

EXPEDITORS INTERNATIONAL OF WASHINGTON INC  
Form 10-Q  
August 09, 2006

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2006

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: 0-13468

**EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.**

(Exact name of registrant as specified in its charter)

**Washington**

(State or other jurisdiction of  
incorporation or organization)

**91-1069248**

(IRS Employer Identification Number)

**1015 Third Avenue, 12th Floor, Seattle, Washington**

(Address of principal executive offices)

**98104**

(Zip Code)

**(206) 674-3400**

(Registrant's telephone number, including area code)

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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 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. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

At August 4, 2006, the number of shares outstanding of the issuer's Common Stock was 213,285,940

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**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIESCondensed Consolidated Balance Sheets  
(In thousands, except share data)  
(Unaudited)

	June 30, 2006	December 31, 2005
<b>Assets</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 454,694	\$ 463,894
Short-term investments	415	123
Accounts receivable, less allowance for doubtful accounts of \$13,397 at June 30, 2006 and \$12,777 at December 31, 2005	751,929	709,331
Deferred Federal and state income taxes	6,679	7,208
Other current assets	28,191	21,405
Total current assets	1,241,908	1,201,961
Property and equipment, less accumulated depreciation and amortization of \$163,939 at June 30, 2006 and \$152,304 at December 31, 2005	444,285	333,787
Goodwill, less accumulated amortization of \$765 at June 30, 2006 and December 31, 2005	7,774	7,774
Other intangibles, net	8,367	8,997
Other assets, net	13,216	13,525
	\$ 1,715,550	\$ 1,566,044
<b>Liabilities and Shareholders Equity</b>		
<b>Current liabilities:</b>		
Accounts payable	529,518	479,546
Accrued expenses, primarily salaries and related costs	128,516	103,674
Federal, state and foreign income taxes	28,754	29,281
Total current liabilities	686,788	612,501
Deferred Federal and state income taxes	29,019	13,278
Minority interest	30,142	13,883
<b>Shareholders equity:</b>		
Preferred stock, par value \$.01 per share Authorized 2,000,000 shares; none issued		
Common stock, par value \$.01 per share Authorized 320,000,000 shares; issued and outstanding 213,258,504 shares at June 30, 2006, and 213,227,042 shares at December 31, 2005	2,133	2,132
Additional paid-in capital	132,120	180,905
Retained earnings	831,090	745,984
Accumulated other comprehensive income	4,258	(2,639)
Total shareholders equity	969,601	926,382

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Commitments and contingencies

	\$	1,715,550	\$	1,566,044
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See accompanying notes to condensed consolidated financial statements.

Certain 2005 amounts have been restated as required by the modified retrospective method in connection with the implementation of SFAS 123R and other amounts have been reclassified to conform to the 2006 presentation.

All share and per share amounts have been adjusted for the 2-for-1 stock split effective June 2006.

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Condensed Consolidated Statements of Earnings  
(In thousands, except share data)

(Unaudited)

	Three months ended June 30, 2006		Six months ended June 30, 2006	
	2005	2005	2005	2005
<b>Revenues:</b>				
Airfreight	\$ 545,273	\$ 421,213	\$ 1,036,271	\$ 794,098
Ocean freight and ocean services	380,280	336,934	724,939	634,078
Customs brokerage and other services	203,771	169,852	392,706	324,987
Total revenues	1,129,324	927,999	2,153,916	1,753,163
<b>Operating expenses:</b>				
Airfreight consolidation	429,976	330,269	810,557	614,707
Ocean freight consolidation	300,780	277,259	571,659	521,229
Customs brokerage and other services	84,998	69,811	161,933	135,884
Salaries and related costs	172,453	145,624	333,427	278,515
Rent and occupancy costs	13,372	13,457	27,095	27,205
Depreciation and amortization	8,626	7,603	16,679	14,942
Selling and promotion	8,957	7,120	16,914	14,666
Other	21,359	18,127	41,448	36,838
Total operating expenses	1,040,521	869,270	1,979,712	1,643,986
Operating income	88,803	58,729	174,204	109,177
Interest expense	(10 )	(219 )	(37 )	(248 )
Interest income	4,390	2,725	8,664	4,872
Other, net	465	874	2,132	2,070
Other income, net	4,845	3,380	10,759	6,694
Earnings before income taxes and minority interest	93,648	62,109	184,963	115,871
Income tax expense	35,503	24,083	72,555	45,745
Net earnings before minority interest	\$ 58,145	\$ 38,026	\$ 112,408	\$ 70,126
Minority interest	(1,816 )	(1,328 )	(3,727 )	(2,382 )
Net earnings	\$ 56,329	\$ 36,698	\$ 108,681	\$ 67,744
Basic earnings per share	\$ .26	\$ .17	\$ .51	\$ .32
Diluted earnings per share	\$ .25	\$ .17	\$ .49	\$ .31
Dividends declared per common share	\$ .11	\$ .075	\$ .11	\$ .075
Weighted average basic shares outstanding	213,725,395	213,552,092	213,574,773	213,504,726
Weighted average diluted shares outstanding	224,374,720	220,901,114	224,051,286	221,160,880

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See accompanying notes to condensed consolidated financial statements.

Certain 2005 amounts have been restated as required by the modified retrospective method in connection with the implementation of SFAS 123R and other amounts have been reclassified to conform to the 2006 presentation.

All share and per share amounts have been adjusted for the 2-for-1 stock split effective June 2006.

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows  
(In thousands)

(Unaudited)

	Three months ended June 30, 2006		Six months ended June 30, 2006	
	2006	2005	2006	2005
<b>Operating activities:</b>				
Net earnings	\$ 56,329	\$ 36,698	\$ 108,681	\$ 67,744
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Provision for losses on accounts receivable	647	(394 )	493	(358 )
Deferred income tax expense	20,790	8,117	33,597	14,902
Excess tax benefits from employee stock plans	(14,973 )	(4,747 )	(21,008 )	(6,322 )
Stock compensation expense	9,418	9,576	17,816	16,684
Depreciation and amortization	8,626	7,603	16,679	14,942
Gain on sale of property and equipment	(68 )	(26 )	(215 )	(45 )
Minority interest in earnings of consolidated entities	1,815	833	4,011	1,670
Other	789	1,220	1,577	293
Changes in operating assets and liabilities:				
Increase in accounts receivable	(49,838 )	(45,318 )	(28,999 )	(1,648 )
Increase in other current assets	(11,394 )	(4,539 )	(6,300 )	(1,746 )
Increase in accounts payable and other current liabilities	33,437	33,183	67,379	30,225
Net cash provided by operating activities	55,578	42,206	193,711	136,341
<b>Investing activities:</b>				
(Increase) decrease in short-term investments	(275 )	631	(283 )	(12 )
Purchase of property and equipment	(100,334 )	(14,175 )	(121,833 )	(43,192 )
Proceeds from sale of property and equipment	87	107	265	249
Other	692	(673 )	486	(1,339 )
Net cash used in investing activities	(99,830 )	(14,110 )	(121,365 )	(44,294 )
<b>Financing activities:</b>				
Proceeds (repayments) of short-term debt, net		43		(2,130 )
Proceeds from issuance of common stock	20,513	8,700	26,020	11,075
Repurchases of common stock	(86,669 )	(35,486 )	(113,628 )	(50,013 )
Excess tax benefits from employee stock plans	14,973	4,747	21,008	6,322
Dividends paid	(23,575 )	(16,055 )	(23,576 )	(16,055 )
Net cash used in financing activities	(74,758 )	(38,051 )	(90,176 )	(50,801 )
Effect of exchange rate changes on cash	6,016	(8,562 )	8,630	(11,356 )
(Decrease) increase in cash and cash equivalents	(112,994 )	(18,517 )	(9,200 )	29,890
Cash and cash equivalents at beginning of period	567,688	457,390	463,894	408,983
Cash and cash equivalents at end of period	\$ 454,694	\$ 438,873	\$ 454,694	\$ 438,873
<b>Interest and taxes paid:</b>				
Interest	\$ 8	\$ 214	\$ 32	\$ 234
Income taxes	30,376	18,444	43,051	28,560

See accompanying notes to condensed consolidated financial statements.

