and costly operational processes and oversight. Fluctuating energy prices and alternative fuel technologies make it difficult for businesses to predict and manage fleet costs.

Operations

For the year ended December 31, 2016, our global FMS business accounted for 61% of our consolidated revenue. U.S. Ryder was founded in the U.S. in 1933. Our FMS customers in the U.S. range from small businesses to large national enterprises operating in a wide variety of industries, the most significant of which are food and beverage, transportation and warehousing, housing, business and personal services, and industrial. At December 31, 2016, we had 529 operating locations, excluding ancillary storage locations, in 50 states and Puerto Rico. A location consists of a maintenance facility or "shop". Our maintenance facilities typically include a shop for preventive maintenance and repairs, a service island for fueling, safety inspections and preliminary maintenance checks, offices for sales and other personnel, and in many cases, a commercial rental vehicle counter. We also operate on-site at 167 customer locations, which primarily provide vehicle maintenance.

Canada. We have been operating in Canada for over 50 years. At December 31, 2016, we had 36 operating locations throughout 9 Canadian provinces. We also operated 14 maintenance facilities on-site at customer properties in Canada.

Europe. We began operating in the U.K. in 1971. At December 31, 2016, we had 63 operating locations primarily throughout the U.K. We also managed a network of 453 independent maintenance facilities in the U.K. to serve our customers when it is more effective than providing the service in a Ryder location. In addition to our typical FMS operations, we supply and manage vehicles, equipment and personnel for military organizations in the U.K. and Germany.

(1) U.S. Fleet as of June 2016, Class 3-8, IHS Markit Ltd. (formerly RL Polk)

(2) U.S. Fleet as of June 2016, Class 3-8, IHS Markit Ltd. (formerly RL Polk)

(3) Canada Outsourced Fleet Market as of September 2016, Class 3-8, IHS Markit Ltd. (formerly RL Polk)

(4) U.K. Lease and Rental HGV Market, Projection for December 2016, Source: The Society of Motor Manufacturers & Traders (SMMT) 2010 & Ryder Internal Estimates

FMS Product Offerings

Full Service Leasing. Our full service leases as well as leases with flexible maintenance options provide customers with vehicles, maintenance services, supplies, and related equipment necessary for operation of the vehicles while our customers furnish and supervise their own drivers and dispatch and exercise control over the vehicles. Our lease customers receive the following benefits:

We are able to leverage our vehicle buying power for the benefit of our customers because we purchase a large number of vehicles from a limited number of manufacturers. Once we have signed an agreement with the customer, we acquire vehicles and components that are custom engineered to the customer's requirements and lease the vehicles to the customer for periods generally ranging from three to seven years for trucks and tractors and typically ten years for trailers.

We provide full service lease customers with complete maintenance program designed to reduce vehicle downtime through a preventive maintenance plan that is based on vehicle type and time or mileage intervals. Alternatively, we offer flexible maintenance options to our customers designed to provide them with choices on their preferred level of maintenance. Given our continued focus on improving the efficiency and effectiveness of our maintenance services, particularly in light of changing technology and increased regulation, we provide our lease customers with a cost effective alternative to maintaining their own fleet of vehicles and the flexibility to choose the maintenance program that works for them. Beginning in 2016 customer's maintenance options include, full service, preventive and on demand.

Our customers have access to our extensive network of maintenance facilities and trained technicians for maintenance, vehicle repairs, 24-hour emergency roadside service, and replacement vehicles for vehicles that are temporarily out of service.

We typically retain vehicle residual risk exposure.

Customers have an opportunity to enhance their standard lease with additional fleet support services including our fuel and related services as described below; liability insurance coverage under our existing insurance policies and related insurance services; safety services including safety training, driver certification and loss prevention consulting; vehicle use and other tax reporting, permitting and licensing, and regulatory compliance (including hours of service administration); environmental services; and access to RydeSmart[®], a full-featured GPS fleet location, tracking, and vehicle performance management system and to Ryder FleetCARESM, our web-based tool that provides customers with 24/7 access to key operational and maintenance management information about their fleets.

For the year ended December 31, 2016, full service lease revenue accounted for 56% of our FMS total revenue.

Beginning in 2017, FMS will report this product as ChoiceLease.

Commercial Rental. We target rental customers that have a need to supplement their private fleet of vehicles on a short-term basis (one day up to one year in length), either because of seasonal increases in their business or discrete projects that require additional transportation resources. Lease customers utilize our commercial rental fleet to handle their peak or seasonal business needs. Although a portion of our commercial rental business is purely occasional in nature, we focus on building long-term relationships with customers so that we become their preferred source for commercial vehicle rentals. Our rental representatives assist in selecting a vehicle that satisfies a customer's needs and supervise the rental process, which includes execution of a rental agreement and a vehicle inspection. In addition to vehicle rental, we may extend liability insurance coverage under our existing policies to our rental customers as well as the benefits of cost savings and convenience of our comprehensive fuel services program. For the year ended December 31, 2016, commercial rental revenue accounted for 19% of our FMS total revenue.