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Certain 2005 amounts have been restated as required by the modified retrospective method in connection with the implementation of SFAS 123R and other amounts have been reclassified to conform to the 2006 presentation.

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

**Note 1. Summary of Significant Accounting Policies**

The attached condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. As a result, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. The Company believes that the disclosures made are adequate to make the information presented not misleading. The condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary to a fair statement of the results for the interim periods presented. These condensed consolidated financial statements should be read in conjunction with the financial statements and related notes included in the Company's Form 10-K as filed with the Securities and Exchange Commission on or about March 16, 2006.

Prior to January 1, 2006, the Company applied APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its stock option and its employee stock purchase rights plans. Accordingly, no compensation cost had been recognized for its fixed stock option or employee stock purchase rights plans.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 123 (Revised 2004), Share-Based Payment (SFAS 123R) using the modified retrospective transition method. Under the modified retrospective method, prior periods may be restated either as of the beginning of the year of adoption or for all periods presented. The Company has elected to restate all periods presented to include compensation expense for all unvested stock options and share awards. Accordingly, salaries and related costs for the three and six-month periods ended June 30, 2005 have been increased to include compensation expense for the fair value of unvested stock options. See Note 6 for further discussion of the impact of the adoption of SFAS 123R on the consolidated balance sheet, the consolidated results of operations, earnings per share and consolidated statement of cash flows.

Certain 2005 amounts have been reclassified to conform to the 2006 presentation.

**Note 2. Comprehensive Income**

Comprehensive income consists of net income and other gains and losses affecting shareholders' equity that, under generally accepted accounting principles in the United States, are excluded from net income. For the Company, these consist of foreign currency translation gains and losses and unrealized gains and losses on securities, net of related income tax effects.

The components of total comprehensive income for interim periods are presented in the following table:

(in thousands)	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net earnings	\$ 56,329	\$ 36,698	\$ 108,681	\$ 67,744
Foreign currency translation adjustments net of tax of: \$(2,586) and \$4,125 for the 3 months ended June 30, 2006 and 2005, and \$(3,732) and \$6,252 for the 6 months ended June 30, 2006 and 2005.	4,802	(7,660)	6,930	(11,611)
Unrealized loss on securities net of tax of \$9 and \$10 for the 3 months ended June 30, 2006 and 2005, and \$52 and \$37 for the 6 months ended June 30, 2006 and 2005.	(13)	(13)	(33)	(51)
Total comprehensive income	\$ 61,118	\$ 29,025	\$ 115,578	\$ 56,082

**Note 3. Business Segment Information**

Statement of Financial Accounting Standards (SFAS) No. 131, Disclosure about Segments of an Enterprise and Related Information establishes standards for the way that public companies report selected information about segments in their financial statements.

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The Company is organized functionally in geographic operating segments. Accordingly, management focuses its attention on revenues, net revenues, operating income, identifiable assets, capital expenditures, depreciation and amortization and equity generated in each of these geographical areas when evaluating the effectiveness of geographic management. The Company charges its subsidiaries and affiliates for services rendered in the United States on a cost recovery basis. Transactions among the Company's various offices are conducted using the same arms-length pricing methodologies the Company uses when its offices transact business with independent agents.

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Financial information regarding the Company's operations by geographic area for the three and six-months ended June 30, 2006 and 2005 are as follows:

(in thousands)	UNITED STATES	OTHER NORTH AMERICA	ASIA	EUROPE	AUSTRAL-ASIA	LATIN AMERICA	MIDDLE EAST	ELIMI-NATIONS	CONSOLI-DATED
<b>Three months ended June 30, 2006:</b>									
Revenues from unaffiliated customers	\$ 230,158	30,254	629,016	156,268	13,435	16,801	53,392		1,129,324
Transfers between geographic areas	27,485	1,962	4,171	7,900	1,621	2,111	2,680	(47,930)	
Total revenues	\$ 257,643	32,216	633,187	164,168	15,056	18,912	56,072	(47,930)	1,129,324
Net revenues	\$ 126,161	15,871	88,945	53,330	8,024	8,287	12,952		313,570
Operating income	\$ 27,659	3,864	40,855	10,051	2,127	1,665	2,582		88,803
Identifiable assets at quarter end	\$ 839,926	57,363	369,930	329,676	22,431	32,241	58,371	5,612	1,715,550
Capital expenditures	\$ 91,578	198	4,467	3,096	109	468	418		100,334
Depreciation and amortization	\$ 4,417	345	1,210	1,729	189	382	354		8,626
Equity	\$ 1,106,283	24,124	276,872	95,304	14,245	13,256	25,951	(586,434)	969,601
<b>Three months ended June 30, 2005:</b>									
Revenues from unaffiliated customers	\$ 182,105	23,405	519,774	133,903	11,745	15,561	41,506		927,999
Transfers between geographic areas	19,232	1,178	3,126	5,583	1,425	1,879	1,926	(34,349)	
Total revenues	\$ 201,337	24,583	522,900	139,486	13,170	17,440	43,432	(34,349)	927,999
Net revenues	\$ 101,950	12,839	66,894	44,724	7,054	6,885	10,314		250,660
Operating income	\$ 16,617	2,781	28,297	6,652	1,592	1,367	1,423		58,729
Identifiable assets at quarter end	\$ 666,572	47,503	317,473	289,708	23,903	23,256	43,215	5,619	1,417,249
Capital expenditures	\$ 10,465	207	1,074	1,309	469	361	290		14,175
Depreciation and amortization	\$ 3,713	362	1,216	1,499	172	286	355		7,603
Equity	\$ 911,406	19,831	245,979	85,294	15,106	8,606	20,623	(463,612)	843,233
<b>Six months ended June 30, 2006:</b>									
Revenues from unaffiliated customers	\$ 449,380	58,635	1,185,711	296,633	25,788	32,910	104,859		2,153,916
Transfers between geographic areas	52,927	3,692	7,854	15,225	3,030	4,004	5,062	(91,794)	
Total revenues	\$ 502,307	62,327	1,193,565	311,858	28,818	36,914	109,921	(91,794)	2,153,916
Net revenues	\$ 251,860	30,553	169,694	101,933	15,424	15,474	24,829		609,767
Operating income	\$ 52,227	7,203	82,139	20,624	4,108	2,939	4,964		174,204
Identifiable assets at period end	\$ 839,926	57,363	369,930	329,676	22,431	32,241	58,371	5,612	1,715,550
Capital expenditures	\$ 108,764	295	7,221	3,810	346	791	606		121,833
Depreciation and amortization	\$ 8,485	696	2,400	3,265	387	747	699		16,679
Equity	\$ 1,106,283	24,124	276,872	95,304	14,245	13,256	25,951	(586,434)	969,601
<b>Six months ended June 30, 2005:</b>									
Revenues from unaffiliated customers	\$ 350,776	43,614	961,787	260,743	23,485	28,665	84,093		1,753,163
Transfers between geographic areas	35,626	2,347	5,848	10,998	2,647	3,438	3,783	(64,687)	

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Transfers between geographic areas

Total revenues	\$	386,402	45,961	967,635	271,741	26,132	32,103	87,876	(64,687	) 1,753,163
Net revenues	\$	196,019	24,195	127,551	86,894	13,769	12,543	20,372		481,343
Operating income	\$	27,261	4,801	57,144	11,764	3,220	2,232	2,755		109,177
Identifiable assets at period end	\$	666,572	47,503	317,473	289,708	23,903	23,256	43,215	5,619	1,417,249
Capital expenditures	\$	36,437	512	2,150	2,519	537	552	485		43,192
Depreciation and amortization	\$	7,222	729	2,386	3,012	326	547	720		14,942
Equity	\$	911,406	19,831	245,979	85,294	15,106	8,606	20,623	(463,612	) 843,233

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**Note 4. Basic and Diluted Earnings per Share**

The following table reconciles the numerator and the denominator of the basic and diluted per share computations for earnings per share for the three and six-months ended June 30, 2006 and 2005:

(Amounts in thousands, except share and per share amounts)	Three months ended June 30,		
	Net Earnings	Weighted Average Shares	Earnings Per Share
<u>2006</u>			
Basic earnings per share	\$ 56,329	213,725,395	\$ .26
Effect of dilutive potential common shares		10,649,325	
Diluted earnings per share	\$ 56,329	224,374,720	\$ .25
<u>2005</u>			
Basic earnings per share	\$ 36,698	213,552,092	\$ .17
Effect of dilutive potential common shares		7,349,022	
Diluted earnings per share	\$ 36,698	220,901,114	\$ .17

(Amounts in thousands, except share and per share amounts)	Six months ended June 30,		
	Net Earnings	Weighted Average Shares	Earnings Per Share
<u>2006</u>			
Basic earnings per share	\$ 108,681	213,574,773	\$ .51
Effect of dilutive potential common shares		10,476,513	
Diluted earnings per share	\$ 108,681	224,051,286	\$ .49
<u>2005</u>			
Basic earnings per share	\$ 67,744	213,504,726	\$ .32
Effect of dilutive potential common shares		7,656,154	
Diluted earnings per share	\$ 67,744	221,160,880	\$ .31

The following shares have been excluded from the computation of diluted earnings per share because the effect would have been antidilutive:

Shares	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Shares	128,000	128,000	128,000	

Note **5. Stock and Cash Dividends**

On May 3, 2006, the Board of Directors declared a 2-for-1 stock split, effected in the form of a stock dividend of one share of common stock for every share outstanding. The stock dividend was distributed on June 23, 2006 to shareholders of record on June 9, 2006. All share and per share information, except par value per share, has been adjusted for all years to reflect the stock split.

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On May 3, 2006, the Board of Directors declared a semi-annual cash dividend of \$.11 per share payable on June 15, 2006 to shareholders of record as of June 1, 2006. The dividend of \$24 million was paid on June 15, 2006.

On May 9, 2005, the Board of Directors declared a semi-annual cash dividend of \$.075 per share payable on June 15, 2005 to shareholders of record as of June 1, 2005. The dividend of \$16 million was paid on June 15, 2005.

## Note 6. Shareholders Equity

### A. Stock Option Plans

At June 30, 2006, the Company has two stock option plans (the 1985 Plan and the 2006 Plan) for employees under which the Board of Directors may grant officers and key employees options to purchase common stock at prices equal to or greater than market value on the date of grant. On May 3, 2006, the shareholders approved the Company's 2006 Plan, which made available a total of 3,000,000 shares of the Company's common stock for purchase upon exercise of options granted under the 2006 Plan. The 1985 Plan provides for non-qualified grants. The 2006 Plan provides for qualified and non-qualified grants. Under the 1985, 2005 and 2006 Plans, outstanding options generally vest and become exercisable over periods up to five years from the date of grant and expire no more than 10 years from the date of grant. Grants under the 2006 Plan are limited to not more than 100,000 shares per person. No additional shares can be granted under the 2006 Plan after April 30, 2007. Under the terms of the 2005 and 2006 Plans, no options can be granted after April 30th of the year following shareholder approval. Accordingly, no options were granted under the 2005 Plan after April 30, 2006.

The Company also has a stock option plan (Directors Plan) under which non-employee directors elected at each annual meeting are granted non-qualified options to purchase 32,000 shares of common stock at prices equal to the market value on the date of grant on the first business day of the month following the meeting. On May 3, 2006, the Directors Plan was amended by shareholder vote to require a one year vesting period. Previously, options granted under the Directors Plan vested immediately.

Upon the exercise of non-qualified stock options and disqualifying dispositions of incentive stock options, the Company derives a tax deduction measured by the excess of the market value over the option price at the date of exercise. The portion of the benefit from the deduction which equals the estimated fair value of the options (previously recognized as compensation expense) is recorded as a credit to the deferred tax asset for non-qualified stock options and is recorded as a credit to current tax expense for any disqualifying dispositions of incentive stock options. All of the tax benefit received upon option exercise which exceeds the estimated fair value of the options is credited to additional paid-in capital.

### B. Stock Purchase Plan

In May 2002, the shareholders approved the Company's 2002 Employee Stock Purchase Plan (2002 Plan), which became effective August 1, 2002 upon the expiration of the 1988 Employee Stock Purchase Plan (1988 Plan) on July 31, 2002. The Company's 2002 Plan provides for 4,305,452 shares of the Company's common stock, including 305,452 remaining shares transferred from the 1988 Plan, to be reserved for issuance upon exercise of purchase rights granted to employees who elect to participate through regular payroll deductions beginning August 1 of each year. The purchase rights are exercisable on July 31 of the following year at a price equal to the lesser of (1) 85% of the fair market value of the Company's stock on July 31 or (2) 85% of the fair market value of the Company's stock on the preceding August 1.

### C. Adoption of SFAS 123R

As described in Note 1, effective January 1, 2006, the Company adopted SFAS 123R, requiring the recording of compensation expense based on an estimate of the fair value of options awarded under its fixed stock option or employee stock purchase rights plans. The Company elected to utilize the modified retrospective method of transitioning to SFAS 123R and has restated all prior periods to recognize the required stock compensation expense.

In applying the modified retrospective method, the Company has recorded compensation expense as previously stated in the Company's pro forma SFAS 123 disclosures in the footnotes to its prior period financial statements. The fair value of options used to determine this compensation expense was originally determined using the Black-Scholes model and no changes have been made to the compensation expense as originally stated in the pro forma disclosures. The original measurements and assumptions previously disclosed in the footnotes to the Company's financial statement included in its annual Form 10-K filings and, in more recent years, in its Form 10-Q filings, also have not been changed. In the process of recording the associated deferred tax assets related to this compensation expense, as required by SFAS 123R, the Company made its computations on a grant by grant basis. As a result of this exercise, the Company determined that the tax benefit amounts previously included in determining the disclosed pro forma net earnings figures, if actually recorded into the Company's financial statements, would have overstated deferred tax assets on the Company's balance sheet that would have been incorrect under that provisions of SFAS No. 109, Accounting for Income Taxes. Accordingly, in restating the results of prior years, management has elected to record adjustments to income

tax expense and to properly record deferred tax assets.

Prior to the adoption of SFAS 123R, in the statement of cash flows, the tax benefits received by the Company from the exercise of certain employee stock options were added back to net earnings in determining net cash provided by operating activities. SFAS 123R requires a different presentation for that portion of the tax benefit received upon option exercise which exceeds the tax

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benefit originally recorded based on the estimated fair value of the options previously recognized as compensation expense. Accordingly, the Company has reclassified this excess tax benefit from cash provided by operating activities to cash provided by financing activities in the statement of cash flows.