Contract Maintenance. Through our contract maintenance product line, we provide maintenance services to customers who do not choose to lease vehicles from us. Our contract maintenance customers commit to utilizing our extensive network of maintenance facilities and trained technicians to maintain the vehicles they own or lease from third parties. We can also customize the services to include ancillary maintenance and/or fleet support services. Vehicles covered under this offering are typically serviced at our own facilities. However, based on the size and complexity of a customer's fleet, we may operate an on-site maintenance facility at the customer's location. For the year ended December 31, 2016, contract maintenance revenue accounted for 4% of our FMS total revenue. Beginning in 2017, FMS will report this product as SelectCare and it will include Contract-Related Maintenance.

The following table provides information regarding the number of vehicles and customers by FMS product offering at December 31, 2016:

	U.S.		Foreign		Total	
	Vehicles	Customers	Vehicles	Customers	Vehicles	Customers
Full service leasing	112,300	11,200	24,200	2,700	136,500	13,900
Commercial rental ⁽¹⁾	30,600	32,100	7,200	5,900	37,800	38,000
Contract maintenance ⁽²⁾	43,100	1,500	5,900	400	49,000	1,900

(1) Commercial rental customers include customers who rented a vehicle for more than 3 days during the year and includes approximately 8,100 lease customers

(2) Contract maintenance customers include approximately 970 lease customers

Contract-Related Maintenance. Our lease and contract maintenance customers periodically require additional maintenance and repair services that are not included in their lease or contract maintenance contracts. For example, additional maintenance and repair services may arise when a customer damages a leased vehicle. In addition, because of our existing relationships with the customer, we may provide service on their owned vehicles and charge the customer on an hourly basis for work performed. By servicing all of our customers' maintenance needs, we create stronger, long-term relationships and have greater opportunity to provide customers with a wide range of outsourcing solutions. For the year ended December 31, 2016, contract-related maintenance revenue accounted for 5% of our FMS total revenue. Beginning in 2017, FMS will report this product within the newly named SelectCare product. More recently, we have contracted with large private fleet operators and for-hire carriers to provide maintenance on demand, particularly in geographic areas where these customers do not have their own maintenance operations. The contract for on-demand maintenance services is based on a maintenance program that is designed to meet the customers' specific needs and all maintenance is performed only when and as requested by the customer. This product allows us to expand our customer base to include customers that have traditionally chosen to own and maintain their fleet of vehicles.

Fuel Services. We provide our FMS customers with access to diesel fuel at competitive prices at over 450 of our maintenance facilities across the United States and Canada. We also provide fuel services such as fuel planning, fuel tax reporting, centralized billing, fuel cards and fuel monitoring. Although fuel sales do not have a significant impact on our FMS earnings, as it is largely a pass-through cost to customers, we believe allowing customers to leverage our fuel buying power is a significant and valuable benefit to our customers. For the year ended December 31, 2016, fuel services revenue accounted for 13% of our FMS total revenue.

Used Vehicles. We primarily sell our used vehicles at one of our 59 retail sales centers throughout North America (18 of which are co-located at an FMS shop), at our branch locations or through our website at www.Usedtrucks.Ryder.com. Typically, before we offer used vehicles for sale, our technicians ensure that the vehicles are Road Ready[®], which means that they have passed a comprehensive, multi-point performance inspection based on specifications formulated through our maintenance program. Our retail sales centers throughout North America allow us to leverage our maintenance expertise and strong brand reputation to realize higher sales proceeds than in the wholesale market. Given our focus on maximizing sales proceeds, we generally sell our used vehicles through retail centers for prices in excess of book value. However, the extent to which we are able to realize a gain on the sale of used vehicles is dependent upon various other factors, including the general state of the used vehicle market, the supply and demand for used commercial vehicles in retail and wholesale markets, the age and condition of the vehicle at the time of its disposal and vehicle depreciation rates.

FMS Business Strategy

Our FMS business strategy is to be the leading provider of fleet management outsourcing services for light, medium and heavy duty vehicles. Our strategy will be achieved if we focus on the following goals and priorities:

Drive profitable fleet growth by (1) successfully implementing sales and marketing initiatives designed to compel private fleet operators and for-hire carriers to outsource all or some portion of their fleet management needs to us; (2) offering innovative products, solutions and support services that will create and strengthen new and existing customer

relationships; and (3) completing targeted acquisitions;

• Deliver a consistent, industry-leading and cost-effective maintenance program to our customers through continued process improvement and re-design, productivity initiatives and technology improvements; and

• Optimize asset utilization and management, particularly with respect to our rental fleet, used vehicle operations and maintenance facility infrastructure.

Successfully driving our fleet growth strategy will require significant capital investments in full service lease and commercial rental vehicles. As a result, during periods of significant growth, our free cash flow may be negative.