The following tables summarize the adjustments to certain line items in the Company's consolidated financial statements as a result of adopting SFAS 123R for all periods presented:

**Restated line items in the condensed consolidated balance sheet:**

	<b>December 31, 2005</b>			
	<b>As previously reported</b>	<b>SFAS 123R Adjustments</b>	<b>Reclassifications</b>	<b>As restated</b>
Deferred Federal and state income taxes	\$ 25,939	\$ (12,661 )		\$ 13,278
<b>Shareholders' equity:</b>				
Additional paid-in capital	18,663	162,242		180,905
Retained earnings	\$ 895,565	\$ (149,581 )		\$ 745,984

**Restated line items in the condensed consolidated statement of earnings:**

	<b>Three months ended June 30, 2005</b>			
	<b>As previously reported</b>	<b>SFAS 123R Adjustments</b>	<b>Reclassifications</b>	<b>As restated</b>
Salaries and related costs	\$ 134,841	\$ 9,576	\$ 1,207	\$ 145,624
Other operating expenses	19,334		(1,207 )	18,127
Total operating expenses	859,694	9,576		869,270
Operating income	68,305	(9,576 )		58,729
Earnings before income taxes and minority interest	71,685	(9,576 )		62,109
Income tax expense	25,712	(1,630 )	1	24,083
Net earnings before minority interest	45,973	(7,946 )	(1 )	38,026
Net earnings	44,644	(7,946 )		36,698
Basic earnings per share	\$ .21			\$ .17
Diluted earnings per share	\$ .20			\$ .17

	<b>Six months ended June 30, 2005</b>			
	<b>As previously reported</b>	<b>SFAS 123R Adjustments</b>	<b>Reclassifications</b>	<b>As restated</b>
Salaries and related costs	\$ 259,395	\$ 16,684	\$ 2,436	\$ 278,515
Other operating expenses	39,273		(2,435 )	36,838
Total operating expenses	1,627,301	16,684	1	1,643,986
Operating income	125,862	(16,684 )	(1 )	109,177
Earnings before income taxes and minority interest	132,556	(16,684 )	(1 )	115,871

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Income tax expense	47,786	(2,040	)	(1	)	45,745
Net earnings before minority interest	84,770	(14,644	)			70,126
Net earnings	82,388	(14,644	)			67,744
Basic earnings per share	\$ .39					\$ .32
Diluted earnings per share	\$ .37					\$ .31

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**Restated line items in the condensed consolidated statement of cash flows:**

	Three months ended June 30, 2005		Reclassifications	As restated
	As previously reported	SFAS 123R Adjustments		
Net earnings	\$ 44,644	\$ (7,946 )		\$ 36,698
Deferred income tax expense	3,728	4,389		8,117
Excess tax benefits from employee stock plans		(4,747 )		(4,747 )
Tax benefits from employee stock plans	6,019	(6,019 )		
Stock compensation expense		9,576		9,576
Net cash provided by operating activities	46,953	(4,747 )		42,206
Excess tax benefits from employee stock plans		4,747		4,747
Net cash used in financing activities	\$ (42,798 )	\$ 4,747		\$ (38,051 )

	Six months ended June 30, 2005		Reclassifications	As restated
	As previously reported	SFAS 123R Adjustments		
Net earnings	\$ 82,388	\$ (14,644 )		\$ 67,744
Deferred income tax expense	7,987	6,915		14,902
Excess tax benefits from employee stock plans		(6,322 )		(6,322 )
Tax benefits from employee stock plans	8,955	(8,955 )		
Stock compensation expense		16,684		16,684
Net cash provided by operating activities	142,663	(6,322 )		136,341
Excess tax benefits from employee stock plans		6,322		6,322
Net cash used in financing activities	\$ (57,123 )	\$ 6,322		\$ (50,801 )

The following tables summarize information about fixed-price stock options for the six months ended June 30, 2006:

	Number of shares	Weighted average exercise price per share	Weighted average remaining contractual life	Aggregate intrinsic value (in thousands)
Outstanding at December 31, 2005	22,266,646	\$ 14.64		
Options granted	3,109,000	44.20		
Options exercised	(2,455,434 )	10.60		
Options forfeited	(184,250 )	19.66		
Options expired	(11,750 )	10.45		
Outstanding at June 30, 2006	22,724,212	\$ 19.08	6.27 years	\$ 839,222
Exercisable at June 30, 2006	12,120,987	\$ 11.65	4.47 years	\$ 537,642



	Unvested Options	
	Number of shares	Weighted average fair value per share
Balance at December 31, 2005	11,368,450	\$ 9.57
Options granted	3,109,000	22.69
Options vested	(3,689,975 )	7.74
Options forfeited	(184,250 )	9.91
Balance at June 30, 2006	10,603,225	\$ 14.05

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions used for grants issued during the six months ended June 30, 2006 and 2005:

	For the six months ended June 30,					
	2006			2005		
Dividend yield	.51			%	.56	%
Volatility	41	43		%	44	49 %
Risk-free interest rates	5.03	5.11		%	3.64	4.14 %
Expected life (years) stock option plans	7.21	8.89			6.67	9.36
Weighted average fair value of stock options granted during the period	\$	22.69		\$	25.38	

No grants were issued under the stock purchase plan during the six months ended June 30, 2006 and 2005.

The total intrinsic value of options exercised during the three months ended June 30, 2006 and 2005 was \$67 million and \$22 million, respectively. The total intrinsic value of options exercised during the six months ended June 30, 2006 and 2005 was \$90 million and \$33 million, respectively.

As of June 30, 2006, the total unrecognized compensation cost related to unvested stock options is \$124,531 and the weighted average period over which that cost is expected to be recognized is 2.16 years.

Total stock compensation expense and the total related tax benefit recognized in the three and six-months ended June 30, 2006 and 2005 are as follows:

	For the three months ended		For the six months ended	
	June 30, 2006	2005	June 30, 2006	2005
Stock compensation expense	\$ 9,418	\$ 9,576	\$ 17,816	\$ 16,684
Recognized tax benefit, net	\$ 2,247	\$ 1,630	\$ 2,556	\$ 2,040

Shares issued as a result of stock option exercises and employee stock plan purchases are issued as new shares outstanding by the Company's transfer agent.

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

### **SAFE HARBOR FOR FORWARD-LOOKING STATEMENTS UNDER SECURITIES LITIGATION REFORM ACT OF 1995; CERTAIN CAUTIONARY STATEMENTS**

Certain portions of this report on Form 10-Q including the section entitled "Currency and Other Risk Factors" and "Liquidity and Capital Resources" contain forward-looking statements which must be considered in connection with the discussion of the important factors that could cause actual results to differ materially from the forward-looking statements. In addition to risk factors identified elsewhere in this report, attention should be given to the factors identified and discussed in the report on Form 10-K filed on or about March 16, 2006.

**EXECUTIVE SUMMARY**

Expeditors International of Washington, Inc. is engaged in the business of global logistics management, including international freight forwarding and consolidation, for both air and ocean freight. The Company acts as a customs broker in all domestic offices, and in many of its international offices. The Company also provides additional services for its customers including value-added distribution, purchase order management, vendor consolidation and other logistics solutions. The Company does not compete for overnight courier or small parcel business. The Company does not own or operate aircraft or steamships.

International trade is influenced by many factors, including economic and political conditions in the United States and abroad, currency exchange rates, and United States and foreign laws and policies relating to tariffs, trade restrictions, foreign investments and

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taxation. Periodically, governments consider a variety of changes to current tariffs and trade restrictions. The Company cannot predict which, if any, of these proposals may be adopted, nor can the Company predict the affects adoption of any such proposal will have on the Company's business. Doing business in foreign locations also subjects the Company to a variety of risks and considerations not normally encountered by domestic enterprises. In addition to being influenced by governmental policies concerning international trade, the Company's business may also be affected by political developments and changes in government personnel or policies in the nations in which it does business.

The Company derives its revenues from three principal sources: 1) airfreight, 2) ocean freight and 3) customs brokerage and other services and these are the revenue categories presented in the financial statements.

As a non-asset based carrier, the Company does not own transportation assets. Rather, the Company generates the major portion of its air and ocean freight revenues by purchasing transportation services from direct (asset-based) carriers and reselling those services to its customers. The difference between the rate billed to customers (the sell rate), and the rate paid to the carrier (the buy rate) is termed net revenue or yield. By consolidating shipments from multiple customers and concentrating its buying power, the Company is able to negotiate favorable buy rates from the direct carriers, while at the same time offering lower sell rates than customers would otherwise be able to negotiate themselves.

Customs brokerage and other services involves providing services at destination, such as helping customers clear shipments through customs by preparing required documentation, calculating and providing for payment of duties and other taxes on behalf of the customers as well as arranging for any required inspections by governmental agencies, and arranging for delivery. This is a complicated function requiring technical knowledge of customs rules and regulations in the multitude of countries in which the Company has offices.

The Company's ability to provide services to its customers is highly dependent on good working relationships with a variety of entities including airlines, ocean steamship lines, and governmental agencies. The significance of maintaining acceptable working relationships with governmental agencies and asset-based providers involved in global trade has gained increased importance as a result of ongoing concern over terrorism. As each carrier labors to comply with governmental regulations implementing security policies and procedures, inherent conflicts emerge which can and do affect global trade to some degree. A good reputation helps to develop practical working understandings that will effectively meet security requirements while minimizing potential international trade obstacles. The Company considers its current working relationships with these entities to be satisfactory. However, changes in space allotments available from carriers, governmental deregulation efforts, modernization of the regulations governing customs brokerage, and/or changes in governmental quota restrictions could affect the Company's business in unpredictable ways.

Historically, the Company's operating results have been subject to a seasonal trend when measured on a quarterly basis. The first quarter has traditionally been the weakest and the third and fourth quarters have traditionally been the strongest. This pattern is the result of, or is influenced by, numerous factors including climate, national holidays, consumer demand, economic conditions and a myriad of other similar and subtle forces. In addition, this historical quarterly trend has been influenced by the growth and diversification of the Company's international network and service offerings. The Company cannot accurately forecast many of these factors nor can the Company estimate accurately the relative influence of any particular factor and, as a result, there can be no assurance that historical patterns, if any, will continue in future periods.

A significant portion of the Company's revenues are derived from customers in retail industries whose shipping patterns are tied closely to consumer demand, and from customers in industries whose shipping patterns are dependent upon just-in-time production schedules. Therefore, the timing of the Company's revenues are, to a large degree, impacted by factors out of the Company's control, such as a sudden change in consumer demand for retail goods and/or manufacturing production delays. Additionally, many customers ship a significant portion of their goods at or near the end of a quarter, and therefore, the Company may not learn of a shortfall in revenues until late in a quarter. To the extent that a shortfall in revenues or earnings was not expected by securities analysts, any such shortfall from levels predicted by securities analysts could have an immediate and adverse effect on the trading price of the Company's stock.

As further discussed under liquidity and capital resources, total capital expenditures in 2006 are expected to exceed \$165 million.

In terms of the opportunities, challenges and risks that management is focused on in 2006, the Company operates in 58 countries throughout the world in the competitive global logistics industry and Company activities are tied directly to the global economy. From the inception of the Company, management has believed that the elements required for a successful global service organization can only be assured through recruiting, training, and ultimately retaining superior personnel. The Company's greatest challenge is now and always has been perpetuating a consistent global culture which demands:

- Total dedication, first and foremost, to providing superior customer service;
- Aggressive marketing of all of the Company's service offerings;





- Ongoing development of key employees and management personnel via formal and informal means;
- Creation of unlimited advancement opportunities for employees dedicated to hard work, personal growth and continuous improvement;
- Individual commitment to the identification and mentoring of successors for every key position so that when inevitable change is required, a qualified and well-trained internal candidate is ready to step forward; and
- Continuous identification, design and implementation of system solutions, both technological and otherwise, to meet and exceed the needs of our customers while simultaneously delivering tools to make our employees more efficient and more effective.

The Company has reinforced these values with a compensation system that rewards employees for profitably managing the things they can control. There is no limit to how much a key manager can be compensated for success. The Company believes in a real world environment in every operating unit where individuals are not sheltered from the profit implications of their decisions. At the same time, the Company insists on continued focus on such things as accounts receivable collection, cash flow management and credit soundness in an attempt to insulate managers from the sort of catastrophic errors that might end a career.

Any failure to perpetuate this unique culture on a self-sustained basis throughout the Company, provides a greater threat to the Company's continued success than any external force, which would be largely beyond our control. Consequently, management spends the majority of its time focused on creating an environment where employees can learn and develop while also building systems and taking preventative action to reduce exposure to negative events. The Company strongly believes that it is nearly impossible to predict events that, in the aggregate, could have a positive or a negative impact on future operations. As a result our focus is on building and maintaining a global culture of well-trained employees and managers that are prepared to identify and react to subtle changes as they develop and thereby help the Company adapt and thrive as major trends emerge.

#### **Critical Accounting Policies and Estimates**

Management believes that the nature of the Company's business is such that there are few, if any, complex challenges in accounting for operations.

While judgments and estimates are a necessary component of any system of accounting, the Company's use of estimates is limited primarily to the following areas that in the aggregate are not a major component of the Company's statement of earnings:

- accounts receivable valuation;
- the useful lives of long-term assets;
- the accrual of costs related to ancillary services the Company provides;
- establishment of adequate insurance liabilities for the portion of the freight related exposure which the Company has self-insured; and
- accrual of tax expense on an interim basis.

Management believes that the methods utilized in all of these areas are non-aggressive in approach and consistent in application. Management believes that there are limited, if any, alternative accounting principles or methods which could be applied to the Company's transactions. While the use of estimates means that actual future results may be different from those contemplated by the estimates, the Company believes that alternative principles and methods used for making such estimates would not produce materially different results than those reported.

As described in Note 1 in the condensed consolidated financial statements in this quarterly report, effective January 1, 2006, the Company adopted SFAS 123R. This accounting standard requires the recognition of compensation expense based on an estimate of the fair value of options granted to employees and directors under the Company's stock option and employee stock purchase plans.

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This expense is recorded ratably over the option vesting periods. The Company elected to utilize the modified retrospective method of adoption and has restated all prior periods to recognize the required stock compensation expense in accordance with the requirements of SFAS 123R.

Determining the appropriate option pricing model to use to estimate stock compensation expense requires judgment. Any option pricing model requires assumptions that are subjective and these assumptions also require judgment. Examples include assumptions about long-term stock price volatility, employee exercise patterns, pre-vesting option forfeitures, post-vesting option terminations, and the future interest rates and dividend yields.

The Company has historically used the Black-Scholes model for estimating the fair value of stock options in providing pro forma fair value disclosures pursuant to SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). After a review of alternatives, and considering the guidance outlined in Securities and Exchange Commission Staff Accounting Bulletin No. 107 (SAB 107), the Company

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has decided to continue to use this model for estimating the fair value of stock options granted subsequent to the adoption of SFAS 123R.

In reviewing the propriety of measurements and assumptions used historically to calculate compensation expense for disclosure purposes, management considered the guidance contained in SAB 107, even though all the Company's stock options had previously been granted under SFAS 123, as opposed to SFAS 123R, for which SAB 107 was expressly written. The Company began granting options under SFAS 123R in the second quarter of 2006. Refer to Note 6 in the condensed consolidated financial statements for the assumptions used for grants issued during the six months ended June 30, 2006 and 2005. The assumptions used by the Company for estimating the fair value of options granted under SFAS 123R were developed on a basis consistent with assumptions used for valuing previous grants.

Management believes that these assumptions are appropriate, based upon the requirements of SFAS 123, SFAS 123R, the guidance included in SAB 107 and the company's historical and currently expected future experience. Looking to future events, management has been strongly influenced by historical patterns which may not be valid predictors of future developments and any future deviation may be material.

The Company's expected volatility assumptions are based on the historical volatility of the Company's stock. The expected life assumption is primarily based on historical employee exercise patterns and employee post-vesting termination behavior. The risk-free interest rate for the expected term of the option is based on the corresponding yield curve in effect at the time of grant for U.S. Treasury bonds having the same term as the expected life of the option, i.e. a ten year bond rate is used for valuing an option with a ten year expected life. The expected dividend yield is based on the Company's historical experience. The forfeiture rate used to calculate compensation expense is primarily based on historical pre-vesting employee forfeiture patterns.

The use of different assumptions would result in different amounts of stock compensation expense. Keeping all other variables constant, the indicated change in each of the assumptions below increases or decreases the fair value of an option (and the resulting stock compensation expense), as follows:

Assumption	Change in assumption	Impact of fair value of options
Expected volatility	Higher	Higher
Expected life of option	Higher	Higher
Risk-free interest rate	Higher	Higher
Expected dividend yield	Higher	Lower

The fair value of an option is more significantly impacted by changes in the expected volatility and expected life assumptions. The pre-vesting forfeitures assumption is ultimately adjusted to the actual forfeiture rate. Therefore, changes in the forfeitures assumption would not impact the total amount of expense ultimately recognized over the vesting period. Different forfeitures assumptions would only impact the timing of expense recognition over the vesting period. Estimated forfeitures will be reassessed in subsequent periods and may change based on new facts and circumstances.