Competition

As an alternative to using our fleet management services, most companies choose to provide these services for themselves, although some may choose to obtain similar or alternative services from other third-party vendors. Our FMS business segment competes with companies providing similar services on a national, regional and local level. Many regional and local competitors provide services on a national level through their participation in various cooperative programs. Competitive factors include price, equipment, maintenance, service and geographic coverage. We compete with finance lessors, truck and trailer manufacturers and independent dealers who provide full service lease products, finance leases, extended warranty maintenance, rental and other transportation services. With the growth of our on-demand maintenance product, we will also face competition from managed maintenance providers who are hired to coordinate and manage the maintenance of large fleets of vehicles through a network of third-party maintenance providers. Value-added differentiation of the full service leasing, maintenance and commercial rental services, as well as continued commitment to offer innovative products and solutions, such as natural gas vehicles, has been and will continue to be our emphasis.

Dedicated

Transportation

Solutions

Value Proposition

Through our DTS business segment, we combine the equipment, maintenance and administrative services of a full service lease with drivers and additional services to provide a customer with a dedicated transportation solution that is designed to increase their competitive position, improve risk management and integrate their transportation needs with their overall supply chain. Such additional services include routing and scheduling, fleet sizing, safety, regulatory compliance, risk management, technology and communication systems support, including on-board computers and other technical support. These additional services allow us to address, on behalf of our customers, labor challenges associated with maintaining a private fleet of vehicles, such as driver recruitment and retention, government regulation, including hours of service regulations, DOT audits and workers' compensation. Our DTS solution offers a high degree of specialization to meet the needs of customers with sophisticated service requirements such as tight delivery windows, high-value or time-sensitive freight, closed-loop distribution, multi-stop shipments, specialized equipment and integrated transportation needs.

Market Trends

The U.S. dedicated contract carriage market is estimated to be \$14 billion⁽¹⁾. This market is affected by many of the same trends that impact our FMS business, including the tightening of capacity in the current U.S. trucking market. The administrative requirements relating to regulations issued by the Department of Transportation (DOT) regarding driver screening, training and testing, as well as record keeping and other costs associated with the hours of service requirements, make our DTS product an attractive alternative to private fleet and driver management. This has become even more significant in light of Compliance, Safety, Accountability (CSA) regulatory changes made effective in 2010. The CSA regulatory changes have also put pressure on the availability of qualified truck drivers, which supply continues to lag market need. In addition, market demand for just-in-time delivery creates a need for well-defined routing and scheduling plans that are based on comprehensive asset utilization analysis and fleet rationalization studies offered as part of our DTS services.

Operations/Product Offerings

For the year ended December 31, 2016, our global DTS business accounted for 15% of our consolidated revenue. At December 31, 2016, we had 200 DTS customer accounts in the U.S. Because it is highly customized, our DTS product is particularly attractive to companies that operate in industries that have time-sensitive deliveries or special handling requirements, as well as companies who require specialized equipment. Because DTS accounts typically operate in a limited geographic area, most of the drivers assigned to these accounts are short haul drivers, meaning they return home at the end of each work day. Although a significant portion of our DTS operations are located at customer facilities, our DTS business also utilizes and benefits from our extensive network of FMS facilities.

In order to customize an appropriate DTS transportation solution for our customers, our DTS logistics specialists perform a transportation analysis using advanced logistics planning and operating tools. Based on this analysis, they

formulate a logistics design that includes the routing and scheduling of vehicles, the efficient use of vehicle capacity and overall asset utilization. The goal of each customized plan is to create a distribution system that optimizes freight flow while meeting a customer's service goals. A team of DTS transportation specialists can then implement the plan by leveraging the resources, expertise and technological capabilities of both our FMS and SCS businesses.

⁽¹⁾ Armstrong & Associates Tightened Up - Third-Party Logistics Market Results and Trends for 2016, June 2016

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To the extent a distribution plan includes multiple modes of transportation (air, rail, sea and highway), our DTS team, in conjunction with our SCS transportation specialists, selects appropriate transportation modes and carriers, places the freight, monitors carrier performance and audits billing. In addition, through our SCS business, we can reduce costs and add value to a DTS customer's distribution system by aggregating orders into loads, looking for shipment consolidation opportunities and organizing loads for vehicles that are returning from their destination point back to their point of origin (backhaul).

DTS Business Strategy

Our DTS business strategy is to focus on customers who need specialized equipment, specialized handling or integrated services. This strategy revolves around the following interrelated goals and priorities:

- Increase market share with customers in the energy and utility, metals and mining, retail, construction, healthcare, and food and beverage industries;
- Leverage the support and talent of the FMS sales team in a joint sales program;
- Align the DTS business with other SCS product lines to create revenue opportunities and improve operating efficiencies in both segments; and
- Improve competitiveness in the non-specialized and non-integrated customer segments.

Competition

Our DTS business segment competes with truckload carriers and other dedicated providers servicing on a national, regional and local level. Competitive factors include price, equipment, maintenance, service and geographic coverage and driver and operations expertise. We are able to differentiate the DTS product offering by leveraging FMS and integrating the DTS services with those of SCS to create a more comprehensive transportation solution for our customers. Our strong safety record and focus on customer service enable us to uniquely meet the needs of customers with high-value products that require specialized handling in a manner that differentiates us from truckload carriers.

Supply
Chain
Solutions