### Results of Operations

The following table shows the consolidated net revenues (revenues less transportation expenses) attributable to the Company's principal services and the Company's expenses for the three and six-month periods ended June 30, 2006 and 2005, expressed as percentages of net revenues. Management believes that net revenues are a better measure than total revenues of the relative importance of the Company's principal services since total revenues earned by the Company as a freight consolidator include the carriers' charges to the Company for carrying the shipment whereas revenues earned by the Company in its other capacities include only the commissions and fees actually earned by the Company.

The table and the accompanying discussion and analysis should be read in conjunction with the condensed consolidated financial statements and related notes thereto which appear elsewhere in this quarterly report.

	Three months ended June 30, 2006			2005			Six months ended June 30, 2006			2005		
	Amount (Amounts in thousands)	Percent of net revenues		Amount	Percent of net revenues		Amount	Percent of net revenues		Amount	Percent of net revenues	
<b>Net revenues:</b>												
Airfreight	\$ 115,297	37	%	\$ 90,944	36	%	\$ 225,714	37	%	\$ 179,391	37	%
Ocean freight and ocean services	79,500	25		59,675	24		153,280	25		112,849	24	
Customs brokerage and other services	118,773	38		100,041	40		230,773	38		189,103	39	
Net revenues	313,570	100		250,660	100		609,767	100		481,343	100	
<b>Operating expenses:</b>												
Salaries and related costs	172,453	55		145,624	58		333,427	55		278,515	58	
Other	52,314	17		46,307	18		102,136	17		93,651	19	
Total operating expenses	224,767	72		191,931	76		435,563	72		372,166	77	
Operating income	88,803	28		58,729	24		174,204	28		109,177	23	
Other income, net	4,845	2		3,380	1		10,759	2		6,694	1	
<b>Earnings before income taxes and minority interest</b>												
Income tax expense	93,648	30		62,109	25		184,963	30		115,871	24	
Net earnings before minority interest	58,145	19		38,026	15		112,408	18		70,126	14	
Minority interest	(1,816)	(1)	)	(1,328)	(1)	)	(3,727)	(3)	)	(2,382)	(2)	)
Net earnings	\$ 56,329	18	%	\$ 36,698	15	%	\$ 108,681	18	%	\$ 67,744	14	%

Airfreight net revenues increased 27% and 26% for the three and six-month periods ended June 30, 2006, respectively, as compared with the same periods for 2005. These increases are primarily the result of increases in airfreight tonnage of 22% and 24% for the three and six-month periods ended June 30, 2006 as compared with the same periods for 2005.

Ocean freight volumes, measured in terms of forty-foot container equivalent units (FEUs), increased 17% for the three-month period ended June 30, 2006 as compared with the same period for 2005 while ocean freight and ocean services net revenues increased 33% during the same period. The difference between these two growth rates is a result of a year over year increase in ocean freight yields and year over year increases in the Company's fee-based order management and ocean forwarding business. For the six-month period ended June 30, 2006 as compared with the same period for 2005, FEU count increased 18% while ocean freight and ocean services net revenues increased 36% during the same period. The difference in these two growth rates is also attributable to the same dynamics as described for the three month period.

The Company continued its focus of offering competitive rates to customers at the retail level, while leveraging freight volumes to obtain favorable rates from carriers at the wholesale level. The Company's North American ocean freight net revenues increased approximately 43% and 46% for the three and six-month periods ended June 30, 2006, respectively, as compared with the same periods for 2005. This was due to an increase in container traffic, primarily from Asia and increases in order management and ocean forwarding business, which was a result of continued marketing efforts. Ocean freight net revenues for Asia and for Europe increased 34% and 11%, respectively, for the three months ended June 30, 2006, and 40% and 6%, respectively, for the six months ended June 30, 2006, as compared with the same periods for 2005. This increase was also a result of continued marketing efforts.

Customs brokerage and other services net revenues increased 19% and 22% for the three and six-month periods ended June 30, 2006, respectively, as compared with the same periods for 2005 as a result of the Company's continuing reputation for providing high quality service. Consolidation within the customs brokerage market has also contributed to this increase as customers seek out



customs brokers with more sophisticated computerized capabilities critical to an overall logistics management program. In addition, increased emphasis on regulatory compliance continues to benefit the Company's customs brokerage offerings.

Salaries and related costs increased 18% and 20% during the three and six-month periods ended June 30, 2006, as compared with the same periods in 2005 as a result of (1) the Company's increased hiring of sales, operations, and administrative personnel in existing and new offices to accommodate increases in business activity, and (2) increased compensation levels. As previously noted, the Company adopted SFAS 123R using the modified retrospective application method and has restated all periods presented to include compensation expense for all unvested stock options and share awards beginning with the first period restated. Accordingly, salaries and related costs for the three and six months ended June 30, 2005 have been increased to include compensation expense for the fair value of unvested stock options.

The effect of including stock-based compensation expense in salaries and related costs for the three and six-months ended June 30, 2006 and 2005 are as follows:

	For the three months ended June 30, 2006		2005		For the six months ended June 30, 2006		2005	
Salaries and related costs	\$	172,453	\$	145,624	\$	333,427	\$	278,515
As a % of net revenue		55.0	%	58.1	%	54.7	%	57.9
Stock compensation expense	\$	9,418	\$	9,576	\$	17,816	\$	16,684
As a % of salaries and related costs		5.5	%	6.6	%	5.3	%	6.0
As a % of net revenue		3.0	%	3.8	%	2.9	%	3.5

Of the 310 and 318 basis point decline in salaries and related costs as a percentage of net revenue for the three and six-month periods ended June 30, 2006, respectively, as compared with the same periods for 2005, 82 and 54 basis points, respectively, are the result of the decrease in stock compensation expense as a percentage of net revenue. One factor affecting the comparability of stock option expense between the second quarters of 2005 and 2006 relates to the treatment of stock options granted under the Directors' Plan. Directors' Plan options granted in June 2005, vested immediately. Accordingly, the Black-Scholes determined fair-value compensation expense for those options of \$1,815, was expensed entirely in June 2005. The terms of the Directors' Plan options issued in June 2006, was amended to require vesting over a 12 month period. Accordingly, only \$293 of the total Black-Scholes determined fair value compensation expense of \$3,575, was included in stock option compensation expense during the second quarter of 2006.

The remaining 228 and 264 basis point reduction in salaries and related costs as a percentage of net revenue for the three and six-month periods ended June 30, 2006, respectively, as compared with the same period for 2005, can be attributed to leveraging increased business volumes with improved productivity and increasing overall efficiency through technological advances. Historically, the relatively consistent relationship between salaries and net revenues is the result of a compensation philosophy that has been maintained since the inception of the Company: offer a modest base salary and the opportunity to share in a fixed and determinable percentage of the operating profit of the business unit controlled by each key employee. Using this compensation model, changes in individual compensation will occur in proportion to changes in Company profits. Management believes that the growth in revenues, net revenues and net earnings for the three and six-month periods ended June 30, 2006 are a result of the incentives inherent in the Company's compensation program.

Other operating expenses increased 13% and 9% for the three and six-month periods ended June 30, 2006, as compared with the same periods in 2005 as communications expense, quality and training expenses, and other costs expanded to accommodate the Company's growing operations. Other operating expenses as a percentage of net revenues decreased 179 basis points and 271 basis points for the three and six-month periods ended June 30, 2006, respectively, as compared with the same periods in 2005. This was primarily due to the continued achievement of cost containment objectives.

Other income, net, increased 43% and 61% for the three and six-month periods ended June 30, 2006, as compared with the same periods in 2005. Due to higher interest rates on higher average cash balances and short-term investments during the three and six-months ended June 30, 2006, as compared with the same periods for 2005, interest income increased \$2 million and \$4 million, respectively.

The Company pays income taxes in the United States and other jurisdictions, as well as other taxes which are typically included in costs of operations. The Company's consolidated effective income tax rate during the three month period ended June 30, 2006, was 37.91% as compared

to 38.78% for the same period in 2005. The Company's consolidated effective income tax rate for the six month periods ended June 30, 2006 and 2005 remained relatively constant at 39.2% and 39.5%, respectively. The periods in 2005 have been restated to include the tax benefit related to stock-based compensation expense recorded as a result of applying the requirements of SFAS 123R under the modified retrospective method. Although a tax benefit related to stock-based compensation expense is recorded for non-qualified stock options at the time the related compensation expense is recognized, the tax benefit received for disqualifying dispositions of incentive stock options cannot be anticipated. The lower consolidated effective income tax rate during the three month period ended June 30, 2006, as compared to the same period in 2005, is partially the result of a larger tax benefit received for disqualifying dispositions of incentive stock options occurring during the second quarter of 2006 compared to 2005.

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### Currency and Other Risk Factors

International air/ocean freight forwarding and customs brokerage are intensively competitive and are expected to remain so for the foreseeable future. There are a large number of entities competing in the international logistics industry; however, the Company's primary competition is confined to a relatively small number of companies within this group. While there is currently a marked trend within the industry toward consolidation into large firms with multinational offices and agency networks, regional and local broker/forwarders remain a competitive force.

Historically, the primary competitive factors in the international logistics industry have been price and quality of service, including reliability, responsiveness, expertise, convenience, and scope of operations. The Company emphasizes quality service and believes that its prices are competitive with those of others in the industry. Recently, customers have exhibited a trend towards more sophisticated and efficient procedures for the management of the logistics supply chain by embracing strategies such as just-in-time inventory management. Accordingly, sophisticated computerized customer service capabilities and a stable worldwide network have become significant factors in attracting and retaining customers.

Developing these systems and a worldwide network has added a considerable indirect cost to the services provided to customers. Smaller and middle-tier competitors, in general, do not have the resources available to develop customized systems and a worldwide network. As a result, there is a significant amount of consolidation currently taking place in the industry. Management expects that this trend toward consolidation will continue for the short- to medium-term.

The nature of the Company's worldwide operations necessitates the Company dealing with a multitude of currencies other than the U.S. dollar. This results in the Company being exposed to the inherent risks of the international currency markets and governmental interference. Some of the countries where the Company maintains offices and/or agency relationships have strict currency control regulations which influence the Company's ability to hedge foreign currency exposure. The Company tries to compensate for these exposures by accelerating international currency settlements among its offices or agents. The Company enters into foreign currency hedging transactions only in limited locations where there are regulatory or commercial limitations on the Company's ability to move money freely or the short-term financial outlook is such that hedging is the way to avoid short-term exchange losses. Any such hedging activity during the three and six-months ended June 30, 2006 and 2005 was insignificant. For the three and six-months ended June 30, 2006, the Company had foreign exchange losses of approximately \$246 and foreign exchange gains of approximately \$803, respectively, on a net basis. For the same periods of 2005, respectively, the Company had foreign exchange gains of approximately \$213 and \$671, respectively, on a net basis. The Company had no foreign currency derivatives outstanding at June 30, 2006 and 2005.

### Sources of Growth

During the second quarter of 2006, the Company opened 1 full-service office (\*) and 1 satellite office (+), as follows:

<b>Latin America</b>	<b>United States</b>
Reynosa, MX*	Calexico, CA+

Reynosa, MX changed from a satellite to a full-service office.

Acquisitions - Historically, growth through aggressive acquisition has proven to be a challenge for many of the Company's competitors and typically involves the purchase of significant goodwill, the value of which can be realized in large measure only by retaining the customers and profit margins of the acquired business. As a result, the Company has pursued a strategy emphasizing organic growth supplemented by certain strategic acquisitions, where future economic benefit significantly exceeds the goodwill recorded in the transaction.

Internal Growth - Management believes that a comparison of same store growth is critical in the evaluation of the quality and extent of the Company's internally generated growth. This same store analysis isolates the financial contributions from offices that have been included in the Company's operating results for at least one full year. The table below presents same store comparisons for the three and six-months ended June 30, 2006 (which is the measure of any increase from the same period of 2005) and for the three and six-months ended June 30, 2005 (which measures growth over 2004).

	<b>For the three months ended June 30,</b>		<b>For the six months ended June 30,</b>					
	<b>2006</b>		<b>2005</b>		<b>2006</b>		<b>2005</b>	
Net revenue	25	%	12	%	26	%	13	%
Operating income	51	%	17	%	59	%	17	%





## Liquidity and Capital Resources

The Company's principal source of liquidity is cash generated from operating activities. Net cash provided by operating activities for the three and six months ended June 30, 2006, was \$56 million and \$194 million, as compared with \$42 million and \$136 million for the same periods of 2005. The \$14 million increase for the three months ended June 30, 2006 is primarily due to increased net earnings. The \$58 million increase for the six months ended June 30, 2006, is principally due to increased net earnings and a favorable swing in the timing of receipts and disbursements represented by the accounts receivable and accounts payable balances.

The Company's business is subject to seasonal fluctuations. Cash flow fluctuates as a result of this seasonality. Historically, the first quarter shows an excess of customer collections over customer billings. This results in positive cash flow. The increased activity associated with peak season (typically commencing late second or early third quarter) causes an excess of customer billings over customer collections. This cyclical growth in customer receivables consumes available cash.

As a customs broker, the Company makes significant 5-10 business day cash advances for its customers' obligations such as the payment of duties to the Customs and Border Protection of the Department of Homeland Security. These advances are made as an accommodation for a select group of credit-worthy customers. Cash advances are a pass through and are not recorded as a component of revenue and expense. The billings of such advances to customers are accounted for as a direct increase in accounts receivable to the customer and a corresponding increase in accounts payable to governmental customs authorities. As a result of these pass through billings, the conventional Days Sales Outstanding or DSO calculation does not directly measure collection efficiency.

Cash used in investing activities for the three and six-months ended June 30, 2006, was \$100 million and \$121 million, as compared with \$14 million and \$44 million during the same periods of 2005. The largest use of cash in investing activities is cash paid for capital expenditures. As a non-asset based provider of integrated logistics services, the Company does not own any physical means of transportation (i.e., airplanes, ships, trucks, etc.). However, the Company does have need, on occasion, to purchase buildings to house staff and to facilitate the staging of customers' freight. The Company routinely invests in technology, office furniture and equipment and leasehold improvements. In the second quarter of 2006, the Company made capital expenditures of \$100 million as compared with \$14 million for the same period in 2005. The Company currently expects to spend approximately \$27 million for ongoing capital expenditures in 2006. In addition to property and equipment, ongoing capital expenditures include leasehold improvements, warehouse equipment, computer hardware and furniture and fixtures. Total capital expenditures in 2006 are estimated to be \$165 million. This includes ongoing capital expenditures as noted above, plus additional real estate acquisitions and development required to carry out the Company's plan adopted under IRC 965. During the second quarter of 2006, the Company spent \$67 million for the acquisition of real estate and office/warehouse facilities in Miami, Florida. The Company expects to finance capital expenditures in 2006 with cash.

Cash used in financing activities during the three and six-months ended June 30, 2006 were \$75 million and \$90 million as compared with \$38 million and \$51 million for each of the same periods in 2005. The Company uses the proceeds from stock option exercises to repurchase the Company's stock on the open market. In 2005, the Company established a policy of repurchasing stock to prevent growth in issued and outstanding shares as a result of stock option exercises. The increase in cash used in financing activities during the three and six-months ended June 30, 2006 compared with the same periods in 2005 is primarily the result of this new policy. During the three months ended June 30, 2006 and 2005 the net use of cash in financing activities included the payment of dividends of \$.11 per share and \$.075 per share, respectively.

At June 30, 2006, working capital was \$555 million, including cash and short-term investments of \$455 million. The Company had no long-term debt at June 30, 2006.

The Company maintains international and domestic unsecured bank lines of credit. At June 30, 2006, the U.S. facility totaled \$50 million and international bank lines of credit, excluding the U.K. bank facility, totaled \$11 million. In addition, the Company maintains a bank facility with its U.K. bank for \$13 million which is available for short-term borrowings and issuances of standby letters of credit. At June 30, 2006 the Company had no amounts outstanding on these lines of credit but was contingently liable for \$60 million from standby letters of credit and guarantees related to these lines of credit and other obligations. The guarantees relate to obligations of the Company's foreign subsidiaries for credit extended in the ordinary course of business by direct carriers, primarily airlines, and for duty and tax deferrals available from governmental entities responsible for customs and value-added-tax (VAT) taxation. The total underlying amounts due and payable for transportation and governmental excises are properly recorded as obligations in the books of the respective foreign subsidiaries, and there would be no need to record additional expense in the unlikely event the parent company were to be required to perform.

Management believes that the Company's current cash position, bank financing arrangements, and operating cash flows will be sufficient to meet its capital and liquidity requirements for the foreseeable future, including meeting any contingent liabilities related to standby letters of credit and other obligations.

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In some cases, the Company's ability to repatriate funds from foreign operations may be subject to foreign exchange controls. At June 30, 2006, cash and cash equivalent balances of \$348 million were held by the Company's non-U.S. subsidiaries, of which \$44 million was held in banks in the United States.

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

The Company is exposed to market risks in the ordinary course of its business. These risks are primarily related to foreign exchange risk and changes in short-term interest rates. The potential impact of the Company's exposure to these risks is presented below:

#### **Foreign Exchange Risk**

The Company conducts business in many different countries and currencies. The Company's business often results in revenue billings issued in a country and currency which differs from that where the expenses related to the service are incurred. In the ordinary course of business, the Company creates numerous intercompany transactions. This brings a market risk to the Company's earnings.

Foreign exchange rate sensitivity analysis can be quantified by estimating the impact on the Company's earnings as a result of hypothetical changes in the value of the U.S. dollar, the Company's functional currency, relative to the other currencies in which the Company transacts business. All other things being equal, an average 10% weakening of the U.S. dollar, throughout the six months ended June 30, 2006, would have had the effect of raising operating income approximately \$14 million. An average 10% strengthening of the U.S. dollar, for the same period, would have had the effect of reducing operating income approximately \$11 million. This analysis does not take in to account changes in shipping patterns based upon this hypothetical currency fluctuation. For example, a weakening in the U.S. dollar would be expected to increase exports from the United States and decrease imports into the United States over some relevant period of time, but the exact affect of this change cannot be quantified without making speculative assumptions.

At June 30, 2006, the Company had approximately \$6 million of net unsettled intercompany transactions. The Company currently does not use derivative financial instruments to manage foreign currency risk and only enters into foreign currency hedging transactions in limited locations where regulatory or commercial limitations restrict the Company's ability to move money freely. Any such hedging activity during the three and six-months ended June 30, 2006, was insignificant. The Company had no foreign currency derivatives outstanding at June 30, 2006 and 2005. The Company instead follows a policy of accelerating international currency settlements to manage foreign exchange risk relative to intercompany billings. The majority of intercompany billings are resolved within 30 days and intercompany billings arising in the normal course of business are fully settled within 90 days.

#### **Interest Rate Risk**

At June 30, 2006, the Company had cash and cash equivalents and short-term investments of \$455 million, the vast majority of which is subject to variable short-term interest rates. The Company had no short-term borrowings at June 30, 2006. A hypothetical change in the interest rate of 10% would not have a significant impact on the Company's earnings.

In management's opinion, there has been no material change in the Company's market risk exposure in the second quarter of 2006.

### **Item 4. Controls and Procedures**

#### **Evaluation of Controls and Procedures**

As of June 30, 2006, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer (CEO) and Chief Financial Officer (CFO), an evaluation of the effectiveness of the Company's disclosure controls and procedures was performed. Based on this evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective to ensure that material information is recorded, processed, summarized and reported by management of the Company on a timely basis in order to comply with the Company's disclosure obligations under the Securities Exchange Act of 1934 and the SEC rules thereunder.

#### **Changes in Internal Controls**

There were no changes in the Company's internal control over financial reporting that occurred during the most recent fiscal quarter that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.



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AND SUBSIDIARIES

**PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

The Company is ordinarily involved in claims and lawsuits which arise in the normal course of business, none of which currently, in management's opinion, will have a significant effect on the Company's financial position or results of operations.

**Item 1A. Risk Factors**

There have been no material changes in the Company's risk factors from those disclosed in the report on Form 10-K filed on or about March 16, 2006.

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

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Maximum number of shares that may yet be purchased under the plans or programs
April 1-30, 2006	1,330	\$ 45.38	1,330	14,455,160
May 1-31, 2006	163,026	53.60	163,026	15,343,930
June 1-30, 2006	1,605,320	48.51	1,605,320	13,940,942
Total	1,769,676	\$ 48.97	1,769,676	13,940,942

In November 1993, the Company's Board of Directors authorized a Non-Discretionary Stock Repurchase Plan. This plan was amended in February 2001 to increase the authorization to repurchase up to 20 million shares of the Company's common stock. This authorization has no expiration date. This plan was disclosed in the Company's report on Form 10-K filed March 31, 1995. In the second quarter of 2006, 411,384 shares were repurchased under the Non-Discretionary Stock Repurchase Plan.

In November 2001, under a Discretionary Stock Repurchase Plan, the Company's Board of Directors authorized the repurchase of such shares as may be necessary to reduce the issued and outstanding stock to 200 million shares of common stock. The maximum number of shares available for repurchase under this plan will increase as the total number of outstanding shares increase. This authorization has no expiration date. This plan was announced on November 13, 2001. In the second quarter of 2006, 1,358,292 shares were repurchased under the Discretionary Stock Repurchase Plan. These discretionary repurchases were made to keep the number of issued and outstanding shares from growing as a result of stock option exercises.

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

- (a) The annual meeting of the Shareholders was held on May 3, 2006.
- (b) The following directors were elected to the Board of Directors to serve a term of one year and until their successors are elected and qualified:

	For	Withheld
P.J. Rose	89,739,582	2,895,153
J.L.K. Wang	89,033,162	3,601,573
R.J. Gates	83,355,095	9,279,640
J.J. Casey	84,576,281	8,058,454
D.P. Kourkoumelis	89,879,616	2,755,119
M.J. Malone	91,722,590	912,145

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J.W. Meisenbach	89,879,134	2,755,601
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	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Non-Vote</b>
(c) Adoption of the 2006 Stock Option Plan	70,808,532	10,547,302	390,240	10,888,661

	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Non-Vote</b>
(d) Ratification of KPMG LLP as the Company's Independent Auditor Selection	92,184,268	404,127	46,340	
	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Non-Vote</b>
(e) Shareholder proposal to amend the Company's existing equal opportunity policy	26,431,053	52,259,295	3,055,726	10,888,661

**Item 5. Other Information**

(a) On August 3, 2006, the Company filed articles of amendment in order to increase authorized common shares from 320,000,000 to 640,000,000 in connection with the 2-for-1 stock split.

(b) Not applicable.

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**Item 6. Exhibits**

(a) Exhibits required by Item 601 of Regulation S-K.

<b>Exhibit Number</b>	<b>Description</b>
Exhibit 31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
Exhibit 32	Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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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.

EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.

August 9, 2006

/s/ PETER J. ROSE  
Peter J. Rose, Chairman and Chief Executive Officer  
(Principal Executive Officer)

August 9, 2006

/s/ R. JORDAN GATES  
R. Jordan Gates, Executive Vice President-Chief Financial Officer  
(Principal Financial and Accounting Officer)

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EXPEDITORS INTERNATIONAL OF WASHINGTON, INC.  
AND SUBSIDIARIES

Form 10-Q Index and Exhibits

June 30, 2006

<u>Exhibit Number</u>	<u>Description</u>
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